

CITY OF NEWPORT NEWS

OFFICE OF THE CITY MANAGER

October 2, 2013

TO: The Honorable City Council

FROM: City Manager

SUBJECT: Fourth Quarter FY 2013 Financial Report

This year-end report prepared by the Department of Budget and Evaluation describes the budgetary performance of revenues and expenditures for FY 2013, prepared by the Department of Budget and Evaluation. The Fourth Quarter Financial Report uses preliminary and unaudited results of operations for the financial year ending June 30, 2013. While the final steps for closing the fiscal year are not complete, this report provides City Council a reasonably accurate estimate of the FY 2013 results. The official and final accounting statements will be issued in the November/December timeframe, when the City publishes its Comprehensive Annual Financial Report (CAFR).

Fiscal Year 2013 represented the fourth full fiscal year that the City faced declining revenue, with the sustained loss of funds from the markedly lower Real Estate Tax revenue collections, which is the City's main source of revenue. Coupled with a consistently low real estate market was a sustained higher unemployment level. In addition, the State continued to reduce its reimbursements to the City for the sixth consecutive fiscal year, increasing the demand on local revenues to support state mandated functions. With these persistent and undesirable conditions, in our first quarter report we projected a revenue shortfall of (\$2.9) million and an expenditure surplus of \$3.1 million. These impacts taken together forecasted a year-end net surplus of slightly more than \$189 thousand in the General Fund. By the second quarter, we projected a larger revenue shortfall of (\$4.2) million and a consistent expenditure surplus of \$3.1 million, for a year-end deficit of (\$1.1) million.

The remaining half of the fiscal year showed improvement in local revenue sources. While the second half of the annual Real Estate Tax

collection was still tracking to be lower than budgeted for the fiscal year, the Personal Property Tax receipts were showing marked improvement.

Machinery and Tools Tax revenue also was showing growth and projected to be marginally above the budgeted estimate. During the third quarter, it was projected that of the total revenue shortfall amount, \$1.1 million in revenue associated with the Human Services Department Foster Care and Adoptions programs would not be collected due to lower program participation. However, the majority of the City's corresponding expense was estimated not to be incurred for the remainder of this fiscal year. In the most general of terms, the City would not receive approximately \$1.1 million in revenue that would be offset by more than \$1.2 million in program expenditure savings.

Revenues

The Fourth Quarter FY 2013 Revenues performed higher than initially forecasted. In local taxes and fees, there was stronger activity with several elements exceeding estimates.

The second half of the Current Real Estate Tax collections for FY 2013 was higher than anticipated. With actual receipts posted through the end of June 2013, the City has received a total of \$149,383,880 from this revenue source. Included in this figure is approximately \$1.6 million in Real Estate Tax Relief (that is, Current Real Estate Tax revenue that is deferred for qualified elderly and disabled citizens) and \$565,000 tax relief for eligible disabled veterans. Taking into consideration the actual value of the two tax relief programs of \$2,165,000, total Current Real Estate Tax receipts exceeded the adopted budget estimate of \$149,089,052 (adjusted for tax relief) by \$294,828. This revenue is 0.2% more than expected, and it is the first time that we have met or exceeded our Real Estate Tax revenue estimate since the recession began in late 2008. Part of the success of exceeding our revenue estimate was that a few large scale building projects were completed earlier than anticipated and enrolled in the City's tax base.

Delinquent real estate tax collections performed reasonably well this fiscal year and were higher by \$37,371 than last year's total. However, with current receipts of \$3.6 million, delinquent collections fell \$325,344 less

than the \$4 million estimated. The collection of delinquent real estate taxes from prior fiscal years is beneficial in the cash flow of the City; a high level of activity should not be anticipated as a constant reoccurring revenue source in any fiscal year, as the recent trend appears to be that current taxes are paid on time to avoid any additional penalties to the individual.

Current Personal Property Tax receipts are stronger than estimated, with collections higher in the second half of the fiscal year than in the first. By the end of the fourth quarter, \$229 thousand over the \$44.4 million estimate had been received. This is \$1.6 million over the actual collections for the prior fiscal year, FY 2012, and over 10% higher than that fiscal year's adopted budget estimate. This is the fourth consecutive fiscal year of growth in this single revenue source, signaling that the value of new car sales and newer used cars sales are impacting the City's Personal Property Tax levy.

Machinery and Tools tax receipts ended the fiscal year at the \$18.1 million or \$1.3 million over the estimate. When Machinery and Tools tax receipts from Public Service Corporations (PSC) are added at \$1.7 million, total collections from this combined revenue is \$19.8 million, which will most likely make Newport News have the highest collection among the localities in the State of this revenue source.

Consumer sensitive revenues of sales, meals, and lodging taxes were projected to be consistently stable each quarter, with the anticipation that each would meet or exceed their individual revenue estimate, within minor fluctuations. This remained true throughout the fiscal year, with the actual revenue gain higher than anticipated, again through stronger receipts in the fourth quarter. Sales Tax revenue collections were \$1 million more than the estimate of \$21.6 million. As compared to FY 2012, Sales Tax for the recently finished fiscal year is over \$903 thousand more. Meal Tax receipts performed very well, exceeding by \$1.62 million more than the \$20.5 million estimate, indicating that the 1% tax rate increase adopted for FY 2013 did not deter dining outside the home to the level as first anticipated. Lodging Tax revenue remained flat through the majority of the year, and at year-end is \$91,000 below the \$3.1 million estimate, or 3% lower than anticipated. This can be attributed in part to the fluctuating vehicle fuel prices that were experienced in the fiscal year. Both Sale and Meal taxes are highly responsive consumer

revenue streams and when taken as a whole seem to indicate a growing stabilization in certain areas of the local economy.

In other local economy generated revenue, there was better news as well. Business Professional and Occupational Licenses (BPOL) taxes ended the fiscal year with stronger than anticipated receipts. Overall, the net revenue over the estimate for all BPOL taxes is over by \$665 thousand. We had forecasted these revenues to perform right at their estimated levels for this fiscal year. The strongest collections from these sources were in the areas of Retail Sales, Wholesalers, and Professional Services. The City receives a recordation tax on deeds that are primarily property transactions. At the end of the fiscal year, this revenue source was \$102,840 higher than the \$1.2 million estimate. While a moderate increase over the prior fiscal year, the stabilization of this revenue source is consistent with the lower than anticipated Real Estate Tax collections, however, but at the same time is indicating that the volume of property transactions in the City seems to be increasing. Vehicle License Fees, the alternative local tax when vehicle decals were eliminated, showed relatively level activity, collecting approximately \$63,965 less than the estimated \$3.9 million for this revenue source. The FY 2013 Vehicle License Fees collection remains within the range for the past five fiscal years. These last two items, taken together, could be a sign that we have reached a certain marginal level of stabilization and an indication that the housing market may not be declining at the same level as we have experienced in the past.

Building permits revenue was below the \$1.1 million estimate by approximately \$266,000 (or 25% lower) in the major permit categories of Building, Mechanical, Electrical, and Plumbing. There were major construction projects in FY 2012 that were not repeated in FY 2013, and with that contributed to an overall lower level of revenue collected. While not at yet restored to the pre-recession FY 2008 levels, it is a signal that there continues to be new construction throughout the City. For the first time in many years the City earned more on Interest Earnings on Bank Deposits, reaching \$80,000 over the \$275,000 estimate. This is due in part of aggressive efforts by the City Treasurer to maximum investments during a continuing historically low interest rate environment.

The full impact of the State revenue reductions were realized by the fourth quarter in all areas: HB 599 funds, cost reimbursements for Constitutional

Officers and inmates, State Aid to Libraries, etc. The first quarter forecast included \$1.3 million in State revenue reductions for the fiscal year, and for the most part, this loss was incorporated into the FY 2013 Adopted Budget for the fiscal year. While State mandated services were not reduced, the City continues to disproportionately fund these costs through local revenues. Approximately \$1.3 million total Human Services program revenues were not collected. While there were some areas where the program revenue exceeded the estimate (mainly in administration costs and direct eligibility payments), \$1.5 million from the foster care, adoption and special needs adoption revenue was not collected. Reduced Human Services program expenditures of \$2.1 million offset this revenue loss.

In general, revenue activity for FY 2013 showed some improved results in limited areas. While the revenue estimates were maximized for the best realistic anticipated collections for this fiscal year, they were still conservative, in light of lingering uncertain economic pressures that were and are still affecting all levels of government. Our Current Real Estate Tax revenue has declined approximately \$5.6 million in collections from the previous fiscal year; this amount is even after several significant construction projects were completed during the year. The loss was mitigated by lower than anticipated use of the tax deferral for the Elderly and Disabled program. Our local consumer taxes are showing moderately sustained growth. When taken from a longer view, the City's revenues are still significantly lower than prior to the recession, hovering just above the FY 2008 level, but are performing reasonably well with the parameters set for FY 2013.

Expenditures

Continuation of the hiring suspension implemented in September 2009 and closely controlled spending by departments has resulted in a total projected savings of about \$3.5 million in normal budgetary expenditures, prior to final adjustments (which will be discussed later). Salary savings were not manifested at year-end as in prior fiscal years as anticipated, for two reasons. First, the shared Fire service agreements with the City of Hampton (for consolidated warehouse operations and automatic mutual aid response along the eight-mile contiguous borders) did not come to full implementation as speedily as planned. An aspect of the shared Fire service agreement was anticipated to allow for some salary savings; due to

the final agreement delay, those savings were not realized to the level budgeted. Second, we have aggressively leveraged attrition savings to balance the proposed operating budget. While, for the most part, this has been a successful strategy, in both the Police and Fire Departments, when recruiting for the upcoming training academies, over-enrollment was necessary to ensure the minimum number of recruits completing the academies to fill existing vacancies. This over-enrollment at the academies reduced the departments' ability to meet the budgeted attrition savings. Fringe Benefits savings were the majority of the savings at \$1.7 million or 2.8% under budget. These personnel savings continue to decrease annually, as we aggressively use attrition credits, eliminate positions, and delay hiring as methods to balance our annual operating budget and still provide the minimal level of staffing needed to provide current service levels. As evidenced in this fiscal year, these personnel savings cannot continue to be relied upon to balance revenue shortfalls at the risk of not providing services to our citizens.

The under-use of the foster care and adoption programs combined with other program savings in the Human Services Department generated \$2.1 million in expenditure savings for operating costs and contractual services. FY 2013 Vehicle fuel was budgeted at 10 cents more per gallon (at \$3.60 per gallon) than last fiscal year. The price per gallon paid monthly by the City fluctuated between a low of \$2.81 (January 2013) and a high of \$3.19 (September 2012). This price variance resulted in an average of \$2.97 per gallon, resulting in an under-expenditure of \$350,546 or 12% savings in fuel costs.

Final Adjustments

Prior to final adjustments required for year-end closing, the budget to actual General Fund surplus will be approximately \$3.5 million. Two transactions that were made at year-end are adjustments in the Payment to Other Funds and Debt/Cash Capital categories at \$1 million, causing in part those categories to be overspent. These year-end adjustments allowed for using \$500,000 of the year-end surplus as a contribution to the Cash Capital Fund, helping us meet our self disciplined cash obligation. One of the conditions of the Special Project Fund is that it is to be replenished with year-end surplus when possible; an additional \$500,000 contribution was made for future use or potential needs in this Fund.

Both of these uses of the year-end surplus allows us to have ready access to funds without either having to use General Fund Balance reserves or to acquire additional debt for projects. Both the Cash Capital and Special Project Fund grants us a certain degree of flexibility and responsiveness, as the needs present themselves during the fiscal year.

At this point, prior to any other adjustments, the year-end General Fund \$3.5 million will be used in part to balance any over-expenditures in the Other General Fund Operating Budgets (as shown on Page 2 of the attached report) and as an additional General Fund Balance contribution. While our General Fund Balance Policy requires us to increase the undesignated/unassigned of at least 7.5% of the actual General Fund revenues for the previous fiscal year, it has been the actual practice of the City is to establish an Undesignated/Unassigned General Fund Balance growth of 10%, whenever possible. The remaining uncommitted balance of the \$3.5 million surplus will be a supplemental contribution over and above the 10% level. This intentional contribution is a signal to the bond rating agencies that it is part of our overall strong financial management to build reserves, as possible, in a declining budget environment.

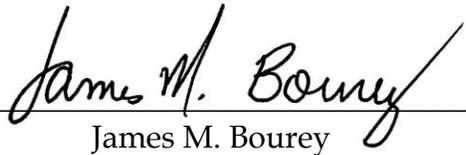
Combined Surplus and Use of Fund Balance

The final combined forecasted budget surplus of \$3.5 million is approximately \$1.7 million more than anticipated by the end of the third quarter in FY 2013. This combined surplus does not reflect year-end write offs for bad debts or other unanticipated accounting charges that typically reduce the year-end surplus.

This combined surplus reflects the financial activity as it relates to the adopted budget as compared to the actual results. During FY 2013 there were no appropriations from the Fund Balance. By building up our Special Project Fund and Cash Capital Fund with previous prior year reserves, we have been able to have funds readily available for paying down debt and redevelopment needs during the fiscal year.

Conclusion

Through careful planning and continued aggressive cost saving measures, the City ended this fiscal year with a respectable surplus. This surplus will be used to supplement our General Fund reserves and special project funds, to be used with discretion during the present and future fiscal years. The local economy, though still caught in the flux of the effects of the national recession and now complicated by federal budget sequestration issues, seems to have some consistent elements of growth and helped to deliver more revenue than anticipated, resulting in the year-end surplus.


James M. Bourey

JMB:LJC:wmp

Attachment

cc: Lisa Cipriano, Director of Budget and Evaluation

**FY 2013 OPERATING BUDGET
PROJECTED RESULTS OF OPERATIONS**

Unaudited - Initial Projections as of June 30, 2013

GENERAL FUND

REVENUES

	Revised Budget	YTD Receipts	Projected Total Revenue	Difference	
				Surplus/(Deficit) Amount Revenue to Revised Budget	Percent of Revenue to Revised Budget
Real Estate Taxes ¹	\$156,826,739	\$156,617,951	\$156,617,951	(\$208,788)	99.9%
Personal Property Taxes ²	47,610,000	48,631,485	48,631,485	1,021,485	102.1%
Machinery & Tools Taxes ³	18,456,000	19,845,244	19,845,244	1,389,244	107.5%
Other General Property Taxes	2,225,201	2,109,339	2,109,339	(115,862)	94.8%
Other Local Taxes	93,826,659	96,537,561	96,537,561	2,710,902	102.9%
Permits and Fees	3,409,794	2,802,921	2,802,921	(606,873)	82.2%
Fines and Forfeitures	2,838,551	2,984,185	2,984,185	145,634	105.1%
Revenue from Use-Money & Prop	2,290,363	2,243,442	2,243,442	(46,921)	98.0%
Charges for Services	6,485,636	5,931,050	5,931,050	(554,586)	91.4%
Miscellaneous Revenue	17,941,537	17,950,279	17,950,279	8,742	100.0%
Recovered Costs	9,995,321	10,188,087	10,188,087	192,766	101.9%
Non-Categorical Aid	740,598	818,620	818,620	78,022	110.5%
Shared Expenses	9,119,842	9,074,635	9,074,635	(45,207)	99.5%
Categorical Aid	31,981,008	30,563,331	30,563,331	(1,417,677)	95.6%
Non-Revenue Receipts	12,241,000	12,241,000	12,241,000	0	100.0%
Payments from Other Funds	529,339	397,846	397,846	(131,493)	75.2%
TOTAL REVENUES	\$416,517,588	\$418,936,976	\$418,936,976	\$2,419,388	100.6%

EXPENDITURES

	Revised Budget	YTD Exp/Enc	Projected Total Expense	Difference	
				Surplus/(Deficit) Expense Amount to Revised Budget	Percent of Expense to Revised Budget
Personnel Services	\$120,878,150	\$121,320,782	\$121,320,782	(\$442,632)	100.4%
Taxes, Benefits, Insurance	61,476,205	59,766,845	59,766,845	1,709,360	97.2%
Contractual Services	14,366,161	13,910,228	13,910,228	455,933	96.8%
Vehicle Costs	4,396,558	4,396,558	4,396,558	0	100.0%
Fuel	2,918,892	2,568,346	2,568,346	350,546	88.0%
Utilities	6,822,524	6,861,668	6,861,668	(39,144)	100.6%
Operating Materials, Supplies, Ins	19,986,867	19,459,185	19,459,185	527,682	97.4%
Equipment (Except Vehicles)	1,497,500	1,476,169	1,476,169	21,331	98.6%
Leases, Rentals	5,070,121	5,035,117	5,035,117	35,004	99.3%
Community Support	8,504,876	8,492,518	8,492,518	12,358	99.9%
Transfer to Schools	113,400,000	113,400,000	113,400,000	0	100.0%
Debt Service/Cash Capital	39,124,571	40,749,232	40,749,232	(1,624,661)	104.2%
Payments to Other Funds	7,833,126	9,865,913	9,865,913	(2,032,787)	126.0%
Direct Program Costs - DHS	10,242,037	8,142,102	8,142,102	2,099,935	79.5%
TOTAL EXPENDITURES	\$416,517,588	\$415,444,663	\$415,444,663	\$1,072,925	99.7%

TOTAL PROJECTED DIFFERENCE

\$3,492,313

¹Includes Current, Delinquent, Tax Relief, Public Service Corp (PSC) Real Estate Taxes

²Includes Current and Delinquent Personal Property Taxes

³Includes Current and Public Service Corp (PSC) Machinery & Tools Taxes

OTHER GENERAL FUND SUPPORTED FUNDS

	Budget	Projected Revenues	Projected Expenditures	<i>Difference</i>	
				Projected Amount Surplus/(Deficit) to Budget	Projected Percent to Budget
Auto Liability Fund	\$1,357,900	\$1,348,312	\$1,192,393	\$155,919	88.4%
General Liability Fund	1,248,600	1,264,046	1,597,159	(\$333,113)	126.4%
Worker's Compensation Fund	3,132,000	3,435,953	3,188,983	\$246,970	92.8%
Recreation Revolving Fund	4,707,800	4,415,723	4,873,161	(\$457,438)	110.4%
Historical Services Fund	1,103,700	1,074,322	1,083,880	(\$9,558)	100.9%
Golf Course Fund	1,795,700	1,297,315	2,030,505	(\$733,190)	156.5%
Leeward Marina Fund	262,600	259,581	242,128	\$17,453	93.3%
Tourism Fund	1,655,900	1,647,607	1,729,405	(\$81,798)	105.0%
TOTAL	\$15,264,200	\$14,742,859	\$15,937,614	(\$1,194,755)	108.1%

PROJECTED DIFFERENCE (OTHER FUNDS)**(\$1,194,755) 108.1%****TOTAL PROJECTED DIFFERENCE - Combined General Fund and Other Funds****\$2,297,558****USER FEE SUPPORTED FUNDS**

	Budget	Projected Revenues	Projected Expenditures	<i>Difference</i>	
				Projected Amount Surplus/(Deficit) to Budget	Projected Percent to Budget
Stormwater Management Fund	\$12,915,000	\$12,903,011	\$12,571,318	\$331,693	97.4%
Solid Waste Fund	\$13,288,700	\$12,389,537	\$12,956,799	(\$567,262)	104.6%
Wastewater Fund	\$18,845,000	\$15,838,387	\$16,468,204	(\$629,817)	104.0%
Public Utilities Fund	\$81,400,000	\$76,835,202	\$79,082,786	(\$2,247,584)	102.9%

EXPENDITURES BY DEPARTMENT

(This is a departmental breakdown of the General Fund expenditures shown on page 1.)

	Revised Budget	YTD Exp/Enc	Projected Total Expense	<i>Difference</i>	
				Projected Amount Surplus/(Deficit) to Budget	Projected Percent to Budget
City Council	\$284,056	\$269,862	\$269,862	\$14,194	95.0%
City Clerk	333,275	313,865	313,865	19,410	94.2%
City Manager	1,808,616	1,785,555	1,785,555	23,061	98.7%
Human Resources	1,198,900	1,147,152	1,147,152	51,748	95.7%
City Attorney	1,593,800	1,519,072	1,519,072	74,728	95.3%
Internal Auditor	477,252	475,582	475,582	1,670	99.7%
Commissioner of the Revenue	2,456,046	2,158,844	2,158,844	297,202	87.9%
Real Estate Assessor	1,538,721	1,524,662	1,524,662	14,059	99.1%
City Treasurer	2,012,028	2,012,028	2,012,028	0	100.0%
Finance	1,122,321	1,119,363	1,119,363	2,958	99.7%
Budget and Evaluation	632,297	552,278	552,278	80,019	87.3%
Information Technology	7,513,455	7,481,533	7,481,533	31,922	99.6%
Purchasing	1,352,440	1,273,255	1,273,255	79,185	94.1%
Registrar	531,625	528,641	528,641	2,984	99.4%
Judiciary	1,317,952	1,249,994	1,249,994	67,958	94.8%
Circuit Court Clerk	1,403,328	1,374,108	1,374,108	29,220	97.9%
Commonwealth's Attorney	3,366,683	3,303,253	3,303,253	63,430	98.1%
Police	40,419,457	40,451,220	40,451,220	(31,763)	100.1%
Fire	28,371,107	29,182,319	29,182,319	(811,212)	102.9%
Sheriff	17,544,825	17,476,979	17,476,979	67,846	99.6%
Adult Corrections	4,128,042	3,961,585	3,961,585	166,457	96.0%
Juvenile Services	7,119,392	7,454,319	7,454,319	(334,927)	104.7%
Codes Compliance	2,598,202	2,545,558	2,545,558	52,644	98.0%
Engineering	6,014,660	5,814,900	5,814,900	199,760	96.7%
Public Works	18,676,162	18,512,531	18,512,531	163,631	99.1%
Health	2,125,999	2,125,999	2,125,999	0	100.0%
Mental Health	1,523,521	1,523,521	1,523,521	0	100.0%
Human Services	32,182,560	29,885,058	29,885,058	2,297,502	92.9%
Parks, Recreation, and Tourism	12,800,538	12,624,968	12,624,968	175,570	98.6%
Libraries	4,595,767	4,503,761	4,503,761	92,006	98.0%
Development	1,474,910	1,388,133	1,388,133	86,777	94.1%
Planning	961,968	890,928	890,928	71,040	92.6%
Customer Service-311 Call Center	333,738	252,014	252,014	81,724	75.5%
Appointed Boards	102,948	83,210	83,210	19,738	80.8%
Nondepartmental-Contingencies	37,738,424	36,170,950	36,170,950	1,567,474	95.8%
Community Support	8,504,876	8,492,518	8,492,518	12,358	99.9%
Transfers to Schools	113,400,000	113,400,000	113,400,000	0	100.0%
Debt Service/Cash Capital	39,124,571	40,749,232	40,749,232	(1,624,661)	104.2%
All Other Payments	7,833,126	9,865,913	9,865,913	(2,032,787)	126.0%
TOTAL EXPENDITURES	\$416,517,588	\$415,444,663	\$415,444,663	\$1,072,925	99.7%