

# CITY OF NEWPORT NEWS

## OFFICE OF THE CITY MANAGER

October 5, 2011

**TO:** The Honorable City Council  
**FROM:** City Manager  
**SUBJECT:** Fourth Quarter FY 2011 Financial Report

This year-end report describes the budgetary performance of revenues and expenditures for FY 2011, 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, 2011. While the final steps for closing the fiscal year are not complete, this report provides City Council a reasonably accurate estimate of the FY 2011 results. The official and final accounting statements will be issued in the November/December timeframe, when the City publishes its Comprehensive Annual Financial Report (CFAR).

Fiscal Year 2011 represented the second full fiscal year that the City faced declining revenue resources due to the national recession, with full anticipation that the sluggish housing market would result in markedly lower Real Estate Tax revenue collections. Coupled with this sluggish real estate market was continued high unemployment causing anticipation of volatile direct consumer-related revenue such as sales, meals, and lodging taxes, all which are associated with discretionary activities. In addition, the State continued to reduce its reimbursements to the City for the fourth consecutive fiscal year, resulting in the demand on more local revenues going to support state-mandated functions. With these persistent negative influences, in our first quarter report we projected a revenue shortfall of \$2.2 million and an expenditure surplus of \$3.9 million, which taken together forecasted a year-end net surplus of \$1.7 million in the General Fund. By the second quarter, we projected a similar revenue shortfall of \$2.3 million and an expenditure surplus of \$3.3 million, for a year-end surplus of \$1 million.

The second half of the fiscal year showed improvement in local revenues. While the first half of the annual Real Estate Tax collection was initially

tracking to be still lower than budgeted for the second half of the fiscal year, the Personal Property Tax receipts were showing marked improvement, with similar sustained upticks in Machinery and Tools Tax revenue. Overall, the revenue trend continued in the third quarter without much bottom-line total variation, with a slightly lower revenue shortfall of \$1.8 million and a consistent expenditure surplus of \$3.9 million, for a projected year-end surplus of \$2.1 million.

### *Revenues*

The Fourth Quarter FY 2011 Revenues performed higher than initially forecasted. In local taxes and fees there was stronger activity, with some elements exceeding estimates.

The second half of the Current Real Estate Tax collections for FY 2011 was slightly lower than anticipated. With actual receipts posted through the end of June 2011, the City has received in total \$158,175,248 from this revenue source. Included in this figure is \$3.3 million in Real Estate Tax Relief estimate (that is, Current Real Estate Tax revenue that is abated to qualified elderly and disabled citizens). The total Current Real Estate Tax shortfall was \$1,299,323 from the adopted budget estimate of \$159,474,571, or 0.8% less than estimated. Delinquent real estate tax collections, while lower than last year's total, performed reasonably well this fiscal year, with current receipts of \$3.6 million, or \$111,825 less than 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 upcoming fiscal years, as the recent local 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 anticipated, with collections higher in the second half of the fiscal year than in the first. By the end of the fourth quarter, \$2.9 million over the \$38.9 million estimate had been received. This 7.5% growth over the adopted budget estimate is the second consecutive fiscal year of more than seven percent growth in this single revenue source, signaling that the value of new car sales and newer used car sales are impacting the City's Personal Property Tax levy.

When the revenue estimates for FY 2011 were being finalized in March 2010, we were concerned that the national recession would continue to manifest itself by job losses, but to a lesser degree than in the previous

fiscal year. With full year impact of some business expansions (e.g., Shipyard, Canon, Continental), Machinery and Tools tax receipts ended the fiscal year at \$1.5 million or 10.7% more than the \$14.7 million dollar estimate.

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 \$579,000 more than the estimate of \$20.6 million. Meal Tax receipts edged over by \$267,000 more than the \$17.5 million estimate. A significant improvement from the beginning of the fiscal year is in Lodging Tax revenue, which at year-end is \$464,000 over the \$2.6 million estimate, or 17.8% more than anticipated. These three highly responsive consumer revenue streams, when taken as a whole, seem to indicate a certain stabilization in the local economy.

In other local economy-generated revenue, there was better news as well. Business, Professional, Occupational License (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 \$1.2 million. We had forecasted these revenues to perform right at their estimated levels for this fiscal year. Stronger collections from these sources were in the areas of Retail Sales and Professional Services, with some loss of revenue in Wholesalers. The City receives a recordation tax on deeds that are primarily property transactions. At the end of the fiscal year, this revenue source continues to lag behind its estimate, and ended the year \$434,000 lower than the \$1.5 million estimate. This tracks consistently with the lower-than-anticipated Real Estate Tax collections, indicating that the volume of property transactions in the City continues to fluctuate. Vehicle License Fees, the alternative local tax when vehicle decals were eliminated, showed relatively level activity, collecting approximately \$21,000 less than the estimated \$3.8 million for this revenue source. The FY 2011 Vehicle License Fees are approximately \$41,000 less than the previous fiscal year, but remain within the range for the past three fiscal years. These last two items, taken together, could indicate that we have reached a plateau in these areas of the local economy.

Building permits revenue exceeded the \$756,000 estimate by approximately \$277,000 (or 36.6%) in the major permit categories of Building, Mechanical, Electrical, and Plumbing. This is the first time over the past three fiscal years (FY 2008 to FY 2011) that this group of building permits exceeds the estimate. The City suffered a loss of \$172,000 on Interest Earnings on Bank Deposits, barely reaching \$372,000 of the \$500,000 estimate, in spite of aggressive efforts by the City Treasurer to maximize investments during a historically low interest rate environment. There are a small number of revenue sources that performed exceedingly well during the fiscal year (consumer Utility Taxes, Sanitary Sewer Connections, EMS Fees), but this exceptional activity should not be considered a meaningful trend on which to base upcoming fiscal estimates.

The full impact of the State revenue reductions was 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 \$1.6 million in State revenue reductions for the fiscal year, and this loss was realized during the fiscal year. While State-mandated services were not reduced, the City continues to disproportionately fund these costs through local revenues. Approximately \$286,000 in Human Services program revenues was not collected. Reduced Human Services program expenditures of \$1.2 million offset this revenue loss.

In general, revenue activity for FY 2011 continued to have mixed results. We based this fiscal year on conservative estimates, in light of the continuing uncertain economic pressures that were and are still affecting all levels of government. Our Current Real Estate Tax revenue has declined \$5.9 million in collections from the previous fiscal year, yet our local consumer taxes are showing sustained minor growth. When taken from a longer view, the City's revenues are significantly lower than previous years, but are performing reasonably well with the parameters set for FY 2011.

### *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 \$9.5 million in normal budgetary expenditures, prior to final adjustments (which will be discussed later). Salary and Fringe Benefit savings and the careful use of Overtime pay represents \$4.5

million in savings or 2.6% under budget. These personnel savings continue to decrease, as we aggressively deploy the use of 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. Decreased expenditures for operating costs and contractual services contribute \$3.1 million to the under-expenditures, which is 32% of the savings. A harsher-than-normal winter combined with a moderate spring season contributed to utility savings of over \$601,000. FY 2011 Vehicle Fuel was budgeted at 73 cents more per gallon than last fiscal year. The actual price per gallon paid monthly by the City experienced minor fluctuations below the budgeted rate for the first seven months of the fiscal year, with sustained price spikes for the remaining five months. This price variance resulted in a slight over-expenditure of (\$22,961) or (1%) in fuel costs.

### ***Final Adjustments***

Prior to these final adjustments, the year-end expenditure surplus would have been \$9.5 million. As shown on the attached report, it is anticipated that the final year-end adjustments in the Payment to Other Funds category will be in the \$12.5 million range, causing the bottom line of expenses to be exceeded by \$2.8 million. Such year-end adjustments allow for making a payment to cover the full cost of benefits (Other Post Employment Benefits - OPEB) for the fiscal year, to build the asset base in this Fund. Due to revenue restrictions in FY 2011, our Cash Capital contribution had to be reduced. In order to meet our Debt Management Policy goals funding Cash Capital, we will be using \$3.5 million of year-end surplus to help us meet our self-disciplined cash obligation. With the establishment of the Special Project Fund in FY 2011, one of the conditions of the Fund is to be replenished with year-end surplus; an additional \$3 million contribution will be made for future use or potential needs in this Fund. We will be setting aside \$2 million for future debt retirement, for when we have the opportunity to retire high interest rate debt closer to its final payment date. Slightly more than \$2 million will be used to fully fund the annual Pension contribution to ensure that we meet our stated intention to meet 54% of the Annual Required Contribution (ARC) for this fiscal year.

*Combined Surplus and Use of Fund Balance*

The final combined forecasted budget surplus of \$3 million is approximately \$1.1 million more than anticipated by the end of the third quarter in FY 2011. 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.

As a cautionary note, this combined surplus reflects the financial activity as it relates to the adopted budget as compared to the actual results. During FY 2011, City Council approved \$15.9 million in appropriations from the Fund Balance for the establishment of the Special Project Fund. This \$15.9 million was available due to the operating surplus achieved in FY 2010.

The accounting rules that regulate financial reporting in the City Annual Financial Report (CAFR) focus primarily on net income (actual revenues less expenditures) in the fiscal year and do not take into account budgetary performance. This method of reporting makes the use of surpluses achieved in previous years difficult to manage in that we are required to treat the use of these surplus reserves as an operating expense in the year they are actually used. In other words, savings achieved in a given fiscal year either must be spent in that year, or if they are to be saved for use in a subsequent year, they must be accompanied by new revenues or additional operating surpluses when they are finally spent. In other words, each year's operating surplus must, for accounting purposes, be used to offset any use of previous years' surpluses.

When considering our budget to actual performance, we could choose not to make the final adjustments, and thereby lose the ability to take advantage of the surplus created in FY 2011. Instead we would "pay back" our use of the \$15.9 million from Fund Balance and show an appreciable gain in our Fund Balance status at year-end. However, in preparing for the bond ratings review and update in June 2011, we informed both bond rating agencies of our intention to use Fund Balance in FY 2011 to establish the Special Project Fund, coupled with our commitment not to use Fund Balance in FY 2012. By use of Fund Balance in FY 2011 and by committing to the final adjustments to Cash Capital, OPEB, debt service retirement, etc., we are able to address priority needs while reducing further debt and other long-term liabilities.

***Conclusion***

Through careful planning and continued aggressive cost-saving measures, the City ended this fiscal year with a respectable surplus. The local economy, though still caught in the flux of the effects of the national recession, helped to deliver more revenue than anticipated, resulting in the year-end surplus.



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Neil A. Morgan

NAM:LJC

Attachment

cc: Lisa Cipriano, Director of Budget and Evaluation

**FY 2011 OPERATING BUDGET  
PROJECTED RESULTS OF OPERATIONS**

Unaudited - Initial Projections as of June 30, 2011

**GENERAL FUND**

**REVENUES**

	Revised <u>Budget</u>	<u>YTD Receipts</u>	Projected <u>Total Receipts</u>	<u>Variance</u>	<u>Percent</u>
Real Estate Taxes	\$167,177,488	\$166,168,209	\$166,168,209	(\$1,009,279)	(0.6%)
Personal Property Taxes	44,434,000	45,572,257	45,572,257	1,138,257	2.6%
Machinery & Tools Taxes	16,205,001	17,310,958	17,310,958	1,105,957	6.8%
Other Local Taxes	85,506,288	88,661,078	88,661,078	3,154,790	3.7%
Permits and Fees	2,596,178	3,372,143	3,372,143	775,965	29.9%
Fines and Forfeitures	1,986,833	2,431,671	2,431,671	444,838	22.4%
Revenue from Use-Money & Prop	2,336,542	2,248,208	2,248,208	(88,334)	(3.8%)
Charges for Services	5,592,506	5,680,008	5,680,008	87,502	1.6%
Miscellaneous Revenue	17,268,695	17,284,185	17,284,185	15,490	0.1%
Recovered Costs	9,352,702	9,773,336	9,773,336	420,634	4.5%
Non-Categorical Aid	245,289	757,550	757,550	512,261	208.8%
Shared Expenses	9,384,675	9,115,628	9,115,628	(269,047)	(2.9%)
Categorical Aid	38,396,709	37,913,486	37,913,486	(483,223)	(1.3%)
Non-Revenue Receipts	11,150,000	11,150,000	11,150,000	0	0.0%
Payments from Other Funds	553,758	553,758	553,758	0	0.0%
<b>Subtotal REVENUES</b>	<b>\$412,186,664</b>	<b>\$417,992,475</b>	<b>\$417,992,475</b>	<b>\$5,805,811</b>	<b>1.4%</b>
Use of Fund Balance	\$15,900,000	\$15,900,000			
<b>TOTAL REVENUES</b>	<b>\$428,086,664</b>	<b>\$433,892,475</b>			

**EXPENDITURES**

	Revised <u>Budget</u>	<u>YTD Exp/Enc</u>	Projected <u>Total Expense</u>	<u>Variance</u>	<u>Percent</u>
Personnel Services	\$119,470,750	\$117,434,499	\$117,434,499	\$2,036,251	1.7%
Taxes, Benefits, Insurance	54,781,978	52,318,960	52,318,960	2,463,018	4.5%
Contractual Services	14,609,634	13,427,818	13,427,818	1,181,816	8.1%
Vehicle Costs	4,498,880	4,498,880	4,498,880	0	0.0%
Fuel	2,278,099	2,301,060	2,301,060	(22,961)	(1.0%)
Utilities	7,007,352	6,405,477	6,405,477	601,875	8.6%
Operating Materials, Supplies, Ins	20,576,198	18,642,752	18,642,752	1,933,446	9.4%
Equipment (Except Vehicles)	1,633,302	1,475,838	1,475,838	157,464	9.6%
Leases, Rentals	5,111,612	5,021,244	5,021,244	90,368	1.8%
Community Support	7,672,239	7,668,279	7,668,279	3,960	0.1%
Transfer to Schools	109,200,000	109,200,000	109,200,000	0	0.0%
Debt Service/Cash Capital	38,279,213	38,278,967	38,278,967	246	0.0%
Payments to Other Funds	8,534,564	20,991,134	20,991,134	(12,456,570)	(146.0%)
Direct Program Costs - DHS	18,532,843	17,326,138	17,326,138	1,206,705	6.5%
<b>Subtotal EXPENDITURES</b>	<b>\$412,186,664</b>	<b>\$414,991,046</b>	<b>\$414,991,046</b>	<b>(\$2,804,382)</b>	<b>(0.7%)</b>
Use of Fund Balance	\$15,900,000	\$15,900,000			
<b>TOTAL EXPENDITURES</b>	<b>\$428,086,664</b>	<b>\$430,891,046</b>			

**TOTAL PROJECTED VARIANCE**

**\$3,001,429**

**OTHER GENERAL FUND SUPPORTED FUNDS**

	<u>Budget</u>	<u>Projected Revenues</u>	<u>Projected Expenditures</u>	<u>Projected Surplus/(Deficit)</u>	<u>% Variance to Proj Revenue</u>
Auto Liability Fund	\$1,584,500	\$1,573,198	\$1,501,952	\$71,246	4.5%
General Liability Fund	1,694,100	1,729,790	1,694,904	34,886	2.0%
Worker's Compensation Fund	3,321,600	3,321,600	2,670,836	650,764	19.6%
Recreation Revolving Fund	4,904,000	4,232,016	4,418,818	(186,802)	(4.4%)
Historical Services Fund	1,129,000	1,109,098	1,091,443	17,655	1.6%
Golf Course Fund	1,697,000	1,476,785	1,709,637	(232,852)	(15.8%)
Leeward Marina Fund	265,000	252,022	248,504	3,518	1.4%
Tourism Fund	<u>1,215,000</u>	<u>1,432,054</u>	<u>1,402,537</u>	<u>29,517</u>	<u>2.1%</u>
<b>TOTAL</b>	<b>\$15,810,200</b>	<b>\$15,126,563</b>	<b>\$14,738,631</b>	<b>\$387,932</b>	<b>2.6%</b>

**PROJECTED VARIANCE (OTHER FUNDS)****\$387,932 2.6%****TOTAL PROJECTED VARIANCE****\$3,389,361****USER FEE SUPPORTED FUNDS**

	<u>Budget</u>	<u>Projected Revenues</u>	<u>Projected Expenditures</u>	<u>Projected Surplus/(Deficit)</u>	<u>Percent</u>
Stormwater Management Fund	\$10,917,000	\$9,982,907	\$9,982,907	\$0	0.0%
Solid Waste Fund	\$12,764,000	\$11,532,745	\$11,532,745	\$0	0.0%
Wastewater Fund	\$17,497,000	\$16,691,652	\$16,691,652	\$0	0.0%
Public Utilities Fund	\$83,597,800	\$78,291,000	\$78,494,000	(\$203,000)	(0.3%)

**EXPENDITURES BY DEPARTMENT**

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

	<u>Revised Budget</u>	<u>YTD Exp/Enc</u>	<u>Projected Total Expense</u>	<u>Variance</u>	<u>Percent</u>
City Council	\$ 324,073	\$ 292,624	\$ 292,624	\$ 31,449	9.7%
City Clerk	386,203	365,637	365,637	20,566	5.3%
City Manager	1,922,094	1,788,323	1,788,323	133,771	7.0%
Human Resources	1,418,734	1,269,652	1,269,652	149,082	10.5%
City Attorney	1,689,870	1,652,105	1,652,105	37,765	2.2%
Internal Auditor	535,364	535,363	535,363	1	0.0%
Commissioner of the Revenue	2,812,435	2,668,777	2,668,777	143,658	5.1%
Real Estate Assessor	1,719,365	1,719,364	1,719,364	1	0.0%
City Treasurer	2,186,591	2,106,469	2,106,469	80,122	3.7%
Finance	1,294,078	1,257,982	1,257,982	36,096	2.8%
Budget and Evaluation	695,615	695,614	695,614	1	0.0%
Information Technology	8,451,690	8,036,866	8,036,866	414,824	4.9%
Purchasing	1,447,122	1,376,196	1,376,196	70,926	4.9%
Registrar	479,010	428,167	428,167	50,843	10.6%
Judiciary	1,574,092	1,397,761	1,397,761	176,331	11.2%
Circuit Court Clerk	1,618,512	1,517,455	1,517,455	101,057	6.2%
Commonwealth's Attorney	3,736,682	3,724,653	3,724,653	12,029	0.3%
Police	45,511,583	45,083,585	45,083,585	427,998	0.9%
Fire	31,649,353	31,646,156	31,646,156	3,197	0.0%
Sheriff	19,497,438	18,639,374	18,639,374	858,064	4.4%
Adult Corrections	4,560,903	4,425,568	4,425,568	135,335	3.0%
Juvenile Services	8,107,637	7,693,662	7,693,662	413,975	5.1%
Codes Compliance	2,905,190	2,804,948	2,804,948	100,242	3.5%
Engineering	7,328,039	6,867,252	6,867,252	460,787	6.3%
Public Works	21,234,702	20,188,375	20,188,375	1,046,327	4.9%
Health	2,076,585	1,931,772	1,931,772	144,813	7.0%
Mental Health	1,523,521	1,523,521	1,523,521	0	0.0%
Human Services	43,346,543	41,034,281	41,034,281	2,312,262	5.3%
Parks, Recreation, and Tourism	13,398,107	13,218,054	13,218,054	180,053	1.3%
Libraries	5,006,205	4,948,935	4,948,935	57,270	1.1%
Development	1,646,241	1,594,180	1,594,180	52,061	3.2%
Planning	1,165,060	1,114,839	1,114,839	50,221	4.3%
Appointed Boards	117,361	89,470	89,470	27,891	23.8%
Nondepartmental-Contingencies	7,134,650	5,215,686	5,215,686	1,918,964	26.9%
Community Support	7,672,239	7,668,279	7,668,279	3,960	0.1%
Transfers to Schools	109,200,000	109,200,000	109,200,000	0	0.0%
Debt Service/Cash Capital	38,279,213	38,278,967	38,278,967	246	0.0%
All Other Payments	<u>8,534,564</u>	<u>12,491,134</u>	<u>20,991,134</u>	<u>(12,456,570)</u>	<u>(146.0%)</u>
<b>Subtotal Expenditures</b>	<b>\$412,186,664</b>	<b>\$406,491,046</b>	<b>\$414,991,046</b>	<b>(\$2,804,382)</b>	<b>(0.7%)</b>
Use of Fund Balance	<u>\$15,900,000</u>	<u>\$15,900,000</u>			
<b>TOTAL EXPENDITURES</b>	<b>\$428,086,664</b>	<b>\$422,391,046</b>			