CITY OF NEWPORT NEWS

OFFICE OF THE CITY MANAGER

September 5, 2012

TO: The Honorable City Council

FROM: City Manager

SUBJECT: Fourth Quarter FY 2012 Financial Report

This year-end report describes the budgetary performance of revenues and expenditures for FY 2012, 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, 2012. While the final steps for closing the fiscal year are not complete, this report provides City Council a reasonably accurate estimate of the FY 2012 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 2012 represented the third full fiscal year that the City faced declining revenue from numerous resources, with the primary loss of funds from the markedly lower Real Estate Tax revenue collections. In addition, the State continued to reduce its reimbursements to the City, for the fifth consecutive fiscal year, resulting in the demand on more local revenues to support State-mandated functions. With these persistent and undesirable conditions, our first quarter report projected a revenue shortfall of $2.2 million and an expenditure surplus of $2.4 million which taken together forecasted a year-end net surplus of $266,000 in the General Fund. By the second quarter, we projected a slightly higher revenue shortfall of $3.6 million and an expenditure surplus of $5.8 million, for a year-end surplus of $2.2 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. The Machinery and Tools Tax revenue was off slightly, but still close to the budgeted estimate. During the third quarter, the State began assuming the responsibility for direct Day Care services for eligible clients, rather than using the City as the fiscal agent. This change in service provision generated a significant change in the year-end surplus projection. (For this one program, the amount of $1.9 million in revenue will be not received as pass-through funds, offset by $3.5 million not being paid out for the Day Care services.) Adjusting for this circumstance, the third quarter projection showed a revenue shortfall of $6.2 million and an expenditure surplus of $10.6 million, for a projected year-end surplus of $4.3 million.

Revenues

The Fourth Quarter FY 2012 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 2012 was slightly lower than anticipated. With actual receipts posted through the end of June 2012, the City has received $154,724,157. Included in this figure is $2.8 million in Real Estate Tax Relief and $475,000 tax relief for disabled veterans. The total Current Real Estate Tax shortfall was $738,435 from the adopted budget estimate of $155,462,589, or 0.4% less than estimated. Delinquent real estate tax collections, while marginally lower by $100,000 than last year's total, performed reasonably well this fiscal year, with current receipts of $3.6 million, or $105,826 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. By the end of the fourth quarter, $3.1 million over the $40.5 million estimate had been received. This growth over the adopted budget estimate is the third consecutive fiscal year of more than 7% 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. Current Machinery and Tools tax receipts ended the fiscal year at $16.3 million or $7,960 over the 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. This remained true throughout the fiscal year, with the actual revenue gain higher than anticipated. Sales Tax revenue collections were $623,000 more than the estimate of $21.1 million. Meal Tax receipts exceeded the $17.5 million estimate by $1.2 million. A significant improvement from the beginning of the fiscal year is in Lodging Tax revenue which at year-end is $211,000 over the $2.9 million estimate, or 7% more than anticipated. These three highly responsive consumer revenue streams, when taken as a whole, seem to indicate a growing stabilization in certain areas of the local economy.

In other local revenue, there was better news as well. Business Professional and Occupational Licenses (BPOL) taxes ended the fiscal year with stronger-than-anticipated receipts. The net revenue over the estimate for all BPOL taxes is over by $1.8 million. 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. This revenue source exceeded its estimate, and ended the year $270,000 higher than the $1.1 million budgeted, due in part to a one-time windfall of approximately $305,000 Shipyard/Huntington Ingalls spin-off that occurred late in FY 2011. Vehicle License Fees, the alternative local tax when vehicle decals were eliminated, showed relatively level activity, collecting approximately $11,000 less than the estimated $3.9 million for this revenue source. The FY 2012 Vehicle License Fees collection remains within the range for the past four 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 $837,000 estimate by approximately $533,000 in the major permit categories of Building, Mechanical, Electrical, and Plumbing. This is the second consecutive fiscal year that this revenue has been higher than estimated. The City suffered a loss of $88,000 on Interest Earnings on Bank Deposits, just reaching $311,000 of the $400,000 estimate, in spite of aggressive efforts by the City Treasurer to maximum investments during a historically low interest rate environment.

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 cover these costs through local revenues. Approximately $3.5 million of Human Services program revenues was not collected. Contributing factors were the $1.9 million related to the cessation of the Day Care program and lower-than-anticipated foster care receipts. Reduced Human Services program expenditures of $5.1 million offset this revenue loss.

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 $7.9 million in normal budgetary expenditures, prior to final adjustments. Salary and Fringe Benefits savings continue to be the majority of the savings at $2.9 million or 1.7% under budget. These personnel savings continue to decrease annually as we aggressively use attrition credits, elimination of positions, and delays in hiring as methods to balance our annual operating budget. The assumption by the State of the aforementioned Day Care services generated a combined savings of almost $3.6 million in expenditures for operating costs and contractual services. FY 2012 Vehicle fuel was budgeted at 78 cents more per gallon than last fiscal year. The price per gallon paid monthly by the City fluctuated between $2.85 (December 2011) and $3.65 (June 2012). This price variance resulted in an average of $3.25 per gallon, resulting in savings of $102,953 or 3.6% in fuel costs. The Community Support category was overspent due to an additional FY 2012 payment of $401,207 to Hampton Roads Transit (HRT) for higher expenses in FY 2011.

A planned year-end expense of $3 million is presented in the Payment to Other Funds category as an additional General Fund Balance contribution. While our policy requires us to maintain an Undesignated Fund Balance of at least 7.5% of the actual General Fund revenues for the previous fiscal year, it has been our practice to establish an Undesignated Fund Balance growth of 10% of actual revenues. This $3 million will be a supplemental contribution over and above the 10% level. This intention was signaled to the bond rating agencies in July 2012 during their review of the City, and is part of our overall strong financial management to build reserves.

Final Adjustments

Prior to final adjustments, the year-end surplus will be approximately $6.2 million. Transactions that have yet to be completed will be adjustments in the $6 million range causing the bottom line of expenses to be exceeded by $1 million, or approximately the equivalent of the revenue surplus of $1.3 million. Such year-end adjustments allow for using

$3 million of the year-end surplus as a contribution to the Cash Capital Fund and an additional $3 million contribution to the Special Project Fund. Both of these year-end surplus uses allow 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 grant us a certain degree of flexibility and responsiveness during the fiscal year.

Combined Surplus and Use of Fund Balance

The final combined forecasted budget surplus of $6 million is approximately $2.1 million more than anticipated by the end of the third quarter in FY 2012. 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 2012 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. The rating agencies acknowledged this was a notable event during their July survey of the City, which helped us affirm our outstanding bond ratings.

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, seems to have some consistent elements of growth and helped to deliver more revenue than anticipated, resulting in the year-end surplus.

Neil A. Morgan

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Attachment

cc: Lisa Cipriano, Director of Budget and Evaluation

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