

Summary of Lynchburg Budget by City Manager Kimball Payne:

Difficult decisions face the citizens of Lynchburg and City Council as public deliberations regarding the annual budget begin. The *Proposed FY 2005 Budget*, summarized in this memorandum, demonstrates the stark reality that, looking forward, there is a gap between the cost of services provided by City government and the resources available to fund those services. This has been coming for some time. Past projections have predicted increasing difficulty in meeting local responsibilities with identified resources. Although the City has managed its finances in a responsible manner and has utilized a number of mechanisms to balance annual budgets, the combination of a weak economy, additional federal and state mandates without adequate funding, the loss of state funding in critical areas, and increasing costs of operations has resulted in a structural deficit that will require strong actions to eliminate. There must be significant and sustainable change to either reduce costs or increase revenues, or a combination of both, to correct the problem. One time fixes would be inconsistent with sound fiscal management principles.

The *Proposed FY 2005 Budget* for the City of Lynchburg includes the General, Schools, Capital, Airport, Water, Sewer, and Solid Waste Management Funds, as well as other minor funds and totals \$214 million. The proposed budget is a radical departure from past budgets in that it calls for both significant increases in local taxes and reductions in services to the citizens of Lynchburg. It offers no general salary increases for City or Schools employees and proposes a reduction in the size of the City workforce. The proposed budget cannot advance City Council's priorities for making Lynchburg a better place to live, work and play. At best, the budget attempts to maintain critical core services while cutting costs wherever possible.

Overall, there is something in the proposed budget for everyone to dislike. It has been developed, however, in an attempt to provide an honest description of the City's fiscal situation and to generate a conversation about the level of City services desired and the willingness or ability of the citizens of Lynchburg to pay for them.

Budget Development

In the abstract, budget development is guided by two principal sets of guidelines, the Financial Management Policies and priorities adopted by City Council.

Financial Management Policies

City Council first adopted Financial Management Policies in 1999 and has amended and reaffirmed them as appropriate. The policies address such areas as adopting a balanced budget, the appropriate fund balance to maintain, restrictions on its use for recurring operating expenses, debt management and the establishment of contingency reserves to address unexpected circumstances. If followed, sound financial management policies should do the following:

- Contribute significantly to the City's ability to insulate itself from fiscal crisis and economic disruption
- Enhance short-term and long-term financial credit ability by helping to achieve the highest credit and bond ratings possible
- Promote long-term financial stability by establishing clear and consistent guidelines
- Direct attention to the total financial picture of the City rather than single issue areas
- Promote the view of linking long-term financial planning with day to day operations
- Provide City Council and the citizens a framework for measuring the fiscal impact of government services against established fiscal parameters and guidelines
- Ensure that the organization is sufficiently resourced to perform mandated responsibilities
- Provide a foundation for evaluating financial analysis and condition

The Financial Management Policies are included in the General Budget Information section of the budget document. During the development of the *Proposed FY 2005 Budget*, an effort was made to remain in compliance with the policies. The proposed budget, however, does include a reduction in the General Fund Reserve for Contingencies to a level below the policy guideline in favor of funding ongoing operations.

City Council's Priorities

City Council has identified and annually reviews priorities upon which City staff should focus resources. The priorities establish a baseline for City policy development and operations. Priorities identified by City Council in August 2003 include:

- A superior education community
- Stable, productive inspired families
- A dynamic economic development center with emphasis on downtown and increased real estate value
- A community environment second to none with emphasis on public safety and infrastructure
- Responsive, effective local government with emphasis on boards and commissions, fiscal responsibility, excellent core services, and fighting unfunded mandates

In tight budget times it becomes difficult to focus on priorities designed to improve the community. Instead, the focus shifts to the practical aspects of managing an organization that must meet mandated and contractual financial commitments while delivering quality services to the citizens of Lynchburg. Those practical aspects include:

- Fund debt service
- Fund mandated programs
- Maintain a fund balance in accordance with fiscal policy
- Fund school construction at a level previously committed to by City Council
- Provide appropriate compensation for City employees
- Preserve employee benefits
- Replace essential equipment, especially vehicles and computers
- Maintain existing facilities
- Provide excellent core services
- Provide quality customer service

The challenge of addressing just these obligations precludes undertaking new activities to address broader community goals.

Biennial Budget

After the adoption of the FY 2004 Budget, a decision was made to prepare a biennial budget covering fiscal years 2005 and 2006. It was felt that the preparation of a biennial budget would provide for informative financial projections, would better demonstrate how budget decisions have multiyear impacts, would correlate the budget more closely to the state's biennial budgeting process and would reduce staff work in the second year. Accordingly, revenue estimates included the next two years and department directors prepared expenditure requests for both fiscal years. As the process progressed, however, it became apparent that the challenges to be confronted in the coming year were so large that giving equal focus to FY 2006 would not be possible. While the budget document does have a section summarizing the *Projected FY 2006 Budget*, it does not provide the same level of detail as the *Proposed FY 2005 Budget*.

Budget Preparation

As calendar year 2003 ended, it became clear that the FY 2005 budget process would be particularly challenging. The tax reform and budget plan offered by the Governor did not restore past cuts in State funding, did not offer any significant new revenues to localities, and, with regard to schools funding, provided even less State revenue than might have been expected from past practices. Shortly after the first of the year, the Chairman of the Senate Finance Committee presented a budget and tax reform proposal that would generate additional revenues with the promise of some increase in funding to localities. Like the Governor's plan, it also would not provide sufficient funding in major areas. In preparing the *Proposed FY 2005 Budget*, although we have not assumed further reductions in state funding, we have been very conservative in our expectations.

A major impact to the FY 2005 City budget came when the Virginia Retirement System (VRS) announced new rates for localities. The rate for City employees rose 3.75%, from 15.25% to 19%, costing an additional \$1.4 million annually. Although the final impact on Schools will not be known until after the conclusion of the General Assembly session, annual VRS costs will rise by as much as \$1.8 million. In addition, the expiration of a holiday on payments for VRS group life insurance and increasing costs of health and dental insurance will mean that the total costs of benefits for City and Schools employees will increase by over \$4 million in the next year.

With minimal growth in revenues anticipated, and with the knowledge of other spending requirements, City Council was informed of a potential \$5 to \$6 million deficit between anticipated revenues and expenditures for FY 2005, and shortly after the first of the new year, I instituted a hiring freeze on vacant City positions. This action was taken in anticipation of the need to reduce the workforce to help balance the upcoming budget.

City departments started preparing for the FY 2005 Budget in the Fall of 2003. For the first time, the Schools Administration and the School Board accelerated their budget preparation and deliberations to provide a funding request to the City Manager prior to the presentation of the proposed City budget. That effort is much appreciated.

While budget requests were being compiled, projected revenues for FY 2005 were examined. Although it is good budget policy to be conservative and underestimate revenues, over the last several years staff has steadily sharpened its revenue projections to ensure that all available resources were identified to support funding requirements. In FY 2003, for the first time in memory, revenues actually came in slightly below projections (about \$100,000, or less than 0.1%) by the end of the fiscal year. While spending was also held to less than projected and the City ended the year in the black, this experience demonstrated the very small margin in revenue projections.

The projections for FY 2005 indicated generally flat revenues when compared with FY 2004 revised estimates. Gains in the Real Property Tax from the biennial reassessment in 2003 were expected to be offset by reductions in other areas such as Personal Property Tax, Machinery and Tools Tax, and Charges for Services. Overall, revenues for FY 2005 were projected to increase by just over one percent (1.1%), or \$1.4 million, from the current year revised estimate.

Once anticipated revenues and combined expenditure requests were compiled, there was a gap of \$17 million. General Fund expenditure requests of \$139 million compared to \$122 million in expected revenues. The gap can be explained by the following expenditure needs or requests beyond the current fiscal year:

- \$1.7 million increase in VRS retirement and group life insurance for City employees
- \$650,000 increase in and health and dental coverage for City employees and retirees
- \$1.8 million increase in VRS payments for Schools employees
- \$200,000 increase in health and dental coverage for Schools employees

- \$1.0 million for police and firefighter pay increases previously approved by City Council
- \$2.6 million in additional debt service (General Fund & Schools)
- \$3.0 million in General Fund requests for non personnel spending (<3% increase from FY 2004)
- \$1.7 million for pay-as-you-go capital projects
- \$3.2 million in additional local funding requested from Schools
- \$500,000 for requested new positions, salary adjustments, and related personnel costs
- \$200,000 for the new storm water management program (a federal mandate)
- \$200,000 in additional support for the Greater Lynchburg Transit Company (GLTC)
- \$400,000 for vehicle fleet replacements

While we recognized that there was some flexibility with regard to a number of the items listed above, the first six, related to increased benefits costs, previously approved salary adjustments, and debt service, totaling \$7.65 million, are unavoidable and present a significant challenge in the face of minimal revenue growth. This is the hard deficit that will take strong action to overcome.

Budget Analysis

The *Proposed FY 2005 Budget* was developed, for the third straight year, using a modified zero-based process. The zero-based process requires each department to prepare a budget request that reflects the actual costs of performing its responsibilities as if it was being done for the first time. Merely proposing incremental additions to a previous year's budget is not acceptable. In a zero-based approach, the fact that a dollar was spent the year before is not relevant to a request for that same dollar in the new fiscal year. Each dollar must be justified as supporting the functions and operations of the department.

To facilitate budget review, volunteers from City staff, and this year a citizen volunteer, a graduate of the first Citizens Academy, served as budget analysts. The analysts were assigned particular departments to review and they met with department representatives, examined past spending patterns, questioned assumptions, and made recommendations to the City Manager. Line item details for both FY 2005 and FY 2006 were scrutinized in the process. Each line item was evaluated with respect to the need or requirement for the proposed expenditure, the anticipated value to be gained by the expenditure, and the reasonableness of the request based on prior years' history. After three years of zero-based budgeting there was little unjustified spending that could be identified.

Balancing the General Fund Budget

The process of balancing the budget required a re-examination of assumptions and expectations of service. There was recognition that service to citizens, even "core" services, might be affected and that City employees would feel the impacts of budget actions. Personnel costs make up over 75% of the General Fund Operating Budget. As a result, General Fund expenditures cannot be significantly reduced without affecting personnel. Given the size of the gap to be closed, no general salary increases could be considered. Furthermore, a reduction-in-force is proposed.

It was unrealistic to assume that across-the-board percentage cuts would be a relatively painless way of reducing costs. A reduction in requested expenditures of slightly over twelve percent (12.2%) would be required. Because of the tight margins in current operating budgets, across-the-board cuts would, in many cases, reduce the resources necessary to deliver quality services, crippling efficiency and effectiveness. Rather than accept mediocre or poor service delivery in important programs it is probably better to eliminate less important programs and try to ensure that the remaining services are adequately funded so that they can achieve their intended purpose. Before cutting programs, however, a community discussion should be held to identify programs that can be eliminated. In the meantime, a number of departments re-examined their budgets and offered additional expenditure reductions. I particularly want to

recognize Social Services, Juvenile Services, the Library, Parks & Recreation, the Police Department, and GLTC for offering additional reductions. Some of the reductions will impact service delivery and City infrastructure.

In balancing the *Proposed FY 2005 Budget* the following decisions were made.

Expenditure Adjustments

- Reduction of pay-as-you-go capital projects (\$2.5 million)
- No funding of the proposed 3% salary increase for Schools employees (\$1.2 million)
- Additional reduction to the Schools request (\$1 million)
- Debt Service savings (\$1.1 million)
- The elimination of 25 General Fund positions (\$750,000)
- The elimination of proposed Information Technology projects (\$650,000)
- Reduction in General Fund overtime (\$500,000)
- Reduction of the General Fund Reserve for Contingencies Account (\$400,000)
- Reduction of the Economic Development Reserve (\$300,000)
- No funding of requests for 5 new positions (Animal Warden, Buildings and Grounds, Information Technology, Police), filling a frozen position (Clerk of the Circuit Court), or the conversion of positions from wage to full-time (Juvenile Services, Procurement, Streets) (\$241,000)
- Reduction of the Reserve for Snow, Streets & Bridges (\$250,000)
- Provide no new funding for the storm water management program (\$220,000, includes two positions)
- Postpone GIS Aerial Photography (\$200,000)
- Reduction of fleet vehicle replacements (\$200,000)
- Reduction from a re-evaluation of the anticipated health insurance cost increase (\$145,000)
- Reductions in Library services (including 5 full-time equivalent positions) to the minimum required to receive State funding (\$140,000)
- Reductions in Parks & Recreation programs including the conversion of 4 full-time positions to part-time (\$135,000)
- Reduction of the transfer to GLTC through a fare increase & service reduction (\$136,000)
- The elimination of discretionary non-profit funding (\$115,000)
- Reductions in non-personnel costs in the Lynchburg Police Department (\$110,000)
- Defer VRS payments until after the initial employment period (\$100,000)
- Reductions in Social Services including a net reduction of 4.94 full-time equivalent positions (\$96,000 net savings)
- Reduction of the General Fund transfer to the airport (\$43,000)
- Reductions in Juvenile Services including the conversion of one full-time position to part-time (\$58,000)
- The elimination of the City's contribution towards the renovation of the James T. Davis Building into loft apartments (\$450,000); funding to be provided from existing reserves and the FY 2004 Reserve for Contingencies.
- The elimination of the Citizens First Coordinator position (\$66,000)

Altogether, these expenditure reductions total \$12.7 million. Other potential reductions are outlined below; however, I was unwilling to propose them without further discussion with City Council.

Revenue Adjustments

The *Proposed FY 2005 Budget* includes a number of actions to increase revenues. Despite the reluctance to increase taxes, I feel that this must be considered as an alternative to

severe service reductions. Accordingly, the following are included in the proposed budget for Council's deliberation:

- \$0.07 increase in the Real Property Tax rate to \$1.18 (\$2.2 million). This would replace state funding lost over the last two years and help offset other anticipated reductions in education funding.
- Increase the Meals Tax Rate from 6% to 7% (\$1.25 million)
- Increase the Personal Property Tax rate from \$3.30 to \$3.50 (\$570,000). The increase would not be subject to reimbursement from the State and would require significant computer programming changes.
- Increase the Amusement Tax from 5% to 10% (\$280,000)
- Increase the Motor Vehicle Decal Fee to the allowable maximum (\$280,000)
- Utilize an anticipated FY 2005 reimbursement from the Blue Ridge Regional Jail Authority due to a lower inmate count than expected in FY 2004 (\$260,000)
- Increase EMS transport fees and mileage charges to the maximum allowed (\$100,000)

Additional revenue from these adjustments would total \$4.9 million.

Additional Potential Reductions to Consider in Lieu of Tax Increases

Although not included in the *Proposed FY 2005 Budget*, the following program reductions are offered for City Council's consideration in lieu of tax increases. They were selected as not being essential to the delivery of "core" services expected by the citizens of Lynchburg. Nevertheless, the elimination of these activities may have unanticipated consequences and would have a detrimental effect on the quality of life in the City. They are not recommended without further analysis and discussion.

- Completely eliminate pay-as-you-go capital projects (\$1.6 million)
- Close the downtown branch library (\$16,600 net savings after the reductions proposed above)
- Eliminate leaf collection (\$118,500, there may be regulatory issues)
- Shut down the Museum system (\$200,000)
- Eliminate the Dare Program (2 officers, \$84,000)
- Eliminate funding for School Resource Officers (5 officers, \$275,000)
- Close one fire station at a location to be determined later (\$700,000)
- Eliminate entire Parks & Recreation programs such as the Naturalist, (\$72,000), Aquatics (\$81,000), Senior (\$222,000), and Arts (\$171,000) programs (indicated savings are gross in the General Fund; associated revenues would also be lost)
- Eliminate funding for the City Cemetery (\$80,000 in Buildings & Grounds costs plus the annual \$80,000 donation for a total of \$160,000)
- Eliminate the Office of Internal Audit (\$195,000)
- Eliminate funding for the Virginia Cooperative Extension Service (\$25,000)
- Eliminate seasonal wage employee funding in Buildings & Grounds: reductions in mowing in parks and along the expressway (conversion of some areas to meadows), reduced mowing on other city property, reduced frequency of trash collection at public facilities, elimination of flower bed maintenance (\$33,000 net), reduced landscape maintenance citywide (total including flower beds \$263,000)
- Eliminate Communications and Marketing, including Citizen's First (\$340,000)
- Eliminate local funding of the State Treasurer's Office (\$18,000)
- Eliminate the Juvenile Services Day Services Program (\$62,000 net)

Savings, if all of the above actions were taken and there was no corresponding loss of revenue, would total \$4.64 million.

Options to Reduce Personnel Costs

In addition to the cuts listed above, a number of additional actions could be taken to reduce personnel costs. These include:

- Further reduction in force (100 positions @ \$30,000 ea. = \$3 million); there will, however, be costs related to unemployment benefits
 - Reduce or eliminate employee benefits
 - stop paying the employee share of VRS (\$1.9 million)
 - shift a portion of the cost of health insurance to employees (for example, have employees pay the projected increase of \$276 annually, or \$23/month, for a total of \$258,000)
 - have employees pick up the cost of dental coverage (\$240 annually or \$20/month for a total of \$224,000)
 - change the health insurance program to reduce benefits and costs (savings to be determined)
 - eliminate the deferred compensation match (\$95,000)
 - Enact mandatory leave without pay for each employee each year (one day = \$144,000)
 - Eliminate the City contribution to retiree health and dental insurance (\$1.3 million; \$1.2 million health/ \$100,000 dental), or ask the retirees to contribute more to offset costs
 - Reduce work hours and reduce pay proportionally (a 10% pay reduction = \$3.7 million)
 - Eliminate employee uniforms (\$50,000) and laundry/dry cleaning (\$11,000)
 - Convert full-time positions to part-time to realize benefits savings (for example, implement phased retirement whereby a full-time employee retires and continues to fill the position on a part-time basis; savings would be realized from not contributing 19% of salary to VRS and health and dental contributions)
 - Change City policies to ensure pay practices are not more generous than that required by the Fair Labor Standards Act (FLSA), e.g., overtime, hours worked, and adjusted hours policies (for example, require all employees to work 40 productive hours prior to earning overtime compensation, require public safety employees to work the requisite number of productive hours in an approved work cycle prior to earning overtime compensation; stop awarding hour for hour time to exempt employees when exceeding 40 hours worked in a week)
 - Prohibit routine overtime (annual overtime payments cost \$1 million in addition to compensatory time currently valued at \$334,000). Note that some overtime is unavoidable and the budget proposal already anticipates a \$500,000 reduction in overtime costs.
 - Eliminate temporary help, seasonal and non-seasonal wage positions (for example, temporary staff hired by Billings and Collections during decal season, seasonal Public Works Associate positions during growing season and less than full-time administrative support staff)

I have given serious consideration to the options listed above and have come to the conclusion that a reduction in the size of the workforce is the only realistic and sustainable means of reducing personnel costs. Reducing the size of the workforce will mean a reduction in the City's ability to deliver services in a timely manner and could involve the elimination of entire programs and an actual reduction in the types of services delivered to the citizens. If this is to happen, I strongly feel it is imperative that the remaining employees be provided a competitive salary and benefits package, that they receive superior training and that they have the best possible equipment to do their jobs. Cutting any of these areas in addition to a reduction in force would be counterproductive.

There are other cost savings or revenue producing ideas that might be worth pursuing as the proposed budget is being discussed. The following are some of those ideas:

- Convert to third party billing of EMS transport charges (\$100,000 estimated savings)
- Eliminate the Land Use Taxation program (\$100,000)
- Consider service charges for tax exempt properties (additional revenues to be determined)
- Apply the business license tax to colleges and universities (additional revenues to be determined)
- Seek a vendor to provide consolidated copying services city-wide (savings to be determined)
- Sell or give away vacant property maintained by the City to reduce carrying costs (savings to be determined)
- Increase fees; e.g., P & R athletic programs (amount to be determined) , institute a charge for oversize vehicle escorts (\$20,000), double parking permit fees (\$4,500), increase parking fines by \$5 or \$10 (\$17,000 or \$34,000, respectively),etc.
- Determine the feasibility of turning off some percentage of the street lights in the City (\$600,000 annual cost)
- Reduce the General Fund Transfer to the Solid Waste Management Fund (currently \$732,529)
- Seek proposals from private companies to provide emergency response at the Airport (savings to be determined)
- Consider reduced funding to other Civic, Community and Regional Organizations (agencies and amounts to be determined)
- Consider further reductions to the Schools request (amount to be determined)
- Increase the Transient Occupancy Tax (additional revenues to be determined)
- Utilize the Transient Occupancy Tax to fund “core” services rather than tourism (\$450,000)
- Significantly scale down the Capital Improvements Program to reduce borrowing and related debt service (savings to be determined)
- Eliminate subsidies to tenants in the Community Market; charge rents that fully cover operating costs
- Intensify efforts to reduce policies and procedures that add little value to direct service delivery
- Continue efforts for greater consolidation of activities, and collaboration/coordination across departments and with the Schools (fleet, information technology, finance, human resources, health insurance, procurement, etc.)
- Implement a tax amnesty program for uncollectible accounts (potential additional revenues to be determined)
- Allow citizens to “round-up” on their utility bills for a quality of life service (for example, Round-up for Flower Beds, Round-up for Parks, Round-up for the Library, Round-up for Downtown, etc.)
- Explore hiring additional medical personnel to provide routine employee and dependent health care with the anticipation of reducing health insurance costs.

Feedback from City Council, early in the budget deliberations, regarding its interest in pursuing any of these ideas would be helpful. In addition, staff will analyze any other ideas offered by Council.

The budget document provides a complete description of the resources received by the City from all sources and their uses. All of the various funds utilized by the City are shown along with their proposed revenues and expenditures and balances.

Major categories within the General Fund are grouped substantially in accordance with guidance provided by the State Auditor of Public Accounts for comparative cost reporting. The budget document also includes organization charts for each department/division that show which positions are supported by local revenues and which are supported by other means such as federal or state aid or grants. Finally, under each General Fund department is a comparison of the Manager's recommendation for FY 2005 to the amended FY 2004 Budget and a listing of major items requested by the department but not recommended for funding.

General Fund Revenues

Total General Fund revenues for FY 2005 are projected to be \$127.7 million, representing an increase of \$9.0 million or 7.6% above the *Adopted FY 2004 Budget*. General Fund revenues consist of both Dedicated Revenues (\$23.9 million) and Non-dedicated revenues (\$103.7 million). Approximately one-half of the increase would result from proposed increases in taxes and fees. The remainder comes from modest increases described below.

Dedicated Revenues

Dedicated revenues are those revenues that are specifically designated by the Federal, State or City government to be used for specific programs. Overall, dedicated revenues are projected to increase \$1.5 million or nearly seven percent (6.7%). The increase is primarily due to an increase in Federal pass-through funds for social service programs (\$1 million), an increase in State highway maintenance funds (\$323,000), and a community prosecution grant (\$150,000). Due to the uncertainty of General Assembly actions, most of the projections for State funding have been held to FY 2004 levels. The projections may have to be further adjusted after finalization of the state budget. It is anticipated that decreases will be seen in support for education, public safety, constitutional officers, juvenile programs, social services, aid to libraries, and state grant funding if the General Assembly does not act to increase State revenues.

Non-Dedicated Revenues

Non-dedicated revenues, or those revenues that can be used at the City's discretion, are projected to increase approximately \$7.4 million from the *Adopted FY 2004 Budget* if the proposed tax increases are enacted. The increase comes, in part, from proposed increases in the real estate tax (\$.07), personal property tax (\$.20), meals tax (1%) and amusement tax (5%). In addition, it is proposed that the vehicle decal fee be raised to the maximum allowed by State law (\$4.50/\$9.50 to \$29.50/\$34.50 depending on weight). These increases would generate an estimated \$4.5 million in additional revenues.

Over eighty percent (83.7%) of non-dedicated revenues and sixty-eight percent (68.0%) of total General Fund revenues are generated by six local taxes, the Real Property Tax (\$37.5 million), the Personal Property Tax (\$16 million, including the state reimbursement), the Local Sales Tax (\$11.6 million), the Meals Tax (\$8.8 million), Consumer Utility Taxes (\$6.7 million) and the Business License Tax (\$6.0 million). With the exception of the real property tax, these revenue sources are especially sensitive to economic conditions.

General Property Taxes

Real Property Tax revenues are projected to increase by approximately \$3.7 million, or about eleven percent (11.5%). This increase is primarily due to a proposed tax rate increase from \$1.11 to \$1.18 per \$100 of assessed value. The proposed rate increase will generate an additional \$2.2 million in revenue. Without the proposed rate increase, Real Property Tax

revenues are projected to increase \$1.5 million, or 4.8%, due to the FY 2004 reassessment and projected growth. Real Property Tax revenue projections are adjusted for an historically uncollectible percentage of two percent (2%), tax relief for the elderly (\$516,000) and rehabilitation tax credits (\$335,000). For budget discussions, each penny on the Real Property Tax rate will generate approximately \$315,500. If the proposed rate increase is enacted, this revenue source will represent over one-third (36.1%) of General Fund non-dedicated revenues.

Personal Property Tax revenues are projected to increase very slightly, by approximately \$140,000, or less than one percent, even with the proposed rate increase from \$3.30 to \$3.50. Without the proposed increase in the personal property tax rate, this revenue source would decline by approximately \$430,000 due to a reduction in business personal property and machinery and tools assessments. The Personal Property Tax category represents nearly sixteen percent (15.6%) of General Fund non-dedicated revenues in the proposed budget.

Public Service Corporations Tax revenue is projected to increase only \$22,000 or less than one percent from \$2.488 million to \$2.510 million. This revenue is assessed by the State.

Other Local Taxes

Local Sales Tax revenue is the third largest portion of non-dedicated revenues to the City, representing eleven percent (11.1%) of those funds. This revenue source reflects the volatility of the economy and appears to reflect a strengthening in consumer spending. Projections indicate an increase of approximately \$600,000 from the *Adopted FY 2004 Budget*, to \$11.7 million.

Consumer Utility Tax revenues are projected to increase by approximately \$190,000 from FY 2004, to \$6.7 million.

Meals Tax revenues continue to grow but are beginning to stabilize. The revenue estimate of \$8.7 million represents over eight percent (8.4%) of General Fund non-dedicated revenues, and includes the proposed rate increase from 6% to 7% for an increase of \$1.2 million. Without an increase in the meals tax rate, revenue growth of \$273,000, or 3.2%, is projected for FY 2005 in contrast to an increase of 4.9% this fiscal year.

Business License Tax revenues of \$6.0 million reflect an increase of \$71,000 or a little over one percent (1.2%) from the current year. This source makes up about six percent (5.8%) of General Fund non-dedicated revenues.

Motor Vehicle License revenues are projected to increase \$280,000, or 22%, to \$1.6 million due to a proposed increase in license (decals) fees to the maximum amount allowable by the State. It is proposed that vehicles weighing less than 4,000 pounds would be assessed \$29.50 and vehicles over 4,000 pounds would be assessed \$34.50 for a vehicle decal beginning in FY 2005.

Amusement Tax revenues are projected to increase 100% from \$280,000 to \$560,000 due to a proposed increase in the tax from 5% to 10%.

Other revenues in this category make up approximately \$4.8 million of the FY 2005 revenue stream. This category includes **Right of Way Fees** (\$320,000), **Cable Franchise License Fees** (\$550,000), **Electricity and Gas Consumption Taxes** (\$337,000), **Bank Stock Taxes** (\$667,000, a loss of nearly \$500,000 from FY 2004), **Recordation Taxes** (\$300,000), **Tobacco Taxes** (\$1.2 million), and the **Transient Occupancy and Lodging Tax** (\$1.3 million).

Permits, Fees, and Licenses (\$789,000), **Fines and Forfeitures** (\$550,000), and **Revenue from the Use of Money and Property** (\$1.1 million) are projected to remain stable in FY 2005.

Charges for Services are projected to generate \$1.5 million, reflecting an increase of \$200,000 or 15.4% due primarily to an increase in the collection of ambulance service fees (both an increase in charges, \$100,000, and additional transports, \$100,000).

Non-Categorical State Aid is projected to increase approximately \$500,000 due to an increase in State reimbursement for personal property tax.

Miscellaneous revenues are projected to increase \$255,000 due to a projected reimbursement of the City's FY 2004 per diem payment to the Blue Ridge Regional Jail Authority (BRRJA). Daily population attributed to Lynchburg is projected to be less than that assessed by the BRRJA.

General Fund Expenditures

Proposed General Fund expenditures of \$128.0 million represent an increase of \$6.0 million or 4.9% over the *Adopted FY 2004 Budget*. (The difference between the \$9 million in additional revenues and the \$6 million in additional expenditures as compared to FY 2004 is explained by the use of \$3 million from the fund balance in FY 2004 for pay-as-you-go capital projects.) The General Fund finances all government activities with the exception of the Airport, Solid Waste Management, Water, and Sewer operations. All major funds contribute to the operations of the Fleet Internal Services Fund. A comparison of each of the General Fund operating departments as a percentage of total General Fund expenditures demonstrates the impact of these service areas on the entire proposed spending plan.

Expenditures as a Percent of Total General Fund Expenditures

	<u>Proposed FY 2005</u>	
	General Fund <u>Expenditures</u>	Percent of <u>General Fund</u>
General Government	\$ 9,934,052	7.7%
Judicial Administration	3,454,694	2.7%
Public Safety	24,761,747	19.3%
Public Works	13,524,885	10.6%
Health and Welfare	13,951,226	10.9%
Parks, Recreation and Cultural	3,708,915	2.9%
Community Planning and Development	2,032,748	1.6%
Civic, Community and Regional Organizations	6,118,039	4.8%
Non-departmental	2,423,617	1.9%
Transfers	35,974,773	28.1%
Reserves	1,250,000	1.0%
Debt Service	10,972,765	8.5%
TOTAL GENERAL FUND	<u>\$128,107,461</u>	<u>100%</u>

General Government includes the Council/Manager Offices, the City Attorney, the City Assessor, the Commissioner of the Revenue, Communications & Marketing, Financial Services, Human Resources, Information Technology, Internal Audit, the Electoral Board, the Registrar and the Treasurer. **Judicial Administration** includes the Circuit, District and Juvenile and Domestic Relations Courts, the Clerk of the Circuit Court, the Commonwealth's Attorney, the Magistrates Office, the Sheriff and the Court Services Unit. **Public Safety** includes the Police Department, the Fire and EMS Department, the Animal Warden, and Emergency Communications. **Public Works** includes Administration, Engineering, the Geographic Information System (GIS), Buildings and Grounds, Snow and Ice Removal and Streets. **Health and Welfare** includes Human Services Administration, Social Services, and Juvenile Services.

Parks, Recreation and Cultural includes Parks and Recreation, the Library, and the Museum system. **Community Planning and Development** includes Planning, Neighborhood Services, Inspections, and Economic Development.

Civic, Community, and Regional Organizations are groups that provide services to the City outside of general government activities. Some activities, such as the regional jail, are mandated. The City has contractual relationships with other agencies. Funding of some organizations is discretionary. Some of the organizations historically funded in this area are non-profits that provide services through volunteers, private donations and grants along with a supplement from the City. The services that they provide are typically not provided by local government but may impact local government services indirectly. The *Proposed FY 2005 Budget* provides no funding for the following agencies that received funding in previous years: Central Virginia Area Agency on Aging, Court Appointed Special Advocate, Keep Lynchburg Beautiful Committee, and the Virginia Legal Aid Society. In addition, new requests for funding from Crisis Line and The Arc of Central Virginia cannot be recommended.

Non-departmental includes those miscellaneous components of the City budget that generally do not fit nicely into an individual departmental budget but are widespread throughout, such as medical and dental costs and a general salary increase if programmed. **Transfers** include payments from the General Fund to other funds as a subsidy or payment for services. The most significant transfer is for City Schools.

Local Contribution to City Schools

Lynchburg City Schools forwarded a budget request involving two scenarios, depending on General Assembly action on the State's biennial budget. One scenario called for \$4.9 million in additional local funding and the other would require \$5.2 million in additional funding, depending on the VRS rate established for teachers in the Commonwealth. Although declining enrollment is expected to continue, the school system faces additional costs for textbooks, special needs students, facilities operations and maintenance, and must cope with inadequate funding from the State and federal governments. Both scenarios requested funding for a 3% raise for Schools employees at a cost of \$1.2 million. The *Proposed FY 2005 Budget* cannot support the proposed salary increases and reduces the requested contribution by an additional \$1 million. Even with this reduction, additional funding to Schools of \$3.0 million beyond the current year would be provided. This indicates the high priority given to public education in this proposed budget. In addition, Schools Debt Service will increase by \$700,000, from \$4.7 million to \$5.4 million. Funding in an amount of \$36.4 million is proposed for school operations (\$31.0 million) and debt service (\$5.4 million). With a projected decline in enrollment of 175 students, local per student support will increase from \$3,730 to \$4,234.

Significant Expenditure Increases

Significant changes from the current year in the proposed General Fund budget include the following:

- Funding to cover the increase in VRS retirement and group life insurance (\$1.7 million)
- Funding to support the annual cost of salary increases provided to police officers effective in January 2004 (\$800,000)
- Funding to continue the implementation of the Master Firefighter Program and Certification Pay in the Fire Department (\$214,000)
- Funding to cover an anticipated ten percent (10%) increase in active and retired employee health and dental insurance (\$440,000)
- An increased transfer to Schools of \$3.0 million to cover increased benefits costs and other needs
- An increase in City and Schools Debt Service (\$1.5 million)

- Funding for targeted salary adjustments and reclassifications for greater market equity (\$150,000)
- An increased subsidy to GLTC for operations (\$73,000)
- Funding to replace previous grant funding for a School Resource Officer (\$55,000)

New Initiatives

Given the fiscal challenges facing the City, the *Proposed FY 2005 Budget* cannot support any new initiatives.

Debt Service

The City finances a large component of the Capital Improvement Program (CIP) with general obligation bonds. Schools debt service is increasing from \$4.7 million to \$5.4 million and City debt service is increasing from \$4.7 million to \$5.5 million for a total increase in debt service costs of \$1.5 million. The increase in FY 2005 debt service is primarily due to the impact of deferring a bond issue in FY 2004.

The FY 2005-2009 CIP anticipates the issuance during FY 2005 of \$20.0 million in bonds for capital projects and a \$7.5 million bond anticipation note to be reimbursed by a Virginia Public School Authority Interest Subsidy Loan in FY 2006. The largest of those projects will be the continued renovations to E.C. Glass High School, a project that is in the second year of a three year construction program and estimated to cost over \$27 million.

City Council's Debt Management Policy requires annual debt service expenditures for tax-supported debt to not exceed 10% of total General Fund expenditures plus transfers to the School Operating Fund and Reserve Allocations. FY 2005 debt service as a percent of operating expenditures is projected at eight percent (8.6%).

Reserves

The *Proposed FY 2005 Budget* includes the following reserves:

Reserve for Economic Development	\$200,000
Reserve for Snow, Streets and Bridges	\$250,000
General Fund Reserve for Contingencies	\$800,000

The Reserve for Economic Development funds activities important for business recruitment, retention and expansion. Funds may be used for infrastructure improvements, land acquisition, or to provide the required local match for state incentive programs. The \$200,000 in proposed funding represents a decrease of \$300,000 from FY 2004.

The Reserve for Snow, Streets and Bridges serves as a contingency should the costs of snow removal exceed budgeted resources. Unused funds are subsequently transferred to the Capital Fund for pay-as-you-go financing of street and bridge projects. Funding in the amount of \$250,000 is proposed for this reserve, half of that provided in the current year.

The General Fund Reserve for Contingencies funds expenditures during the fiscal year that were unanticipated during budget development. Any funds remaining in this reserve at the end of the fiscal year revert to the General Fund Balance. The Financial Management Policies establish a goal of \$1.2 million for this reserve. The *Proposed FY 2005 Budget* does not meet this goal, but instead proposes a reserve for contingencies of \$800,000, a number more consistent with actual experience over the past several years. In an effort to comply with the Financial Policy, it is proposed that any balance in the FY 2004 Reserve for Contingencies be used to restore the FY 2005 reserve to the goal of \$1.2 million.

In addition to the Reserves already noted, there are four designated reserves from prior years. These reserves are:

Reserve for Court Facilities	\$206,292
Reserve for Renovations to the James T. Davis Building	\$190,252
Reserve for Emerging Issues	\$214,602
Reserve for Health Insurance	\$390,000

The Reserve for Court Facilities is funded through the collection of Criminal Court Fines. The State gives localities authority to collect a small fee for each case to be dedicated to court improvements. It is anticipated that these funds will be used for the renovation of the Juvenile and Domestic Relations Court capital project.

The Reserve for Renovations to the James T. Davis Building was set aside in FY 2002 to help fund the City's contribution to the redevelopment of this building into commercial space and market-rate loft apartments.

The Reserve for Emerging Issues is the balance left in the Emerging Issues account that was abolished by City Council in FY 2002. The combined funds from the James T. Davis Reserve and this reserve will fund the balance of the incentive promised to the developer of the James T. Davis Building when construction of the loft apartments/retail project is complete. An additional \$45,146 will be requested from the FY 2004 Reserve for Contingencies to fully fund this commitment.

A Reserve for Health Insurance was funded in FY 2003 and FY 2004 to be used in the event that health insurance claims exceeded budgeted funds.

Fund Balance

City Council's Financial Management Policy requires an Undesignated Fund Balance equal to 7% of General Fund revenues with a targeted goal equal to 10% of General Fund revenues. In the event that the Undesignated General Fund Balance is used to provide for temporary funding of unforeseen emergency needs, the policy requires that the City restore the fund balance to the minimum of 7% within two fiscal years. If the Undesignated General Fund Balance falls below the target of 10%, the policy requires that it shall be restored to the 10% target within five fiscal years. The proposed budget provides for a 9.7% fund balance, amounting to \$12.4 million. It recommends utilizing \$354,000 in fund balance for pay-as-you-go capital outlay. That amount represents debt service savings in FY 2004 that can be dedicated to one-time expenditures. Given the uncertainty of actions by the General Assembly, and consistent with past practice, it is recommended that the fund balance be carefully guarded and that actions be taken to maintain the proposed fund balance or even increase it to a higher amount.

The *Proposed FY 2005 Budget* complies with the financial management policy of matching ongoing expenditures with annual revenues. Utilizing fund balance to cover recurring costs is inconsistent with the financial management policies and would require actions to either increase revenues or reduce recurring expenditures in subsequent years.

Personnel

As with any service organization, the largest part of the City's operating budget, just over 75%, is devoted to employee compensation through salaries, wages and benefits. City Council understands the value of competitive employee compensation in recruiting and retaining a qualified, competent and diverse workforce capable of maintaining excellent core services. In furtherance of that goal, in November 2003, City Council adopted a *Compensation Philosophy* that articulates the principles under which the City's compensation plan will be managed. The City continues efforts to promote workforce stability and has experienced acceptable voluntary turnover rates and positive recruiting experience for most vacant positions. Addressing specific concerns about turnover and recruitment difficulties in the Police Department, in December 2003

City Council approved funding to adjust pay ranges and individual employee pay for sworn police officers.

The foundation of the City's compensation plan rests on the goal of attracting and retaining employees that are qualified, competent and representative of the community through pay ranges with minimums and benefits levels that are competitive with the relevant labor market. Using the Compensation Philosophy principles that guide periodic review of the pay plan, the Human Resources Department most recently measured market competitiveness in January 2004. That review indicated that, on average, the current pay range minimums lag the market by about seven percent (7%). The proposed budget includes \$150,000 to fund pay range and salary adjustments for positions where the annual market survey indicated an adjustment was justified. It also supports skills-related pay increases for Public Works Associates.

When City Council acted to increase the pay of sworn officers in the Lynchburg Police Department effective January 2004, it was agreed that the pay of civilians in the police department and employees of LynComm would be examined during the budget process. Overall analysis of the market indicators of pay range comparisons, turnover rates and recruitment experience included specific review of civilian positions in the Police Department, LynComm and sworn Fire/EMS positions. The *Proposed FY 2005 Budget* includes funding to make adjustments to those positions where indicators support the establishment of new pay range minimums. While the funding will not provide salary adjustments similar to those granted to sworn police officers, it will allow for an increase to the pay range minimums and salary adjustments to bring employee pay to the new minimums for Public Safety Communication Specialists and sworn Fire/EMS positions. In addition, the proposed budget includes \$214,000 to support the third and final year of the transition to a Master Firefighter program and certification pay in the Lynchburg Fire Department.

Competitive pay ranges are vital to the recruitment of a qualified workforce, but actual employee pay is also critical for retaining employees able to maintain high performance and productivity. Actual average pay of City employees is compared to the average actual pay of employees performing comparable work in market organizations. There are large disparities among average employee pay: the pay for some positions is very competitive with respect to market, but many fall below market. Market analysis indicates that the overall average pay for City employees is approximately seven percent (7%) below the average pay for similar jobs in the relevant labor market. The average represents a significant improvement compared to last year but is consistent with historic trends, indicating that perhaps last year was an aberration. The improvement may also be due to a variety of factors such as the volatility of the market, general wage increases, and pay adjustments for sworn police officers. The inability of this proposed budget to support pay increases for City employees may result in further disparity from the market with an impact on employee morale, turnover and recruitment. Ultimately, service delivery to citizens could be affected.

The City continues to experience rising health insurance costs due to increasing membership and industry-wide increases in medical and dental services as well as prescription drugs. It is projected that a ten percent (10%) increase in insurance funding for active employees will be required at a cost of \$258,000. Funding for the increase is included in the *Proposed FY 2005 Budget* without making plan changes or shifting costs to employees as was done in the past. The enterprise funds will also see proportional increases. In addition, costs for retiree medical and dental insurance are expected to rise approximately \$137,000. The City will continue to maintain a Health Insurance Reserve to buffer unexpected costs. In the spring, the City in combination with the Schools, will be seeking proposals for health insurance and prescription services. It is hoped that by combining the two groups together, multiple options can be offered to employees and overall costs savings can be realized.

Eight (8) new full-time positions were requested by General Fund departments: a Systems Analyst II for Information Technology, a School Resource Officer, Property Evidence Clerk, and PC Technician in the Police Department, an additional Animal Warden, a Public

Works Associate in Buildings & Grounds, a Program Administrator for the storm water management program, and a Storm Water Inspector in Community Development and Planning. The School Resource Officer was previously grant funded and is the only position of the eight recommended for funding in the *Proposed FY 2005 Budget*. The only other new position in the proposed budget is a grant funded one to support the Comprehensive Services Act

In addition, there were requests to convert eight (8) part-time wage positions to full-time. Only one, in Social Services, where the costs are fully reimbursable, can be supported.

Previously approved positions will remain vacant in the City Manager's Office, and the Clerk of the Circuit Court.

As previously stated, balancing this budget has not come without a cost to the City's workforce. The proposed budget includes the elimination of sixteen (16) full-time equivalent positions in Communications & Marketing, Social Services, Parks & Recreation, the Library and Juvenile Services. In some cases the full-time positions are converted to part-time. Twenty-five (25) additional positions are proposed to be eliminated. Details on how a reduction-in-force will take place have not yet been developed.

With these proposed adjustments, the workforce supported by the General Fund would total 1052.40 Full Time Equivalent (FTE) employees, composed of 901.85 full-time classified, 37.45 part-time classified, 49.60 grant and 63.50 state positions. The City's workforce in all funds would total 1261.95 FTE's. This includes 1,106.00 full-time classified, 41.70 part-time classified, 50.75 grant positions and 63.50 state positions.

Fleet Services Fund

The Fleet Services Fund is an internal services fund that manages the City's fleet of over 600 vehicles and equipment. The Fleet Services Manager reports to a Board of Directors consisting of representatives from various departments that utilize fleet services. The total operating budget of \$4.1 million for Fleet Services increased two and one-half percent (2.5%) from FY 2004, primarily as a result of projected increases in fuel as well as an increase in debt service expenditures for fire and emergency medical services equipment.

Annually, Fleet Services, in consultation with each department, determines the most efficient fleet replacement program for the next year based on actual miles driven and maintenance costs. A General Fund transfer of \$857,000 is provided for fleet replacement in FY 2005. This is \$200,000 less than requested but represents an increase from the \$585,000 provided in FY 2004 and continues to provide fleet replacement funding consistent with prudent fleet management objectives. Due to fiscal constraints, an equipment depreciation component has not been factored into the annual charges to departments for fleet replacement.

Capital Fund

The *Proposed FY 2005-2009 Capital Improvements Program* (CIP) includes \$75.3 million for City capital projects and \$38.9 million for school capital projects. Adoption of the CIP is anticipated coincident with adoption of the annual budget. Major bond financed projects proposed for funding in FY 2005 include continued work on the addition to and renovation of E.C. Glass High School, Major Bridge Repairs, Street Overlay projects, Downtown/Riverfront improvements, New Juvenile and Domestic Relations Court, Breezewood Drive improvements, and Old Graves Mill Road improvements. Proposed capital project appropriations total approximately \$24.9 million in FY 2005. Further, during FY 2005 the Lynchburg Regional Airport is expected to receive approximately \$7.5 million from the Federal Aviation Administration to cover the costs to extend Runway 4.

Ideally, a portion of the Capital Improvement Program should be funded each year on a “pay-as-you-go” basis. Beginning in FY 2001, a portion of the fund balance above the targeted ten percent (10%) of General Fund Revenues was allocated to pay-as-you-go capital construction for smaller projects and/or projects that have a life of less than 20 years. In FY 2005, there are no funds available above the targeted 10% fund balance for pay-as-you-go capital construction. The *Proposed FY 2005 Budget* provides \$1.6 million for pay-as-you-go projects with funding from debt service savings in FY 2004 (\$354,000) and a transfer from the General Fund.

FY 2005 Requested and Proposed Pay-As-You-Go Capital Projects

	<u>Requested</u>	<u>Proposed</u>	<u>Increase/ (Decrease)</u>
Buildings			
Financial Services Renovation	\$ 548,359	\$ -	\$ (548,359)
Fire, EMS and Police Logistics Facility	\$ 756,250	\$ -	\$ (756,250)
Major Building Repairs (241,906)	\$ 741,800	\$ 499,894	\$
Market Parking Deck Renovation	\$ 149,600	\$ -	\$ (149,600)
Old Court House Renovation	\$ 75,000	\$ -	\$ (75,000)
Roof Replacement	\$ 252,885	\$ 200,000	\$ (52,885)
West Building Repairs	<u>\$ 35,274</u>	<u>\$ 35,274</u>	<u>\$ -</u>
Total Buildings	\$ 2,559,168	\$ 735,168	\$ (1,824,000)
Transportation			
GLTC	\$ 134,379	\$ 134,379	\$ -
Traffic Signal Replacement	<u>\$ 150,000</u>	<u>\$ -</u>	<u>\$ (150,000)</u>
Total Transportation	\$ 284,379	\$ 134,379	\$ (150,000)
Economic Development			
CVCC	\$ 105,707	\$ 105,707	\$ -
General Development Support	\$ 350,000	\$ 175,000	\$ (175,000)
Street & Util. Exts./Promote Ec. Dev.	<u>\$ 300,000</u>	<u>\$ 150,000</u>	<u>\$ (150,000)</u>
Total Economic Development	\$ 755,707	\$ 430,707	\$ (325,000)
Parks and Recreation			
Athletic Field Improvements	\$ 105,653	\$ 105,653	\$ -
Parks Paving and Athletic Court Paving	\$ 189,000	\$ 100,000	\$ (89,000)
Playground Replacement & Improve.	\$ 70,928	\$ 70,928	\$ -
Templeton Senior Adult Center	<u>\$ 50,000</u>	<u>\$ 50,000</u>	<u>\$ -</u>
Total Parks and Recreation	\$ 415,581	\$ 326,581	\$ (89,000)
Miscellaneous			
Va. Pollutant Discharge Elim. System	\$ 112,000	\$ -	\$ (112,000)
TOTAL GENERAL FUND PAY-AS-YOU-GO	<u>\$ 4,126,835</u>	<u>\$ 1,626,835</u>	<u>\$ (2,500,000)</u>

Airport Fund

The Lynchburg Regional Airport is budgeted as a separate fund to clearly delineate its financial operation and the support from the General Fund. Cost Center revenues and a General Fund subsidy of approximately \$528,981 cover total expenditures of \$2.2 million. Aggressive efforts to maximize revenues and good management of expenditures will result in no increase in the General Fund subsidy to the Airport. Airport revenues cover annual expenditures with the subsidy covering debt service on the terminal building. FY 2005 operating expenditures are projected to be basically unchanged from the current year.

Water Fund

The City's water system can be characterized as having low rates and ample capacity, while being positioned for significant growth opportunities in its customer base. In addition to serving approximately 21,295 City accounts, water is sold by contract to the counties of Amherst, Bedford and Campbell and to several large industrial customers. The Water Fund operates as an enterprise fund and requires no subsidy from the General Fund.

Water Fund total revenues are projected to increase by \$750,000, from \$8.9 million to \$9.7 million. Expenditures are projected to equal revenues. Two additional treatment plant operator positions and the reclassification of one maintenance position to a water plant operator are required for the City to remain in compliance with Virginia Department of Health staffing requirements. The hiring of a GIS Technician is also recommended. Revenues from Charges for Services are expected to increase from \$6.9 million to \$7.3 million with the implementation of a proposed rate increase for larger commercial customers. It is also anticipated that revenues from water contracts with large users will increase by approximately \$350,000.

The FY 2005 utility rate study proposes a 4% increase in the Water Block 1 rate, charged primarily to residential customers, but the rate for Block 2, which includes commercial, institutional and industrial customers, is proposed to increase nearly fourteen percent (13.6%). The City's goal for over ten years has been to eliminate the water block rate structure and have a single water volume rate for all non-contract customers. With the proposed increase in FY 2005, the Block 2 rate will be eliminated and the transition to one water rate will be completed.

With the rate increase recommended by the City's utility rate consultant, the unrestricted cash balance is projected to be forty-four percent (44%) of total fund expenditures for FY 2005 with a debt coverage ratio of 1.38, in compliance with City Council's policy to maintain a fund balance at forty percent (40%) of annual fund expenses and a debt coverage ratio of no less than 1.2.

Sewer Fund

The City's sewer system serves Lynchburg and portions of the surrounding counties. Although operated by the City, the wastewater treatment plant is a regional asset with capital costs shared by the localities proportionally. The City has contracts with several large industrial users. The Sewer Fund is also operated as an enterprise fund and requires no subsidy from the General Fund.

The *Proposed FY 2005 Budget* projects revenues of \$15.1 million against expenses of \$14.0 million. Revenues are projected to increase slightly (\$137,000) and expenditures are projected to decrease \$750,000, or five percent (5.1%) from the current budget. The net revenue increase is a combination of an actual loss of approximately \$127,000 in revenue from large industrial users and a proposed rate increase of four percent (4.0%). The level of rate increase is intended to maintain the fund balance and debt coverage ratio at levels that ensure compliance with a Special Order between the City and the Department of Environmental Quality (DEQ) for the correction of Combined Sewer Overflows (CSO) and to provide for operating and debt service costs. The net decrease in expenditures is primarily due to a reduction in debt service of approximately \$750,000 resulting from the refinancing of various Virginia Revolving Loans.

The special order with DEQ establishes a compliance schedule and project priorities for implementation of the CSO control plan. Although the City has spent over \$143 million on CSO control since 1993, the estimate to complete remaining necessary work is over \$255 million. The compliance schedule does not contain fixed dates for implementing the CSO control plan, but rather provides for implementation based on three criteria that reflect the limits of the City's financial capability. These criteria are:

1. The City is required to maintain rates so that the annual sewer bill for the average residential customer, using 9 hundred cubic feet (hcf) a month, equals or exceeds 1.25% of median household income (MHI).
2. The City is required to maintain a sewer operating debt coverage ratio within a range of 1.15 to 1.5.
3. The City is required to have reserve funds equal to no more than 25% of the prior year's budgeted operating expenditures.

With the rate increase recommended by the City's utility rate consultant, the unrestricted cash balance is projected to be 22% of fund expenses for FY 2005, with a debt coverage ratio of 1.36, therefore meeting the criteria defined by DEQ. Based on 2000 Census data, adjusted to July 1, 2004, the annual sewer bill for the average residential customer is estimated to be 1.16% of median household income.

In November 2003, DEQ agreed to restructure existing Virginia Revolving Loan Fund (VRLF) debt issued for CSO projects from 20 to 30 year repayment terms. Further, DEQ agreed to issue future VRLF loans based on 30 year repayment terms. As a consideration for the refinancing of the existing VRLF loans, the City agreed to begin utilizing 7 vs. 9 hundred cubic feet (hcf) as the average residential usage per month to meet the Special Order requirement for rates producing an average annual sewer bill of 1.25% of MHI. In order to reach the 1.25% threshold, the City agreed to enact annual rate increases of 4% until the threshold is achieved in approximately five years. This restructuring will allow the City to fund approximately \$20 million more in CSO and other water quality projects over the next six years. Furthermore, the debt restructuring will allow the City to plan future activities and avoid the less than favorable financial results it has been experiencing in this Fund.

Solid Waste Management Fund

The Solid Waste Management Fund is established as an enterprise fund. The fund assesses solid waste disposal costs through a tipping fee at the landfill, and a decal and tag system for residential collection. Collection costs are covered through a General Fund transfer. In addition, as of January 1, 2004, residents are charged a monthly fee of \$5, added to utility bills, to pay for certain "common good" services such as litter control, response to illegal dumping, recycling, and bulk and brush collection. In October 2003 residential solid waste collection was converted to a semi-automatic system and new trash carts were distributed to all households. Besides standardizing containers, it is anticipated that the semi-automatic collection method will reduce personnel injuries and result in lower workers' compensation costs. The changes to the Solid Waste Management Fund instituted by City Council in 2003 stopped the past reliance on fund balance to cover operating costs and put the fund on a sound and sustainable financial basis. Questions still remain, however, about the cost effectiveness and viability of the recycling program that is subject to a weak market, price fluctuations and problems with contamination.

FY 2005 revenues are projected to be \$7.1 million against expenses of \$6.2 million after adjusting for a one-time allocation of \$1.2 million to create a Reserve for Landfill Construction.

In August 1999, City Council adopted financial policies that established a debt coverage ratio of no less than 1.2 and fund balance targets of 40% of annual fund expenses for enterprise funds. The *Proposed FY 2005 Budget* will meet the debt coverage ratio target. It is projected

that the debt coverage ratio will be 1.67. The fund balance is projected to be fifty-six percent (56%) of expenses or \$3.9 million.

The creation of a Reserve for Landfill Construction is proposed for the Solid Waste Management Fund through the set-aside of \$1.2 million from the fund balance. The intent of this reserve is to accumulate funds for the construction of the next landfill cell in 2008 and to avoid borrowing for this expense. The long term goal is for landfill operations to be debt free by the time the useful space in the current location is filled up. Achieving debt free operations will allow the City to more freely explore alternatives to constructing another landfill. We believe that the creation of this reserve and a strategy to bring it to the level required to pay for construction of the new cell (approximately \$2 million) can be accomplished while meeting adopted financial targets.

Outstanding Issues

There are several outstanding issues that may impact budget deliberations.

- Revenue projections in the *Proposed FY 2005 Budget* are based on an analysis of actual revenues and trends up to January 1, 2004. There is some reason to believe that the economy might be strengthening and that revenues from taxes related to consumer spending might improve. For example, sales tax revenues from December sales will not be known in time for inclusion in this proposal. Staff will re-examine revenues after April 1, 2004 and at that time we should have a better idea of how revenues such as sales tax and meals tax are trending. Unfortunately, any projected gains may be offset by the next issue.
- As this message is being written the Virginia General Assembly is in session. Some of the bills under consideration would impose costly new mandates on local governments and others would curtail local authority to make decisions regarding local taxes. The adoption of the biennial budget for the State, in whatever form, will have a significant impact on localities across the Commonwealth. If actions are not taken to increase revenues, then cuts of over \$1 billion in the State budget will be necessary and localities will not be spared. Based on past reductions in State support, the City could expect to lose hundreds of thousands of dollars in State funding. Further reductions in State support for Constitutional Officers, public education, human services, libraries and public safety, will either require more difficult decisions about service delivery or the shifting of resources from other areas of the budget.
- The City and Schools will be seeking proposals for employee health insurance. Carving out prescription services for greater efficiency and lower costs will also be explored. Combining employees from both organizations into one pool could result in more program options and some cost savings.
- If additional resources can be identified during budget deliberations, I encourage City Council to consider salary increases for City employees to both improve market competitiveness and reward performance. In particular, I would like to address salary adjustments for civilian and LynComm employees in the Police Department and employees of the Fire and EMS Department in a manner consistent with the *Compensation Philosophy*.

Outlook

I expect that the structure of City government and the services that it provides may look very different after July 1, 2004. The choices that must be made to balance the FY 2005 Budget

will force that change. Without a doubt, the City will continue to focus on the core services of public safety, education and transportation in spite of the difficulty in meeting even those basic needs with available resources. The question will be whether or not the City can continue to make progress in other areas that make Lynchburg an attractive place to live, work and play including downtown redevelopment, parks & recreation facilities and programs, and amenities such as libraries, museums and other cultural facilities.

As an older central city, Lynchburg faces many fiscal challenges and while it has been able to manage so far, the pressures facing the City are growing. These include the national economic slowdown, the state fiscal crisis with its cuts in funding and shifting of responsibilities to localities, a concentration of individuals needing services and of tax-exempt properties that serve the entire region, aging infrastructure, middle class flight to the surrounding counties, and the lack of any reasonable mechanisms for revenue sharing. Many observers are beginning to wonder how long cities in the Commonwealth can survive without an urban policy that recognizes the value of cities to the State and fosters initiatives to address the problems facing them.

Localities in the Commonwealth are tools of the State that were established to deliver certain services that the citizens, through the Constitution and statutes adopted by the General Assembly, have determined are important. This implies some joint responsibility for the delivery of services such as public education, public safety, social services and transportation. The partnership between the State and its localities, however, is increasingly dysfunctional. The State has increased costly mandates on its localities while cutting State funding and, at the same time, limiting the authority to raise local revenues or to be innovative in service delivery. The result is increasing pressure on a few local taxes, primarily property taxes, to make up the difference. There is nowhere else to turn.

The shortfall in the State meeting its obligations to fund K-12 education, social services and public safety is well documented and yet neither the Governor's nor the House of Delegates' budget proposals would make any significant progress in closing the gap. While additional funds may be provided in some areas, without additional revenues beyond those needed to correct the State's fiscal structural deficit, there will only be a shifting of resources from one area to another. The result is the State giving with one hand and taking away with the other.

Expecting additional revenues from the State, given its own fiscal challenges, might be wishful thinking, but, there is hope that the General Assembly will adopt a budget that balances revenues and expenditures without further shifting costs to localities. The strong ideological differences in the General Assembly regarding tax and spending policies, however, make the passage of any budget proposal questionable. It is imperative, nevertheless, that the structural imbalance in the State budget be rectified, for the long term fiscal health of both the Commonwealth and its localities. Failure to increase resources will require additional cuts in State spending of over \$1 billion, and, once again, will result in less State funding to localities in areas of joint responsibility such as education, public safety, social services, transportation, and natural resources. As in the past, localities will be forced to either cut services or raise local taxes to offset State funding reductions. Lynchburg will continue to work with the Virginia First Cities Coalition and the Virginia Municipal League to address the structural inadequacies in the Commonwealth's governmental and tax structure.

The City also faces a challenge of civics. Its citizens demand more and better services while insisting that they should pay no more for them. There seems to be an expectation that there is a great deal of waste and inefficiency in City government that can be eliminated to provide resources for desired services. The reality, however, is that City government operates on a tight margin and the minimal revenue growth experienced over the last several years cannot keep up with increasing costs in such areas as retirement, health insurance, utilities, fuel, and other goods and services necessary for City operations. It is unrealistic to expect that we can cover increasing costs without increasing revenues or cutting services.

City revenues depend to a large degree on the willingness of people to live, work and shop in the City. Accordingly, we must take steps to encourage investment in the City. We must provide an attractive environment, a functioning public infrastructure and a facilitative regulatory process that encourages business owners and residents to locate and expand in the City. We must ensure that regulations designed to protect or improve the quality of life in the City do not discourage the purchase and improvement of private property. The balance that must be struck requires open communication and consensus on common goals.

Nowhere is this better demonstrated than in downtown Lynchburg. Redevelopment of the central business district has involved regulation, flexibility, creativity, public investment and private entrepreneurship. By the end of FY 2005 investment over a four-year period will exceed \$100 million. Completed projects include the City's Human Service Building, the Riverviews loft apartments and commercial/art space, offices for the Lynchburg Redevelopment and Housing Authority, three blocks of Ninth Street and the YMCA. A number of projects are proceeding to completion including the Academy of Fine Arts, the final block of Ninth Street, riverfront improvements, renovation of the Old Courthouse/Museum and Monument Terrace, the Bluffwalk hotel/restaurant/brew pub complex, the new Federal Courthouse and Post Office, and several apartment projects. The downtown pioneer, Amazement Square, continues to enjoy great success and has plans to expand its operations with the development of additional exhibits, a café and a skateboard park. Interest is also growing in new, renovated or expanded commercial space downtown while restoration activity remains strong in the historic inner city neighborhoods. All of this activity positions the downtown to regain its prominence as the cultural, entertainment, dining and shopping center of the region. In spite of fiscal challenges, the City should continue with efforts to revitalize downtown and its approaches such as Fifth Street. Investment in these areas will forestall further deterioration and, if successful, will ultimately strengthen the tax base and bring additional revenues to the City.

Conclusion

The *Proposed FY 2005 Budget* is offered for City Council consideration, deliberation, amendment and adoption. I have no illusions that this budget will be adopted as proposed. As stated previously, there is much to dislike in this proposal and I expect a strong negative reaction from many stakeholders. Nevertheless, it is essential that there be a community-wide discussion regarding desired services and our willingness or ability to pay for them. Over the next several weeks, Council will have the opportunity to hear from and question the representatives of the various departments and agencies seeking funding in FY 2005. Work sessions will be held on Tuesday afternoons throughout the months of March and April. A public hearing on the proposed budget is scheduled for April 6, 2004, at 7:00 p.m., in Council Chambers. During Council's deliberations, staff is prepared to provide assistance and additional information as Council works towards budget adoption.

Copies of the *Proposed FY 2005 Budget* are available for public review at the main public library and the downtown branch as well as on the City's web site at www.lynchburgva.gov.