Manager's Budget Message
Fiscal Year 2014-2015

To: **The Honorable Mayor and Members of City Council**

Date: **April 7, 2014**

This binder contains the City's recommended annual budget as required by North Carolina General Statute 159 and the *Local Government Budget and Fiscal Control Act.* Three general sections comprise the document. The first section is the continuation budget for all funds necessary to carry out the services authorized by the Washington City Council. This section contains financial information and narrative descriptions of the programs and services. The narrative portions of this section are created in an attempt to help explain the purpose and function of the different departments and programs in order to better educate the reader about City services. Financial summaries, as well as line item details, are also provided for the reader to review. The second section is a fee manual that describes the user fees that attempt to recover some or all of the costs of services from the direct beneficiaries of the services, rather than taxpayers. The third section contains information on 26 General Fund and 2 Electric Fund service expansions proposed by departments and outside agencies. These are "new and different" programs or activities that expand the current level of service to City of Washington citizens and taxpayers or requests from outside agencies for funding above the level provided to them by the City in the previous fiscal year. The budget is balanced and prepared in accordance with the policies and procedures outlined in the *Local Government Budget and Fiscal Control Act.*

Goals

This budget is a vision of what the City will strive toward in the coming year. The values communicated during the budget process and incorporated into the recommended budget are:

- Continue to rely on financial plans and systems in the preparation of the proposed budget;
- Conservatively estimate revenues and expenditures to avoid expectations of performance that are not realistic;
- Create an atmosphere where efforts to "spend down" during the fiscal year are discouraged;
- Present a budget that re-evaluates all expenditures in order to offset projected losses in revenues so that in light of the current economic conditions a tax increase is not needed for general government operations, but allows for policy review and potential service reductions or expansions based on other policy directives.

- Provide an analysis of general government cost centers in order to more clearly demonstrate where general fund tax dollars are being spent and what services are provided.

- Reduce short-term financing for capital projects and instead use pay-as-you-go financing when appropriate.

The budget team prepared this document to meet these goals. In spite of the increasing costs of operations, the proposed FY 14-15 budget maintains all City programs and services at the current tax rate of $0.50 per $100 of valuation as directed by the City Council. This level tax rate is accomplished by decreasing expenditures and using transfers (payment-in-lieu-of-taxes and fund balance) to close the revenue/expenditure gap.

Overview of the Budget

The City's fiscal year begins on July 1st and ends on June 30th. The budget is divided into separate funds in order to account for revenue collected and services provided. The following is a list of the funds accounted for in this budget:

- General Fund – this fund is the "typical" governmental fund, where all taxes and some user fees and intergovernmental transfers are used to provide basic governmental services, such as police, fire, finance, planning, zoning, inspections, parks and recreation, library, street maintenance, and administration of all City services.

- Enterprise Funds – these funds are separate "self-sustaining" funds, commonly including all utility services and other functions where taxes are not generally used in its operations. Washington's enterprise funds include:
  - Water Fund
  - Sewer Fund
  - Electric Fund
  - Storm Water Management Fund
  - Airport Fund
  - Solid Waste Fund
  - Cemetery Fund

- Trust Funds – these funds are primarily received from interest proceeds from investments maintained by the City for specific purposes, such as Library and Cemetery operations.

- Special Revenue Funds – these funds are typically restricted in purpose and designation by City Council, and include such funds as capital reserve funds and a façade grant fund.

- Grant Funds – grant funds are restricted in their use and are typically used for ongoing projects. These projects are usually funded by grants from outside agencies and are for short-term operating expenditures.

- Capital Project Funds – these funds are similar to grant funds in that they are restricted for specific uses. They are usually for specific capital improvements projects and can span several fiscal years.

- Internal Service Funds – these funds are utilized by the City in managing services across the entire organization, such as the City's self-insured workers' compensation fund program.

General Fund

The recommended General Fund budget for FY 14-15 is **$14,149,757**. This is $907,657 or 6% less than the FY 13-14 amended budget. This is equal to 7.6 cents in current taxes and is comparable to spending levels in the originally adopted FY 10-11 budget.

Revenues

- ⇨ The recommended budget maintains the ad valorem tax rate of $0.50 for each $100 of assessed property valuation.

- ⇨ The proposed tax rate continues to include $0.0198 designated for the Public Safety Capital Reserve Fund to service the debt for Fire Station #2.

- ⇨ Ad valorem taxes are projected to be 1% less than the prior year due to the "Tax and Tag" program implementation that added an additional four months of revenue in FY 13-14 that will return to a normal twelve month distribution in FY 14-15.

- ⇨ Other Taxes and Licenses are projected to be flat due to continued slow sales tax growth and reductions in local privilege license taxes adopted by Council last year.

- ⇨ Unrestricted Intergovernmental revenues are 25% higher than the prior year due to new payment-in-lieu-of-taxes (PILOT) assessed against the value of the water and sewer infrastructure. This payment of $329,468 is consistent with the current PILOT assessed against the electric infrastructure and helps close the revenue/expenditure gap. The airport property tax grant is projected to be 30% less due to decreased hangar occupancy. The remaining revenues in this class are projected consistent with current year levels.

- ⇨ Restricted Intergovernmental revenues are projected to be 11% lower than current year due to the City not providing school resource officer services to the Beaufort County School System in FY 14-15. This change occurred due to school budget restraints and the need for the City to recover its costs for providing the service. The Beaufort County Sheriff's Office will now provide these services to the School System.

- ⇨ Permits and Fees revenues are projected to increase by 33% due to increased demand for building permits and fire permit/inspection services.

- ⇨ Sales and Services revenues are projected to decrease by $570,692 from last year with the overwhelming majority of it ($569,466) coming from the loss of rent due to the sale of the City's property at 234 Springs Road. $176,731 of the rental loss is for supplemental rent used to pay the debt service on building improvements made by the City. This loan will be paid off by the buyer when the sale is completed. However this still leaves a $392,736 loss in recurring revenue that must be filled.

- ⇨ Investment Earnings are projected to increase by $9,590 due to laddered investments in one, two and three-year certificates of deposits on idle City funds.

- ⇨ Miscellaneous revenues are projected to increase by $2,691 due to library memorials and contributions for senior center functions.

- ⇨ Transfers From revenues are recommended to remain flat. It was a desire of Council to again reduce the amount of the Electric Fund transfer this year, however due to the substantial recurring loss of revenue from the rental of the building at 234 Springs Road, this transfer is recommend to remain at the FY 13-14 level.

- ⇨ Administrative Charges are recommended to increase by $82,020 due to allocating administrative charges to the Stormwater Fund and adjusting charges to funds based on this year's budget. The charge to the Stormwater Fund is new this year, but is done in order to show the true cost of this cost center. An offsetting transfer from the General Fund to the Stormwater Fund is required to balance the fund. Council will need to discuss a stormwater revenue policy change to correct this imbalance in future years.

- ⇨ The recommended budget appropriates $391,783 in General Fund Balance or 2.8% of General Fund expenditures. This is a decrease of $714,918 or 65% from the prior year. The majority of the appropriation, $352,095, is for pay-as-you-go General Fund capital expenditures.

- ⇨ As of June 30, 2013 the unassigned/unreserved General Fund Balance was $5,962,328. In FY 09-10 the Council adopted a resolution recognizing the need to maintain a $2M unassigned/unreserved General Fund Balance for a natural disaster recovery in excess of a 16.7% or two-month operating reserve. This equals $4,358,293 for FY 14-15.

Expenditures

- ⇨ Administrative Cost Centers – expenditures in these cost centers decreased overall by 8%. Larger decreases were seen in information services where capital expenditures for infrastructure were placed on hold pending a review of potential cloud-based services compared to site-based services and in the municipal building due to the completion of the chiller replacement project. A few of the smaller administrative areas were up slightly due to personnel costs. The billing and customer service areas were up slightly due to increased postage and credit card service fees.

- ⇨ Other Cost Centers – expenditures in these cost centers increased overall by 4%. The largest increase was in the miscellaneous area which included the new General Fund transfer to the Stormwater Fund to balance the fund. The largest decreases were seen in legal services and debt service. Council directed that legal services be decreased and this new level of funding provides approximately six months of billing time for legal needs. The debt service decrease was due to the pay off of the loan used to finance the building improvements at 234 Springs Road.

- ⇨ Public Safety Cost Centers – expenditures in these cost centers decreased slightly overall by 1%.

- ⇨ Public Works Cost Centers – expenditures in these cost centers decreased overall by 27% due mostly to the shift in stormwater expenditures to the Stormwater Fund. Previously these expenditures were absorbed by the General Fund and they are now shown in the cost center in which they apply. The largest increase of 13% was in equipment services due to the need to purchase a new vehicle lift for safety reasons.

- ⇨ Cultural and Leisure Cost Centers – expenditures decreased overall by 11% with generally an equal amount across each area. In general the decreases were due to capital projects that were completed in the prior year or deferred this year.

- ⇨ Outside Agencies – expenditures in this area decreased slightly due to moving the US Highway 17 Association funding to economic development. The funding for all outside agencies was held flat in the recommended budget with any requested increases being addressed as service expansions.

Enterprise Funds

The combined Enterprise Fund budgets for FY 14-15 are **$45,823,743**. This is $3,049,774 or 6% less than the FY 13-14 amended budget. All of the enterprise funds are balanced. A careful review of fee revenues should be considered by the Council in certain enterprise funds in order to reduce and eliminate General Fund transfer needs.

Water Fund

The Water Fund recommended budget is $3,036,749, which is 24% less than the prior year and includes the following significant changes:

- ⇨ The Water Fund has no debt service. All bonds and installment notes are paid off
- ⇨ There is no transfer from the water service fund needed this year
- ⇨ Water sales and service revenues are anticipated to be flat from the prior year
- ⇨ No fund balance is appropriated this year as was in the prior year due to the EDA project
- ⇨ Expenditures include a payment-in-lieu-of-taxes (PILOT) to the General Fund in the amount of $135,035 and a transfer to the water capital reserve in the amount of $155,000
- ⇨ Capital expenditures in the amount of $40,000 are recommended as PayGo and are detailed on the recommended capital sheet

Sewer Fund

The Sewer Fund recommended budget is $3,187,016, which is 24% less than the prior year and includes the following significant changes:

- ⇨ Sewer bonds will be paid off in FY 14-15 leaving only the State Revolving Loan debt
- ⇨ Sewer sales and service revenues are anticipated to be flat from the prior year
- ⇨ $147,619 in Sewer Fund balance is appropriated to balance the budget. This amount includes $78,650 that was credited to Flanders Filters in the prior year and is significantly less than the amount appropriated last year due to the EDA project
- ⇨ Expenditures include a payment-in-lieu-of-taxes (PILOT) to the General Fund in the amount of $194,433.
- ⇨ Capital expenditures in the amount of $101,000 are recommended as PayGo and are detailed on the recommended capital sheet

Stormwater Management Fund

The Stormwater Management Fund recommended budget is $1,078,110, which is 53% higher than the prior year and includes the following significant changes:

- ⇨ $423,460 increase in operations due to the shifting of personnel/benefits costs and general fund administrative charges from the General Fund to the Stormwater Fund to more accurately show the cost of services related to the activities of this cost center
- ⇨ $42,858 in Stormwater Fund balance is appropriated to help balance the budget
- ⇨ $450,564 is transferred into the Stormwater Fund from the General Fund to help balance the budget. This again is to more accurately show the cost center activities

Electric Fund

The Electric Fund recommended budget is $36,592,286, which is 3% less than the prior year and includes the following significant changes:

- ⇨ Sales and service are anticipated to be flat from the prior year
- ⇨ In excess of $800,000 decrease in revenues due to prior year solar farm projects
- ⇨ No fund balance is appropriated
- ⇨ Transfer to the General Fund remains at $470,000
- ⇨ One position (Engineering Technician) was eliminated
- ⇨ Adjustment was made to reduce wholesale power cost as a result of the legislative tax law change, however retail rates on the revenue side remain the same

- ⇨ $196,000 in PayGo capital expenditures and $1,375,000 in capital installment financing are detailed on the recommended capital sheet

Airport Fund
The Airport Fund recommended budget is $309,218, which is 55% less than the prior year and includes the following significant changes:

- ⇨ Significant grant funds reductions for prior year projects
- ⇨ Additional airport grant funds for this year will be allocated when they are approved
- ⇨ Hangar and building maintenance funds have been increased
- ⇨ Grounds maintenance funds have been increased
- ⇨ $81,263 transfer from the General Fund is required to balance the budget
- ⇨ Request for replacement courtesy vehicle was addressed in the prior year budget

Solid Waste Fund
The Solid Waste Fund recommended budget is $1,295,824, which is 8% less than the prior year and includes the following significant changes:

- ⇨ Sales and services are anticipated to be flat from the prior year
- ⇨ $41,324 in fund balance appropriation is recommended to balance the budget. This is however significantly less than the prior year.
- ⇨ Capital expenditures in the amount of $60,000 are recommended as PayGo and are detailed on the recommended capital sheet

Cemetery Fund
The Cemetery Fund recommended budget is $324,540, which is $13,277 more than the prior year and includes the following significant changes:

- ⇨ Sales and services are anticipated to be flat from the prior year
- ⇨ $165,040 transfer from the General Fund is required to balance the budget
- ⇨ Capital expenditures in the amount of $30,000 are recommended as PayGo and are detailed on the recommended capital sheet

Summary

The City of Washington continues to face many challenges in the coming year. This recommended budget continues current operations and maintains the Ad Valorem tax rate at the prior year's level, in accordance with the Council's directive at the budget planning session, despite the increasing costs of providing these services. The local and state economies in FY 14-15 will be important factors in the performance of this budget.

This recommended budget does not meet all the expectations expressed by the City Council. It does not reduce the transfer from the Electric Fund and it finds an additional source of revenue in the form of a payment-in-lieu-of-taxes (PILOT) from the water and sewer funds in order to balance the budget without a tax increase. Readers of this budget may view this new PILOT as simply a way to "kick the can down the road" and not address the revenue/expenditure issue head on. I would disagree. There is a significant policy debate that must occur within the City Council as it considers the services it provides to the citizens of Washington and who ultimately pays for those services. This debate will and should take time. It is not something that should be rushed. Over the next fiscal year all the services provided by the City should be carefully considered, including the level at which they are provided and even whether they should be provided at all. Careful consideration must then be given to determine the most fair and equitable way to generate revenues to pay for these services. It is as simple and as complicated as that. This whole process will not be easy, but it must be done. I believe this recommend budget provides some of the initial analysis that clearly defines the issue and can be used to start the debate. If this is not done and we find ourselves back here next year facing the same challenge, then we can rightfully be labeled as simply "kicking the can down the road."

Putting together a budget is a tremendous effort. Chief Financial Officer Matt Rauschenbach and Assistant Finance Director Anita Radcliffe, as well as the entire Finance team, did an outstanding job in creating an informative and functional document that serves as a management tool and an outline from which to debate policy. Thank you for your many long hours of hard work.

Department managers did an outstanding job of analyzing and compiling budgets that met the expectations they were given. They deserve many thanks and tremendous admiration. The people working for City of Washington are truly special people who care about their community and take pride in providing efficient and effective services that make life better for others. I am grateful to have the privilege to work with them.

Respectfully submitted,

Brian M. Alligood, City Manager

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