CITY OF NEWPORT NEWS

OFFICE OF THE CITY MANAGER

November 16, 2016

TO: The Honorable City Council

FROM: City Manager

SUBJECT: FY 2017 First Quarter Financial Report

This first quarter forecast of the current fiscal year operating budget is prepared by the Department of Budget and Evaluation, and provides budgetary projections based on actual performance of revenues and expenditures for the first three months (July through September), and a forecast of financial activities for the remaining nine months.

The first quarter revenues are the most difficult to predict as this quarter occurs prior to the collection of the majority of our semi-annual revenues (Real Estate Taxes, Personal Property Taxes, and Machinery and Tools Taxes). At the end of the first quarter, just 2% of the $262.6 million of the entire General Property Tax revenue category had been collected. To further illustrate this point, only $89,000 in Current Real Estate Taxes was received by the end of September of the $177.2 million estimate. Generally speaking, revenue performance during this first quarter is consistent with collections during the same period last fiscal year. It is important to recall that the estimate for this category of revenues is higher than FY 2016 by $10 million due to stronger Real Estate (primarily in assessment of the commercial/industrial properties) and Machinery and Tool tax collections estimated during the FY 2017 budget development cycle.

Revenues

Revenues are expected as estimated for the fiscal year, with a few minor deficits projected in some budgeted amounts at this early point in the fiscal year.

One exception is the unknown impact of the State's operating budget performance for both the prior and current fiscal years. The State experienced a revenue shortfall at FY 2016 year-end, and has reported lower than anticipated collections in the first quarter of FY 2017, thereby affecting the FY 2016-2018 biennial budget by an initial State projection of a possible $1.2 billion.

In August 2016, Governor McAuliffe instructed state agencies to prepare 5% budget reduction plans based on agencies' appropriations for FY 2017, with the information due by the end of September. The reduction plans were to exempt Aid to Localities and mandated and/or formula driven programs. However, we have experienced unanticipated State mid-fiscal year funding reductions previously, mostly recently being in FY 2015. There is also the possibility that Aid to Localities reductions could be included in the FY 2017 State amended budget that the Governor will submit to the General Assembly this December. The City is already experiencing some degree of revenue loss, with the State withholding FY 2017 pay increases for state-supported local employees (i.e., Constitutional Officer staff).

With this in mind, and noting that the City has not received any official announcement of potential program reductions, it is only practical to prepare for some level of State funding cuts this fiscal year that could result in less City revenue for FY 2017. Based on an estimated 2% reduction in State revenue, we would lose amounts in the $650,000 to $1 million range. The potential $650,000 loss of State reimbursements is included in this quarterly projection. As a reference, the Aid to Localities reductions from FY 2009 to FY 2015 for the City resulted in approximately $8.8 million less in State reimbursements. I will be able to advise you of the impact of the State reductions, should they occur, in the coming weeks.

As a reminder, in July 2016, City Council adopted a change to the Real Estate Tax Deferral program after the FY 2017 Operating Budget had been adopted. The change was the inclusion of allowing applications for tax exemption status for qualified homeowners over age 65 or older, with an annual household income equal or less than $25,000 year, and qualified assets equal or less than $10,000, with 40% of household income spent on housing costs. During the first quarter and slightly beyond, the Commissioner of Revenue's Office has reviewed 85 applications with slightly more than half qualifying in FY 2017 for tax exemption status. In July, our initial minimum projection of the loss of revenue from this source was $255,000. We are including the amount of $150,000 of lost revenue in this projection, until the entire tax relief and tax exemption application process has been reviewed and final.

In the Other Local Taxes revenue category, Sales Tax revenue is performing on a monthly basis slightly better compared to the prior fiscal year. At the present time we are collecting an average of $1.980 million per month; that is approximately $38,000 more per month than FY 2016. We are anticipating meeting the Sales Tax estimate of $24.7 million. Meal Tax receipts were strong during the first quarter, and are anticipated to exceed the $24.8 million estimate by $200,000. Lodging Tax collections appear to be slightly lagging behind the $3.8 million budget, but at this time, we are not making any projections lower than the estimate. In a turnaround from trends from many prior fiscal years, Cigarette taxes seem to be ahead of pace in the first quarter, as compared with prior years, projecting to meet the $5 million estimate.

The receipts from two significant revenue sources remain unknown at this point, those being Machinery and Tools (paid on the same semiannual bases as Real Estate and Personal Property taxes) and Business Professional and Occupational Licenses (BPOL) taxes. The majority of the BPOL taxes will not be received until March. We were disappointed in our mixed performance experience in these taxes in FY 2016, resulting in under collection of $676 thousand in revenue. With this recent occurrence in mind, we are forecasting these revenues to underperform to the estimate for this fiscal year, but are cautiously optimistic that the revenues collected in March 2017 will meet the $17.3 million estimate. These revenues sources will be watched closely.

In all the other revenue categories there are some moderate fluctuations that are mostly seasonal in nature. When taken as a whole, the variances at this point do not suggest any additional cause for concern.

Included in this revenue estimate is the use of General Fund Reserves in the amount of $4.7 million. At this time, it is prudent to include the anticipated use of reserves, as budgeted, to balance all revenues and expenses for the fiscal year. However, as in the prior fiscal years, if there is sufficient revenue from all sources, coupled with under expenditures across the General Fund, we will make the decision to either draw down the reserves for future needs or leave them intact to build our reserves to our desired eventual goal of 20% of General Fund Balance.

Expenditures

The projected expenditure savings at the end of the first quarter is slightly more than $2 million.

Personnel Services (salaries) are projected to be potentially overspent, due to staffing conditions in a few departments. This will be discussed in more detail further in this memorandum. The Fringe Benefits category totals $1,054,928 or 52% of the total projected savings. This is a temporary savings projection, as the new health insurance premium rate change will take effect in December 2016, thereby increasing that cost for the remainder of the fiscal year.

In a few of our departments, Police, Fire, Sheriff, and Parks, Recreation and Tourism, we have experience elevated vacancies rates during the first quarter of the fiscal year. These vacancies are placing pressure on the departments to still provide the high level of professional services with fewer full time staff. As a result, some of the vacancy savings from unfilled full time positions is being funneled for part time employees or by paying overtime to existing staff. Coupled with higher than normal vacancies rates, these departments also have an Attrition Credit budgeted for FY 2017. Combined, these four departments carry $2.8 million or 54% of the $4.4 million Attrition Credit for the General Fund. While the Attrition Credit is a useful tool to recognize salary savings from normal position turnover, in this circumstance, those savings are now diverted to part time salaries and overtime pay. This is why I have pushed to dramatically reduce the Attrition Credit in City departments that had been used to help balance the budget during the tough recessionary times. The reduction of the Attrition Credit will continue to be one of my priorities in the upcoming budget cycle.

With this condition existing in salaries, that leaves $1.5 million in potential year-end savings in all other expenditure categories to cover the projected salary shortfall. The majority of these lower projections are found in the overall lower use of Human Services programs (at $511,208), and vehicle fuel savings ($51,718). Vehicle fuel is budgeted at 24 cents less per gallon than last fiscal year. Even with a higher than average rate spike for the first two months of FY 2017 due to two separate pipeline delivery interruptions, fuel expenses may be lower than the budgeted amount. However, this trend is not expected to continue for the entire fiscal year.

We are already anticipating that we may see more steadily increasing fuel rates occurring in calendar year 2017, impacting both the current and upcoming fiscal years.

Combined Results

When creating the final revenue projections for FY 2017, the FY 2015 revenue receipts and FY 2016 year-end projections to date were used and modified for potential economic changes. As a result, the FY 2017 revenue projections are equal to or slightly higher than where the City ended the prior fiscal year. At this point we expect the revenue collections to be on pace and to be close to our first quarter estimates.

With the anticipation of generally meeting our revenue estimates and an early potential for not fully expending planned operating costs, we will continue to manage the General Fund budget to end the fiscal year with a the goal of achieving a surplus. We hope to continue to see some growth in the consumer sensitive revenue receipts as the economy continues to stabilize. With the major revenue sources to be collected over the next month, and the potential of additional receipts from consumer generated taxes and fees, the second quarter projections will bring more clarity to a potential year-end result.

We will continue to monitor our revenue activity closely. We hope that there will not be a mid-fiscal year State Aid to Localities reduction, which would improve our revenue outlook. I feel that with our current projected expenditure surplus and continued development throughout the City, we will be in a position to balance this year's budget as planned.

James M. Bourey

JMB:LJC

cc: Lisa J. Cipriano, Director, Department of Budget and Evaluation