



MANAGER'S OFFICE
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Dear Mayor Kleinschmidt and Members of the Chapel Hill Town Council:

The adopted annual budget for the Town of Chapel Hill for Fiscal Year 2010-11 is submitted herein, in accordance with the Local Government Budget and Fiscal Control Act. These are challenging economic times. Although we have entered into a period of economic recovery, we have not made up the ground we lost during the financial crisis of the last two years. Revenues continue to be stagnant for the Town as well as for the State and County budgets. State and County solutions for budget woes often fall on the Towns, who only have taxpayers to pass on to directly.

To provide a budget that meets Council's objectives of no tax increase while maintaining core services, we employed the following strategies:

- Manage spending during the current year (2009-10) to provide additional fund balance to offset potential revenue shortfalls in next year's (2010-11) budget;
- Concentrate efforts on maintaining core service levels and a compensation plan that retains experienced employees; and,
- Use fund balance in excess of 15% for one-time costs such as capital expenditures.

The Adopted Budget is balanced using these strategies. The methods used in the past two years to balance the Town's budget, however, are not a sustainable long-term strategy. Over the past two years we have tightly managed expenditures by delaying hiring for open positions, reducing discretionary expenditures and minimizing new initiatives that could improve the efficiency and effectiveness of operations. In the short term, we have survived the global financial crisis without the level of sacrifice seen in other parts of the country. Our continued success is contingent on closing the gap between our current revenues and current expenditures.

As shown in the following table the Town has experienced a shortfall in budgeted revenues in recent years. Only through conservative budgeting practices have we been able to maintain our financial position. As we continue to pare down the budget during these lean times, the amount available from fund balance will eventually be insufficient to balance future budgets.

General Fund Original Budget						
	FY2005-06	FY2006-07	FY2007-08	FY2008-09	FY2009-10	FY2010-11
GF Revenue	\$ 44,839,007	\$ 47,368,000	\$ 47,814,000	\$ 46,877,126	\$ 46,681,627	\$ 47,625,770
GF Expenditures	<u>46,354,000</u>	<u>49,247,000</u>	<u>52,129,000</u>	<u>49,621,000</u>	<u>49,816,000</u>	<u>52,690,000</u>
Gap (Fund Balance)	\$ 1,514,993	\$ 1,879,000	\$ 4,315,000	\$ 2,743,874	\$ 3,134,373	\$ 5,064,230

We are appropriating \$5,064,230 from the Town’s fund balance to balance the General Fund budget and accomplish the Council’s goals. A portion of this appropriation, approximately \$3.0 million, comes from the budget savings set-aside during the current fiscal year. The remainder is from existing fund balance. A significant portion of the existing fund balance being used is for one-time costs such as capital expenditures.

Based on our preliminary estimates it looks like we will finish the current fiscal year with an undesignated General Fund balance of approximately 20%. This level of reserves is consistent with the average for the triple A rated peer group. Maintaining an adequate level of fund balance is critical to meet the cash flow requirements of this municipal corporation and to provide an emergency fund to safeguard the Town against the costs of recovering from unforeseen economic, emergency and natural disasters.

Balancing revenues and expenditures in future years will require careful attention to increasing revenue from existing sources, identifying new revenue sources and considering changes in service levels. Even as the economy improves, our work will get no easier.

Employee Costs

The Town’s services are highly valued by our residents, as evidenced by their comments and the recent community survey. The Town’s ability to consistently deliver high quality services is dependent on our ability to hire and retain a high quality work force. Part of the Town’s on-going strategy to accomplish this has been a competitive compensation package including comprehensive medical benefits for full-time employees. In recent years, the increasing costs of health insurance have made it very difficult to maintain the Town’s benefit package. The current budget included a 17.1% increase in health insurance costs. When we began budget planning for the Recommended Budget for 2010-11, our insurance carrier projected a 22% increase in health insurance premiums. This level of increase is not sustainable. To address this issue, I convened a task force of employees from all areas of the organization to learn together about the challenges of healthcare costs and to think together about changes to the plan that will reduce costs in the long-term while retaining a competitive benefit for employees. This budget contains minor changes in co-pays that reduce the rate of increase in our premiums for 2010-11 to 13.9%, close to the general trend in cost increases. We discussed these changes with Council in our recent budget status update. This is one small step in getting control over the costs of healthcare.

In addition to addressing the health benefits plan directly, we are also working to reduce costs by promoting our health metrics program and healthy lifestyles choices through our expanded wellness programs. We are working with UNC Hospitals to find creative

ways to match our healthcare needs with their delivery capacity and to create efficiencies and cost savings through a cooperative, innovative approach, including an onsite health facility.

In addition to the increasing cost of health insurance, this budget also includes a 32% increase in the employer contribution to the Local Government Employees Retirement System (LGERS). The poor investment performance of recent years presents the need for increased contributions to put the plan back on a course of full funding. LGERS also anticipates increases in employer contributions for FY2011-12 and beyond.

The Town's ability to maintain a high level of service delivery and high customer satisfaction, as shown in the recent community survey, is directly attributable to the quality and dedication of our workforce. Like most local governments the Town did not provide a salary adjustment to employees last year. Although, the general rate of inflation has been very low, Town employees that pay for dependent care through our health care plan received a 17.1% increase in their premium payment for the current year and they will receive a 13.9% increase next year, in addition to higher co-pays. In order to mitigate the effect these increases in health care costs have on employees and to show appreciation for the truly outstanding work done by Town employees, I have included in my recommended budget a one-time, flat rate payment for permanent employees employed by the Town as of June 30, 2010. This payment is calculated as an amount equivalent to 2% of the median employee's annual pay. Each employee will receive the same dollar amount. This amount will be paid in one lump sum and, similar to a bonus, it will not become part of the employee's base pay. Since this is a one-time expense and because it was the effort of these employees that created the budget savings portion of the fund balance, I believe it is appropriate to use a portion of the Town's fund balance in excess of 15% to fund this cost.

Departmental Budget Reductions

In order to balance the budget, I instructed departments to submit proposed departmental budgets at the same level of funding as the current year's original budget. This required each department to make adjustments in their budgets to cover increased operating costs as well as increases in the medical insurance premium and the employer contribution to the retirement system. Each department was also given a savings target for the current fiscal year representing the amount of money we need to save in the current year in order to balance next year's budget. To achieve these savings departments are employing a number of different strategies including:

- Delaying or deferring training and travel expenses
- Delaying lower priority projects or initiatives
- Holding vacant positions open

Despite the strain on departmental budgets, I believe we can continue to provide the same high level of service due to the dedication and ingenuity of our employees who continue to do more with less.

Goals for the FY2010-11

For the upcoming year the Town's goals have been established in the context of the recent economic downturn. Although we are officially in a "recovery" period, continued stagnant revenues and significant increases in healthcare and pension costs require a cautious approach to establishing short-term goals. The emphasis is on minimizing the impact of the economy on residents and employees, by maintaining the existing strengths of the Town including high service levels, an experienced work force and a stable economic base. The FY2010-11 Budget accomplishes this with the following strategies:

- No tax increase for FY2010-11
- Manage health care costs by making minor plan adjustments and seeking creative solutions through a partnership with the UNC Healthcare System
- Use fund balance in excess of 15% for one-time costs
 - Expanded capital improvement program
 - One time, lump sum payment to employee in lieu of salary adjustments
- No layoffs, no furloughs
- Transition to a defined contribution plan for post-employment health care for new employees
- Strategically manage vacant positions to maximize savings without significantly impacting services
- Maintain funding levels for outside agencies

Long-Term Goals

The Town's primary long-term goals are stated in the revised Comprehensive Plan adopted by the Town Council in the spring of 2000, with goals updated on May 12, 2003. The Town's Comprehensive Plan is organized around 12 major themes which together form a strategy for Chapel Hill's future. These themes are:

- Maintain the Urban Services Area/Rural Buffer Boundary.
- Participate in the regional planning process.
- Conserve and protect existing neighborhoods.
- Conserve and protect the natural setting of Chapel Hill.
- Identify areas where there are creative development opportunities.
- Encourage desirable forms of non-residential development.
- Create and preserve affordable housing opportunities.
- Cooperatively plan with the University of North Carolina.
- Work toward a balanced transportation system.
- Complete the bikeway / greenway / sidewalk systems.
- Provide quality community facilities and services.
- Develop strategies to address fiscal issues.

Taken together, the major themes show a pattern of commitment to community involvement in development and services in the community.

Planning Retreat Priorities

The Council held a planning retreat with members of the Senior Management Team on February 28th and March 1st, with a wrap up session on April 10, 2010. The results of that retreat focused our attention on the following priorities:

- **Govern with Quality, Responsiveness and Efficiency:**
 - Adopt strategy for key Council focus areas; Public Art, Communications, Affordable Housing and Sustainability.
 - Adopt a balanced compensation philosophy that helps to attract and retain the best employees and is financially sustainable.
 - Approve an organizational approach to strengthening community connections and resolving issues of discrimination and mistreatment.

- **Champion Downtown:**
 - Adopt Downtown Development Action Plan and Framework as a guide to investment
 - Compare alternative approaches from successful peer communities and modify ordinances and policies as appropriate in key downtown policy areas of; panhandling, cleanliness, bicycle and pedestrian safety, economic development and parking.

- **Focus Economic Development, Land Use and Transportation for a Balanced and Sustainable Future:**
 - Consider revising Comprehensive Plan to clarify the Vision and to guide planning and managing growth
 - Identify policy aspects of the development review process for revision and adopt timetable for review and action including:
 - Roles of Boards and Commissions
 - Revisions to the Land Use Management Ordinance
 - Council role in development review
 - Identify and address barriers and opportunities in business development within the Town's control(e.g., rents, regulatory environment, space available, focused incentives)
 - Define interests and needs
 - Develop and adopt strategies addressing the barriers
 - Define the Town's role in regional transportation
 - Use lessons learned from the Carolina North Development Agreement experience to improve collaboration with UNC-CH, UNC Healthcare and partners in local government and non-profit sectors

- **Maintain and Improve Community Facilities and Services:**
 - Decide Library expansion issues
 - Fund and adopt new Parks Master Plan
 - Decide municipal solid waste strategy for the future

- **Set Course for a sustainable financial future:**
 - Adopt Debt Management policies for Debt Service Fund
 - Adopt plan for future investment in capital projects
 - Adopt strategies for enhancing the non-residential tax base
 - Seek new and dependable revenue sources

- **Plan Ahead for Carolina North:**
 - Adopt implementation strategies and agreements set forth in Development Agreement
 - Continue regular meetings with Trustees

New initiatives funded in this year's budget include

- Matters related to the Council goals such as the Parks Master Plan;
- The wellness/alternative healthcare delivery project described above;
- The development review software project. The purpose of the development review project is to streamline the land use management processes through the application of a contemporary technology system to improve customer service and staff productivity.

Other budget issues

Outside agency funding remains at the same level as the current year. The Human Service Advisory Board and staff will come to Council with recommendations on specific agencies. The Chapel Hill Museum has petitioned Council for funding. We will be working with them to consider options for the needs they have expressed as we renegotiate their lease for Council consideration. Funds for repair to the building can come from the Town's maintenance funds.

The Council SEE Committee has been discussing carbon reduction strategies and funding for those strategies. The Council Economic Development Committee has been discussing strategies for meeting the initiatives of the economic development portion of Council goals. Rather than including activities related to these ongoing discussions in the Recommended Budget, I recommend that we continue to work with the committees to develop specific programs and identified measurements of results. We can return to the Council in the fall of this year with recommended programming, funding sources and possible new and sustainable funding sources for these priorities.

The Library budget, like all other departmental budgets is the same basic level as the current year. If the Council decides to proceed with the expansion project, we understand that interim operations in the coming year will be contained within the approved budget.

Reevaluating long-term commitments such as CIP projects and debt issuance

In the past few budget years, the Town has made significant investments in public facilities. As a result of those investments between 2004 and 2008, annual debt service on outstanding debt increased from \$2.4 million to more than \$6 million. For the FY2008-09 budget, a debt management plan was adopted to provide a better system for management of the Town's debt and its effect on the Town's operating budget. The current tax rate dedicated to the debt fund is sufficient for the debt service on issued debt and for the debt service on the \$20.4 million of authorized, but unissued, general obligation bonds. Our projections indicate that we can issue these bonds now without increasing the dedicated tax for the debt fund.

In addition to delaying debt-funded capital projects, last year we significantly reduced CIP projects funded through a transfer from the General Fund. For next year, we are recommending increasing our investment in CIP projects using one-time money from fund balance. The projects listed below represent our highest priority projects. They are, for the most part, minimal levels of major maintenance and facility improvements. The Fiber Optic Network Project represents a one-time opportunity to install a municipal fiber optic system in conjunction with NCDOT's traffic signal project, consistent with Council's stated priorities. This project will create a fiber-optic infrastructure for the Town at approximately one tenth the cost of building it ourselves. Total funding for capital projects in the CIP is recommended at \$1,237,800. Projects included in the CIP for this year include the following:

Extraordinary Maintenance - Emergency Repairs	\$ 75,000
Fire Station #3 Capital Maintenance	120,000
Curb Repairs: ADA Compliance	20,000
Fiber optic cable	100,000
Small Park Improvements	75,000
Playground Replacement	75,000
Greenways	40,000
Parking Lots/Paths/Trails	40,000
Skate Park	46,000
Cedar Falls Parking Lot Paving	63,000
Battle Branch Trail	80,000
Street Maintenance	75,000
In-Car Police Cameras	108,800
Reserve Fire Truck	300,000
Cemetery Beautification	20,000
Total	<u><u>\$ 1,237,800</u></u>

General Fund Budget

As shown in the following table, the recommended General Fund Budget represents a 5.6% increase over the current year's original budget. The major factors in this increase are as follows:

- Increase in the tax collection contract with Orange Co.
- Increase in grant matching costs
- Increase in employer cost for retiree medical insurance
- On-site health care facility and wellness initiative
- Development review and permitting software initiative
- Increase in the CIP funding level
- A one-time salary adjustment for permanent employees
- Increase in funding parks maintenance

With the exception of parks maintenance and the salary adjustment all of these items are accounted for in the General Government portion of the General Fund Budget.

General Fund Expenditures			
	FY2009-10	FY2010-11	
Function	Original Budget	Adopted Budget	% Change
General Government	\$ 8,826,125	\$ 11,300,504	28.0%
Environment & Development	13,357,480	13,351,009	0.0%
Public Safety	19,434,467	19,352,451	-0.4%
Liesure	8,197,928	8,600,036	4.9%
General Fund Budget	\$ 49,816,000	\$ 52,604,000	5.6%

Fund Balance

With respect to budget preparation, there are two sources of available or “spendable” fund balance. The first is the residual fund balance accumulated from prior years and the second is the excess of revenues over expenditures from the current year’s budget. The limitation on using fund balance as a funding source in the next year’s budget is the need to maintain a prudent level of fund balance to deal with circumstances such as a sudden loss of revenue or extraordinary unplanned expenses from which the Town cannot recover in the same budget period.

For the Town of Chapel Hill, given our status as a triple A rated municipality, the minimum level of fund balance should be 12%. In recent years, the Town has become more dependent on the excess of revenues over expenditures from the current year to fill the revenue gap in the next year’s budget. For FY2010-11, we are planning to use \$3.0 million from the current year. The additional fund balance needed to balance the budget is approximately \$2,072,230. This amount will come from residual fund balance and will off-set one-time expenditures including CIP funding and the cost of the one-time employee pay adjustment. Based on our estimates this will drop the fund balance to approximately 15%

The potential for the carryover in any given year to be significantly reduced by unexpected expenditures suggests that the carryover should be treated as one-time money

and as such should not be applied to the operating budget. Instead, any annual budget carryover is preferably applied to one-time costs such as capital needs. This will require current revenues to match current expenditures without reliance on carry-over fund balance. This is a key element in creating financial sustainability. Given the current economic conditions, it may take several years to achieve equilibrium between revenues and expenditures and subsequently provide a regular source of funding for the Town's CIP. We are recommending that, as we work through the current economic downturn, we keep these goals in mind.

Transit Fund

The adopted budget for the Transit Fund includes a 4.8% increase over last year's budget. This increase is due in part to the increases in fixed route, demand response and vehicle maintenance. Overall operating costs for fixed route bus service is up 7.8%, due in part to the increased cost of fuel. State assistance is expected to increase by 14.5%, while federal assistance is declining by 6.9% and federal operating grants have been eliminated. Significant challenges lie ahead in FY 2011-12 and beyond as the continued availability of state and federal funds is not guaranteed. We need to pursue strategies for reducing costs and/or seeking alternative sources of funding to ensure the long-term stability of the system. In order to mitigate these challenges and to operate a more cost effective system, Chapel Hill Transit staff will:

- Evaluate individual route performance and introduce efficiencies as part of the short range planning process
- Identify additional funding options
- Develop short range operating and capital plans to identify future system needs

Conclusion

The focus for the FY2010-11 recommended budget is to continue to mitigate the impact of stagnant revenues on our ability to deliver services, while making strategic investments to accomplish Council's goals and to achieve long-term financial stability. We believe this recommended budget achieves our goal of maintaining service levels at or near current levels, continued funding of performance agreements with outside agencies, maintaining salaries and benefits for employees, and investing in key public assets. To do this we are recommending a budget that uses a significant amount of fund balance to pay for one-time costs. The strategies employed in prior budgets have allowed the Town to build its fund balance during a time of global financial crisis.

As we emerge, slowly, from the recessionary economy, we have positioned ourselves to renew our investments in our community assets. We have the capacity to increase our CIP investment as well as the capacity to take on additional debt to finance projects that have been delayed. This budget also includes minor changes to the employee healthcare plan, reducing the Town's cost, but maintaining a very competitive benefit that our employees value highly. We have also included a one-time flat rate pay adjustment to help off-set the health insurance cost increases for the employee portion of dependent care and to recognize our employees for their hard work during these hard times.

The budget as presented is balanced without a tax increase. Long-term projections suggest that significant increases in revenues and development of new sources of revenue as well as reductions in costs must be achieved in order to avoid future tax increases.

I look forward to working with the Council and staff to refine our strategic focus for the future.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read 'R. Stancil', with a large, sweeping flourish extending to the left.

Roger L. Stancil