

April 11, 2014

Mayor Wallace, City Council Members and Citizens,

I am pleased to transmit the FY 2015 Manager's Recommended Budget, totaling \$452,819,700, a 0.94% increase over the FY 2014 budget. Of this amount, the City portion is \$257,075,586, and the School portion is \$195,744,114. Much of the growth in the budget is attributable to increased revenue with dedicated purposes, such as the use of the ATF proceeds to advance youth violence initiatives and an expected increase in Fort Monroe PILOT revenues in the event the currently imposed cap is removed by the General Assembly. Indeed, this budget calls for the key revenue components – the total of real estate and personal property taxes paid by our residents and businesses – to remain essentially flat at the current year total of \$176.3 million.

This is the fifth budget I have prepared since becoming city manager. Like the others I have prepared, this budget was extremely challenging due to the combination of lower revenues - most notably in our largest source of revenue, the real estate tax - and mandatory expenditure increases. Past efforts to cut the budget have left precious little to cut without significant reduction and/or elimination of services the public values highly.

Last year in the middle of the budget cycle, Hampton faced a sudden uptick in youth gun violence. While the trend is a national one, our local response included both city government and community action. The budget includes ongoing funding for increased action as well as some new actions to be piloted with earmarked ATF funding for two years. This budget also proposes transitioning the Teen Center facility into one that can serve both teens and other residents (at different times of day); the addition of a Freedom of Information Act officer to increase transparency; continued management streamlining and efficiencies; avoidance of cuts residents found unacceptable; a small revenue increase to help prevent cuts and teacher furloughs; and, continues two-thirds of the investment revenues that were dedicated for growth strategies that residents and Council supported last year.

As with all of my recommended budgets, this one was compiled with significant public input. As I promised residents in meetings this year, that strong partnership and investment of citizens in their city government will continue no matter what our economic situation looks like in the future. We committed to residents this year that we will seek their input not just in years when we are forced to make significant cuts, but also in years in which we show growth and could potentially expand programs or services. I remain cautiously optimistic that the time for growth is around the corner. Even now, we are seeing signs that new housing construction is burgeoning, banks are lending money for development and companies are hiring workers.

Community Budget Input

Understanding the years of budget cuts necessitated by the economy, our residents overwhelmingly supported a large tax rate increase last year. Although that increase did not return real estate taxes to the pre-recession levels, it did support last year's recurring operational needs of both the city and school system. Additionally, that change allowed us to set aside funding for investments for both

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entities. The school investment money has been used to start a 1:1 technology initiative that will put tablet learning devices in the hands of every middle and high school student within four years. The city investment money was used to accelerate master plan and economic development activities that will grow our tax base faster.

As part of the community conversations that led to that large rate increase, residents noted that - in retrospect - it might have been better to enact smaller tax rate increases over time, as real estate revenues declined from 2010-2014. The Council Finance Committee, made up of citizen financial experts, recommended a new guideline relating to real estate tax rate changes. That policy, which was ultimately approved by Council, suggested that an annual review be done to consider offsetting losses in real estate revenue with an increase in rate and, conversely, growth in real estate revenue with a corresponding decrease in rate.

Since the FY 2015 budget does contain a loss of real estate revenue of approximately \$1.3 million, we did consider a real estate tax rate adjustment of one penny, which would have largely offset this loss. As we have done in past years, we actively engaged the community in budget conversations that outlined our starting position with both the city and school budgets. Specifically, as part of those conversations, the community was asked whether they continued to support this tax rate policy, even in light of the large rate change last year.

Overwhelmingly, residents polled in person, online and even by random, scientific telephone survey did support a one-cent increase in real estate tax rate. Residents who participated on-line or in person also generally supported an alternative - an increase in the personal property tax rate - that could similarly be considered to offset this lost revenue while those who participated in the random, scientific-based survey did not. Finally, residents supported a change in our tax relief program for the elderly and disabled. That change would still provide the relief, in the same amounts, but would shift the program from an exemption program to a deferral one.

In this year's polling, residents were also asked whether they would support deferring some, or all, of the money that had been dedicated from last year's tax rate increase to accelerating master plan and economic development projects. Residents made clear in their responses that they continued to support these, and other similar capital investments, that would grow jobs, retail, tourism and higher value housing in our city. The high levels of support for investments that grow our revenue base reflects a community that is focused not just short-term but on the future of our city as well.

This community input was critical in shaping the budget recommendations contained herein. While we always strive to avoid tax and user fee increases, community support for changes, if needed, is desired.

Education Funding

The cost pressures for both the city and schools, coupled with the revenue loss, meant that significant cuts needed to be made. Cuts would have been worse if we did not consider some of the citizen-supported changes.

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The impact of lost revenue had the greatest impact on our school system, which had to deal with the decrease from the real estate tax as well as major decreases in state revenue. The State has consistently cut school systems across the Commonwealth. Our school division receives more than \$21 million less in state revenue than it did in 2009. The magnitude of these losses, and the mandatory cost increases the State has also passed on to our school system, are simply insurmountable from the local tax base.

Nevertheless, the City has a responsibility to do all we can to support a quality school system. Strong schools are not only essential for the students who attend them but also for the community at large. Economic and housing investments are often based, at least in part, on the perception of the school system. In recent years, our school system has made exciting advancements -- focusing on career academics and becoming the first urban district in our area to commit to providing tablet devices to all middle and high school students. Giving all students access to up-to-date textbooks and research opportunities can help level the playing field so all students can achieve to their highest potential. Our district performs better than other urban districts in all measures, and does so with fewer dollars per student. This is due, in large measure, to the excellent cadre of teachers who prepare our youth for high stakes testing and their post-secondary career and higher education paths.

While I wish we were able to provide sufficient additional funding to the schools to offset all of the cuts they have had to make because of the State impacts, it is simply not possible. However, I did feel it critical to provide at least some additional revenue to avoid teacher salary impacts such as the furlough day the Board had to include in the budget. A furlough is a pay cut by another name, and I know this was a painful choice for both the Board and Superintendent. My proposed budget does provide sufficient additional funding to allow the Board and Superintendent to revisit this impact to the excellent workforce which serves our students so well.

Personal Property Tax Increase

To do this will require an increase in tax rate. Either the one-cent real estate tax or the 25-cent personal property tax increase would have been sufficient to provide additional funds needed to eliminate the furlough for teachers. While the public support for the real estate tax increase was stronger, I ultimately decided to propose the personal property rate as it has not been raised since FY 1988. Our rate is also lower than several peer communities. Newport News raised their rate 25 cents last year, and the proposed increase for us this year would bring our rate in alignment with theirs. The amount of revenue generated in FY 2015 is roughly equivalent to the one-cent real estate change. Last, but not least, there is also a strong community perception that a change in this rate better shares the tax burden with non-property owners. Thus, this option seemed, on balance, preferable to another real estate tax increase this year.

Assuming Council concurs with this recommendation, we will be able to approve an increase of approximately \$600,000 above the School Board adopted budget based on the budget formula which spells out how taxes are allocated among the two entities. While we cannot legally obligate the School Board to use the additional revenue they will receive from this increase to eliminate teacher impacts such as the furlough, I am hopeful they will use these additional funds for that purpose.

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Aside from the personal property rate change, no other taxes or user fees are recommended for increase this year. According to the Commissioner of Revenue, the impact on individuals of the personal property increase is minor. The average personal property tax bill would increase by \$6.46 per year, a relatively small increase to help address these critical needs. It is also worth noting that, since we have chosen not to raise the real estate tax rate to offset the assessment declines, half of the city's homeowners (those whose property values declined) will therefore see a reduction in their real estate property tax bills.

City Budget Cuts: Reorganizations and Efficiency Adjustments

Just as this increase does not provide enough additional revenue to offset all of the school system cuts, it does not offset all of the city cuts. In addition to the real estate loss, the city has lost considerable state revenue for the administration of the social service programs. Large increases in mandatory expenses including but not limited to the regional jail, state health department and regional transit agencies also put pressure on the budget. To resolve the difference between revenues and expenses, this budget does contain reorganization of several functions, the elimination of several management positions and a deferral of a portion of the investment money approved last year. By making these cuts, we were able to avoid any impact to programs and services residents asked the city not to cut during input sessions last year. Indeed, I believe that while some of these choices impact people and thus are painful, we will end up with stronger and more viable programs in the future.

The largest impacts are to the Human Services Department. This department has largely been spared from cuts in past years, as federal and state revenues were covering the majority of expenses. However, this year, there was a large gap between revenues and expenses for these programs. Since this department had not undergone a rigorous examination of the upper and middle management structures - as other city departments had done in years past - we chose to focus on eliminating duplicative positions and increasing span of control. The line workers whose caseload has significantly grown during the recession will not be impacted, but upper management will be asked to do more. For example, rather than having two deputies and two program supervisors, this department will now have one of each. A total of five permanent full-time positions will be eliminated. Three of these are vacant. We will work to try to successfully place the two employees in other city positions.

Another two permanent-full time positions are eliminated as the result of a consolidation of the Budget Office with the City Manager's Office. The retirement of the Budget Director has afforded us this opportunity to eliminate both an executive and an administrative support position. I am confident that the work can be appropriately supervised and managed out of my office, saving the taxpayers approximately \$200,000. I am also proposing that one budget analyst position be eliminated and converted to a productivity/re-engineering analyst. As we move forward, we will need to continue to explore ways to make departments even more cost effective. Having a professionally trained productivity analyst can help us more aggressively achieve our goals.

Finally, and with excitement, I am proposing a conversion of the current Teen Center facility into a flexible community space. We will maintain our commitment to young people by offering afternoon

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and evening activities focused around performing, creative and expressive arts, and will build on the success of, and become the new home to, our own Parks & Recreation Department's urban performing arts programs. Hampton will, thus, have the first Urban Performing Arts Center in the region. In addition, we will continue to offer leisure and learning programs; exercise, fitness and conditioning; and, extracurricular activities for young people. But, this shift will also afford us the opportunity to expand these same types of offerings (minus the fitness activities which are deed restricted) to our seniors and adults as well. By reorganizing and returning center management to the Parks & Recreation Department, we will eventually be able to operate the building during daytime hours as a community center for these other populations, gaining better utilization of a wonderful community asset. While this reorganization will not result in fewer positions or savings, it will allow Hampton to offer more programs in an excellent facility that is centrally located for no additional cost. A major offsetting swing in the funding levels for the Youth, Education & Family Services and Parks & Recreation Department will be noted in the budget document.

Strategic Investments

As noted above, this budget also reduced the new strategic investment funds approved by Council last year as part of the tax rate increase. Three cents, or \$3 million, had been set aside in the FY 2014 capital budget as a result of the public support for initiatives that will grow our tax base. The money is critical in building a stronger Hampton tax base through our focus on jobs, tourism, retail and higher value housing. However, to balance the budget, we reduced the amount dedicated for this purpose from \$3,000,000 to \$2,000,000. The capital budget nevertheless makes major investments in the future, as we were able to dedicate some fund balance in excess of policy and available bond capacity to many of the needed capital investments. Some examples of new investments included in the capital budget are design work for a sports/recreational facility that would meet community needs as well as serve as a sports tourism destination; design work for renovations of Gosnolds and Briarfield parks; and, a commercial blight abatement program. The capital budget also continues funding for maintenance of school, city and parks & recreation facilities; enhanced waterway management; street resurfacing and roadway projects; and, public safety enhancements, to name a few.

Safe & Clean

So far, I have focused on what this budget does not fund. I am pleased to report that we were able to continue enhanced funding for our Safe & Clean initiatives. Nearly \$500,000 is provided to continue enhanced police saturation patrols as well as partnerships with the Hampton Redevelopment Housing Authority and Probation/Parole offices. These efforts – which were an initiative in FY 2014 in response to an uptick in gun violence – were effective and warrant continued funding. Also in response to the increase in youth violence, a new Court-City-School initiative was begun in FY 2014 to focus additional prevention resources in the school environment. Continuing this initiative, and expanding it to at least one additional school, was a high priority. Additional HB 599 funds will be utilized to partially offset some of the increased funding of these Safe & Clean efforts.

We have also established a new budgetary unit in the FY 2015 budget to track the use of the ATF proceeds the City inherited in mid-FY 2014. The City received approximately \$700,000, and Council agreed to invest these funds in youth violence and crime prevention efforts. We will be using approximately half of those funds in FY 2015 to begin or continue comprehensive initiatives that address parenting, neighborhood capacity building and youth employment opportunities. Additionally, funding is provided to hire a full-time Youth Violence Prevention Coordinator who will both link existing city and community based efforts and write grants to seek additional funding to expand evidence-based practices. Finally, funding from these proceeds will be used for enhanced gang and illegal gun prosecutions. We believe this comprehensive approach on prevention, intervention and prosecution is a wise investment of the ATF proceeds. By using only half of the ATF funds now, we ensure that there is continued funding for these efforts next year.

City Department Funding

Other than the increase in public safety funding for these purposes and the other adjustments referenced above, you will note that most city departments have flat or declining budgets. This is not a sustainable condition for the long-term. These departments have had to cover increased costs of goods and services, like all homeowners have. In addition, they have been forced to cover the costs of unfunded mandates, mostly from the state. Many departments have justifiable needs for new positions. Had there been sufficient funds, I would have approved additional operating and/or personnel to most departments.

Instead, I was only able to do so in a handful of truly unique circumstances. As an example, we have provided staffing for a full-time FOIA Coordinator in the City Attorney's Office due to the increasing volume of such requests and our absolute requirement to fulfill these requests in a timely fashion. This will also increase transparency and serve citizens who are seeking information. I have also authorized an additional attorney position in that office, but this will be funded with internal savings resulting from bringing back in-house previously outsourced work. The City Attorney and I believe that this is a more responsible use of existing legal funds.

We have also been able to include the transition of eight SAFER firefighter grant positions to the Fire Department's general fund budget effective January, 2015. We have found the addition of these grant funded positions to be invaluable in the provision of fire and emergency medical services, and have funded the cost to the general fund with increased EMS fee revenue. While the rate will not change, increased utilization of these services by the public has generated more revenue which is appropriately used to permanently fund the SAFER positions.

Finally, in this category, we have also provided minimal additional funding to the Library budget to support the exploration of a pilot with Langley Air Force Base to expand the use of their base facilities. There is much work to be done on this initiative, but the \$50,000 provided will be sufficient to advance the conversations during the fiscal year.

I would be remiss if I did not acknowledge the excellent stewardship of the tax dollars our departments are given. Many regional jurisdictions offer comparable level of services but with

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considerably more staff. As but one example, a neighboring jurisdiction provides the same number of library facilities as does Hampton – but with literally double the staff.

Employee Compensation

Because of the circumstances outlined above, my clear preference would have been to provide a real salary increase to employees – that is, a raise that increases the overall salary, based on employee merit. Our employees are our greatest asset. Without them, we could not be a city that is as efficient and lean as the aforementioned example demonstrates. Our employees have done “more with less” for too many years. Yet, their dedication and commitment to the citizens has been unwavering.

In the current fiscal year, we did provide a real salary increase (of 1% plus up to \$1,000 additional base salary adjustment) and it had been my hope that we could build on that increase with another; but the combination of declining revenue and cost pressures made my goal unattainable for FY 2015.

I am pleased, however, that we are able to provide a strong bonus for our employees. Because of strong end-of-year performance by conscientious departments (who save taxpayer dollars instead of spending when possible), we have internally generated funding to support a merit-based bonus of up to \$1,000 after taxes. (Employees with a 3 merit rating are eligible for a take-home amount of \$500; those with a 4 merit rating will earn a take-home amount of \$750; and, those with a 5 merit rating will receive \$1,000.) The bonus will be split in two payments, one in July and the other in December. Permanent part-time or WAE employees will be eligible for a \$250 payment, assuming they earn a rating of 3 or higher.

Again, this bonus is being funded out of one-time funds available from our fund balance, which has funds in excess of our AA+ bond rating standard of 10% of our total budget. Since much of these funds have been created over time through the careful savings on the part of departments and employees – including leaving jobs vacant longer and taking on additional tasks, it is only fitting and proper that we return a portion of those funds to our well-deserving employees.

Just as we must realize that city departments cannot survive indefinitely without increases, so too should we note that our employees deserve more. If we do not take care of our workforce, we may find an increasing number leaving for other jurisdictions and/or the private sector. A compensation study is under way which will assess our employees' wages compared to both the public and private sector. I plan to push, and hopefully the community will too, for the appropriate pay increases supported by the study results next fiscal year. In the meantime, I believe the bonus payment coupled with the raises we did provide this year and last, as well as the bonus personal days begun in FY 2013, will convey our serious commitment to the workforce.

Looking Ahead

While this budget has been challenging, it is worth noting that the City portion, at least, has been much better than in years past. Were it not for the continued loss of real estate tax revenue and unfunded state mandates, raises and re-investment in city departments would likely have been

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possible. While it might be too much to hope that the state policies will change, I do believe Hampton's economy and housing market is improving and may be significantly better next year. New housing construction is up, and high value houses are being built. New retail and restaurants are popping up in many locations; and, businesses are announcing expansions and new locations. Hampton is home to small start-up companies like Mango Mango Preserves, featured this year on Shark Tank, and rapidly expanding international businesses like Measurement Specialties, featured in Fortune and Forbes magazines. As more and more businesses like these choose Hampton as their home, our tax base will grow, making future budgets less challenging.

I want to publicly thank the many businesses and residents who have joined our Choose Hampton campaign. You will note their stories are highlighted throughout our budget document this year. I hope that all who read the budget document will feel the same optimism about our future that I feel when I reflect on the many reasons people call Hampton home.

This budget takes steps to ensure this growth continues, but also takes steps – such as switching from a tax relief exemption program to a deferral one – that will also responsibly improve our tax base over time.

Closing Thoughts

As I reflect on the budget we are delivering to you, I realize that it isn't a terribly exciting one. There are not many new or bold initiatives, but neither are there many drastic cuts. So, in a sense, this is a transitional budget – one that helps us to stay the course through what I hope is one last year of declining revenue.

The choices have been tough, requiring new ways of doing business, the downsizing of staff and an increase in the personal property tax rate. However, I am pleased that despite the challenges, we have both protected our core services and invested in activities that will make our city even safer, cleaner and stronger economically. I truly believe we have made the tough choices we were called to make in the least damaging way possible and in a manner that is respectful of the public input provided not just this year but in prior years as well.

I would like to publicly acknowledge and thank a wonderful group of department heads, assistant city managers and our budget team for ensuring that this proposed budget accomplished these goals. We look forward to working with each of you in the coming weeks to better understand this budget and its impact on our community and workforce. As always, we stand ready to assist you and the community in your deliberations.

Sincerely,



Mary B. Bunting
City Manager