

BUDGET MESSAGE

I. INTRODUCTION AND OVERVIEW

The adopted budget for 2004-05 maintains the Town's high level of services as in prior years. In addition, the budget includes funds for Council initiatives. One major initiative is funding the continued planning for development of parking lots 2 and 5 for possible retail, housing, parking, a public transportation transfer station and public space. The budget provides for a contract with a new economic development entity which, together with the community and the University of North Carolina at Chapel Hill, will establish direction for downtown development.

In response to the Council's plan to restore streams, reduce flooding and protect the environment, the budget provides for a new Stormwater Management Fund. The Fund was established to protect and restore local streams, reduce flood damage through capital improvements, safeguard Jordan Lake water quality and educate citizens about water quality, flood damage and stream protection. The new services will be funded through a fee charged on all properties contributing to stormwater runoff.

The Town continues to plan for a 15-year capital improvements program. The current year portion of the program funds park improvements, street improvements, and capital repairs to bike paths as well as design work for major renovations to the Town's Community Center on South Estes Drive.

The budget provides for the continuation of fare free bus service. In order to support the increased demand for service, the budget has been increased for additional para-transit services. The budget provides for increases in medical insurance rates and workers' compensation insurance rates for all Town employees. In order to keep abreast of market trends, a 3.78% increase in employee pay is included. The budget also includes funds for a web programmer to improve the Town's ability to share information with its citizens and visitors.

The adopted budget has an overall property tax rate of 57.5 cents. The rate includes a 1.4 cent tax rate increase (from 50.2 cents to 51.6 cents) in the General Fund and a .8 cent tax rate increase (from 5.1 cents to 5.9 cents) in the Transportation Fund for a total increase of 2.2 cents.

TAX RATE CHANGE

(in cents per \$100 assessed value)

	2003-04 Rate	Change	2004-05 Rate
General Fund	50.20	1.40	51.60
Transportation Fund	5.10	0.80	5.90
	55.30	2.20	57.50

BUDGET MESSAGE

Key issues discussed and considered by the Council for the 2004-05 budget include the following:

- Cost of continuing economic development work focused on downtown Chapel Hill.
- The need for additional staff in several departments to meet service demands.
- Estimated cost increases for new debt service for the Town Operations Center and the cost of issuing a portion of the bonds approved by voters in 2003.
- Estimated cost of initiating a Stormwater Management Fund.
- Pay plan adjustments to be competitive with rates already being paid by other employers in the Triangle labor market.
- Increases in employee medical and workers' compensation costs.
- Increases in certain operating costs to maintain current services.
- Current economic conditions, including the slow pace of the economic recovery.

General Fund

The General Fund budget adopted by the Council for 2004-05 totals \$42,712,000. The budget provides for continuation of existing Town services. Additions over a continuation budget include employee pay increases averaging 3.78%, continued funding for the downtown Chapel Hill economic development initiative, funding for a new Downtown Chapel Hill Economic Development Corporation, continuation of the Capital Improvements Program and additional funding for the Public Arts Commission. The budget was balanced by a General Fund tax rate of 51.6 cents (an increase of 1.4 cents).

The budget will preserve a fund balance of about the same as last year, above the 12% of budget that we consider a minimum amount considering cash flow needs, potential emergencies and the desire to maintain the Town's good bond rating. The bond rating is important, because it affects the interest rate that is charged on Town debt service.

Transportation Fund

The adopted 2004-05 Transportation Fund budget includes increases in employee pay and medical and workers' compensation costs. The budget also includes an increase for anticipated increases in fuel costs and for adding 1.5 positions in the EZ rider para-transit program, a special service for individuals with mobility limitations. The adopted Transportation Fund budget of \$11,416,600 is balanced with an increase in the Transportation tax rate of .8 cents, from 5.1 cents to 5.9 cents.

BUDGET MESSAGE

Stormwater Management Fund

The Council approved the establishment of a Stormwater Management Fund beginning with this budget year. The Fund will address the stormwater needs identified by federal law and the Council including maintenance of water quality and minimization of flooding and erosion. Funding for services will be provided through assessment of fees to properties in the Town's jurisdiction, in the form of Equivalent Rate Units or ERUs. One Equivalent Rate Unit (ERU) will be assessed for each 2,000 square feet of impervious surface on a property. The adopted budget of \$1,760,000 for the Stormwater Management Fund is funded through annual fees of \$39 per ERU.

Other Funds and Budget Details

The budget is balanced for all other funds. Revenue and cost changes are included in the Summary and department sections, with descriptions of major revenue sources and costs by fund.

A brief description of each department's services and costs is included in this document. Departmental budget line item detail is available in a separate document distributed with the adopted budget and on the Town web-site. (Contact the Town of Chapel Hill Finance Department or go to www.townofchapelhill.org/townhall/TownServices/budgeting_and_financial_manageme.htm.)

I. LONG AND SHORT-TERM GOALS AND PROJECTIONS

The Town's primary long-term and short-term goals are stated in the revised Comprehensive Plan adopted by the Town Council in the spring of 2000. 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

BUDGET MESSAGE

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

II. 2004-05 BUDGET GOALS

The Council's guiding short-term objectives and principles for the 2004-05 budget were:

- Maintain basic Town services.
- Retain employees and continue to invest in the maintenance of employee skills, knowledge and abilities as a key community resource.
- Provide funding for maintenance and capital projects at a reasonable level to adequately maintain Town facilities.
- Retain fare free transportation services.
- Invest in technology as a means to provide fast, secure and reliable information for Council, staff and citizens.
- Explore opportunities for partnerships for investing in Town assets.
- Maintain current transit service levels and routes.
- Invest in stormwater management.

These short-term goals are consistent with planning goals in the prior year's budget. While this is the first year that we included stormwater management as a major short-term goal, the Council began planning for new stormwater management policies and seeking advisory committee recommendations two years ago.

In order to meet the goal of maintaining fund balance at no less than the current levels, the Town must continue to have revenues equal or exceed expenditures. Unrestricted fund balance represents assets that are immediately available to assure that the Town will have adequate cash in periods of slow cash flow and in case of emergencies or unexpected opportunities.

The N. C. Local Government Commission requests that all North Carolina municipalities maintain a minimum of 8% of their budget in unrestricted fund balance for cash flow and an additional amount for emergencies and opportunities. Based on the past history of damaging hurricanes and ice storms, we believe that a minimum of 12% is necessary to meet emergency needs, and that a higher fund balance is desirable and financially prudent. The Town's General Fund unrestricted fund balance at June 30, 2004 was about 18% of that year's operating costs, or \$7.4 million. Bonding agencies consider fund balance as a key indicator when assessing the Town's creditworthiness. With the adoption of the final budget for 2004-05, we estimate that the Town's unrestricted fund balance will remain at about the same level at the end of the 2004-05 fiscal year.

BUDGET MESSAGE

We believe that the 2004-05 Budget as adopted is consistent with the long-term and short-term goals adopted by the Council.

III. BUDGET ENVIRONMENT

Major issues that may affect Town revenues in the 2004-05 budget year include uncertainty about the pace of economic recovery in North Carolina in 2004-05 and uncertainty about the after-effects of the war with Iraq.

The adopted budget incorporates the following assumptions:

- Economic conditions in North Carolina will continue to improve in 2004-05.
- We estimate that the Town's revenue from the local 1% and older ½ % sales taxes will increase about 3% over the current year receipts.
- The property tax base will increase about \$140 million from normal growth. The total base is estimated to be about \$4.44 billion in 2004-05.
- Carol Woods Retirement Center, now exempt from property taxes, will continue to make a donation to the Town (\$125,000).
- Interest rates and interest income will begin to increase.

IV. REVENUES

General Fund

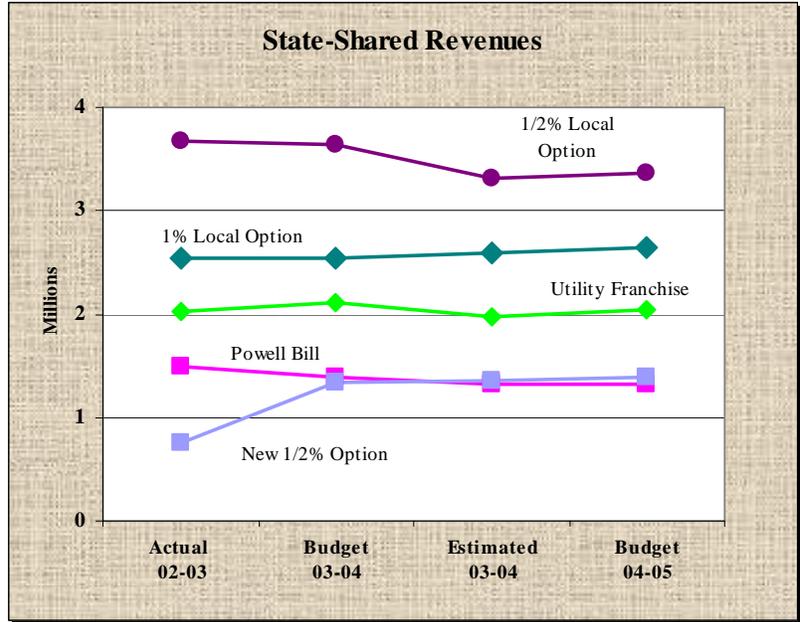
Revenues in 2003-04 met the adopted budget in total. Increases over the preliminary estimates presented to the Council in January came largely as a result of sales tax revenues increasing in the last half the year and garbage collection fees in excess of estimates.

The adopted revenue budget for 2004-05 totals \$42,712,000. The budget includes increases in the two largest revenue sources for the Town, property tax with an increase of about 4% and sales tax with an increase of about 3%. The receipt of state-shared revenues in excess of the budgeted amounts for 2002-03 created a reserve available for use in the future budgets. The budget adopted by the Council uses about \$490,000 of these funds for balancing the 2004-05 budget.

BUDGET MESSAGE

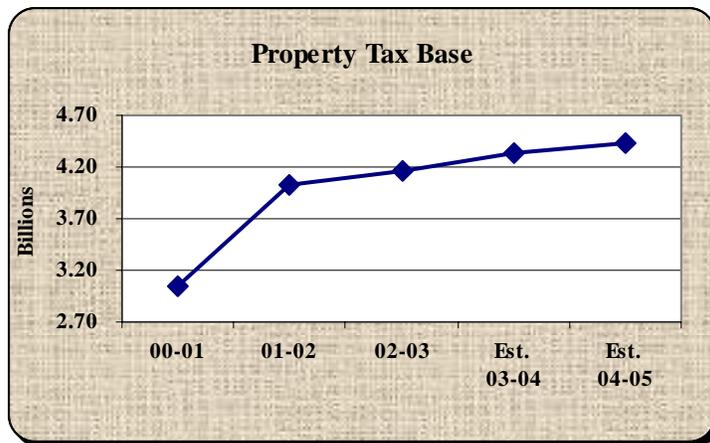
State-Shared Revenues

In 2003-04 sales tax revenues came in at about \$7.6 million and were budgeted at \$7.5 million. The improvement in the local economy in the last half of the fiscal year brought in revenues in excess of budget. Both Utility Franchise Fees and Powell Bill (fuel tax) revenues were below budget as expected. Utility Franchise Fees were low because of mild weather conditions during both the summer and winter months. The reduction in the Powell



Bill revenues was as a result of the recalculation and lowering of the Town census figures because of an error in the federal count in 2000 of about 2,700 persons. The graph above shows past and projected revenues for the major State-shared revenue sources that total about \$11,795,000 for 2004-05. State-shared revenues increased over the 2003-04 budget as a result of projected increase in sales tax revenues of about 3%. Other state-shared revenues are expected to be about the same as 2003-04 actual revenues.

Property Tax Base



The Town's property tax base continues to increase at a consistent pace of about 3% to 4% in years without revaluation. Property tax revenues were in excess of budget in 2003-04 by about \$530,000, slightly more than projected in the preliminary estimates presented to Council in January. The final tax base for the 2003-04 year was about \$4.3 billion, an increase of

\$132 million, or 3.1% over the base in 2002-03 of about \$4.17 billion.

BUDGET MESSAGE

Based on information for 2004-05 provided by Orange County, we estimate the total tax base to increase about \$140 million in 2004-05. With these additions, the estimated tax base totals about \$4.44 billion for 2004-05.

At a tax base level of \$4.44 billion, each cent of the tax rate generates about \$442,000. The adopted General Fund tax rate of 51.6 cents generates about \$22.6 million in property tax revenue.

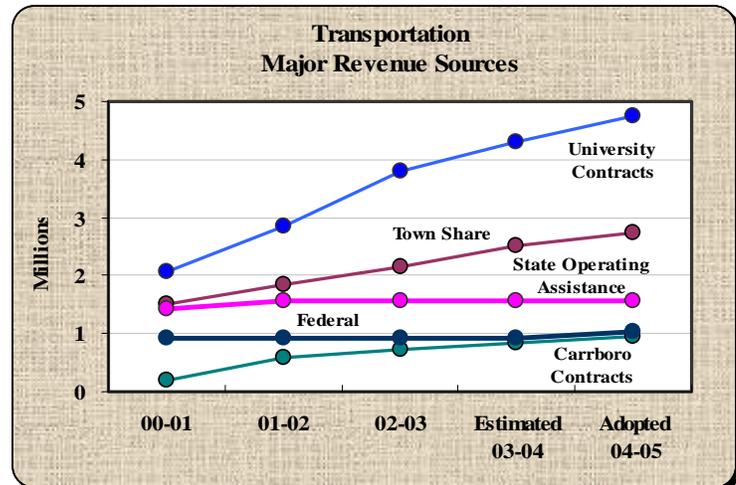
Other General Fund Revenues

Revenue from other sources in the General Fund is expected to remain at about the same level as in the 2003-04 year, with no significant variation in any major source. However, the newly established Stormwater Management Fund will reimburse the General Fund about \$400,000 for expenditures made in 2003-04 for preparing for the establishment of the new fund. As in past years, we recommended the use of \$800,000 in normal carryover fund balance for the 2004-05 budget. Additional information about General Fund revenues for 2004-05 can be found in the budget section on General Fund Revenue Sources and Descriptions.

Transportation Fund

The major revenue sources for the Transportation Fund include federal operating assistance, State operating assistance, University contract payments, Town of Carrboro contract payments and Town of Chapel Hill contributions, including the Town's property tax levy for transit. The Transportation budget required an increase of .8 cents in the Transportation tax rate, from 5.1 cents to 5.9 cents. This tax rate is expected to generate about \$2,560,000 in property tax revenue for the transit system.

The adopted 2004-05 budget includes State assistance of \$1,566,000. State assistance shows a slight reduction from the original 2003-04 budget, which is more than compensated for by a \$93,000 increase in federal assistance (\$1,025,000) for a total of about \$2.6 million. University and Carrboro contract payments total about \$5.69 million based on cost



BUDGET MESSAGE

sharing agreements. All other revenue sources are expected to remain about the same as in the 2003-04 fiscal year bringing total revenues for the Transportation Fund to about \$11.4 million.

The graph above shows major revenues for the transit system over the last several years and for the 2004-05 adopted budget. With revenues as discussed above, fare free service will continue.

Public Housing Fund

Federal Assistance (about \$1,135,000) and rents paid by residents (about \$364,000) provide most of the revenue for the housing program, as in past years. The federal department of Housing and Urban Development is expected to amend its subsidy program. We anticipate receiving notice of changes in October 2004 when the new federal year begins. The Council may need to amend the Public Housing budget if there is a significant change in the amount of the subsidy.

Parking Funds

The adopted budget for parking operations in 2004-05 includes continuation of the on-street and off-street parking rates adopted last year. Just under half of \$1.3 million in estimated revenue for off-street operations expected from the Wallace Parking Deck. Revenues of \$450,000 are anticipated from Lot 2. Revenues are estimated to be sufficient to fund operating costs and debt service costs on these parking facilities.

Downtown development opportunities on Lots 2 and 5, as well as above the Wallace Parking Deck, may affect the parking revenue streams as early as 2005-06. The Council will continue to plan for the parking needs of the Town and the replacement of revenue streams as a part of their development considerations.

For on-street meter and parking enforcement operations, we estimate total revenue of about \$624,000, sufficient to meet operating costs and allow a transfer of about \$160,000 to the General Fund.

Stormwater Management Fund

The Stormwater Management Fund, established on July 1, 2004, has a budget of \$1.76 million. The budget is based on funding through the assessment of fees of \$39 per each 2,000 square feet of impervious surface on property that contributes to stormwater runoff.

BUDGET MESSAGE

Other Funds

Revenues are expected to remain approximately the same in 2003-04 for most of the Town's remaining funds, including the internal service funds for computer replacement and fleet maintenance, and the Downtown Service District Fund. The Council lowered the contribution to reserves for the Vehicle Replacement program by about \$500,000. Reserves will need to be increased gradually over the next few years to continue to provide a smooth pattern for vehicle financing. The Council reduced the contribution to the Capital Improvements Program from \$1,225,000 to \$927,000, but continued to provide for the basic capital improvement needs for the Town. The \$29.36 million bond issuance approved by voters in November 2003 will provide for a combination of new projects, primarily a major library expansion, but will also provide funding for some capital programs previously budgeted in the annual Capital Improvements Fund.

V. MAJOR SERVICE LEVELS AND COSTS

General Fund

The budget allows for the continuation of basic services totaling about \$40,323,000 or about 5% more than the base operating budget in 2003-04. The 5% increase covers the full-year cost of pay increases authorized for nine months in 2003-04, increased cost of employee medical and workers' compensation premiums, and additional debt service on the final issuance of the 1996 approved general obligation bonds.

The budget adopted by the Council includes the following major additions:

- A merit pay adjustment averaging 3.78% for all employees to be competitive in the Triangle Labor (\$635,000).
- Increase the Mayor and the Council's health insurance to a full-time benefit (\$40,926).
- \$55,000 increase to \$125,000 in funding for the public art program; \$20,000 increase to \$30,000 for the N. C. High School Athletic Association.
- 6 months' funding for a web programmer/analyst (\$36,000).
- Funding for a traffic signal technician to be offset by an increase in a traffic signal grant from the North Carolina Department of Transportation (\$66,700).
- Increase in the cost of gasoline and biodiesel fuel (\$69,500).
- An update of topographic aerial photography for the Town (42,500).
- Debt service for the Town Operations Center (\$150,000) and the first payment on \$4 million issuance of the new General Obligation bonds (\$202,500).
- Funding for the Downtown Chapel Hill economic development initiative, Phase 2 (\$266,000).

BUDGET MESSAGE

- Contract with the new Downtown Chapel Hill Economic Development Corporation (\$70,000).
- Addition to contingency reserve for Transit Master Plan (\$75,000).

In addition, the Council has continued its investments in support of human services, visitor services and tourism, cultural and arts programs, economic development, and development of affordable housing through performance agreements with other agencies as follows:

Performance Agreements with Other Agencies	Budget 2004-05
Human Service Agencies	
Human Services Advisory Board Recommendations	206,000
Special Council allocation to Interfaith Council	30,000
Cultural Arts Dinner	500
Joint Orange-Chatham Community Action	18,900
Friends of the Chapel Hill Senior Center	30,000
Hotel/Motel Tax Allocation	
Chapel Hill/Orange Visitors Bureau	67,000
Chapel Hill-Carrboro Arts Center	10,000
Chapel Hill Public Arts Commission	125,000
NC High School Athletics Association	30,000
Orange County	
Retired Senior Volunteer Program	12,300
Economic Development Commission	6,000
Affordable Housing	
Orange Community Housing and Land Trust	110,000
Total Investments	645,700

All together the General Fund budget totals \$42,712,000. The General Fund tax rate is increased from 50.2 to 51.6 cents.

BUDGET MESSAGE

Transportation Fund

The budget for the Transportation Fund for 2004-05 totals \$11,416,600 and includes an increase in the Transportation tax rate of .8 cents, from 5.1 cents to 5.9 cent. The budget includes cost increases for base level services as follows:

- Funding for the full-year costs of pay increase authorized for 9 months in 2003-04 (\$61,000).
- Funding for rate increases of 12% in employee medical costs and an increase of 17% in workers' compensation costs (\$123,000).

The increase in ridership after implementation of the fare free system has created additional needs for the system, particularly in the area of EZ rider para-transit service, a special service for individuals with mobility limitations. In response to these needs, the Council approved the following additions to the base budget:

- Part-time EZ Rider/Shared Ride Reservationist (total cost of \$23,757 for all partners, Town share - \$7,920).
- Full-time EZ Rider Transit Operator (total cost of \$39,981 for all partners, Town share - \$13,330).

In addition, a merit pay adjustment averaging 3.78% is included in the budget at a cost of about \$58,000 to the Town.

Stormwater Management Fund

In the first year, the primary objective in the Stormwater Management Fund is to prepare the master plan for future services including restoring streams, reducing flooding and protecting the environment through capital improvements, mitigation activities and maintenance. In addition, the fund will support citizen education about water quality, flood prevention and stream protection. The total adopted budget for the Stormwater Management Fund is \$1.76 million.

Capital Improvements Fund

The Capital Improvements Fund budget adopted by the Council totals \$927,000. Funding for the capital improvements program at the adopted level requires a transfer of \$872,000 from the General Fund, and is supplemented by \$55,000 in estimated revenue for cell tower leases.

BUDGET MESSAGE

Other Funds

For other operating funds, service levels in the adopted budget for 2004-05 remain about the same as in 2003-04, including services for the Town's public housing program, downtown service district, and parking programs.

VII. Issues, Trends Projections

We believe that key issues in the next several years will pose additional fiscal challenges that will require further tax rate increases:

- The costs of the Public Works portion of the new Town Operations Center (needed by December 31, 2006 and now being planned) is likely to be about \$25 million. The debt service cost of financing this construction is estimated to be about \$2.5 million annually, with the full annual cost beginning in 2005-06. The current tax rate equivalent of this cost is about 5.5 cents.
- The new Transportation Maintenance and Operations Facility needed by 2006-07 is expected to cost about \$19 million. The Town and its partners have already reserved the major portion of local matching funds for the Facility. We have commitments of approximately \$17 million in federal and State support for the construction of the facility, but local funding may be required to cover cash flow needs, since federal and State grants are received after costs are incurred.
- Our projections include significant needs for capital repair and maintenance of the Town's assets that would require funding of about \$1.7 million next year, increasing gradually to about \$3.3 million in 2018-19.
- In March of 2004, the Town Council authorized a schedule for issuance of the \$29.36 million in bonds approved by voters in November 2004. The largest portion of the bonds is for a \$16 million expansion of the Town Library. In addition, \$5.6 million is approved for various sidewalk and street improvements, \$5 million for parks and recreation facilities, \$2 million for open space and \$500,000 for energy efficient projects for public buildings. After the first issuance of \$4 million in 2004-05, there are three additional issuances authorized by the Council: \$7.75 million in 2006, and \$8.8 million in 2008 and 2009.
- Pay adjustments will continue to be needed to remain competitive in the Triangle labor market, and employee medical and workers' compensation costs are likely to continue to increase.

BUDGET MESSAGE

- We believe that operating costs will continue to increase approximating the rate of inflation in the general economy in future years and with some additional operating costs associated with expansion of the library.
- Projections show that the increased cost of debt service, capital improvements and average operational increases could require as much as an 11.5 cent tax increase in the General Fund in 2005-06, not taking into account the effects of property tax base revaluation or potential program changes by the Council. Forecasts for the following years, shown in the Projections section of the budget, indicate that tax rate increases averaging about 3.5 cents annually could be required to meet projected operating and capital needs over the next five years.

VIII. SUMMARY

We believe the adopted budget for 2004-05 will maintain basic General Fund services at a level similar to the 2003-04 fiscal year. Priority additions to budget as discussed above were funded within the total revenue and reserves available for next year, with a 2.2 cents increase in the combined General and Transportation Fund tax rate totaling 57.5 cents.

Respectfully submitted,

W. Calvin Horton
Town Manager