



MANAGER'S OFFICE
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June 8, 2009

Dear Mayor Foy and Members of the Chapel Hill Town Council:

The adopted annual budget for the Town of Chapel Hill for Fiscal Year 2009-10 is submitted herein, in accordance with the Local Government Budget and Fiscal Control Act. As we have discussed, the global financial crisis and the continuing recession have created a difficult environment for constructing next year's budget. To provide a budget that meets Council's objectives of a revenue neutral tax rate while maintaining core services, we employed strategies using basic principles of financial management in times of uncertainty. These strategies include:

- Reevaluating long-term commitments such as CIP projects and debt issuance
- Scaling back spending where possible during the current year to provide additional fund balance to offset potential revenue shortfalls in next year's budget
- Concentrating efforts on maintaining core service levels and compensation plan elements that help to retain experienced employees

State law requires the Town to declare a revenue neutral tax rate for FY2009-10, a revaluation year for Orange County. The revenue neutral rate calculated in accordance with state statutes is shown in the table below. We also show the recommended rate that is slightly lower than the revenue neutral rate. We are recommending the slightly lower rate because the growth factor used to calculate the revenue neutral rate is skewed by unusually large growth in the portion of the Town that is in Durham County. The Durham County part of the Town grew at 26.6% per year during the revaluation period, while the Orange County portion grew at a rate of approximately 1.8% per year. To reflect what we believe to be a true growth rate for the Town, we are recommending a tax rate calculated using the average annual growth for Orange County only. We balanced this budget using the following tax rates for the General Fund, Debt Fund and Transit Fund.

Property Tax Rates

	FY2008-09 Current	FY2009-10 Revenue Neutral	FY2009-10 Adopted
General Fund	42.3	36.3	36.0
Debt Fund	11.0	9.4	9.3
Transit Fund	4.8	4.1	4.1
Total	58.1	49.8	49.4

We are appropriating \$3,163,493 from the Town's fund balance to balance the General Fund budget and accomplish the Council's goals. A portion of this fund balance comes from the budget savings set-aside during the current fiscal year and the remainder is from existing fund balance. Based on our preliminary estimates it looks like we will finish the current fiscal year with a 13.0% undesignated General Fund balance. This level of reserves is slightly below 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.

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.

Service Goals

The Town of Chapel Hill strives to achieve the following service goals:

- Provide fair, effective, efficient and fast customer service;
- Offer secure, reliable and affordable services;
- Maintain safe environment and attractive public facilities;
- Provide protection and public safety;
- Provide accurate and timely current and historical public information;
- 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;
- Maintain current transit service levels and routes;
- Preserve overall financial health of the Town of Chapel Hill; and
- Provide economic, cultural and leisure opportunities.

Planning Retreat Priorities

The Council held a planning retreat with members of the Senior Management Team on February 20-21. The results of that retreat focused our attention on the following priorities:

- **Steward Organizational Development:** Continue to work with the Town Manager to develop a style and system of leadership that will ensure the effective provision of services, while supporting the delivery of Council goals and objectives.
- **Champion Downtown:** Create and market an attractive, magical entertainment, cultural, and dining district; mitigate the impact of the High Density Development construction process; and work with the IFC in identifying a site for the shelter and transitioning out of downtown to assist them in achieving their goal of providing optimal services.
- **Continue Focus on Land use, Transit and Development:** Make Chapel Hill a better place to live, work, learn, and play; make Chapel Hill a more diverse community; and make Chapel Hill a more sustainable community.
- **Maintain and Improve Community Facilities and Services:** Sustain Chapel Hill's vibrant, unique spirit and sense of community; provide a safe and secure community; support and enhance the quality of life in Chapel Hill.
- **Improve Town's Fiscal Condition:** Diversify revenue sources consistent with Town values to reduce pressure on residential property tax; identify and pursue internal operating efficiencies; and develop a strategic financial plan for long-term sustainability.
- **Plan Ahead for Carolina North:** Establish a collaborative and trusted environment to enable the University to develop and plan for a Carolina North strategy that will correctly balance the needs of the University with the needs of the citizens of Chapel Hill.

While there are no new initiatives in the adopted budget, our efforts are guided by this focus.

Balancing the Budget with a Revenue Neutral Tax Rate

To address the anticipated revenue shortfall resulting from the faltering economy we have taken steps to balance next year's budget consistent with prudent and sustainable financial practices.

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 controlling its effect on the Town's operating budget. While the current tax rate dedicated to the debt fund is sufficient for the debt service on issued debt, it is not sufficient to pay 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 in Spring of 2010 without increasing the dedicated tax for the debt fund. We also anticipate that the economic conditions that have caused us to delay debt issuance will have improved by that time.

In addition to delaying debt funded capital projects, we have significantly reduced CIP projects funded through a transfer from the General Fund in the FY2009-10 Budget. The projects listed below, for the most part, are 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. 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 \$749,000. Projects included in the CIP for this year include the following:

Extraordinary Maintenance - Emergency Repairs	\$ 100,000
Curb Repairs: ADA Compliance	30,000
Fiber optic cable	300,000
Small Park Improvements	60,000
Playground Replacement	75,000
Greenways	50,000
Parking Lots/Paths/Trails	100,000
Sport Art Gymnastics Building and Grounds	14,000
Cemetery Beautification	20,000
Total	\$ 749,000

By delaying debt issuance until spring of 2010 and scaling back the CIP program, we eliminated approximately \$1.4 million of next year's budget gap.

Scaling back spending where possible during the current year to provide additional fund balance to offset potential revenue short-falls in next year’s budget: In October of this fiscal year, as it became evident that the global economic crisis would affect Town revenues, we took steps to reduce costs and set aside funds in a budget savings account to be available to help balance the FY2009-10 budget. We exceeded our 5% budget savings target for FY2008-09 with approximately \$2.6 million available to balance the FY2009-10 budget. In addition to the Budget Savings Plan, we placed specific restrictions on new hires and travel in order to help control personnel and operating costs.

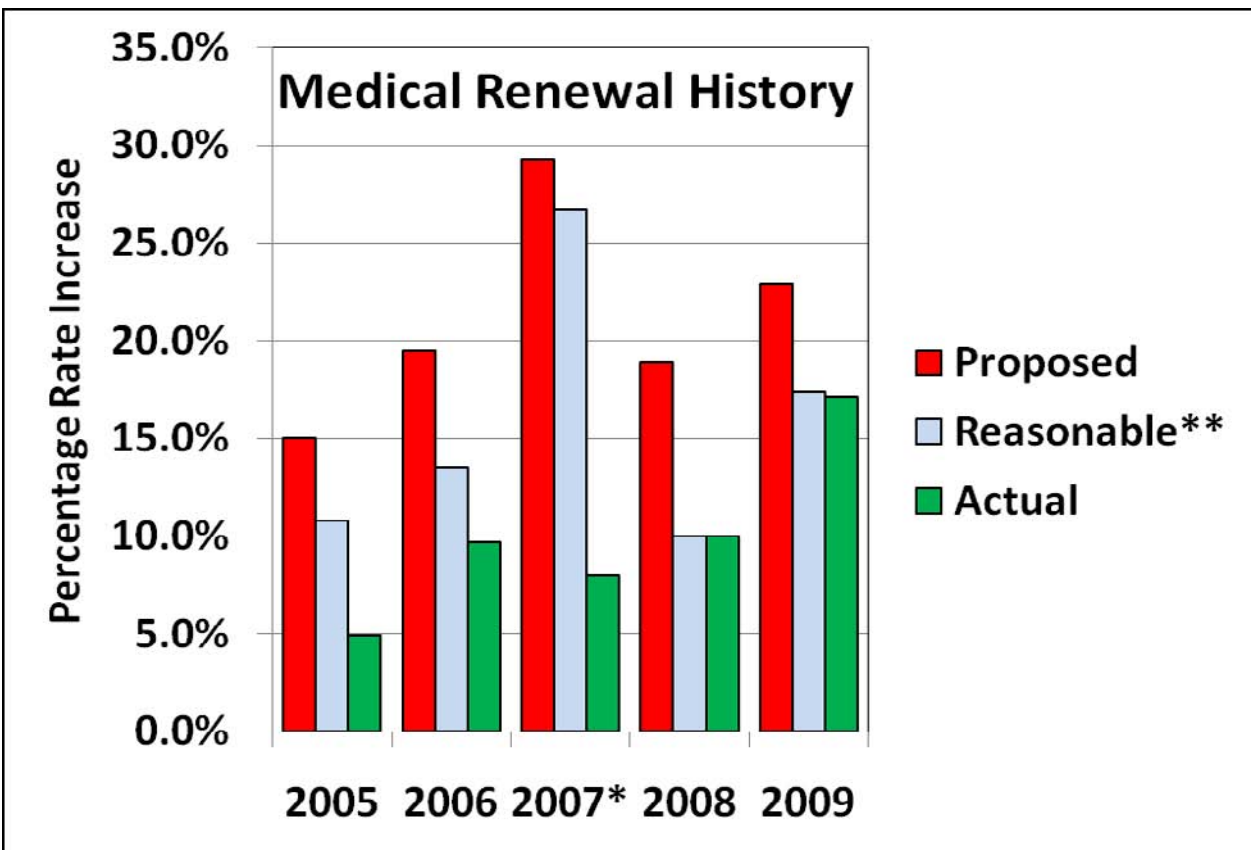
In order to create a balanced budget with reduced revenues and no tax increase, we asked departments to balance maintaining current levels of service with the goal of zero increase in their operating budgets. We could not accomplish that goal without affecting the level of some services. We placed our emphasis, however, on making budget reductions that had the least impact on services to residents. The following General Fund expenditure budget reflects this strategy.

General Fund Expenditures			
Department	08-09 Original Budget	09-10 Adopted Budget	% Change
General Government	9,269,763	8,826,125	-4.8%
Environment and Development	13,286,985	13,357,480	0.5%
Public Safety	19,155,021	19,434,467	1.5%
Leisure	7,909,231	8,197,928	3.7%
General Fund Budget	49,621,000	49,816,000	0.4%

Overall, general fund expenditures for FY2009-10 are approximately the same as last year’s original budget. The Town will continue to fund its retiree healthcare liability at the same level as the current year, \$400,000. Although this is only a fraction of the amount needed to fully fund the liability in 30 years, maintaining this minimal funding level is appropriate given the revenue constraints on next year’s budget and to continue to demonstrate our commitment to meeting our funding requirement. The overall funding for performance agreements with outside agencies is proposed at the same level as last year.

Concentrating efforts on maintaining core service levels and compensation plan elements that help to retain experienced employees: Employee pay and benefits comprise almost 70% of the General Fund Operating expenditures. They also represent the greatest challenge in cost containment. The Town compensation plan strives to maintain compensation that is competitive and continues to attract and retain quality Town employees, based on prevailing wages and benefits in the Triangle labor market. The keystone of this strategy is maintaining highly competitive employee benefits.

Repeatedly, our conversations with employees and prospective employees suggest that the Town's benefit levels are an important recruiting and retention tool. Unlike many of our surrounding communities we have not decreased benefit levels in response to health care cost inflation. As the following graph shows, we have been successful in recent years in keeping the costs below both what our carrier has proposed and what our consultant says would be reasonable under the circumstances. The pattern shown in the following graph suggests that we have avoided some escalation in costs by changing carriers. Due to the narrow market for medical insurance coverage, however, we will not continue to benefit from changing carriers. We need to continue to address these rising costs through employee health initiatives and by ensuring we have the most efficient plan structure for the level of benefits we wish to provide. Over the next year, I will work with our healthcare consultants and our employees to review the current benefit structure to develop a plan for strategic plan refinements that protect our employees on a sustainable basis and continues to serve as a recruiting tool.



* 2007: Changed Carriers – Proposed and Reasonable based on United and Actual is BCBS

** Reasonable: Based on claims experience and standard costs

For FY2009-10, we are expecting a 17.1% increase in employee medical benefits. Absorbing this additional expense puts significant pressure on departmental budgets. In order to accommodate this cost increase and still achieve the Council goal of adopting a revenue neutral tax rate, I am recommending no adjustments to employee pay for next fiscal year. Our survey of other jurisdictions indicates that the vast majority of North

Carolina governments are not providing a cost of living increase next year. For this reason we believe that the total compensation package offered by the Town continues to be competitive.

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 FY2009-10, we are planning to use \$2.6 million from the current year. Most of this money has been set aside in budget savings accounts as part of the Town’s plan to deal with the economic crisis. The additional fund balance needed to balance the budget is approximately \$500,000. This amount will come from residual fund balance. Based on our estimates this will drop the fund balance to approximately 13%

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 expenditure 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 2.4% increase over last year’s budget. This increase is due in part to the increases in administrative and non-departmental costs. Overall operating costs for fixed route bus service is down 4.7%, due in part to the use of a fixed price fuel contract to lock in prices at a level far below the current year’s average price. State assistance is expected to decrease by 18.2%. This loss, however, is more than made up for by an increase in federal assistance and the anticipated receipt of Recovery Act (Stimulus) funds. Significant challenges lie ahead in FY 2010/11 as the continued availability of stimulus 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

While the current year's budget took several important steps toward correcting the structural imbalance between revenues and expenditures, the FY2009-10 budget is focused on mitigating the impacts of the worst economy since the Great Depression while maintaining service at the highest possible level. The budget as presented is balanced using the revenue neutral tax rate, but this was not possible without some difficult decisions. Postponing the Library expansion, reducing the CIP despite growing capital needs, foregoing employee salary increases and holding departmental budgets to the same level as the current year's adopted budget were decisions that we would have preferred not to make. These decisions were made based on sound financial principals and have allowed us to keep the core elements of our budget intact, including: maintaining service levels at or near current levels, continued funding of performance agreements with outside agencies, maintaining salaries and benefits for employees, and maintenance of key public assets.

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