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May 20, 2020

Dear Mayor and Council:

I formally present for your consideration, the Fiscal Year 2020-2021 Recommended Budget for the Town of Chapel Hill. The total budget of $110,885,256 is a 2.2% decrease from FY 2020. The last three months have proven to be a tumultuous, devastating period of time for our nation. The rapid spread of the COVID-19 virus and heartbreaking loss of life have taken an emotional and economic toll on all of us, and has, at least temporarily, changed our way of life. The pandemic has also altered the budget our team was prepared to present to you this spring. Instead of a budget focused on the future, we offer a budget that protects the Town's core services and provides some level of flexibility if the current economic situation fails to improve during the next fiscal year.

A municipal budget reflects its community's values and even in these unusual times this recommended budget is no exception. It continues to significantly invest in the core services offered by the Town and expected by our residents and businesses, including, but not limited to, public safety, transit, affordable housing, streets and sidewalks, public library, and parks and recreation. These services are sources of pride for the community and make Chapel Hill more accessible to all those who live, work, and visit here. This budget keeps those commitments in place even while reducing overall spending. We are putting the Town in the best possible position to respond to a continually changing economic situation brought on by this global health crisis.

5-Year Budget Strategy

In Fiscal Year 2019, we began conversations about the growing gap between the community's interests and the resources needed to fund them. The Council approved Strategic Goals and Objectives in June 2019 that organized and prioritized the community's interests. Following approval, the Council initiated a long-term budget strategy to fund strategic priorities and address outstanding operational needs. In October 2020, a core group of staff led this 5-year strategy process. Throughout the fall and winter months, staff from every department contributed to the strategy. We believe that the final product will be a useful resource for the Council and could act as a roadmap for future budget processes. Once the economy improves, it is our plan to resume conversations on the five-year budget strategy.

Initial Projections

Our initial budget projections from January 2020 were very positive. Sales tax revenues were higher than we had ever experienced. Occupancy tax numbers were high. Department revenue projections looked good. We were looking forward to incorporating elements of the five-year budget strategy into the FY 2021 budget and increasing funding in several focus areas:

- Climate Action Plan
- Street Resurfacing
- Building & Parks Maintenance
- Vehicle Replacements
- Pay-Go Capital Projects
- Employee Pay

Regarding employee pay, the FY 2020 budget included $100,000 to fund a comprehensive classification and compensation study. Studies like these review a municipality's salary ranges and compare job classes for appropriate pay, helping to ensure competitive balance. We knew that the results of the study would not be finalized before this budget presentation, but planned to recommend funding in FY 2021 to begin a phased approach to implementing the study's recommendations.

Like the five-year budget strategy, this plan is on hold and we will address the findings from the compensation and classification study as the economy improves. My goal is to use that document as a guide for us to respond to the disparities we may have in compensation.

Impacts of COVID-19

We are all aware of the sudden, significant effects of the pandemic on our nation's economy. Unfortunately, Chapel Hill has not been spared the financial hit.

For context, here are some national economic impacts:

- More than 33 million people have applied for unemployment since the beginning of the crisis. For perspective, 8.8 million jobs were lost during the entire 2008 financial crisis.

- As this document went to print the unemployment rate in the United States stood at nearly 15%, the highest rate since the Great Depression.

- Retail sales were down 16.4% in April 2020. That report followed an 8.9% decline in the month of March.

Here are a few details on our local economy:

- We are projecting a 10% decrease in sales tax growth through the end of FY 2020 (approximately $800,000).

- We are projecting a 50% decrease in occupancy tax revenues through the end of FY 2020 (approximately $350,000).

- We are projecting decreases to department revenues in the areas of building & development, parks and recreation, library, public works, police, and fire (impact depends on how long services are either suspended or reduced).

- We are working to mitigate the more than $1 million revenue shortfall in department operating budgets in the current fiscal year.

Figures like these underscore the need to be cautious with our revenue projections for FY 2021. We do not know how long this event will last, so it is difficult to project the impact on our budget with any certainty. However, we are not alone on this journey as the entire country is feeling the effects and we will continue evaluating and responding to changing conditions.

In order to respond to this uncertain situation, we are recommending little to no increase in discretionary spending for FY2021 while we continue to search for savings in operational costs. We are reducing our sales tax projections and have identified reductions that have the least impact on the organization and community. Our goal is to maintain the high-quality core services that we provide to our residents, businesses, and visitors. We will continue to monitor the Town's budget as the year unfolds.

Balancing the Budget

In recent years, the cost of providing services has outpaced Town revenue trends. This budget includes slight growth in property tax (1.5%). As a result of COVID-19 impacts, this budget includes a 9.5% decrease in sales tax revenues, 7.7% decrease in occupancy tax, and a 2.7% decrease in department revenues and licenses and permits. We have reduced our fund balance appropriation by 25.8% in order to prepare for the unknowns related to the ongoing impacts of COVID-19. The total recommended tax rate remains at 54.4 cents per $100 of assessed valuation. There is no increase recommended for the General Fund, Debt Service Fund, or Transit Fund.

As mentioned earlier, we have made some operational reductions in order to balance the FY21 budget. We have reduced funding for street resurfacing by $300,000, removed the $472,000 allocation for building maintenance, eliminated funding for vehicle replacement, and cut the pay-go CIP. Below are the impacts of these budget reductions:

Street Resurfacing – Reducing Funding Allocation - $300,000

With an existing resurfacing backlog of $10 million to $11.2 million, reducing our budget will delay future planned projects. Reducing our budget by $300,000 will delay the reconstruction of Country Club Road, currently scheduled for summer 2020. The project is estimated to cost $575,000, which is 86% of the department's annual street resurfacing budget. Country Club Road is a high-use multi-modal street, and the project was coordinated to directly follow the

major waterline replacement project by OWASA. The waterline replacement project resulted in additional pavement damage. Deferring this project for another year will also delay the FY22 scheduled milling and resurfacing of West Cameron Avenue, which was also coordinated to follow a scheduled waterline replacement project by OWASA.

Facilities Maintenance Budget Cut Impact – Eliminating Funding Allocation - $472,200

In FY 19 and FY 20, Council allocated $472,200 annually to begin addressing a backlog of facilities maintenance and capital needs identified in a recent facilities assessment.

The $472,200 annual budget over the past two years has allowed the Town to address various long-standing issues including needed roof replacements at Fire Station 1, Hargraves Community Center, and Northside Gym; HVAC and boiler replacements; and soffit and duct work repairs at the Homestead Aquatic Center.

Public Works is scheduled to replace the Post Office roof and refurbish the cupola in Fall of 2020. The Post Office roof and cupola are in poor condition, and the project will require the full $472,200 budget for FY21. Town Hall's roof also needs to be replaced, and the project is scheduled for FY22. Both the Post Office roof and Town Hall roof are failing and past the point of refurbishment and preventive maintenance to extend the useful life. Postponing these roof replacements will result in additional damage and associated needed maintenance and costs.

Fleet Replacement – Eliminating Funding Allocation - $525,000

To maintain an effective and available fleet and a cost-effective replacement schedule, it is imperative to replace vehicles when they have reached the end of their useful life. As the fleet gets older, repairs become more difficult, time-consuming, and costly. As a result, downtime increases, which negatively impacts services provided. Deferring replacements also results in a lesser return on the vehicle when it is sold.

Eliminating the fleet replacement budget will result in no replacements in FY21. FY21 planned replacements of three police vehicles, one pickup truck in the streets division and one in the fire department, one solid waste rear loader, and one leaf collection machine will be deferred which will result in an increase in maintenance costs and downtime.

CIP Pay-Go Budget Cut Impacts

Facilities' Extraordinary Maintenance - Reducing Funding Allocation - $37,500

- Public Works receives an annual allocation of $100,000 for critical repairs associated with unanticipated failures of building systems and/or facility improvements. As noted above, the Town's facilities are aging, requiring major repairs and renovations at higher costs. We have a history of spending the full $100,000 allocation, and when critical repairs are required, they must be addressed. With the $37,500 reduction, the Town

will have to identify funds elsewhere in the budget to respond, requiring mid-year funding reductions and negative impacts to other service areas.

Street Resurfacing and Sidewalk Related ADA Improvements - Eliminating Funding Allocation - $50,000

- The Town needs to develop an ADA Transition Plan in FY 21 to comply with ADA regulations. While the $50,000 is typically used to address ADA maintenance needs, we plan to use this funding allocation in FY 21 for the ADA Transition Plan.

Eliminating the funding will delay completion of the ADA Transition Plan, putting the Town at a greater liability risk.

Parking Lots, Trails & Paths – Eliminating Funding Allocation - $50,000

- The Town owns parking lots at facilities, trails, and paths for which maintenance is required to protect our investment.

Eliminating the funding may result in further deterioration of these facilities and result in greater cost at time of repair and/or resurfacing.

Responding to Council and Community Priorities

The goal of the budget is to align allocations with Council and community priorities. Even during this year, the budget supports high-quality core services and key investments in strategic goal areas prioritized by the Council.

Strategic Initiatives

As previously mentioned, the Five-Year Budget Strategy was a plan for funding the Council's FY 2020-22 Strategic Goals and Objectives and addressing outstanding operational needs. The delayed five-year budget strategy discussion and Town revenue losses are a disruption to the Council's 2020-22 Strategic Plan but do not fundamentally change the Council's goals. While initiatives and work plans may need to be postponed or adapted, the Strategic Plan will still provide policy guidance and strategic direction. Following the adoption of the FY 21 budget, staff will consider how to adjust projects and initiatives with decreased funding and return to Council with revised strategic work plans.

The Council emphasized the overarching priorities of Environmental Stewardship, Economic Development and Equity in the FY 2020-22 Strategic Goals and Objectives. These priorities have influenced the recommended FY 21 budget in the following ways:

Environmental Stewardship:

- Although we are not recommending supplemental funding for the Climate Action Plan in this budget at this point, we will finish the community engagement portion of the Climate Action Plan, initiate any practical, low-cost community-focused activities, and use a climate lens when we make operational decisions, such as encouraging telecommuting, during the year.

- The recommended budget includes $62,500 to implement interim remedial actions based on the results of the ongoing assessments of coal ash remediation at the police station property (828 Martin Luther King Jr. Blvd.).

Economic Development:

- The Town continues to work towards diversifying the tax base by adding more commercial property taxes with public private partnerships like the East Rosemary Street Redevelopment Project and the Eastowne Master Plan and Development Agreement.
- The Town is working with local businesses to support recovery efforts by increasing its focus on safety and cleanliness in its commercial districts and making adjustments to regulations that support public safety and commercial activity.

Equity:

- The Town's Affordable Housing and Human Services funding will remain intact in a year where other discretionary funds are being reduced. These funds provide support for the Town's most vulnerable and marginalized populations. The Town's language access plan is a part of this program that has been a critical asset during the coronavirus pandemic response.
- The Town will continue to implement its Diversity, Equity and Inclusion strategic plan through employee training and the application of a racial equity lens when we make operational decisions, such as reopening facilities and the restoration of services.

Effect on Town Employees

We are not recommending a pay increase for employees and have implemented a hiring freeze on vacant positions to provide personnel savings. Many of those frozen positions will extend into next fiscal year and will be reconsidered at the end of the first quarter if economic conditions improve. We are not proposing any reductions in staff, and we will reevaluate pay mid-year if economic conditions improve.

Our healthcare broker continues to negotiate our health insurance premium to ensure the best rate possible. The recommended budget includes a 4% increase in health insurance, which is lower than last year's 4.9% increase. After several years of moderate increases including an 8.5% reduction in FY16, our rates increased substantially in FY17 and FY18. The spike in rates is due to a combination of significant claims experience from a relatively small number of high dollar claims and a general increase in the cost of healthcare. In FY19, the Town implemented a $250 deductible which reduced premiums by 1.5%.

Prior to COVID-19, the Town renewed its application with the Orange County Living Wage (OCLW). The 2021 standard is $14.90 per hour for employees without health benefits and $13.40 with health benefits. This affects some seasonal and program support employees. As a result of COVID-19, we have been granted a six-month extension to meet the new wage standard. The FY 21 Manager's Recommended budget does not include any additional funding to pay for this increase.

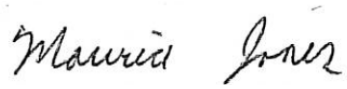
Meeting Current and Future Needs

This budget continues the delivery of high-quality core services to our residents, businesses, and visitors. The budget also supports strategic goal areas, from affordable housing to climate action, to the extent possible under current conditions. We have preserved the affordable housing funding from last year's levels and already allowed greater flexibility in the use of those funds to meet the community's unexpected needs. This budget balances our Town's commitment to the policy decisions of the Council and upholding the community's values.

We will continue to address the growing gap between the wants and needs of our community and the resources to fund those initiatives. In order to reach a shared understanding of how we prioritize our resources in the future, I propose that we engage in regular updates on the Town's budget and needs during the year, folding in the information gathered in the draft five-year budget strategy. This on-going conversation will allow us to gather current data, evaluate how the battle against the pandemic is progressing, and guide future budgeting decisions.

In the meantime, this recommended budget provides the operational preparedness and financial resilience to respond to difficult and changing conditions. We will continue having in-depth, open discussions about the future of Chapel Hill with the Council and members of the community over the next 6-12 months. Through open dialogue and careful planning, we will have the flexibility to respond to new opportunities and continue making strategic investments in the future of Chapel Hill.

Sincerely,



Maurice Jones
Town Manager