Mid-Year Budget Update

City Council Informal Session

February 1, 2011

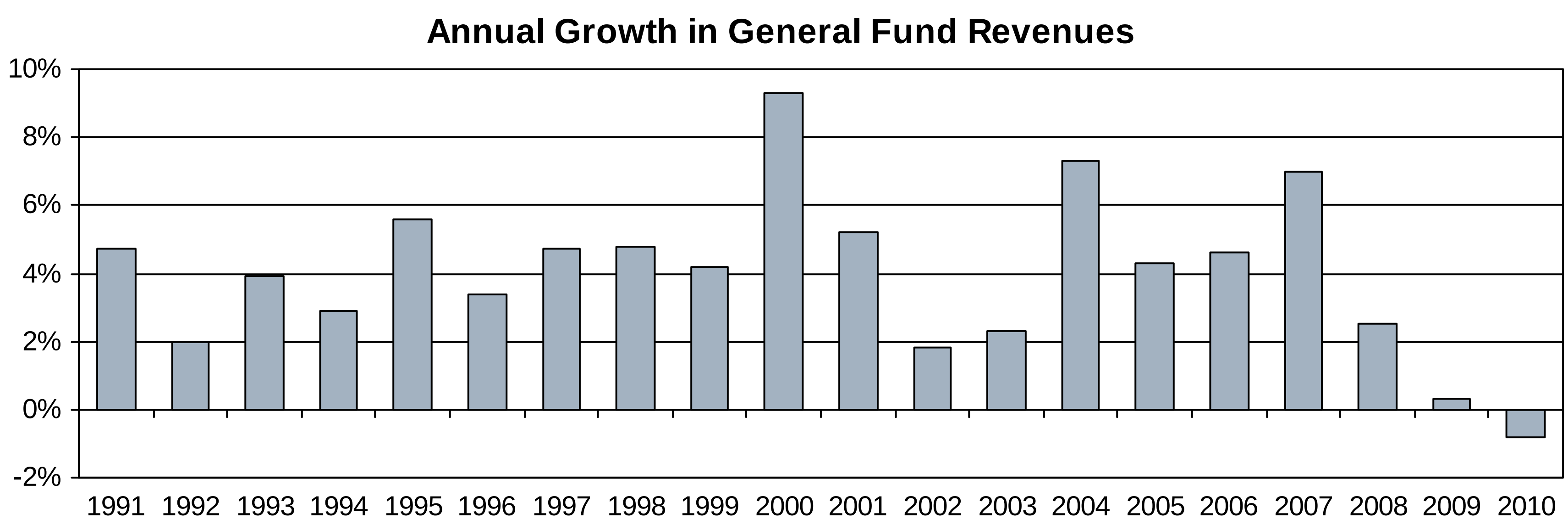
Presentation Overview

- The purpose of today's presentation is to provide City Council with a mid-year update of the City's financial condition.
- The presentation is divided into the following sections:
  - FY 2010 General Fund End-of-Year Overview
  - Overview of National Economy
  - Overview of State and Local Economy
  - FY 2011 General Fund Mid-Year Update
  - Preliminary Five-Year Forecast
- No action is required from City Council at this time.

FY 2010 General Fund
Year-End Overview

FY 2010 revenue variance declined by 0.8 percent

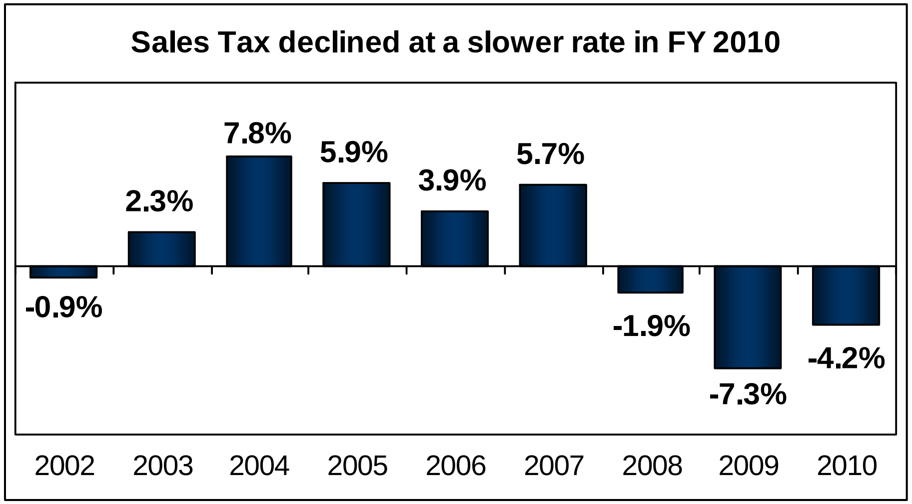
- Revenue variance was driven by:
  - State's reduced aid to localities mid-year in order to address the $1.8 billion revenue shortfall in the 2008-2010 biennium.
    - State reduced HB 599, support for constitutional officers, education, street maintenance, and libraries. Actual revenues received from the State in FY 2010 fell to below the FY 2007 level.
  - Continued decline in other local taxes and interest due to the economy.
- Overall, General Fund revenues declined by 0.8%, the first annual decline in over twenty years.

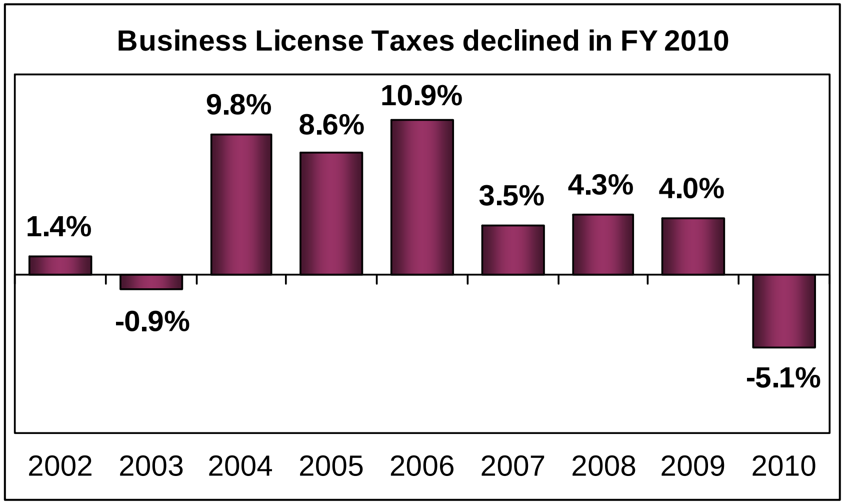


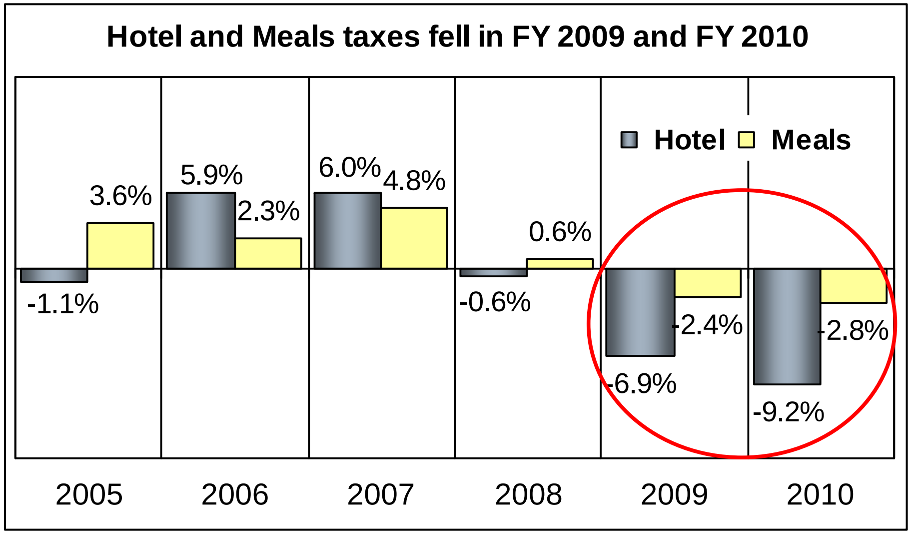
Source: Comprehensive Annual Financial Report (CAFR), Schedule of Revenue, Budget and Actual, for various years.

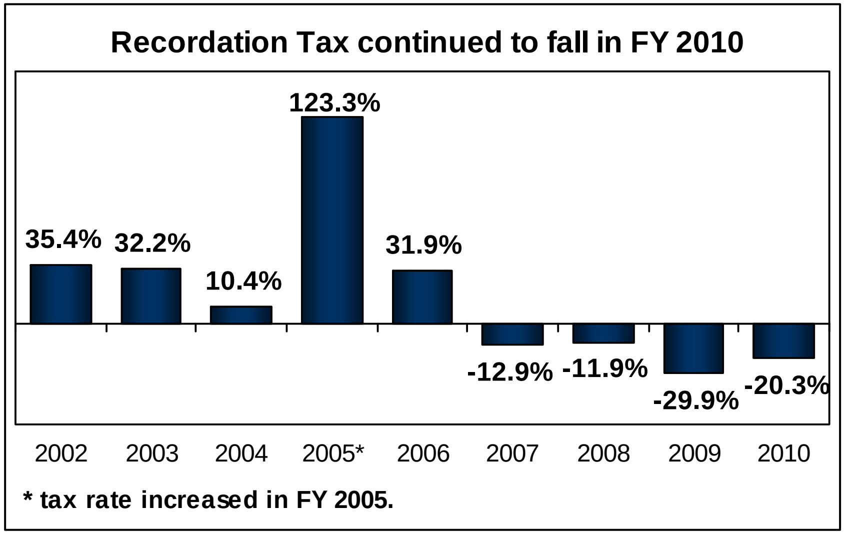
Key revenues continued to decline in FY 2010

- Sales and recordation taxes fell to their lowest level since FY 2004. The hotel tax fell to its lowest level since FY 2002.



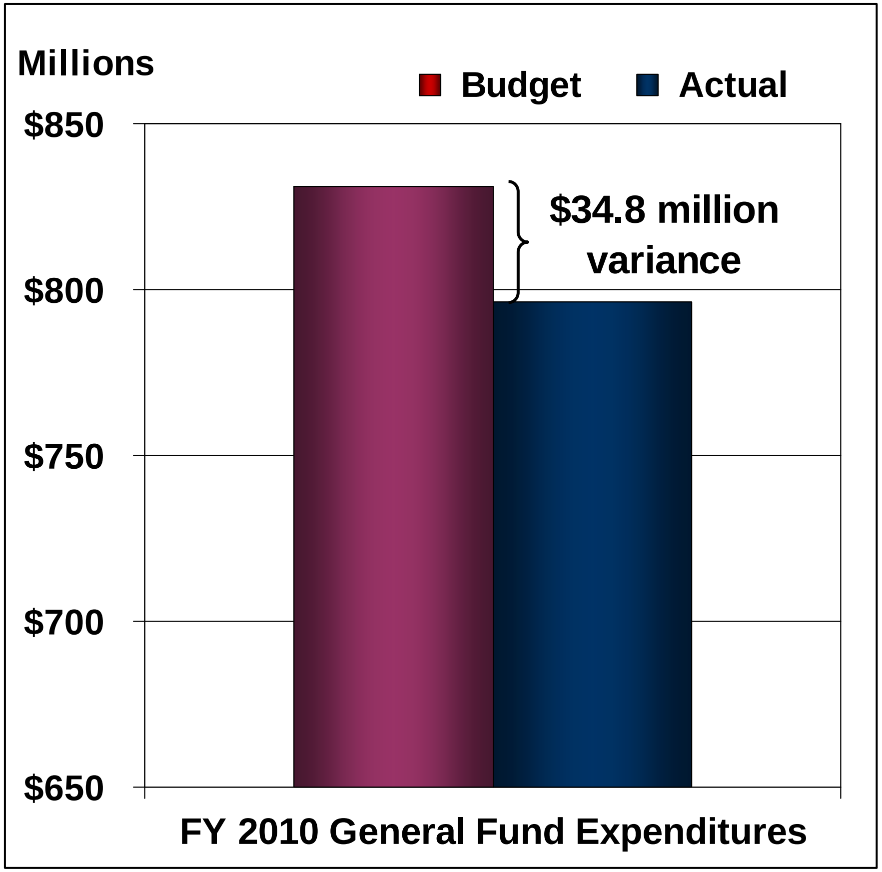






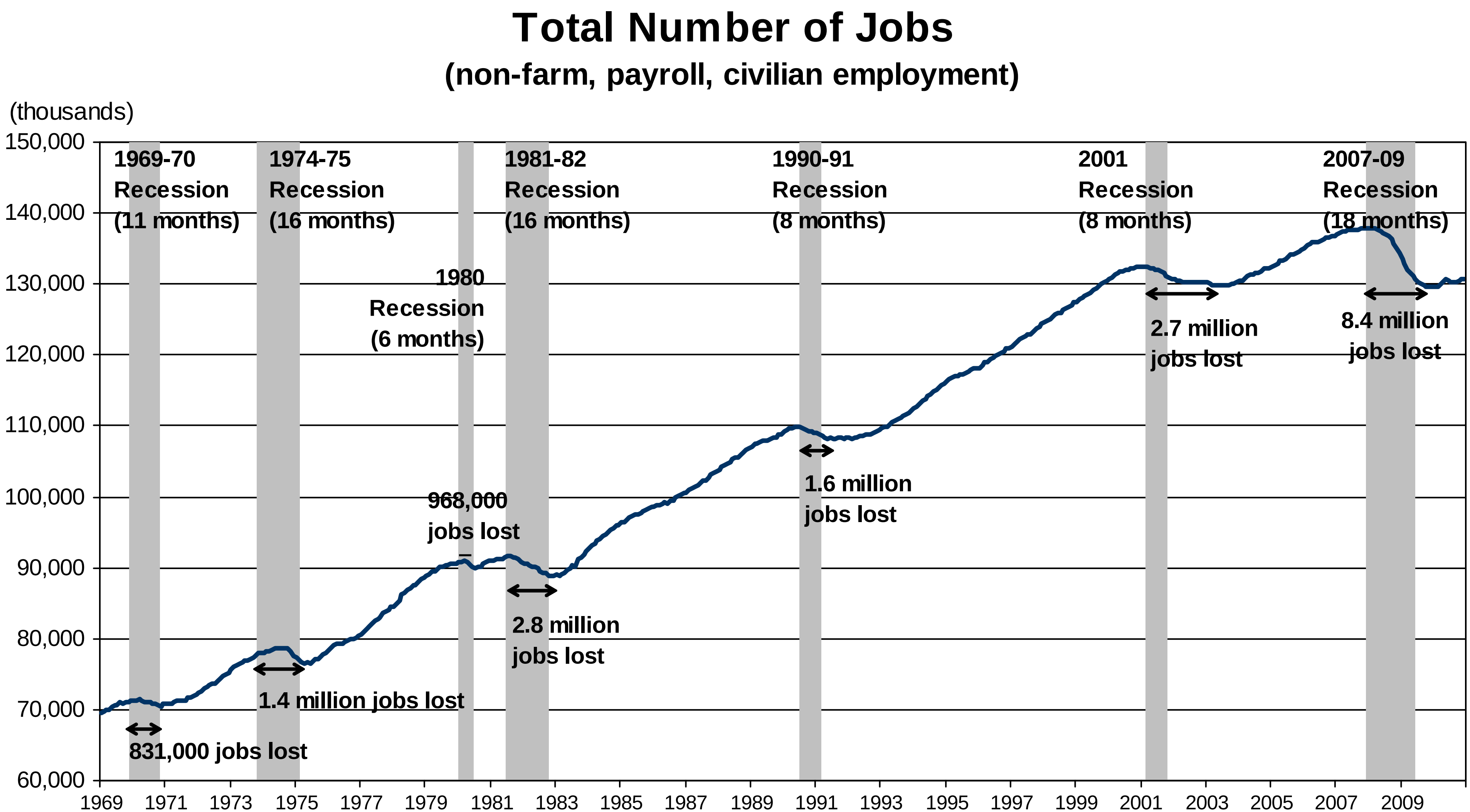
FY 2010 measures addressed revenue shortfall

- Budget rebalancing strategies in FY 2010 included:
  - Across-the-board reductions and targeted reductions to food, travel and training expenditures;
  - Froze vacant positions, except in sworn public safety and vitally required positions;
  - State reductions absorbed by specific departments/offices;
  - Controlled department spending and use of procurement cards.
- Captured savings from the debt service budget



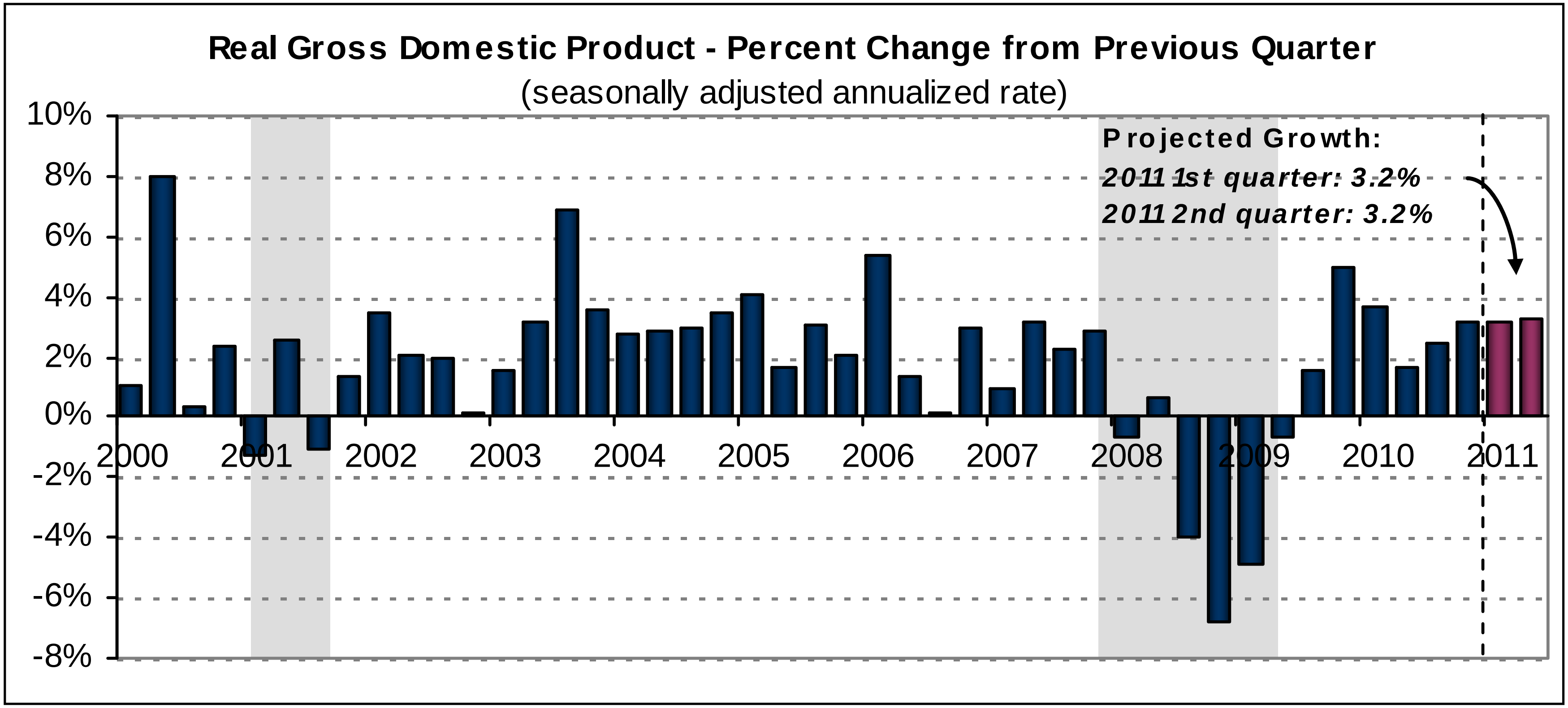
National Economy

Overview of Previous Recessions: Impact on Employment



Economic recovery began June 2009 (2nd quarter of 2009)

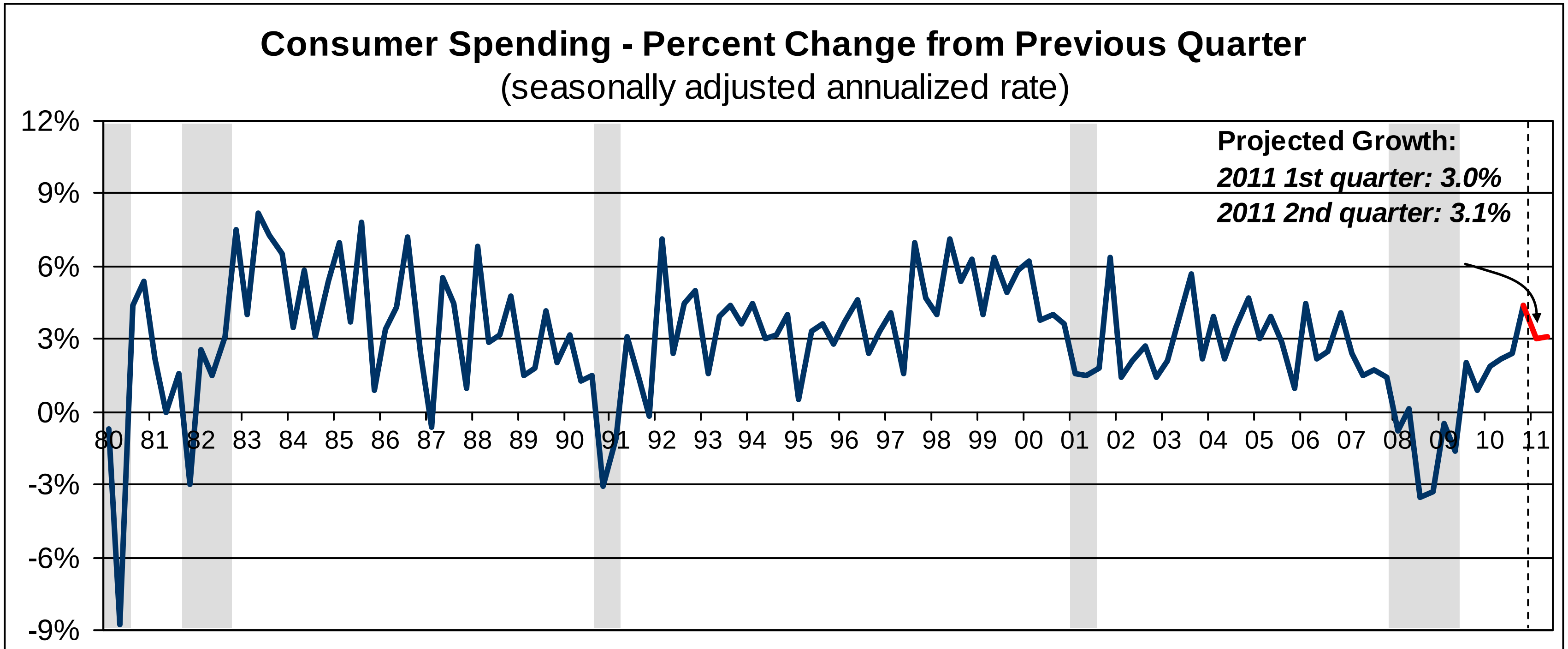
- The Great Recession, which began December 2007 and technically ended June 2009, lasted 18 months and was the longest recession since the Great Depression.
- Since the end of the recession, the economy has grown for six consecutive quarters. The increase reflected an upturn in consumer spending, businesses rebuilding inventories, and business investment in equipment and software.
- The positive outlook for economic growth is based on increased optimism regarding consumer spending.



Source: Bureau of Economic Analysis. Blue Chip Economic Indicators (projection in red). Note: Shaded area denotes recession.

Consumer spending began rising in the latter half of 2009

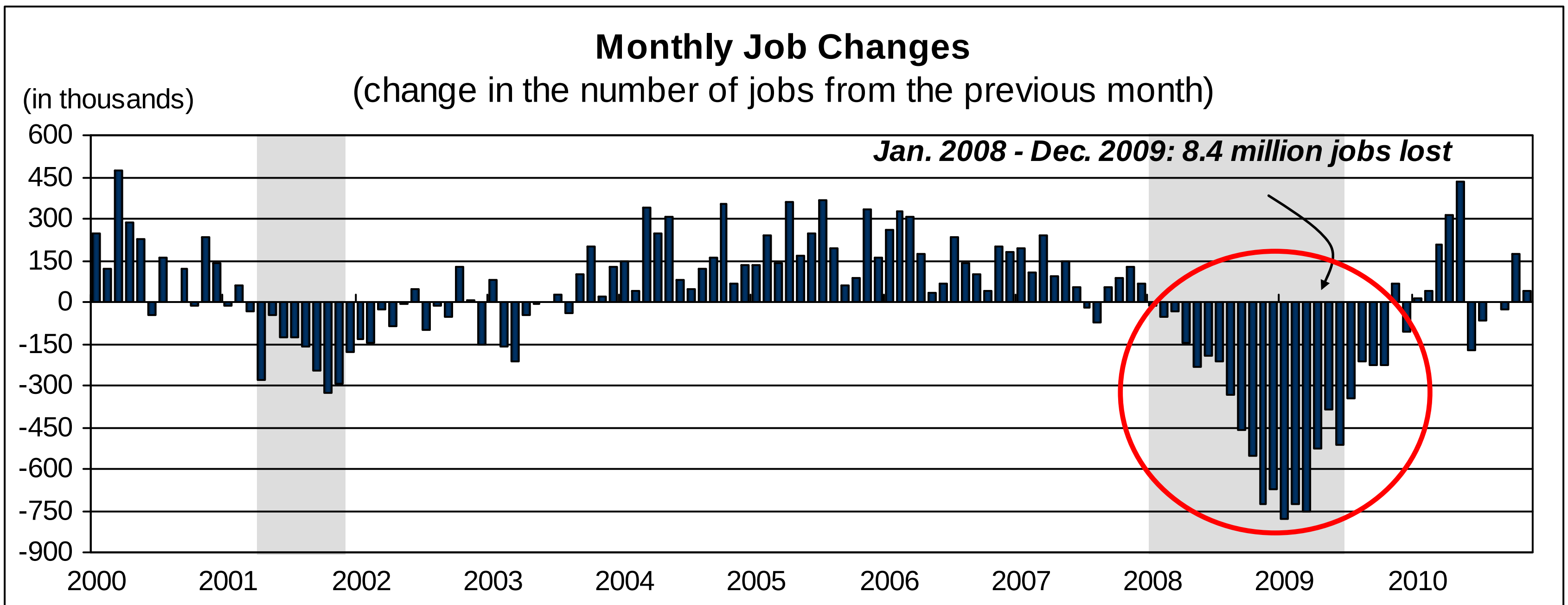
- Consumer spending increased 4.4% during the last three months of 2010, the largest increase since the first quarter of 2006.
- Consumers had reduced spending during the recession in response to:
  - significant job losses and high unemployment
  - tight credit conditions, which made it difficult to finance spending on big ticket items (such as, cars, homes, furniture)
  - high level of household debt
  - decrease in household net worth ("wealth") due to the drop in home values and stock market



Source: Bureau of Economic Analysis; Blue Chip Economic Indicators (projections in red). Note: Shaded area denotes recession.

The economy added jobs for the first time since 2007

- In 2010, the economy added 1.1 million jobs. However, the 2010 gains follows steep job losses of 4.74 million in 2009 and 3.62 million in 2008.
    - Private sector drove the growth, adding 1.3 million jobs (113,000 jobs/month)
    - Public sector lost 222,000 jobs (mainly in local government – 256,000 jobs lost)
- Several sectors added jobs. Biggest gains were in temporary help services, healthcare, and leisure and hospitality.
    - Job losses continued in construction, utilities, information and financial activities sectors lost jobs.

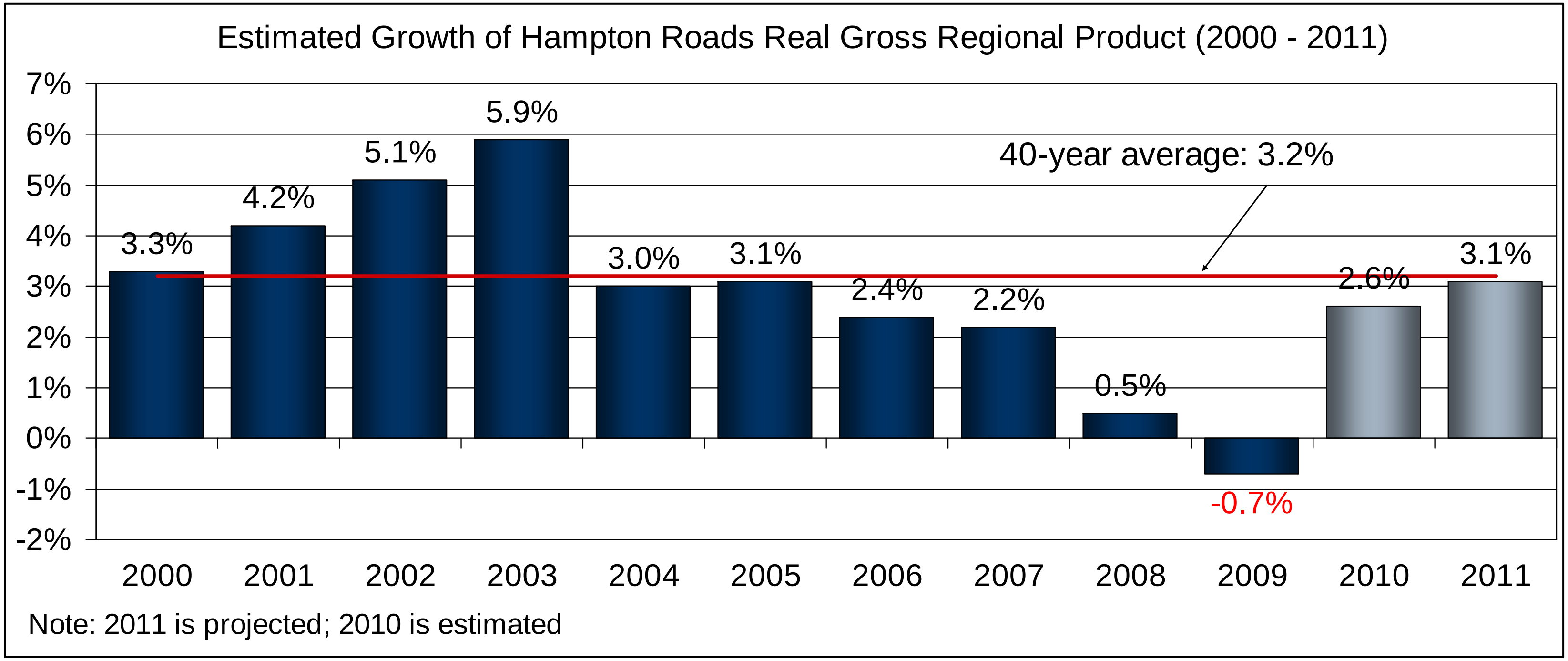


Source: Bureau of Labor Statistics. Note: Shaded area denotes recession.

State and Local Economy

Hampton Roads economy recovering from the recession

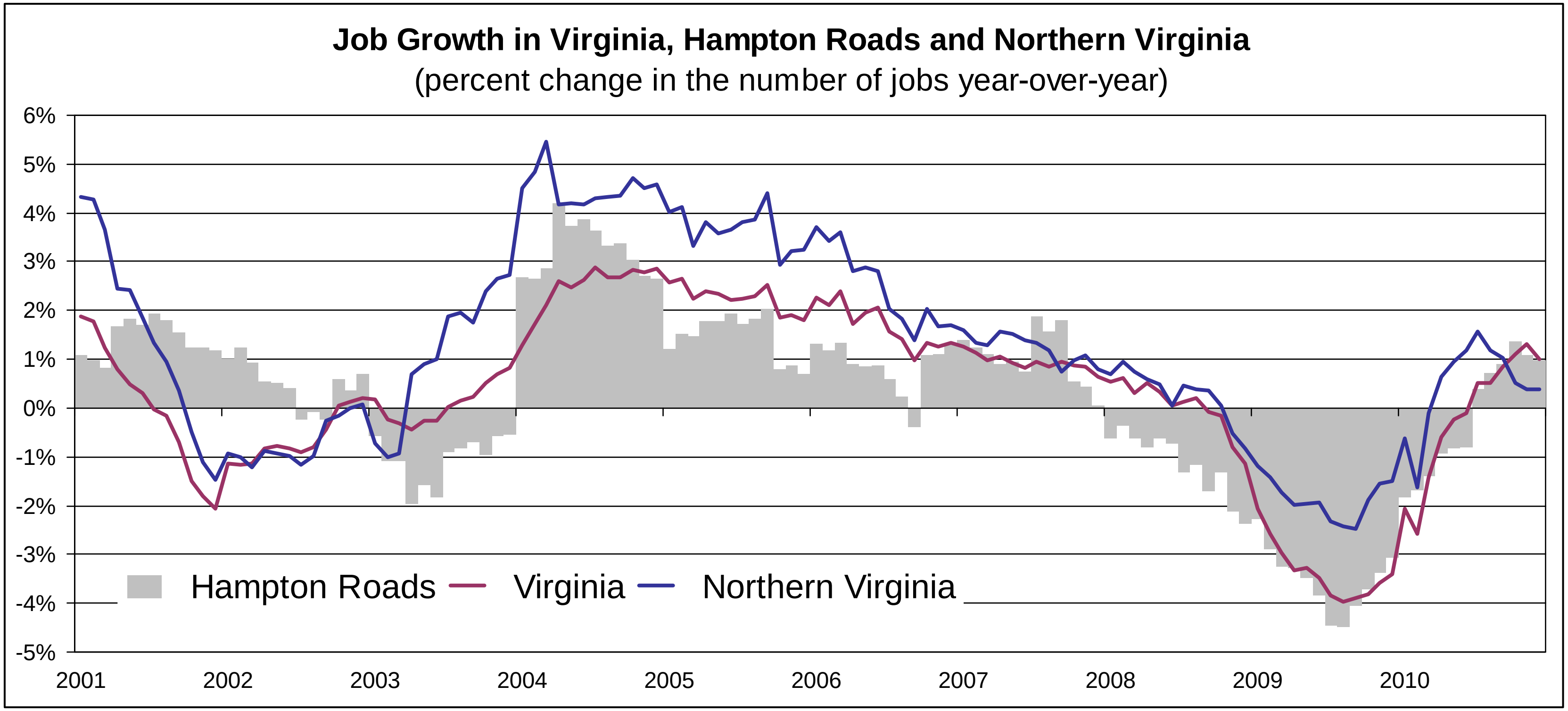
- The Hampton Roads economy is projected to grow 3.1 % in 2011 and 2.6% in 2010, after declining 0.7% in 2009.
  - The decline in 2009 was the first since 1975 and was the biggest decline in 40 years.
- Projected increase in 2011 is nearly at the regional 40-year average annual growth.
  - Positive outlook for Hampton Roads is attributed to growth in defense spending, the port, health care, and tourism.
- Long-term outlook for the region will be determined by future growth of defense spending in the region.



Source: 2010 State of the Region and ODU Economic Forecasting Project

Hampton Roads beginning to see job growth

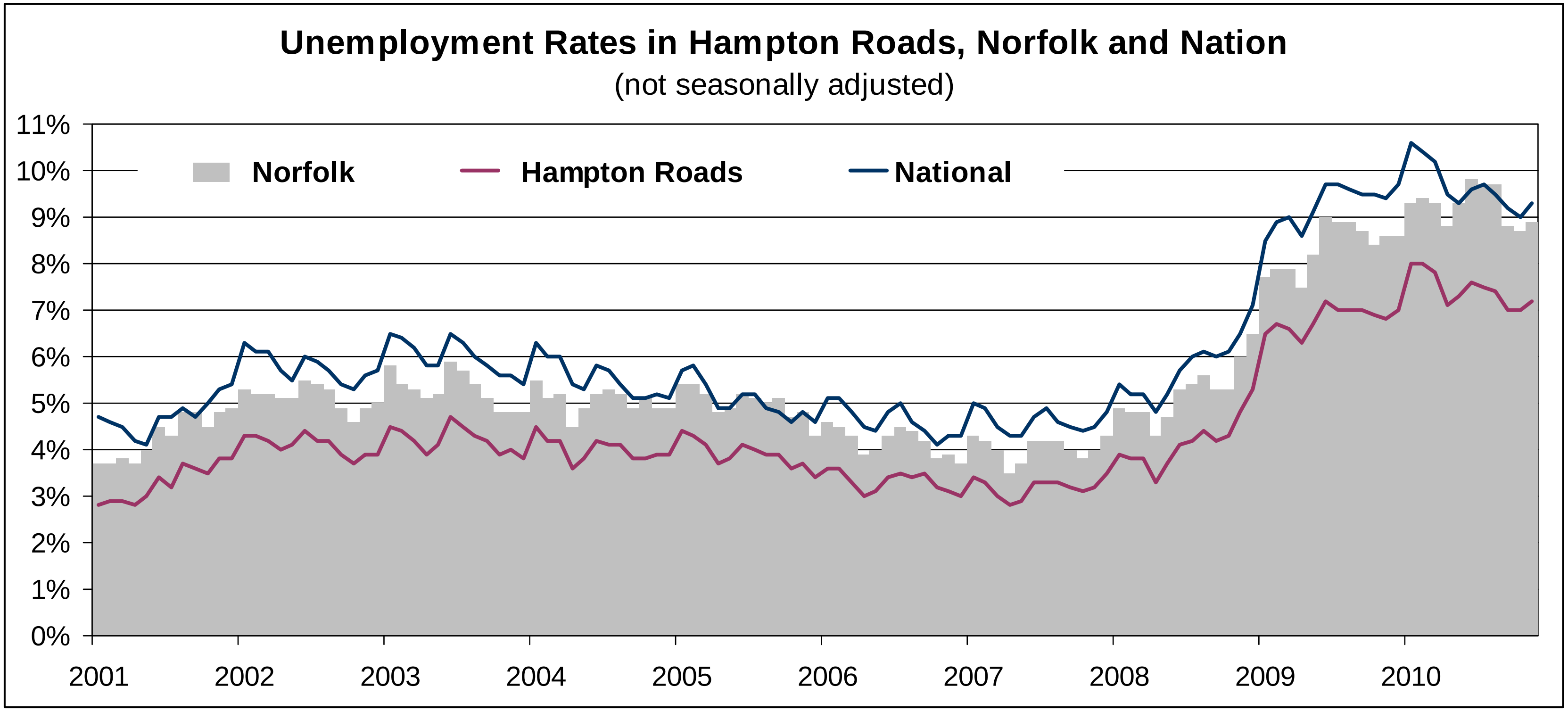
- In December, Hampton Roads added 7,100 jobs (1% increase) from last year.
  - This is the sixth consecutive month of year-over-year job growth in the region, which follows 30 consecutive months of year-over-year job losses.
  - Growth led by professional & business services, leisure & hospitality (mainly restaurants & bars), retail trade, health care, and federal & state government.
- Hampton Roads exceeded the year-over-year growth in Northern Virginia in the past three months.



Source: Virginia Employment Commission. Data are not seasonally adjusted.

Unemployment rates remain near historic highs

- The Hampton Roads unemployment rate in November 2010 stood at 7.2%, a 0.4 percentage point increase from November 2009.
- Similarly, Norfolk's unemployment rate in November 2010 stood at 8.9%, a 0.3 percentage point increase from November 2009.
- Unemployment in Norfolk and in the region remain below the national rate.



Source: Virginia Employment Commission.

The number of homes sold and average sales price of homes sold in Hampton Roads have fallen in 2010

City	Median Sales Price		Median Sales Price % Change	Units Sold		Units Sold % Change
	CY 2009	CY 2010		CY 2009	CY 2010	
Hampton Roads	$218,000	$215,000	-1.4%	18,515	16,957	-8.4%
Norfolk	**$183,500**	**$170,000**	**-7.4%**	**2,034**	**1,898**	**-6.7%**
Virginia Beach	$238,400	$239,900	0.6%	5,696	5,223	-8.3%
Portsmouth	$154,880	$138,000	-10.9%	1,046	974	-6.9%
Chesapeake	$240,000	$240,000	0.0%	2,867	2,720	-5.1%
Suffolk	$242,250	$237,000	-2.2%	1,188	1,049	-11.7%
Hampton	$179,500	$165,000	-8.1%	1,371	1,190	-13.2%
Newport News	$188,900	$175,000	-7.4%	1,785	1,473	-17.5%
Northern Virginia*	$431,018	$469,567	8.9%	19,035	17,858	-6.2%
Greater Northern Virginia*	$359,733	$402,581	11.9%	34,661	31,023	-10.5%
Virginia	$127,250	$119,000	-6.5%	90,959	82,809	-9.0%

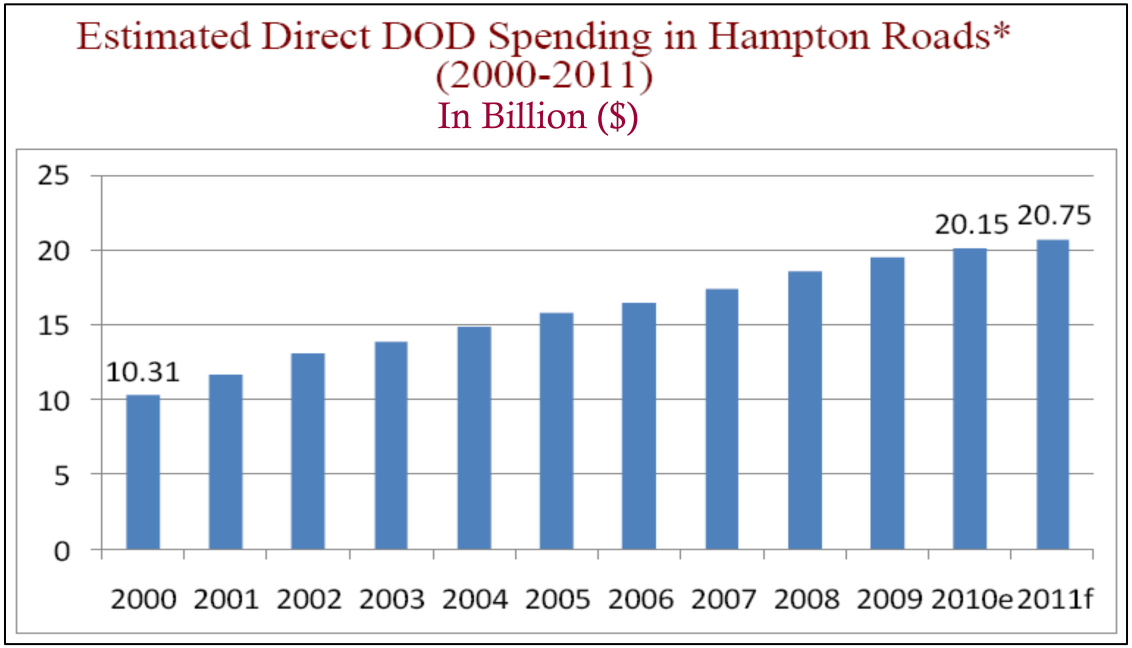
Notes: “CY” stands for calendar year (January – December). “Northern Virginia” includes the counties of Fairfax and Arlington, and the cities of Alexandria, Falls Church, Fairfax, and the towns of Vienna, Herndon and Clifton. “Greater Northern Virginia” includes Northern Virginia as well as Prince William, Loudoun, Fauquier, Culpeper, Madison, Orange, and Rappahannock counties.

* Median sales price was not available for these areas. Sales price data reflects average sales price.

Source: Real Estate Information Network (REIN); Virginia Association of Realtors; Northern Virginia Association of Realtors

Defense spending growth in Hampton Roads is moderating

- Defense spending is projected to grow by about 3% in 2011, which follows the 3.1% estimated growth in 2010. These are the lowest rates of increase since 2000.
  - In comparison, defense spending has grown at an average annual rate of 7% from 2000 to 2010, according to the 2010 State of the Region Report.
  - Defense spending accounts for roughly 45% of our regional economy.
- Increases in defense spending since 2000 accounted for more than 75% of the region's growth.
- Growth of defense spending in 2011 will be dampened by the closure of Joint Forces Command (JFCOM). Loss of employment will come over the course of the next 3 years. However, the impact of the closure will be greater in 2012 and 2013.

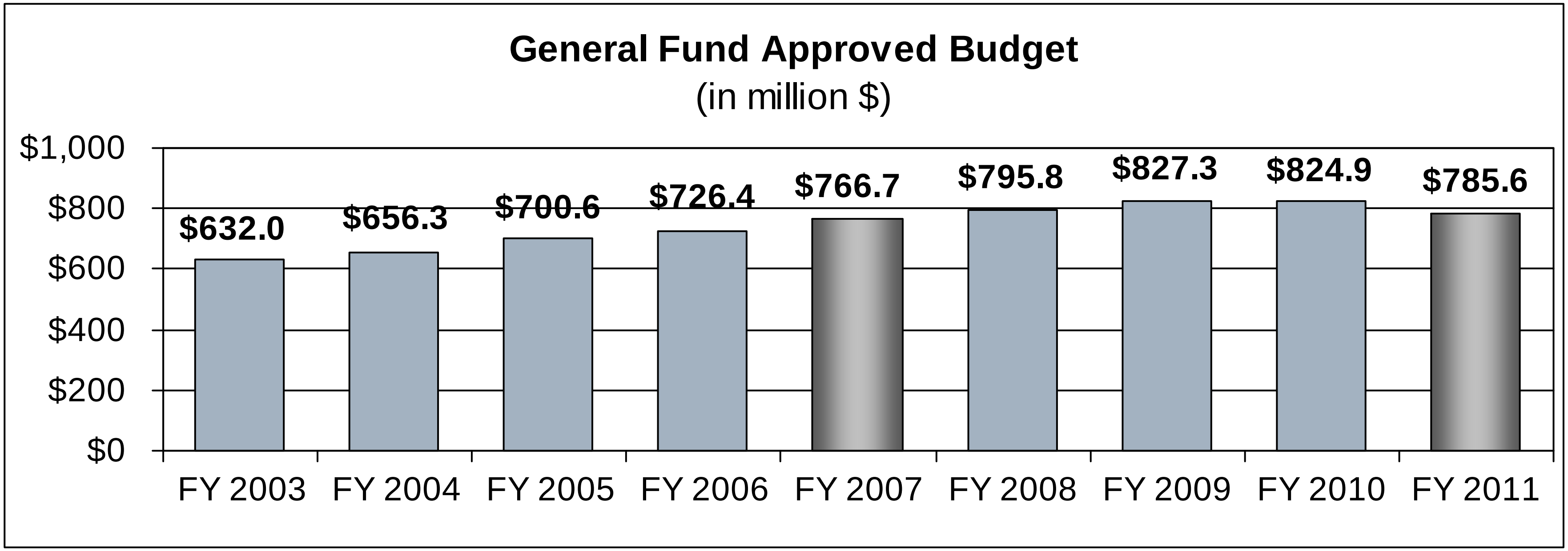


Source: ODU Forecasting Project, 2010 State of the Region. Note: "e" – estimated; "f" – forecast.

FY 2011 Mid-Year Update

FY 2011 Budget Overview

- In FY 2011, the general fund approved budget declined 4.8%. This was the second consecutive decline and was the steepest decline since FY 1992.
  - The FY 2011 Approved Budget was also the lowest since FY 2007.
- Key budget drivers include:
  - Declining state and local revenues
    - Real estate assessments (overall) fell 3.1%, the first decline since FY 1995.
    - Revenue from the Commonwealth budgeted to be the lowest since FY 2005.
  - Rising operating costs



FY 2011 Budget Overview

- FY 2011 budget strategies to close the gap included:
  - Organizational restructuring
  - Cost cutting that included the elimination of 208 positions, of which, 60 were filled, and passing on 50% of the increase in healthcare premiums to employees
  - No salary increases (merit or across-the-board)
  - Personal property tax rate increase by 8¢ on vehicles and business property
  - Modest fee increases – right of way and utility cut permits, survey fees, library fines, zoo admissions, recreation center fees
  - Use of $2 million from the Economic Downturn/Leveling Fund; however, the 5% contingency reserve was not used to balance the budget
  - Use of $3.1 million from the Public Amenities cash reserve for the Waterside project in the Capital Improvement Program and to offset one-time the 5% reduction to Outside Agencies in order to transition them to reduced funding in future years

Mid-Year Budget Update

Based on year-to-date spending trends and revenue collections, the general fund is tracking the Approved Budget.

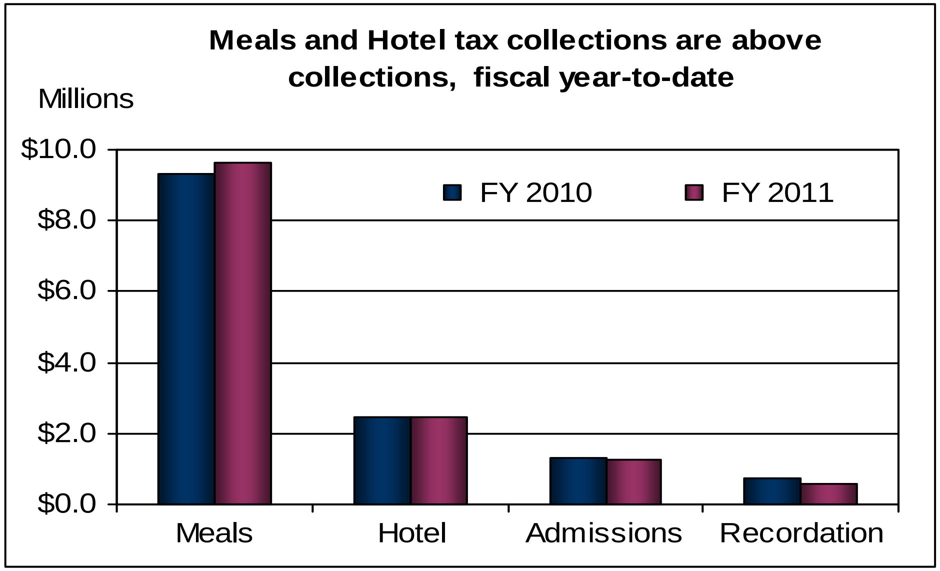
<u>FY 2011 Year-End Estimate</u>

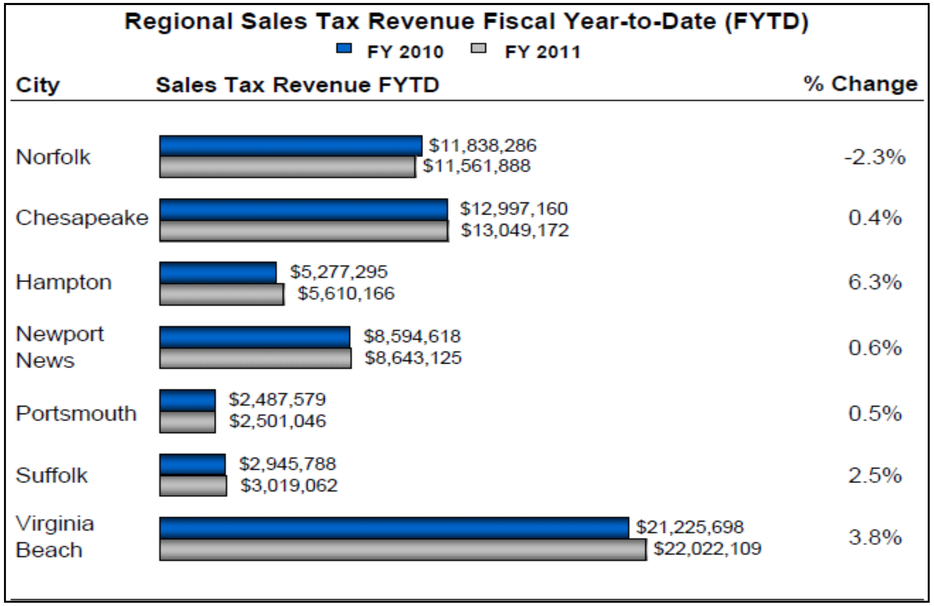
- Revenues and Expenditures are tracking approximately 1% less than the Approved Budget.

- Revenue shortfall year-to-date due to:
  - State aid for schools and human services, slow recovery of economy driven revenues.
- Expenditures savings year-to-date mainly due to:
  - Personnel savings, tipping fee, corresponding savings in schools and human services, debt refunding.

Mid-Year Budget Update

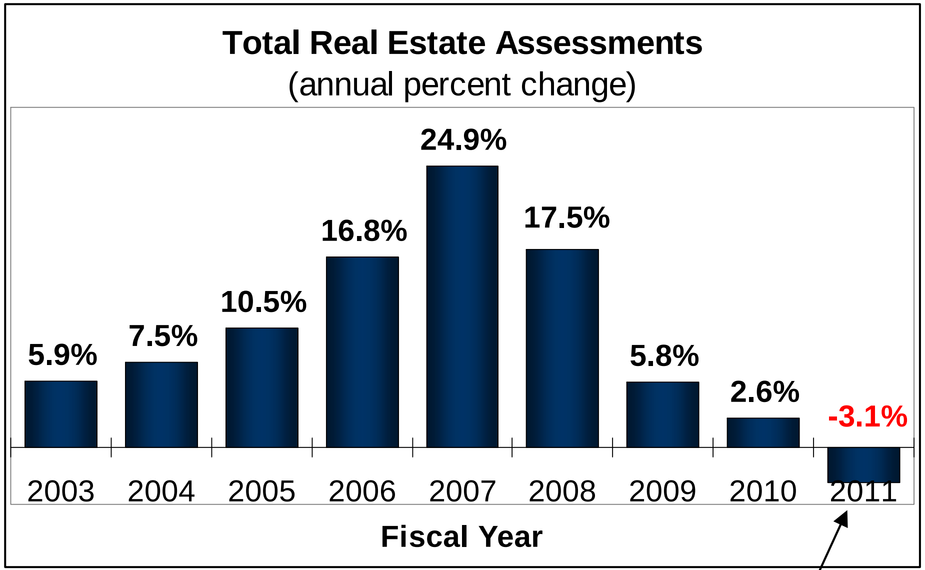
- Some revenue collections tied to the economy (such as, restaurant tax) appear to be recovering.
  - Restaurant tax collections have increased 3.6% year-to-date, while hotel taxes are up slightly.
- However, sales and recordation tax collections have continued to decline year-to-date.
  - Sales tax collections in Norfolk are lagging the region.
  - Sales tax decline year-to-date though November is 2.3%; however, adjusting for the impact of the Virginia tax amnesty program last year, the decline year-to-date is 1%.

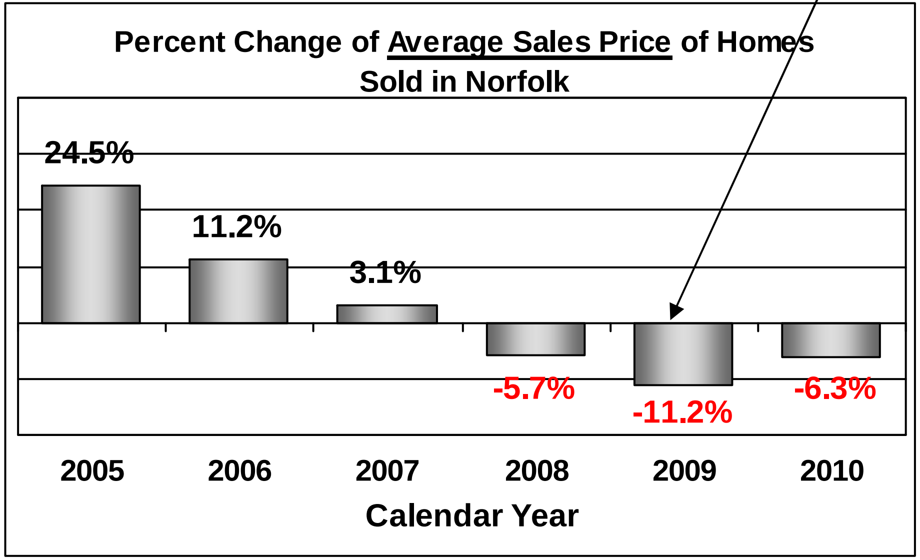




Decline in real estate assessments reflects the downturn in the housing market

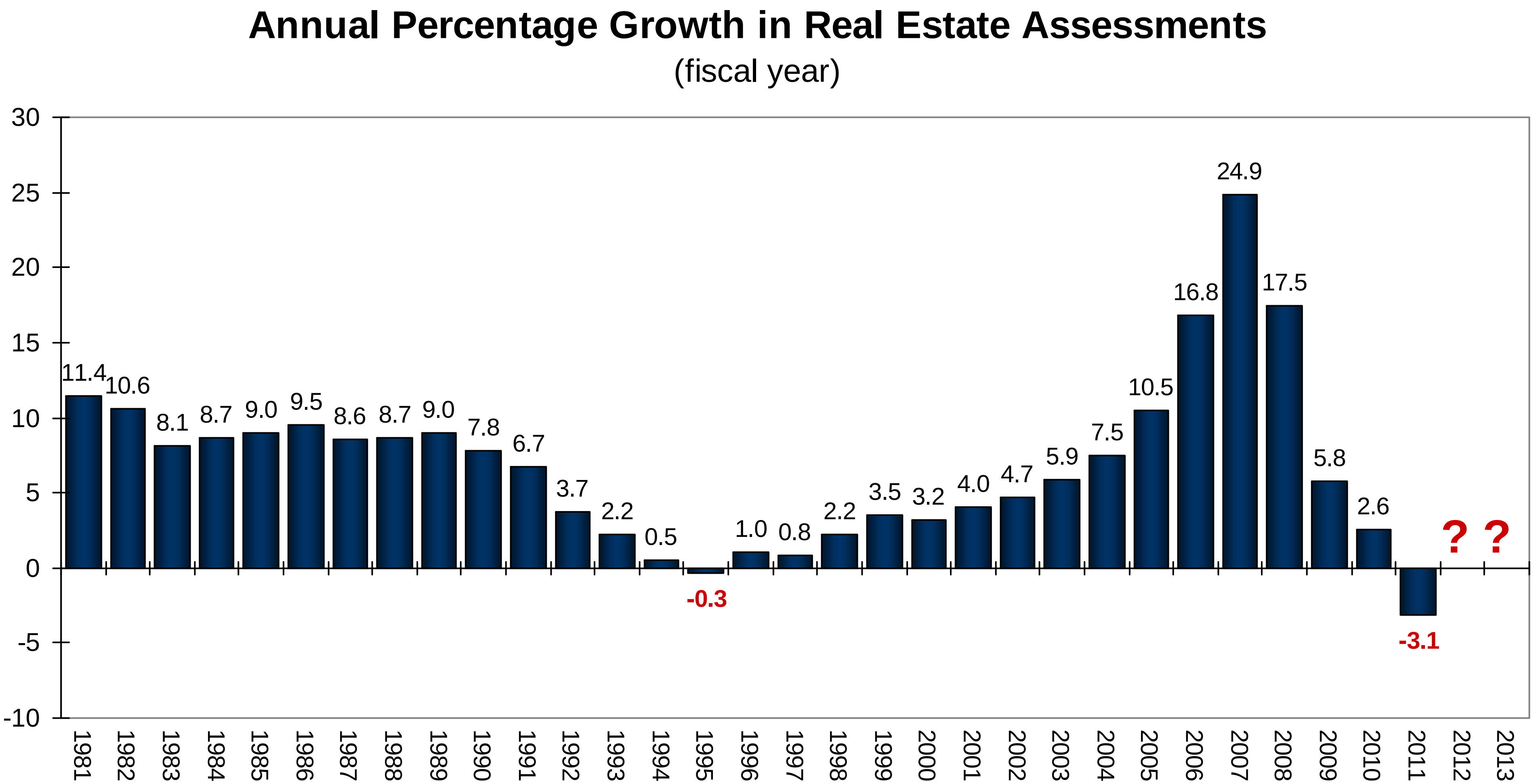
- In FY 2011, overall real estate assessments declined 3.1%.
  - This was the first decline in overall assessments since FY 1995.
  - The assessed value of both residential and commercial properties declined in FY 2011.
- Due to the lag in property assessments vs. market activity, the decline in the housing market in 2009 did not show up in real estate assessments until FY 2011.
- As the housing market continues to decline, Norfolk will again see lower revenues from real estate taxes in FY 2012.





Source: City Assessor's Annual Report; Real Estate Information Network

Real estate assessments may take several years to recover



Preliminary Five-Year Forecast

Five-Year Forecast and Base Budget Development

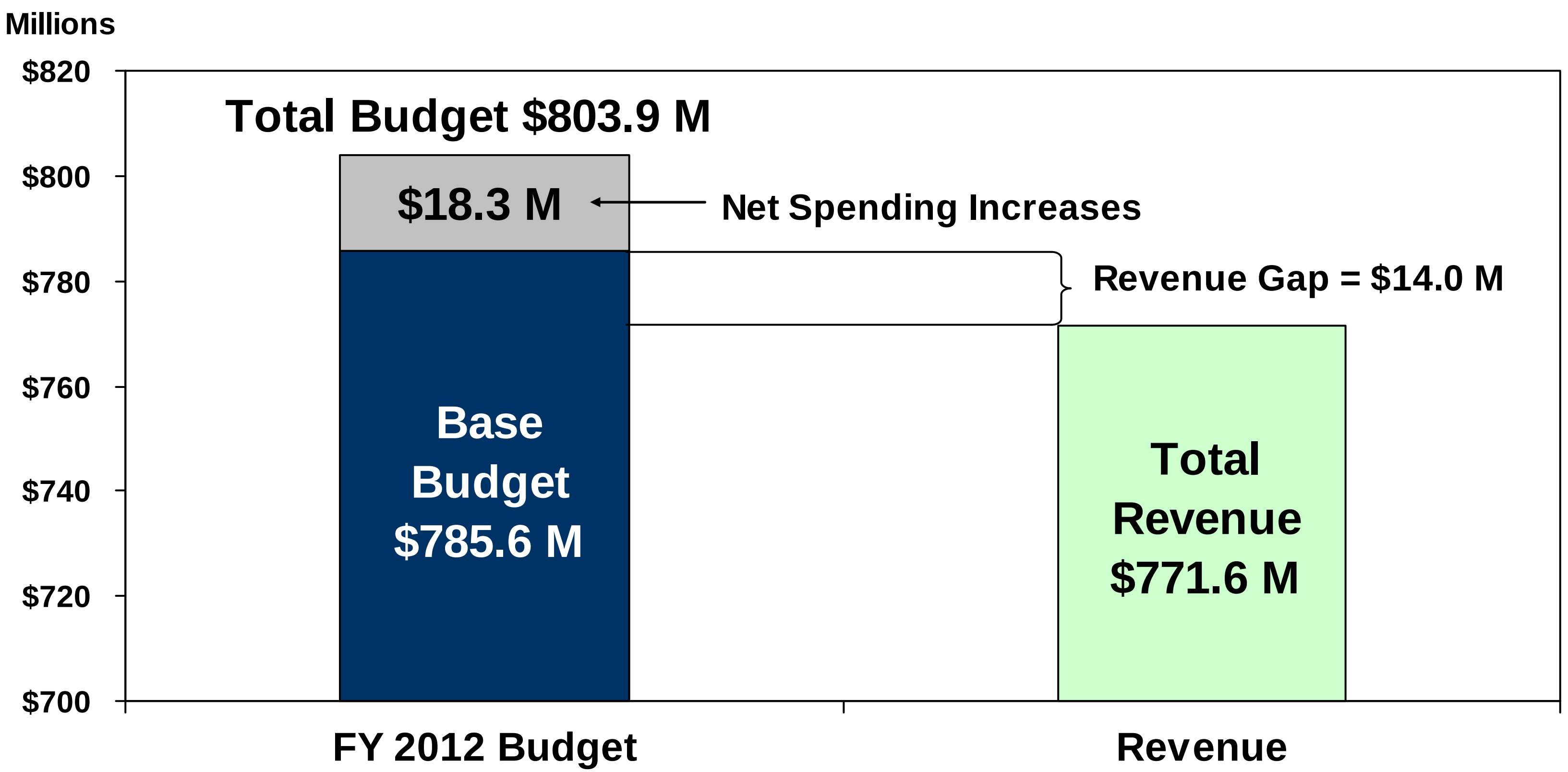
- Annually, the Administration does a five-year revenue and expenditure forecast.
- The Five-Year Forecast of revenues and expenditures are produced to provide a starting point for budget deliberations.
  - Preliminary information on known budget issues such as, increase in cost of healthcare and retirement, as well as, economic forecasts, revenue collection trends, and known expenditure impact of planned projects are incorporated in the Forecast.
- The Base Budget starts from the current year's budget and includes adjustments for one-time expenditures, personnel changes, and annualizing prior year adjustments.
  - The Base Budget reflects a continuation of programs and services in the current year's budget and is the starting point for budget deliberations.
- The Five-Year Forecast and Base Budget Development are part of the City Manager's Internal Budget Process.

Five-Year Forecast and Base Budget Development

- It is important to keep in mind that the forecast presented today is based on information currently available.
- The Five-Year Forecast and Base Budget Development are preliminary and will be updated continually during the Budget Development process.
- The first year of the five-year forecast (FY 2012) is more detailed and uses more refined estimates than in the out-years.
- The FY 2012 estimate and the out-years incorporates the following assumptions:
  - Remove all one-time revenue and expenditures, such as, rollover of funds from prior years, one-time purchases of vehicles, furniture and fixtures, and other equipment.
  - Anticipated increases related to health care, retirement, debt service, fuel, contracts, and utilities.
  - Preliminary estimates of the impact on the operating budget from CIP projects anticipated to come online.

FY 2012 Preliminary Budget Gap
(without Norfolk Public Schools)

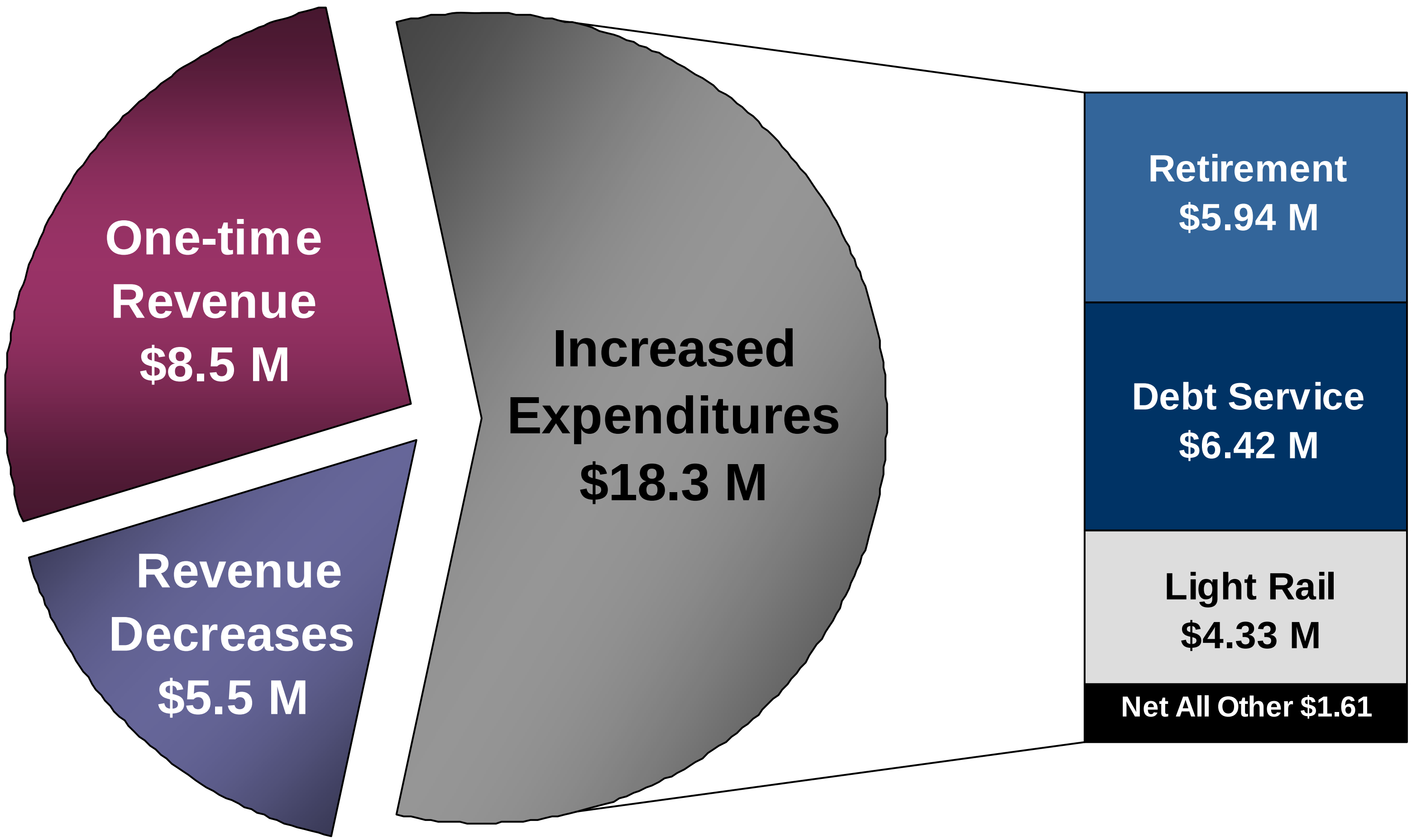
- In FY 2012, the general fund budget gap is estimated to be $32.3 million. The estimate excludes Norfolk Public Schools (NPS) gap.
  - Revenue gap = $14.0 million
  - Spending increases = $18.3 million



FY 2012 Preliminary Budget Gap
(without Norfolk Public School)

Revenue Base	**$785,638,700**
One-time revenues	($8,508,000)
Real estate tax (current)	($4,575,000)
State Aid Reductions (HB599, Aid to Localities)	($1,955,800)
Net all other	$1,019,800
Preliminary Revenue Forecast	**$771,619,700**
Expenditure Base	**$785,638,700**
Base Budget Adjustments (one-times, personnel, savings)	($5,438,300)
Healthcare, Debt, Retirement	$14,965,800
Inflationary Increases (regional jail, fuel, utilities, rent, mailings, charges)	$1,355,000
Light Rail Operations (estimate for a full year)	$4,330,500
Operating Impact from new facilities	$298,200
Pass through funds (DID/Bed tax, Tourism Infras.) & other adjustments (NCVB adjustment)	$936,700
New required spending (line of duty, redistricting mailings, performance based grants)	$1,858,100
Preliminary Expenditure Forecast	**$803,944,700**
Preliminary Gap from FY 2010 Base	**($32,325,000)**

FY 2012 Preliminary Budget Gap
(without Norfolk Public Schools)



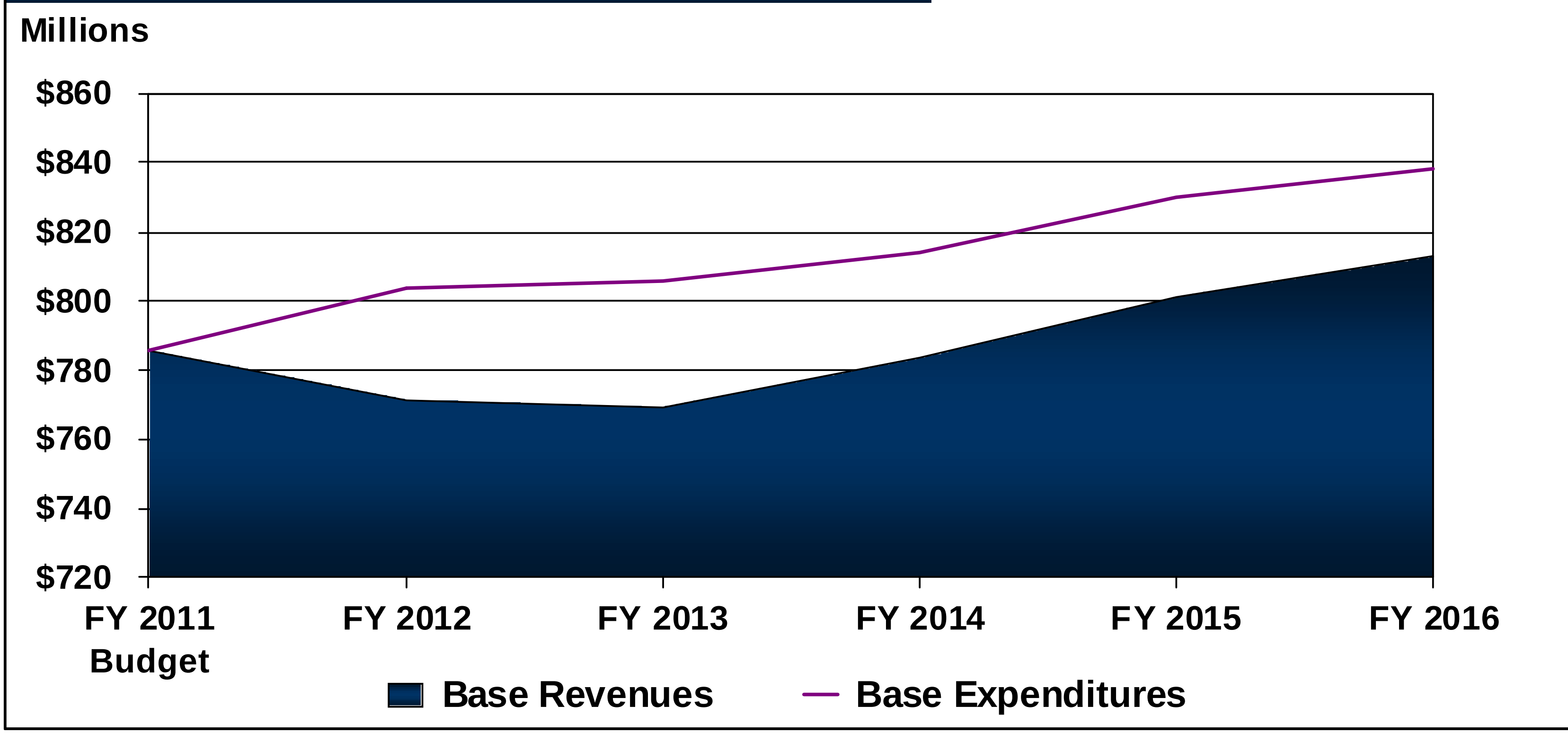
FY 2012 Preliminary Budget Gap

- The FY 2012 preliminary budget gap for the City's general fund is approximately $32 million.
- Norfolk Public Schools (NPS) indicated during a presentation to the School Board that they currently face a $21 million budget gap in FY 2012.

	FY 2011 Approved Budget	FY 2012 Proposed	$ Change
• Total Revenue	$295,657,690	$286,408,070	$(9,249,620)
• Total Submitted Expense	$295,657,690	$307,431,094	$11,773,404
• Total Deficit		$(21,023,024)	$(21,023,024)

- The City's preliminary general fund budget gap would rise to $53 million with the budget gap NPS is projecting.

Preliminary Base Forecast of General Fund Revenue and Expenditures FY 2012 – FY 2016 (without Norfolk Public Schools)



The budget gap persists over the next five years, with revenue slowly recovering but with the cost of services continuing to rise.

Addressing the FY 2012 Gap

- The FY 2012 outlook will be more difficult than the FY 2010 or FY 2011.
  - It is important to keep in mind that the FY 2012 budget gap follows the significant gaps that were addressed in FY 2010 and FY 2011.
- In FY 2012, as in prior years, the aim is to be structurally balanced. But this will not be easy given the current economic environment.
  - In balancing the FY 2010 budget, there was no use of the "Rainy Day" fund.
  - However, in balancing the FY 2011 budget, the Economic Downturn Fund and Public Amenities cash reserve were tapped to close the budget gap, reducing the balances available in these funds for future years.
- Key policy decisions will need to be made in order to close the budget gap.
- It is important to keep in mind that actions to restore reductions that were approved in FY 2011 will further increase the FY 2012 budget gap.