

MEMORANDUM



To: City Council
From: Wynter C. Benda
Date: March 30, 2023
About: Responses to Budget Questions

Mayor, Vice Mayor and Members of Council:

This memorandum serves as a response to a letter that I received on March 27th from Vice Mayor Faraldi and Council Members Helgeson, Misjuns and Taylor. The letter, in its entirety, is posted on the City's website [here](#). Additional questions from Council will be answered in a separate memo prior to Tuesday's public hearings.

To summarize the request, four Council Members have requested that the City Manager construct a budget that will:

- Reduce the real estate tax rate from \$1.11 to \$0.89 per \$100 of assessed value;
- Waive the refuse collection and vehicle license fees in FY 2024;
- Assess vehicles at 90 percent of fair market value to calculate personal property tax;
- Eliminate Business Professional and Occupational License (BPOL) tax on the first \$150,000 of gross receipts for Lynchburg businesses;
- Provide additional local funding to Lynchburg City Schools to meet the required local match for the state salary increase for Standards of Quality (SOQ) funded positions;
- Implement the proposed public safety pay progression and compression strategic plan;
- Provide a five percent GWI to general city employees – where needed;
- Maintain city service levels at or above their current levels.

When building Lynchburg's Annual Operating Budget there are a number of guidelines and policies that we must take into consideration. At the top of the list is the Code of Virginia that governs some aspects of local finance and budget management. Next on the list are the Financial Management Policies that City Council has adopted to provide the framework for sound fiscal management. When considering the request outlined above, several of these guidelines become relevant and are listed below:

- **Code of Virginia:** The city must produce a balanced budget where revenues are equal to expenditures.
- **City Council Financial Policy:** The City shall not use the Unassigned General Fund Balance to finance recurring operating expenditures.
- **City Council Financial Policy:** City Council shall adopt a balanced budget in accordance with all legal requirements.
- **City Council Financial Policy:** One-time revenues shall be used for one-time expenditures only.

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We will start by taking a look at the city’s General Fund revenue and expenditure projections for FY 2024 and how we use these projections to build the budget. At this point we will focus only on ongoing revenue and expenditures as City Council’s Financial Management Policies call for all ongoing expenses to be funded with ongoing revenues.

Revenues

We begin with the FY 2023 Revenue budget and then subtract one-time revenues to identify the ongoing revenue in the FY 2023 budget. From there, we add projected revenue growth in FY 2024 to arrive at our total projected ongoing revenue for FY 2024. That calculation is below in **Table 1**.

The FY 2023 budget included \$206.5M in ongoing revenues. In FY 2024 we are projecting \$29.5M in ongoing revenue growth, assuming no changes in any tax rates. This includes \$13.8M in real estate tax, \$11.7M in other local taxes, and \$4.0M in all other revenue, bringing total projected FY 2024 ongoing revenue to \$236.0M.

Table 1 (All Numbers Expressed in Millions)

FY 2024 Ongoing Revenue Analysis

FY 2023 Revenue Budget	\$223.10
Subtract: FY 2023 Use of One-time Revenues	(\$16.60)
FY 2023 Ongoing Revenue	\$206.50
Add FY 2024 Real Estate Tax Revenue Growth	\$13.80
Add: FY 2024 Other Local Taxes Growth	\$11.70
Add: FY 2024 All Other Revenue Growth	\$4.00
FY 2024 Ongoing Revenue Base	\$236.00

Expenditures

On the expenditure side we follow a similar path. We begin with the FY 2023 expenditure budget and then subtract one-time expenditures to identify the ongoing expenditures in the FY 2023 budget. From there we add any contractual, inflationary or other mandated cost increases associated with providing the same level of service in FY 2024 as the City is providing now. This calculation is shown below in **Table 2**. The FY 2023 budget included \$205.8M in ongoing expenses. In FY 2024, we have identified \$12.1M of contractual, inflationary and other mandated cost increases to provide a status quo level of service, bringing projected FY 2024 ongoing expenditures to \$217.9M

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Table 2 (All Numbers Expressed in Millions)

FY 2024 Ongoing Expenditure Analysis

FY 2023 Expenditure Budget	\$223.10
Subtract: FY 2023 One-time Expenditures	(\$17.30)
FY 2023 Ongoing Expenditures	\$205.80
Add: FY 2024 Contractual and Inflationary Growth	\$12.10
FY 2024 Ongoing Expenditure Base	\$217.90

It’s important to note that we spend months each summer and fall working with departments to identify ways to deliver services more effectively and efficiently. This year, as we do every year, we challenged departments to examine services from a zero-base perspective to operate as efficiently as possible.

Calculating the Base Budget Surplus / (Deficit)

The next step is to calculate the city’s FY 2024 base budget surplus or deficit. To do this, we subtract our FY 2024 Expenditure Base from our FY 2024 Revenue Base. The result of the calculation is an \$18.1M base budget surplus as shown in **Table 3**. While this is a big number, it does not include any cost of living adjustment for city employees, any investment in public safety, any additional local funding for Lynchburg City Schools, or any other service level enhancements.

Table 3 (All Numbers Expressed in Millions)

FY 2024 Base Budget Analysis

FY 2024 Ongoing Revenue Base	\$236.00
FY 2024 Ongoing Expenditure Base	\$217.90
FY 2024 Base Budget Surplus / (Deficit)	\$18.10

Revenue and Expenditure Policy Adjustments - Proposed Budget

The next step in the process is to adjust the revenue and expenditure budgets to reflect any tax rate or fee changes and any budget initiatives. We will first review the City Manager’s Proposed FY 2024 Budget (Proposed Budget) and then layer on the adjustments requested in the letter (Adjusted Budget).

On the revenue side, the Proposed Budget reduces the real estate tax rate by six cents from \$1.11 to \$1.05, waives the refuse collection fee for two years and the vehicle license fee for one year, and assesses vehicles at 90 percent of their fair market value for the purpose of calculating personal property tax. The six-cent reduction to the real estate tax rate is the only item that will impact ongoing revenue. This action will result in a \$4.5M reduction and bring proposed budget ongoing revenue down to \$231.5M. This is shown in **Table 4** below. The refuse collection and vehicle license waivers are temporary and will be

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funded with one-time revenue, so are not included as adjustments to ongoing revenue. The 90 percent vehicle assessment ratio was previously adopted by City Council and has already been accounted for.

Table 4 (All Numbers Expressed in Millions)
FY 2024 Ongoing Revenue Analysis

FY 2023 Revenue Budget	\$223.10
Subtract: FY 2023 Use of One-time Revenues	(\$16.60)
FY 2023 Ongoing Revenue	\$206.50
Add FY 2024 Real Estate Tax Revenue Growth	\$13.80
Add: FY 2024 Other Local Taxes Growth	\$11.70
Add: FY 2024 All Other Revenue Growth	\$4.00
FY 2024 Ongoing Revenue Base	\$236.00
Revenue Adjustment (Six Cents Rate Reduction)	(\$4.50)
Proposed FY 2024 Ongoing Revenue	\$231.50

On the expenditure side, the Proposed Budget includes new initiatives totaling \$13.05M in ongoing costs, listed below in **Table 5**.

Table 5
Proposed FY 2024 Budget Initiatives

Description	Amount
Increased Funding for Lynchburg City Schools	\$3,000,000
Five Percent General Wage Increase (GWI)	\$2,620,000
Debt Service Reserve	\$1,380,000
Public Safety Targeted Compression/Progression	\$3,020,000
Lynchburg Fire Department Compression Adjustments	
Public Safety Pay Progression (LPD & LFD)	
Increased Starting Pay for 911 Call Takers	
Other Org Capacity Positions and Operations	\$950,000
New Police Positions and Operational Support	\$860,000
Other New Public Safety Positions and Operations	\$530,000
New Constitutional Positions and Operations	\$320,000
Housing Toolkit	\$200,000
Police Take Home Care Program (Ongoing Costs)	\$170,000
Total	\$13,050,000

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When combined with the ongoing expenditure base, these initiatives bring the Proposed Budget ongoing expenditures to \$230.95M. This is shown in **Table 6** below:

Table 6 (All Numbers Expressed in Millions)

FY 2024 Ongoing Expenditure Analysis

FY 2023 Expenditure Budget	\$223.10
Subtract: FY 2023 One-time Expenditures	(\$17.30)
FY 2023 Ongoing Expenditures	\$205.80
Add: FY 2024 Contractual and Inflationary Growth	\$12.10
FY 2024 Ongoing Expenditure Base	\$217.90
Proposed FY 2024 Budget Initiatives	\$13.05
Proposed FY 2024 Ongoing Expenditures	\$230.95

The policy adjustments in the Proposed Budget result in \$231.5M of ongoing revenue and \$230.95M in ongoing expenses. The budget is structurally balanced with ongoing revenue supporting ongoing expenses and in compliance with City Council’s Financial Policies. When one-time revenues and expenditures are added to the budget it is balanced at \$248.4M and in compliance with state code.

Revenue and Expenditure Policy Adjustments – Adjusted Budget

Next, we will layer on the impacts of the Adjusted Budget as requested by the letter. On the revenue side, the Adjusted Budget further reduces the real estate tax rate by 16 cents from \$1.05 to \$0.89. This results in a revenue reduction of \$12.0M. The Adjusted Budget also eliminates Business Professional and Occupational License (BPOL) tax on the first \$150,000 of gross receipts for Lynchburg businesses. This results in a revenue reduction of about \$650,000. When combined, these adjustments reduce FY 2024 ongoing revenue by \$12.65M to \$218.85M. This is shown in **Table 7** below:

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Table 7 (All Numbers Expressed in Millions)
FY 2024 Ongoing Revenue Analysis

FY 2023 Revenue Budget	\$223.10
Subtract: FY 2023 Use of One-time Revenues	(\$16.60)
FY 2023 Ongoing Revenue	\$206.50
Add: FY 2024 Real Estate Tax Revenue Growth	\$13.80
Add: FY 2024 Other Local Taxes Growth	\$11.70
Add: FY 2024 All Other Revenue Growth	\$4.00
FY 2024 Ongoing Revenue Base	\$236.00
Revenue Adjustment (Six Cents Rate Reduction)	(\$4.50)
Proposed FY 2024 Ongoing Revenue	\$231.50
Additional Real Estate Tax Reduction	(\$12.00)
Additional Tax Relief BPOL	(\$0.65)
Adjusted FY 2024 Ongoing Revenue	\$218.85

On the expenditure side the adjusted budget eliminates some of the initiatives in the proposed budget. The updated list of initiatives is included below in **Table 8**.

Table 8
Proposed & Adjusted FY 2024 Budget Initiatives

Description	Proposed	Adjusted	Difference
Increased Funding for Lynchburg City Schools	\$3,000,000	\$2,100,000	(\$900,000)
Five Percent General Wage Increase (GWI)	\$2,620,000	\$2,620,000	\$0
Debt Service Reserve	\$1,380,000	\$0	(\$1,380,000)
Public Safety Targeted Compression/Progression	\$3,020,000	\$3,020,000	\$0
Lynchburg Fire Department Compression Adjustments			
Public Safety Pay Progression (LPD & LFD)			
Increased Starting Pay for 911 Call Takers			
Other Org Capacity Positions and Operations	\$950,000	\$0	(\$950,000)
New Police Positions and Operational Support	\$860,000	\$0	(\$860,000)
Other New Public Safety Positions and Operations	\$530,000	\$0	(\$530,000)
New Constitutional Positions and Operations	\$320,000	\$0	(\$320,000)
Housing Toolkit	\$200,000	\$0	(\$200,000)
Police Take Home Care Program (Ongoing Costs)	\$170,000	\$0	(\$170,000)
Total	\$13,050,000	\$7,740,000	(\$5,310,000)

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The adjusted budget eliminates \$5.31M of initiatives from the proposed budget. This reduction lowers total ongoing expenditures in the adjusted budget to \$225.64M. This is shown in **Table 9** below.

Table 9 (All Numbers Expressed in Millions)

FY 2024 Ongoing Expenditure Analysis

FY 2023 Expenditure Budget	\$223.10
Subtract: FY 2023 One-time Expenditures	(\$17.30)
FY 2023 Ongoing Expenditures	\$205.80
Add: FY 2024 Contractual and Inflationary Growth	\$12.10
FY 2024 Ongoing Expenditure Base	\$217.90
Proposed FY 2024 Budget Initiatives	\$13.05
Proposed FY 2024 Ongoing Expenditures	\$230.95
Reductions to Proposed FY 2024 Budget Initiatives	(\$5.31)
Adjusted FY 2024 Ongoing Expenditures	\$225.64

The policy adjustments included in the request by the group result in ongoing revenues of \$218.85M and ongoing expenditures of \$225.64M and create a budget deficit of \$6.79M. This is detailed in **Table 10** below:

Table 10 (All Numbers Expressed in Millions)

FY 2024 Adjusted Budget Analysis

FY 2024 Ongoing Revenue	\$218.85
FY 2024 Ongoing Expenditures	\$225.64
FY 2024 Adjusted Budget Surplus / (Deficit)	(\$6.79)

Closing the Adjusted Budget Gap

In order to balance the adjusted budget gap, we need to close the \$6.79M budget deficit. We can do this in a few different ways.

1. Implement budgeting strategies that increase the city’s financial risks to help close the gap
2. Use one-time funds from fund balance or through a reduction to pay-as-you-go capital projects as revenue to fund the deficit
3. Reduce spending and consequently services across the organization
4. A combination of the three methods.

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1. Budgeting strategies that increase the city’s financial risks

In this scenario, City Council can consider two strategies:

- Reduce expenses by budgeting for vacant positions
- Reduce funds budgeted for worker’s compensation expenses

The proposed budget fully funds all budgeted positions. This is a budgeting best practice that provides the city with the budgetary flexibility to respond to unexpected increases in expenses or reductions in revenues. Reducing the expenditure budget to account for anticipated vacancies is a widely used budgeting strategy even though it does introduce more financial risk to the budget.

Currently the city has 94 vacant positions that are funded in the General Fund. The salary and benefits budgeted for those positions is approximately \$6.4M. Roughly half of these positions (45.75 FTEs) are in public safety (Police, Fire, Emergency Services). We expect the number of vacancies to decline throughout the rest of FY 2023 and in FY 2024 if Council adopts the proposed compensation actions for these departments in the FY 2024 Budget.

Given these facts, reducing expenditures by up to \$1.6M to account for vacant positions is a strategy that Council may choose to pursue.

The FY 2023 Budget includes \$1.2M in funding for worker’s compensation expenses. Our updated budget data shows actual expenses are tracking lower than this. Staff feels comfortable recommending that Council reduce the budget for this expenditure by up to \$200K in the FY 2024 Budget.

If Council chooses to implement both of these strategies it would result in budget savings of \$1.8M and reduce the adjusted budget deficit from \$6.79M to \$4.99M. This is detailed in **Table 11** below:

Table 11 (All Numbers Expressed in Millions)
FY 2024 Adjusted Budget Analysis

FY 2024 Ongoing Revenue	\$218.85
FY 2024 Ongoing Expenditures	\$225.64
FY 2024 Adjusted Budget Surplus / (Deficit)	(\$6.79)
Reduce Expenses to Account for Vacant Positions	\$1.60
Reduce Workers Compensation Expense	\$0.20
Updated Adjusted Budget Surplus / (Deficit)	(\$4.99)

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2. Use one-time funds as revenue to close the budget deficit

City Council may choose to use one-time funds from fund balance or through the reduction of funding for pay-as-you-go capital projects to fund the budget deficit. This would result in a budget where ongoing expenses are greater than ongoing revenues. This strategy is rather painless initially but creates a structural imbalance in the budget that will need to be addressed in the future. While this strategy would satisfy the state code requirement of a balanced budget, it does not comply with City Council's financial policy that states: *"One-time revenues shall be used for one-time expenditures only"*.

3. Reduce spending, and consequently services, across the organization

The alternative to the use of one-time funds to close the budget gap is to reduce spending across departments and city operations. This strategy is the most painful initially, but it maintains a structurally balanced budget that keeps ongoing expenses and revenues in-line. The conventional wisdom with governments is that they can "cut the fat" or "eliminate wasteful spending." This may have been possible prior to the great recession but it is not today's reality for Lynchburg or most any other locality.

The City has done more with less almost every year going back to 2009/10 without making substantial sacrifices to the services that we offer to our residents. During that time our work has become more complicated and more regulated, all of which adds complexity and cost that we are not resourced to deal with. We are operating at razor thin margins across our operations to the point where service levels will necessarily be impacted by a reduction in resources.

If Council were to elect to reduce spending and services then we would look to do so through either targeted reductions or across the board cuts. Staff would bring multiple scenarios to Council to consider.

Next Steps

City staff can build a budget fulfilling the requests of the letter of lowering revenue without sacrificing services but cannot do it in alignment with City Council's financial policies. Alternatively, we can build a budget that reduces revenue, makes the investments requested in the letter, complies with Council financial policies but necessarily reduces expenses and services to residents. We look forward to continuing this conversation with City Council at our next work session on April 11.