



MEMORANDUM

TO: Honorable Mayor and Members of City Council
FROM: Timothy J. Baroody, City Manager
RE: Recommended Operating Budget for FY 2024
DATE: March 14, 2023

I am pleased to present the FY 2024 City Manager’s Recommended Operating Budget, which will begin on July 1, 2023. The Recommended Budget for FY 2024 is a balanced budget that represents a responsible spending plan for the upcoming fiscal year while looking towards the future. The budget development process considers City Council’s Vision and Priorities, national, state, and local economic outlooks, existing and future financial commitments, multi-year capital planning, and investing available resources in strategic priorities. The FY 2024 Recommended budget continues to prioritize public safety, our schools, our residents, businesses, and our workforce while meeting the needs of a growing community.

The FY 2024 Recommended Budget anticipates continued positive growth in revenues. The local and regional economy has remained resilient despite inflationary impacts and changes to the way we live post-pandemic. The budget reflects increased projections in consumption-related taxes including sales tax, meals tax, lodging tax, admissions tax, and business license tax. In addition to robust organic revenue growth this budget relies on a \$.02 real estate tax increase, moving from \$0.86 to \$0.88 per \$100 in valuation (a roughly 2.5% increase). This will generate approximately \$915,000 in new general fund revenue. There is also a recommended Lodging Tax fee increase from 6% to 8% generating an estimated additional \$560,000. The FY 2024 budget also includes some changes in Parks and Recreation fees and EMS fees.

The Recommended General Fund budget of \$120,552,445 is an increase of \$5,567,690, or 4.84% from the FY 2023 original General Fund appropriation of \$114,954,755. The General Fund is the primary fund for most City operations. This budget document also includes a variety of other funds including Transit, City Grants, and Stormwater Management. Please note the Water and Wastewater Funds will be presented to City Council at a later date.

It should be noted that the City is also moving aggressively in pursuit of state and federal grants. Over past several years the City has successfully been awarded more than \$40 million in

Commonwealth directed support for our wastewater treatment plant rebuild. This project will also qualify for as much as \$54 million in grants from Commonwealth of Virginia Water Quality Improvement Fund (WQIF) sources. The City has also assisted the School Board in their pursuit of Commonwealth of Virginia grant funding, which may offer millions of dollars in support of the newly planned middle school construction project. Lastly, the City of Fredericksburg just submitted a \$5 million request for federal Congressional delegation support of our wastewater treatment plant and a \$4 million request to support our public safety Computer Aided Dispatch (CAD) system.

The largest drivers for expenditures in the FY 2024 budget are: employee recruitment, retention and associated compensation, new debt service, and inflation. More on each of these drivers is highlighted below.

Compensation and Personnel

Employees are the most valuable resource in moving the City ahead successfully, while honoring City Council's priorities. The City continues, as most organizations throughout the nation, to be challenged with significant recruitment and retention challenges. This past week, for example, the City was advertising for more than 25 open positions. The FY 2024 budget designates an historic amount of funding, over \$3 million in new investments in compensation, to better enable recruitment and retention efforts moving forward. This budget recommends that compensation for employees increase between 5% and 10% - depending on various factor, with the average being 7.14%.

The City Council supported this multi-phased study, which led to the retention of human resources consultant *Bolton* in the current fiscal year. This review validated the comparisons with the market which supported the recommended adjustments. The budget as proposed includes an expenditure line item of \$900,000 that is in the general fund that has not yet been distributed to the departmental line items that includes sufficient funding to make the recommended adjustments. Most of this amount will be allocated before the adopted budget is approved.

The additional recommendations called for moving the entire salary scale upward by 5.1%, encouraged movement to the midpoint of grades for tenured employees, and urged better recognition of length of service (reducing some compression pressures). Even after the above moves a small portion of job classes remains less competitive vs. the market. To address this issue we recommend using the available funding in the amount of \$250,000 from the \$900,000 amount set aside in the general fund to make these adjustments. The study also affirmed the City's benefits are generally at market, and offered multiple recommendations for the City's compensation policies.

The City's departments, officers, and partner agencies strive to meet growing and ongoing service and maintenance needs. Although the City Manager's Office always reduces the departments' requested amounts prior to forming a final recommended budget, the total

requested General Fund budget for FY 2024 was over \$127 million, which suggests the magnitude of growth in demand for City services and infrastructure. There were 23 positions requested in the General Fund by Departments. The Recommended Budget does include five new (and one conversion from part time to full time) General Fund positions, as well as 7 positions in other funds. -The positions included in the recommended budget are listed below:

<u>Department</u>	<u>Position</u>
<u>GENERAL FUND</u>	
Community Planning/Building	Building Inspector II (1/2 year funding)
Fire	Battalion Chief/Training & Special Operations
IT	Admin Support Specialist IV (convert PT to FT)
Parks and Recreation	Maintenance Superintendent (1/2 year funding)
Police	Police Officer (1/2 year funding)
Police	Deputy Police Chief
<u>ALL OTHER FUNDS</u>	
Social Services	Family Services Specialist (convert PT to FT)
Social Services	Human Services Aide II
Social Services	Family Services Specialist
Transit	Mechanic
Transit	Dispatcher
Transit	Customer Service Specialist (convert PT to FT)
Transit	Admin Support Specialist II

Major Capital Projects – Debt Service

The FY 2024 Recommended Budget advances several major capital projects, including the Wastewater Treatment Plant rebuild/renovation, new middle school, new fire station design and stormwater projects. These projects include funding from existing cash balances, grants, funding through the American Rescue Plan Act, and debt issuance.

The FY 2024 Recommended Budget includes the full year debt service payments for General Government projects. The City issued this debt on December 7, 2022 with a favorable interest rate of 3.839%. This rate was less than projected and allowed the City to save \$5.35 million dollars over the life of the loan from what was originally presented in September 2022. The FY 2023 budget included a budgeted amount for half of a year debt service payments. Due to the timing of the debt issuance the City will not be using all of those funds according to the payment schedule. The City has placed those funds in the Debt Service Fund as a reserve and plans on

utilizing those funds to help offset the debt payments in both FY 2024 and FY 2025. The amount is approximately \$518,000 to be used in each fiscal year.

Inflation and the Economy

The City is continuing to see inflation impact the goods and services we purchase. This in turn means we are also seeing larger revenue collections due to the increased cost consumers are paying. While inflation growth has slowed, the Federal Reserve believes it will need to continue to raise interest rates in 2023 to meet its target rate. Once the target is met, economists anticipate the Federal Reserve will hold rates, for an unspecified period, to prevent a rebound. Consumers are expected to see the costs of goods normalize but not see significant decreases. There is an expectation by most economists that there will be continued inflationary pressures through FY 2025. While it is certain we are in an “uncertain” time, City Management and staff have been and will continue monitoring economic outlooks along with the impacts it has to the City and our region.

The City was extremely proactive about its response to the pandemic in the last couple fiscal years and we will continue those sound approaches as we look towards the future and the unknowns. Bond rating agencies continue to acknowledge Council’s strong financial management practices and during FY 2023 affirmed the City’s ratings of Aa2 (Aaa1 enhanced) by Moody’s, AA+ by Fitch, and AA+ by Standard and Poor which allowed the City to issue debt at an extremely favorable rate. These ratings are just one level below the highest grade of AAA, which less than 5% of localities nationwide achieve, and are consistent with the City of Fredericksburg’s ratings over the past decade. Moody’s specifically noted “fund balance and liquidity are strong, supported by management’s conservative budgeting and adherence to formal policies.” Fitch notes: “General fund reserves are consistently maintained above the city’s conservative fund balance policy and provide exceptional gap closing capacity.” Lastly, S&P states: “Fredericksburg demonstrated financial resilience through the pandemic as a result of its economic stability and management practices, which continue to support the rating.”

This favorable review is in part due to the actions taken by City Council to ensure the City of Fredericksburg is making fiscally responsible decisions and plans for the future.

We have challenges ahead, and several costly generational projects are underway. The City of Fredericksburg though today is home to a resilient and growing economy, one that is re-emerging from the uncertainty and disruption of the global pandemic, and now challenged by inflation. Through it all the City’s taxable real estate values have grown over \$1 billion since 2016 and are now approaching a total of \$5 billion – just one measure of fiscal growth. We remain an enviable visitor destination, and an attractive home to a growing and diverse mix of resident and business populations.

City Council began more strategic preparations for the future in 2016 as they crafted a *2036 Vision for Fredericksburg*, and have stayed the course. This Vision has been advanced by the setting of community *Priorities*, which are tracked and reported quarterly. Now in Phase Four of

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this work, staff is focused on the critical work Council has directed and is working with community stakeholders in pushing resources and attention to what matters most. As I have stated, the City Vision (and *Desired Future States*, and *Priorities*) better present clarity of purpose for the City management team and our great workforce. Please be assured that these *Priorities*, and many community needs, are intricately woven into this FY 2024 budget recommendation.

In closing, the recommended Budget is the result of many hours of hard work on the part of our departments, Constitutional Officers, local and regional partners, and many others. I would especially like to thank our Budget Analyst, our Finance Department, and both Assistant City Managers for their tireless efforts in bringing the recommended budget and the capital improvements plan together.

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