

May 29, 2020

Honorable Mayor Weaver and Board of Commissioners:

Submitted is Hillsborough's FY21 Annual Budget Workbook. The budget is prepared in accordance with the North Carolina Local Government and Budget Fiscal Control Act. As this proposed document is transmitted from the town manager to the Board of Commissioners, it now becomes the governing body's budget to review, question, debate, adapt and ultimately adopt. It is expected that changes will be made to the proposed budget as new information becomes available and alternatives are considered. Town staff is ready to provide whatever information the board deems necessary to make well-informed decisions on the budget and financial plan. Therefore, the mayor, Board of Commissioners, advisory boards and the community are encouraged to share their views regarding what should be funded or modified because this is ultimately your budget!

Budget workshops and ultimate adoption have been delayed several weeks to provide additional preparation time due to the challenges and uncertainty created by the COVID-19 pandemic. Delaying budget adoption from June 8 until June 22 or June 29 allows more time to obtain updated financial information, review, and adjust if needed. This additional information on key revenue sources and expenses will help paint a slightly clearer picture of how the current fiscal year is looking and the impacts on FY21.

In previous years the budget message included detailed summaries on each of the funds. This year the budget message is relatively short and focuses on the overall approach to developing the document, a few highlights, and some thoughts about recovery after emerging from COVID-19. The fund summaries are separate, and follow immediately after the budget message, and contain much of the information that has traditionally been seen in the longer message. Budget Director Emily Bradford coordinated the preparation of the General Fund and its associated summary. Assistant to the Town Manager/Deputy Budget Director Jen Della Valle did the same for the Water and Sewer Fund and the Stormwater Fund. Hopefully this new division of information makes it easier to get an overview before delving into details of individual departments and divisions, including their unfunded requests.

### **Approach to Developing the FY21 Budget**

For quite a few years the town's approach to building its budget and multi-year financial plan has been: 1) take care of what we've got, 2) invest for the future, and 3) minimize rate impacts on the community. COVID-19 is a health and economic crisis that needs no further explanation as everyone is acutely aware of its impacts. It's further complicated due to the difficulty in forecasting the length and severity of the financial impacts on global, national, and local economies, especially if there is a second or third wave of infections.

Revenue assumptions are critical as they are the primary factor in determining expenditure limits for the budget. Assumptions from local governments across North Carolina vary wildly with far greater ranges than I've ever seen in my 33-year career. There are no common baselines when it comes to projecting key revenue sources, such as property tax collection rates, sales taxes, Powell Bill (state gas tax), food and beverage, accommodations tax, water and sewer revenues, and many others.

This is the first budget presented to Hillsborough's town board in the last 23 years that is not in a multi-year format. Hillsborough is one of the only local governments in the state that uses a multi-year format. Currently, it's difficult to accurately project for three months, much less three years. To minimize wasted time and focus everyone's attention on the most pressing issues, this document is in a traditional one-year format. Hopefully the situation will stabilize going into next year's budget process and we can resume with the multi-year format that's been so successful.

Due to all the current uncertainty, the following approaches have been used in developing the FY21 proposed budget: 1) simplify and prioritize, 2) increase options, and 3) prepare for more tight budgets ahead.

1. Simplify and prioritize by focusing on the basics: core service delivery, asset maintenance, and retaining employees since skill, experience, and know how are a service organization's most important resource. Most everything else will need to wait until the situation stabilizes, then financial condition and priorities can be reassessed.

2. Increase options to have the financial flexibility to deal with the unexpected issues that will arise, especially if it gets worse in FY21 and continues into FY22 or beyond. Increasing options is being done through conservative projections on the revenue side and trimming expenses to protect the town's financial reserves. Many requests, even those that have been planned for some time have been cut, delayed, or reduced. Most vacant positions are being frozen. Making tough decisions today gives us more options to weather unexpected challenges, especially if it's a prolonged event. Now is the easiest time to do this. Underestimating potential financial impacts creates significant risks for the organization and its ability to serve our community. Being overly optimistic with revenue estimates means potentially having to make significant mid-year cuts - this narrows options and unnecessarily makes the situation more complicated. If things turn out to be better than projected, then it's a relatively easy adjustment to add unfunded items back into the budget.
3. Prepare for more tight budgets ahead. While everyone hopes the recovery will be quick and robust it's important to remember that during recessions governments are often the last to feel the impact, compared to businesses, but also last to recover. After emerging from the recession there is usually a backlog of deferred vehicle and equipment replacements, and other maintenance projects to address before high priority projects can be funded, thus further extending the length of the recovery.

## Highlights

- ✓ No rate increases. Property tax and water, sewer, and stormwater rates all remain unchanged for FY21.
- ✓ Employees: 1) no new positions added, 2) most vacant positions from FY20 remain frozen in FY21, 3) some FY20 positions have been eliminated – purchasing manager, accounts payable technician, part-time water plant operator, and billing & collection supervisor, 4) the temporary budget technician position ends in October, and 5) no merit raises in FY21.
- ✓ Major General Fund expenses
  - *Valley Forge Road repair (\$475,000)*. This section of road is relying on temporary repairs due to the washout that took out about half of the road in early 2019 due to high creek levels during a storm. Street re-paving has been put on hold in FY20 and FY21, and a contribution from the Stormwater Fund has been made to help pay for this high priority repair.
  - *Replace Residential Garbage Truck (\$310,000)*. This may be the most important and heavily used piece of town equipment. When the 1-arm trucks go down, an older rear-loading unit is pressed into operation that requires three employees instead of one to operate. This is the only major equipment purchase in FY21.
  - *Comprehensive plan (\$75,000)*. This project was initially intended to already be in progress but is funded for FY21. The plan will update the Vision 2020 document and include other planning components such as climate, resiliency, development, transportation, and others. Developing this plan includes significant community engagement.
- ✓ Major Water/Sewer Fund Expenses
  - *West Fork Reservoir expansion*. The Series 2020 revenue bonds were sold earlier this year to complete the last portion of this project. Due to COVID-19, construction to raise the road and bridge have been delayed about six months. The full impact of annual debt service on the fund is now occurring, increasing almost \$400,000 for FY21. The annual debt for the project is now \$840,550.
  - *Wastewater Collection*. Evaluation of the system's condition and capacity allows the utilities staff to prioritize the most important needs. This should be completed by the fall. Funds are included to start design on replacing the River Pump Station along with associated parts of the collection system. Funds are included to address other problem areas, such as "inflow & infiltration," line capacity, pump stations, etc.
  - *Capital projects* – several are funded in the budget with a focus on ensuring adequate service to existing and new customers and the Economic Development District (EDD) south of I-40 and Old NC86. Making sure the EDD has adequate water and sewer service availability increases the likelihood this valuable property will be developed and add to the town's commercial tax base. There has been regular interest in this property over the past few years.
- ✓ Deficits, the use of savings, and other non-recurring revenue sources to balance the budgets. Even with minimizing capital expenses, no new positions, position freezes, no employee raises, and other cuts, the FY21 General and Water/Sewer Funds both have deficits due to anticipated revenue losses at \$455,000 and \$461,000 respectfully. This includes the use of one-time funds in the Water/Sewer fund to pay for some projects and debt service.

System Development Fees (SDF), formerly called Capital Facilities Fees, are being used to fund a portion of debt service on the reservoir. While perfectly legal and often done by systems, it's preferable and financially prudent to use these funds to either completely pay for a project or portion of to limit the amount of required debt. These types of uses allow SDF's

to reduce pressure on the operating funds required to balance future budgets, thereby reducing pressure on rates. Several projects are being funded with SDF's for this exact type of use. Using SDF's to supplement recurring needs is risky and not a good long-term strategy. In the short term, in limited amounts during a crisis such as COVID-19, using some of these funds serves as a bridge to get through the crisis is appropriate.

### **Unfunded Requests**

There are millions of dollars in unfunded request listed in the budget by department. If the financial situation turns out to be much better than expected a review of these requests can take place to identify what items may be moved back into the FY21 budget. This is unlikely to happen anytime sooner than mid-March of 2021 since that allows review of the audit in the fall to get an accurate assessment of FY20, as well as a mid-year review of key revenues and expenditures for FY21.

### **Updated Strategy Map & Strategic Planning**

The town's balanced scorecard and strategy map have served the town well for 12 years – this was a long run for any strategic planning format. A change was explored to improve organizational focus, prioritize, and better lead the town in managing challenges posed by pressures from growth, transportation, development, climate change, asset maintenance, and providing daily services. Progress was made on the new strategic plan and the framework was approved by the town board during the retreat. Development of the action plans for each of the five strategic goals was delayed due to the COVID-19 response. The new framework is included in this document and will continue to evolve as time permits. While the balanced scorecard is going away, performance measures will continue to be a key part of Hillsborough's evaluation, decision making, and annual reports.

### **After the Crisis: Reassess Priorities After COVID-19**

Lessons learned during this event, along with climate change, should significantly change organizational priorities in terms of previously planned capital projects, staffing, service levels, community needs/wants, financial policies, development patterns, focus on sustainability and resiliency, etc. Traditional ways of working, delivering services, expanding and designing facilities may now be outdated. If our priorities and ways we deliver service don't evolve then a great opportunity will have been missed to learn from these experiences.

### **Constraints Drive Innovation**

This is true in the worlds of business, science, medicine, government, and many others. Approximately half of today's Fortune 500 companies were founded in either a recession or the Great Depression. The timing of the town's comprehensive plan, funded in the FY21 budget, may be an excellent opportunity to start this process. In addition, from a budgeting perspective, the town may want to incorporate Zero-Based Budgeting principles and other concepts to aid in reevaluating what, how, and when services are delivered. There are certainly aspects of what we are doing today that can be redesigned, refined, reorganized, reduced, or eliminated to pay for higher priority needs.

### **Moving Forward Towards Budget Adoption**

Thanks to all town employees, department and division heads, and the budget team for their extra work in preparing this year's document. Departments worked with budget and finance staff to make extra rounds of reviews to update FY20 and FY21 projections. This was critical in gaining a clearer picture of how things were looking heading into FY21. While I'm not confident about what the future is going to look like, I am confident in the excellent people we have on our town board, management team, and employees that will allow us to weather this situation.

Please do not hesitate to contact me, Budget Director Emily Bradford or Assistant to the Town Manager/Deputy Budget Director Jen Della Valle if you need additional information. Town staff will make every effort to respond quickly and objectively to help you develop a budget that you feel best addresses the needs of the community!

Sincerely,



Eric J. Peterson  
Town Manager