COMMONWEALTH OF VIRGINIA
County of Henrico

John A. Vithoulkas
County Manager

May 12, 2020

The Honorable Board of Supervisors
County of Henrico
Virginia

Honorable Members of the Board:

In the days following the introduction of the FY2021 Proposed Budget in March, the financial landscape has shifted dramatically. Our local economy has been stunted by the health crisis stemming from COVID-19 and the subsequent actions from our federal and state governments to flatten the curve. As many people sheltered in place and many businesses closed their doors, our consumer revenues have taken an inverted curve that mirrors that of the virus. Even still, our employees have continued to provide core services for our community – albeit in somewhat different ways – as we have continued to work our way through this new reality. The workforce has responded demonstrably; our frontline employees continue to provide services to our most vulnerable and nearly 1,800 employees have been teleworking daily during this period. In these times, we are intentional to make every decision with our residents and their needs in mind, especially as tens of thousands of them are now without work and unsure of what their futures hold.

The original budget proposal envisioned further progress in education, enhancements to our public safety capabilities, a coordinated response to the addiction crisis in our community and rewarding the hard-working public servants who make Henrico the great locality it is. While much of that progress must be paused as we weather this storm – those priorities remain intact. And, as we begin to rebuild, those initiatives will again come to the forefront, ready to be deployed as revenues allow.

With that as a backdrop, I am relieved to say that the FY2021 budget is rebalanced, within the available revenue projections. Most notably this plan reflects nearly $100 million in reductions from the original proposal, which was no small feat in the face of an immediate health and economic crisis. The approach to this revised budget is fairly straightforward – to provide the Board with a framework that will ensure our residents and businesses are supported, our workforce is protected, and that core service delivery is not impacted while providing as much flexibility to the Board as possible to adjust the strategies to meet those goals moving forward.

The Fiscal Impact of a Pandemic

The timing of this health crisis creates an issue not just for FY2021, but for the fourth quarter of FY2020 as well. Until March, the County was on pace to exceed revenue estimates by nearly $48 million. That outlook is substantially different today. While we will still meet the original revenue estimates, the differential is now less than half of the original projection. That is troubling because the county budgeted significant uses of one-time reserves for capital projects in FY20, the biggest component more than $26

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million of meals tax reserves for the J.R. Tucker High School and Highland Springs High School replacement projects.

That significant use of fund balance paired with declining revenues could, if left unchecked, amount to a reduction in the County's reserves of $60 million. Some use of fund balance was anticipated, but a reduction of this magnitude must be met with a response to minimize the impact. Knowing that, in March the County implemented a spending freeze, hiring freeze, and began evaluating what existing projects had balances that could be recouped to soften impact to the bottom line. With those combined efforts, the goal is to minimize the reduction in fund balance to something commensurate to the planned use for the high school projects noted above.

Those savings efforts are complicated by the fact that the County is having to spend substantial resources to combat the coronavirus for the benefit of our residents and our employees. Some of those added financial exposures have included the purchases of substantial quantities of personal protective equipment, additional cleaning and supplies, and testing kits to ensure access to testing for our workforce. The County even ran a program, Nourish Henrico, that provided meals to first responders at local restaurants, to support locally owned restaurants who were struggling to keep afloat.

Revised FY21 Revenue Estimates

FY21 General Fund Revenues					
Category	**FY20 Approved**	**FY21 Original**	**FY21 Revised**	**Original to Revised $ Change**	**Original to Revised % Change**
General Property Taxes	$487.3 M	$517.8 M	$499.1 M	($18.7 M)	(3.6%)
Other Local Taxes	$168.6 M	$173.9 M	$139.4 M	($34.5 M)	(19.8%)
Permits, Fees, and Licenses	$5.3 M	$5.5 M	$5.3 M	($0.2 M)	(3.7%)
Fines & Forfeitures	$2.1 M	$2.1 M	$2.1 M	($0.0 M)	(0.2%)
Use of Money & Property	$8.2 M	$9.3 M	$3.3 M	($6.0 M)	(64.6%)
Charges for Services	$4.1 M	$4.2 M	$3.8 M	($0.4 M)	(8.5%)
Miscellaneous Revenues	$11.2 M	$13.4 M	$8.1 M	($5.3 M)	(39.5%)
Total Local Revenues	$686.7 M	$726.2 M	$661.1 M	($65.0 M)	(9.0%)
State Aid for Schools	$278.5 M	$292.6 M	$261.3 M	($31.3 M)	(10.7%)
State Gasoline Tax	$47.0 M	$47.7 M	$47.0 M	($0.7 M)	(1.5%)
All Other State & Federal	$49.1 M	$49.2 M	$48.1 M	($1.1 M)	(2.2%)
Total State and Federal Revs.	$374.6 M	$389.1 M	$356.4 M	($33.2 M)	(8.5%)
Total General Fund Revs.	**$1,061.3 M**	**$1,115.7 M**	**$1,017.5 M**	**($98.2 M)**	**(8.8%)**
Transfers/Cash Reserves	($142.7 M)	($153.2 M)	($118.4 M)	$34.8 M	(22.7%)
TOTAL NET REVENUES	**$918.7 M**	**$962.5 M**	**$899.1 M**	**($63.4 M)**	**(6.6%)**

The revised FY2021 General Fund revenue estimates, as shown in the table above, total just over $1.0 billion and reflect bottom line reduction of nearly $44 million when compared to the FY20 budget, and a staggering reduction of almost $100 million from the original FY21 proposal in March. Overall, across the board declines in revenues are anticipated, with the greatest impact projected in consumer-driven lines such as sales, occupancy, and meals taxes. These consumer areas account for $37.6 million, or more than 38% of the revenue reductions. Some of these projected declines are breathtaking, but have recently been validated as March meals tax and occupancy collections are down 33% and 50%, respectively, compared to the prior month.

The revenues shown remain within the bounds of the existing tax structure, holding the real estate tax rate at 87 cents – a hallmark of Henrico's ability to provide the lowest residential tax burden of any large locality in the Commonwealth. Further, the exemption level for BPOL taxes will be increased to $500,000 of a business's gross receipts. This tax relief is even more critical in this recessionary environment, assisting our small businesses amid this downturn and ensuring they continue to thrive as we recover together. With this increase, approximately 15,000 or 78% of the applicable businesses will be exempt from BPOL taxes in Henrico County.

State and Federal revenues have been reduced $33.2 million in the updated proposal. Finance staff anticipates the Commonwealth putting forward additional reductions that have not yet been announced. As we watch what happens in the capitol, notable assumptions are missing from the Commonwealth's projections as it relates to sales taxes, even though the Secretary of Finance noted in March that sales taxes would be impacted. At the state level, there have also not been adjustments made to lottery proceeds, despite lottery sales being down $45 million or 28% in March. Our approach is to hedge against a worst-case scenario when it comes to outside funding, as demonstrated by our state revenue estimates that are considerably more conservative than what has been put forth by the state itself, to date. Further, this revised budget does not assume any resources from federal stimulus efforts as not enough details have been released to comfortably include them at this time – and knowing, that we cannot and will not spend one-time dollars on ongoing operating expenses.

With the cautionary approach to revenues that we have taken, it is my hope that we are adopting a plan that will represent the floor of this economic environment. If, and when, additional revenues materialize, this plan will be amended to account for them.

Strategic Approach to the Expense Side of the Plan

Balancing a budget with a nearly $100 million revenue decline in just over a month was no small undertaking. A careful, thoughtful, and strategic approach was deployed to do so. The first step – which arguably was the easiest and the hardest – was to remove all new initiatives from the original plan for FY2021. In addition, the County still had some cost increases that could not be avoided for items like changes in VRS and healthcare rates, staff for the Staples Mill Firehouse who were already brought on board, and three positions in the Commonwealth's Attorney's Office as those were approved by the Board of Supervisors in December. These increases total $13.3 million making the offsetting cuts, to accommodate those costs paired with the projected revenue loss, even deeper.

The Board of Supervisors and School Board met several times to strategize about the year ahead, and out of those discussions the collective boards provided input on their priorities which ultimately drove all other balancing decisions. Underscored by the need for substantial flexibility, those priorities include:

- Limiting the impact and financial burdens on our residents,
- Helping our small businesses survive during these difficult times,
- Protecting the workforce by maintaining jobs and avoiding pay reductions, and
- Ensuring continuity of service delivery for core services – namely, Education and Public Safety.

In order to balance the budget with these pillars intact, substantial cuts to operating and capital budgets were necessary. A minimum reduction of 5% to operating budgets for every department, including schools, was required. Additionally, certain departments were able to identify savings beyond that, resulting in some disproportionate reductions in certain lines like library materials and event funding in Recreation.

To further reduce the budget without impacting service levels, hundreds of vacant, non-public safety positions will be frozen for the duration of FY21 to achieve $5.7 million in savings. For HCPS, a total of

$4.5 million in savings will be realized through a similar strategy of holding non-instructional positions vacant and other personnel related adjustments. These strategies do mean that we will be asking our existing employees to continue to do more as we bridge the gap.

On April 14, we announced the longest budget public hearing in Henrico's history. We opened an email address, budgetfeedback@henrico.us, that will remain open for cost saving strategies and suggestions for the duration of FY21. That strategy has already proven productive as we have received hundreds of responses, many of which are bringing forward legitimate strategies for the county to explore. As a complement to that feedback mechanism, a team of more than 40 employees have volunteered to vet each suggestion that comes through and to work throughout the next year to craft additional cost savings strategies for the Board to consider. In fact, this revised plan includes one strategy that came directly from that public feedback, a voluntary retirement incentive program that is estimated to save $1.5 million in FY21.

Finally, the largest savings comes on the capital front. Nearly $23 million in cash-funded capital projects are being deferred from the original FY21 Capital Improvement Plan. Make no mistake, however, that once the economy rebounds, we will be poised to continue pushing these critical infrastructure projects forward.

One of the biggest changes as we move ahead will be the nearly constant budget touchpoints that are planned through a quarterly appropriation process. What you are adopting is a framework that provides a roadmap for how we will operate throughout the fiscal year. On July 1, the Board will appropriate only a quarter of the total budget - requiring staff to work diligently to remain within existing resources, to constantly evaluate programs and services, and to provide the Board the opportunity to reevaluate the plan every 90 days before making the next quarter appropriation.

We Will Emerge Stronger, Together

Without doubt, the revised FY2021 Budget is not the plan we had hoped for, but it is exactly the plan we need to navigate this turbulent environment. And, while our resources for the coming months remain limited, we will continue to deliver the core services our community relies on and remain mindful of the continued impacts this event will inevitably have on our residents.

This budget would not have come together without the many hours of hard work by staff. Henrico County employees are again asked to serve with significantly fewer resources, and their efforts will see us through this. I would like to thank you, our dedicated Board of Supervisors, for your input and guidance in this most important process. And I also extend my sincere gratitude to our strong Superintendent and School Board for working hand-in-hand with us during this extended budget process.

While our local economy has been devastated over the past two months, unlike anything we have ever seen, I know that our community is resilient and will rebound from this. It is in times like these where we can truly exemplify The Henrico Way and demonstrate our collective hearts for service. We will emerge from this event stronger, together.

Respectfully submitted,

John A. Vithoulkas
County Manager