

June 1, 2007

To the Board of Commissioners and Citizens of Rockingham County:

Enclosed is the County Manager's recommended annual budget for Fiscal Year 2007-08. The main portion of the recommended budget, the General Fund is \$91,069,078 which projects an increase of \$2,857,176 over the current year adopted budget. The budget seeks to continue implementation of the Board's primary program and capital objectives from the current year. Due to financial limitations, no new major initiatives are proposed in the upcoming year's budget. The budget, as presented, will require a three (3) cent ad valorem property tax increase. The County has not raised taxes to cover the General Fund operating budget in five years and projected revenue increases are simply too small to support even a very modest budget increase of 3.07 percent. (The board did raise taxes five cents in the current year, but this revenue was totally devoted to funding the five-year capital improvement plan).

Rockingham County's economy is in a structural transition that is likely to continue for several years. This situation means that the County, unless some major economic events occur, is likely to continue to see the loss of manufacturing jobs for the next several years and consequently will have very little growth in revenues to fund mandated and desired programs. We have had success recruiting new industry and helping existing businesses expand but we are still losing jobs and tax base faster than they can be replaced. The county's ad valorem tax base has been growing at a rate of 1 to 1 1/2 percent a year. This is far less than needed to sustain the programs and services that Rockingham County presently provides. Therefore, the County is faced with having to increase the property tax rate each year or reduce services. Probably some combination of both will be needed.

If the Board desires to remove the proposed three-cent tax increase from the recommended FY 2007-08 budget, then reductions in the number and scope of county programs needs to occur. Considerable work has already been done to identify mandated and discretionary services and their costs, but staff will need Board help to prioritize reductions. If the Board does choose to consider reductions in services, the Manager suggests that as much time as possible be allowed to evaluate impacts and to gain public comment. Due to long-term history and commitment to programs, it is probably wise to consider lesser priority programs targeted for possible reductions as a work activity in the county budget. This will allow time to fully evaluate the impact of the reductions.

Some reduction in the tax rate may be possible if the State provides Medicaid relief to counties in this Session of the General Assembly. It appears that Medicaid relief is possible this year, but counties will need to wait and see how much relief, if any, is granted. Hopefully, we will know before a decision is required to implement the coming year's budget (June 30, 2007).

An overview of the projected FY 2007-08 budget revenues, program initiatives and expenditures is provided below.

Revenue Overview

A summary of the projected General Fund revenues is shown in Exhibit A. The County's primary sources of unrestricted revenue used to balance the budget are the ad valorem tax, the sales tax and investment earnings. As previously mentioned, the ad valorem tax base has been growing at a very slow rate for the past several years (see Exhibit L for more detail). The tax base is only projected to grow 1.1 percent or an additional \$397,129 in tax revenue with no tax rate increase. The growth in ad valorem property taxes with the three-cent tax increase is 5.69%.

The growth in the unrestricted portions of Article 39, 40, and 42 taxes is projected to be 3 percent, or about \$280,260. However, this growth is tempered by the loss of approximately \$315,000 in

Article 44 tax and hold-harmless funding from the State of North Carolina. When the State repealed the local manufacturing and intangible taxes several years ago, it provided counties with a reimbursement to cover this lost revenue. Four years ago the State also eliminated this reimbursement and allowed counties to implement a half-cent sales tax to cover this lost revenue. Rockingham County was one of 14 counties where the new sales tax did not fully cover the lost reimbursement. The State promised to hold these counties harmless for the difference each year until the sales tax grew enough to completely cover the lost reimbursement revenue. Unfortunately the State estimate for growth in the sales tax revenue has been higher than the actual revenue generated. This discrepancy has forced us to reduce the budget for these two revenues by approximately \$315,000. We have pointed out this problem and have asked the State to correct the funding but so far have not received any adjustment. So the next year's unrestricted net sales tax is projected to be \$34,740 less than the current year.

The sales tax increase shown on Exhibit B is not actual growth in sales tax but a change in budgeting approach to fully budget expected sales tax revenue. The Fund Balance appropriation is also being reduced to reflect the increased sales tax projections. This change is intended to provide more accurate budget figures.

We are also recommending that we change the way the County budgets restricted sales tax dedicated to school capital outlay for the coming year. In the past we have budgeted most of the projected restricted sales tax going into a reserve for future school capital needs but retained some to help with the General Fund appropriation to the Schools for Category I, II and III capital needs. This year we are recommending that we budget all of the restricted sales tax going to the Reserve Fund but that the Schools address their Category I needs from that fund (subject to Board approval) and we fund Category II and III at \$500,000 from the General Fund. This change will allow the County to reallocate \$352,000 (previously used to fund school capital outlay) of County General Fund revenue to fund additional School operating budget needs. This change will effectively increase School System current expense funding in the proposed budget from the preliminary \$200,000 to \$552,000. The only down side to this change is less money being placed in reserve for future school major capital outlay needs. However, this change allows more money to be provided to the School System for current expense and capital outlay while holding the tax increase down.

Investment earnings are projected to increase by approximately \$200,000 in the coming year due to better interest rates. The growth in investment earnings is dependent on the County maintaining and growing the Fund Balance. This is becoming increasingly more difficult given our economy.

Another source of revenue used to balance the budget is Fund Balance appropriation. Historically we have learned that with each annual budget there are always higher than expected revenues and lower than expected expenditures at the end of the year. During past years we have felt comfortable budgeting \$4.2 million in Fund Balance knowing that the anticipated revenue and expenditure surplus would cover this appropriation. This year we are dropping this figure to \$3.3 million due to tightening of the budget as we continue to cut the margins of operation in all departments. Six hundred thousand of this reduction is due to changing the way we budget sales tax to more accurately reflect actual receipts.

We are budgeting an additional \$701,548 in Fund Balance to cover the second year funding commitment to our Mental Health Program. The County has pledged \$2.5 million in transition money over a three-year period to help our Mental Health Program become self-sustaining. This current year the County budgeted \$1.3 million in Fund Balance for Mental Health. It is our and Mental Health's hope not to spend all of this appropriation and to be able to place some of this money in reserve for future Mental Health needs. Mental Health has asked that \$400,000 of the unspent appropriation from the current year be carried over in the FY 2007-08 Mental Health budget. This is in addition to the \$701,548. If Mental Health, for some reason, does spend most

of its current year fund balance appropriation, then their FY 2007-08 budget will need to be reduced accordingly to compensate for this reduced availability of funds.

Major Budget Initiatives and Expenditure Overview

The major budget initiatives of the County for the coming year are a continuation of the current year priorities. The primary work program and funding priorities of the County for the coming year are:

1. Construction of a new Courthouse, Jail, Sheriff's Office, Emergency Operations Center and Communications Tower on the new Justice Center Campus in Wentworth,
2. Construction of an Emergency Medical Base in western Rockingham County,
3. Development of an 800 megahertz Emergency Radio Communication System,
4. Continued efforts to improve efficiency and effectiveness through Performance Based Budgeting and other measures,
5. Work with the School System and Community College to improve education and work force skills,
6. Development of an Equestrian Center,
7. Work with the Partnership for Economic and Tourism Development, the Business Technology Center, our municipalities and State agencies to promote economic development in the county, and
8. Work with the State, the Alamance-Caswell-Rockingham LME and our County Mental Health Agency to promote adequate mental health, developmental disabilities and substance abuse services and treatment for our citizens.

Public Safety Capital Projects. Priorities one through three are projects that have been funded in the County's five-year Capital Improvement Plan with the five-cent tax enacted this current year. Moseley Architects has been hired to work with departments, Courthouse agencies, and a Judicial Center Coordinating Committee to design the Courthouse, Jail, Sheriff's Office and Emergency Operations Center (EOC). The Sheriff's Office was not part of the original plan but could be included in the original budget price by holding planned space and costs down. The County will seek financing for these buildings in early 2008, but debt service payments will not start until FY 2008-09. The Emergency Operation Center is being fast-tracked with occupancy planned for fall of 2007. The other buildings should be completed in 2010. The new Wentworth communications tower should be ready for operation in time for the opening of the new EOC.

The County is also working with the State of North Carolina to build three Viper emergency communication towers, one in Reidsville, one in Eden and one in western Rockingham. These towers, along with the Wentworth Tower, will provide the backbone for a new emergency 800 megahertz radio communication system that is interoperable with the State, neighboring counties and county municipalities. Funding for this system has been secured through grants and the five-cent CIP tax.

Efficiency and Effectiveness. The County will continue its efforts to improve the efficiency and effectiveness of county departments through the implementation of Performance Based Budgeting. This current year nine departments have participated in this effort and nine more are expected to join this year. Basically, this effort is intended to provide budgeting and personnel flexibility and rewards as an incentive for departments finding ways to lower costs. Professors from the UNC School of Government and the County's Budget and Performance Manager work with departments to develop mission statements, overall goals and objectives and measurable outcomes for success. With this method, departments, employees and the public can clearly see what is expected and whether or not departments are achieving desired outcomes. We are also seeking to implement increased training throughout the County and greater use of technology.

Finally, the County must prioritize its limited resources and be strategic in the provision of services and funding. The Manager is recommending that the County either undertake Budgeting for Outcomes or develop a Strategic Plan to help the County prioritize how to best utilize limited resources and provide priority services. Eighty thousand dollars was budgeted in the current year to fund Budgeting for Outcomes but was not spent. If the Board decides to move forward with this budgeting prioritization approach in the coming year, then these funds should be rolled over from the current year. Development of a Strategic Plan will cost approximately \$40,000 and can be funded from this same money.

Education. The County is seeking ways to continue to partner with the Rockingham County School System and the Rockingham Community College to improve education and work force skills. Representatives from the County, School System, Community College and Partnership for Economic and Tourism Development have begun meeting on a regular basis to develop closer working relationships and improve communication. As this group meets it may be desirable to expand the group to include others involved in promoting education and work force development in the County. The proposed change in budgeting of restricted sales tax revenue is an effort to provide the School System with more funding in the very difficult financial situation facing the County.

The Board has discussed maintaining the informal formula used by the County to fund school current expense for the past several years. Under this formula, the County calculates the growth in the property tax and sales tax and allocates 31.5 percent of the total increase to school current expense. The question came up in a budget workshop about a general tax increase to support the General Fund. The Board agreed that any across-the-board increase should maintain this percentage. As previously mentioned, the Manager and Assistant Manager/Finance Director are recommending a reallocation of General Fund dollars from school capital to current expense and greater use of restricted sales tax dollars to cover needed capital items. This move provides more current expense funding to Schools but avoids adding a fourth cent to the tax increase. The Board may want to discuss this point to make sure that it agrees with this recommendation.

Equestrian Center. The County has purchased 157 acres of land on US 29 (future I-785) and Barnes Street in Reidsville for a new regional equestrian center. The County has also conducted a feasibility study and formed a regional advisory committee to provide advice and support for this project. A 501C(3) corporation has also been formed to better enable private foundations and grantors to make contributions. The County is actively seeking funding to build the center and hopes to have sufficient funding to begin design and construction on this \$12 to \$15 million facility later this year. Among other benefits, the center is expected to generate approximately \$60 million in annual economic benefit and create hundreds of jobs throughout the County.

Economic Development. The Partnership for Economic and Tourism Development has been recently reorganized and has undertaken a fund raising campaign to complement public funding. A new President has been hired and an aggressive work program established for the coming year. The four identified focuses of economic development are recruitment, retention/expansion, tourism and small business development. The Business Technology Center has now been in operation for approximately one year and is refining its mission. One question that will need to be addressed in the coming year is, "How close a relationship should the Partnership and Business Technology Center have?" It is now estimated that approximately 85 percent of all new jobs created will be in small business. It is also estimated that 75 percent of all jobs will be in or require use of technology. It will be important for the County and Partnership to study the availability of broadband and wireless communication in the County in the coming year and possible development of a Technology Plan.

Mental Health. The State of North Carolina has made several major reforms in the delivery of mental health services in the State. Rockingham County and other counties are concerned that this mental health reform effort will fail and our citizens will be hurt in the process because needed services will not be available in appropriate settings. For this reason, the County decided

last year to form a new County Mental Health Agency once the old Mental Health Area Authority was required by the State to dissolve. Rockingham County is the only county in the State that has taken this action. The County has committed \$2.5 million in transition money to help the County agency become self-sufficient.

We will continue to work closely with our County agency, the Alamance-Caswell-Rockingham Local Management Entity charged with administering State and Federal Mental Health programs and funding, and the State of North Carolina. This year the County is budgeting \$701,548 in Fund Balance funds plus \$400,000 in carry-over funds to supplement the agency's operation. An additional \$300,000 is being budgeted as our Mental Health maintenance-of-effort funds with the LME.

Salaries and Benefits. The Manager is proposing a 3 percent merit adjustment on the anniversary date of all employees with satisfactory performance. This adjustment will be a net cost to the County of \$500,000.

We have determined through a number of sources that our salary and benefits package is not as competitive as some of our neighboring counties and is causing problems retaining and recruiting quality employees. Therefore, the Manager is recommending starting a 401-K deferred compensation program for county employees. The initial county contribution proposed is one percent which will cost \$190,000. This benefit is proposed to start in October. The County has been attempting to maintain a competitive salary plan by studying one-third of the total positions each year and making necessary adjustments. A necessary component of this adjustment is to move employees along when their grade changes. For the past three years the County provided a 2 percent adjustment for each grade change. This current year the County did not provide any grade change adjustment and morale suffered as a result. The Manager is proposing that a 1.25 percent adjustment be made for each pay plan grade adjustment. The cost to do the one third pay plan adjustment for the coming year will be \$165,000. The Manager also recommends going back and providing a 1.25 percent adjustment for employees who had a grade change for the one-third positions studied in the current year. This cost is an additional \$85,000.

No increase in health insurance costs for employees is projected. We implemented a 10 percent increase in the current year plus implemented consumer driven health care which has helped to control costs. Our retiree health insurance costs are projected to increase by 10 percent or \$100,000 primarily due to a large number of persons retiring.

Personnel Requests. Departments understand our very tight budget position and have not asked for new employees unless they are badly needed or have offsetting revenues. Eleven new positions were requested with five being recommended. All but one of these positions has offsetting revenues. A summary of these requests and recommendations are shown on Exhibit E.

Utilities and Rate Schedules. Very little change is proposed in the utility/enterprise funds or in the rate schedules for services except that building inspection fees are proposed to be increased from 70 percent of market to 90 percent of market. The Board may want to discuss taking these fees to 100 percent of market.

Medicaid Relief. Rockingham County and The North Carolina Association of County Commissioners have identified Medicaid relief as their top legislative priority. We have been lobbying the State for relief for years. North Carolina is the only State in the Nation that still requires counties to pay a portion of this cost even though counties have absolutely no control over the program or associated costs. This mandated program now costs Rockingham County an equivalent of 11 cents on the tax rate.

The State estimate of our Medicaid cost for the coming year is \$6.275 million. We are only budgeting \$5.725 million due to our actual costs being considerably less than the State

projections. We estimate that our current year cost will be \$5.6 million which is around \$500,000 less than the State estimate. We have not been able to gain a clear understanding why our costs are so much under State estimates, but do not feel that we will reach the State estimate. However, if for some reason, these costs do increase to the State estimates then we will have a big budget hole to fill.

The House budget proposal provides some Medicaid budget relief while the Senate budget contains no relief. However, a separate Medicaid relief proposal has been developed in the Senate outside of the budget. Therefore, some Medicaid relief may come in this Session of the General Assembly. The Board may want to delay adoption of the budget until late June to see if any relief is forthcoming.

Budget Summary.

It is reasonable to consider a small tax increase every couple of years to offset inflation and the four to eight year property revaluation cycle where property valuations do not change. It is even more compelling when the economy is down and there is little growth. It has been five years since the County increased taxes to support the General Fund expenses of the budget.

Rockingham County has traditionally offered its citizens a fairly high level of services. Given our reduced capacity to fund services and the expectation that this situation will continue for some time it is also reasonable to consider reductions in services. County departments have tightened their operations for the past several years and are working to make improvements in efficiency through Performance Based Budgeting. The Budget and Performance Manager has provided a listing of mandated and discretionary services with costs and associated personnel for your consideration. We stand ready to help you in your deliberations if you desire to consider reductions in services.

I would note that the Board has considered using a consultant to undertake Budgeting for Outcomes. This budgeting process would help the County prioritize its services. However, I do not recommend that the County undertake this involved process unless the Board is strongly committed to making reductions. The process is both painful and costly. The bottom line is that no one wants to pay more taxes but they also do not want to have services reduced either. Budgeting for Outcomes can definitely help justify reductions.

I greatly appreciate the cooperation from county departments in putting together reasonable, responsive budget requests. I am especially appreciative of the strong help that Mike Apple, Kelly Burton and Adam Lindsay have provided to help develop the recommended Rockingham County annual budget for FY 2007-08. We are ready to help you in your deliberations on this budget proposal.

Respectfully submitted,

Thomas B. Robinson