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April 5, 2006

The Honorable Members of the Board of Supervisors
County of Hanover County, Virginia

Dear Members of the Board:

I am pleased to present Hanover County's Adopted Fiscal Year 2007 Budget as well as the Five-Year Plans. We have worked closely with County departments, Constitutional Officers and the School Superintendent to develop a fiscal year 2007 financial plan that addresses our current challenges and seeks to maintain or improve County and School services for the five-year planning horizon. This budget and the related five-year financial plans are based on maintaining our current real property tax rate while reducing the personal property tax rate by seven cents in coordination with the conversion of the annual motor vehicle decal to a permanent motor vehicle decal. The personal property assessment method will be changed to offset the financial impact of not collecting the annual motor vehicle decal fee and the lower personal property tax rate accomplishes the "revenue-neutral" objective.

This document reflects an enormous amount of work, and while we recognize that a ~400 page document is necessary to describe the full spending plan, I will highlight what I see as the critical issues associated with the 2007 financial plan in this letter and the budget synopsis.

Financial and Economic Condition

The County continues to be in a strong financial position and this message was shared with our citizens in over 100 public presentations on the 2005 Bond Referendum. Voters overwhelmingly acknowledged the County's need for the projects and our ability to fund the bond referendum projects with an over 73% approval in each of the three referendum questions.

The financial and economic condition appears to be very strong as evidenced by strong State revenues being received, in both income taxes (6.0% increase) and sales taxes (11.6% increase). This is also reflective of the low State unemployment and high median adjusted gross incomes as compared to other states. As the State Car Tax Relief is now capped at \$950.0 million, State revenue growth can now be distributed to other areas. One fortunate area for Hanover is the State's investment in local public schools, for which the State plans to contribute \$6.6 billion, an increase State-wide of \$900 million. Another area for the County that recognizes this revenue capacity is in the proposed State Compensation

Board merit increases for constitutional offices. Finally, it is also hoped that a reinvestment of these additional State revenues can be directed to State transportation initiatives with some of these needed projects located right in Hanover.

The local economy continues to be very strong as evidenced by key indicators of low unemployment (2.2% March 2006), high median adjusted gross incomes (\$40,797), local sales tax growth (11.0% in FY06), median new home sale values (\$347,000) and commercial/industrial property growth (\$178.0 million higher tax base). The population growth rate of 1.9% in FY05 is a reflection of moderate residential growth and our six-year average is in-line with our Comprehensive Plan goal of 2.5%. The County also continues to maintain a strong fund balance in excess of 10% of its revenues, which meets our cash flow needs and provides for a contingency reserve for unanticipated expenditures. In addition, the County has specific reserves set aside for economic development incentives.

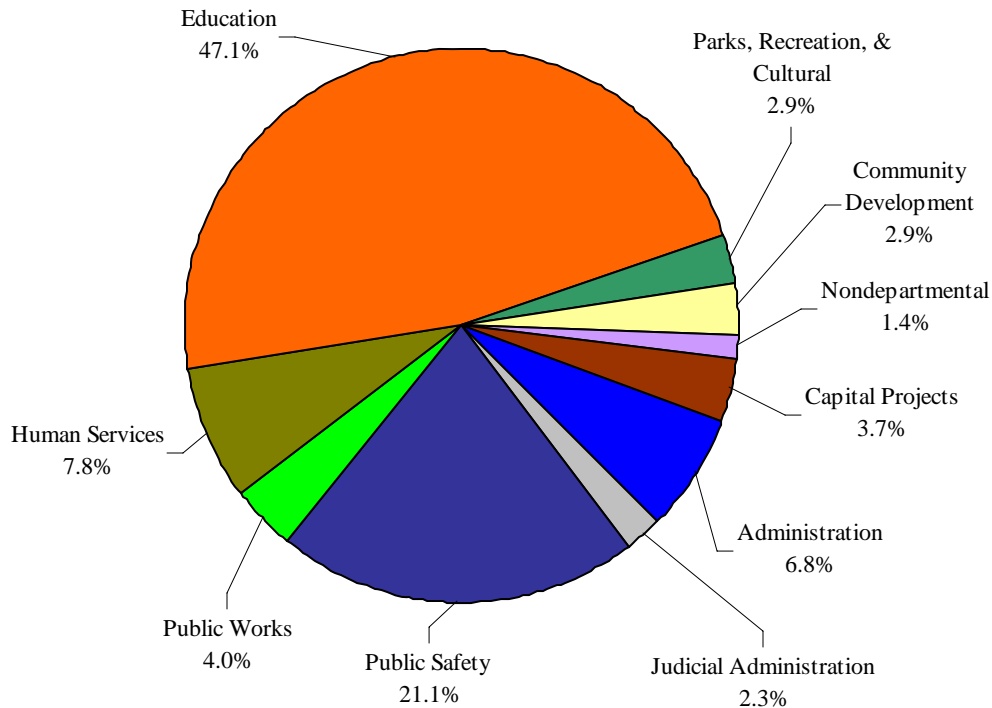
The County has had a very successful year in economic development with over \$78.0 million in new business investment with 39 businesses directly assisted in location or expansion plans. This has also contributed to the County's total employment increase by 800 workers, a 2.0% increase. Included in these total figures are the following examples:

- Newmarket IT, an asset recovery firm, will bring 100 new technician jobs to the County.
- International Truck Sales recently opened its new facility in Northlake and will bring over 100 new employees.
- Handleman Corporation, a music CD packaging and distribution company, at the Enterchange at Northlake.
- Pratt Industries, a manufacturer of cardboard boxes, in Ashland.
- Sound Structures, a truss, floor system and wall panel manufacturing company, who purchased the former Circuit City warehouse in Doswell.
- SpecOps, Inc, a defense contractor that makes portable command centers.
- Bondioli and Pavelsi, Inc., an Italian manufacturer of agricultural equipment gearboxes and drives for agricultural equipment.

Budget Summary

We traditionally measure changes in our budget by comparing the total budget and the total General Fund budget. The total General Fund budget increase reflects increased service costs and citizen demands for new services. The total budget also includes impacts of any capital expenditures, which may vary from year to year depending on the construction of new facilities such as a new school.

- The budget for all funds is \$408.2 million, reflecting a 24.6% increase. Approximately 59% of this increase, or \$47.5 million, is due to an increase in the County and School capital budgets, primarily related to the bond referendum projects approved by County voters in November 2005. The increase reflects the overall increase in operating budgets of 10.5%.
- Total General Fund budget is \$182.3 million, an 8.9% increase. This increase provides for a 4.0% merit pay increase for County and School employees, the personnel initiatives adopted in the previous Five-Year Financial Plan (April 13, 2005) and provides funding for fuel-related cost increases. We continue to spend most of our revenues on Education (47.1%), Public Safety (21.1%) and Human Services (7.8%). These three services account for 76.0% of the total General Fund budget. The following graph illustrates the uses of the General Fund expenditures by function:



General Fund Revenues

Our Five-Year Financial Plan anticipated ongoing revenues for the upcoming year to increase at a conservative 6.2% while current year projections show that we will increase 9.0%. While there are many dynamics to increases or decreases in a budget, the following revenues have been highlighted:

- **Real Property (\$9.4 million increase):** This revenue source is up 12.7% due to continued strong growth in real property values. This sustainable tax base of both residential and commercial properties, including new construction growth, reflects the high quality of life in the County.
- **Public Service Corporation Taxes (\$305,000 decrease):** While the tax base in this category represents 61 businesses, overall net investment has not increased. The 6-cent increase in the generating equipment tax rate will maintain the revenue-neutral goal agreed-upon by the primary business impacted by this tax in 2002.
- **Personal Property (\$4.5 million increase including State reimbursement):** Base personal property growth remains steady with a projected growth rate of 6.0%. However, with the modifications in the State’s participation in car tax relief frozen at a fixed \$15.0 million annually and not the 70% relief plan that had existed in 2005, the County taxpayer will be seeing less and less State car tax relief on their bills for the foreseeable future. In addition, with the elimination of the annual decal fee under the “revenue-neutral” proposals presented to the Board, the County’s personal property tax rate will be reduced from \$3.64 to \$3.57; which also reflects the change in valuation method from loan value to trade value. The net effect of the reclassified annual decal revenues, valuation method change, rate reduction and declining State tax relief results in \$3.4 million of the personal property revenue increase.
- **Sales Taxes (\$2.9 million increase):** With the new retail establishments recently opened, the County should be poised to gain a greater share of taxable sales in the marketplace. The current year has continued the trend started in the prior year with a projected 11.0% increase in FY06 that

resulted from general growth in all taxable sale sectors. The projected annual increase of 8.0% in FY07 over the FY06 forecast recognizes the contributions from the many new retail establishments.

- State and Federal Revenues (\$754,000 increase): Primarily this increase is a combination of State support for local constitutional offices, including 3.0% salary increase effective December 2006, and support of local programs; such as Social Services that is increasing \$409,000.
- EMS Revenue Recovery (\$516,000 decrease): As the fees for this program established in March 2005 were based upon various estimates for which the County had limited trend data and included a hurricane and a severe flu season, it appears that actual trends reflect a lower number of transports and the budget has accordingly been modified.
- Public Works Fees (\$166,000 increase): Stormwater management fees and erosion and sediment control fees were established to recover the cost of the County's adherence to State guidelines for inspections and monitoring of construction projects along with providing funds for designing, acquiring and building drainage basins. Both of these programs necessitate a fee increase to provide the additional personnel support services needed to maintain compliance.

General Fund Expenditures

Education

Our nationally recognized school system continues to perform in the top 5% in Virginia on measures of student achievement. The expectations of our citizens are high and all indications are that we are meeting these expectations. A few of the school's major accomplishments are: 98% satisfaction rating of parents, SACS Quality assurance team accreditation, 8 U.S. Department of Education Blue Ribbon Schools and the 79% approval of the school bond referendum question. The Hanover School district is now the 14th largest system among the 134 in Virginia.

The School Budget is \$176.1 million or a 12.0% increase over the current year (excluding the self supporting Cafeteria Fund). While the State increase is \$12.9 million, which is higher than anticipated at 19.3%, local funding is at the targeted 7.2% increase. The State initiative restores funding levels to 46.7% of total School budget, one of the highest in recent years. This funding will provide for the mandatory retirement/life insurance cost increase of \$3.4 million or 46.0% increase, health care insurance increase of \$842,000, or 15.0%, and 4.0% compensation increase for our teachers and support staff. The school budget includes funding for 111 new positions which will allow us to reduce our student-instructional position ratio and provide additional resources to our children, especially those with special needs. In addition, local funding will provide for the opening costs of two new schools (Kersey Creek Elementary School and new Alternative Education Center) along with the related debt service for these facilities.

The capital program includes design and construction of 2008 Trades-Based Center and the 2008 elementary school on Lee-Davis Road. In addition, \$28.1 million in school renovations which will provide significant upgrades and enhancements to all facilities built prior to 2000 are included as part of the Five-Year Capital Improvements Program.

Public Safety

Public Safety services include Sheriff's Office, Pamunkey Regional Jail, Fire/Emergency Medical Services, Emergency Communications, Animal Control, Community Corrections and Building Inspections. Funding for these departments represents \$38.5 million or 21.1% of the budget.

The Sheriff's Office continues to be recognized as a leader in the State as noted in the re-accreditation assessment report issued in January 2006 by Virginia Law Enforcement Professional Standards Commission (VLEPSC). We are one of only four organizations to hold both national and State

accreditation and are the only Sheriff's Office in the State with primary law enforcement responsibility that is nationally accredited. Only 5.0% of law enforcement agencies nationwide are accredited. The Sheriff's Office budget is \$16.6 million, an increase of \$1.7 million and 11.3%. The budget includes funding for nine additional officers, which will put us at 18.8 sworn officers per 10,000 population. With the addition of these nine officers, we will have raised our sworn officers ratio from 18.4 in FY06 and anticipate meeting our goal of 20 officers per 10,000 population in the five-year planning horizon.

In September 2005, the volunteers of the Mechanicsville Fire Company asked the County for help in staffing what was previously an all volunteer fire company. Mechanicsville Fire Company ran 2,000 calls during FY05, ranking as one of the busiest of the twelve fire companies. The continuing workload prompted Mechanicsville to request 16/24 coverage (coverage 16 hours/day for 3 weekdays and 24 hours/day for 2 weekdays). In order to respond to this request, four additional firefighter/EMT positions and a battalion chief have been funded for FY07. With the addition of this staff and the shifting of four other firefighter/EMT staff, we will provide the requested coverage. The addition of paid staff in Mechanicsville results in nine of our twelve volunteer fire stations receiving assistance from paid staff. With the combination approach, over 70% of the call responses are now a combination of volunteer and career staffing.

The Fire and Emergency Medical Services (Fire/EMS) budget is \$11.3 million, an increase of \$1.5 million and 15.7%. In addition to the staff mentioned above, \$100,000 is included to address the salary competitiveness issues for advanced life support (ALS) providers. Surrounding jurisdictions are providing substantial compensation incentives to EMS providers who maintain their ALS certifications. While we have not determined how best to establish this program, we are at risk of becoming a training ground for other localities and face potential recruitment challenges.

Emergency Communications is currently experiencing an 18.0% turnover rate and is five officers short of the Association of Public Communications Officers (APCO) staffing standards. This very critical function must be staffed 24 hours a day with proper staffing and the continuation of mandatory overtime to support this function must be limited to resolve this condition. Therefore, two additional emergency communications officers are funded to bring us closer to the APCO standards and reduce the required overtime by officers.

Human Services

Human Services agencies include the departments of Community Services Board, Social Services, Health and Community Resources along with the programs of Comprehensive Services Act and tax relief for the elderly and disabled. Human Services makes up 7.8% of the General Fund budget with local funding for human services agencies totaling \$14.3 million or 9.1% increase.

The Board of Supervisors, the Commissioner of the Revenue and the Social Services departments continue to promote the real estate tax relief for the elderly and disabled program and the result of their efforts is reflected in an increase of 189 individuals and \$264,000 in tax relief for the 2007 fiscal year. Real estate tax relief ranges from 25% to 100% for qualifying individuals.

The Social Services budget is \$5.7 million and is comprised of 82.8% in program-related services which are funded by State and Federal reimbursements. The Social Services staff continues to outperform its peers as we were recently notified that Hanover has the highest rate (99.5%) of timely processing for Medicaid applications.

Over the last several years, the Community Services Board (CSB) has been faced with clients presenting more challenging behaviors and increased medical needs. In meeting this growing demand for service, a new 8,000 sq. ft. East Hanover Office will open Spring 2006 as well as a new clubhouse day program for

the chronically mentally ill located in the Ashland area. The CSB budget will add four positions to meet service demands to include one case manager to reduce the MR waiting list by 40 individuals, a Supervisor for the Youth Day Treatment Program at Stonewall Jackson Middle School, and a case manager for the mental health clubhouse program. All three of these staff positions will be supported through Medicaid funding. In addition, a counselor will be added to provide more intensive substance abuse treatment service for court-referred individuals.

Public Works

During the past year we have been audited by the EPA, the Department of Conservation and Recreation's Division of Soil and Water Conservation and Chesapeake Bay Local Assistance Division. While we have received numerous audit comments on procedures, the overriding issues which have been communicated to us are the need to inspect construction sites in a more timely manner and strictly enforce erosion and sediment control (E&S) standards. Therefore, a full-time position has been funded to provide for more timely inspections. The costs associated with the additional inspections to meet the mandated requirements will be funded by increasing the erosion and sediment control (E&S) fees.

Furthermore, an additional part-time position is funded by stormwater fees to meet increased inspection requirements on privately-owned facilities to meet "best management practices" as required. An additional position, which will be funded by the General Fund, is funded to meet supervisory workload of developing a mandated septic pump-out enforcement program and to provide construction and planning oversight for the projects approved in the 2005 Bond Referendum. During 2007, we anticipate planning and/or construction for the Mechanicsville Library, 911 Center, Ashland Fire Station, Farrington Fire Station and various parks improvements.

The Public Works Operations Division continues to expand and has increased its tonnage of solid waste 2.0% over the prior year. New recycling efforts have been implemented, including corrugated and non-ferrous metals recovery at the transfer station, and a cooperative program with the CSB has resulted in a 40% reduction in hazardous wastes at solid waste convenience centers. This continued effort required replacement equipment totaling \$165,000 for the upcoming year. In concert with the anti-litter efforts advanced during the 2006 year, we are using our convenience center as staging areas for an expanded litter pick-up program. By working co-operatively with VDOT, Commonwealth Attorney, General and Circuit Courts and juvenile and adult court services, we will expand the use of community service for local offenders to include roadside pick-up of litter.

Parks & Recreation

Our summer playground programs continue to be very popular as evidenced by 1,362 children who were enrolled (100% of capacity). Recreation program growth has exceeded 17.1% during the past year and the additional fees collected from these programs will be used to further meet these needs for 2007; including the addition of a Recreation Program Coordinator which will be added mid-year. In addition, our Heritage Day budget has been moved from the Board of Supervisors budget to Parks and Recreation to recognize the department's financial oversight of this project.

Other General Fund Budget Highlights

Some of the other significant changes in the budget include:

- Fuel prices: Gas and diesel price increases are reflected throughout the operating budget and account for over \$401,000 of the increase, a 66% increase.
- Planning: Addition of a Code Enforcement official (\$44,500) and professional services for the Comprehensive Plan update (\$50,000).
- Facilities Management: Conversion of telecommunications service contract to in-house support position providing contractual savings of \$80,000.

- Judicial Administration: Facility renovations of various court facilities (\$66,000) and Assistant Commonwealth Attorney (\$79,300, pending State approval).
- General Government Administration: Debt issuance cost for General Obligation Bonds (\$100,000), Safety Specialist (\$54,400), and Succession Planning and Leadership program (\$40,000).
- Contributions: VCU School of Engineering and Business (\$25,000) and J. Sergeant Reynolds capital improvements (\$66,800).

Capital Improvements Program

The Capital Improvements Program (CIP) is the County’s five-year plan for investing in facilities, equipment and vehicles whose individual costs exceed \$50,000. The proposed five-year plan for County projects (not including Education and Public Utilities) is \$94.0 million, \$44.0 million in FY07. It is funded with General Fund cash, grants, developer proffers, and debt, of which \$57.8 million is debt related to bond referendum projects. The County budget policies recommend the use of pay as you go funding for 10% or more to recognize the need to balance the use of debt with the use of other resources for funding. This plan uses “pay as you go” funding for 38.5% of County and School projects. The following are the County projects proposed for FY07 CIP:

Information Technology Equipment	\$607,000
New Courts Building (Facility Study in FY07)	50,000
Communications System and Facility (bond referendum)	28,000,000
Pro QA Talking Software	54,000
Ashland Fire Station (bond referendum)	2,267,000
Farrington Fire Station (bond referendum)	3,023,000
Fire Apparatus Replacement	950,000
Ambulance Replacement	276,000
Roadway Safety Improvements (90% funded by Federal grant)	500,000
North Lakeridge Parkway (50% Revenue Sharing/50% Proffers)	1,000,000
Roadway Improvements	200,000
Regional Stormwater Implementation	400,000
Taylor Complex Well Improvements	150,000
Wickham Building Generator	50,000
Airport Improvements (80% funded by grants)	615,000
Courthouse Park (bond referendum)	100,000
Cold Harbor Battlefield Park	50,000
Pole Green Park (bond referendum)	650,000
New Park: Horse Trail Development (bond referendum)	25,000
New Montpelier Park Development (bond referendum)	300,000
New Doswell Park Development (bond referendum)	25,000
Mechanicsville Library (bond referendum)	4,727,000
TOTAL	<u>\$44,019,000</u>

Perhaps the greatest challenge in developing a long-term capital program is determining the inflation rate for construction, especially for those projects involving concrete and steel. Recent trend reviews of school construction illustrate that the inflation increase in the last two years was 48%, which is equivalent to the cumulative inflation increase over the past 14 years. The County will continue to develop a CIP using conservative assumptions. However, scope modifications and alternative strategies may need to be used to offset significant unforeseen construction industry increases.

Employee Compensation and Benefits

Hanover County schools and local government are service organizations whose budgets for employee compensation and benefits make up 71% of the total operating budget. Our ability to provide quality service and meet the high standards of the community is dependent on our ability to hire and keep qualified staff. As we look to determine what level of compensation will keep us at the competitive level in the Richmond region, we find that our peers are funding 4.0% or more in compensation increases. In fact Governor Kaine has recommended 4.0% for all school systems across the State to address his concerns with teacher salaries. For Hanover to recognize the significant efforts of our employees, the 4.0% merit pay increase for all County and School employees is funded, as well as the continuation of the benchmarking program.

Health care insurance increases have averaged 13.6% for the last five years, and we have generally shared these increases with our employees. For some employees, especially those at lower salary levels, the merit pay increase they have received has been almost as much as the increase in health care insurance premiums. The County will fully fund the increase in health care insurance premiums for fiscal year 2007, resulting in no increase to the employee rate. With the 4.0% merit increase and stabilized health insurance deductions from an employee's paycheck, FY07 should represent the first time since FY03 that employees will not see their merit increase offset by increases in health insurance.

The Virginia Retirement System's rate for County employees has increased from 11.0% to 12.5%, as a result of actuarial updates. This increase required an additional \$560,000 to be provided by the County to comply with VRS funding requirements. The school system faced a similar issue in formulating their budget with their rate increase costing \$2.3 million.

I am continuously impressed with the performance of our employees and the efficiency with which we are able to provide services to our citizens. Maintaining our compensation and benefits at a competitive level will ensure that we're able to continue this high level of service into the future.

Public Utilities

As previously reviewed with the Board of Supervisors and business community during seven meetings in 2005, the FY07 budget represents the implementation of the 2005 rate study recommendations. The rate study was commissioned due to a number of significant changes that have occurred since the previous study in 2000. A key change is the decrease in the growth rate in the Suburban Service Area. The growth rate is below that envisioned by the County's Comprehensive Plan and has resulted in revenues below previous assumptions and projections. The effect of this decrease is compounded by the requirement that several Capital Improvement Program projects must now be undertaken to support the County's Comprehensive Plan. Fees charged by Richmond and Henrico for water and wastewater services have also increased significantly.

A number of facility upgrades must also be undertaken due to new or revised regulations. For example, the Chesapeake Bay 2000 Agreement and related implementing regulations will require improvements to three of the County's wastewater treatment plants with a total estimated cost of over \$12.2 million. Other regulations, both existing and proposed, along with industry standards, necessitate that the County increase its investment in the renewal and replacement of existing infrastructure to maintain the quality and reliability of services. Therefore, user fees will increase 8.0% for water, 7.0% for sewer, and capacity fees to increase by 16.0%. These increases will enable long-term financial planning, operating and capital goals to be attained. As

identified in the five-year rate study, it is anticipated that future rate increases will be necessary to meet anticipated expenditure requirements to ensure financial integrity of the system.

Conclusion

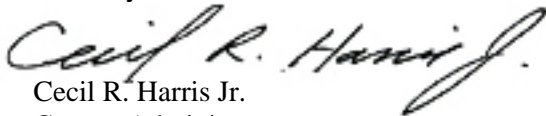
This budget addresses the community's demand for quality County and School facilities and services. We have met the referendum year one goals of funding the Emergency Communications System and 911 Center, Ashland Fire Station, Farrington Fire Station, Mechanicsville Library, Parks and Recreations projects, various school renovations, 2008 elementary school and the Trades-Based Center without a tax rate increase. We have provided competitive compensation and benefits for employees and provided significant additional resources for schools and public safety departments.

Our commitment to the future remains strong and our Five-Year Financial Plan reflects the County's conservative approach to future commitments. The real estate tax rate remains at 86 cents for the full five-year financial planning horizon while maintaining full compliance with all financial policies.

Hanover's citizens sent a resounding message to the Board of Supervisors and County staff in their comments to the citizen survey, when 92% of our respondents said the County was a good or great place to live. Our job is to improve upon County services and keep Hanover a great place to live, work and play. As the fiscal year 2007 budget is presented in coordination with my 2007 initiatives for the upcoming year, all initiatives are funded through this process.

In closing, I would like to thank the department heads and their dedicated staffs who have worked to develop this budget. The County and Schools enjoy very dedicated staffs who have worked together as a team to establish this financial plan. In particular, I would like to thank Deputy County Administrator Joe Casey, Budget Division Director Chris Sorensen, Finance Director Terry Adams and Human Resources Director Jim Taylor for the long hours put in over weekends and holidays to complete this budget.

Sincerely,



Cecil R. Harris Jr.
County Administrator