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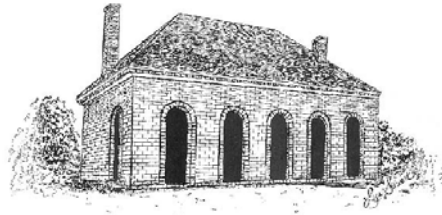
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April 13, 2011

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

Dear Members of the Board:

As we enter this budget process we are told that the "Great Recession" is over and better times are right around the corner. While we all hope this is the case, unfortunately this is not yet true for either our County government or for the citizens that you represent and that we serve. We all continue to struggle with diminished resources and greater needs. Many people in Hanover remain unemployed and many families, after years of making mortgage payments, find they have no equity in their home and little money to send their children to college or fund their retirement plans. For our County government, we have seen a significant reduction in our workforce, though we have been able to maintain our core services by re-aligning staff. This year we will continue to focus on **sustaining key services while preparing for the future**; all within existing tax rates. While we do see some positive economic signs, we are not yet ready to declare the recession is over.

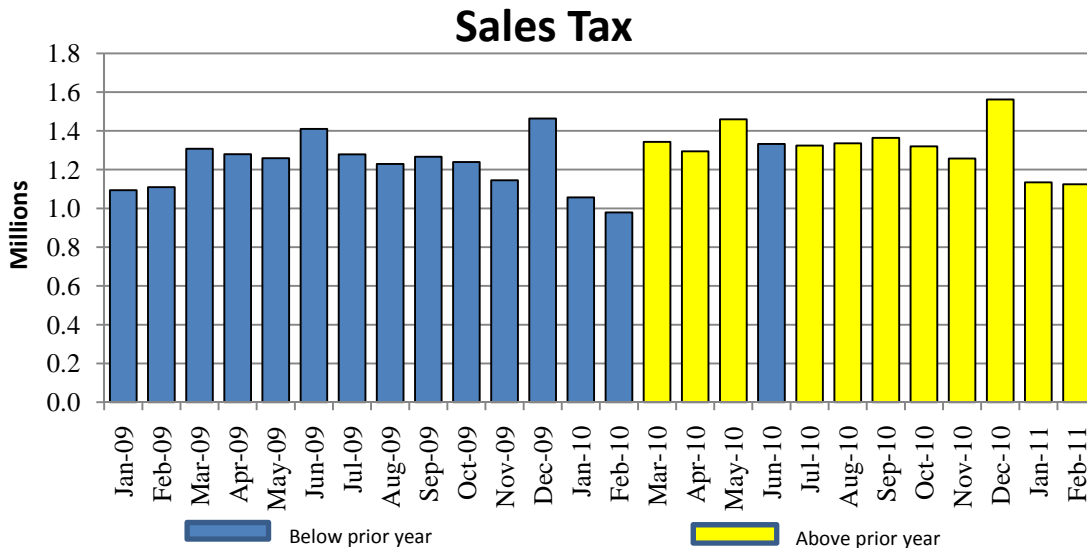
Challenging Economic Conditions

We find ourselves facing somewhat mixed economic indicators and possibly a new challenge that is different than growing or contracting periods. This challenge is one in which there appears to be limited growth in the foreseeable future. This may hinder our ability to invest in the community or invest in the employees for the next several years. Our challenge will be to leverage any savings to meet inflationary costs, mandated increases and employee investments.

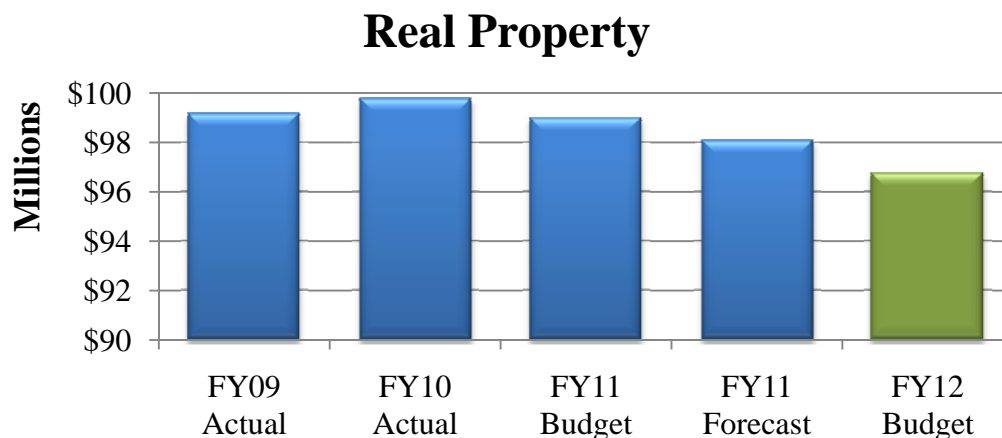
Mixed Economic Indicators

In March 2011, we had an unemployment rate of 5.9%. During this recession it has been as high as 7.3% in February 2010. The decline to 5.9% does represent over 500 citizens now being employed that didn't have jobs just one year ago. We are fortunate that County business employment has been healthier since many of the impacts to our citizens were in businesses that they once worked for outside the County.

The monthly local sales tax collection is a good lead indicator of what may be forthcoming in other economic indicators. Beginning in March 2010, the streak of 19 months in a row of declines from the preceding year's month came to end. During this time period, sales tax collections declined over 11% (\$3.0 million) as we continually had to readjust our spending plans to recognize lower revenues. Between January 2009 and February 2010, average monthly sales tax collections decreased over \$150,000 per month. Since that period, average monthly sales tax collections are approximately \$75,000 higher than the prior year. For FY11 year-to-date, we have experienced a 7.9% cumulative increase over the prior year; which enables us to forecast a \$1.9 million increase for FY12.



In contrast to sales tax, real property revenues have continued to decline. Because real property revenues are more than five times larger than sales tax, even modest decreases in real property can offset higher increases in sales tax. As the following graph illustrates, we are forecasting a 2.2% decrease (\$2.2 million) in FY12 as new construction has somewhat moderated the decline in assessments. As a positive indicator, recent reports indicate a 6% decline in the number of homes for sale and there have been 236 residential building permits year-to-date; 17% higher than the prior year.



For personal property, we are projecting a 1.9% (\$419,000) revenue decrease based upon our preliminary assessment of existing vehicles and continued conservative assumptions for new vehicle purchases. Prior to the recession, new vehicle purchases averaged 7,000; we are projecting a number at half that total in FY12.

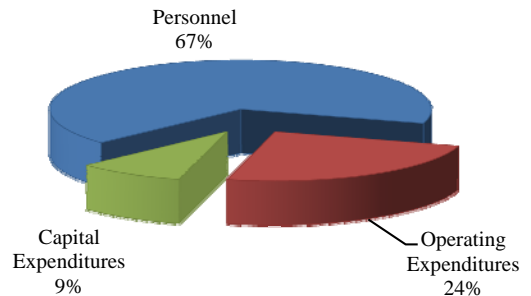
As with any budget, we are very dependent upon State and Federal support. Since the start of this recession, the County and Schools have sustained a decline of over \$14 million in State and Federal revenues or 11.0%. As we do so every budget cycle, we first estimate State revenues primarily based upon the Governor’s budget and make appropriate adjustments as the General Assembly deliberates.

Budget Summary

We traditionally measure changes in our budget by comparing the total budget for all funds and the General Fund budget. The total budget for all funds is \$391.3 million, a 1.9% increase from FY11. In addition to operating expenditures, the total budget includes impacts for capital expenditures, which may vary from year to year depending on projects. While on-going General Fund revenues are actually 0.3% lower, we have been able to use accumulated savings as well as Federal recovery funding for one-time needs. As the following graph illustrates our primary investment is in our employees; representing 67% of the budget.

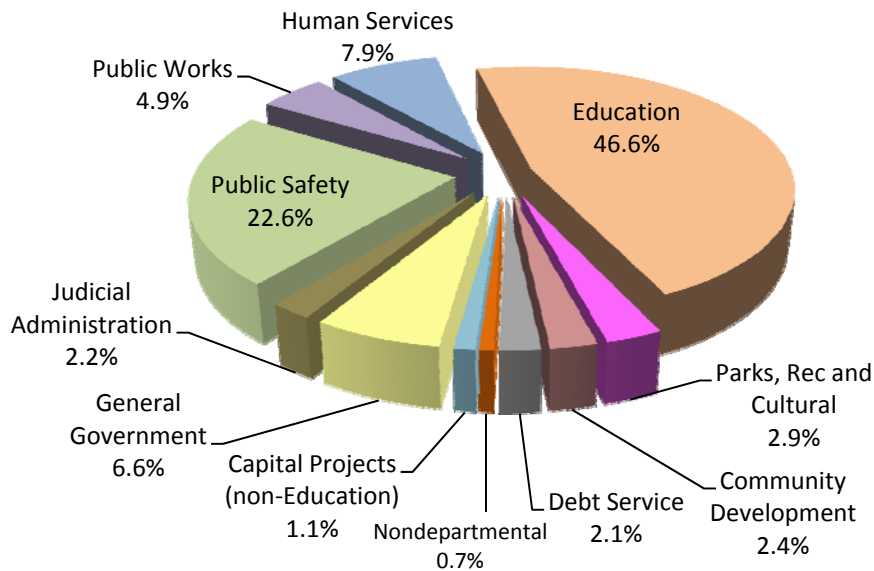
Expenditures - by Category

Personnel	\$ 260,548,635
Operating	95,397,202
Capital	<u>35,331,777</u>
Total FY12 Expenditures	<u>\$391,277,614</u>



The total General Fund budget is \$202.7 million, a 2.1% increase from FY11. We project to spend about 77% of our money on our priority areas (Education, Public Safety, and Human Services). The following chart illustrates the uses of the General Fund expenditures by function:

FY12 General Fund Expenditures



For FY12, over \$4.0 million is invested in the Capital Improvements Program with a focus on replacement of vehicles and technology infrastructure. Over the past three years we have deferred many capital improvements projects and sought to leverage our resources. For example, the FY12 budget reflects over \$260,000 in rental cost savings that have been replaced with lower debt service for over 31,650 sf of County-owned facilities.

Public Utilities

This self-supporting business unit balances its operational and capital cost with user fees and not any General Fund dollars. The operating component of the budget is impacted by many expenses that are uncontrollable in nature (e.g., contractual agreements for the purchase of water) that will be balanced with user rate increases of 3.0% for water and 2.0% for wastewater. The typical residential customer's water/sewer bill would increase by \$15 in FY12.

Utility capital planning has been limited to essential projects and Board initiatives. Consequently, we are recommending no increases in capacity fees. We believe this will position the County favorably when the economy recovers, especially in regards to the Rt. 33/I-295 area we have targeted for business development; which is critical to the County's long-term fiscal health.

How We Have Leveraged Our Resources

We have leveraged workforce talents and funding reserves from good years to make it through the recessionary period. Now we also need to recognize the next phase of this economic cycle. This phase is all about sustainability and leveraging resources for continuation of excellence. All of this can be accomplished while preserving key services within existing tax rates.

Because of the recession, our workforce will be reduced for the third straight year in FY12 with virtually all County and School divisions having less staff than just a few years ago. We have utilized the savings from those positions to minimize service level impacts, reducing services only after careful thought and deliberation with staff, elected officials and the public. These are just some examples of how leveraging resources for continuation of excellence has benefitted all of us in quality of life attributes and our priority service levels.

Quality of Life

We were named among the 100 Best Communities for Young People for the third time in 2010. Our emphasis on providing the best opportunities for our youth is also borne out by BusinessWeek.com recently naming Ashland as "Virginia's Best Place to Raise Your Kids", followed by Mechanicsville. The most important judges of all, of course, are Hanover's residents. In our most recent Citizens Survey, 96% of respondents rated Hanover as an "excellent" or "good" place to live.

SPQA

Last year we became only the second county government in Virginia to receive a U.S. Senate Productivity and Quality Award (SPQA). This followed months of hard work by numerous County departments in illustrating the story of management principles and strategies that help make Hanover unique and operate at peak performance.

Bond Ratings

In January 2011, all three agencies affirmed our Triple AAA bond rating. The bonds were issued to finance the last of our 2005 Bond Referendum projects. This referendum had the highest voter approval in the State in 2005; with over 70% approval rates for each of the three questions. Last year we became the smallest County to earn the Triple AAA bond rating. Our AAA bond ratings also serve as a strong indicator to prospective businesses of our financial health.

Education

We recently learned that Hanover leads all of Virginia's school districts with 68% of expenditures directed to classroom instruction. Our school system continues to be among the highest performing in the state while maintaining among the lowest per-pupil costs (fourth-lowest per-pupil cost among the 15 school divisions with enrollment greater than 15,000 students).

Public Safety

The Sheriff's Office recently reported that Hanover has the lowest crime rate in over 35 years. Fire-EMS's quick response vehicle program and other initiatives have greatly helped reduce response times. The National Association of Counties recognized this accomplishment with a special "Best in Public Safety Category" Achievement Award. Emergency Communications became only the 14th Emergency Dispatch Center in the world to be internationally accredited as Fire Dispatch Center.

Just as the schools lead the state in dedicating their resources towards the classroom, the County also leads the region and all of our neighboring rural counties with the lowest general government administration costs per capita currently at \$85.63 per capita. This reflects our commitment to leveraging our finite resources into priority and service-related areas (e.g., public safety and human resources).

Investing in Resources for Continuation of Excellence

It is so critical for us to recognize that our greatest assets during any economic cycle are our employees. Yet we haven't invested in this asset since 2008; the last time we had a merit-based compensation increase. Therefore, in working closely with Superintendent Stewart Roberson, we have designed the FY12 budget to accommodate a 2.25% compensation increase as a clear indicator of investing in resources for continuation of excellence. We believe that it has been fiscally prudent for us to have gone three years without an increase to employees. I believe the time has come to not only say thanks to our employees, but to acknowledge their hard work with a financial reward. In addition, we requested an additional 1.75% compensation increase to recognize one-third of the workforce required to work increased hours without additional compensation since 2010. This additional increase recognizes the dedication of these employees and their willingness to meet the County's service needs as the workforce has continued to decrease over the past few years.

As a comparison, 2008-2011 market trends indicate 10% employee compensation increases and 5% inflation increases. While we are conservative during these times to not emulate the market, we recognize that a modest investment in our great employees helps to retain and reward them for their contributions.

It is through our close relationship with the School Board that we were able to have joint discussions on such an important topic and I would be remiss if I did not take a moment to personally thank Superintendent Stewart Roberson. He and I have worked together for 16 years and we have shared the stage many times in community, business and statewide meetings. We have a shared goal in serving our respective Boards and the community in providing key services to citizens and students through a workforce we are grateful to represent.

In the past year the Hanover team of excellence saw many long-serving leaders retire. They were not only well-recognized names, but many others as well who will be sorely missed. However, we will all continue to work together to ensure that the customer is served and that the County continues to aspire to even greater things through **investing in resources for continuance of excellence.**

Preserving Key Services within Existing Tax Rates

We recognize that in this challenging economy, citizens and businesses are strapped to meet their obligations. You have not raised the real estate tax rate since 2004, and this budget has no tax rate increase. In addition, there are no fee increases except for the inflationary water and sewer fee increases in meeting contractual and regulatory requirements. We have also not proposed any service level reductions; thus we are able to achieve our goal in **preserving key services within existing tax rates.**

Our local revenue sources are based predominantly on real and personal property values and, as we have seen in prior recessions, recovery of these sources will lag behind that of businesses. Therefore, even if the recession were to end today with job opportunities and business profitability, it will not be over for local governments until at least FY13.

Planning for the Future

As I indicated in the introduction of the budget message, this is a time to focus on **sustaining our core services while planning for the future.** This budget has continued to align our resources to the core services of public safety, education and human services. We have invested in our employees, while at the same time selectively filling only critical positions as they may become vacant. We are aligning ourselves for the new reality of a smaller workforce with limited revenue growth in the near future.

We are focusing on expanding our economic development opportunities. We will extend water and sewer to the Rt. 33 corridor and hope to continually expand the use of our small business incubator, which now has seven clients. We continue to work closely with the Greater Richmond Partnership and other business partnerships to create more work opportunities for our citizens by attracting new businesses and encouraging the expansion of existing businesses.

Our five-year financial plan continues to keep us well grounded in planning for the future. Focusing not just on today or next year but on the entire five years ensures Hanover is planning for the future. Our plan is not a wish list; as it balances all five years with conservative revenue assumptions and tough, realistic expenditure decisions. Our priorities over the next five years will be to reinstate targeted frozen positions in service areas that are vulnerable while seeking out

efficiencies from all service areas without raising tax rates. By using this approach, we feel we will not make promises we cannot keep and, if we must make further reductions, we can do so in a deliberate manner.

In Conclusion

I continue to feel strongly the future is bright. We have survived the most severe economic downturn in the last 60 years and have done so in a fashion of teamwork, collaboration and a focus on **sustaining our core services while planning for the future**. Will the future be easy? No, but it will be better and we are committed to making that future something for all Hanoverians to be proud of.

In closing, I would like to thank the dedicated staffs of the County and School Board who have worked together for many long hours as a team to establish this financial plan. We will continue to seek timely economic and fiscal data to best gauge what actions we need to take on behalf of the County. The appendix that follows this letter provides more in-depth analysis and departmental summaries.

Sincerely,

A handwritten signature in cursive script that reads "Cecil R. Harris, Jr." The signature is written in black ink on a white background.

Cecil R. Harris, Jr.
County Administrator