PRELIMINARY
FIVE-YEAR FINANCIAL FORECAST

PRESENTED TO FINANCE AND ECONOMIC DEVELOPMENT COMMITTEE

NOVEMBER 2022

WHY DEVELOP A MULTI-YEAR FORECAST?

- Five-year revenue forecast is required by city code to be presented by January 31
- Financial forecasting is a best practice and endorsed by the Government Finance Officer's Association (GFOA)
- Estimates provided are at a point in time and will change as the budget development process is implemented
- Projections help to make decisions and serve as a basis for future financial planning

Foundational Philosophy

Forecasting as a financial best practice helps the city to:

- Better understand the economic climate
- Provide funds for our priorities
- Strengthen our community services
- Capitalize on our competitive advantage
- Leverage our resources through private sector investment
- Diversify our tax base

Philosophy Going Into the Next Budget

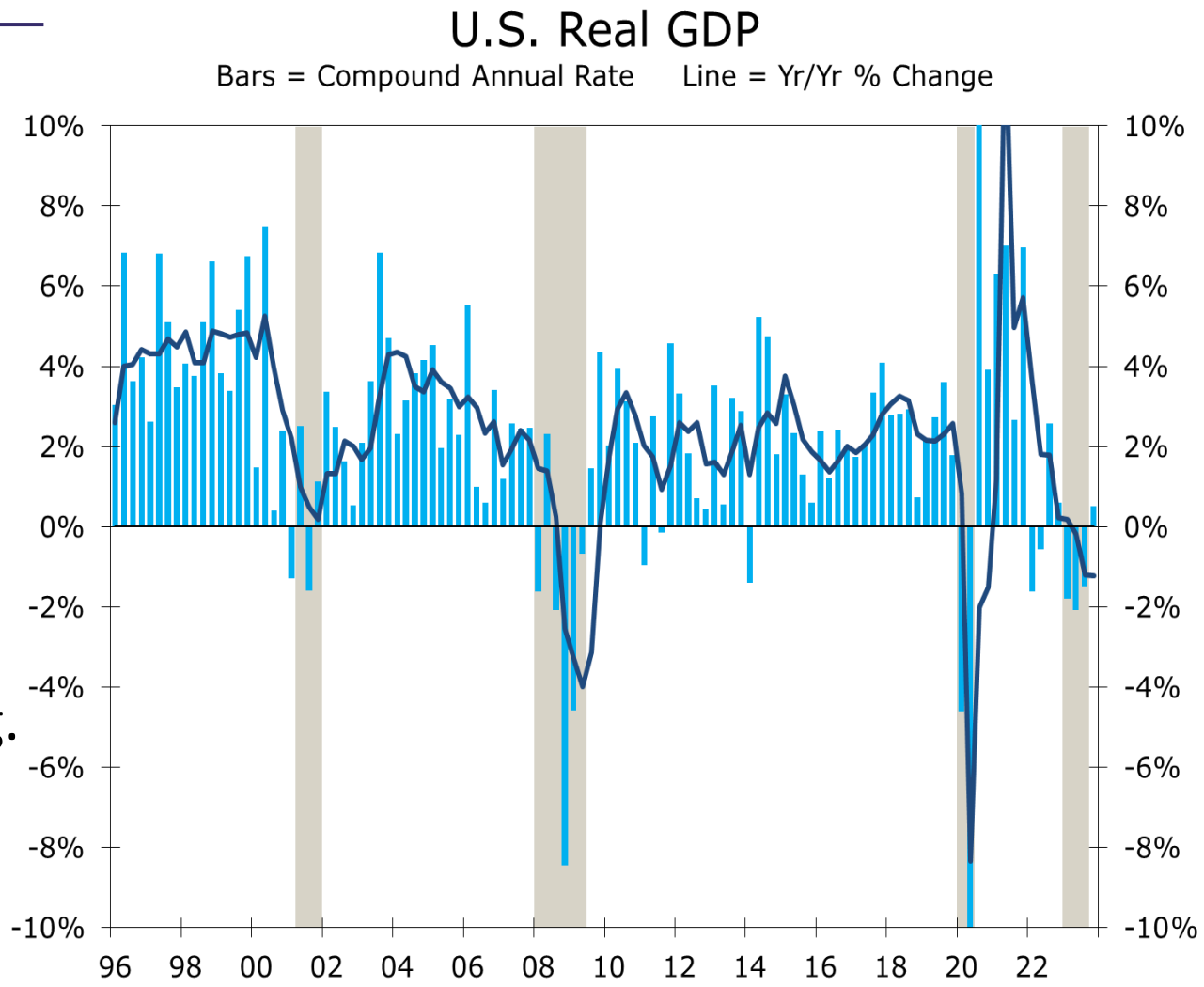
How the Economic Climate Impacts Our Forecast

- The National Bureau of Economic Research defines a recession as:
  - "A significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real gross domestic product (GDP), real income, employment, industrial production, and wholesale-retail sales."
- Several economic indicators forecast a recession, including:
  - Gross Domestic Product (GDP)
  - Labor Force Participation (Employment and Unemployment)
  - Inflation in the Consumer Price Index (CPI) and Personal Consumption Expenditures (PCE)
- Key questions:
  - How will a recession affect the Richmond region?
  - What effect will an economic downturn have on the city's financial decisions?

Indicator 1: Gross Domestic Product Decline

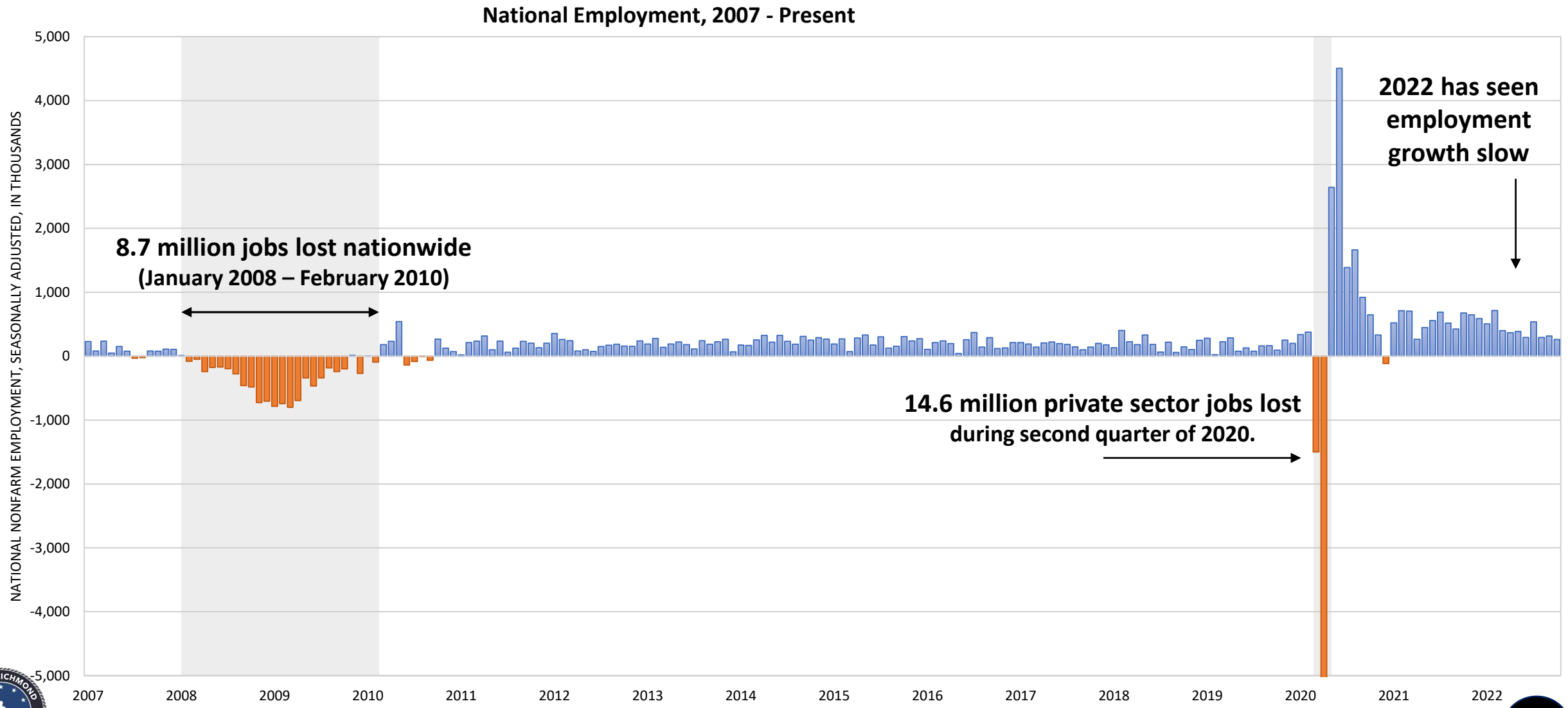
Real GDP rebounded in Q3 of 2022, following two consecutive declines. While the earlier drop had prompted some to say the economy had already slipped into a recession, growth has, so far, only slowed.

A recession is a **pronounced, prolonged, widespread decline** in economic activity – typically evident in employment, industrial output, real income and consumer spending. We expect these conditions to be met early next year, resulting in a modest-to-average recession.



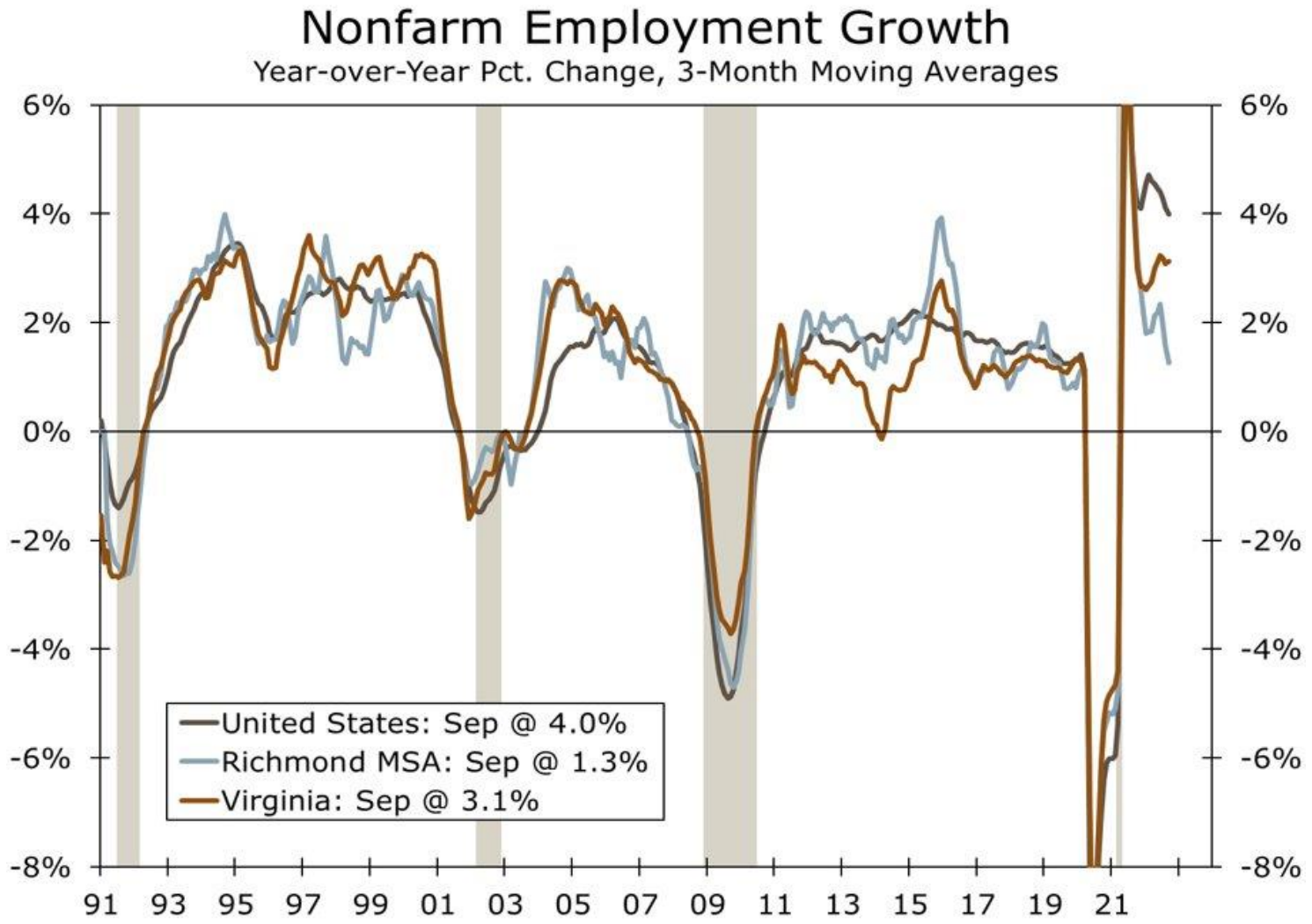
Source: U.S. Bureau of Economic Analysis and Mark Vitner, Chief Economist, Piedmont Crescent Capital.

Indicator 2: Labor Force Participation Slowdown



Source: U.S. Bureau of Labor Statistics. Shaded areas represent recession as determined by the National Bureau of Economic Research (NBER).

Indicator 2: Labor Force Participation Slowdown

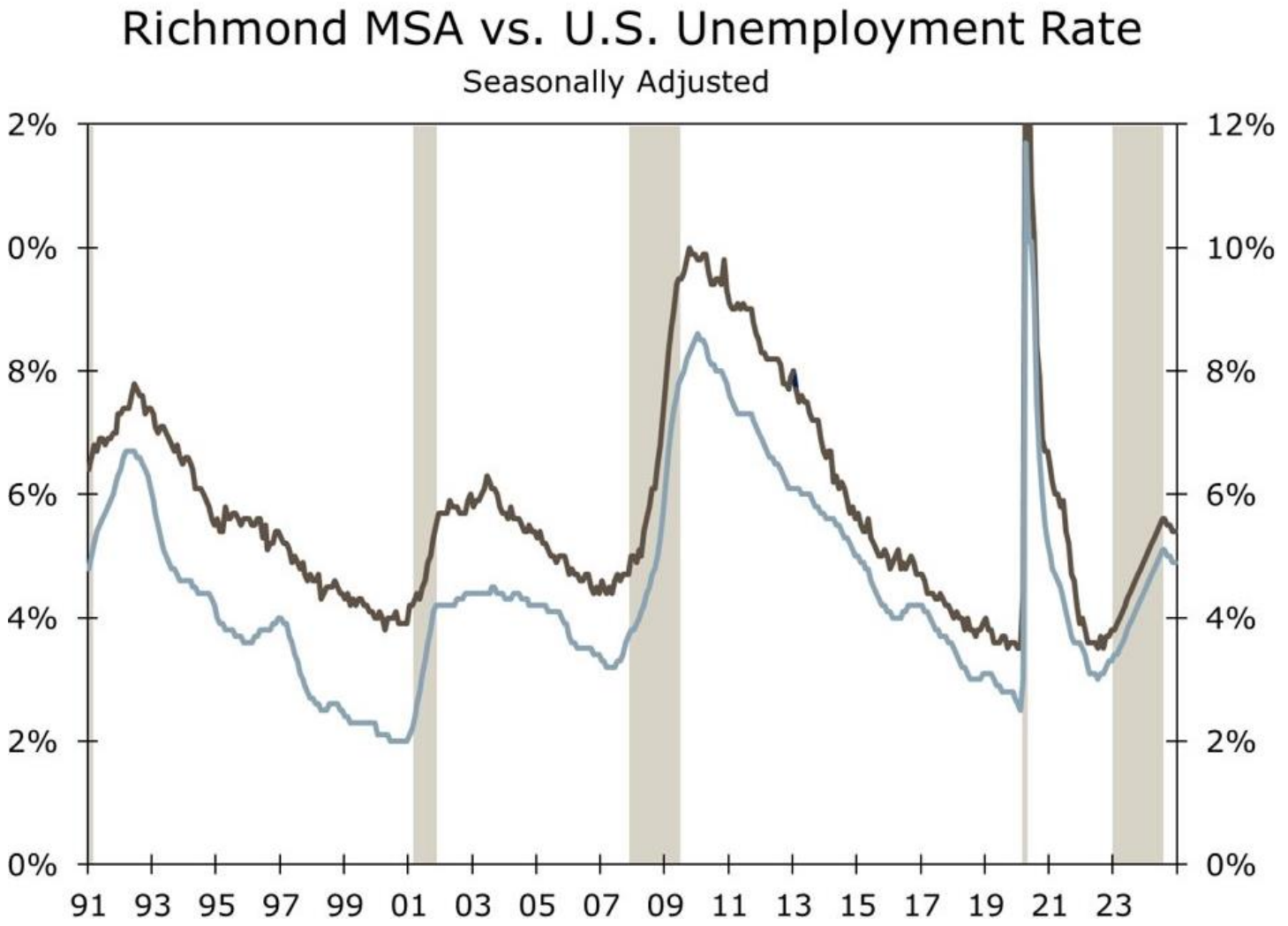


Richmond's job growth has lagged the state and national rates since the pandemic.

Urban areas have had a tougher time bringing workers back to the office.

Source: U.S. Bureau of Labor Statistics and Mark Vitner, Chief Economist, Piedmont Crescent Capital.

Indicator 2: Labor Force Participation Slowdown

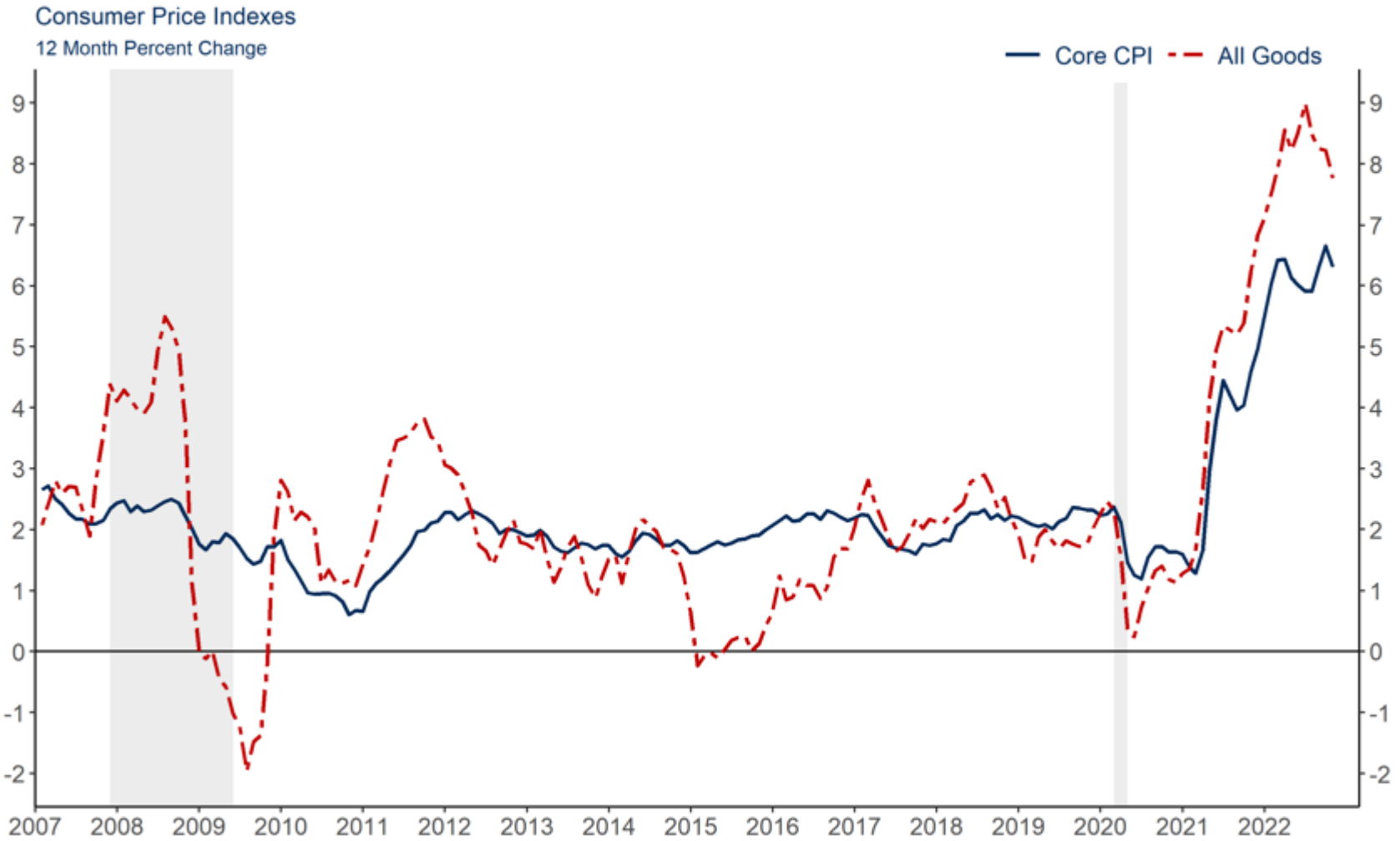


Source: U.S. Bureau of Labor Statistics and Mark Vitner, Chief Economist, Piedmont Crescent Capital.

Richmond's jobless rate has consistently remained below the nation, reflecting the regional large public sector.

The jobless rate is expected to rise later this year and peak around the middle of 2024 at around five percent.

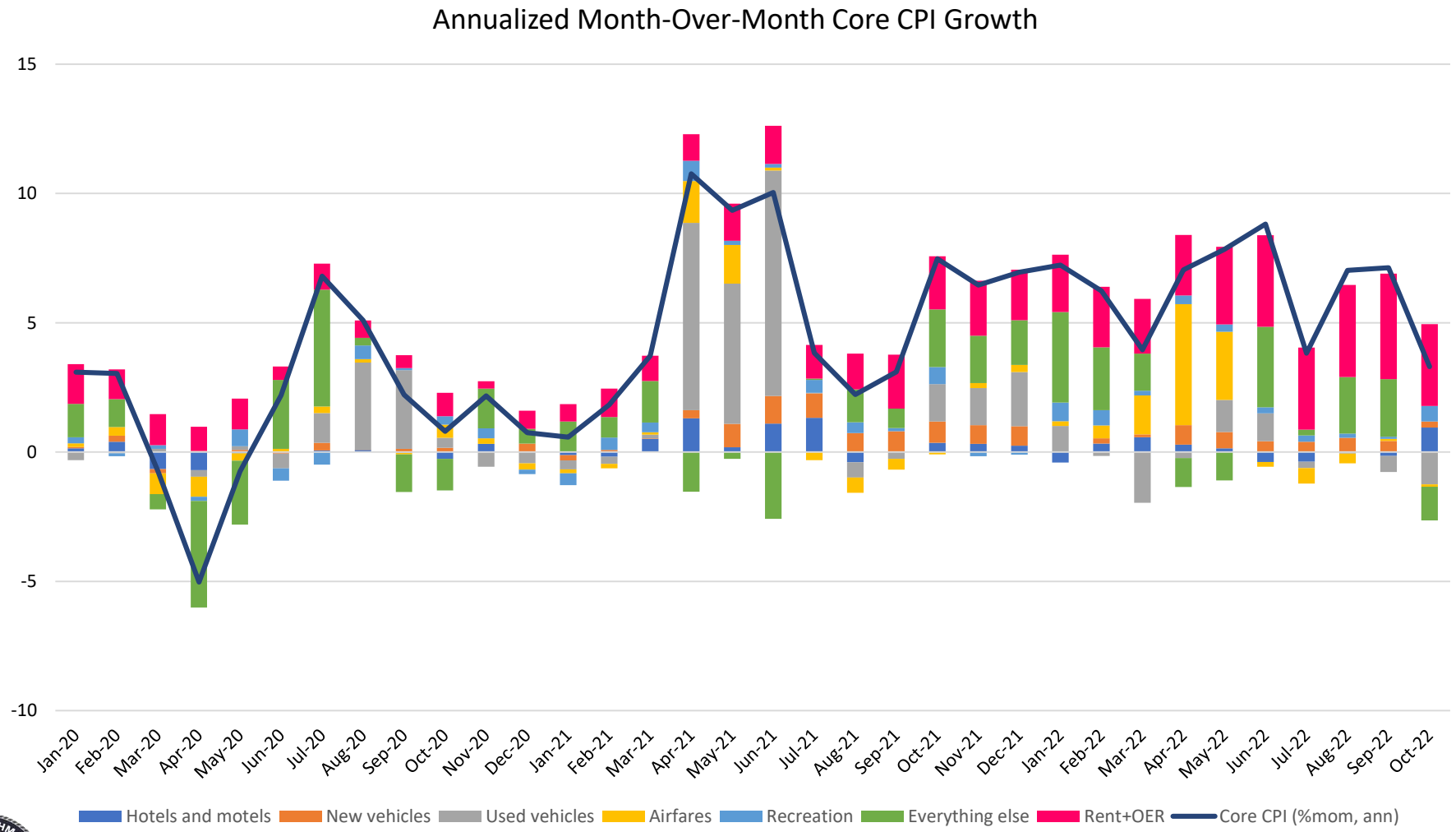
INDICATOR 3: RISING INFLATION



- High inflation can indicate an impending recession.
- Inflation occurs when there is a **sustained and broad rise in prices** of goods and services over time.
- Prices have steadily increased since the pandemic.

Source: U.S. Bureau of Labor Statistics and Federal Reserve Bank of Richmond

Indicator 3: Rising Inflation



A key property of inflation is broad and sustained Rent + Owners' Equivalent Rent (OER) prices, which have remained high since the pandemic.

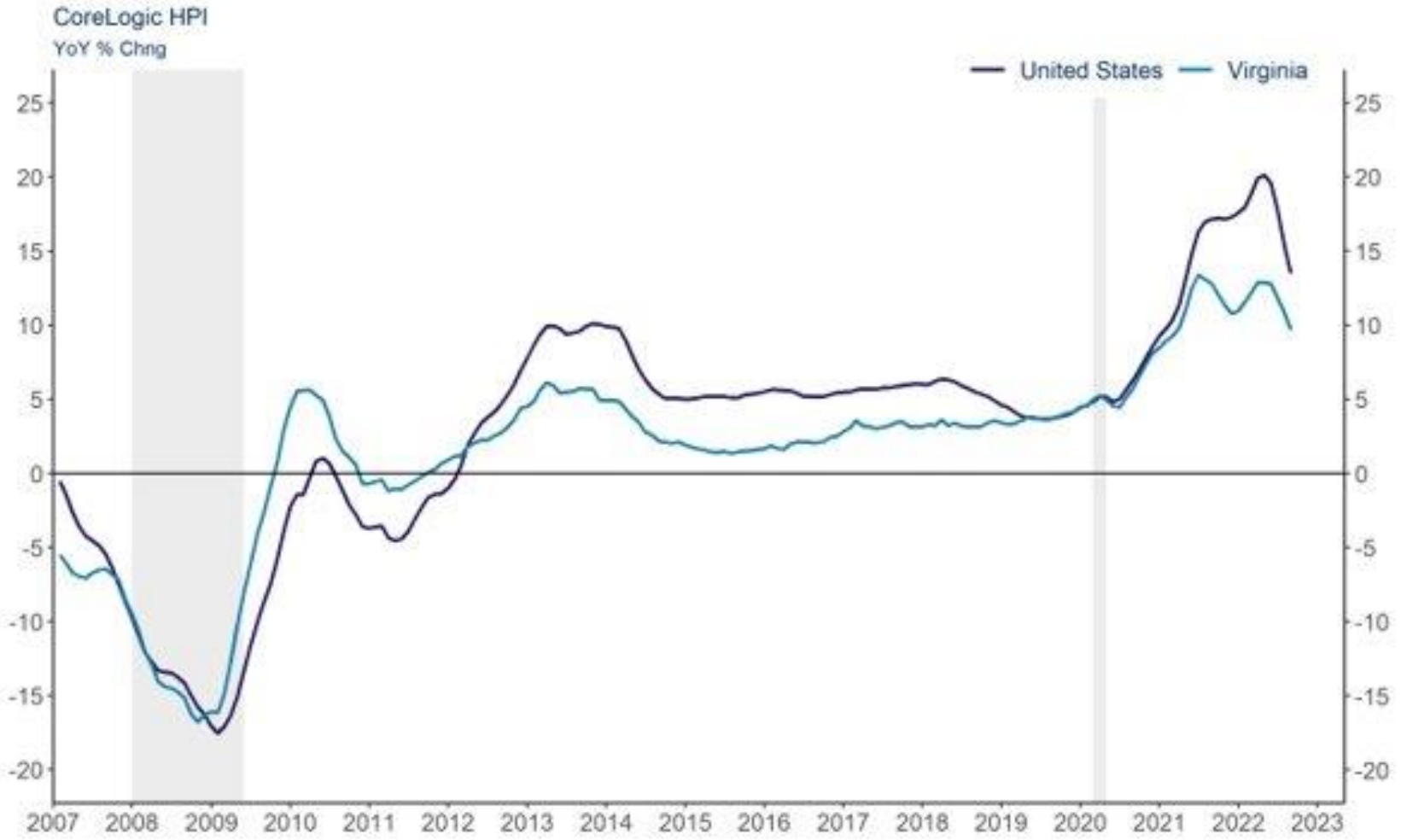
Source: U.S. Bureau of Labor Statistics and Renee Haltom, Vice President and Regional Executive, Federal Reserve Bank of Richmond

Indicator 3: Rising Inflation

- The Federal Reserve targets two percent inflation over time. When inflation moves significantly above or below the target in a sustained way, the Fed's primary tool for responding is its policy interest rate.
- Surging demand has resulted in surging inflation.
- Inflation will come down in three ways:
  - Demand moderating (the Fed mainly works via this channel)
  - Supply expanding (happening, but slowly)
  - Global commodity prices moderating (happening, but uncertain)
- All three forces are in progress, but all are hard to forecast, especially in a slowing economy.

Source: Federal Reserve Bank of Richmond

Housing Prices in U.S. and Virginia are Declining



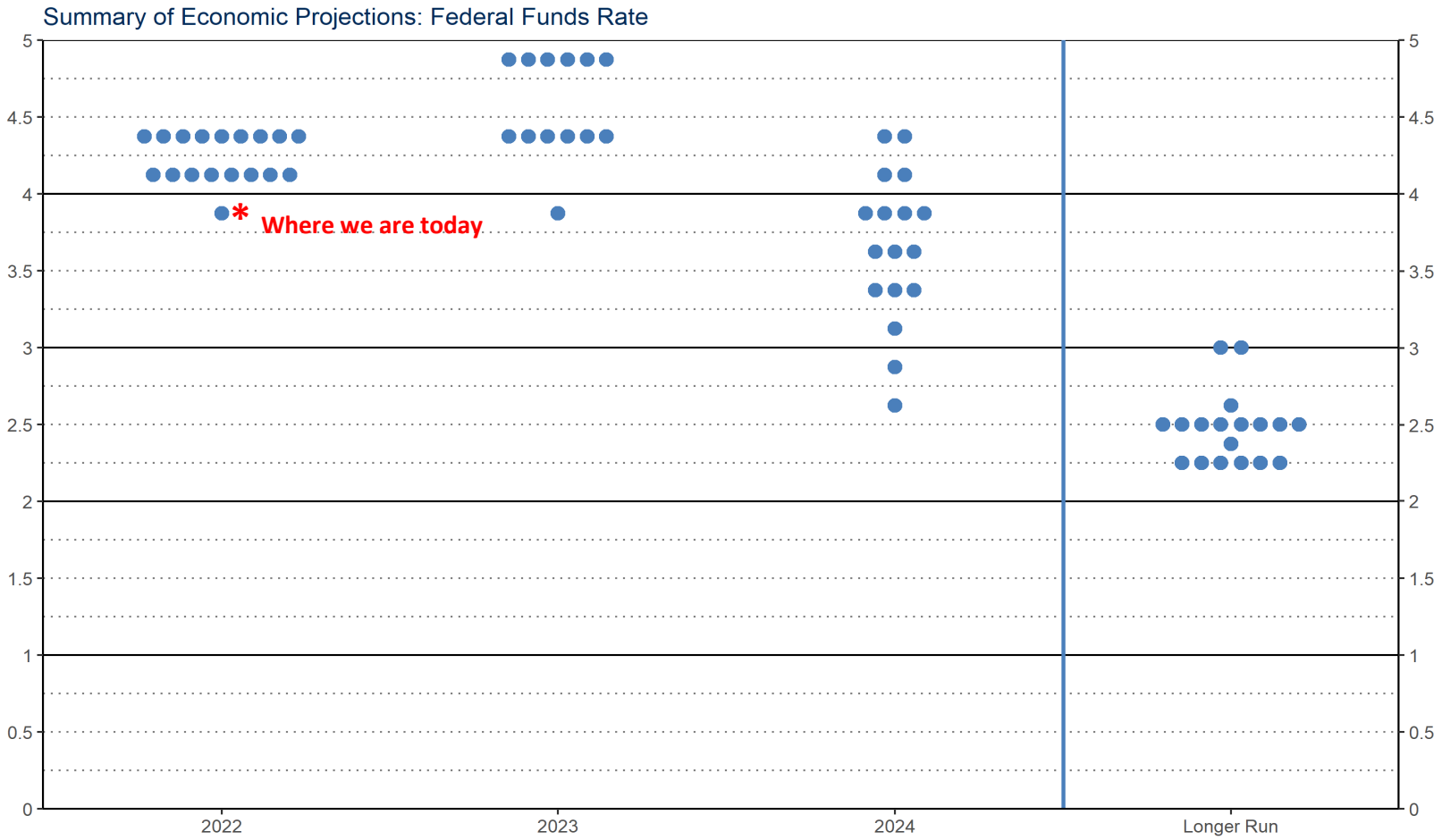
As the Federal Reserve hikes interest rates, housing prices are expected to drop.

Virginia's housing prices were keeping pace with national increases in late 2020 but began to lag the national market in 2021, which continues to present.

Source: Federal Reserve Bank of Richmond

Projection of the Federal Funds Rate

Federal Open Market Committee (FOMC) members' forecast as of Sept. 21, 2022

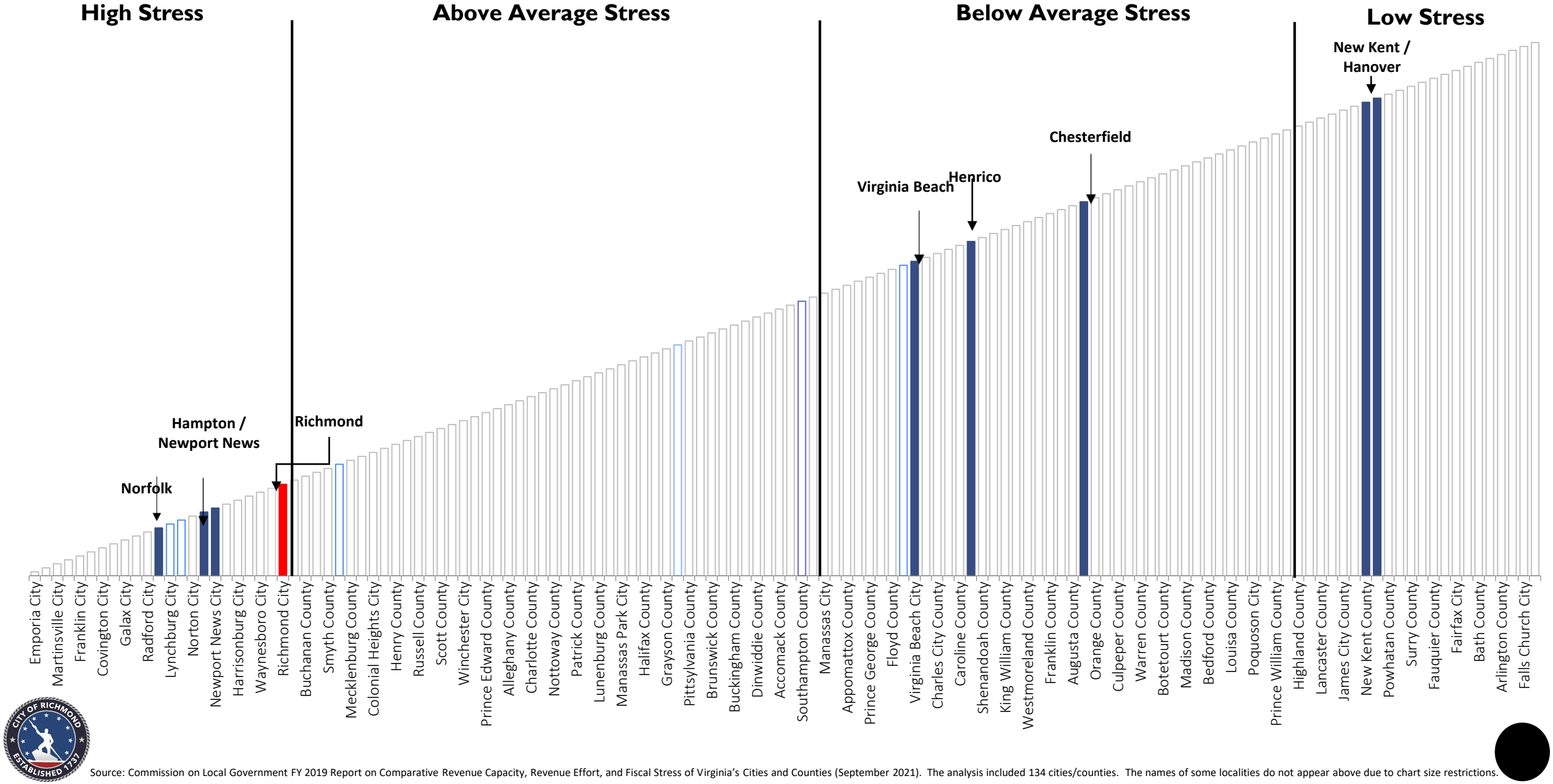


Each dot represents an individual Fed policymaker's expectation of the appropriate setting of the federal funds rate as of the end of that calendar year. The Fed has only just begun to be restrictive.

The chart shows that the FOMC expects the federal funds rate to continue to raise and remain high through 2023. (Forecast as of September 2022; next released in December 2022).

Source: Federal Reserve Board of Governors Forecast and Federal Reserve Bank of Richmond

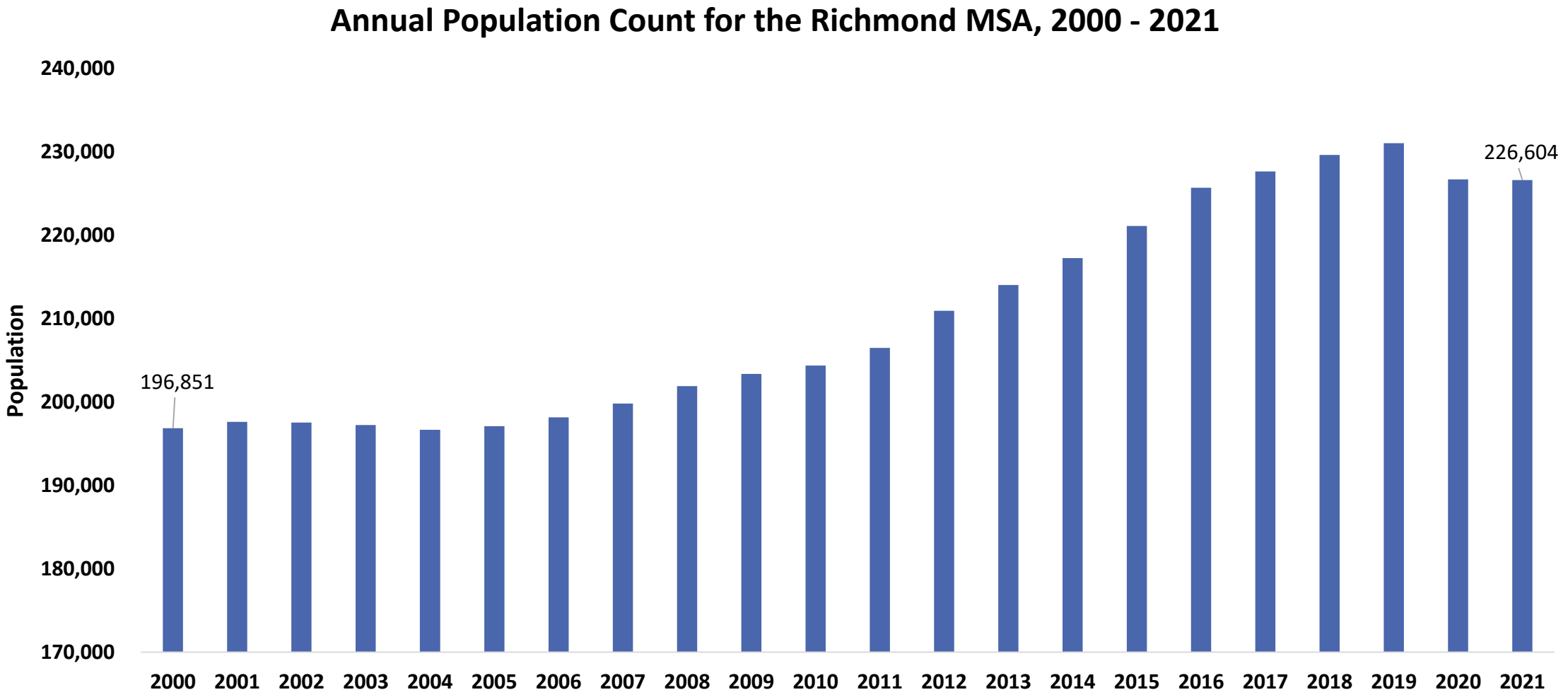
Richmond: 23rd Most Fiscally Stressed in Virginia



Source: Commission on Local Government FY 2019 Report on Comparative Revenue Capacity, Revenue Effort, and Fiscal Stress of Virginia's Cities and Counties (September 2021). The analysis included 134 cities/counties. The names of some localities do not appear above due to chart size restrictions.

City of Richmond Population Growth

Richmond has seen steady population growth with a 15.1 percent increase since 2000.



Source: U.S. Census Bureau

Is a recession coming and what will it mean for Richmond?

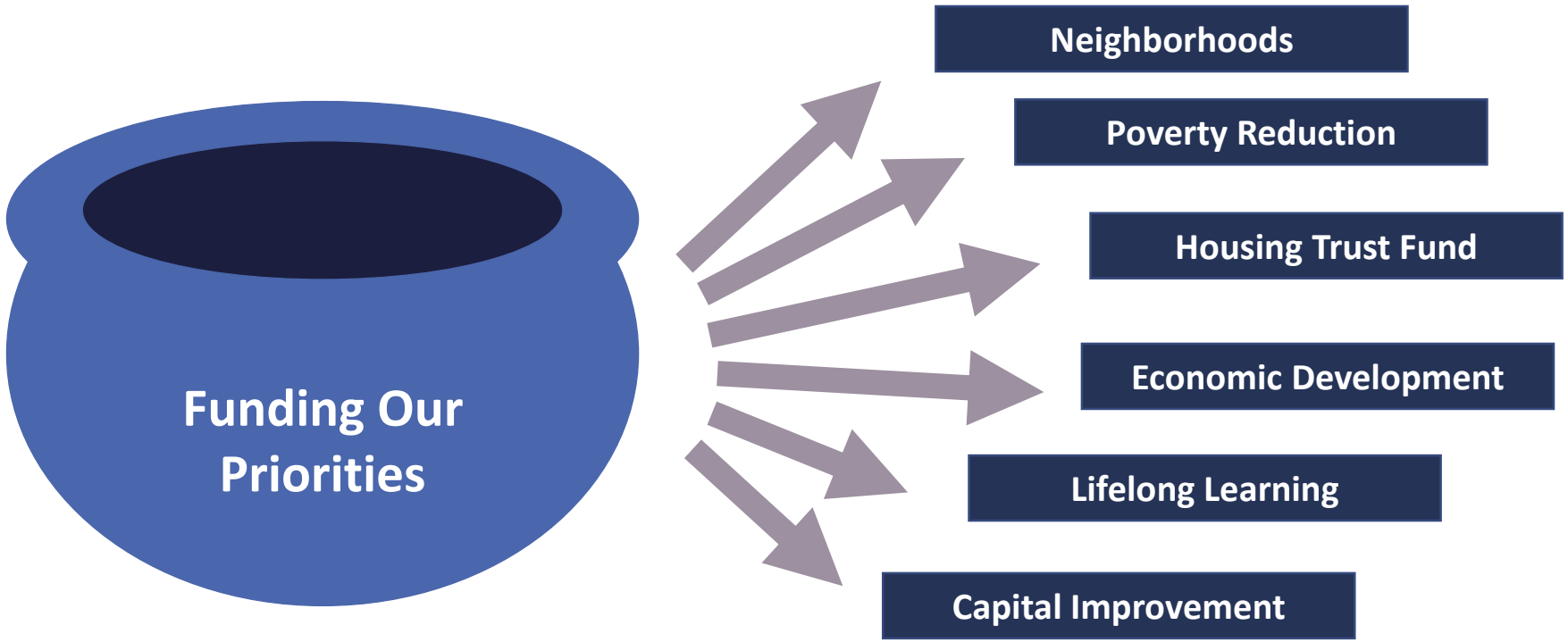
- Indicators show that the economy is slowing and is expected to slow even more in 2023 (but it is unclear how much)
- The course of inflation will determine how high the Federal Reserve decides to raise interest rates to tame prices
- At the national level, a recession may look mild in comparison to 2008
- Locally and regionally, service providers and businesses remain cautious about adding to payrolls and taking on additional expenses until revenues are comfortably outpacing costs

City Services Are Not Immune to Economic Changes

- Population continues to increase
- The labor force is tighter in the state and region
- Employee recruiting and retention is extremely competitive
  - Tight labor market
  - Higher expectations
  - Salary competition
- Inflationary increases
  - Energy (fuel, natural gas, electricity)
  - Contractual increases
  - Information Technology (IT), vehicles, insurance, goods and services, etc.
- Construction cost escalations

FY 2023 and Beyond: Funding Our Priorities

With an uncertain economic climate, how do our forecasts help us make sound financial decisions to fund our priorities?



Three Economic Forecasting Scenarios

Given a $1.20 Real Estate Tax Rate, the forecast projects budget variance through FY 2028 under three revenue growth rates dependent on the economic climate:

BASE Scenario:

5% Organic Revenue Growth

PESSIMISTIC Scenario:

2% Organic Revenue Growth

OPTIMISTIC Scenario:

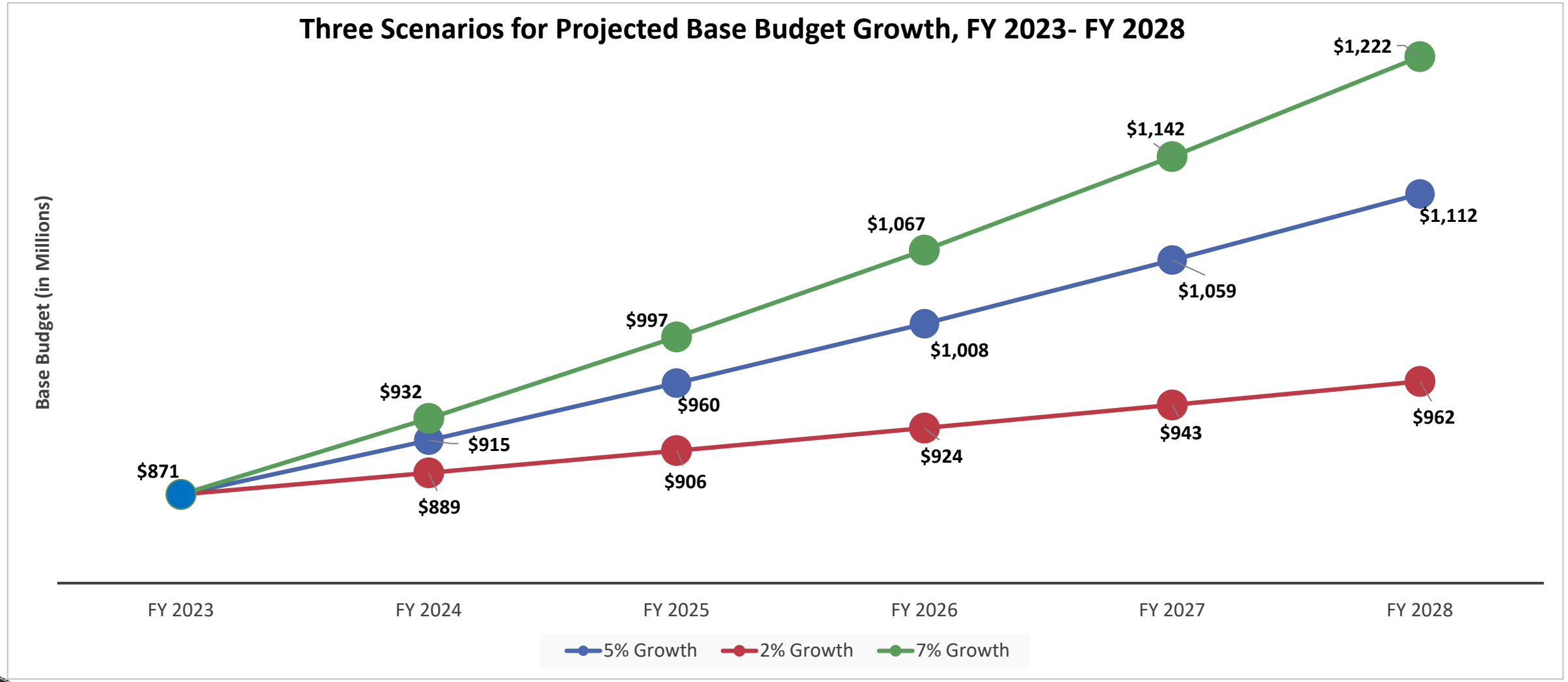
7% Organic Revenue Growth

FORECAST ASSUMPTIONS

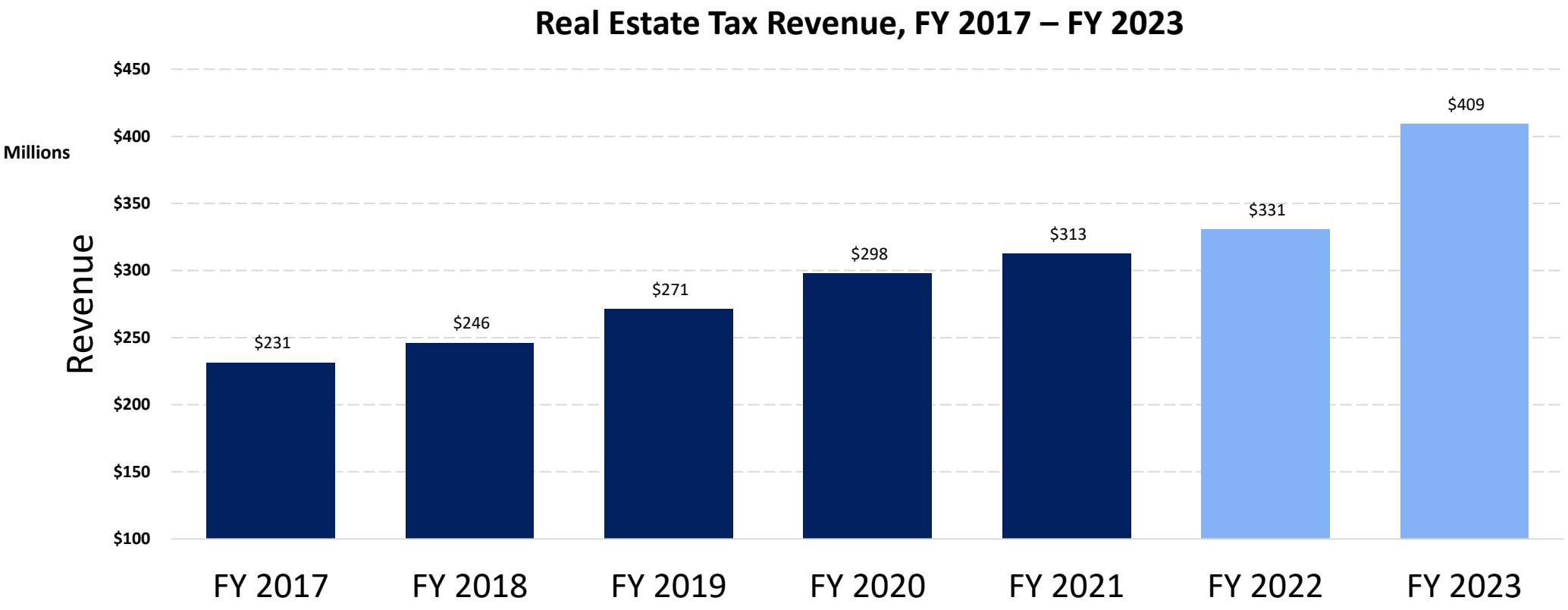
- Each year's base budget incorporates both organic growth rates and prior year costs

- Variance is the difference between the resources available to support projected costs

PROJECTED BASE BUDGET GROWTH SCENARIOS ESTIMATES



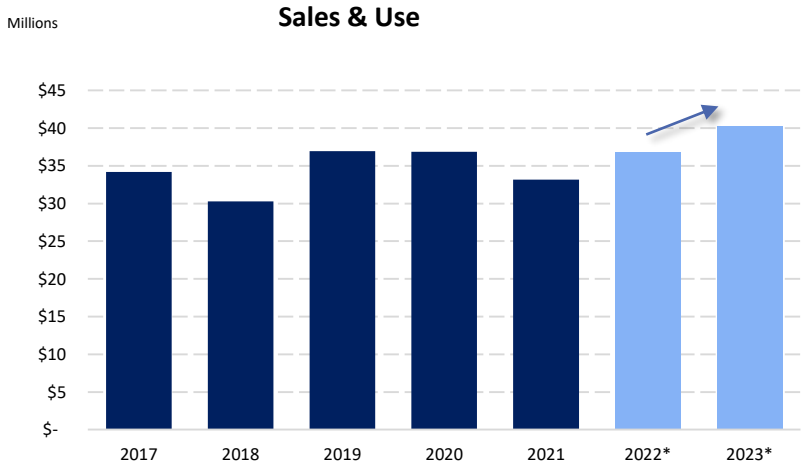
Real Estate Tax Revenue Growth

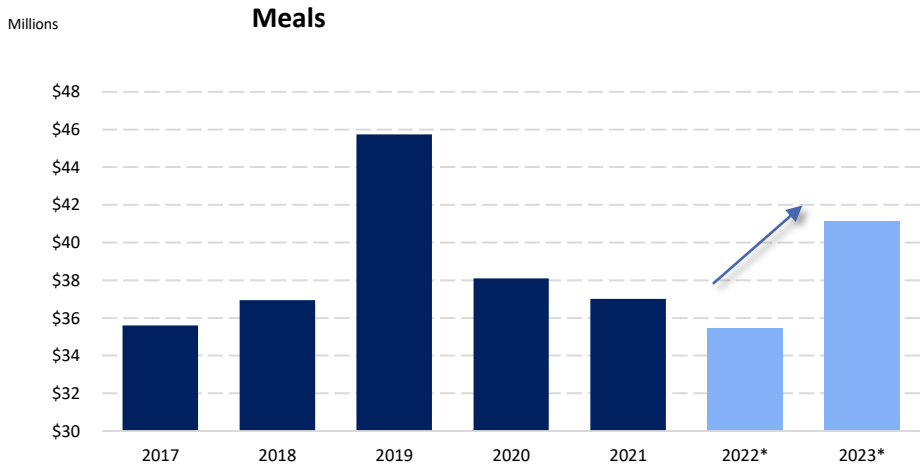


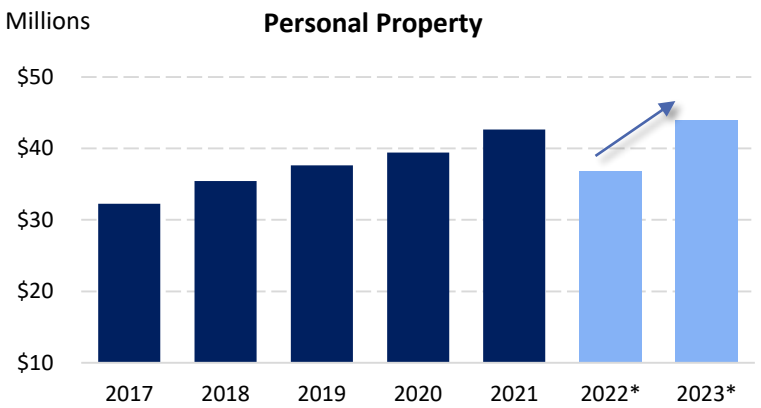
Note: FY 2022 and FY 2023 are based on Adopted Budgets, FY 2017-2021 are actual

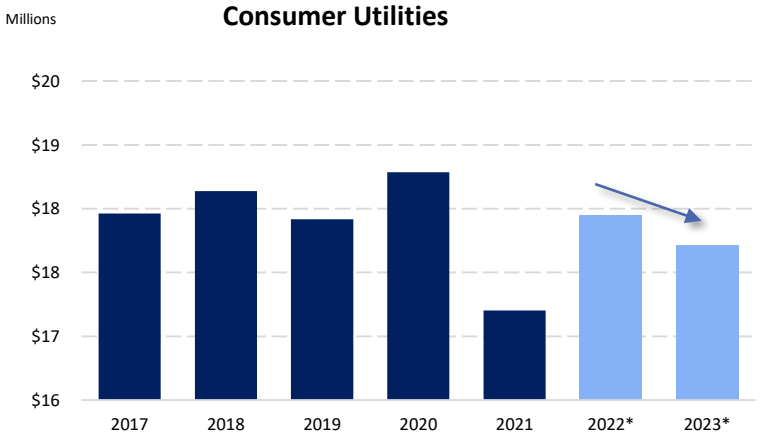
Real estate tax revenue is the single largest revenue source of the General Fund.

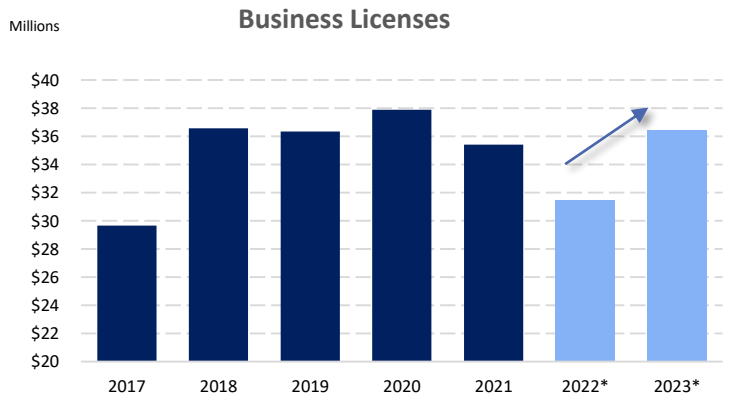
KEY LOCAL REVENUE TRENDS INTO FY 2023











Note: FY 2022 and FY 2023 are based on Adopted Budgets, FY 2017-2021 are actual

What Are Our Known Costs?

- The financial forecast includes estimated costs on known items at a point in time
- Estimates are developed based on the following assumptions:
  - Anticipated commitments
  - Contractual increases
  - Historical expenditures
  - Market trends
  - Past trends
  - Rate increases

General Pricing Guide – Selected Items

Police Officer/ Fire Fighter	Police Vehicle	Ladder Truck	Trash Truck
$74,200	$50,000	$2.0 million	$300,000

Personnel is a Cost Driver

Personnel Cost Estimates (FY 2024 – 2028)

- Annual Salary Increases:
  - Public Safety Sworn Officers: $4.0 - $4.4 Million (One Step Increase)
  - General Wage Employees: $7.5 - $9.1 million (Five percent)
- Transition to Virginia Retirement System (VRS)?
  - Cost is currently unknown
  - For purposes of this forecast, an initial cost of $10.0 million in FY 2024 and a five percent increase in the subsequent years is assumed

Maintaining the Competitive Edge

- Health Insurance
  - $2.0 million or six percent increase (from FY 2022 to FY 2023)
  - Assumes an additional $2.0 million increase in out years
- Other Personnel Costs - $18.3 million
  - Compensation Reform – Competitive/Market Adjustments
  - Critical Positions/policy adjustments to wages such as on-call
  - Supplemental pay (Language Incentive)
  - Ongoing program commitments (Fire and Emergency Services SAFER grant)
  - Collective Bargaining?

Operating Expenses Continue to Increase (Estimated Costs)

- Affordable Housing Trust Fund: $10.0 million per year
- Debt Service (includes construction of schools): $14.9 million over the five years)
- Richmond Public Schools: increase over the next five-years of $75.2 million
  - RPS receives a portion of real estate tax revenue. Adjustments to this revenue source will impact funding to schools
- Rent and Contracts – increases for lease agreements, security upgrades, software fees, waste management and recycling, etc.
- Utilities – increases based on increases in rates

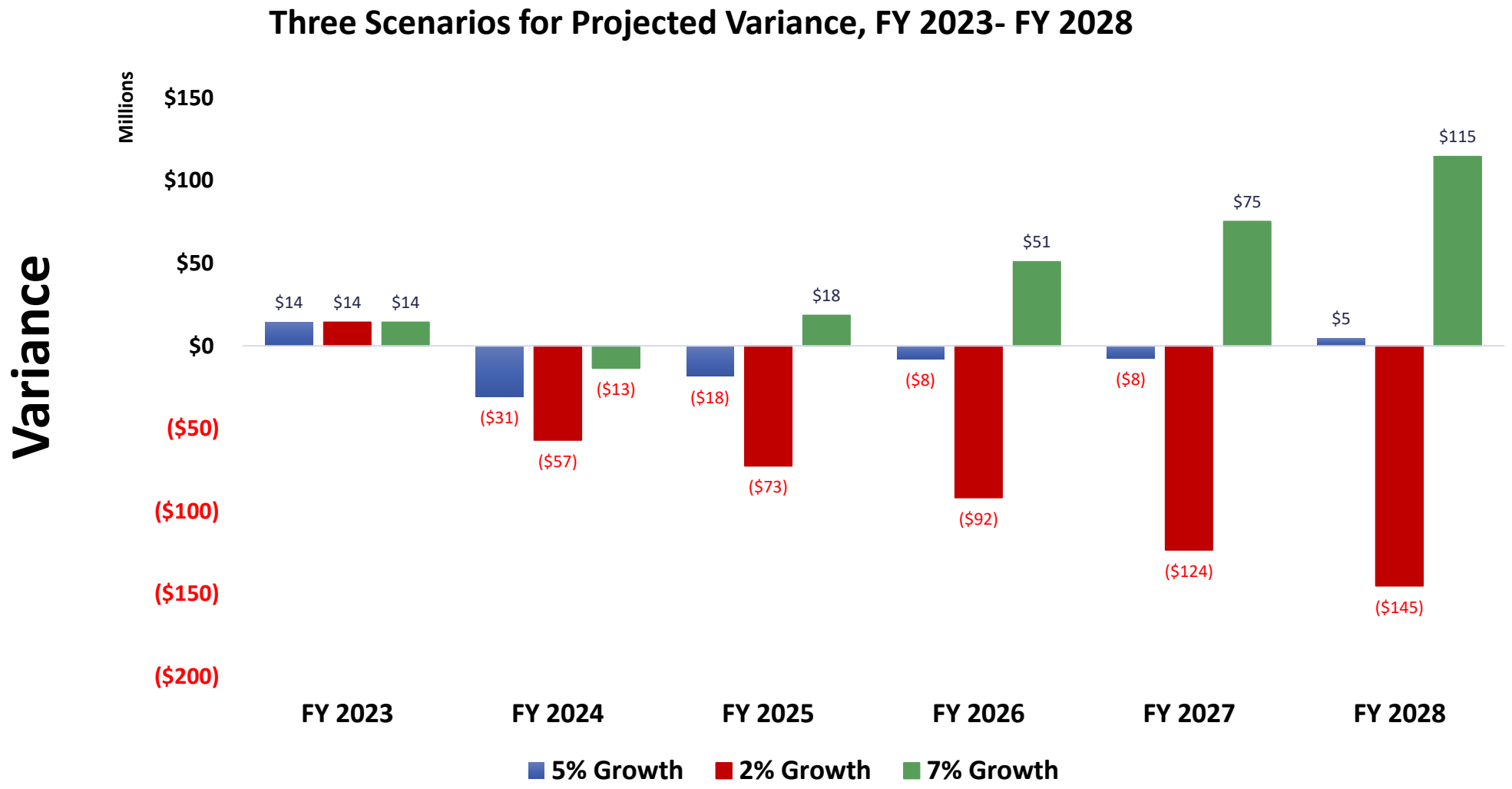
Other Cost Impacts

- Risk Management/Insurance: $2.0 million increase over the five years (assumes an annual three percent increase)
- Increase cash funding to Capital Improvement Program
- Economic Development contractual costs and incentives: $4.1 million
- Presidential election cost: $1.0 million
- Tax Relief for Senior and Disabled moving to a rolling application process
- Internal Service Funds: IT and Fleet
- Funding agreements:
  - Greater Richmond Transit Company (GRTC), Richmond Behavioral Health Authority (RBHA), Richmond Retirement System (RRS)
- Inclement weather shelter

How Do We Weather an Unpredictable Economic Climate?

Competitive Advantage	• Foster economic development • Increase regional programming • Foster vitality in the city
Financial Management	• Manage debt • Preserve a structurally balanced budget • Long-term view on decisions
Employer of Choice	• Attract and retain qualified talent • Competitive salaries • Expand positive cultural norms
Infrastructure	• Invest in facility maintenance • Update IT, automate where possible • Long-term view for vehicle purchases

PROJECTED VARIANCE SCENARIOS



Final Thoughts

- A five or more percent growth scenario is needed to meet the city's budget needs of the future

- Good fiscal management and planning helps us to manage shocks and stresses to the system.

DISCUSSION