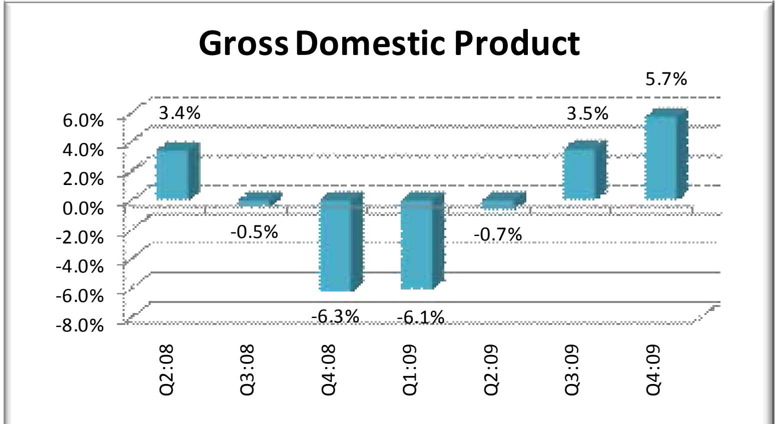
REVENUES

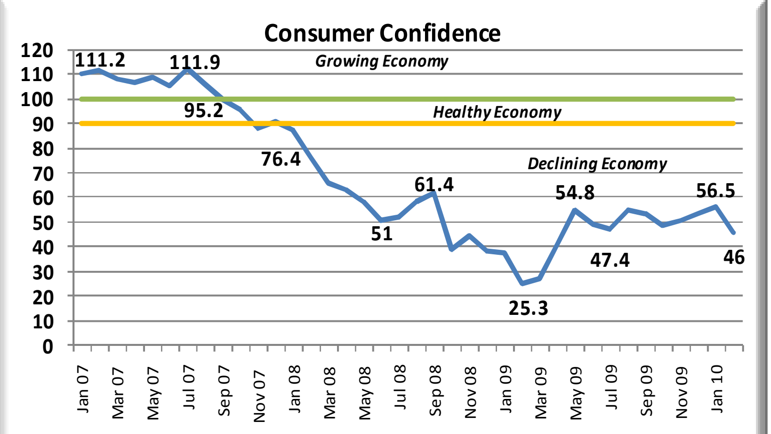
Revenues

National Economic Overview - Following the gravest recession, since the Great Depression, the national economy is showing some potential green shoot activity. The federal government's American Recovery and Reinvestment Act (ARRA), America's Recovery Capital Loan Program (ARC), and Troubled Asset Recovery Program (TARP) have moderated the longevity of the recession, and the gross domestic product (GDP) has shifted from four record setting consecutive declining quarters (see adjacent graph) to two quarters of growth, but is this sustainable? Furthermore, have manufacturers, wholesalers and retailers caused an economic aberration?[1] Over the past year, with consumer spending waning, these sectors depleted their business inventories. Anticipating a modest holiday season, they replenished. This had a positive effect upon GDP. During this same period, national household spending declined year-over-year 0.3%. This indicates the replenishment played a major role in the quarterly economic growth; moreover further obscuring consumer spending, the previous year was the worst holiday retail sales season in forty years (-3.2%). Overall, in 2009, consumer sales fell -6.2%.[2]



Source: Bureau of Labor Statistics

Why aren't consumers spending? Unemployment and job loss anxiety have decreased the ability and desire to spend. With unemployment hovering around 10% and representing almost 16 million job seekers (a 26 year high), disposable income is scarce for the unemployed; moreover job loss anxiety makes it desirable for employed workers to save and avoid spending. In 2005, the savings rate was less than 2%. In 2009, it climbed to nearly 5%. The last time it reached this level was ten years ago.[3] Unemployment, job loss anxiety, and the financial crisis have shaken consumer confidence. Consumer confidence began declining in 2008 and bottomed out in 2009. With 90 on the index indicating a healthy economy and 100 a growing one, the low point of 25 indicated fiscal distress across America. Presently, the index is approximately 46.



Source: Conference Board

During the robust growth years of the mid-2000s, consumer spending was bolstered by relaxed credit standards, creative credit opportunities and an abundance of credit options. Credit cards were easily attained, and many consumers leisurely used them and sought more. Additional credit requests were often granted; moreover with home values aggressively escalating, homeowners were able to use equity to make purchases and invigorate GDP, but when credit institutions began to falter, credit card offers evaporated, credit limits were lowered, and home equity loans became more difficult to attain. Further constraining the credit user, credit card interest rates escalated and required more monthly disposable income to

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1 Gongloff, Mark, December 1, 2009, *Growth's Albatross: Inventory Rebound,* Ahead of the Tape, Wall Street Journal, Vol. CCLIV, #142, NY, NY, p. C1.

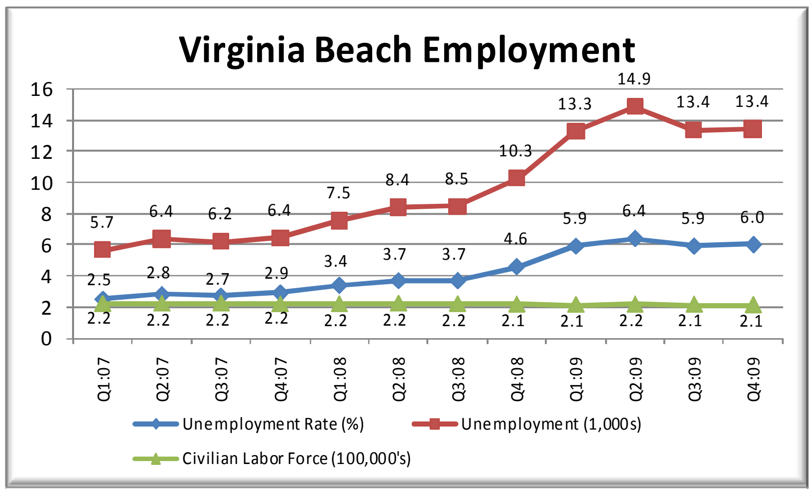
2 Crutsinger, Martin, November 15, 2009, *Mixed Message,* businessday, The Virginian-Pilot, Norfolk, VA, Main section, p. 10.

3 Walzer, Philip, January 15, 2010, *Retail Sales Drop, Slamming Register Shut on Dismal Year,* The Virginian-Pilot, Norfolk, VA, Business section, pp. 1 and 3.

make the minimum payment. For those unemployed and/or overextended, credit was no longer a purchasing option. This financial and unemployment crisis resulted in a national GDP decrease.

The national economic engine is beginning to churn, but it may take years to reach robustness. The last decade was disappointing. It was a period of zero job growth; GDP rose at its slowest pace since the 1930s; and the average middle income household earned less, after adjusting for inflation, than they did at the end of the 1990s.[4] Typically, after a recession, twenty-five percent of jobs do not return.[5] If this holds true for this past recession, nationally, four million jobs will no longer exist. Further complicating employment, typically, newly employed post-recessionary workers incur pay scale reductions.[6] This erodes a worker's discretionary ability to spend disposable income. Presently, the ratio of job seekers to available jobs is 6:1.[7] To reach a level of full national employment, the economy needs to produce 400,000 jobs per month for three years. Presently, job losses have dropped from 500,000 to 31,000.[8] Positive net job creation has not started. While corporations are finding creative ways to finance growth,[9] they are being cautious and utilizing present employees and temporary staff to reach higher productivity levels.[10] The key to accelerating GDP is through job growth. While growth will come, it will likely be slow.

Virginia Beach Economic Overview – During the 1990-91 and 2001 recessions, Virginia Beach experienced economic insulation. The city fared better than the nation. The diversity of local industry created a beneficial circumstance; however, the gravity of the most recent recession had a negative effect upon the community. For instance, according to the Virginia Employment Commission, the unemployment rate has climbed to 6.0% and has remained there for four quarters. In a growing economy, the average number of workers seeking employment is approximately 6,200 per quarter. During the past recession, the average climbed to 13,700. This compares to the 2001 recessional average of 6,400. The greatest credit pressure manifested in mortgage payments. According to the New York Federal Reserve, at the end of the third quarter of 2009, the national rate of mortgage payments, more than 90 days late, was 5.0%. Virginia Beach's rate was 2.9%. This is 1.4% more than Virginia Beach's previous year. Unemployment is also depressing students' ability to pay back college loans. Nationally, 10.5% of student loans are more than 90 days late. In Virginia Beach, the rate is 11.3%. This is 1.5% above last year. Credit card (1.7%) and auto loans (1.2%) delinquent more than 60 days are equal to the national average. These delinquencies were the same as last year. Upon review of the two most previous recessions, recovery of pre-recessionary employment was slow. For instance, after the three quarter 2001 recession, where unemployment topped out at 3.4%, it took 61 months to recover. During the 1990-1991 three quarter recession, unemployment peaked at 5.2%, and it took 86 months to recover. Currently, with unemployment above 6% and the recession's duration extending an additional quarter, all indicators imply an extensive recovery period.



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4 Irwin, Neil, January 3, 2010, *The Awful Aughts,* The Virginian-Pilot, Norfolk, VA, Main section, pp. 1 and 12.

5 Izzo, Phil, February 12, 2010, *Many Jobs Gone Forever, Economists Say,* U.S. News, Wall Street Journal, Vol. CCLV, #35, NY, NY, p. A4.

6 Couch, Kenneth, Nicholas A. Jolly and Dana W. Placzek, April 2009, *Mass Layoffs and Their Impact on Earnings During Recessions and Expansions,* Occasional Paper Series 2009-10, Connecticut Department of Labor, Office of Research, Wethersfield, CT.

7 Rugaber, Christopher S., October 10, 2009, *About Six Workers Seek Each U.S. Job Opening,* businessday, The Virginian-Pilot, Norfolk, VA, Main section, pp. 1 and 12.

8 Di Leo, Luca and Sara Murray, February 19, 2010, *New Jobless Claims Jump by 31,000,* U.S. News, Wall Street Journal, Vol. CCLV, #40, NY, NY, p. A2.

9 Henry, David, December 21, 2009, *Companies Jump into the Financing Gap,* Finance, Business Week, NY, NY, p. 068.

10 Cooper, James C., November 23, 2009, *The Signs Say: Job Growth Ahead,* Business Outlook, Business Week, NY, NY, p. 018.

Forecasting Methodology

The City uses the following qualitative and quantitative methods to forecast revenues:

- Survey departments regarding trends in revenues.
- Interview local economists concerning the current and future state of the economy, and review national economic forecasting projections.
- Monitor national and local economic trends.
- Examine State and Federal budgets and legislative changes.
- Examine relationships between revenues and economic variables.
- Use the following statistical techniques: Exponential Smoothing; Auto Regressive Integrated Moving Average (ARIMA); Autoregressive Distributed Lag Models; Vector Autoregression (VAR); and Regression Analysis.

The final projections are based upon a combination of the above techniques and educated judgment. The generally accepted public finance forecasting margin of error is 2.0%. The City has been within 1% of projections for six of the last ten years. From FY 2004 through FY 2006, the City experienced unusual General Sale, Deed, Cell Phone and Meal tax revenues. This growth led to collected revenues exceeding forecasted revenues by a greater margin than historically accustomed. In FY 2009, the national financial economic shock caused revenues to underperform.

Dedication of Other Local Taxes and Real Estate Taxes for Specific Purposes

Recent Real Estate Tax Rate Adjustments and Distributional Purpose Historical Perspective - The table below chronicles real estate tax rate changes from FY 1987-88 through FY 2010-11 and identifies the dedications. From FY 1982-83 through FY 1986-87, the City's real estate tax was 80¢ per $100 of assessed valuation. Single asterisk indicators represent voter-approved bond referenda rate increases. Beginning in FY 2004-05, the City Council lowered the overall tax rate and adjusted the following dedications: The Recreation Center rate decreased from 3.8¢ to 3.476¢ and Outdoor Initiatives from 0.7¢ to 0.47¢. In FY 1995-96, the Agriculture Reserve Program dedication was established at 1.5¢. In FY 2004-05, it was lowered to 1¢, and in FY 2006-07, it was lowered to 0.9¢. The adoption of the City/School Revenue Sharing Formula in FY 1997-98, which originally dedicated 53.13% of all Real Estate Taxes to Schools, replaced specific rates for school-related purposes identified below. Due to City Council approved modifications and State revenue changes, the formula percentage changed to 51.3%. All the non-school related purposes are funded within the City's share of 48.7% of Real Estate Taxes.

		Real Estate Tax Adjustment from FY 1986-87's Rate of 80¢					
Fiscal Year	Tax Rate Change	General Government	Parks and Recreation	Road Bonds	School Operating Budget	School CIP	Agriculture Reserve Program
1987-88	7.7¢			5¢*		2.7¢*	
1988-89	3.8¢		3.8¢*				
1989-90	6.2¢		0.7¢		5.5¢		
1990-91	5.5¢	0.6¢				4.9¢*	
1991-92	5.8¢				5.8¢		
1993-94	5.0¢	-0.7¢				5.7¢	
1995-96	4.8¢					3.3¢	1.5¢
1996-97	3.2¢				3.2¢		
2004-05	-2.36¢	-2.36¢					
2005-06	-17.25¢	-16.75¢					-0.5¢
2006-07	-3.39¢	-2.99¢	-0.3¢				-0.1¢
2007-08	-10¢	-9.746¢	-0.254¢				
TOTAL CHANGE	9¢	-31.946¢	3.946¢	5¢	14.5¢	16.6¢	0.9¢

*Note: Originally approved via referendum.

City/School Revenue Sharing – With the exception of real estate, personal property, and E-911 telecommunication taxes, the revenue sharing formula dedicates 51.3% of local revenues to the schools. Prior to FY 2011, the dedication for real estate and personal property was also 51.3%. As allowed under the City/School revenue sharing policy, in FY 2011, the City is recommending a rate increase to support City operations. The adjustment will not reduce pre- or post-recommendation school funding but changes the dedication percent.

Prior to the restructuring of telecommunication tax legislation, E-911 telecommunication revenues were not included in the revenue sharing formula. After the legislative restructuring, telecommunication tax revenue distributions included E-911. Maintaining the previous arrangement, E-911 revenues remain a 100% City source. The following table represents the current revenue sharing formula between the City and Schools:

City /School Revenue Sharing Formula		
Revenue Source	**General Government**	**Virginia Beach Schools**
Real Estate Property Tax	48.7%	51.3%
Personal Property Tax	48.7%	51.3%
Short Term Rental Tax	48.7%	51.3%
General Sales Tax	48.7%	51.3%
Utility Tax	48.7%	51.3%
Business Permits and Occupational Licenses	48.7%	51.3%
Cable Television Franchise Tax	48.7%	51.3%
Telecommunication Tax	48.7%	51.3%
E-911 Telecommunication Tax	100.0%	0.0%

Other Local Taxes - The following table indicates selected local tax dedications having specific purposes:

Dedication of Tax

Tax	Local Rate	General Fund	T.G.I.F.	T.A.P.	Beach Events	EDIP's	Major Projects	Open Space	Tax Elas-ticity*
Amusement Tax	10.0%		2.0%				8.0%		0.65
Hotel Room Tax	8.0%	2.0%	2.0%	1.0%	0.5%		2.5%		0.84
Restaurant Meal Tax	5.5%	3.5%	0.5%	0.5%			0.56%	0.44%	0.96
Cigarette Tax (per pack)	65¢	48¢				12¢	5¢		0.96

*Statistical Measure of Tax Elasticity – Elasticity is a measure of how one variable responds to a change in another variable. From a governmental perspective, the elasticity indicates whether a rate change would affect consumer usage and revenue generation. Using regression analysis in logarithmic form, the elasticity computation is Tax Revenues = f(tax rate, other causal variables). A calculation greater than "1" indicates governmental tax elasticity, and consumer behavior changes very little with a rate increase. Less than "1" suggests governmental inelasticity causing consumer behavior to change. For example, the elasticity of the Amusement Tax is 0.65; therefore, a 1% increase in the Amusement Tax will generate a 0.65% increase in tax revenues. As the elasticities indicate, all of the listed taxes are inelastic. Due to specificity and quantification complexities, these results are approximations.

Tourism Growth Investment Fund (TGIF) - This fund receives revenues from a variety of sources. They are hotel room, restaurant meal, and participatory sport admission taxes. City Council designated a portion of these to fund specific tourism projects, capital projects and special events. Beach Events are included in this fund.

Tourism Advertising Program Fund (TAP) - City Council designated funding for tourism's advertising and marketing costs.

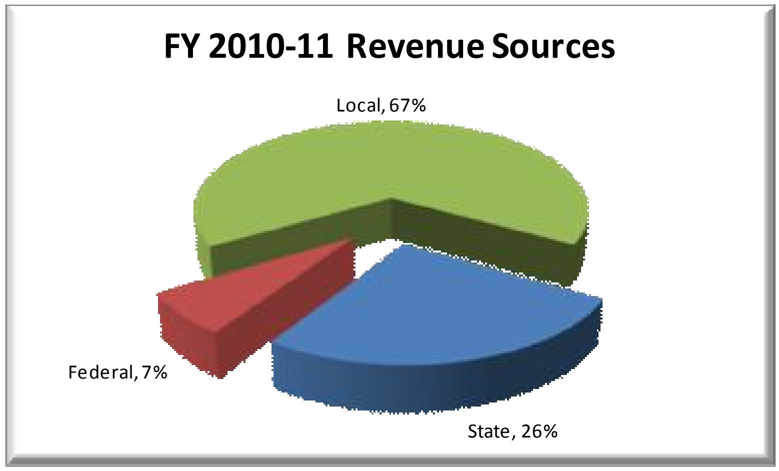
Economic Development Investment Program Fund (EDIP) - To support and enhance the City's economic development program and strategic plan, twelve cents (18.5%) of the local Cigarette tax rate is dedicated to this fund. This includes an FY 2011 increase of 2¢ dedicated to this program. The program will leverage grant dollars, fund infrastructure, and other case-by-case approved economic development initiatives. A policy to guide the use of these funds has been adopted by City Council.

Major Projects - This pays the debt service for the Convention Center, the Sandler Center; and the Virginia Aquarium and Marine Science Center.

Open Space - To acquire and preserve land for future generations, this fund provides open space initiative resources. Due to adverse economic circumstances, the FY 2011 operating budget recommends a two year programmatic acquisition moratorium, and the revenues temporarily diverted for other requirements. For additional information, the Parks and Recreation section discusses the other requirements.

Fees and Charges for FY 2010-11

To recover the cost of various services, the City relies upon various fees and charges. To keep pace with rising costs, each year, a proposed fee or charge increase is made. In FY 2011, there are fourteen proposed increases. They range from animal adoption to parking fees. In addition, three new fees are proposed. Within the Library fee structure, an average cost per citizen calculation was made. A new non-resident fee, based upon the average resident cost, will be charged. Lastly, the Treasurer's Office will begin collecting court fees improving delinquency collections and charging an administrative fee.



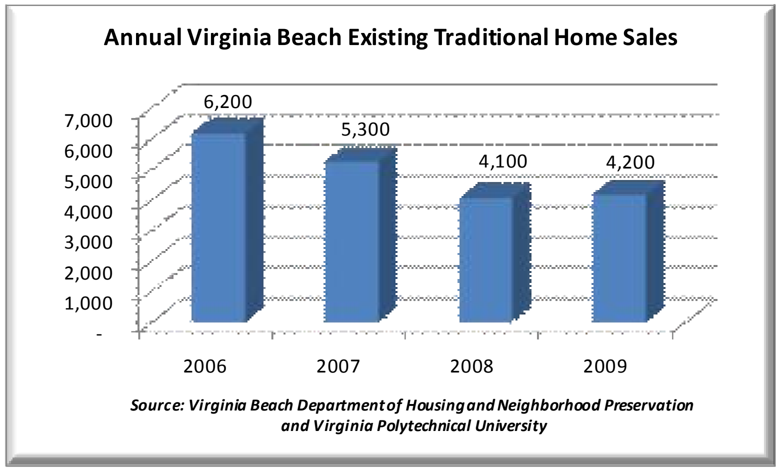
Overall, local sources comprise the largest portion of City revenues (see graph above). To review the various rate and fee changes, they can be found in the Executive Summary and in the individual department sections.

Changes in Funds

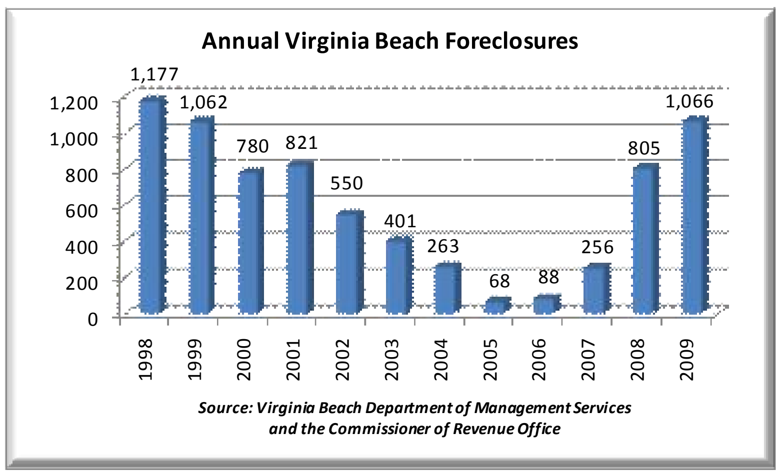
Consolidation/New Funds - To consolidate recreational programs and reporting, the Golf Course Special Revenue Fund merged with the Parks and Recreation Special Revenue Fund. Also, the Museum Grant Fund has been dissolved and made a budget unit within the Grants Fund.

General Fund Revenue Source Analysis

Real Estate Tax – After four years of double digit housing appreciation, the national housing and financial market recession has impinged upon most localities. This includes Virginia Beach. While most Virginia Beach neighborhoods are depreciating, homes with values greater than $500,000 are experiencing the largest depreciation rate.[1] In FY 2008-09, the number of homes sold was approximately 5,700. Of those homes sold, seventy-three percent, or 4,200, were classified as existing home traditional sales. A traditional sale is one going through a customary sales process. Typically, the home had been previously dwelled in and the buyer, real estate broker, seller and bank complete the sales transaction. In average years, the Ciy Real Estate Assessor would use these sales to annually assess entire neighborhoods. In FY 2006, there were approximately 6,200 of these sales. In FY 2007, there were 5,300. Each year thereafter, the sample pool for assessing existing homes decreased (see graph above). With a shortage of traditional transactions, as a proxy and supplement to existing home sales, the Assessor has used foreclosure sales.



In FY 2009, there were 620 foreclosure sales. Driving assessed values downward, the average foreclosure sale depreciated 14%; moreover the number of foreclosures rose to pre-decade levels (see adjacent graph). With foreclosures on the rise and prices declining, sales have expectedly increased and are having a depreciative affect upon many neighborhoods. Over the past three years, sub-prime adjustable rate mortgages (ARMs) have invigorated foreclosures. With most of these loans resetting at a rate 14% higher than the introductory period's rate and the banking crisis rendering tighter lending standards,[2] many of the sub prime borrowers were not able to refinance and lower their monthly mortgage payments. With limited disposable income, some of these borrowers defaulted. Fortunately, the precarious resetting of most sub-prime loans is complete. Unfortunately, another wave of ARMs are coming. Alt-A ARM loans similarly have a resetting period, but the introductory terms differ. During this period, the borrower was allowed to determine their payment schedule. Upon termination of the introductory period, the loan interest rate resets, and the banking institution compares the payment history to the minimal amount anticipated. During the introductory period, if the borrower didn't pay enough, the outstanding amount is added to the principal, and the interest rate resets on the new principal.[3] There were 13% more Alt-A loans issued in Virginia than sub-primes, and initial reset rates have been 7.7% above the introductory rate. Alt-A loans are anticipated to increase the foreclosure count.



While residential assessments are the largest tax revenue contributor, commercial properties also play a role. Throughout the region, commercial property values are decreasing. Most problematic are the multi-unit facilities. Utilizing an income

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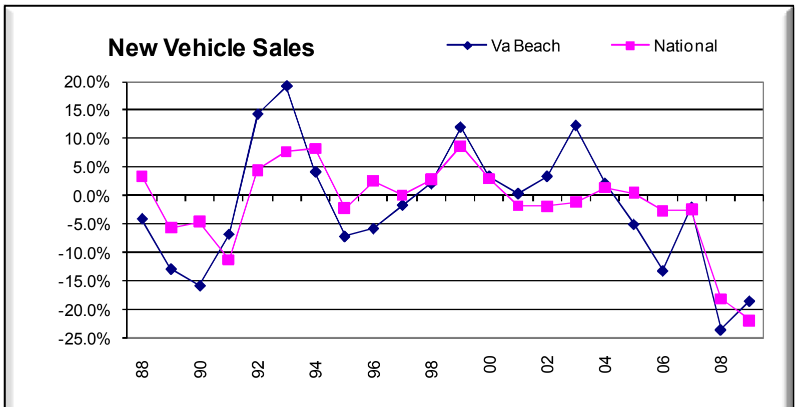
[1] Gongloff, Mark, December 29, 2009, *Higher-End Homes Face the Price Pressure,* Ahead of the Tape, Wall Street Journal, Vol. CCLIV, #152, NY, NY, p. C1.

[2] The Virginian-Pilot, August 12, 2008, *Banks Tighten Lending Standards Even More, Federal Reserve Finds*, bizworld at a glance, The Virginian-Pilot, Norfolk, VA, Business section, p. 3.

[3] Kelly, Tom, August 23, 2008, *More Gloom: Option ARM Fallout Might Surpass Subprime Mess*, gimme shelter, The Virginian-Pilot, Home., p. 14.

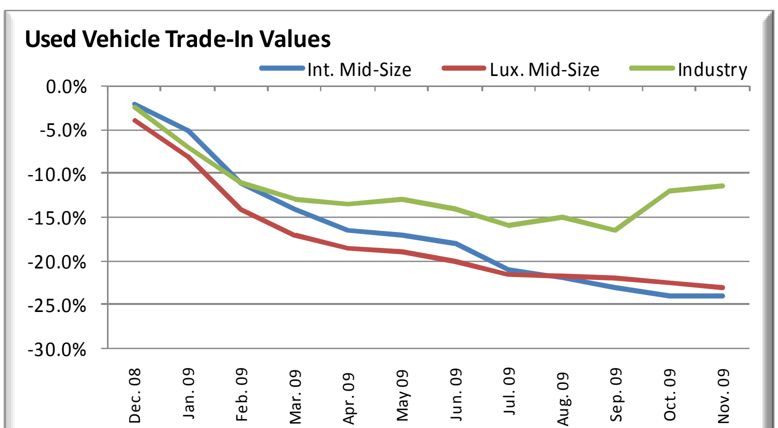
approach to calculate the assessed values, the City Real Estate Assessor uses rent charges as one determinant. With many businesses also incurring recessionary income constraints, some are downsizing and others closing. When office, industrial, retail, and apartment vacancies increase, owners lower rent to entice businesses to occupy. In 2009, vacancies increased approximately 15%. In 2010, vacancies are anticipated to increase another 12% - 18%. In 2009, rental rates decreased 14%, and in 2010, the rental rates are expected to fall an additional 11%.[4] With these variables declining, commercial property values are decreasing.

Estimated Revenue – Real estate growth projections are provided by the City Real Estate Assessor. For FY 2010-11, total real estate revenues are forecast to be $488,902,801 which is 2.1% under the previous year's budgeted amount. The revenue decrease is mitigated by a 3¢ rate increase. The renovation of the Bow Creek and Kempsville recreation centers are funded by 0.3¢ of the 3¢ increase. Public service real estate tax revenues (assessed by the State Corporation Commission) increased slightly.



Sources: Virginia Automobile Dealers Association & National Automobile Dealers Association Axis Title

Personal Property – Eighty percent of personal property taxes pertain to vehicle assessed values. Traditionally, in Virginia Beach, there has been a healthy vehicle buying churn. As vehicles aged and lost value, they were sold or traded in for a newer and higher valued vehicle. Typically, during a recession, the churn quiets. When the 1990 recession occurred, new vehicle sales decreased 11%. The insulated economic nature of Virginia Beach kept it from dipping as low as the national measurement of 16%. During the 1990 recession, unemployment peaked at 5.2%. Comparatively, during the 2001 recession, unemployment peaked at 3.4% and new vehicle sales dipped 1%. Demonstrating the magnitude of the most recent recession, unemployment climbed to 6.4% and new vehicle sales decreased 22%. Nationally, despite the federal governments "Cash-for-Clunkers" program, new car sales followed a similar trend (see graph above). Furthermore, used vehicles weren't selling, and gasoline prices reached $4 per gallon. To sell used vehicles, dealerships and individuals were willing to drop prices considerably. This had a noticeable effect on Virginia Beach's vehicle personal property assessed values. The decline was large, because new vehicle sales stalled, and used vehicle values declined. Both of these factors magnified the decrease in personal property revenues.



Source: NADA Used Car Guide

Nationally, according to the National Automobile Dealers Association (NADA), December 2008 was the month 1-5 year old used vehicle values began rapidly deteriorating. Annually compared values indicated a significant downward slide. Normally, when the change is measured, the trend is flat or appreciating. This is due to the inflationary effect over time upon new car values. Between November 2008 and January 2009, contrary to historical and inflationary trends, used vehicles depreciated greater than normal. December 2008 was the worst month. The sampling depreciated 7.5% for most used vehicle types. Two months later, trade-in values also plummeted. For instance, luxury and intermediate mid-size vehicle trade-in values fell 18%. To date, these vehicle

[4] Newswanger, Philip, October 26, 2009, *Commercial Vacancies Rise, Construction Slows*, News, Inside Business, Norfolk, VA, p. 3.

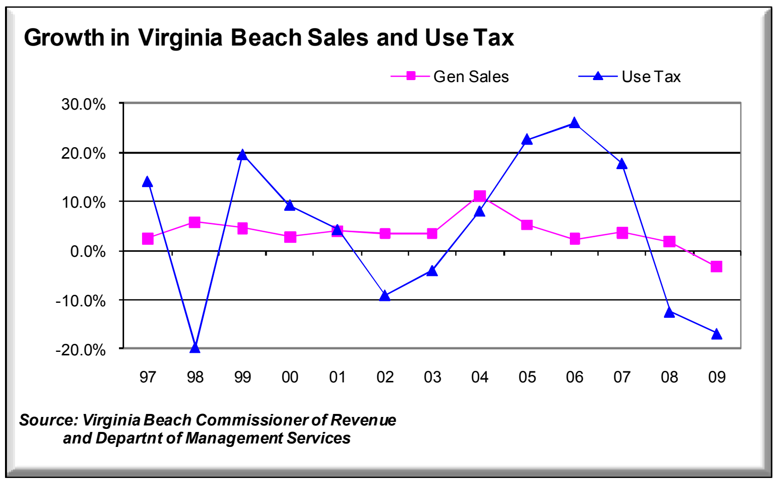
types have continued to decline. Both have declined 23% (see graph on previous page). With trade-in depreciation occurring monthly, some prospective consumers were not able to trade in vehicles for newer ones, because they owed too much on the trade-in and were reluctant to sink further into debt.

Further complicating the purchase of new vehicles, dealerships were requiring higher FICO credit scores. Between October and December 2008, the average required FICO score to purchase a new vehicle was 760. Since then, the requirement has declined to 715. Presently, the FICO score for a used vehicle has fallen from 708 to 650.

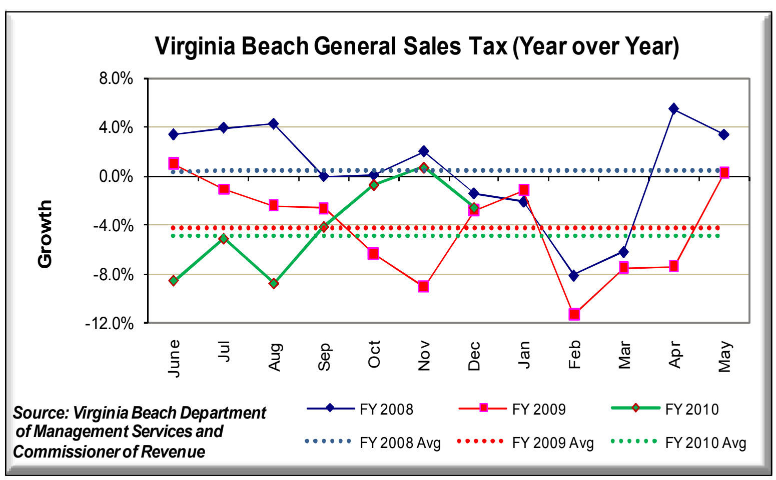
During FY 2005-06, the State implemented the Personal Property Tax Relief Act. In this act, localities receive a flat reimbursement, and it is not adjustable. The amount of the State reimbursement to Virginia Beach is $53.4 million. With projected growth in the vehicle base, this budget proposes a relief percentage of 70%. Consistent with original legislation, vehicles valued under $1,000 are not subject to taxation. Owners of vehicles valued between $1,001 and $20,000 will have to pay the remaining at 30% of the assessed value rate of $3.90 per $100, and vehicle values exceeding $20,000 will be taxed 100%.

Estimated Revenue - For FY 2010-11, Personal Property taxes are $120,124,744. This is 0.2% higher than last year's estimate and reflects a 10¢ vehicle rate increase.

General Sales – The general sales tax is comprised of a use tax and a merchandise sales tax. The merchandise sales tax represents the vast majority of the revenue. Reflecting historically, the use tax has experienced volatility, but compared to the sales tax, the amount collected is small. For instance the steep use tax declines in 1996 and 2002 did not have a profound effect upon the total tax collected. Conversely, up until 2009, the merchandise sales tax has shown steady growth between 1% and 10%. In 2009, the recession created the first decline in many years. Again, demonstrating the recession's magnitude, the 1990 and 2001 recessions had little effect upon the sales tax (see adjacent graph). Consumers maintained their buying behaviors.



When merchandise sales and use tax are combined and reflect monthly changes, declining patterns emerge. After many years of consistent growth (FY 2007 was +5.4%), September 2007 (FY 2008) proved to be a warning sign. Flat growth occurred two months in a row, and two months later, consumers began to adversely modify their spending patterns. February was the low point (-8%) of the fiscal year. This latter decline pulled the average annual growth down to 0.3%. With the exception of June 2008 and May 2009, every month in FY 2009 declined. Characteristic of the previous year, February was the low point (-11%). For FY 2009, the average rate of decline was 4.1%. In FY 2010, the average rate of decline is 4.8%. In FY 2010, the hope for a robust holiday season did



not materialize.[5] Retail establishments maintained profit margins by reducing inventory[6] and consumers saved their discretionary income; moreover the prior year's October and November performance was poor. In FY 2009, sales did not sink any further, but they didn't gain any upward momentum either.

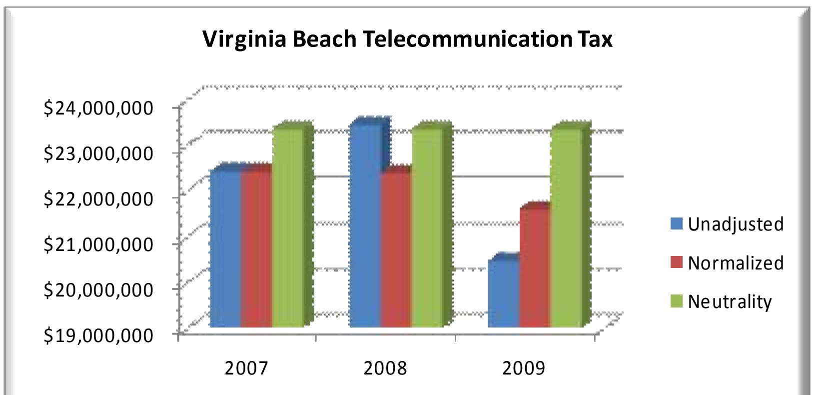
Internet sales tax collections, to the extent consumers are willing to report them, are reflected in the sales tax collection data. Over the past seven years, national Internet sales have grown between 20% and 40%. In 2008, Internet sales represented 6% of all U.S. sales, and 2009 approximately 7%.[7]

Historically Virginia Beach sales do not correlate strongly with national sales trends. Other causal variables have been analyzed. For instance, the correlation between annual military compensation increases and local sales is not strong. Employment serves as the strongest predictor. The Conference Board's Consumer Confidence Index is moderately correlated. When consumer confidence rises and bank lending standards relax, sales tax revenue should rebound.

Estimated Revenue - For FY 2010-11, estimated revenue for General Sales is expected to be $50,596,245. This is 1% under the previous year's budget.

Utility Tax – The utility tax represents residential and commercial electric, gas, and water bills. Historically, this revenue grows at a modest rate. When the state imposed a change to the local government utility taxing structure, all local governments were negatively affected.

Estimated Revenues - For FY 2010-11, estimated revenue for utility taxes is expected to be $25,235,300. This represents a 1.9% decrease under the previous year's budget and reflects a decrease in business consumption.



Source: Virginia Beach Department of Management Services and Virginia Department of Taxation

Virginia Telecommunications Tax - In January 2007, the State replaced all local telecommunication and cell phone taxes with a uniform 5% tax. The taxation applies to satellite TV, Internet phone service, Voice-Over-Internet-Protocol (VOIP), and satellite radio. To eliminate the various rate structures imposed by over 100 local governments, telecommunication industries intensely lobbied for this change. From a local government perspective, there were concerns about achieving revenue neutrality (a legislative promise). In actuality, with the proliferation of telecommunication means, most local governments experienced a decline. Anecdotal data suggests this. For instance, more people, particularly young and single, are canceling their land line service and are using cellular service only. Because those who made the transition had a cellular and landline telephone, the City does not benefit; the City loses taxation on the landline telephone. As a result, since its inception, the telecommunication tax has not reached neutrality.

Neutrality was based upon FY 2006 revenue collections and represents $23.4 million per annum. Revenues are received monthly, but they usually incur adjustments. Each month, the City receives adjustment information. The adjustments include overpayments, amnesty collections, and misapplied revenues. To measure the correct annual collections, the adjustments are applied, and a normalized collection is calculated. Over the course of three years, normalized revenues

5 Crutsinger, Martin, January 15, 2010, *Retail Sales Drop, Slamming Register Shut on Dismal Year,* businessday, The Virginian-Pilot, Norfolk, VA, Main section, p. 10.

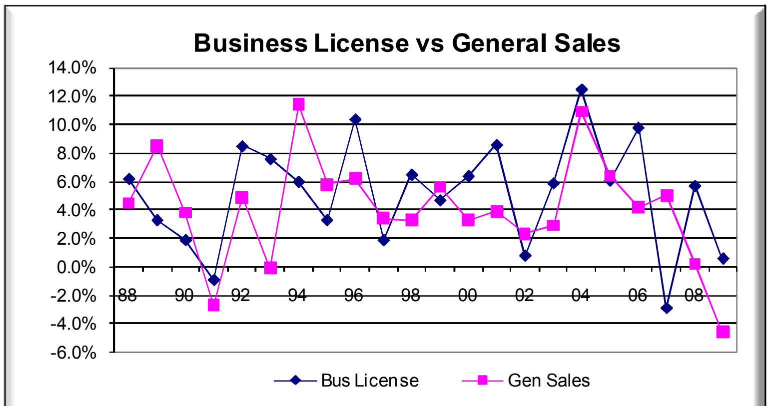
6 Holmes, Elizabeth, Ann Zimmerman and Rachel Dodes, November 30, 2009, *More Shoppers Hit Stores, But Spend Less,* Marketplace, Wall Street Journal, Vol. CCLIV, #128, NY, NY, p. B1.

7 Fowler, Geoffrey A., December 21, 2009, *As Stores Sputter, Sales Sizzle Online,* Marketplace, Wall Street Journal, Vol. CCLIV, #145, NY, NY, p. B1.

have not met neutrality. In 2008, revenues got close, but in 2009, along with large overpayment adjustments, a discount was applied. When the original legislation was adopted, there was a neutrality stipulation. According to the legislation, over a period of time, once unadjusted statewide revenues reached neutrality, a discount rate was yielded to the telecommunication companies. Mid-year 2009, statewide neutrality was reached, and the discount began. This has increased the local marginal difference between neutrality and normalcy.

Estimated Revenue - For FY 2010-11, this revenue is projected to be $22,017,919. The 7% decrease (compared to the previous budget) is attributed to the statewide discount.

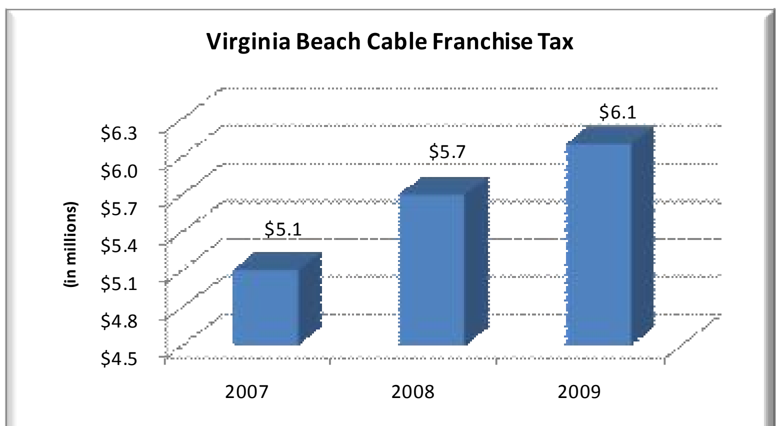
Business Permit and Occupational License Tax (BPOL) - As the adjacent graph illustrates, this revenue consistently outperforms General Sales. BPOL uniquely captures service sector activity and has more volatility. Some of the volatility is due to rebates, reporting and auditing issues. When audits produce adjustments, the change is posted in the current operating year distorting the current year and the correction year. While these variations can alter the collections, some of the volatility is not explanatory. For instance, business cycle shocks are difficult to pinpoint. A profitable business may simply choose to close, while another may declare bankruptcy. At the same time, a chain of stores may create new businesses throughout the City. The offsetting effect over the course of a year would require considerable analytical work. Last year's decline serves as a notable example. Sophisticated forecasting techniques do poorly; moreover none of the broad local economic indicators are good predictors either. Hence, this revenue is often projected based on simple trend analysis and economic outlook.



Source: Virginia Beach Department of Management Services and the Commissioner of Revenue

Estimated Revenue - For FY 2010-11, estimated revenue for BPOL is projected to be $40,771,644. Anticipating the beginning of a slow recovery period, this is a 0.5% increase over last year's budget.

Cable Franchise Tax – During the recession, many discretionary spending decisions were made by consumers. For instance, some big ticket purchases were delayed, and consumers turned to discount stores for goods. One area unaffected by the recession has been entertainment. While theater prices have escalated, movie rentals and pay-per-view have only modestly increased. At the beginning of 2009, Cox Communications modestly raised their standard cable service rate 6.4% to $48.95 per month, and on-demand prices increased to $4.99 per movie. This low cost option has created a "nesting process." Cox Hampton Roads General Manager, Gary McCollum, describes the nesting process as, "Customers who are more inclined to spend less money by staying at home and ordering a pay-per-view or on-demand movie from cable rather than taking the family out to the movie."[8] For families desiring to save money, pay-per-view has been an affordable option.[9] Enhancing the home entertainment experience has been a growing sector of the cable industry.



Source: Virginia Beach Department of Taxation and Virginia Department of Taxation

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[8] Schwartz, Michael, May 4, 2009, *Cox Fighting Economy and Competition*, News, Inside Business, Norfolk, VA, p. 9.

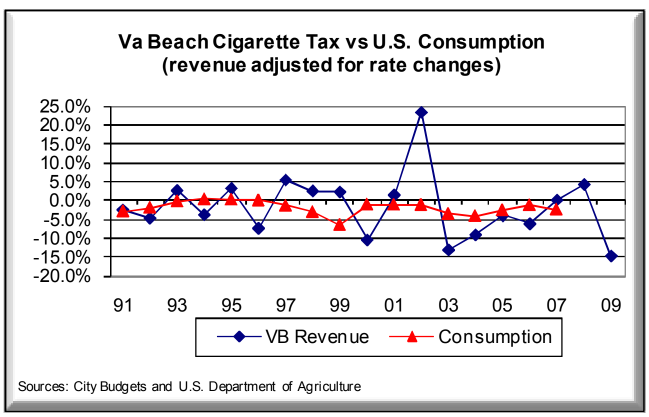
[9] McCollum, Gary, January 5, 2009, *Gary McCollum, General Manager, Cox Hampton Roads, Chesapeake*, Economic Forecast, Inside Business, Norfolk, VA, p. 10.

More and more high definition and digital channels have been introduced. To receive the channels, consumers are required to pay increased monthly rates. For instance, Cox Cable has added 13 new HD channels[10] and Verizon Fios launched 53. To receive the Fios upgrade, a customer has to purchase the TV Extreme HD package; moreover thirty-three of the channels require an additional subscription to premium movie networks. In addition to the premium channel prices, the Fios HD package costs $57.99.[11] Cox Cable offers a digital package for $7.50 per month.[12] As the cable menu options have increased, consumers have used preferential cost saving entertainment strategies to supplant higher cost entertainment venues. Because the cable franchise tax is based upon gross revenues and prices have increased with options, the cable franchise revenues have also gone up.

Estimated Revenue - For FY 2010-11, cable franchise revenues are projected to be $6,538,943. This is an increase of 11% over the previous year's budget.

Automobile License Fee - This revenue has historically grown in a moderate and stable manner. This partially reflects the slow growth in our population. In FY 2003-04, the City eliminated physical issuance of decals and began using the DMV State registration process to collect license fees. Because DMV has a more comprehensive vehicle discovery process, this collection process has produced additional revenue. In May 2004, the City entered into an agreement; whereupon, until delinquent license fees are satisfied, tax payers are not allowed to register vehicles. More recently, this revenue has experienced flat or declining growth, and may be attributable to several factors. Traditionally, the City has had an offsetting vehicle effect. New drivers and in-migrating families offset out-migration and vehicle driving cessation. New drivers typically come from high schools. According to school enrollment statistics, the driver age student population is declining; moreover unlike older generational traditions, some teenagers have less zeal to drive. Both factors would decrease the need for vehicles. Another diminishing factor is the graying of America. Demographically, the baby boom generation, representing a very large proportion of the population, is aging, and they are giving up their driver's licenses and selling their undriven vehicles. Lastly, the City has experienced a net out-migration of residents. When all these factors are netted against each other, there is a tendency for no growth to modest gain. When recessionary shocks occur, this tends to mitigate gains.

Estimated Revenue – Given the explained factors, further complicated by a deep recession, for FY 2010-11, automobile license fees are projected to be $8,734,363. This is 3% below the previous year's budget.



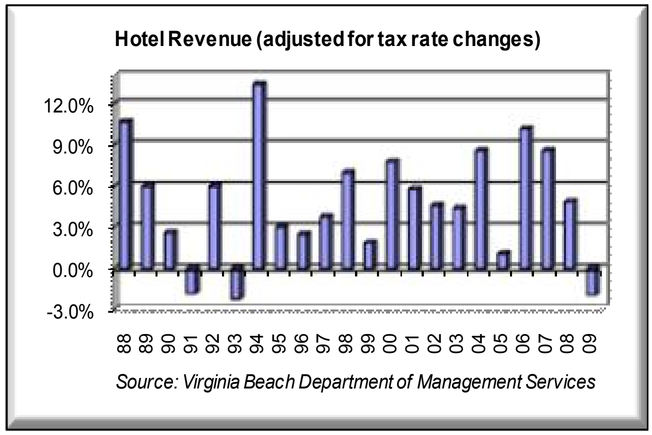
Cigarette Tax - The cigarette tax revenue trend is volatile (see adjacent graph). There are numerous factors contributing to this. Some of those factors include health awareness, non-smoking legislation, cancer litigation, prices, and competition. Overall, national consumption has generally declined. In 2008, the cigarette user population was at a low of 19.8%. Theoretically, when economic shocks occur, tobacco consumption increases. This is true for the recent recession. Consumption increased to 21% of the population and represents the first increase since 1994. Prior to the recession, between 1997 and 2004, cigarette prices jumped 63% and contributed to a consumption decline of 15%. Between 2004 and 2008, prices rose 2% and consumption decreased 1%.[13] Approximately 46 million people consume cigarettes. This compares with 50.1 million in 1965. Of those currently consuming, 10% smoke at least 25 cigarettes a day compared with 20.1 cigarettes in 1965; 34% currently smoke 15-24 cigarettes a day compared to 44% in 1965; and 56% smoke fewer than 15 cigarettes a day compared to 36% in 1965. Clearly, there is a desire to consume tobacco, but usage has shifted to what might be termed a "part-time smoker." Average usage in 1980 was 21 cigarettes per day to 13 today.[14] Historically, after a tax rate increase, this revenue declines.

[10] Shapiro, Carolyn, December 5, 2008, *Cox Adds 13 More HD Channels*, bizworld at a glance, The Virginian-Pilot, Business section, p. 3.
[11] Shapiro, Carolyn, November 7, 2008, *Verizon Adds 55 Channels for Fios*, bizworld at a glance, The Virginian-Pilot, Business section, p. 3..
[12] Shapiro, Carolyn, October 22, 2008, *Cable Rates on the Rise*, Television, The Virginian-Pilot, Business section, p. 1 and 3.
[13] Stobbe, Mike, November 13, 2009, *Smoking Decline Hits a Rough Patch*, The Virginian-Pilot, Main section, p. 5.
[14] Beck, Melinda, January 12, 2010, *Rise of the Part-Time Smoker*, Personal Journal, Wall Street Journal, Vol. CCLV, #9, NY, NY, p. D1.

Presumably, this either encourages cessation or alternative purchasing decisions. Likely, it's a combination of both with more weight going to the latter.

Estimated Revenue - For FY 2010-11, cigarette tax revenues are projected to be $12,721,345. This is 2% below last year's budget. To focus on preserving programs supporting the business community and enhance the Economic Development Investment Program, the rate is proposed to increase from 61¢ per pack to 65¢.

Hotel Tax – With the exception of last year, over the last fifteen years, the City has been able to maintain a healthy tourism and convention oriented business growth trend. Up until last year, during this period, only 1999 and 2005 experienced modest growth. 2005's small growth was attributable to excess summer rain. The last time city hotel revenues decreased was sixteen years ago (see adjacent graph).



While Virginia Beach incurred a 2009 loss in hotel revenues, the City has fared better than other resort cities and the region. Comparative data is available for 2008 and the first quarter of 2009. Old Dominion University conducted a study and found, in 2008, hotel revenues decreased 5.3% in Hampton Roads, 3.0% in Jacksonville, FL, 2.6% in Charlotte, NC, 0.7% in Charleston, SC, and 1.9% in Richmond. Raleigh, NC realized a gain of 0.1%, and Virginia Beach gained 4.9%. In the first quarter of 2009, further deterioration occurred. During the summer, Virginia Beach's June and July average hotel room profitability measurement, called Rev-Par, decreased 12% and 3% respectively, but occupancy rates were 90%. While total revenues were slightly off, upper-end hotel average room revenues did very well.[15]

Nationally, according to the Bureau of Economic Analysis, tourism spending peaked in the third quarter of 2008. By the second quarter of 2009, it had bottomed out at 12% (comparatively, during the 2001 recession, tourism spending bottomed out at 11%). The third quarter of 2009 mitigated the decline. Lodging revenues increased 17%. The increase was driven by leisure travelers lured to inexpensive room rates. Rates dropped 4.7%.[16] In September, Virginia Beach lodging revenues climbed 22%, but it wasn't enough to carry the quarter.

While tourism has many contributing factors, one major source is Canadian visitations. Virginia Beach attracts many Canadian tourists. According to the U.S. Office of Travel and Tourism Industries, Canadian tourism in 2009 declined 5.9%, but it is forecasted to increase 3% in 2010 and 5% for the following years. Statistically, in 2008, five hundred and fifty-eight thousand Canadians visited Virginia, incurred 1,790,000 visitor nights, and spent $221 per visitor. Of those visitors, at least 43% lodged in a hotel and stayed on average 3.2 nights.

According to the Virginia Beach Convention and Visitor Bureau, last summer, tourism was good, but families used a reduced spending strategy. One savings strategy had families lodging at campsites. Typically, campsite usage is modest, but during the summer of 2009, rentals increased as much as 11.9%.[17]

Estimated Revenue - For FY 2010-11, hotel taxes are expected to be $22,659,486. This is 5.2% under the previous year's budget.

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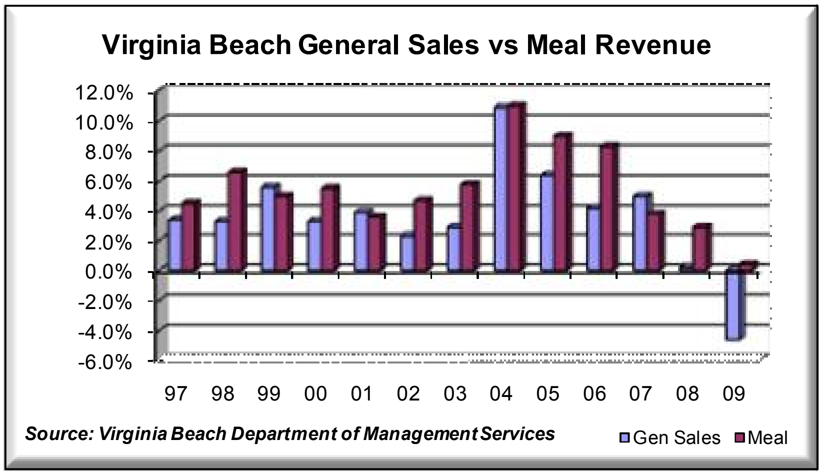
[15] Walzer, Philip, September 13, 2009, *2009 Tourism Season, Pretty Good Considering*, The Virginian-Pilot, Business section, pp. 1 and 4.

[16] Murray, Sara, December 16, 2009, *Tourism Spending Rebounds Slightly*, U.S. News, Wall Street Journal, Vol. CCLIV, #142, NY, NY, p. A2.

[17] Shean, Tom, October 15, 2009, *Tight Money Sent More Vacationers Packing – for Campgrounds*, Economy Vacation Spending, The Virginian-Pilot, Beacon, p. Princess Anne 1.

Restaurant Meal Tax – Over a period of thirteen years, this revenue has performed well; however, during the most recent recession, dining out stalled. While many Virginia Beach tax revenue sources have incurred a 2009 decrease, this revenue was the exception. It grew 0.4%. This compares unfavorably with the 2001 recession. In 2001, the revenue grew 3.6%.

Conversely, during the robust years of 2004 – 2006, growth averaged 9.4%. Likely, the availability of credit and equity fueled the growth, but by 2007, energy prices dampened the industry.



At their peak, gasoline prices reached $4 per gallon and trickled throughout the economy affecting other goods. Energy inflation touched any and every industry transporting or receiving transported goods and materials. Most industries, including restaurants, were affected. By the time these costs got to the restaurant owner, their marginal profits were feeling squeezed. When energy costs escalated, food inflation did not immediately occur. There was a lag between the two measureable periods. In 2008, food prices spiked 6.7%.[18] In 2009, not only did consumers have less discretionary income to use, but the cost of restaurant menu items rose. Faced with raising prices or using a reduced portion strategy, many restaurateurs chose a combination of both. They reduced portion sizes and raised prices. Ultimately, consumer value was reduced. With discretionary income declining, prices rising, and portion sizes diminishing, dining out declined.

According to the NPD Group, traffic at fast food restaurants declined 3% over the summer of 2009. Typically, fast food is perceived as a bargain, and during economic downturns, they are more resilient. Primarily, NPD found morning traffic waning. With more families eating breakfast at home, this has affected a very busy part of the fast food day. In 2009, Americans averaged 202 restaurant meals. This compares to 211 in 2001.[19]

A hopeful sign pertains to 2009's food price inflation. It increased a paltry 0.5%, and in 2010, it is forecast to moderately increase 2.5% to 4.0%. If unemployment begins to subside and consumer confidence rises, this revenue will likely be one of the first to signify a strengthening local economy.

According to restaurant industry experts, meals away from home are often driven by specific demographic variables. They are the percentage of women working, percentage of households with incomes higher than $25,000, and percentage of population between the ages of 25 and 44. Comparative local restaurant quality with neighboring localities can also be a factor. Local resident wealth and tourism also serve as positive factors. Finally, between 30% and 35% of meal tax revenues are generated by non residents. Hotel bookings for 2010 Virginia Beach conferences will reach an all-time high. The second highest year was 2008, and 2010 will exceed it by 18%. Virginia Beach is scheduled to host 30. Ten of them are new conventions.[20] Conventioneers will contribute significantly to this revenue.

Estimated Revenue: For FY 2010-11, total meal taxes are expected to be $48,188,033. This is 3.3% below the previous year's budget.

Admissions Taxes – Likely, the most resilient 2009 revenue, admission taxes fared well. Simply, Americans cut back on many aspects of consumerism, but they were not willing to reduce their entertainment expenses. With 610 films released

[18] The Virginian-Pilot, September 9, 2009, *Food Prices for the Home Drop in July*, businessday, nation and world, The Virginian-Pilot, Main section, p. 11.
[19] Boyle, Matthew, November 23, 2009, *What's Eating McDonald's*, Business Week, NY, NY, p. 32.
[20] Applegate, Aaron and Deirdre Fernandes, January 24, 2010, *City this Year is Scheduled to Host 30 Conferences*, beachcombing, The Virginian-Pilot, Beacon, p. 3.

in America last year,[21] theater business was robust. The latest Harry Potter movie premiered on a Wednesday. Compared to other Wednesday openings, it had the second highest revenue collection in history.[22] During the summer, national theater revenues were $4.25 billion and ran well above 2008.[23] Thanksgiving and Christmas weekend also set records.[24] At year-end, theaters broke 2007's record of $9.7 billion with over $10 billion in ticket sales. The 3-D movie Avatar pushed the industry beyond the record. Of the 242 IMAX theaters nationwide, over a ten day period, Avatar showings were completely sold out. Industry-wide, in 2009, approximately 1.4 billion tickets were sold exceeding 2008 by 5%.[25]

At the Virginia Beach Amphitheater, more than 250,000 people attended concerts. With the Dave Matthews Band and Nickelback leading the attendance pace, an average of 12,750 ticket holders attended over twenty concerts.

Estimated Revenue - For FY 2010-11 are forecasted to be $5,700,550. This is 7.6% above the previous year's budget.

Permits, Privilege Fees, and Regulatory Licenses - This represents a broad range of governmental service permits, privileges, and regulatory licenses.

Over the last five years, these revenues have varied greatly, because rate changes, new revenue sources , and deleted fees have altered the foundation. These revenues are primarily a function of population count, population age, the economy, and real estate/construction industry activities. Because regulations and rates change, historical data is not a good forecasting tool. As a result, departmental input was used.

Estimated Revenue - For FY 2010-11, the estimated revenue for Permits, Privilege Fees, and Regulatory Licenses is $4,627,805. This is 6.9% above last year's estimate. This increase reflects the Treasurer's administrative fee for servicing court collections, an increased fee for taxi driver permits, precious metal dealer permit increases, and new special event fee rates.

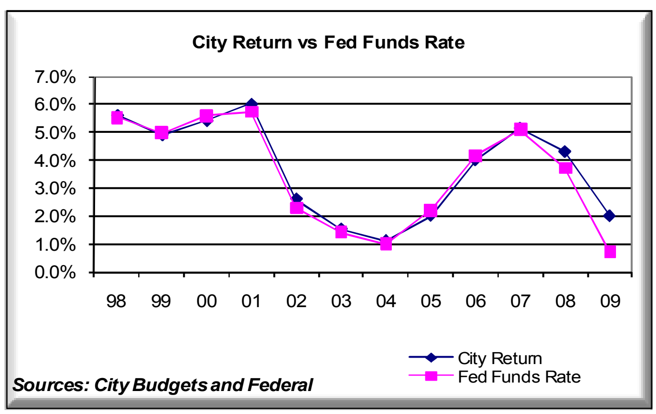
Fines and Forfeitures - This represents a broad range of local government applied fines and forfeitures.

These revenues are primarily a function of population count, population age, and rate changes (e.g., parking fines). Projections are based on historical trends.

Estimated Revenue - For FY 2010-11, the estimated revenue for Fines and Forfeitures is $7,640,072. This is 3.8% below last year's estimate, and primarily reflects the effectiveness of the Red Light Camera program. As awareness increases, violations decrease.

Revenue from the Use of Money and Property - This represents a broad range of financial and physical resource revenues.

This revenue category trends with interest rates and is primarily a function of the rates and cash balances invested. Because the Federal Fund rate has been between 0% and 0.25%[26] since 2008, this has had a diminishing effect upon



[21] The Economist, November 28, 2009, *A World of Hits*, Briefing Media, pp. 79-81.
[22] Associated Press, July 21, 2009, *'Half-Blood Prince' Gets Off to a Fast Start*, Box Office, The Virginian-Pilot, Tuesday Break section, p. 5.
[23] Germain, David, September 8, 2009, *'Final Destination' Still the First Stop*, Box Office, The Virginian-Pilot, Daily Break section, p. 6.
[24] Associated Press, December 1, 2009, *'Twilight' Nearly Blindsided by Bullock Flick*, Box Office, The Virginian-Pilot, Tuesday Break section, p. 5.
[25] Smith, Ethan, December 28, 2009, *Weekend Box-Office Sales Hit Record,* Wall Street Journal, Vol. CCLIV, #151, NY, NY, p. B1.
[26] Cooper, James C., November 16, 2009, *The Fed: A Whole New Playbook for Tightening*, Business Outlook, Business Week, NY, NY, p. 022.

City returns. With a very fragile national economy, the federal rate will likely stay low for an extended period of time.[27]

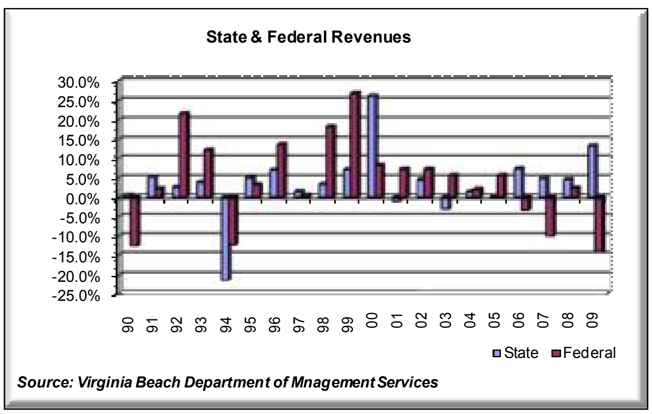
Bond sale timing and amount affects the City's invested principal. The 90-Day Treasury bill rate serves as a conservative proxy for City investment earnings.

Estimated Revenue - For FY 2010-11, the estimated revenue for Use of Money and Property is $6,073,335. This is 38.2% below last year's estimate. This primarily reflects the sustaining of low interest rates.

Charges for Services - This represents a broad range of revenues offsetting the cost of delivering services and programs.

Due to increased demand for fee-based services and additional charges for the cost of City services, these revenues have been increasing at a rather brisk pace. Most of these revenue estimates were historically trended, discussed with departments, and calculated using the prevailing rate. In FY 2007-08, to balance service delivery with costs, the Council appointed a Blue Ribbon Tax, Fee, and Spending Task Force, and they recommended regular fee increases.

Estimated Revenue - For FY 2010-11, the estimated revenue for Charges for Services is $41,512,723. This is 21.2% above last year's budget. This increase is attributed to additional Human Service related revenues, non-resident library fees, spaying and neutering fees for adopted pets, and event charges.



State and Federal Revenue - Estimates are based on historical trends, General Assembly budget proposals, gubernatorial recommendations, and congressional processes. Because state and federal budgetary timelines lag the locality cycle, budgets are based upon speculative reports. Typically, the state and federal bicameral establishments have not jointly resolved budgetary issues by the time of this report. Further complicating the projection, there is a fair amount of volatility in these revenues (see graph).

Estimated State and Federal revenues for FY 2010-11 are $107,854,135. This is 3.1% below last year's estimate. This primarily reflects reductions in state Board of Compensation contributions for the constitutional officers, state law enforcement support, and state human service contributions.

Transfers from Other Funds - These estimates reflect the City's on-going policy of charging self-supporting and fee-generating funds for support costs financed through the General Fund.

Estimated revenue for FY 2010-11 is expected to be $14,402,973. This is 11.4% below last year's estimate and primarily reflects the one-time use of fund balance from other funds. In FY 2009-10, the balance was used to mitigate major service reductions.

Summary of General Fund Revenues - Total estimated revenue for the General Fund is expected to be 2.2% lower than last year's estimate. This primarily reflects the dramatic decline in real estate assessments, the under-performance of general sales, hotel, and meals taxes, and reduced funding from the State.

Tax Increment Financing and Special Service District Analysis

Tax Increment Financing (TIF) – When TIF districts are designated, a base taxation year is established, and additional revenues above the base year are dedicated to the district. With a specific funding need in mind, typically, the incremental

[27] The Virginian-Pilot, February 25, 2010, *Bernanke: Low Rates Needed for Recovery*, businessday, nation and world, The Virginian-Pilot, Main section, p. 9.

increase in real estate tax revenues are used to pay for the City's public purpose commitment. For example, the funding pays for Town Center and Lynnhaven Mall's public parking and Sandbridge's sand replenishment.

Presently, Virginia Beach has three TIF districts. They are the Central Business District South (CBD), Lynnhaven Mall, and Sandbridge TIFs.

Effective July 1, 1998, the CBD TIF required a public sector $83.6 million investment in the Town Center's parking garages and infrastructure; moreover a $392 million private sector investment was committed. For every $1 the City of Virginia Beach spent, the private sector spent $4.70. In FY 2007-08, the Westin Hotel, Studio 54 Lofts, and McCormick and Scmick's Seafood Restaurant were introduced to the district. Since the establishment of the TIF, real estate assessments have grown $568.8 million. In FY 2008-09, this incremental assessment growth was estimated to generate $5 million in additional revenue and is designated to pay the debt service on the $83.6 million investment. In FY 2007-08, other tax revenues generated by the TIF district, but not subject to designation, were $5.2 million.

Effective July 1, 1997, the Lynnhaven Mall TIF required a public sector $11.5 million investment in the mall's ring road, connector roads and parking spaces; moreover a $100 million private sector investment was committed. For every $1 the City of Virginia Beach spent, the private sector spent $8.70. Since the establishment of the TIF, real estate assessments have grown $233 million. In FY 2007-08, this incremental assessment growth was estimated to generate $2 million in additional revenue and was designated to pay for mass transit and roads. In FY 2007-08, other tax revenues generated by the TIF district, but not subject to designation, were $9.7 million.

Effective July 1, 1997, the Sandbridge TIF required a public sector $12.7 million investment in Sandbridge's sand replenishment. Since the establishment of the TIF, real estate assessments have grown $1.1 billion. In FY 2007-08, this incremental assessment growth was estimated to generate $10.2 million in additional revenue.

Special Service District (SSD) – When SSDs are designated, the real estate taxation rate is adjusted upward, and the incremental amount is dedicated for the district's needs.

Presently, Virginia Beach has two SSDs. They are in the CBD and Sandbridge.

Effective July 1, 2002, the Central Business District South SSD was established to generate funding for parking garage and streetscape maintenance. In FY 2007-08, this additional 50¢ per $100 generated $1.3 million. In FY 2008-09, the tax rate decreased to 45¢.

Effective January 1, 1995, the Sandbridge SSD was established to generate funding for Sandbridge sand replenishment. Over the past fifteen years, as need determined, the SSD rate fluctuated. Between January 1, 1995 and June 30, 1997, the rate was 6¢ per $100 of real estate assessed value within the district. On July 1, 1997, the rate increased to 12¢ per $100. Presently, the rate is 6¢ per $100. In FY 2007-08, the SSD generated $3.6 million. In addition to the real estate levy, the SSD receives lodging tax and Little Island Park revenues. The next sand replenishment project is scheduled for 2010.[28]

[28] Phillips, Patricia A., July 1, 2008, *The City of Virginia Beach Report on Tax Increment Financing Districts and Special Service Districts in Virginia Beach, Virginia*, City of Virginia Beach Finance Department, Virginia Beach, VA, pp. 1-7.

Special Revenue Funds

This section highlights the major Special Revenue Funds:

Schools/Education - The following funds comprise the total School operations: School Operating; School Vending Operations; School Grants; School Textbook; School Athletic; School Cafeteria; School Reserve; School Technology Category; School Equipment Replacement; School Instructional Technology; and School Communication Tower Technology. The revenue estimates for these funds are provided by the School Administration and by the state, and are based on information received from state and federal agencies at the time of the preparation of the budget, except for local tax funding which is provided by the City.

Revenue is received from three sources: Federal, State, and local governments, including local fees for charges by Schools. Federal funds are of two types. Federal revenues primarily consist of impact funds, which are allocated to Schools for use in the operation of the total instructional program to support the cost of educating military children, and funds for the School lunch program. State funds are allocated based on a two-part, General Assembly, adopted formula: 1) The Standards of Quality are used to determine the number of teachers that are required by each school system. The state also uses an average salary figure to arrive at the total level of funding. 2) A Composite Index of Local Ability to Pay is used to determine the funding split between the State and localities. Wealthy communities receive less State aid while less wealthy communities receive more. The City is responsible for the residual amount from the Composite Index (subject to a cap). Certain categorical State funds are dedicated to certain specific courses or activities, such as pupil transportation, vocational education, special education, and technology initiatives. The State Share Sales Tax (one cent on the sales dollar) is returned by the Commonwealth to localities exclusively for public education and is distributed based on the number of School age persons residing in each locality. Regarding local funds, historically, these consisted primarily of monies derived from property taxes. Because local, School Boards in Virginia are fiscally dependent bodies, they must rely on the City Council to appropriate the required local tax funds and also to approve the total budget. In FY 1997-98, the City adopted a revenue-sharing formula as a means to provide funding for Schools. The formula initially provided 53.13% of the following taxes: Real Estate; Personal Property; General Sales; Utility; Cell Phone; Business Professional License Occupancy tax, and the Cable Franchise tax. The actual percentage is recomputed after the adoption of the budget each May to reflect changes in the revenue streams and rates. A copy of the Policy is provided in the Appendix section of this document. For FY 2010-11, the real estate tax rate is proposed to increase from $0.89 to $0.92, and the personal property rate on automobiles only (not on business personal property) is proposed to increase from $3.70 to $3.80. Because this increase was at the request of the City, 100% of the increase was allocated to the City.

Estimated revenue for these funds is expected to decrease 8.1% over last year's estimate. In total, the revenue sharing formulas will decrease by 3.6%. State funding will decrease by 9.8% for FY 2010-11, and reflect the State's fiscal situation and slightly declining local enrollment.

Housing - The following funds comprise the majority of the housing operations for 2010-11: Grants Consolidated, Community Development Special Revenue, CD Loan and Grant, Federal Housing Assistance Grant, and Federal Section 8 Programs. Revenue estimates for these funds are provided by the Department of Housing and Neighborhood Preservation (HNP) and are based on information received from State and Federal agencies at the time of the preparation of the budget. Revenue is received from three sources: Federal, State, and local governments. Federal funds are received both directly through the Department of Housing and Urban Development (HUD) and indirectly through the Commonwealth. Local funds are allocated to offset administrative costs for certain salary and fringe benefits, rental of office space, and utility costs.

Estimated revenue for these funds is expected to be 2.9% below last year's estimate for FY 2010-11. This does not reflect the latest Federal revenue figures that were not available at the time this documented was printed. It also reflect the transfer of a Homeless Intervention Grant that was previously funded with the Human Services department.

Parks and Recreation - The Parks and Recreation Special Revenue Fund comprise the total operations for the Parks and Recreation Department. The Golf Course Special Revenue Fund is merged into this fund for FY 2010-11. Funding is derived from user fees and charges for the use of Parks and Recreation facilities and sponsored activities, a dedicated portion of the real estate tax to support recreation center operations, and additional support from the General Fund to support park operations.

Estimated revenue is expected to be 3.4% below last year's estimate for FY 2010-11. Modest fee increases are proposed to help offset declining usage (see discussion of fees as previously noted above in Parks and Recreation write-up under the Cultural and Recreational Opportunities section of this document).

Sheriff Department and Inmate Special Revenue Funds - Revenue is derived from three sources: Federal, State, and local governments. Revenue for the Sheriff's Department Special Revenue Fund is derived from reimbursement from State and Federal governments for the care and custody of persons placed in the Virginia Beach Correctional Center by the courts and from the City's General Fund. The Federal reimbursement is specifically related to a contractual arrangement between the City and the Federal government to house Federal prisoners when necessary. Revenue for the Inmate Services Special Revenue Fund is derived from 38% of the telephone company's gross receipts from collect calls placed by correctional center inmates. Use of the revenue is restricted to purchases that benefit the inmates but would not be made through other local funding.

Estimated revenue is expected to be 1.4% above last year's estimate for FY 2010-11, which reflects a significant use of fund balance to offset reductions in State revenues due to the poor economy. This use of fund balance that represents a short-term strategy.

Tourism Growth Investment Fund - This dedicated revenue stream was established to fund tourism related capital projects. Revenues in this fund are primarily generated from: two cents of the Hotel tax; one-half cent of the Meal tax; and the ten cent Admissions tax.

Estimated revenue is expected to be 7.9% below last year's estimate for FY 2010-11. The decline is primarily due to the to a downward adjustment to the base level of meal taxes, which performed below the budgeted amount for FY 2009-10 and has not recovered from the recessionary level, which was partially offset by a reduction in the transfer to General Fund (for services provided to the resort area). This transfer was increased by $1 million in FY 2009-10 to help balance the General Fund, and is reduced to its previously level for FY 2010-11.

Tourism Advertising Program Fund - The Tourism Advertising Program Special Revenue Fund generates revenue for increased tourist advertising by: a levy of a $1 charge per hotel room night; a one-half cent tax on Restaurant Meals; and a one cent on Hotel tax.

Estimated revenue is expected to be 9.0% below last year's estimate for FY 2010-11. The decline is primarily due to the to a downward adjustment to the base level of hotel and meal taxes, which performed below the budgeted amount for FY 2009-10 and has not recovered from the recessionary level.

Agricultural Reserve Program Fund (ARP) - This program is designed to promote and encourage the preservation of farmland in the rural southern portion of the City, in which agricultural uses predominate, by means that are voluntary rather than regulatory. Revenue was initially derived from a 1.5 cent increase in the Real Estate Tax. A financial scenario analysis, based on various participation levels (number and price of acreage) and interest rates indicated that the dedicated revenue can be reduced from 1.5 cents to 1.0 cent. Due to the rising value of real estate assessments, this level of funding was deemed sufficient to meet current and projected future commitments, and City Council lowered the dedication to 1.0 cent in FY 2004-05. A similar analysis revealed that the dedicated amount was lowered to 0.9 cent in FY 2005-06, primarily again due to rising real estate assessments.

Total revenue is expected to be 42.0% lower for FY 2010-11. The decrease reflects the one time use of fund balance in FY 2009-10 and the downturn in real estate appreciation.

Parking Enterprise Fund - This fund is totally self-supported from revenues generated through the operations of the Parking Systems Management Office, which has been moved from the Department of Convention and Visitor Bureau to the Strategic Growth Area Office. Parking lots are operated at the Oceanfront and at Sandbridge; parking meters are installed along certain streets at the Oceanfront; and the City operates garages at 9th street and 31st street at the oceanfront, and oversee the contract for the management of the Town Center garages and the structural engineering contract all the garages.

Estimated revenue is expected to increase 52.0% over last year's estimate for FY 2010-11, and is attributable to increases in meter and parking lot charges. A complete list of these changes can be found in the "Non Departmental" section of this document.

Tax Increment Financing Funds - The Code of Virginia (Sect 58.1-3245 – 3245.5) authorizes the use of Tax Incremental Financing (TIF), which can serve as a means of financing the cost of public improvement in an area. The financing mechanics work as follows: for the target geographical area covered by the TIF, the current real estate assessments are anchored as a base, and subsequent increases in real estate taxes derived from increases in assessments are earmarked to a fund from which public improvements are paid. TIF's are often set for predetermined limits, usually associated with the funding of these improvements. A substantial reduction in the Real Estate tax will affect the cash flow of these TIF's, particularly the Central Business District-South. The City has established three TIF's, which are described below:

- Sandbridge TIF - The Sandbridge area, which is an important real estate and aesthetic asset of the City, has long battled sand erosion. Over the years, the City has pursued a multi-front strategy of funding sand replenishment: seeking Federal funds; appropriating local funds; and establishing the Sandbridge Special Services Tax District (see above). The establishment of this TIF is another method to ensure stability to this area. These revenues are designed to reserve the revenue for future costs, and these revenues are transferred directly into the fund, $8,038,054 for FY 2010-11, and these figures reflect a significant decrease in real estate appreciation that is occurring after a period of exceptional growth. A financial analysis indicates that sufficient monies will be available in the future to fund sand replenishment and transfer surplus funds from the TIF to finance roadway projects in the CIP.

- Lynnhaven Mall TIF - The Lynnhaven Mall TIF is associated with a public private partnership to expand the Lynnhaven Mall, which is the third largest shopping mall in Virginia and represents an important retail asset to residents and tourists. The developer will be funding over $100 million dollars of improvements while the City will contribute $11.5 million (present value), which translates into a favorable 10:1 leverage ratio. Additionally, the City will reap the benefits of increased retail, restaurant, utility, and business license taxes. The TIF revenues are currently serving as a reserve against future costs and are transferred directly into the fund, $1,897,984 for FY 2010-11, and this level reflects the decline in commercial property values. Fund balance is appropriated for FY 2010-11 in the event the unlikely event that significant construction occurs so that the City has appropriation authority to meet its financial obligations of the TIF.

- Central Business District-South TIF (Town Center) - Town Center is associated with a public-private partnership to develop a high-rise office, hotel, and retail complex in the Pembroke area of the City. These revenues are funding the debt service costs associated with the construction of public parking, and these revenues are also transferred directly into this fund, $5,456,290 for FY 2010-11, and this level reflects the decline in commercial property values.

Open Space Special Revenue Fund - This fund provides $62.7 million in funding for the acquisition and preservation of property. The Parks and Recreation Department developed an Outdoor Plan, which includes an Open Space initiative. This plan was developed with public input, and calls for the preservation of approximately 5% of the City's land for parks, trails or natural vistas. There is some empirical data that suggests open space bolsters property values and cited as factors in appeals to relocation decisions for businesses. The source of funding for this plan includes: $0.44 cent increase in the Restaurant Meal tax; and a one-time $5 million transfer from the ARP fund, fund balance. The fund has been appropriating a planned use of fund balance that grew in the early years of the fund and is now being appropriated to acquire and maintain land via the Capital Improvement Program. Because the Open Space Program has nearly achieved its goal of acquiring land, a two-year moratorium of the allocation of funding to specific Open Space CIP project was implemented in FY 2010-11. This is discussed more thoroughly in the "Cultural and Recreational Opportunities" overview in the Capital Improvement Program budget.

Estimated revenue is expected to decrease by 0.5% from FY 2009-10. The decline is primarily due to the to a downward adjustment to the base level of meal taxes, which performed below the budgeted amount for FY 2009-10 and has not recovered from the recessionary level.

Major Project Special Revenue Fund - This fund provides funding for $203.3 million for a completely rebuilt Convention Center on the existing site; $32.3 million for a new performance theater; and $3 million to expand the Virginia Aquarium and Marine Science Center parking facilities. Staff and public-private committees analyzed the scope and selection of these projects, and citizen input was received at two public hearings. The source of funding for these projects include: a $0.56 cent increase in the Restaurant Meal tax; a $2.5 cent increase in the Hotel tax; a 0.5 cent per pack in the Cigarette tax; a $10 million contribution from the State; and 80% of the Admissions tax diverted from TGIF.

Estimated revenue is expected to decrease by 4.9% from FY 2009-10. The decrease is attributable to the reduced need for Specific Fund Reserves (accumulation of excess revenues that over time are drawn down to fund the debt service over the life cycle of the fund), which is associated with the retirement of debt, and the decrease in meal and hotel taxes associated with the economic downturn.

Enterprise/Utility Funds

Water and Sewer - The Water and Sewer Fund operates as a self-supporting enterprise fund, meaning that all operating and debt service costs are financed/recovered primarily through user charges. Historically, major sources of revenue for operation of the water and sewer system include: Sale of Water; Water Service Charges; Sewer Charges; Interest on Bank Deposits; Sewer Main Extensions; and Sewer Line Fees. The charges for the sale of water are actually projected to decrease; however, this budget will implement a Right-of-Way Utility Transfer of $1.85 per month. Many localities in the state, including ones in Hampton Roads, impose similar charges. In FY 2011-12, the Public Utilities department will implementation of a four-year, stepped sewer rate increase to support capital and operating budget impacts of the regional consent order. This is discussed more in the Public Utilities budget discussion in the Quality Physical Environment section of this document.

Estimated revenue is expected to increase by 4.0% more than the FY 2009-10 budget. These increases reflect the new charge discussed above.

Storm Water Utility Enterprise Fund - This fund is also self-supported through two sources of revenues: charges for services and reimbursements from the Commonwealth of Virginia. Charges for services are billed by the utility to owners of developed properties within the City. These charges are dependent upon the amount of impervious surface at each property generating storm water run-off. The State reimburses the City, upon audited proof of work performed by the City, for road ditch maintenance.

Estimated revenue is expected to decrease by 4.1% over the FY 2009-10 budget, and primarily reflects a shift of $2.7 million of State funding from the Storm Water Fund to the General Fund. This will result in the delay of three Storm Water capital projects.

Council Amendment

On May 11, 2010, City Council voted to maintain the tax rate increase for real estate at 89 cents rather than the proposed rate of 92 cents. The personal property tax rate will remain at $3.70 rather than the proposed rate of $3.80. Additionally, City Council voted to change the proposed increase in the Animal Adoption Fee (fee will remain at $25 for dogs rather than the proposed increase to $50, and will remain at $20 for cats rather than the proposed increase to $40); and to modify the proposed Taxi Cab Fee to $50 every two years (previous fee was $10 annually and proposed increase was to $100 annually), and institute an annual Taxi Cab Inspection Fee of $50.