TOWN OF
HILLSBOROUGH
NORTH CAROLINA

May 12, 2025 (Recommended Budget)

Honorable Mayor Bell and Board of Commissioners:

Submitted is Hillsborough's FY26-28 annual budget workbook. The budget is prepared in accordance with the Local Government Budget and Fiscal Control Act. As this proposed document is transmitted from the town manager, it becomes the governing body's budget to review, question, debate, adapt and ultimately adopt. It is expected that changes will be made to the proposed budget as information becomes available and alternatives are considered. The mayor, town board, appointed boards, and community are encouraged to share their views on what should be funded or modified, starting with the public hearing and first workshop on May 19.

FY26 Budget Highlights

Expenditures	
General Fund	$17.917,625
Water and Sewer Fund	$14,670,866
Stormwater	$ 1,164,863
Total Budget	**$33,753,354**
Property Tax Rate	51.3 cents per $100 valuation 9.4 cents less than FY24-25 tax rate 5.7 cents more than the revenue neutral rate of 45.6
Water Rate	7.5% increase over FY24-25 rate.
Sewer Rate	7.5% increase over FY24-25 rate.
Stormwater Fee	$105 for residential properties. Increase of $15 over FY24-25 fee; non-residential tiers modified for FY26 with proportional fee adjustments.

Multi-year Forecasting

The multi-year forecasting component of this document, used since 1998, makes it easier to look forward, identify and mitigate potential problems while they are still manageable. The financial plan acts as a fiscal radar, giving Hillsborough more time and flexibility to plan responses to problems and needs. Hillsborough is one of the only local governments in North Carolina using a multi-year budget format. While only the first year of the budget is legally binding, years 2 and 3 of the financial plan include critical information that provides a more accurate picture of the town's fiscal and operational challenges.

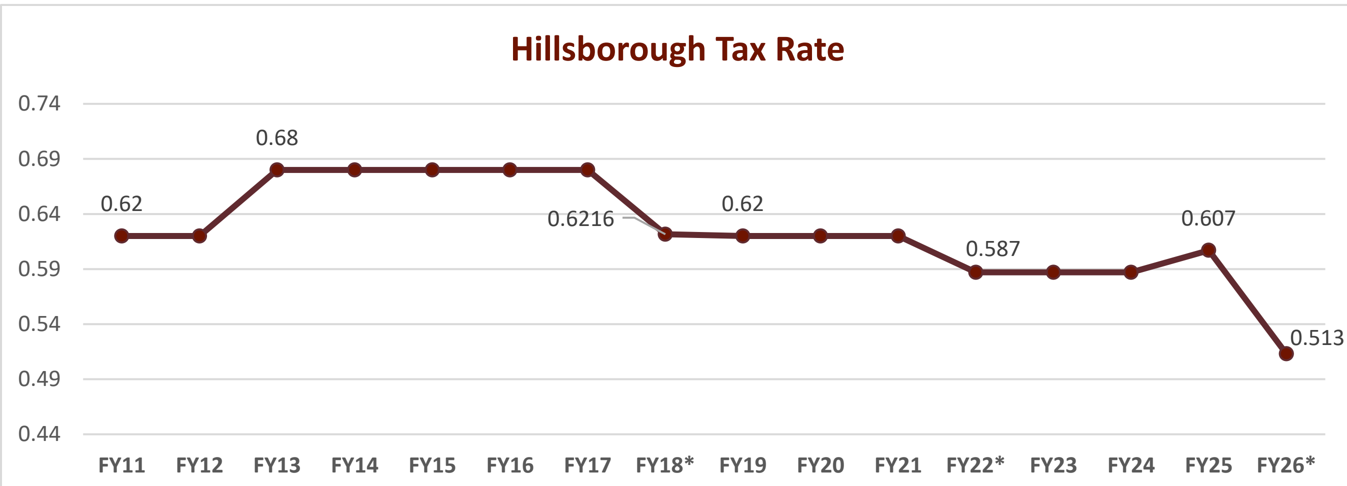
"Taking Care of What We Have"

The town's mission, vision, strategic priorities, and objectives can't be achieved if the basic tools of service implementation are not in working order: the town's infrastructure, equipment, buildings, employees, and systems. The longer a municipality waits to repair or replace these assets (tangible and intangible), the more expensive it becomes in the long term. Governments are notorious for not adequately maintaining assets as is evidenced in the American Society of Civil Engineers' infrastructure report cards. This is an excellent reminder to avoid the errors others routinely make in budget prioritization and ensure we are properly maintaining Hillsborough's assets. This is especially relevant in the FY26-28 budget and FY26-32 Capital Improvement Plan (CIP), which includes millions of dollars to replace large portions of the water and sewer system that are roughly 50 – 100 years old.

Tax and Rate Highlights

Revaluation

North Carolina law requires counties to revalue their real property at least once every eight years. Counties may perform a revaluation more frequently, however, with Orange County following a four-year revaluation cycle. Even though counties are normally allowed to delay revaluation if desired (subject to the eight-year limit), Orange County would still have been required to go through the revaluation process in 2025 because the ratio of tax value to sales price of property in the county fell below the N.C. Department of Revenue's minimum threshold. During revaluation, property tax assessments are updated to reflect the property's market value. The 2025 revaluation resulted in a 36.7 percent change in assessed value in Hillsborough, but this varies by property. Local governments are required to determine a revenue-neutral rate (see property tax section below for more information on this rate).



*Reflects property revaluation years.

Property Tax

- ✓ Decreases from 60.7 cents to 51.3 cents – a 9.4 cent reduction. The decrease counters some of the effects of property values increasing as part of the revaluation process.
- ✓ The revenue-neutral rate for Hillsborough is 45.6 cents (the rate that would generate approximately the same amount of revenue had the revaluation not occurred).
- ✓ The proposed rate for FY26 equates to a 5.7-cent increase. If adopted, the town will have had only four property tax rate increases over the past 16 years.

Property Tax Bill Cost Difference
Between Revenue Neutral Rate and Proposed 5.7-cent Increase

Home Value	Revenue Neutral Rate 45.6¢	Proposed 5.7¢ Rate Increase 51.3¢	Monthly Increase/ Difference	Annual Increase/ Difference
$200,000	$912	$1,026	$9.50	$114
$300,000	$1,368	$1,539	$14.25	$171
$400,000	$1,824	$2,052	$19.00	$228
$500,000	$2,280	$2,565	$23.75	$285
$600,000	$2,736	$3,078	$28.50	$342
$700,000	$3,192	$3,591	$33.25	$399

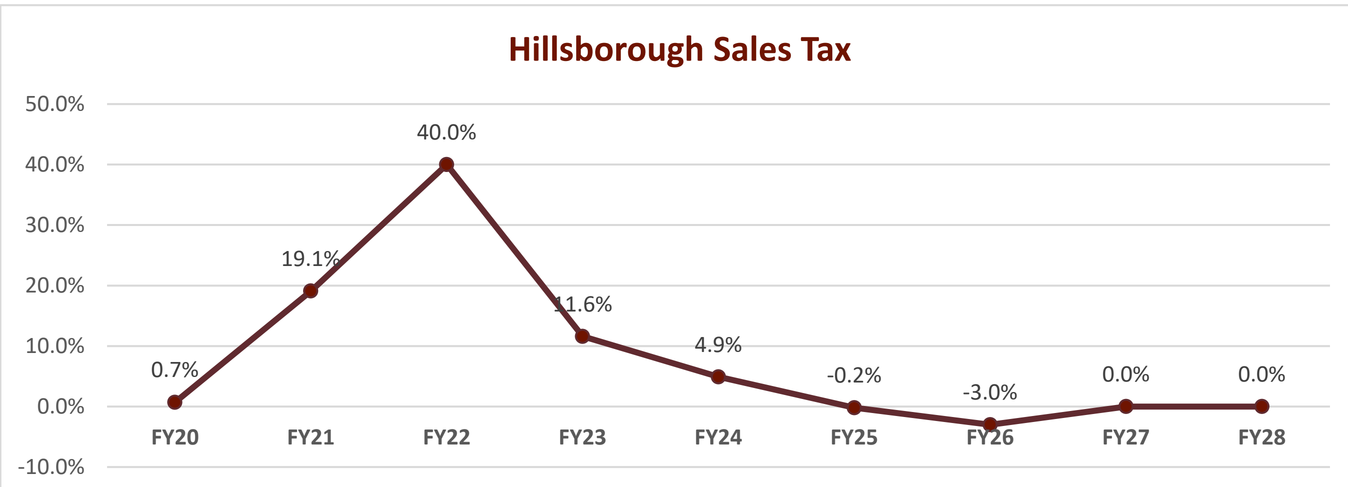
Note: The chart does not factor how various properties may have been affected by the revaluation process, just the difference between the revenue neutral rate and the proposed rate increase.

General Fund Highlights

Financial Overview

The FY26-FY28 budget and financial plan is essentially a “continuation budget” that implements previously approved projects, priorities, and strategic plan initiatives that were already in motion. It has little in terms of new or expansion items. Most new requests were relatively small dollar amounts or fall into the "taking care of what we have" category related to maintenance, equipment, vehicle replacements, and daily operational needs.

Last year’s budget message identified deficits in the General Fund as a significant concern. A 2-cent property tax increase was adopted as a minimal step to start paying for the many projects, priorities and initiatives that were in the financial plan. The increase also provided additional time to see if the financial picture improved with a focus on revenues, especially sales tax. The most recent audit confirmed that FY24 sales tax and other revenues came in close to projections; thus, there was no unexpected surplus. The trend of sales taxes flatlining means action must be taken to reduce the projected deficits in the General Fund.



The severe damage inflicted by Hurricane Helene late last year was a vivid reminder of how important it is for local governments to maintain strong savings in their fund balances. Many western North Carolina local governments had to obtain emergency loans just to keep operations running at times when their communities needed assistance the most. Spending down Hillsborough’s savings and running deficits is financially risky and would impair the town’s emergency response capabilities when the community’s needs are the greatest.

To balance this year’s budget, a combination of cost-containment strategies was used, coupled with a proposed property tax rate that is 5.7 cents above the revenue-neutral rate and a small fund balance appropriation for FY26. This approach keeps the savings levels solid for the next few years, maintains services at current standards, and follows through with projects and other priorities already in motion.

Projected Surplus/(Deficit)

General Fund	FY25 Estimate	FY26 Budget	FY27 Projection	FY28 Projection
Surplus/(Deficit) – $ amount	$1,042,132	($37,425)	($830,604)	($1,331,459)
Surplus/(Deficit) – percent	6.0%	(0.2%)	(4.5%)	(6.9%)
Fund Balance – available cash	$13,578,846	$13,541,421	$12,710,817	$11,379,358
Fund Balance – % of expenditures	77.9%	75.6%	68.3%	59.3%

Hillsborough is not alone in having a property tax increase above the revenue-neutral rate during a revaluation. This appears to be a regional trend as local governments are struggling with inflation, growth, replacing old infrastructure, and other challenges. Last year, all 13 Wake County local governments raised their rates with the average and median increases being near 7.5 cents; three units had increases ranging between 12.3 and 15 cents. Orange County and the other two municipalities in the county also are proposing tax rates above revenue neutral.

Several significant expenses with full-cost impacts will affect the budget in FY29, just outside the focus of this three-year plan. Debt service payments for the fire station, Ridgewalk's northern segment, and the train station are projected to start in FY29, followed by replacements of two fire trucks (an engine in FY30 and ladder in FY32). Timing, costs and options to pay for these cost impacts are discussed later in this message. Planning and design costs for Ridgewalk's southern segment come on in FY29, which will require $800,000 if the project moves forward.

Cost and Deficit Reduction Strategies

The list below covers some of the actions and approaches used to reduce the deficit, protect the fund balance, minimize the tax rate increase over revenue-neutral, and make funding more manageable of those major project costs that begin in FY29 and shortly thereafter.

- ✓ <u>No new full-time employees (FTEs)</u>. This constraint started in FY25 for the General Fund and continues in the FY26-28 plan. Keeping pace with the labor market in this region along with retirement system contribution percentages being raised annually have made personnel costs the biggest driver of budget increases, along with new capital projects. Situations may arise that warrant adding positions, but the goal is to not add permanent positions until the financial picture improves. If additional personnel or support is needed to address gaps or unexpected issues, short-term flexible resources such as contractors, consultants, temporary or part-time positions, and interns are preferred as more cost-effective options, when practical. <u>The General Fund FTEs per thousand population has declined over the past 17 fiscal years from 9.4 in 2010 to 7.2 in 2026</u>. That number should continue to decline over the next few years by attempting to hold the line on adding positions.

- ✓ <u>Operating Cost Control.</u> Divisions and departments worked during this process to find more efficient ways to run their operations and limit new expenses. Analysis conducted by staff in March indicated the projected operating expenditure increases are well below the rate of inflation and historical trends.

- ✓ <u>Public Works relocation to Highway 86 North Facility – loan as the primary funding source instead of cash</u>. Changed the plan from using cash from savings to pay for this $4.7 million project. The reasons for this change include: 1) the lessons from Hurricane Helene, weather-related emergencies, and protecting fund balance; and 2) allow the town to better absorb deficits in years two and three of the financial plan. Approximately $1.1 million in cash that's already in the project fund will be used, reducing the loan amount.

- ✓ <u>Eliminated "ramp-up" savings to construct new police department building.</u> A large cut to the list of capital projects in FY25 was removing the "ramp-up" savings plan for a new police headquarters. Annual debt for a $10 million police station would be about $800,000 for the next 20 years, or close to 4 cents on the tax rate.

- ✓ <u>Use retired debt capacity from the Riverwalk/Gold Park loans to pay a portion of the Ridgewalk – Northern Segment project.</u> While $233,000 per year for this project is only a fraction of the anticipated annual debt of $670,000 for this segment of Ridgewalk, it still provides a substantive amount of funding by saving cash and covering a good portion of the annual debt likely to start in FY29.

- ✓ <u>Freeze or stop "ramp-up" savings contributions for several major projects and expenses.</u> Stopped increasing the amount of "ramp-up" funds saved each year or completed cancelled planned contributions to pay for these major capital expenses. The town often starts setting aside funds annually and increasing the amount each year until enough is available to make the annual debt service payments. The cash saved is used to pay for preliminary costs, design, cost overruns, and/or reduce the amount of money that needs to be borrowed. The chart below shows the annual contributions at their current FY25 rate, planned "ramp-ups" in FY26-28, and how much will be saved each year via freezing expenses at the FY25 amount for the fire station and Ridgewalk Greenway Northern Segment, plus completely cutting the contributions for the fire engine and fire ladder trucks. While no "ramp-up" had yet been implemented for the train station debt, that amount is included in the chart to provide a clearer picture of upcoming debt pressures to pay for these capital items.

Ramp-up Savings and Upcoming Debt Payments					**Full Amount**
	FY25	**FY26**	**FY27**	**FY28**	**Annual Debt**
Fire Station	300,000	~~375,000~~	~~450,000~~	~~525,000~~	634,000
Ridgewalk Greenway - Northern	333,000	~~383,000~~	~~433,000~~	~~483,000~~	670,000
Train Station					285,000
Fire Engine & Ladder Truck	-	~~50,000~~	~~100,000~~	~~150,000~~	647,000
TOTAL	633,000	808,000	983,000	1,158,000	2,236,000
Amount Saved By Freeze/Cuts	**-**	**175,000**	**350,000**	**525,000**	**1,603,000**
Amount of Funding Needed to Cover Annual Debt					1,603,000
Tax Rate Equivalent (Cents) Needed to These Projects					**7.29**
FY29 Tax Rate Impact (Fire Station, Ridgewalk North, Train Station)					4.35
FY30 Tax Rate Impact (Fire Engine)					0.84
FY32 Tax Rate Impact (Fire Truck -Ladder)					2.10

Note: This does not include $800,000 to start planning and design for Ridgewalk Greenway South in FY29, which was not yet included in the ramp-up funding strategy. It currently does not have a funding source.

✓ <u>Future growth will bring additional revenue but only covers a portion of future deficits, therefore limiting future expenses and capital projects is critical until the financial stabilizes.</u> There are still many approved residential units that have not yet started construction. At some point, the Daniel Boone property will be redeveloped and that could provide a substantive revenue boost, but no plans have been submitted, and that's likely years away from happening. The recent slowdown in new home construction makes it hard to predict when these units will come online. Minimizing new expenses related to serving these projects via absorbing with current assets and staff can provide resources to pay for portions of longer term and expensive projects that are in the Capital Improvement Plan. Even after new units are occupied, there is a delay before they start paying property taxes, thus we are still several years from getting another influx of revenue to help with pressure on the budget.

To add context, the budget is projected to increase an average of 3 percent, or $590,000 per year for the next 3 years, down from the $1,050,000 (9 percent) average increases experienced between FY18 – FY25 due to inflation and other reasons. Just to keep pace with the projected $590,000 increase would require 200 new homes valued at $500,000 plus 3% sales tax growth annually. Or, 785 multi-family units plus the same 3% sales tax growth annually. This does not cover any expansion items, including paying for the fire station, train station, and Ridgewalk. This emphasizes the challenges and limitations of what the town can afford now and going into the future.

Noteworthy Expenses

✓ <u>Passenger Rail/Multi-Modal Station</u>. Approximately $8.2 million of this $10.4 million project comes from the State Transportation Improvement Program (TIP), NCDOT Rail TIP, and Transit Tax. The town will be responsible for any costs over that amount and for the cost of the town offices. The earliest construction start is spring of 2028. The projected funding gap and amount to be financed is $2.2 million, or $285,000 annual payments on a

10-year installment-financing agreement. If no other funding source is secured, this is the equivalent to a 1.3 cent property tax increase.

- ✓ Ridgewalk Greenway Northern Segment. Annual contributions ($333,000) to the project fund reserve capacity to make annual debt service payments. The funds being saved each year have the added benefit of lowering the amount that needs to be borrowed. Construction is projected for late FY28 and another $5.17 million is needed for this project. Applying the annual $333,000 contribution towards the $670,000 debt payments starting in FY29 leaves a funding gap of $337,000. If no other funding source is located this is the equivalent of a 1.53 cent property tax increase.

- ✓ Affordable Housing. In FY24 the board agreed to the "ramp-up" plan where annual spending is increased in this area annually until meeting the equivalent of two cents on the property tax rate at that time, or about $320,000 in FY27 achieves the town board's target contribution. See the chart below for details. The FY26 budget provides an option for utilizing a portion of the reserved housing funds for two pilot projects focused on "safety net" needs for low-income residents of town. The funds would be used for: 1) a home repair/rehabilitation program to keep residents in their current naturally occurring affordable housing; and 2) emergency housing assistance to prevent residents from being displaced from their current housing. Both options are extensions of currently existing programs, reducing the amount of administrative work needed to deliver these funds to residents. These programs are consistent with the town's Strategic Plan and Comprehensive Sustainability Plan, and also with the actions prioritized by the HOME consortium and Orange County's housing department.

Ramp Up to 2 Cents for Affordable Housing

	FY22	FY23	FY24	FY25	FY26	FY27	FY28
Community Home Trust	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500
HOME Funds Match	$4,200	$6,486	$6,281	$6,281	$6,281	$6,281	$6,281
OC Partnership to End Homelessness	$15,788	$59,080	$61,128	$51,910	$59,640	$59,640	$59,640
Subtotal, Current Commitments	$22,488	$68,066	$69,909	$60,691	$68,421	$68,421	$68,421
Ramp-up Funds	$22,488	$68,066	$102,793	$175,000	$250,000	$320,000	$320,000
OCPEH Expansion Request					$7,753	$7,753	$7,753
FY26 Pilot Programs (Repair & EHA)					$200,000		
Remaining Funds for Housing (New and Preservation)	**$0**	**$0**	**$32,884**	**$114,309**	**($26,174)**	**$243,826**	**$243,826**
Affordable Housing Reserve Funds	**$0**	**$0**	**$32,884**	**$147,193**	**$121,019**	**$364,845**	**$608,671**

- ✓ Public Works facility and relocation ($4.7 million). After being in the flood plain, in substandard facilities, with no equipment shelters, and little storage for about 50 years, funds are allocated to move the Public Works Division from their Dimmock's Mill Road location to the Highway 86 North Facility. As mentioned in the above section, the financing strategy for this project was adjusted in order to preserve fund balance flexibility. The proposed budget includes the use of approximately $1.1 million in accrued cash for the project and approximately $3.6 million financed via a 15-year installment purchase agreement. The estimated annual debt service in FY27 and beyond is approximately $375,000.

- ✓ Downtown fire station. Construction is projected for FY28 with the first debt payments occurring in FY29. Continue "ramp-up" savings contribution of $300,000 but "freeze" the annual contribution at his level instead of increasing it annually by $75,000 to minimize the proposed tax rate increase. The new downtown station is estimated to cost $10 million, but a more refined cost will be available once the feasibility study is completed over the next year. These funds are being placed in a capital project fund to help pay for design costs first, decrease the loan amount, and provide a funding source for the annual debt.

- ✓ Vehicle Replacement Funds: Police - $250,000, Solid Waste - $275,000, Streets - $85,000 allows replacing expensive vehicles with cash, saves by not paying interest through loans and smooths out the impact on the annual budget.

- ✓ Police Department
  - Flock Camera System ($44,000) – aids in reactive and preventative crime response while allowing collaboration between regional agencies. The annual fee is reduced to $37,500 in FY27.
  - In-car camera system replacements (FY27 - $48,000; FY28 - $50,000).
  - Replace three to four vehicles per year.
  - Social worker – the grant funding for this position was ended unexpectedly in March 2025. The financial plan anticipated taking over this cost starting in July or the beginning of FY26. This will be the third year for this position, but the town will now have to absorb the full cost of an additional $98,000.

- ✓ Public Works
  - Street repaving: $483,500 ($327,500 from Powell Bill and $156,000 from general operating revenues)
  - Garbage truck replacement ($387,000)
  - Interchangeable dump body allows year-round use of leaf truck chassis ($45,000)
  - Knuckle boom truck replacement ($254,000) in FY27

- ✓ Public Space & Sustainability
  - Sustainability ($320,000) annual commitment to energy efficiency and carbon reduction goals in operations or other areas
  - Small connectivity projects - $20,000 per year
  - Cates Creek Basketball Court Design (FY27) - $20,000

- ✓ Engineering Services
  - Moves from Utilities Administration to the Community Services Department in FY26 to provide more efficient and responsive service to development-related applications as this places most of the responding operations in the same department. The realignment improves internal coordination between the planning, economic development, public works, stormwater, public space, water and sewer operations. This adds $143,500 to the General Fund for FY26, thus providing some financial relief to the Water/Sewer Fund and capacity for the utilities director to focus on operations.

Water and Sewer Fund Highlights

Water rates

A 7.5% increase is recommended in FY26 with 12.5% increases in both FY27 and FY28. This is primarily to help pay for significant upcoming capital projects, addressing other water system needs, complying with the covenants for the Series 2018 and 2020 revenue bonds to pay for the reservoir, as well as keeping the fund in a fiscally sound position.

Sewer rates

A 7.5% increase is recommended for each of the next three years to help pay for significant capital projects, especially to address aging parts of the system as well as “pinch points” in the wastewater collection system that are limiting further development.

Rate Impact FY24-25 → FY25-26		
How much higher will water and sewer rates be per month after the rate increases?		
	Average Household Consumption 4,000 gallons/month	**Minimum Household Consumption** 2,000 gallons/month
In-Town		
Water	$3.44	$1.72
Sewer	$4.88	$2.44
Out-of-Town		
Water	$6.72	$3.36
Sewer	$9.52	$4.76

Rate Structure Alternatives Study – Anticipated Presentation to Town Board Late Summer

Most water and sewer utilities use one of two billing methodologies:

1. Minimum usage charge with a consumption allowance, then a volumetric charge for usage above the established minimum threshold. Hillsborough's minimum charge is 2,000 gallons per month, which aligns with the median monthly consumption allowance in North Carolina. Approximately 55% of water rate structures in North Carolina use this approach.

2. Base rate that is a monthly charge for having service available, regardless of usage, then a volumetric rate per gallon. The base rate helps cover fixed costs like maintaining infrastructure, while the volumetric rate covers the cost of providing water.

There are advantages and disadvantages to each approach. The minimum usage charge is easier and less expensive to implement and manage. The base rate requires more sophisticated accounting to accurately calculate this charge, and it must be updated regularly. Raftelis Financial consulting firm, nationally recognized experts in utility billing and financial analysis, have been working on a study comparing these approaches for Hillsborough to assess whether a change would provide financial relief for certain customers based on their average consumption and which methodology may be a more equitable way to charge water and sewer. The results of the analysis are scheduled to be presented to the town board in August or September. It's anticipated the merits will be deliberated to determine whether a change in billing approach would be beneficial to the customer base and still provide a structure capable of funding the system's operational and capital needs.

Financial Overview

The big news within the past month was that FEMA rescinded almost $7 million in BRIC (Building Resilient Infrastructure and Communities) grants that Hillsborough was awarded in 2021 for two key projects: the River Pumping Sewer Station and the Emergency Water Booster Pump Station connected to our neighboring utility to the south – OWASA. The abrupt and surprise elimination of the program removed approximately $880 million in funding for about 450 projects nationwide, including 45 local governments in North Carolina. With this just happening weeks ago, the current budget and financial plan do not factor the potential loss of those funds. The town's mayor, board of commissioners, and staff will work to find alternative grant funding sources for these projects.

The summary table below shows amount of savings/fund balance being appropriated each year to cover the deficits projected for the current year (FY25) as well as the over the next three years (FY26-28). The recent rate increases have helped and are necessary going forward given the many large capital projects needed for the system. It's important to note the deficits are projected even with spending a large amount of one-time revenues from grants, system development fees, savings, and other sources. Staff deferred several major capital projects to help keep the finances in line with key financial metrics. Still, days of cash on hand are well below our preferred level of 360 days. Staff will continue refining the schedule of capital projects to look for further opportunities to defer implementation, where practical and given risk levels (e.g., sewage spills, system outages, development moratoriums, lost opportunities due to inability to serve new developments, and others).

Water & Sewer Fund Balance					
Water & Sewer Fund	**FY24 Actual**	**FY25 Estimate**	**FY26 Budget**	**FY27 Projection**	**FY28 Projection**
Fund Balance Appropriation		$2,430,114	$665,366	$260,333	$495,013
Remaining Balance	$10,999,979	$8,569,865	$7,904,499	$7,644,166	$7,149,153
Fund Balance as % of Operating Budget	83.7%	48.6%	53.9%	51.2%	43.7%
Days of Cash on Hand	428	282	252	245	218

As a reminder, the Water/Sewer Fund cannot afford to risk having key financial metrics and ratios falling behind industry standards as well as to ensure we meet requirements from the Series 2018 and 2020 Revenue Bonds issued to pay for the reservoir expansion. The bond covenants provide non-negotiable standards for funding levels to provide adequate capacity to make debt payments and remain fiscally sound. If those standards are not met, then the Trustee for the bondholders and/or the Local Government Commission has the right to compel the increase of our rates to whatever level is needed to meet the various bond coverage ratios. In addition, even getting close to key metrics would have a negative impact on our bond rating and thus make future borrowings more expensive and difficult.

Variety of Challenges with the Water and Sewer Operations

Most who have lived in Hillsborough for a while are familiar with the unique challenges Hillsborough's water and sewer systems must contend with: 1) high debt levels to pay for the reservoir expansion, wastewater plant upgrade, water tank at Waterstone, and other expensive system needs, 2) stringent Falls Lake Rules, some of the tightest in the country that escalated the wastewater plant upgrade costs as well as limiting the feasibility of future expansion, 3) costs of maintaining 25 sewage pump stations, 4) small systems find it hard to benefit from economies of scale, thus the reason many small units get absorbed by larger cities utilities, 5) aging assets, many near 50 years old and up to 100 years, need to be repaired or replaced, and 6) new growth is putting pressure to spend money on certain upgrades before there are enough new customers to help spread the costs and minimize rate increases.

Some of these issues were already embedded in the budget and thus not new, such as debt on already constructed assets. Inflation has increased costs across the board and the utilities industry nationally is seeing higher annual increases just to keep pace with daily and annual operations. In addition to the millions of dollars required over the next seven years to replace aging pipes, pumps, systems, and tanks, there is also a deficit when it comes to funding the "continuation budget" or those items needed to carry daily operations, as well as projects already in the pipeline. Some of the reasons for the projected deficits and need to increase rates include:

- ✓ <u>Decreased usage</u>. While the number of residential accounts increased by 472 (about eight percent) between 2019 and 2023, total consumption decreased during that time. Usage has ebbed and flowed but has generally been trending downward. In 2023, less water was billed than in 2019 in all but one class, and that one was flat.

- ✓ <u>Annual revenue lost (approximately $520,000) from lowering the minimal monthly rate charge from 2,500 to 2,000 gallons per month from FYs22-25)</u>. This initiative provided substantial savings to low volume users and provides a more equitable charge methodology. It's estimated approximately 45% of customers benefited from this change, that came close to holding their bills steady during this period. Last year's newly built rate model estimates this billing change cost about $520,000 in lost annual revenue. Questions have been raised about whether this change actually benefited the intended recipients and whether there is a more equitable method of billing. This will be deliberated when the Rate Structures Alternatives Study is presented in late summer.

- ✓ Construction "slow down." The effects of inflation, increases in building material costs, labor shortages, and high interest rates have put the brakes on new residential development, even on developments that have already received approval. From discussions with the development community our staff has heard that investors are waiting for stability in the federal government and macro economy, so the construction industry has also turned into a waiting game. Everyone is getting their projects shovel-ready and then just waiting. This stall means fewer new units are available to help share the cost of operating the system.

  Even if there is a "groundbreaking" today on a new development, it's roughly a year out before a residence will be constructed, receive a certificate of occupancy, then start paying water/sewer bills. Thus, it's likely to be at least two to three more years before we see a noticeable increase in accounts that can provide relief as contributing rate payers. The good news is there about 1,200 units approved but have not yet started construction (e.g., Collins Ridge apartments, Collins Ridge Phase 2 (single-family and townhomes), Auman Village, Persimmon (apartments and townhomes) and Waterstone South (apartments and townhomes). Having these units completed and connected to the system can be a significant help, but there is no way to accurately project when that will occur, as well as other developments going through the approval process.

- ✓ Cost escalations and inflation. This has impacted line items across all utility operations from chemicals, equipment costs, contractors, supplies and materials such as pipes/valves, and market rate salary adjustments to retain and recruit skilled staff.

- ✓ Significant system rehabilitation projects and overdue upgrades. The number and cost of highly expensive projects needed to address system needs now is more than the fund can afford; plus, it's more than staff can manage at one time. Thus, difficult decisions have been made to defer high priority needs, such as further delaying the replacement of the 90-year-old Hasell Street water tank and 50-year fragile asbestos concrete water lines. The focus is starting with the needs that exist at the "core" of our system, such as replacing the sewer interceptors along the Eno River and the River Pump station. In most cases, these assets affect all system users, even in new developments located on the edge of the service area. Taking care of the "core" assets must be done first, before spending funds to accommodate new development via projects like upsizing the Cates Creek Outfall and Elizabeth Brady Road Sewer Pump Station.

Water & Sewer Assets – Approximate Ages

90 - 100 Years

- Bellevue Sewer Outfall (1920s)
- Water and sewer lines in the historic parts of town
- Hassell Street Water Tank (mid-1930s)
- Fire hydrants and valves in parts of historic district (1920s and 1930s)
- Adron Thompson Operations Facility – converted from the original water plant (1936).

50 Years

- Water (1972) and wastewater treatment plants (1977)
- River Pump Station at the Wastewater Treatment Plant (1977)
- Highway 70A water mains made of asbestos-concrete. These old and fragile lines connect Hillsborough to Durham's water system during emergencies as well conveying water to central and south pressure zones daily (1973)
- Sewer mains along the Eno River and Exchange Club Park

  Not keeping pace with replacement of assets, referred to as depreciation, is a common flaw with utility systems where maintenance and replacement of assets is delayed avoiding rate increases. It's typical that utility systems won't even replace 1-2% of their assets annually. This means the catch-up gets expensive. This is a national problem and a primary reason why the American Society of Civil Engineer's report cards for water and sewer systems are so poor across the country. While Hillsborough has emphasized "taking care of what we have," it's not been done to the levels needed as evidence by prior UNC Environmental Finance Center financial metrics in which Hillsborough has traditionally been in the “yellow” or caution zone, which is better than red but not in the desired green. While Hillsborough is likely far better than most in this area, at approximately 36%, asset replacement is not nearly where it needs to be. Thus, more must be invested in system maintenance.

- ✓ Maintaining financial health and complying with bond covenant requirements.
  - To maintain the town’s bond rating and meet bond covenants, the town must maintain a debt coverage ratio of at least 1.00. This metric is an indicator of whether the town’s operating revenue (i.e. rates) are sufficient to cover annual debt obligations. Even with annual rate increases, the projected debt coverage ratio is at the bare minimum in year 1 at 1.01, increasing slightly to 1.27 and 1.37 in years 2 and 3 respectively. The industry standard is 1.20.
  - Days of cash on hand is a key metric in determining the town’s ability to meet short-term obligations. Days of cash on hand is projected to be below the industry standard of 365 days in all three years, at 252 in year-1, 245 in year-2, and 218 in year-3, even with the projected rate increases.
  - Steps need to be taken to ensure the town continues to not only meet minimum requirements but improves the financial condition to be more in line with industry standards.

Major expenses

- ✓ Water plant generator replacement ($350,000).
- ✓ Sodium Hypochlorite Conversion ($1.96 million): FY26 design, FY27 construction, FY28 debt payments start.
- ✓ Sewer lift station abandonment analysis ($50,000). Note: reduced from $90,000.
- ✓ Hassell Street Water Tank replacement, yearly “ramp-up” of $95,000 starting in FY26 to afford projected debt service payments of $460,000. Design in FY28 with construction in FY29.
- ✓ Elizabeth Brady Pump Station & Force Main Upgrade Project design ($450,000) in FY26 with construction ($1,050,000) in FY27. Note: construction was phased, delaying $3,500,000 until FY29.
- ✓ Eno River Sewer Interceptor East Project construction ($2,080,000) in FY27. Note: construction was phased, delaying $3,120,000 until FY29.
- ✓ Exchange Club Interceptor Project construction delayed until FY29 ($1,100,000).
- ✓ Undersized sewer main replacements FY27 ($500,000)
- ✓ Cates Creek Sewer Outfall Upgrade: begin funding “ramp-up” of $75,000 per year to help make debt service payments on the first phase (approximately $7 million) of an $11 million project.
- ✓ Sewer Jetter/Flush Truck in FY27: $222,006.
- ✓ Wastewater Treatment Plant Solids Storage Mixing Pump Replacements: $105,000 during FY26 and FY27.
- ✓ Adron Thompson operational facility ($7.31 million). Annual debt service of $500,000 begins in FY27.
- ✓ Lawndale sewer basin rehabilitation project ($1.2 million): Annual debt payments of $33,000 start in FY26.
- ✓ Water system master plan annual improvements $400,000 starting in FY28. Note: $400,000 was cut from the budget in FY26 and FY27 for an $800,000 reduction.
- ✓ Hydrant and valve replacement project, primarily in the historic district ($270,000), delayed to FY28.
- ✓ Vacuum excavator in FY28: $155,000

Ten Strategies for Long-term Stabilization of Water and Sewer Rates

1. **Use reserve funds, a portion of available savings and other one-time revenues to pay for long-term capital needs.** This strategy minimizes future debt services payments and reduces pressure on future budgets.

2. **Use system development fees (SDF) strategically.** Accrue and save SDFs until there is enough to pay for a capital project or reduce the amount borrowed to a manageable amount.

3. **Delay and eliminate projects where practical**. Several major projects were deferred in the FY26-28 budget and FY26 – 32 Capital Improvements Program.

4. **Leverage assistance from national experts in utility financing.** Working with consultant annually to update regularly and analyze the rate model to explore options to minimize rate impacts yet still construct high priority projects to replace aging infrastructure and allow for future development.

5. **Gain increased economies of scale through new development.** Addition of new customers in parts of the system that can accommodate water and sewer capacity can provide a large base of accounts to share the cost burden of paying for system's operations.

6. **Limit staff additions.** Staffing is one of the most expensive parts of a business. Limiting personnel-related expenses is an important cost containment strategy – no new staff in FY26-28.

7. **Re-evaluate interfund cost allocations.** Evaluate whether adjustments are needed to how Water and Sewer Fund contributes to shared services with the General Fund.

8. **Reduce service areas.** A smaller service area allows for more compact and cost-effective service provision and limits growth that would necessitate expansion of utilities plants.

9. **Reduce inflow and infiltration into the sewer system.** Reduces the loads and risk of exceeding wastewater collection and treatment capacity.

10. **Consider updating system development fee cost analysis.** While Hillsborough just updated these fees two years ago, this is required by law every five years, proposed new developments are placing additional cost pressure to add or accelerate capital projects to serve some areas of town. There is also greater clarity on which projects will be constructed over the next several years if funding can be secured.

Stormwater Fund Highlights

Stormwater rates. Increasing the fee's residential tier by $15 and non-residential tiers proportionally.
The $15 stormwater fee increase in FY26 follows the plan established in the FY25 budget to increase the stormwater fee for the residential tier by $15 per year for three fiscal years (FY25-27), for a total of $45. This is only the second fee increase since the Stormwater Fund was created in FY17.

The town board could choose to phase the increases in a different way, such as covering the remaining $30 in one of the years.

- ✓ Program Updates. During FY24, the town completed its first ever state stormwater program audit and received approval of an updated Stormwater Master Plan. Audit recommendations that were included in the updated Master Plan include updated written procedures, expanded public input processes and additional outreach and expanded efforts for illicit discharge control, construction site runoff and pollution prevention.

Stormwater Rates	
Residential Property	$105
Non-Residential Property	
Tier 1 – 0 to 10,000 sq. ft.	$210
Tier 2 – 10,001 to 30,000 sq. ft.	$735
Tier 3 – 30,001 to 100,000 sq. ft.	$2,415
Tier 4 – 100,001 to 200,000 sq. ft.	$5,670
Tier 5 – 200,001 to 600,000 sq. ft.	$15,015
Tier 6 – 600,001 sq. ft. and above	$26,250

- ✓ Infrastructure Maintenance. Improved levels of service and updated permit requirements will require additional investments in personnel, equipment and a stormwater capital improvement plan (CIP) to plan for large projects, such as a culvert replacement on Elizabeth Brady Road. The FY26-28 recommended budget includes ramp-up funds for a stormwater CIP. The requested equipment operator and Jet-Vac truck were not able to be funded in the recommended budget.

- ✓ Planning Ahead. While the Stormwater Fund currently has a sufficient fund balance, the approval of a new Stormwater Technician position in FY24, along with the recommended CIP investments in the FY26-28 budget and overall operating cost increases will rapidly deplete that fund balance without fee adjustments.

Employees

- ✓ Market pay adjustments to compensation and classification plans. As was done three years ago, the town contracted with the Piedmont Regional Council through the Central Pines Regional Council to complete the market analysis and update the pay plan. The benchmark units were similar as was the methodology of arriving at recommended adjustments. The annual cost of implementation, including impact on benefits such as social security, retirement, and 401(K) contributions is as follows by fund:
    - General Fund: $220,000
    - Water/Sewer Fund: $105,000
    - Stormwater Fund: $7,000

- ✓ Merit Pay and Cost of Living Adjustment (COLA). Compensation and staying competitive with the market continue to be a major challenge for all employers, regardless of sector in the economy. The budget recommends the same adjustments as in recent years: $1,500 per employee for a cost-of-living adjustment (COLA) and merit raises in the 3 to 5% range depending on performance.

- ✓ Health and dental insurance. For the first time in six years, there will be an increase to health insurance (2.3%). Dental rates will increase by 7%.

Moving Forward

Please do not hesitate to contact me, Budget Director Emily Bradford (Emily.bradford@hillsboroughnc.gov or 919-296-9427), Budget & Management Analyst Josh Fernandez (josh.fernandez@hillsboroughnc.gov or 919-296-9428), or Administrative Services Director Jen Della Valle (jen.dellavalle@hillsboroughnc.gov or 919-296-9424) if you need additional information, have suggestions, concerns, or would like to propose alternatives, Town staff will make every effort to respond quickly and objectively to help you develop a budget that you feel best addresses the needs of the community! Finally, a big "thank you" goes to all town employees, department and division heads, and the budget team for their work in preparing this year's document!

Sincerely,

Eric J. Peterson

Eric J. Peterson
Town Manager

Emily H. Bradford

Emily H. Bradford
Budget Director

Jenifer Della Valle

Jen Della Valle
Administrative Services Director