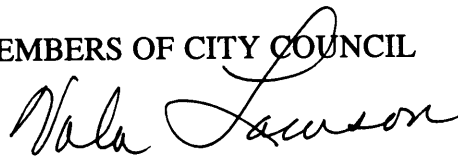


*City of Alexandria, Virginia*

**MEMORANDUM**

DATE: APRIL 14, 1997

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: VOLA LAWSON, CITY MANAGER 

SUBJECT: BUDGET MEMO #12: BUDGET AND FISCAL AFFAIRS ADVISORY COMMITTEE REVIEW OF THE FY 1998 PROPOSED BUDGET

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**ISSUE:** Budget and Fiscal Affairs Advisory Committee (BFAAC) review of the FY 1998 Proposed Budget (Attachment 1).

**RECOMMENDATION:** That City Council receive this report.

**BACKGROUND:** In accordance with the mission of the Budget and Fiscal Affairs Advisory Committee (BFAAC) to advise and support City Council by forecasting future revenue and expenditure requirements and evaluating comparative tax, revenue and expenditure levels in Alexandria, BFAAC has prepared an analysis of the FY 1998 Proposed Budget for Council's consideration.

**DISCUSSION:** Staff will forward its comments to City Council under separate cover.

**ATTACHMENT:** Attachment 1 - Budget and Fiscal Affairs Advisory Committee Review of the FY 1998 Proposed Budget.

**STAFF:** Lori E. Godwin, Director, Office of Management and Budget  
Nancy Saari, Deputy Director, Office of Management and Budget  
Leslie Swanson, Budget/Management Analyst, Office of Management and Budget

# Budget and Fiscal Affairs Advisory Committee

## Report on the City of Alexandria FY 1998 Proposed Budget

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## EMPLOYEE COMPENSATION

### **RECOMMENDATIONS**

1. **Given the City's financial outlook over the next three fiscal years, BFAAC strongly recommends that the City Council limit the annual cost of addressing current pay competitiveness issues to the \$1.8 million dollars allocated in the City Manager's proposed budget.**

The City Council's Watson Wyatt compensation subcommittee's plan would cost \$3.37 million per year, although because some adjustments would come at mid-year, the full impact would not be felt by taxpayers until the following year. Many taxpayers may believe that the proposal will not put pressure on the tax rate. Our analysis shows that the proposal will have a significant impact in FY 1999 equivalent to approximately one and one-half cent on the tax rate. Therefore, the City Council should accept the City Manager's recommended allocation of \$1.8 million to cover all adjustments.

2. **To address shortcomings of the current pay system, the Council should adopt the recommended compensation philosophy of its compensation subcommittee with minor modification. BFAAC recommends that the City Council specify a range of competitiveness (in percentage terms) between the City and comparator jurisdictions.**

The compensation philosophy proposed by the City Council's Watson Wyatt compensation subcommittee essentially addresses the issue of new employees losing ground in the early years of their tenure with the City and effectively defines the guidelines for addressing comparability overall.

3. **Like other job families, the pay scales for each of the four public safety job families should be tied to the market not to each other.**

The City Council should use the same market-driven approach in addressing pay fairness for public safety departments that it uses for other City departments. Pay parity among public safety departments throughout the U.S. is rare. Most jurisdictions view the lines of work, although all aimed at public safety, as different. In addition, according to the Watson Wyatt study, pay levels in both the Fire Department and the Sheriff's Office are generally competitive with the major comparator jurisdictions. Therefore, the City Council should adopt a policy to tie each of the three departments to the market and not to each other.

4. **To rectify the disparities at the non-supervisory police officer and sheriff's deputy levels caused by the pay system in recent years, the City Council should remove the limits on the number of non-supervisory slots above level I.**

Moving up a career ladder slot within the police officer or sheriff's deputy levels is accompanied by a 3 percent increase in pay. Officers and deputies eligible for moving up to the next slot should receive that designation and the increased pay level at the beginning of FY 1998. This should eliminate much of the ground lost by new sworn public safety officers since the new pay system was implemented in FY 1994.

5. **The City Council should direct the City Manager to identify the position classifications and job families across City government that are clearly non-competitive with Arlington and Fairfax County and make reasonable salary adjustments.**

The City Manager and her staff should identify the specific job classifications throughout the City government (including public safety supervisory positions) that appear from the Watson Wyatt report to be significantly undercompensated and take steps to make them more competitive with the other major jurisdictions. This should be completed by July 1, 1997 and pay increases should take effect on that date. The City Council should also commission a study of competitiveness for the positions not covered in the Watson Wyatt study. This study should be completed during FY 1998. The City Manager and her staff should review the study, identify positions with non-competitive salaries and make adjustments. This study could not possibly be completed by July 1, 1997. Therefore, the City Council should make all pay adjustments resulting from the second study retroactive to July 1, 1997.

6. **After public safety slot limits have been lifted and pay adjustments have been made to those classifications that are clearly non-competitive across the City, the City Council should approve a general pay adjustment.**

The City Manager should inform the Council of the amount of the \$1.8 million allocation that is left after the cap on public safety pay slots is lifted and adjustments for the classifications across the City are addressed. The Council should then allocate that amount to a general pay adjustment for all City government employees, with all of them receiving an equal percentage increase. BFAAC estimated the cost to eliminate the slot limits for career ladders at approximately \$200,000 based on information in Budget Memo #8.

Adopting these recommendations may allow most employees to receive a total pay increase in the range of 6 percent in FY 1998. Those public safety officers currently eligible to move to a higher non-supervisory level may receive an increase in the range of 9 percent in FY 1998. Other employees in pay classifications that are clearly non-competitive may receive an adjustment, plus 6 percent.

## **BACKGROUND**

The City Council is considering a proposal to approve 10 percent pay increases for almost all of the City's sworn public safety employees and 7 percent pay increases for non-sworn public safety employees and all non-public safety employees by 1/1/98. The City Manager's proposal is 5 percent for all employees.

The issue emerged from the Police Department last year, when officers did not receive the higher pay increase that some in the department had requested. In response to these concerns, the City Council commissioned a pay study by the human resources consulting firm of Watson Wyatt Worldwide. The firm released its final report in December. The key findings are as follows:

Alexandria's current base pay and salary ranges are competitive with Arlington and Fairfax Counties. However, actual average pay is generally somewhat lower in Alexandria. Generally, turnover in the City is lower than in comparator jurisdictions. Alexandria's average annual employee pay increases (merit plus COLA) over the last five years were slightly higher than Fairfax County, but somewhat less than Arlington County.

Although the issue originally focused on the Police Department, debate of fairness and parity issues led to other proposed increases, one equivalent to the proposed police increase for both the Sheriff's Office and the Fire Department and a second proposal for a smaller increase for all other City government employees. To avoid the need for a tax increase this coming year, these proposals delay most of the pay adjustments until January 1998. This limits the impact of the decisions during the coming fiscal year. However when the full impact of these proposals is realized in FY 1999, the cost of the additional 5 percent for all sworn public safety officers is projected to be \$1.77 million annually. The cost of the additional 2 percent for all other employees is projected to be \$1.6 million. Therefore, the total annual cost of the proposals is \$3.37 million. This exceeds by \$1.57 million the City Manager's recommended allocation. The \$1.57 million is equivalent to almost one and one-half cent on the tax rate. With respect to pay parity, the Council is reviewing bringing fire, police and sheriff's salaries into line with each other. This would increase pay levels for the firefighters and sheriff's deputies by 5 percent, at an approximate cost of \$819,000 per year, equivalent to more than another half-cent on the tax rate.

If approved, these increased salary costs will intensify the pressure on the budget that over the next six years will need to cover the costs of significant capital projects and improvements for the City schools (\$32 million), new information technology for the City government (\$22

million), a new West End library (\$12 million), the Queen/Lee parking garage (\$6 million), and new development of park land at Cameron Station (\$3.6 million). BFAAC, in other recommendations, notes there are additional potential capital projects in the City that need to be considered in any analysis of future demands on the budget.

Moreover, the proposed FY 1998 budget projects significant budget shortfalls in FY 1999 and FY 2000. The shortfall in FY 1999 (beginning 7/1/98) is projected to be \$15.6 million. The deficit in FY 2000 is projected to be \$28.1 million. All this with City staff reporting that revenue projections for the current year are "much more aggressive" than they have been over the past several years.

Each year, the budget includes an allocation from the City's fund balance of up to several million dollars to balance the projected revenues and expenditures. For several years, none of the allocation has been used. This year (FY 97), for the first time in many years, the City will use some of the allocation -- a projected \$1.25 million.

## **ANALYSIS**

Although there do appear to be some disparities in police pay between Alexandria and Arlington and Fairfax County, there are several facts that are not widely known by the taxpayers:

### **1. On the whole, Alexandria's Police Officers are not grossly underpaid compared to Arlington and Fairfax Counties.**

A significant amount of time has been spent by the Office of Management and Budget, the public safety departments, the City Council subcommittee on compensation and the BFAAC to try to fully understand what the comparative information in the Watson Wyatt report really means. We have concluded that comparisons at the police officer levels are valid. However, the comparisons at the supervisory levels are more difficult because actual job duties and scope of responsibility vary for positions with the same ranks across departments. Overall, however, salaries for the Alexandria's police officers are not substantially lower than those of officers in Arlington and Fairfax Counties.

### **2. Alexandria police officers on the whole have not lost ground to the City's key comparators.**

Over the past five years, Alexandria has lost ground with respect to salaries - but remains competitive with - Arlington, where the compounded COLA and Merit increase has been 25.3 percent. However, the five year compounded COLA and Merit increase in Alexandria (22.2 percent) exceeds that of Fairfax County (21.4 percent).

3. **A number of individual officers, particularly those in first line jobs with only a few years experience, are clearly underpaid.**

The City adopted a new pay plan in 1993 that abolished the old step system, which awarded people a 5 percent step increase every year until they reached the top of the pay grade. It provided for particularly high salary growth for new officers when combined with COLAs. The new system, designed to be more like the private sector, established open ranges so that, at any one time, fewer employees would be at the top of the scale. However, unlike the private sector, it did not have a mechanism that provides for higher percentage growth at the low end of a pay range than at the middle or higher ends of the range. As a result, younger officers have not experienced the higher salary growth that a true private sector pay structure would have provided.

4. **The City Manager's proposed pay increases in the FY 1998 budget should position Alexandria to essentially maintain its competitive position with Arlington and Fairfax counties.**

Under the proposed increases in all three major jurisdictions, salaries of Alexandria's police officers would be very competitive with Arlington and Fairfax, but the differences with Fairfax, particularly at the supervisory levels, would broaden.

5. **Turnover in the police department is unusually low.**

Despite all of the apparent discontent over pay in the police department, voluntary turnover last year was only 1.9 percent among sworn officers. This appears to indicate that, taken as a whole (pay, benefits working conditions, department leadership, promotional opportunities, community support, etc.), the job of police officer in Alexandria is highly valued by the incumbents. But because turnover is low, officers also have limited career growth opportunities. There are a fixed number of supervisory positions. Moreover, police officer levels II to IV, which reflect higher levels of police officer proficiency, have limited slots. As a result, qualified officers are not able to move up the police officer career ladder even when they are qualified to do so.

6. **There are many other job classifications across City government that have average pay levels that are not competitive with Arlington and Fairfax Counties.**

The emphasis in this year's debate over pay has focused an inordinate amount of attention on public safety sworn officers. Lost in the debate have been the many employees in job classifications with salaries that are clearly not competitive. In fact the comparative

differences are greater in several other City job classifications than they are in any of the police ranks.

**7. Salaries in Fire Department and Sheriff's Office are very competitive with Fairfax and Arlington Counties.**

The Watson Wyatt study does not show any significant differences in pay for the overwhelming majority of firefighters and sheriff's deputies.

**8. There appears to be no rationale for having equal pay for police officers, firefighters, and sheriff's deputies.**

Although each of these groups is involved in the general function of public safety, the jobs are very different. They require different skills and training and involve very different activities. As a result, police, fire and sheriff's deputies positions represent four job families, not a single one. Also, relatively few jurisdictions in the U.S. have adopted pay parity, opting instead to view the job families separately.

**9. The City's pay structure has not worked as intended and is the major source of the current problems.**

As discussed earlier, newer people have been particularly burdened. In addition to addressing their situations and other comparability issues, the City must modify its pay structure. The City Council subcommittee on compensation has developed a workable compensation philosophy that should help resolve the problems with the structure.

## CAPITAL IMPROVEMENT PROGRAM

### RECOMMENDATIONS

1. **BFAAC recommends that the Council recognize and begin planning for the fact that the demand for capital spending by the City will exceed the \$123.8 million contained in the proposed Capital Improvement Program (CIP) during the period of FY 1998-2003.**

There is a high likelihood that requests will be received for a number of possible additional projects that are not included in the proposed CIP. The total value of such possible requests is in the \$33.5 to \$81.1 million range.

2. **In light of these potential additional demands for capital spending, BFAAC recommends that the Council reexamine the Debt Related Financial Policies adopted on June 9, 1987 and reaffirm or update those policies as appropriate. BFAAC renews its previous call for a five year projection of revenues and expenditures in the operating budget.**

The current guidelines have served the City well. As the City begins the process of reentering the bond market any updates should be developed in a manner designed to maintain the superior credit ratings the City currently enjoys and yet permit the Council to meet the considerable capital needs that are facing a City with Alexandria's economic, social and demographic profile.

3. **BFAAC recommends that in the process of this examination the Council develop and maintain appropriate target ranges for unreserved and undesignated fund balances that will assist with maintaining a superior credit rating. The Council should hold fast to its own current guidelines and not fund operating costs that continue for more than a two-year period from the City's reserves.**

BFAAC recommends emphasizing the importance of these fund balances to the City's current financial health. BFAAC also recommends providing a better explanation of the importance of the fund balances and presenting them more simply and clearly to improve the community's understanding of the role of these reserves.

## **BACKGROUND**

To avoid arbitrage restrictions imposed by the federal government on issuers of tax exempt financing, the City plans to begin construction on projects in its CIP before borrowing in the market with tax exempt bonds. For instance, the proposed \$35 million borrowing in FY 1999 would be used to pay off \$29.6 million in construction costs incurred in FY 1998 and \$5.4 million of construction costs incurred in FY 1999. The \$30 million to be borrowed in FY 2001 would pay for \$26.3 million of capital construction costs in FY 1999 and \$3.7 million in FY 2000. The \$30 million to be borrowed in FY 2003 would pay for \$8.3 million in capital construction costs in FY 2000, \$7.0 million in FY 2001, \$8.6 million in FY 2002, and \$6.1 million in FY 2003. (See page 13 of the Proposed Budget for the CIP for schedule.) Given this schedule, when the City goes to borrow funds, the bond issue will have to be of a sufficient amount, after deductions for various debt issuance costs, that it can reimburse the general fund for previously incurred construction costs.

The size of the required bond issue thus depends on the projected costs of the capital projects within the CIP, which can only be estimates at this time. If the costs of these projects exceed current estimates, the size of the debt issues may have to be larger to cover those projects. Otherwise, additional general funds would have to be appropriated to cover the costs of the capital projects. Furthermore, the net proceeds available to pay for these construction costs may be subject to the uncertainty of any costs incurred to go to market (e.g., underwriter, bond counsel, or financial advisor) and any original issue discount desired to carry a relatively lower nominal interest rate.

Thus, under these procedures the City will begin the capital construction program in anticipation of bond revenues that have not yet been acquired in the market and whose interest rates are unknown. The Council must, and we expect it will, take every precaution in these circumstances to obtain sound financial advice from the City Manager and her staff and from outside experts that might be necessary such as a financial advisor, underwriter and bond counsel.

Besides carefully managing the mechanics of going to the credit market, the City Council also should be aware of the factors considered by the credit rating agencies in rating municipal debt. The Government Finance Officers Association's publication, An Elected Official's Guide to Debt Issuance (1993) says that the credit rating agencies focus on four primary factors in assessing the credit worthiness of a debt issue.

1. An assessment of the community's ability to support existing and planned debt obligations, using as indicators key financial ratios.
2. An analysis of revenue and expenditure trends, and the adequacy, dependability, and scope of revenues.

3. An evaluation of the economic outlook for the jurisdiction, focusing on income, population, employment, diversity and composition of employers, and real estate values.
4. A review of the organization and powers of the government's administration, and the services for which it is responsible. (p. 62)

With this background in mind, BFAAC makes the following observations and recommendations concerning the proposed Capital Improvement Program.

## **ANALYSIS**

1. **Recognize and begin planning for the fact that the demand for capital spending by the City will exceed the \$123.8 million contained in the proposed Capital Improvement Program.**

Beyond the immediate upcoming year, FY 1998, the estimates contained in the Capital Improvement Program are not meant to be final estimates. The change from last year's CIP to this year's CIP illustrates the magnitude of change that can occur from year-to-year. The City's share of this year's proposed six year CIP has increased to \$123.8 million from last year's estimate of \$106.1 million--a 16.7 percent increase. The reasons for this increase are varied. This year's CIP shows large increases for several projects including \$8.4 M for a new elementary school in the City's West End and \$3.3 million in other school facility improvements, an increase of \$1.1 million for the new library, an increase of \$6 million for a new parking facility at Queen and Lee Streets, and an increase of \$4 million for technology projects. The following table shows a comparison of the two plans:

**City Share of Proposed CIP**

Fiscal Year	1998	1999	2000	2001	2002	2003
FY 1997-2002 CIP Est.	\$24.9 M	\$17.3 M	\$17.5 M	\$11.3 M	\$9.9 M	NA
FY 1998 - 2003 CIP Est.	\$34.4 M	\$39.8 M	\$17.3 M	\$12.4 M	\$10.9 M	\$8.9 M
Change	+\$9.6 M	+\$22.5 M	-\$0.2 M	+\$1.1 M	+\$1.0 M	NA

A host of potential capital projects loom on the horizon and could add significantly to the proposed Capital Improvement Program.

The report of the consultant to the School Board on Long Range Planning included rough cost estimates for several projects that are not included in the proposed CIP but will be under

consideration by the School Board for possible inclusion in next year's CIP request. The cost range for the following projects could be from \$12.4 million (the low estimate of the least expensive alternative) to \$47.5 million (the high end of the most expensive alternative). The possible projects include:

- Renovated/expanded or new middle school to handle expected enrollment increase.
- Renovated or new ninth grade center to handle expected enrollment increase or a new ninth and tenth grade facility on the Chinquapin site.
- Renovated T. C. Williams cafeteria to create an attractive and effective dining facility that can keep students on campus at lunch.
- Renovated or expanded administrative facilities.
- Alternative education/ESL/adult education facilities.

In addition to potential additional capital needs for the school system, a number of other requests and future capital projects are either excluded from the proposed CIP because they were not recommended by the City Manager or because they were not yet ripe for inclusion. Some other projects are included but only for a nominal amount of \$5,000 proposed in FY 2003. The cost range for these projects is estimated by BFAAC based on information supplied by City staff to be from \$21.1 million to \$33.6 million. Some of the projects that fall into these categories include:

- Renovation of the Health Department's St. Asaph St. facility.
- Construction of an animal shelter.
- Expansion of existing or construction of new recreation centers.
- Acquisition and renovation of several Community Services Board Facilities.
- DASH bus facility and bus yard.
- Impact of technology on City facility energy needs.
- Impound lot security and building improvements.

Together, the potential school capital projects and the other potential City capital projects total \$33.5 million to \$81.1 million. The volume and dollar magnitude of these additional, potential capital projects clearly requires the Council to begin advance financial planning. BFAAC is not making any recommendation for or against any particular project in the proposed capital plan or for any potential addition to that plan. But BFAAC wishes to advise the Council of the likelihood that it will face difficult future choices in deciding whether to fund these additional projects either through (1) borrowing above and beyond the \$95 million contemplated in the proposed CIP, (2) providing annual appropriations from the General Fund (thus increasing pressures to increase current taxes), or (3) by postponing or rejecting these or other capital projects.

**2. Reexamine the Debt Related Financial Policies adopted on June 9, 1987 and reaffirm or update those policies as appropriate.**

With such large additional demands for capital spending on the horizon, it would be prudent for this City Council to reexamine the debt related financial policies adopted 10 years ago and reaffirm or update those policies as appropriate.

BFAAC believes that adhering to a sound set of debt related financial policies is the best way to protect the City's credit rating. Again, quoting An Elected Official's Guide to Debt Issuance (1993):

A debt policy offers a number of advantages. First, a debt policy can help community leaders to integrate the issuance of debt with other long-term planning, financial and management objectives. A debt policy is also useful once bonds are issued to evaluate the impact of each issue on the jurisdiction's overall financial position. Finally, a debt policy provides guidance to community leaders so as not to exceed acceptable levels of indebtedness. While debt policies are beneficial in establishing a framework for debt issuance, they should be sufficiently flexible to permit governments to take advantage of market opportunities or to respond to changing conditions without jeopardizing essential public services.

A carefully crafted and consistently applied debt policy provides evidence to the rating agencies of a community's commitment to controlled borrowing practices. As such, it is regarded positively in evaluating a jurisdiction's creditworthiness. (Page 12).

BFAAC notes that City staff have estimated that under the proposed CIP the City's net debt per capita will rise to \$791 dollars by 2003, just below the target of \$800 set by the Council in its 1987 debt related financial policies. However, the City's debt under the proposed CIP will probably remain well below other debt service indicator targets established in FY 1987. By fiscal year 2000,

- the ratio of debt service to general expenses will be 2.51 percent--below a maximum target of 8.0 percent;
- the ratio of outstanding debt as a percentage of assessed real and personal property will be 0.47 percent--below a maximum target of 1.0 percent;
- the ratio of debt per capita as a percentage of per capita income will be 1.39 percent--below a maximum target of 3.0 percent; and

- under the City Manager's proposed budget and CIP, the ratio of the general fund balances as a percentage of general fund revenue will be 12.3 percent (unreserved) -- above the minimum target of 5.5 percent.

BFAAC believes the City should prepare a five-year projection beyond the budget year of revenues and expenditures as well as a similar projection of the impact of its FY 1998 operating and capital budget programs on debt service indicators. The 1987 Debt Related Financial Policies adopted by Council already call for a five-year projection of revenues and expenditures. But this policy has not been followed during the 1990's.

BFAAC notes and appreciates that in this year's budget a projection through FY 2000 is provided. BFAAC recognizes the difficulty of projecting revenues an additional three years into the future. The current projection two years beyond the budget year have already shown its worth by highlighting the potential for operating budget deficits in the near future. Six-year projections--assuming extension of current services and policies--will capture projected changes in operating expenses from CIP projects, future impacts of pay raises, and other expenditure changes. This six year "current services" projection will make future consequences of current policy and program decisions more readily apparent.

In BFAAC's view it would be sufficient for the City staff in this regard to simply project current trends through the five year budget horizon without attempting to forecast changes in the business and economic cycles of the City. Even with this simplifying assumption, the extension of the projection an additional three years would support the debt capacity policies currently governing the multi-year capital improvement program. BFAAC believes, as did the Council in 1987, that such projections will "improve financial planning and decisions". It also would provide more assurance to the taxpaying citizens of Alexandria and its capital lenders that the City is cognizant of the long range impact of current decisions. Therefore, BFAAC renews its previous call for the production of such long range projections of the operating budget.

BFAAC is proud of the City's current AAA/Aaa bond rating and recognizes its symbolic value as well as its practical effect of holding down borrowing costs. We recognized that no City Council and no City Manager would wish to see our City's credit rating reduced. Furthermore, we recognize that if the City's credit rating dropped to AA from AAA, the cost of borrowing would increase 10 basis points--or one million dollars over the 20-year life of the bonds used to borrow \$95 million under the proposed CIP. Nevertheless, such a rating is not a goal in itself, but rather an indicator of our City's sound fiscal condition and policies. It is impossible to predict how re-entering the bond market in the next few years by itself may affect the City's current bond rating.

The most practical way the Council can continue to maintain the trust and confidence not only of the bond rating agencies, but of its own citizens, is to reassert its commitment to a

sound set of debt policies, to take the long- range perspective in both its capital and operating budget decision-making, and continue to promote excellence in the financial management policies and procedures currently followed by the City staff.

Specifically, BFAAC recommends that the Council consider adjusting the measurement of debt per capita against the target to consider the effects of inflation. City staff have provided BFAAC with a chart showing the measurement of debt per capita adjusted for inflation. (Please see the chart at the end of this section.) If the target of \$800 is adjusted for inflation since 1987, it has increased to \$1,068 by 1996 and may increase to \$1,311 by 2003 under current trends in inflation. Another way to account for inflation would be to adjust the capital debt of the City to 1987 dollars. Seen in these terms the City would have \$483 dollars of debt per capita (in 1987 dollars) by 2003--40 percent below the target of \$800. Given the effects of inflation since 1987 on this debt policy indicator, the Council may wish to consider such a modified, inflation adjusted target as part of its Debt Related Financial Policies.

The development of the debt policies should consider the financial performance indicators achieved by other jurisdictions with AAA/Aaa ratings. However, Alexandria is generally a much more diverse political entity than many of these jurisdictions and faces many additional social and economic challenges. Therefore, our debt policies must be set with an eye both on maintaining our credit rating, but also on meeting the needs of our citizens. A year ago the City staff provided Council with a comparison between Alexandria's fiscal and social condition and that of other jurisdictions with AAA/Aaa bond ratings. (See attached table.) These indicators show that Alexandria, even though it faces a much more challenging set of social and economic conditions, outranks a majority of these AAA/Aaa rated municipalities in terms of its fiscal condition.

### **3. Develop and maintain appropriate target ranges for unreserved and undesignated fund balances that will assist with maintaining a superior credit rating and preserve the fiscal health of the City.**

BFAAC recommends emphasizing the importance of the unreserved and undesignated fund balances to the City's current financial health. In their current presentation, however, the calculation and display of the these funds balances and their centrality to budget planning is nearly incomprehensible to the uninitiated citizen. The presentation of these fund balances should be simplified and clarified to improve the community's understanding of the importance of these reserves.

BFAAC also supports accurately representing and projecting these fund balances and stresses their importance to the integrity of the City's budget process. We believe that the accounting treatment of such items as the expected change in Government Accounting Standards Board rules for compensated absences and other accruals can be an important marker noticed by the bond rating agencies in developing their assessments of the City's financial management

practices. In plain words, the temptation to use accounting gimmicks- to appear to have more money available than the City really has- will be noticed first by the bond rating agencies and eventually by the citizens of Alexandria. Conversely, it is equally important not to reserve more funds than necessary and thus appear to have fewer funds available than the City really has for current operating expenses. This mistake can erode the credibility of the budget estimates in the community.

In its review of debt related financial policies, the Council should establish consistent criteria to be used for setting aside annual contributions for each designated reserve fund. The rationale for the annual contribution to each designated fund should be fully explained in the budget document. Such policies and explanations will strengthen the maintenance of these reserves during the budget process.

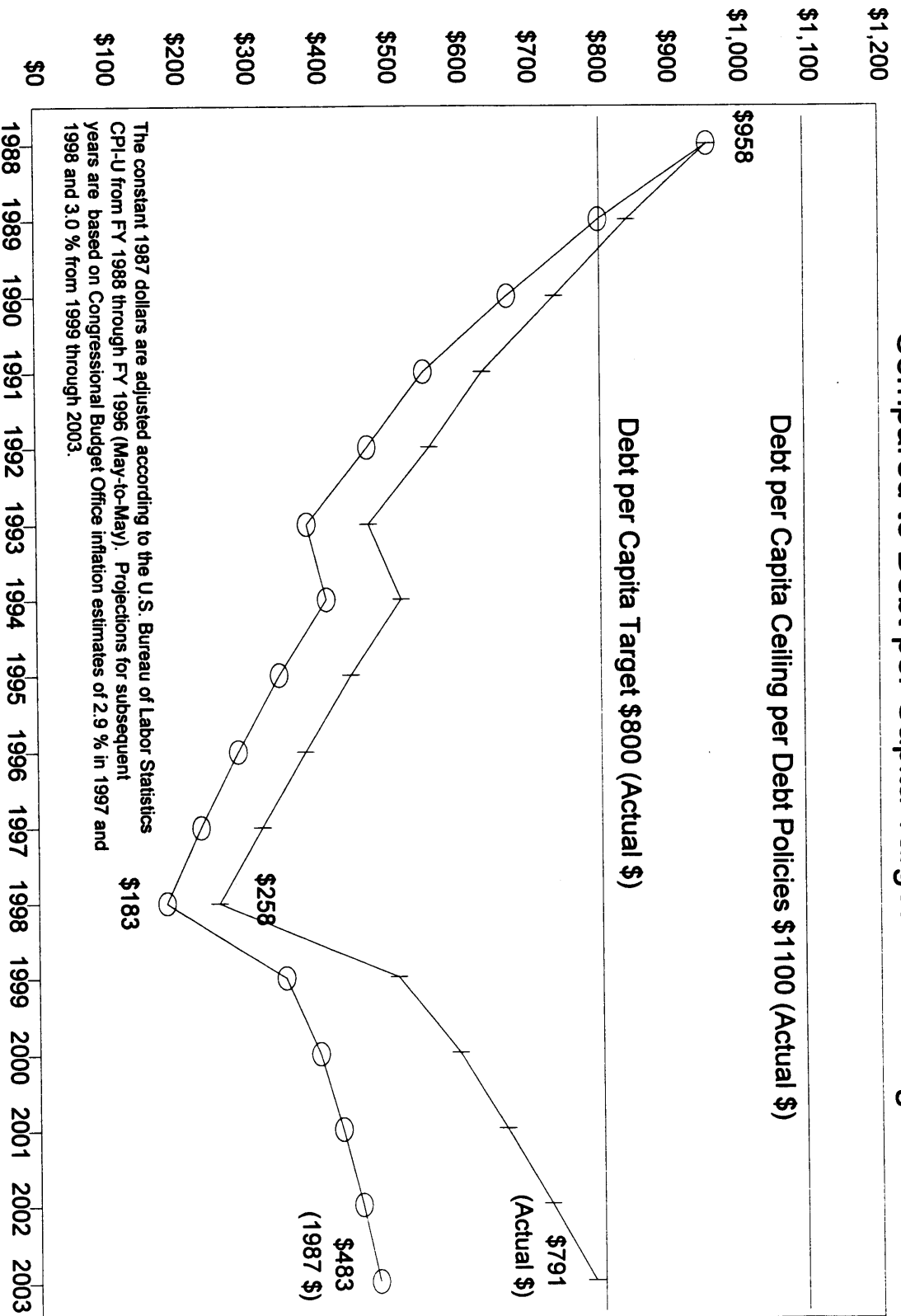
Lastly, the Council should hold fast to its own current guidelines and not fund operating costs that continue for more than a two-year period from the City's reserves. Such discipline is an important indicator observed by the credit rating agencies. More importantly, such action may endanger the future fiscal health of the City.

### Relative Ranking of Alexandria's Debt Capacity and Social and Economic Indicators

(as of most recent data available in Budget Memorandum of March 20, 1996)

<b><u>Debt Capacity Indicator</u></b>	<b><u>Alexandria</u></b>	<b><u>Arlington Co.</u></b>	<b><u>Fairfax Co.</u></b>	<b><u>Avg. of All AAA/Aaa Municipalities</u></b>	<b><u>Alexandria's Rank</u></b>
Debt per capita	\$447	\$1,633	\$1,292	\$658	10/30
Debt as % of assessed value	0.482%	1.69%	1.65%	1.11%	5/30
Debt service as % of General Govt. Expenditures	3.80%	6.05%	6.18%	8.78%	3/30
General Fund unreserved balance as % of General Fund Revenue	22.36%	7.15%	8.30%	19.50%	10/30
General Fund undesignated balance as % of General Fund Revenue	6.60%	0.00%	8.30%	12.62%	21/30
<b><u>Social Indicators</u></b>	<b><u>Alexandria</u></b>	<b><u>Arlington Co.</u></b>	<b><u>Fairfax Co.</u></b>	<b><u>Avg. of All AAA/Aaa Municipalities</u></b>	<b><u>Alexandria's Rank</u></b>
Assisted students as % of total	48.17%	39.44%	18.36%	25.25%	18/21
AFDC cases as % of total population	1.25%	0.72%	0.44%	1.20%	15/28
Food stamp cases as % of total population	3.90%	1.49%	0.78%	2.39%	22/28
Assisted housing units as % of total housing units	7.52%	5.76%	3.25%	5.84%	20/26
Persons below poverty line as % of total population	6.93%	6.96%	3.45%	7.41%	16/30

# Debt per Capita in Actual Dollars and in 1987 Dollars Compared to Debt per Capita Target and Ceiling



## REVENUE AND ECONOMIC DEVELOPMENT

### RECOMMENDATIONS

1. **Given the importance of continued economic development to Alexandria's future, BFAAC recommends that Council explore ways to assess and evaluate the scope and effectiveness of current City-driven economic development efforts.**

The Committee commends the City Manager for proposing a budget that sends the right message for employment growth and economic development by not increasing taxes, utilizing the funds generated through this year's economic growth for key community issues, and planning for a vibrant future through commitments to the Capital Improvement Program (CIP). BFAAC recognizes that the Manager has also included a small but noted reinvestment in future growth through increased funding for economic development.

### BACKGROUND AND ANALYSIS

BFAAC's Report to Council on the FY 1997 Proposed Budget recommended an increase in spending for economic development as the City's strongest hope to cover future projected revenue shortfalls. It should be noted that although changes were made to reduce BPOL taxes for small businesses, these taxes are up 2.5 percent compared to 1996. We recommend a continued policy of tax fairness and a continued investment in economic development.

In evaluating current economic development efforts, areas for possible consideration include:

Economic Development/Marketing Efforts Initiate a single strategic public relations effort that utilizes information provided from the Old Town, Potomac West, Eisenhower Area, and other areas of the City to more effectively advocate job development and tourism in Alexandria.

Possible Consolidation of Economic Development Efforts The Alexandria Economic Development Partnership (AEDP) was established in 1981 as a public/private partnership between the City and the business community. Since its inception, five other organizations receive funds targeted for development issues. Each one of these organizations must spend a percentage of its capital in operational expenses. A recent report on the newly approved Potomac West Alliance showed that only \$14,000 of the \$100,000 spent would actually go to marketing the City. Is it possible that under one central organization, some of these operational costs could be minimized? Arlington's Organization of Economic Development

receives the greatest portion of economic development funds from its city and designates specific (and equal) funds to key geographic regions within the territory. Such a method may allow equal funds to be more effective.

Targeted Business. There are many ideas as to what the best businesses are to attract to Alexandria and where. Would a large convention hotel with significant meeting space be our best investment for Potomac Yard? Can a large base of Technology Firms in the Eisenhower Avenue area provide the most high paying jobs and best utilization of space? A more specific list of the wants and needs of Alexandria should be created. A wish list may be used to judge the effectiveness of our economic development efforts. Alexandria 2000 is already here and a marketing plan is necessary.

Increased Tourism. The revenue assumptions in the proposed budget project an increase in Transient Lodging Taxes of less than 1 percent. Perhaps more could be done to market tourism in the City, particularly in the area of large meetings and conventions. The Virginia Tourism Corporation calculates that for each \$1 spent on marketing, the City would generate \$8 in revenue from lodging taxes, restaurant taxes, retail, parking, public transportation, and more. While the Alexandria Convention and Visitors Association (ACVA) is developing a long range tourism promotion of Alexandria's winning heritage, waterside location, and natural beauty, one questions what facilities we might be missing that would make Alexandria a destination in itself. The facilities and services that might be considered should be user friendly to those visiting our city, maximize revenue generation, and should not disturb its business climate and home town feel.

## **BFAAC Statement for the Budget Public Hearing on April 7, 1997**

The Alexandria Budget and Fiscal Affairs Advisory Committee is charged with advising the City Council on fiscal and budgetary matters. Every year, the committee submits a report to Council outlining its analysis of the City Manager's proposed budget. The committee is currently working on this year's report, but it felt compelled this year to voice its concerns in oral testimony at this hearing and contribute to the public debate over several important budget matters.

Alexandria is financially healthy primarily because the City Council has always looked to the long term when formulating city policy. BFAAC urges Council to continue that practice of long-term thinking when making its decisions on the city's budget for fiscal year 1998.

The primary focus of this year's budget discussions has been employee compensation. BFAAC recognizes that numerous city employees are paid below market level. Many of those underpaid employees work in the public safety departments. BFAAC wants to make clear that it joins with the vast majority of Alexandria residents in praising the hard work and professionalism of the City's employees. Every effort should be made to identify those employees who are paid significantly below market level and to adjust their compensation.

The City Manager has proposed a generous pay increase in the form of a 2 percent cost-of-living adjustment and a 3 percent merit increase, while raising the pay ceiling for all classes so that all employees, regardless of longevity, will be eligible for the full 5 percent. As Councilman Euille noted at a work session last month, such an increase is rare in the public sector these days, and indeed is uncommon even in the private sector.

On top of that, the Council subcommittee on compensation issues has proposed an additional increase of two percent for all city employees and three percent for sworn public safety employees in order to eliminate pay inequities.

The committee is compelled to point out to Council that such generosity has a cost. In this case, the cost could haunt the city in future years.

The committee proposes a more cautious approach to pay inequity. By targeting the increases to employees whose compensation levels actually fall significantly below the market level, the Council will eliminate pay inequities to a large extent, while maintaining a sound financial basis for the city's future. The City Manager has included \$1.8 million in her proposed budget that could be used for just such a targeted approach.

For those employees whose compensation should be adjusted, we recommend those adjustments be in the form of reclassifications or promotions instead of across-the-board increases to the general pay schedule.

For the past few years, the city has enjoyed the fruits of far-sighted fiscally prudent measures taken in the 1980s. Among these measures are a series of financial guidelines that City Council adopted in 1987 that put the city on a sound financial basis. These guidelines include a floor and a target for general fund balance reserves, policies setting targets and ceilings for the city's debt capacity, and a policy against funding ongoing operating expenses out of the reserve fund.

BFAAC's report to Council will contain recommendations regarding the need to review and possibly update or reaffirm these policies, which have played a key role in Alexandria's outstanding credit ratings. These guidelines, however, could be in jeopardy if City Council commits future city resources to cover what could be an overly generous spending package this year.

The city plans to issue \$95 million in bonds over three years beginning in 1999. Debt service on that borrowing will begin in 2000. A large commitment of future spending on personnel compensation, such as the one Council is currently considering, could make it more difficult for the city to repay the the bonds. A bond rating agency could reasonably decide to downgrade the city's bond rating based on excessive spending increases, thereby forcing the city to repay the bonds at a higher interest rate.

Furthermore, a commitment of future spending for personnel compensation could limit the Council's ability to meet other emerging community needs. For example, in addition to the capital needs outlined in the city's proposed Capital Improvement Program, the committee understands that there are a number of unstated capital needs that will emerge in the coming years that are not accounted for in that document. These projects will require funding either through additional future borrowing or allocations from the city's fund balance.

Another issue lurks in the future. It is not widely known, but the city incurs each year a nearly invisible budget deficit which is annually bridged by a designation from the city's fund balance. In recent years, this fund balance designation has not been spent, as revenues higher than those projected have served to make up the difference. This "invisible" budget deficit is projected by the City Manager to grow to \$15.5 million in FY 1999 and to \$28 million in FY 2000. With this growing imbalance between projected revenues and anticipated spending, the committee deems it important to warn Council that additional spending commitments will only swell that deficit, and could drain the fund balance that is so important to the city's financial stability. In its report to Council, BFAAC will be recommending that the current three year projections, which have already shown their value in this year's budget discussions, be extended to five years as already called for by the Council's financial guidelines.

In discussions about how to fund the proposed compensation package, members of Council and members of the community have put forth the suggestion of using money from the fund balance beyond the levels already being contemplated in the city manager's proposed budget. The committee would remind Council that its own self-imposed

guidelines prohibit the use of fund balance reserves to fund operating costs for more than a two-year period.

If Council decides to implement compensation increases totaling more than the \$1.8 million available in the city manager's budget for this purpose, the committee would urge Council to hold fast to its own spending guidelines and not fund this increase from the fund balance. Indeed, as unpopular as it may sound, offsetting expenditure reductions or an increase to the real property tax rate would be more financially sound ways to fund this increase in operating costs than would ill-considered withdrawals from the city's reserve fund.

The revenue projections that form the basis of the City Manager's proposed FY 1998 budget are, as even city staff concedes, optimistic. Although city staff is uncommonly accurate in evaluating economic trends and projecting revenues, the future will always be uncertain. The commitment of millions of dollars in future spending on compensation demands a greater certainty about future revenue flow than is currently available to us.

BFAAC is well aware of the extraordinary public demonstration of concern by various interest groups. Indeed, to a member, the committee strongly supports efforts by city employees to achieve pay parity with neighboring jurisdictions. However, the committee believes that sound and clear-eyed financial decisions are the best way for the city to show its enduring commitment to its excellent employees and to the city's taxpayers over the long run. BFAAC merely urges Council to fully consider the future impact of spending commitments made in a bubbling political cauldron. Our city has an historic tradition of fiscal responsibility, and the current Council can be proud that it has added to that tradition. Please carry on those civic values of stewardship, far-sightedness, and sound reason, and consider the future well-being of the city as you prepare the city's FY 1998 budget.

## FAIR SHARE

**Recommendation:** BFAAC recommends that the financial concepts related to the fair share issue be examined in depth, based on the attached list of terms-of-reference questions developed by BFAAC. We also recommend that City Council charge other commissions and city staff more suited to exploring all aspects of the issue with examining the issue in its entirety, including the results of the financial analysis.

**Background:** At our Fall 1996 meeting with City Council, BFAAC undertook the task of examining fair share issues from a financial point of view. Because of the very emotional nature of this issue, we have crafted BFAAC's approach very carefully to ensure that we strictly focus our study on some selected financial indicators, thus leaving examination of the social and philosophical dimensions of fair share to others in the city more suited to that task.

As we embarked on this task, we quickly became aware of the complexity of the issue and the immensity of the task. In order to begin at least a preliminary examination, we tried to focus our efforts on housing issues where information appeared to be the most readily available and the issues appeared to be relatively narrow. The attached list of questions, some of which can be answered with current resources and others which need much more extensive work and data gathering, was meant to frame the financial end of the discussion.

**Next Steps:** We have already met with the City Assessor to refine these questions, and we plan to contact other city staff who can assist further. Once we are satisfied that we have framed the financial debate to some degree, someone should be identified to delve into the details. Concurrently, other city resources should be examining related issues.

**Details:** The questions thus far that we hope serve to frame the debate are the following:

### Trends in Assisted Housing Stock Values

1. What has been the trend in total assessed value of all city residential housing stock from 1987-1997? What is the trend in average assessed value of single-family detached unit? Condominium unit? Rental units?
2. What is the trend from 1987-1997 (show year-by-year figures if available) in the total assessed value of property of ARHA-owned property? What is the trend on a per-unit basis?
3. What is the trend, for recent years available, in the tax-exempt value of ARHA properties subject to payment in lieu of taxes (referred to as PILOT)? What is the trend on a per unit basis?
4. What has been the trend, for recent years available, in the tax-exempt value of other property in which there is a private ownership interest as well as ARHA's interest (e.g., ARHA resolution 830 properties)? What is the trend on a per unit basis?

### Effects on City Revenues

1. What has been the trend in tax payments as a result of PILOT and what would have been the tax payments if the property were fully taxable? (Please note those years for which PILOT payments have been deferred due to ARHA's strained financial condition.)
2. What is the trend in taxes that have been foregone completely on ARHA-owned property for which no PILOT is received?
3. What has been the trend in the assessed taxes on any other assisted housing property in which there is a private ownership interest as well as ARHA's interest (e.g., ARHA resolution 830 properties)? Would there any taxes foregone on this type of property? If so, what would be the trend in those taxes foregone?

4. What has been the trend in tax-exempt value on non-profit-owned assisted housing (shelters and other social service facilities) on a per-unit basis?

#### City Expenditures for Assisted Housing

1. What are the city departments, activities, programs, that provide low-income housing assistance in addition to the ARHA?
2. What has been the budget for these activities over the last 10 years? Please include any grants or loans made by the city to the ARHA.
3. What percent of the city's budget has been devoted to provide low-income housing assistance over these ten years (on a year-by-year basis)?
4. Do you have any comparative statistics on the budgets of neighboring jurisdictions for low-income housing assistance that can be compared to the amounts spent by the City of Alexandria (either in percentage or absolute dollar terms)?

#### Demographic Information

1. What are the ages (pre-school, school age, over 65) of residents in city or ARHA-assisted housing units?
2. What is the average income level of residents (per capita and household) of residents of city- or ARHA-assisted housing units?
3. What is the employment and occupational status of residents of city- or ARHA-assisted housing units?
4. What is the educational status of residents of city- or ARHA-assisted housing units?
5. What is the length of residence in Alexandria of residents of city- or ARHA-assisted housing units? What is the average length of residence in Alexandria as a whole?

6. What is the length of residence in city-assisted housing units of current residents of city- or ARHA-assisted housing unity?