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*City of Alexandria, Virginia*

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**MEMORANDUM**

DATE: APRIL 24, 1998

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: VOLA LAWSON, CITY MANAGER *Vola Lawson*

SUBJECT: BUDGET MEMO # 19: BUDGET AND FISCAL AFFAIRS ADVISORY  
COMMITTEE REVIEW OF THE FY 1999 PROPOSED BUDGET

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**ISSUE:** Budget and Fiscal Affairs Advisory Committee (BFAAC) review of the FY 1999 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 1999 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 1999 Proposed Budget.

**STAFF:** Lori Godwin, Director, Office of Management and Budget  
Arthur Gitajn, Director, F&ITS

# **Budget and Fiscal Affairs Advisory Committee**

## **Report on the City of Alexandria Proposed Budget Fiscal Year 1999**

Jim McIntyre, Chair  
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Don Casey  
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Bruce Johnson  
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Brian Meehan  
Bill Rossello  
John Stody

*BFAAC dedicates this year's budget report to the memory of our friend and colleague, Henry Fenlon, who died earlier this month. Henry served as Councilman Bill Cleveland's representative on the committee from 1990 until failing health forced him to resign last month. He served the Committee, the City Council, and the City with quiet dedication and decency, and we will miss him.*

## INTRODUCTION

The Budget and Fiscal Affairs Advisory Committee presents its report on the City Manager's Proposed FY 1999 Budget with a mixture of optimism and concern. The short-term revenue outlook through next year has improved after several recent years of stagnancy and slow growth. The remaining potential for this upswing, which has been fueled largely by new development, is uncertain over the middle and long term as the City eventually will run out of undeveloped land and find its tax base stretched to the limit.

City Council has asked BFAAC to undertake an ambitious study of the City's revenue resources, and we plan to begin the study soon. We will examine current and potential supplies of city revenue, the most appropriate mix of future revenues, the likelihood of change, and the equitable spreading of the tax burden among City residents. Whatever findings we supply to City Council in our study, however, will not increase the current supply of revenue against which City Council must make spending decisions for fiscal year 1999. And while the City Manager has presented City Council with a balanced FY 1999 budget, the 2000 fiscal year and beyond pose substantial fiscal challenges for the City.

Alexandria is embarking on a vigorous capital program that anticipates expenditures of \$137.4 million over the next six years, much of it funded through bond sales. One key to the City's fiscal health over the past decade (a period when several neighboring jurisdictions were forced to raise taxes several times) has been the City's aggressive policy of paying down its debt. This trend will reverse itself in the fall, when we return to the bond market and our debt per capita ratio begins to rise for the first time since the mid-1980s.

BFAAC reminds City Council that this bonded indebtedness will add substantial financial stress to the operating budget in the form of increasing bond repayments in future years, as well as increased operating costs associated with many of the new capital projects. The coming months before the first of several planned bond sales present the City with a good opportunity to reassess our capital needs, to address several future needs that are not included in the proposed CIP, and to refocus on those projects that are most necessary and will serve the widest public purpose. In addition, City Council should be certain that the CIP financing methods minimize the impact on the operating budget and still preserve the sound financial condition of the city, including maintaining its superior bond rating.

We also point out that the forecast scenarios in the budget document, included at BFAAC's request, show the possibility of significant future revenue shortfalls under certain projections. These projections are based on various assumptions regarding revenues, expenditures, and the bond financing plans that are all subject to change in the coming months and years. BFAAC plans to work closely with City Council and City staff to monitor and make recommendations regarding these plans.

This is the fiscal background against which BFAAC presents its 1998 report. Based on the above stated assumptions, and with the understanding that these assumptions can change in the future, BFAAC offers to City Council a set of recommendations that include the following:

- We recommend a significant expenditure savings in the personnel area. By implementing the new pay plan on a half-step basis, the City Council can cut spending in FY 1999 by nearly \$1 million. BFAAC recommends that any savings be directed toward lowering the proposed real property tax rate increase. As an alternative, the committee would recommend using those funds for capital needs.
- We make several suggestions for budget process improvements for the operating budget. Among these are the recommendation that the City Manager include the five-year financial impact of any new proposed change in baseline expenditures.
- We examine in some detail certain capital improvement program financing issues involving bond financing, cash capital contributions, and other areas of potential concern.
- We address some questions regarding designations of monies from fund balance.
- We also address several issues involving economic development and tourism that have been the topics of much citywide discussion.

We hope these recommendations will assist City Council in its final deliberations concerning the FY 1999 budget.

City Council faces some difficult fiscal challenges in the future. With a rapidly dwindling supply of developable land, an inability to tax rising income, and commitment to substantial capital improvements looming over the next few years, the City must find a way to equitably and efficiently marshal its limited financial resources to serve the best interests of City residents. BFAAC stands ready to assist City Council in making these difficult financial choices.

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## OPERATIONS AND PERSONNEL

### RECOMMENDATIONS

**1. BFAAC recommends that City Council reduce the cost of the transition to the new City Employee pay plans by inserting half-steps into the proposed scales.**

Last year, the City Council authorized a 3% market rate adjustment for all employees in addition to the 5% general salary increase (a total of an 8% pay increase for all employees). In addition, the City Council voted to bring firefighters and sheriff's deputies up to pay parity with police officers. BFAAC did not support these decisions, recommending that the City limit employee pay raises to 5% and other pay adjustments to \$1.8 million, as the City Manager had recommended. While BFAAC believed that the 5% raise was justified, our analysis showed that salaries for only a portion of employee positions were non-competitive and that a general market rate adjustment was not needed. Together, the market rate adjustment and public safety pay parity decisions represent an additional annual cost to taxpayers of \$4 million beyond the City Manager's FY 1998 proposal.

Also last year, the City Council approved the return of City employee compensation to a step system in response to the wishes of certain employee groups. These groups believed that such a move would help employees maintain greater competitiveness with neighboring jurisdictions, particularly during the early years of employment. In the wake of this decision, two pay scales were proposed, one for general city employees and one for public safety employees. The proposed FY 1999 budget sets out the proposed scales on pages 9-20 and 9-21. The proposed plan for implementation is projected to cost the City another \$1.9 million annually.

The cost of implementation of the pay system is high because of the method currently proposed for placing employees on the new pay scales. Under the proposal, most employees would have their salary assigned to the step immediately above the current level. (Note: Some employee salaries are currently at a step level and would not be adjusted under the proposal). For example, a typical employee in the middle of Grade 16 (a medium-level grade) currently making \$44,500 would fall between steps G (\$44,172) and H (\$45,718). Because it would be unfair to penalize an employee for the administrative change in pay plans, the proposed method would move the employee up to step H and not back to step G. As a result, the employee will receive a bump of \$1,218 for this administrative change, an increase not tied to performance, experience, skills, market competitiveness or any criterion commonly related to compensation increases.

By inserting half steps, the City can cut the cost of the transition substantially. In our example, a half step, "G+," would be inserted between G and H at the level of \$44,945. The employee would then have his or her salary placed at G+ with an increase of \$445 rather than \$1,218. Like the employee in the example, any City employee with a salary below the midpoint between two steps would go to the midpoint or half-step.

While there would be no savings from BFAAC's proposed method on employee salaries that

would fall above the midpoint of two grades, the savings on employee salaries that would fall below the midpoint would be substantial: one-half step for each employee under the midpoint. BFAAC projects an annual savings of \$950,000.

This recommendation allows the Council to keep its promise to employees to move back to a step system in FY 1999, while minimizing the cost to taxpayers who are already bearing the significant additional cost of compensation decisions made last year. The recommendation also provides the Council and the City Manager greater flexibility in proposing and setting pay increases. Under the method outlined in the proposed budget, the City Manager is limited to proposing no steps, one step, two steps, etc. (equivalent to increases in total payroll of 0%, 3.5%, 7.0%, etc., respectively) Under BFAAC's recommendation, the City Manager could propose no steps, one-half step, one step, one-and-one-half steps, two steps, etc. (equivalent to increases in total payroll of 0%, 1.75%, 3.5%, 5.25%, 7.0%, etc., respectively) depending on what the City can afford in a given year.

The Council should also consider the implication of this recommendation on the Alexandria City Public Schools (ACPS) budget in light of the historical equitable treatment of City and ACPS employees with respect to pay adjustments. A commensurate adjustment in the ACPS budget would increase the annual savings from following this recommendation by approximately \$610,500.

BFAAC strongly recommends that the \$950,000 savings (or \$1.56 million if an adjustment is also made to the Schools Budget) should be used reduce the proposed tax increase from 4 cents to 3 cents (or to 2.5 cents if the ACPS adjustment is made). As an alternative the City Council could allocate the annual savings to fund balance and designate it for funding capital projects, such as those requested by the Schools, but yet unfunded.

**2. BFAAC recommends that the City Manager furnish the City Council with a five-year cost estimate in addition to a one-year estimate for any proposed change in baseline expenditures.**

As the out-year revenue/expenditure scenarios have revealed, it will be important for the City to place greater emphasis on long-term impacts of proposed expenditure increases or decreases. In some cases, the five-year impact may only be a multiple of the single-year cost. In many cases the total will be larger due to built-in annual increases. For example, increases in employee salaries have a compounding effect year after year. BFAAC believes that such attention to the longer-term impact on decisions made to increase operating expenditures during any given budget year will lend greater insight to the decision-making process.

**3. The City Council, City Staff and BFAAC should work together to establish a framework that explicitly differentiates between core and discretionary City services, enabling the Council to make sound service portfolio and service level decisions, particularly in difficult budget years.**

As the City moves into a period of high capital investment and uncertain revenue streams, BFAAC foresees the need for a framework that equips Council to make difficult decisions about the portfolio of services as well as the level of service provided to citizens by City government. BFAAC believes that the City needs to be able to assess the degree to which services and changes to service levels are essential or desirable. The City already employs such an approach in evaluating capital projects, categorizing them as either "essential," "very desirable," or "desirable." BFAAC believes that this approach should be extended to City services as well. However, to make it more applicable to the evaluation of services, we believe that a more detailed approach is called for, as shown in the example categories below<sup>1</sup>. This framework might be used assign new and existing services -- as well as proposed increases to service levels -- into broad categories. Ideally, the City Manager in next year's budget, would use this or a similar framework to evaluate proposed changes in baseline expenditures. Following is an example of the type of categories that might be used:

**Mandated:** Services that are required by State or Federal law, e.g., operating a jail, providing basic classroom education to school-aged children, or prosecuting criminals.

**Other Mission-Critical:** Services that support the stated mission of the City or are needed for the effective operation of mandated or mission-critical services, e.g. responding to emergency public safety calls for service or repairing streets.

**Community Desirable:** Services that are not mission-critical but are considered desirable by citizens throughout the community, e.g. services related to preserving Alexandria historic character, certain cultural activities (such as City parades), certain recreational programs with wide appeal, or the collection of leaves in the fall. These services would only be offered if the core service portfolio were fully funded.

**Specific-group Desirable:** Services desired by a specific group of citizens, such as recreational programs with limited appeal or participation. These services would not be fully funded, but could be subsidized by the City on a sliding scale based on a pre-determined set of criteria. Subsidies would only be available if the community desirable services were fully funded. The total amount of available subsidy funding would be determined annually based on what the City could afford without raising the tax rate.

Within such a framework, the first two categories would represent the City's core service portfolio. The other two categories would comprise the discretionary component of the service portfolio.

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<sup>1</sup>If a consistent set of terminology is desired between the operating budget and CIP, perhaps the same set of categories should be applied to the CIP as well, or if the CIP categories are preferred, they should be similarly defined and applied to the operating budget.



This framework could be used in the following ways:

- Refocusing annual budget discussions on the examination of all discretionary services (in addition to discussions about proposed new services and service enhancements);
- Identify existing services that do not meet the criteria for any of the service categories and should be discontinued;
- Examine the relative priority of proposed new services;
- Select the services that the City cannot afford during difficult budget years.

Such a framework and what it implies -- the examination of services against pre-determined criteria -- will furnish Council the tools it needs to make tough decisions in the difficult years and rational decisions about adding services in better times.

BFAAC recommends that the formal framework be developed in time to be employed in the preparation of the FY 2000 proposed budget.

Beyond decisions about the City's service portfolio, the framework should also help the Council make decisions about the appropriate standards for service levels for all services, core and discretionary. The intent would be to create a process for matching service level standards to actual citizen expectations, thereby minimizing overspending.

To some extent this examination of service level standards will begin this year with the City Manager's plan to aggressively apply vacancy reduction factors, as discussed in #4 below. Reducing the factors is likely to reduce service levels. In some cases, citizen expectations will still be met, indicating that previous service levels were too high. In other cases, citizens will notice a change in service levels and complain, indicating that previous levels were appropriate. In any case, this testing of service levels will allow the City to ensure that it is not overspending to meet a service standard that substantially exceeds citizen expectations.

**4. BFAAC recommends that the City Manager and the City Council evaluate the approaches used by the Manager in the proposed FY 1999 budget to reduce costs through vacancy management and revised equipment purchasing policies.**

As discussed above, BFAAC believes that the City Manager's proposed approach to vacancy management is sound. Similarly, we support the reasoning for the proposed approach for equipment replacement funding, which is to rationalize the type of vehicle purchased, the length of time it is used and other policies. While we agree with the City's intentions, we recommend that the City Manager evaluate the effectiveness of these efforts to rationalize community service standards and equipment purchases.

## CAPITAL IMPROVEMENT PROGRAM

### **MAJOR OBSERVATIONS AND RECOMMENDATIONS**

#### **Section 1 – At least \$50 million of additional capital projects are not fully addressed by the proposed Capital Improvement Program (CIP).**

The City Manager has proposed a new CIP budget of \$137.4 million over 6 years, which represents an increase of \$13.6 million or 11 percent over the previously approved CIP. That CIP, in turn, represented a 16.7 percent increase over the CIP approved a year earlier. As one can see, the trend in Alexandria's capital spending is upward.

The upward trend follows a fairly long period of restrained capital spending by the City. Thus it is perhaps not surprising that in spite of the dramatic increase in planned capital spending over the last few years, the City still faces at least \$50 million of unbudgeted capital needs. These needs are not extravagant extras without any community support. Indeed, most of these needs have significant support within the community and many have been recognized as legitimate and received some encouragement, if not conceptual endorsement, from the City Manager and the City Council.

**Recommendation #1 -- In light of the support for these needs, BFAAC believes City staff and City Council, working with the School Board and its staff, should work out a plan to respond to a large number of these needs. This will not be easy. Future CIPs will continue to generate extremely difficult choices between a large number of competing capital needs.**

For instance, without additional funding for schools in future CIPs, it is unlikely that a construction of a third middle school can begin before fiscal year 2004. BFAAC recognizes the desire of the community for more elementary school capacity in the West End to meet the needs of the students living in the West End. Nevertheless, to meet system-wide capacity pressures, as well as for educational and school management reasons, a third middle school seems to be a high priority. This is one example of why a plan needs to be worked out to respond to a large number of unfunded capital needs.

#### **Section 2 – Solving the future imbalance between operating revenues and expenditures is the key to providing for additional capital needs.**

In order for the City to be able to afford legitimate demands for bricks and mortar, long-lived capital equipment and information technology, it must be able to balance future operating budgets.

Although the City Council may choose to balance the FY 1999 budget by a tax rate increase of up to 6 cents, this will not be sufficient to balance the projected operating

deficits in future years under current projected revenues, expenditures and bond financing plans assumed in the mid growth scenario.

In order to accommodate additional capital projects in future CIPs and live within its debt policy guidelines, the City must solve the imbalance facing future operating budgets. This situation is not several years in the future. It will be apparent next year as the City Council addresses the fiscal year 2000 budget.

Significant reductions in future operating budget costs could result from lower than expected debt service costs due to market conditions and the choices made by the City in structuring future debt. (See section 4 below.)

To provide for additional capital spending, City Council would have to do some combination of the following: impose additional tax rate increases, find new revenue sources, establish significant new spending controls, or alter the proposed structure and methods of financing the CIP. Elsewhere BFAAC discusses various ways to address the projected future imbalance between revenues and expenditures.

**Section 3 -- The City otherwise has sufficient population, personal income and real property assessed value to support additional borrowing beyond that envisioned in the proposed CIP and still remain within most of its recently adopted debt policy guidelines.**

The City's rather extraordinary success in paying down its debt over the last 10 to 15 years has left it in a strong position to borrow additional funds to meet its capital needs. The City also now spends relatively less of its general fund operating budget on debt service than comparative double triple A jurisdictions.

Under the proposed CIP, the City would remain well below its targets for debt per capita, debt per capita as a percent of per capita income, debt as a percent of real property assessed value, and debt as a percent of total general fund expenditures. These targets established in the debt-related policy guidelines are based on the experience of other municipal jurisdictions that have double triple A ratings.

Putting aside for the moment the operating budget problem and the City's difficulties in meeting its guidelines for unreserved and undesignated fund balances, the City has the capacity to borrow from approximately \$90 million to \$101 million more and still meet its other debt policy guidelines.

**Section 4 – Market conditions and the structure of debt financing will have a great impact on future debt service costs and the operating budget.**

The interest rate that must be borne by the city is much more dependent on bond market conditions than it is on the rating the city receives for its debt. Although the maintenance

of a double triple A rating is much to be desired for its symbolic value and for the discipline it imposes on the City's financial planning, the economic effect of this designation on the City's operating budget is dwarfed by even modest fluctuations in the bond market.

A one percentage point increase or reduction in interest rates would change the estimated debt service cost of a \$55 million 20 year bond issue by about \$550,000 in the first year, \$2.5 million over 5 years, and \$5,775,000 over the 20 year life of the bond. The proposed CIP assumes a 6 percent interest rate while current interest rates for double triple A rated debt is about 5.0 percent.

The spread between a double triple A rating and a double double A rating (AA/Aa) is approximately 10 basis points or 0.1 of a percentage point in the interest rate. Current double double-rated tax free municipal debt is rated at about 5.1 percent. A one tenth of one percentage point increase or reduction in interest rates would change the estimated debt service cost of a \$55 million 20 year bond issue by about \$50,000 in the first year, \$250,000 over 5 years and \$575,000 over the 20 year life of the bond.

The proposed CIP also assumes a level principal repayment schedule for the debt to be issued. Such a repayment schedule has three advantages: it frees up debt capacity more quickly, it leads to overall lower interest payments, and it may be a "plus" with the rating agencies. The disadvantage is that it front loads the debt service costs. Assuming a 6 percent interest rate paid on 20 year bonds totaling \$55 million, a level total debt service schedule, like that used for home mortgages, would cost about \$5.5 million more in the long run, but save \$1.3 million in the first year and \$4.8 million over the first 5 years.

The City can minimize the impact on the operating budget of the financing requirements of the CIP by making careful and deliberate choices in structuring its debt. The City Manager's proposed CIP would fund \$154.1 million in capital projects over the next 6 years (including \$16.8 million in costs incurred in FY 1998) through \$115 million in borrowing and \$39.1 million in pay-as-you-go cash capital. These financing plans present significant choices relating to the timing of borrowings, the maturity of the bonds to be offered, and the percentage to be funded through cash capital contributions from either undesignated fund balances or current general fund revenues.

**Recommendation #2 -- BFAAC recommends that the term short-lived be applied to assets with a useful life of less than 5 years. For assets with a longer useful life, BFAAC believes it would be preferable to acquire them through debt financing, rather than cash capital contributions. Such a policy would significantly reduce the cash capital contributions required to finance the CIP. The City Manager should provide a justification of why debt financing should not be used to acquire assets with a useful life of more than 5 years, whether they are financed through the CIP or through the equipment replacement fund found in the operating budget.**

**Recommendation #3 -- BFAAC recommends that additional information be provided in the CIP concerning the useful life of assets to be constructed or acquired. The maturity of the bonds issued then can be matched against the useful life of the assets to be acquired. We understand from City staff that such matching is what will occur in fact when the city goes to the capital market next January.**

BFAAC's conclusion from materials and briefings provided by City staff is that the magnitude of the cash capital contribution as detailed in the City Manager's proposed CIP is not necessarily determined by a particular mix of assets that "require" cash capital contributions. There is a great degree of discretion and judgement being exercised in making these determinations. Because of the potential impact on the operating budget and the affordability of additional CIP projects, we believe the City Council should look closely at these choices.

**Recommendation #4 -- In the meantime, for purposes of finalizing a fiscal year 1999 CIP and operating budget, BFAAC has no objection to approving the City Manager's recommended methods for financing the CIP plan in fiscal year 1999.**

**Recommendation #5 -- BFAAC recommends that the City Council study the above financing issues closely, however, before designating any additional reserve funds for a large cash capital contribution in fiscal year 2000 projected at approximately \$8.7 million. This designation would be made initially by approval of the proposed CIP. But it can be reviewed again as part of the Council's approval of the Comprehensive Annual Financial Report to be issued in the fall of 1998. By that time (approximately November 1), the City Council should be able to have a better grasp of how it may want to finance the CIP. The City Council will need to address such issues as the amount of the CIP to be financed by cash capital contributions, and the maturity length and repayment schedules of the debt to be issued next January. This review should determine the CIP financing methods that minimize the impact on the operating budget and still preserve the sound financial condition of the City. BFAAC would be quite willing to work with City staff and assist the City Council over the coming months in examining the options available to the City to accomplish these goals.**

**Recommendation #6 -- The City Manager proposes to use a reimbursement mode of issuing debt whereby the City would provide interim financing for the previous 18 months of its capital needs and then reimburse itself by debt proceeds for those expenditures. The debt proceeds also would be used to finance the next six additional months of anticipated capital expenditures. BFAAC also recommends this method of timing the debt issuance as a fiscally and legally prudent way to do business.**

**Section 5 – Given the pressures on the operating and capital budgets and the importance of fund balances to both, it is desirable to revise the budget document to improve further the understanding and acceptance of fund reservations and designations.**

At present the budget document does not include individual explanations of the reasons for fund reservations and designations. Additional explanatory information will help the Council and citizens understand more clearly the specific rationale for each reserved and designated reserve item, and the methods by which the amounts are determined.

**Recommendation #7 -- BFAAC recommends that the City Manager include in the proposed operating budget section on fund balance a clear explanation of the purpose of each reserved and designated reserve item, as well as an explanation of how the amount of the reservation or designation, or the proposed change in the reservation or designation, was determined. The reservations and designations also should be separated into two categories: those that City Council has a definite intent to appropriate at a future date and those that are true contingency allowances that may or may not be appropriated at a future date. The exact steps and timing necessary to implement the reservations and designations and to appropriate funds to execute these reservations and designations should be spelled out. Lastly, the fund balance chart in the Operating Budget on page 3-43 should be reformatted to improve its understandability and clearly show the sum of the funds appropriated to date from the fund balance through the current fiscal year.**

BFAAC notes that reducing the designation for compensated leave to 50%, as proposed, could lead to the unintended consequence of harming our double-triple A credit rating. Credit rating agencies could view unfavorably any decision by the city to reduce the designation for a future expense as the date of having to accrue that expense gets closer.

**Recommendation #8 -- BFAAC recommends that the City Council should reexamine this designation if the Government Accounting Standards Board (GASB) makes no changes to the planned implementation date for full accrual of these expenses and if there are indications that the credit rating agencies will be concerned about this cost accrual issue.**

## **BACKGROUND**

One year ago, BFAAC recommended that the Council recognize and begin planning for the fact that the demand for capital spending by the City would exceed the \$123.8 million contained in the proposed Capital Improvement Program presented to it for fiscal years 1998 through 2003. To do so, BFAAC recommended that the City Council:

- reexamine its Debt Related Financial Policies and reaffirm or update those policies as appropriate,
- develop and maintain appropriate target ranges for unreserved and undesignated fund balances that will assist in maintaining a superior credit rating, and
- hold fast to its guidelines and not fund operating costs for more than a two-year period from the City's reserves.

BFAAC also recommended that the City Manager:

- develop a five year projection of revenues and expenditures in the operating budget, and
- provide a better explanation of the importance of fund balances and present them more simply and clearly to improve the community's understanding of the role of these reserves.

Virtually all of these recommendations were adopted and implemented. As a result the City finds itself with more time to address rationally the still looming demands for capital projects.

The City Council has reexamined, updated and reaffirmed its Debt Related Financial Policies. These policies provide benchmarks against which the City Council can judge more effectively its capacity to borrow to finance capital projects. One part of those policies reaffirmed appropriate target ranges for unreserved and undesignated fund balances. The existence of these policies, and the City Council's recent commitment to them, will provide a measure of reassurance to the credit rating agencies and the bond market that the City will be a responsible and prudent borrower.

The City Manager is proposing a budget that will not fund recurring operating costs for more than a two-year period from the City's reserves. (The proposed draw down of reserves in FY 1999 and FY 2000 is targeted to fund capital improvement projects.) This disciplined approach to living within the City's current revenues will highlight to our citizens that ultimately we cannot receive more from City government than what we put into it in taxes. It also highlights to the credit markets that our City will not fall into the alluring but fatal trap of paying for today's City services with necessary reserve funds.

The City Manager has developed a five-year projection of revenues and expenditures in the operating budget. This projection will assist the City to assess the long-term potential impact of its spending and tax policies.

The City Manager also has provided a better explanation of the importance of fund balances and presented them more succinctly and clearly in Appendix J of the City's operating budget. We hope that this document, will be followed by continuing efforts on

the part of City staff, BFAAC and the media, to improve the community's understanding of the role of these reserves. (See section 3 below for specific recommendation in this regard.)

Our committee has been pleased to be of assistance to the City Council, the City Manager, and her staff in laying this solid foundation for dealing with the City's difficult financial choices in both its capital and operating budgets.

## **ANALYSIS AND RECOMMENDATIONS**

### **Section 1 – At least \$50 million of additional capital projects are not fully addressed by the proposed CIP.**

The City Manager has proposed a new CIP budget of \$137.4 million over 6 years represents an increase of \$13.6 million or 11 percent over the previously approved CIP. That CIP, in turn, represented a 16.7 percent increase over the CIP approved a year earlier. As one can see, the trend in Alexandria's capital spending is upward.

The upward trend follows a fairly long period of restrained capital spending by the City. Thus it is perhaps not surprising that in spite of the dramatic increase in planned capital spending over the last few years, the City still faces at least \$50 million of unbudgeted capital needs. These needs are not necessarily extravagant extras without any community support. Indeed, most of these needs have significant support within the community and many have been recognized as legitimate and received some encouragement, if not conceptual endorsement, from the City Manager and the City Council.

**In light of the support for these needs, BFAAC believes City staff and City Council, working with the School Board and its staff, should work out a plan to respond to a large number of these needs. This will not be easy. Future CIPs will continue to generate extremely difficult choices between a large number of competing capital needs.**

The Alexandria City Public Schools requested \$22.9 million more for projects to be funded through 2004 than was provided in the City Manger's proposed budget. Although the City Manager's budget does not specify what projects are to be funded or not funded, the practical effect of cuts of this magnitude would make it impossible for the ACPS to build new capacity to meet all its CIP objectives during this time period. Those objectives are:

1. to expand the West End elementary school capacity by adding one elementary school,



2. to improve the manageability of its middle schools and to meet the expected growing middle and secondary school population by adding a third middle school,
3. to improve alternative education by providing a separate facility for this purpose, and
4. to provide for the postponed upkeep and modernization of its buildings which have an average age of 48 years.

In the proposed capital budget, the City Manager proposes to work with the School Board to phase-in the remaining \$22.9 million in capital requests "over a longer multi-year time frame." In comments at a joint City Council and School Board meeting, the City Manager said the question was "not if, but when" to meet these school needs.

BFAAC wishes to point out that the approval of this proposed CIP, which includes land acquisition and construction funding for the West End elementary school, necessarily implies a choice to proceed with that project. An additional \$4 million in construction costs will be required to complete this project in fiscal year 2000. Without additional funding for schools in future CIPs, it is unlikely that a construction of a third middle school can begin before fiscal year 2004. BFAAC recognizes the desire of the community for more elementary school capacity in the West End to meet the needs of the students living in the West End. Nevertheless, to meet system-wide capacity pressures, as well as for educational and school management reasons, a third middle school seems to be a high priority. This is one example of why a plan needs to be worked out to respond to a large number of unfunded capital needs.

The proposed CIP provides \$20,000 in FY 2003 for planning and development of a West End, multi-purpose, multi-generational recreation center in the Cameron Station development. No additional funds are budgeted in the CIP for this project through FY 2004. In February of 1997, the City Council endorsed, in concept, a plan to construct such a facility within four to six years. City staff have provided BFAAC with an estimate that a 32,000 square foot facility may cost between \$6.5 and 7.0 million or more depending on the building program.

The proposed CIP provides \$55,000 in FY 1999 to begin site evaluation, soils testing, and other preliminary design work for a new animal shelter at an Eisenhower Avenue location, a site identified by the city for this facility. No additional funds are budgeted in the CIP for this project through FY 2004. The Alexandria Animal Welfare League has been asked to begin a private fund raising effort to assist with the funding of construction of a new shelter. City staff have provided BFAAC with an estimate that this facility may cost between \$2.0 and 2.5 million.

The proposed CIP provides \$720,000 for architectural and engineering work necessary to determine the most cost effective approach to renovation or relocation of the Health Department facility on St. Asaph St. No additional funds are budgeted in the CIP for this project through FY 2004. The proposed CIP, however, estimates the full cost of

renovating this facility may exceed \$6 million.

The proposed CIP provides nothing for a new DASH bus facility and bus yard. City staff have provided BFAAC with an estimate that this project may cost approximately \$12 million.

The proposed CIP provides significant funding for information technology in FY 1999--\$10.1 million. Thereafter, the amount budgeted for these activities declines dramatically to \$4.8 million in 2000, \$2.3 million in 2001, \$2.5 million in 2002, \$1.5 million in 2004, and \$0.65 million in 2004. This pattern of spending for information technology projects may not provide sufficient funding for cyclical replacement of technology equipment and updating of systems in 2001 through 2004, especially since the City's reliance on such technology is sure to increase during the next 6 years.

## **Section 2 -- Solving the Future Imbalance Between Revenues and Expenditures is the Key to Providing for Additional Capital Needs**

In order for the City to be able to afford legitimate demands for bricks and mortar, long-lived capital equipment and information technology, it must be able to balance future operating budgets. Although the City Council may choose to balance the FY 1999 budget by a tax rate increase of up to 6 cents, this will not be sufficient to balance the expected operating deficits in future years. In order to accommodate additional capital projects in future CIPs, however, the City must solve the budget imbalance facing future operating budgets.

Significant reductions in future operating budget costs could result from lower than expected debt service costs due to market conditions and the choices made by the City in structuring future debt. (See section 4 below.) Otherwise, this problem will be further exacerbated by the additional capital projects that are likely to be added in future CIPs, as well as any increases in expenses for recurring operations beyond those already projected in the forecast scenarios.

To provide for additional capital spending, City Council would have to do some combination of the following: impose additional tax rate increases, find new revenue sources, establish significant new spending controls, or alter the proposed structure and methods of financing the CIP. Elsewhere BFAAC discusses various ways to address the projected future imbalance between revenues and expenditures.

Under the mid range forecast scenario of revenue growth, the problem facing the City is that revenues and expenditures are not sufficiently in balance to maintain the target rates for the unreserved fund balance and undesignated fund balances.

This situation is not several years in the future. It will be apparent next year as the City

Council addresses the fiscal year 2000 budget. In materials provided to BFAAC, City staff estimate the following deficits and fund balances as a percent of general fund revenues in the mid range growth scenario:

Fiscal Year	1999	2000	2001	2002	2003	2004
Mid Range Scenario Deficit	\$0.0M	\$6.8M	\$6.6M	\$5.1M	\$3.6M	\$2.1M
Deficit as a % of the General Fund Budget	0%	1.9%	1.7%	1.3%	0.9%	0.5%
Unreserved Fund Balance as % of General Fund Revenue (Limit = 10%)	13.3%	12.8%	12.4%	12.0%	11.6%	11.2%
Undesignated Fund Balance as % of General Fund Revenue (Target = 5.5%; Limit 4.0%)	6.0%	5.7%	5.6%	5.4%	5.2%	5.0%

This problem will be further exacerbated by any additional capital projects that may be added in future CIPs. For instance, the City Manager's staff prepared for the City Council an estimate of the impact of full funding of the schools capital improvement budget request by an additional \$20 million in borrowing. Given certain assumptions about cash capital contributions and other debt financing assumptions, the deficits were increased above those shown above by \$1.3 million in 2000, \$2.7 million in 2001, \$2.9 million in 2002, \$3.0 million in 2003, and \$3.1 million in 2004.

Although serious, the operating budget problem facing the City is not insolvable. The mid range and long range budget scenario projects a 4 percent annual growth in revenues—above the expected 2.0 percent forecast rate of inflation for the next several years. This rate of growth, should it occur, would provide for 2.0 percent annual real growth in city expenditures. Furthermore, the projected deficits under the mid range scenario are not a significantly high percentage of the City's budget. They fall approximately within a range of 0.5 to 2.0 percent of the total budget and average 1.2 percent over the forecast period.

**Section 3 -- The City otherwise has sufficient population, personal income and real property assessed value to support additional borrowing beyond that envisioned in the proposed CIP and still remain within its recently adopted debt policy guidelines.**

The City's rather extraordinary success in paying down its debt over the last 10 to 15 years has left it in a strong position to borrow additional funds to meet its capital needs.

The City now spends relatively less of its general fund operating budget on debt service than comparative double triple A jurisdictions.

Under the proposed CIP, the City would remain well below its targets for debt per capita, debt per capita as a percent of per capita income, debt a percent of real property assessed value, and debt as a percent of total general fund expenditures. These targets established in the debt-related policy guidelines are based on the experience of other municipal jurisdictions that have double triple A ratings.

Putting aside for the moment the operating budget problem and the City's difficulties in meeting its guidelines for unreserved and undesignated fund balances, the City has the capacity to borrow from approximately \$90 million to \$101 million more and still meet its other debt policy guidelines.

The proposed CIP and operating budgets contain charts and graphs that show how the borrowing necessary to fund the CIP is well within several of the debt related financial policy guidelines.

- Debt per capita would remain at a level between 61 percent and 74 percent of the adopted debt policy target guideline through 2004.
- Debt per capita as a percent of per capita income would remain at a level between 62 percent and 76 percent of the adopted debt policy target guideline through 2004.
- Debt as a percent of real property assessed value would remain at a level between 55 percent and 64 percent of the adopted debt policy target guideline through 2004.
- Debt service costs as a percent of total general fund expenditures under the mid range forecast scenario would remain at a level between 29 percent and 56 percent of the adopted debt policy target guideline through 2004.
- This level of borrowing is even further below the maximum allowable limits specified in the guidelines.

**Section 4 – Market Conditions and the Structure of Debt Financing Will Have a Great Impact on Future Debt Service Costs and the Operating Budget.**

The City can minimize the impact on the operating budget of the financing requirements of the CIP by making careful and deliberate choices in structuring its debt. The City Manager's proposed CIP would fund \$154.1 million in capital projects over the next 6 years (including \$16.8 million in costs incurred in FY 1998) through \$115 million in borrowing and \$39.1 million in pay-as-you-go cash capital. These financing plans present significant choices relating to the timing of borrowings, the maturity of the bonds

to be offered, and the percentage to be funded through cash capital contributions from either undesignated fund balances or current general fund revenues. Depending on the financing choices made and other uncontrollable uncertainties, debt service costs and cash capital contributions required from the operating budget could vary significantly from what is proposed in the CIP. The financing choices made can affect not only the credit rating to be given by the credit rating agencies, but also the impact of the CIP on the operating budget. Therefore, the City Council should examine the proposed structure of its upcoming debt issues closely and deliberately over the coming months.

BFAAC wishes to call attention to the following four factors that will affect the impact that funding for the CIP will have on the city's operating budget:

- the use of cash capital as opposed to borrowing to fund the CIP;
- the market interest rates at the time the City goes to market and the City's ability to maintain a triple A rating on the interest rate;
- the structure of the debt issued by the city; and
- the ability to match the pace of borrowing to the expected pace of capital construction and acquisition using the proposed reimbursement mode of issuing debt.

### **The Magnitude of the Cash Capital Contribution**

The recently updated debt-related financial policies call for paying for short-lived and maintenance oriented projects out of current operating revenues or fund balances. BFAAC continues to support these policies. The policies, however, do not define these types of projects specifically. Budget Memo #4 suggests that DASH buses be considered short-lived. Others may think that buses with a 12 year life are more than short-lived and should be financed by debt of similar maturity. Certain information technology infrastructure improvements also may be considered more than short-lived.

**BFAAC recommends that the term short-lived be applied to assets with a useful life of less than 5 years. For assets with a longer useful life, BFAAC believes it would be preferable to acquire them through debt financing, rather than cash capital contributions. Such a policy would significantly reduce the cash capital contributions required to finance the CIP. The City Manager should provide a justification of why debt financing should not be used to acquire assets with a useful life of more than 5 years, whether they are financed through the CIP or through the equipment replacement fund found in the operating budget.**

In this fashion the taxpayers benefitting from the asset would more likely be the taxpayers

paying for the asset. This approach makes the most sense from an intergenerational equity point of view as well as by smoothing out the financial impact of uneven construction or acquisition schedules.

**BFAAC recommends that additional information be provided in the CIP concerning the useful life of assets to be constructed or acquired. The maturity of the bonds issued then can be matched against the useful life of the assets to be acquired. We understand from City staff that such matching is what will occur in fact when the city goes to the capital market next January.**

In her Budget Memo #4, the City Manager proposes to use debt financing for some portion of relatively short-lived projects like DASH buses and Information Technology. Although for simplicity and ease of presentation and analysis the proposed CIP financing assumes that all debt to be issued will be issued as 20-year General Obligation bonds, in fact we understand from City staff that the City actually will attempt to match the useful life of the asset, either individually or by project with bonds of a similar maturity.

The same Budget Memo #4, however, also provides information that indicates that under the proposed CIP a good deal of these same projects are to be paid for out of cash capital payments. The DASH buses and Information Technology projects total approximately \$25 million of \$38.8 million to be paid by cash capital. The remainder of the cash capital is to pay for maintenance-oriented projects, like stream and waterfront dredging, landscaping, painting and carpeting, and the two projects (the Torpedo Factory and the Queen Lee Parking Garage) that cannot be financed with tax-exempt General Obligation bonds.

BFAAC's conclusion from these materials and briefings is that the magnitude of the cash capital contribution as detailed in the City Manager's proposed CIP is not necessarily determined by a particular mix of assets that "require" cash capital contributions. There is a great degree of discretion and judgement being exercised in making these determinations. Because of the potential impact on the operating budget and the affordability of additional CIP projects, we believe the City Council should look closely at these choices.

**In the meantime, for purposes of finalizing a fiscal year 1999 CIP and operating budget, BFAAC has no objection to approving the City Manager's recommended methods for financing the CIP plan in fiscal year 1999.**

**BFAAC recommends that the City Council study the above financing issues closely, however, before designating any additional reserve funds for a large cash capital contribution in fiscal year 2000 projected at approximately \$8.7 million. This designation would be made initially by approval of the proposed CIP. But it can be reviewed again as part of the Council's approval of the Comprehensive Annual**

**Financial Report to be issued in the fall of 1998.**

**By that time (approximately November 1), the City Council should be able to have a better grasp of how it may want to finance the CIP. The City Council will need to address such issues as the amount of the CIP to be financed by cash capital contributions, and the maturity length and repayment schedules of the debt to be issued next January. This review should determine the CIP financing methods that minimize the impact on the operating budget and still preserve the sound financial condition of the City. BFAAC would be quite willing to work with City staff and assist the City Council over the coming months in examining the options available to the City to accomplish these goals.**

### **Interest Rate Assumptions and Impact**

One of the uncertainties facing the city is what will be the market interest rate for double triple A (AAA/Aaa) rated tax free municipal debt. The City Manager's proposed CIP assumes that the City will have to pay a six percent rate on its borrowings through fiscal year 2004. Six percent was chosen because it represents an average rate for 20 year debt issued by double triple A jurisdictions over the last 10 or 15 years. However, in April of last year double triple A rated jurisdictions were paying 5.65 percent on 20 year debt. Currently, due to a drop in long term interest rates over the last year, double trip A rated jurisdictions are paying about 5.0 percent.

A one percentage point or increase or reduction in interest rates would change the estimated debt service cost of a \$55 million 20 year bonds by about \$550,000 in the first year, \$2.5 million over 5 years, and \$5,775,000 over the 20 year life of the bonds.

Another uncertainty facing the city is whether it will be able to maintain its double triple A rating. The spread between a double triple A rating and a double double A rating (AA/Aa) is approximately 10 basis points or 0.1 of a percentage point in the interest rate. Current double double-rated tax free municipal debt is rated at about 5.1 percent.

A one tenth of one percentage point increase or reduction in interest rates would change the estimated debt service cost of a \$55 million 20 year bonds by about \$55,000 in the first year, \$250,000 over 5 years and \$577,500 over the 20 year life of the bonds.

The conclusion one must reach from this analysis is that the interest rate that must be borne by the city is much more dependent on bond market conditions than it is on the rating the city receives for its debt. Although the maintenance of a double triple A rating is much to be desired for its symbolic value and for the discipline it imposes on city financial planning, the economic effect of this designation on the city's operating budget is swamped by even modest fluctuations in the bond market.

We will know by next January what interest rate the City will pay on approximately \$55 million in debt, and this rate can be incorporated into future operating deficit projections.

### **The Structure of Debt Being Issued**

Maturity of the Bonds. The City can issue bonds for different periods of time. The maturity of the debt is usually determined by the type of project being financed, the financial circumstances of the issuer, and any legal constraints on the term of the debt.

The Government Finance Officers Association states that

Many issuers structure their debt so that the final maturity approximately corresponds to the useful life of the project being financed. For example, a water treatment plant with an expected service life of 30 years would be financed by a bond issue with a 30-year final maturity; the purchase of a fire truck with a 10 year expected service life would be financed by a bond issue with a 10-year final maturity. Equity considerations should be balanced with credit concerns, which could encourage issuers to retire debt more rapidly.

An issue then for the City Council to consider is whether the maturity of some or all of the bonds can be extended to average more than 20 years, provided that cash capital payments are made to cover all short-lived and maintenance oriented expenditures. This may make particularly good sense in the case of facilities such as school buildings.

- If \$55 million in bonds are issued at 6 percent for an average of 25 instead of 20 years, the debt service costs would be lowered by \$0.6 million in the first year, and \$2.4 million over the first 5 years, but they would be raised by \$8.25 million over the length of the bond.
- If \$55 million in bonds are issued at 6 percent for 30 instead of 20 years, the debt service costs would be lowered by \$0.9 million in the first year, and \$4.0 million over the first 5 years, but they would be raised by \$16.5 million over the length of the bond.

Repayment Structure. Another choice available to issuers of tax free municipal bonds is how to structure the repayment of principal. The GFOA states that:

The two most frequently used debt service structures in the tax-exempt market are a level principal maturity schedule and a level total debt service schedule. A level principal schedule retires principal evenly over the life of the bonds, so that total debt service (principal plus interest) decreases over time. With a level total debt service schedule approach, early payments primarily cover interest costs, and principal repayment increases over the life of the bonds.

As mentioned above, the City Manager has priced the proposed CIP debt service costs assuming an average length of maturity of 20 years. The proposed CIP also assumes a



level principal repayment schedule for the debt to be issued. Such a repayment schedule has three advantages: it frees up debt capacity more quickly, it leads to overall lower interest payments, and it may be a "plus" with the rating agencies. The disadvantage is that it front loads the debt service costs. Assuming a 6 percent interest rate paid on 20 year bonds totaling \$55 million, a level total debt service schedule, like that used for home mortgages, would cost about \$5.5 million more in the long run, but save \$1.3 million in the first year and \$4.8 million over the first 5 years.

### **Timing of Debt Issuance**

The City Manager has proposed an innovative way to match the pace of borrowing to meet the expected pace of capital construction and acquisition. This method uses a reimbursement mode of issuing debt whereby the City would provide interim financing for the previous 18 months of its capital needs and then reimburse itself by debt proceeds for those expenditures. The debt proceeds also would be used to finance the next six additional months of anticipated capital expenditures. As explained in Budget Memo #4, this strategy has several advantages. It minimizes the risk of borrowing more than necessary to fund the actual pace of capital construction and acquisition. It saves a modest amount of money for the city over the first two years by allowing the city for a short time to earn interest revenue at a higher rate than it borrows without violating the arbitrage rules imposed on tax exempt borrowers. It also reduces the administrative burdens associated with compliance with arbitrage restrictions. And it postpones interest payments for 18 months. **BFAAC also recommends this method of timing the debt issuance as a fiscally and legally prudent way to do business.**

It should be noted that City Council can reduce the first year issuance and consequent debt service costs by moving projects back from year-to-year. In any event the \$55 million bond issue for January 1999 is only an estimate. It depends on the actual construction schedule and expenses experienced in the preceding 18 months and that planned for the succeeding 6 months.

### **Section 5 – Given the pressures on the operating and capital budgets and the importance of fund balances to both, it is desirable to revise the budget document to improve further the understanding and acceptance of fund reservations and designations.**

The debt policy guidelines adopted by the City Council contain targets and limits for the City to meet regarding the unreserved fund balance and the undesignated fund balance. It is these targets that prove to be most difficult to meet in the operating budget forecast scenarios. Given their importance to the ability of the City to afford additional debt financing costs, the reasons behind any reservations and designations of fund balances should be clearly explained and understood by more people in the City.

present the budget document does not include individual explanations of the reasons for fund reservations and designations. Additional explanatory information will help the Council and citizens understand more clearly the specific rationale for each reserved and designated reserve item, and the methods by which the amounts are determined.

**BFAAC recommends that the City Manager include in the proposed operating budget section on fund balance a clear explanation of the purpose of each reserved and designated reserve item, as well as an explanation of how the amount of the reservation or designation, or the proposed change in the reservation or designation, was determined. The reservations and designations also should be separated into two categories: those that City Council has a definite intent to appropriate at a future date and those that are true contingency allowances that may or may not be appropriated at a future date. The exact steps and timing necessary to implement the reservations and designations and to appropriate funds to execute these reservations and designations should be spelled out. Lastly, the fund balance chart in the Operating Budget on page 3-43 should be reformatted to improve its understandability and clearly show the sum of the funds appropriated to date from the fund balance through the current fiscal year.**

BFAAC is concerned that reducing the designation for compensated leave to 50%, as proposed, could lead to the unintended consequence of harming our double-triple A credit profile. Bond rating agencies may well view unfavorably any decision by the city to reduce the designation for a future expense as the date of having to accrue that expense (fiscal year 2001) gets closer.

BFAAC appreciates the City Manager's view that the accounting profession will not implement this proposed rule on the schedule that is now set. However, BFAAC notes that the standards board has not in fact made any change as of this time. We understand that the association will be meeting this June. If at that meeting the proposed target is not delayed then it may be appropriate to make a subsequent adjustment. This could be done at the time of publishing the city audited financial statement in November. If fiscal year 2001 is retained as the year in which this rule becomes effective, these designations should be timed to phase in so that they reach 100 percent by fiscal year 2001, the year in which the GASB rules would be implemented for local governments.

**BFAAC recommends that the City Council should reexamine this designation if the Government Accounting Standards Board (GASB) makes no changes to the planned implementation date for full accrual of these expenses and if there are indications that the credit rating agencies will be concerned about this cost accrual issue.**

If nothing else changed in the revenue/expenditure picture, retaining the 75% designation would reduce the availability of undesignated reserves for use as cash capital in FY 2000 by approximately \$2.4 million.

## REVENUE

**RECOMMENDATIONS**

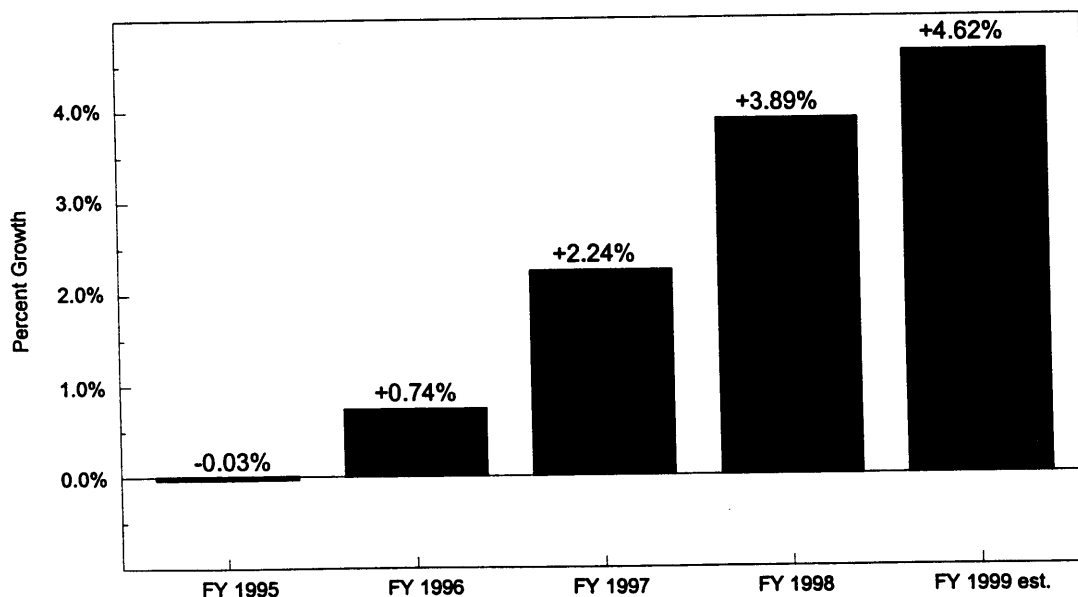
1. BFAAC recommends the City study Alexandria's remaining new construction potential to determine the time until exhaustion and the amount of remaining revenue from this source.
2. BFAAC recommends an examination of the current revenue structure and an analysis of the issues surrounding a change in the revenue structure.
3. BFAAC recommends expanding opportunities for private donations to City programs.

**BACKGROUND AND ANALYSIS**

The revenue picture for the City may be broken into two parts. The short-term revenue outlook for the City this year and next year is good. Almost all types of revenue including real and personal property taxes, local sales tax, utility taxes and business licenses grew this year and will grow next year. The mid- to long-term growth outlook is uncertain. Much of the present growth in real property tax revenues is based on new construction. The City will eventually exhaust this form of revenue and will need to then rely on other current or alternative revenues to support future budget growth. BFAAC's revenue recommendations seek to address this issue.

According to the Calendar Year 1998 Real Property Assessment Report (Budget Memo #1), the City's overall real property tax base in 1998 grew by 3.9 percent over 1997. Real property revenues are expected to grow in 1999. The Proposed City of Alexandria, Virginia FY 1999 Budget projects the 1999 overall real property tax base to grow by 4.6 percent over 1998.

The table below displays the rate of growth in the City's real estate tax base for the five years from FY 1995 to FY 1999.



Annual Growth in Overall Real Property Tax Base

The overall commercial real property tax base grew by 5.9 percent over last year and the overall residential real property tax base grew by 2.5 percent over 1997. Actual revenues collected by the City confirm this positive revenue outlook. Using the City's assessed and estimated assessed values and their estimated collection rate, BFAAC estimated FY 1998 real property tax revenues, without a tax increase, will be over 4 percent higher than FY 1997. BFAAC estimates that without a tax increase, FY 1999 real property tax revenues will rise 3.9 percent from FY 1998 and FY 1999 total general fund revenue will increase over 3 percent from FY 1998. With the City Manager's proposed tax increase, FY 1999 real property tax revenues would increase over 8 percent from current FY 1998 amended levels and total general fund revenues would increase by 6 percent over FY 1998 amended levels. Additionally, personal property tax revenues are increasing beyond projections. With 95 percent of personal property tax revenues collected at the end of February, collections were \$2.4 million or 6.8 percent higher than collections at the same time last year.

Other evidence exists of the recent growth in the City's tax base. The numerous construction cranes over the City skyline can provide testament to City residents and visitors of new construction and growth in the City's real property tax base. According to the City's most recent Comprehensive Annual Financial Report, as of June 1997, the City had almost 1.2 million square feet of major new office and industrial development approved and under construction at sites such as the Carlyle development, Cameron Center, SHRM Office Building and 1737 King Street. The number of major new office sites under construction as of June 1997 is double the number of the previous year. Another 3.6 million square feet of major new office and industrial development was pending as of June 1997 at sites such as Southern Plaza and Potomac Greens.

Real property activity is not limited to commercial property. According to the Calendar Year 1998 Real Property Assessment Report (Budget Memo #1), the average sales price for residential property sold in the City during Calendar Year 1997 increased 5 percent over 1996. This 5 percent increase for Alexandria compares to a 1.9 percent increase in the average sale price of residential property in the Northern Virginia area. The number of residential units sold in the City in 1997 increased 22.8 percent over 1996. Additionally, the City's market share of residential sales in Northern Virginia is at its highest point in the last five years at almost 11 percent.

The make up, however, of the increasing growth in the City's real property tax base forms the basis for the BFAAC recommendation to examine the extent of remaining potential new growth. While new construction of residential property added \$92.6 million to the 1998 tax assessment base and new construction of commercial property added \$206.4 million to the tax base, these increases represented the vast majority of overall growth in the tax base. In fact, the assessed value of the average existing residential property increased less than 0.1 percent and the value of the average existing commercial property increased 2.5 percent. Taxpaying property sellers may favorably view a slight increase in assessment values coupled with a 5 percent increase in sales price, but this phenomena also shows that most of the growth in assessments has come from new construction, not from rises in existing property values.

The City will eventually exhaust its available property for new construction. Some sources estimate there are less than three dozen sites remaining and available for new

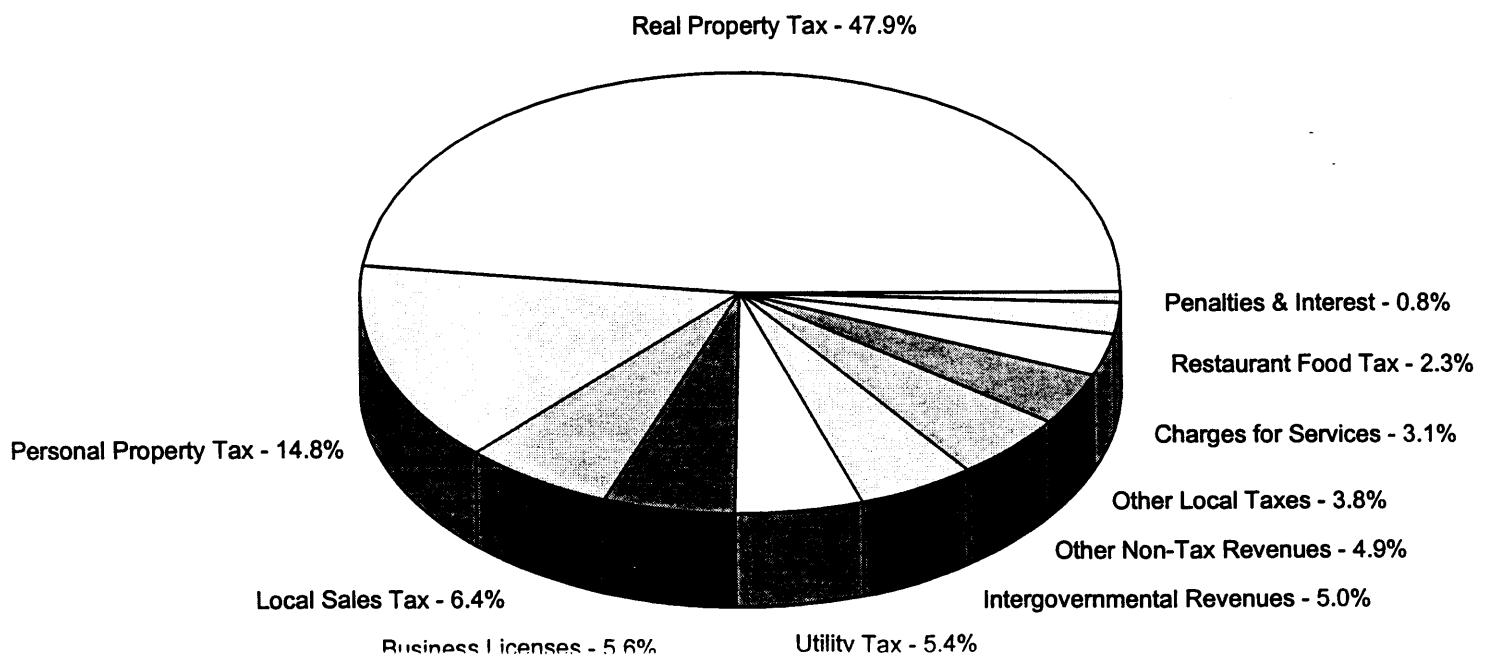
commercial construction. The exhaustion of new construction as a source for tax base growth will limit growth in the overall real property tax base to the rate of existing property growth. If future growth in existing property assessments remains low growth then overall real property tax base growth will fall to these lower levels. The "overall limited by existing" scenario does not impact revenue collections for this year or next year, but it does have a significant impact on future growth projections over the mid and long-term ranges.

**BFAAC recommends the City study Alexandria's remaining new construction potential to determine the time until exhaustion and the amount of remaining revenue from this source.** The study should examine quantitative issues such the actual number of remaining properties available for new residential or commercial construction, the number of properties currently held but undeveloped, the rate at which those properties will be developed, and the time until new construction will exhaust the City's remaining supply of available sites. The study should consider qualitative issues such as the mix of recent new construction between residential and commercial construction and different types of residential and commercial construction. Additionally, the examination should recognize the inherent trade-offs between maximizing revenue growth and quality of life issues which make Alexandria unique.

The make-up of the City's current tax base and the impact of that mix on the potential for tax base growth leads to the second BFAAC recommendation. **BFAAC recommends an examination of the current revenue structure and an analysis of the issues surrounding a change in the revenue structure.** The Committee recognizes that the Mayor last month tasked BFAAC with such a study, and we look forward to further discussions with City Council and City staff about the scope and focus of this study.

Currently, nearly 50 percent of the City's revenues come from taxes on real property. A further 15% of City revenues are derived from the personal property tax. Remaining revenues are collected from various taxes and fees including a local sales tax, utility tax, business license tax and intergovernmental revenues. Those revenues are represented in the pie chart below:

**General Fund Revenue Distribution - Proposed FY 1999**



Analysis of the potential, or lack of potential, in new growth in one of the above pie slices may lead Alexandria to find sources of revenues from other means. Part of an analysis of potential new mixes of revenues, either from new revenue sources or from different ratios of current sources, is dependent on the needs of the City. BFAAC expects that the results of the City's study of the potential for additional revenues from remaining new construction will feed directly into establishing a need for alternative sources or mixes of revenues.

A study of Alexandria's revenue structure should examine the revenue potential of different mixes of revenue sources. The examination should analyze the likelihood of gaining the authority from the Commonwealth to add revenue sources such as an income or other taxes not currently within the powers of the City to levy. The study should also consider the inherent nature of different revenue sources and their effects on overall revenues during bad times as well as good. Reliance on revenue sources which are volatile or tied to the business cycle can compound the negative effects of an economic downturn as well as produce revenue gains during prosperous times. The revenue mix study should examine the impact of different types of alternative revenues on taxpayers focusing on which segments of Alexandria, such as those on a fixed income, would bear the burden of a given type of revenue. The study should also examine the current and historic shares of income the current revenue mix represents. The study may also choose to discuss alternatives such as exemptions to the current revenue mix to shield the effect of increases in existing or alternative revenues on certain segments of the population.

**BFAAC also recommends expanding opportunities for private donations to City programs.** The recently-established Alexandria Library Foundation, which will help raise funds for the West End Library, and the private fundraising effort being organized to help fund the new animal shelter are two examples of ways that private donations can help fund City programs. Private donations could be especially useful for programs like open space acquisition, public art and recreational programs that are very desirable, especially to some Alexandria residents, who might be willing to make tax-deductible donations to these programs.

BFAAC supports the recent Council initiative to form an ad hoc committee to review the experiences of other jurisdictions with private donations and recommend additional efforts Alexandria could undertake in this regard. We look forward to assisting the efforts of this committee. We hope the committee will explore a wide range of options, including the idea of an Alexandria Foundation to accept and distribute donations to City programs and mechanisms for actively pursuing such donations.

## ECONOMIC AND TOURISM DEVELOPMENT

### **RECOMMENDATIONS**

**1. BFAAC recommends that two proposed revenue initiatives (increased permit fees and admission taxes) be viewed as components of a larger picture, namely Alexandria's business and tourism development strategies, to ensure that all components are complementary.**

The gains these initiatives would bring may be outweighed by potential revenues from attracting more businesses and entertainment seekers to Alexandria.

Increased Permit Fees: Processing costs should be monitored closely to ensure that collected fees stay in line with actual costs. In addition, we commend Code Enforcement for their initiatives in streamlining permit processing and encourage further expansion of these services to serve businesses better and create efficiencies.

Admission Taxes: Expansion of entertainment businesses, particularly the addition of movie screens in the City, increases the potential effect of these taxes on revenues. However, this gain must still be weighed against the potential benefits of increasing the broader appeal of Alexandria as an entertainment, dining and shopping locale.

**2. BFAAC recommends that the City continue to focus on and expand efforts aimed at attracting technology businesses to Alexandria.**

Alexandria's success thus far in attracting technology firms to Alexandria can be expanded in the near future, especially with the recent completion of fiber optic resources. BFAAC has a seat on the Technology Commission and will be supporting its planned efforts to recommend new initiatives.

**3. BFAAC recommends that measures and indicators be developed for, and applied next year to, funding for tourism and economic development. BFAAC is willing to work with City staff and ACVA and AEDP staff to develop such measures and indicators. We also recommend that the City encourage teaming approaches when allocating funding.**

BFAAC fully supports the expansion of economic and tourism development efforts and funding this year. We believe such efforts will contribute significantly to long-term revenue growth in the City. Because of the importance of these expenditures to Alexandria's future, it is important to establish the means for measuring our successes in these areas. It is also essential that the ACVA and the AEDP coordinate their plans for attracting businesses and tourists to Alexandria, including seeking efficiencies between the two agencies in terms of staffing, development of written promotional materials, making better use of sales missions, etc.

**4. BFAAC recommends that the City consider the long-term revenue and expenditure implications of development decisions in the coming years.**

Alexandria must decide the mix of residential and commercial development it wants for the coming years as soon as possible. Increased emphasis on economic and tourism development necessitates decisions on infrastructure support for these initiatives, such as convention/meeting spaces, hotel rooms, etc.

## **BACKGROUND AND ANALYSIS**

**1. Proposed revenue initiatives should be viewed as components of a larger picture, namely Alexandria's business and tourism development strategies, to ensure that all components are complementary.**

The projected revenues from increasing building permit fees and the imposition of an admissions tax are \$150,000 and \$100,000, respectively. The City should weigh these benefits against initiatives we may have planned to attract business and tourism.

We must ensure that increasing business permit fees does not contribute toward an image of Alexandria as unfriendly to business and that the increases are consistent with any other "package" of incentives or services Alexandria would offer. While increased fees would certainly not present a problem to large businesses, such as the Patent and Trade Office, we would be especially concerned about the effect this might have on small and medium-sized businesses. This is addressed to some extent by the 50% fee reduction granted to small commercial tenant layout permits which currently provide tenant spaces under 1500 square feet; this exemption is expected to be retained. We acknowledge that the increase in business permit fees is designed to recover direct costs to the City. Processing costs should be monitored closely to ensure that collected fees stay in line with actual costs.

If these fees are to be increased, the City should consider:

- \* looking for ways to expand efficiencies and innovations that have resulted from the "one-stop shopping" program that Code Enforcement already administers (Code Enforcement already has some plans in this regard); and/or

- \* making certain commitments to these businesses for improved service, e.g., guaranteed timelines, the expansion of streamlined service mentioned above, etc.

We must also consider how other initiatives affect Alexandria's strategy for increasing tourism: How would Alexandria's imposition of an entertainment tax affect a strategy, for example, for attracting moviegoers who might also dine and shop in Alexandria? The Alexandria Convention and Visitors Association expressed concern to BFAAC that collecting and tracking entertainment taxes would impose an additional burden on entertainment providers at a time when there is increased pressure to focus on marketing.



**2. BFAAC recommends that the City continue to focus on and expand efforts aimed at attracting technology businesses to Alexandria.**

Jones Communications has literally ringed the City with fiber optic cable---ripe for extensive high technology uses. Loudoun County has achieved some success in beginning plans for a mini-Silicon Valley. Alexandria should easily be able to build on recent successes in attracting technology firms to Alexandria and create some unique initiatives, perhaps beyond what we can imagine in 1998. BFAAC has a seat on the Technology Commission and will be supporting its planned efforts to recommend new initiatives.

**3. BFAAC recommends that measures and indicators be developed for, and applied next year to, funding for tourism and economic development. BFAAC is willing to work with City staff and ACVA and AEDP staff to develop such measures and indicators. We also recommend that the City encourage teaming approaches when allocating funding.**

We commend the City Manager for recognizing that business and tourism development need our attention in the years to come. We also understand the complexities of the marketing required to obtain the business Alexandria wants and can handle. Unlike a wide-open, un- or under-developed county, Alexandria's resources are limited and, therefore, development decisions and marketing must be very focused and targeted. The evolution of the City's marketing plan is essential to our future and should build on past successes, the natural attributes of the City, and best practices from other locales. We must be able to measure the return on dollars expended for economic and tourism development, and restructure strategies accordingly as needed. Measures and indicators should be developed immediately and applied as often as possible in the process, e.g., certain strategies might be re-evaluated quarterly or every six months to determine the success in drawing business or tourism to Alexandria.

BFAAC has met three times with the ACVA, once jointly with the AEDP. Because of the importance we attach to these efforts, we encourage these two organizations to closely coordinate their plans for attracting businesses and tourists to Alexandria, including seeking efficiencies between the two agencies in terms of staffing, development of written promotional materials, making better use of sales missions, etc. It is essential that those who will represent Alexandria present a unique vision of Alexandria as a whole, while recognizing the diverse attributes of its parts.

We cannot overemphasize that Alexandria's 250th Birthday offers a unique opportunity to create a lasting marketing strategy for attracting tourism to and enhancing business development in Alexandria. Marketing Alexandria as an historic waterfront area are obvious first steps for attracting tourists and conferences (local, nationwide and international). Careful planning for spending by ACVA, AEDP and other City groups this year is crucial. We would expect that a good portion of marketing will revolve around the 250th Birthday. Funds should be allocated to City departments or groups depending on detailed, insightful plans demonstrating a vision for the future. A teaming approach (or quality circle) to allocating all related City funding might be considered, i.e., while individual departments or public/private partnerships best equipped to handle

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specific projects could actually carry out the project, funds might be held in a special fund administered by a board of City and community participants---already existing, such as the ACVA's Ad Hoc Marketing Committee or the 250th Birthday Commission, or a newly-created entity. Money could be allocated for specific projects which might require the participation of several departments/organizations, rather than to specific departments/groups.

The AEDP is rightfully very concerned about business retention. We support efforts to track these gains and losses, which for some reason has not been done to date, in order to remedy any negative influences on doing business in Alexandria.

BFAAC also supports Alexandria's participation on marketing missions, to promote both business and tourism. Alexandria did not participate in any mission last year, and we believe re-engaging in this process in a focused fashion would be a worthwhile expenditure of development funding. Teaming with other local jurisdictions, while promoting Alexandria's unique assets, to accomplish more is a commendable strategy.

**4. BFAAC recommends that the City consider the long-term revenue and expenditure implications of development decisions in the coming years.**

It has frequently been stated that Alexandria has made different life-style choices for its economic development than, for example, Arlington. Over the longer term, we are now faced with deciding the fate of several of our last developable parcels of land. We must now consider the costs of choosing residential over commercial development. While infrastructure, such as public safety, is needed for both types of development, certain other costs result from residential development such as the need for new schools and other City services. Commercial development could bring greater net revenue in the long run. Should Alexandria continue to make the same life-style choices, we must be aware of and plan accordingly for revenue increases (i.e., probably tax increases). Over the last year, there were only five new commercial starts, compared to 258 residential starts---valued at \$3,000,000 and \$33,000,000 respectively. What direction should Alexandria take? Some ideas BFAAC has heard for economic and tourism development are attracting more association meetings, conferences, leisure travelers, sports spectators (e.g., nearby minor league baseball spectators), etc. Success in these goals would depend on providing more meeting space and hotel rooms.

It is essential that Alexandria decide on this mix now to either attract the best commercial investors or prepare residents for the coming revenue needs. Finding the right mix for Alexandria is like painting a picture. Because of our location, development will occur. We should choose the type of development we want, rather than letting it occur. Even in by-right use cases, constructive business/City/community partnerships can yield benefits for all. Let us try to paint the best picture we can at the least amount of overall cost to the City and its residents.

April 27, 1998

Received by CC

II  
4-27-98

To: The Honorable Mayor Kerry Donley and Members of City Council

From: Kirk S. Fedder, Parks and Recreation Commissioner Planning District II

Re: Ramsay Recreation Center

Dear Mayor Donley and Members of City Council,

With your consideration and action on the City's budget pending and since timing of such action has precluded the Parks and Recreation Commission from meeting as a body to formally make its recommendation to you ; I want to express my recommendation and concerns directly. I enthusiastically support the concept plans for the construction of a new Ramsay recreation center, and while it is unfortunate that current budget limitations preclude the immediate construction of the recreation center and the expansion of the Buddy Ford Nature Center, the recreational opportunities in the West end of Alexandria have not kept pace with the substantial increase in population or the increased need for recreational facilities associated with it. The residents of the West end of the City have waited patiently for long ago promised significant improvements to the Ramsay recreation center. Now is the time to make those improvements as promised.

While I will continue to work with staff and other members of the Commission to expedite the expansion of the Buddy Ford Nature Center, I strongly recommend that City Council move forward immediately with the process for building the new Ramsay recreation center.

On a related matter I am extremely upset and concerned to learn of the School Board's efforts to convince City Council to rob the Parks and Recreation budget of money for the Ramsay recreation center. With limited resources and a very tight City budget all departments as well as the School Board are looking for more money but, even so, I find the School Board's action offensive and it causes me to seriously reconsider if the School Board really wants to work with the Parks and Recreation department in providing for the needs of the City's youth or if they have adopted an "every man for himself" agenda. Have I been under a misconception that there is supposed to be a spirit of cooperation and sharing of facilities? If the School Board takes action that undermines the trust of the Recreation department and Commission future working relationships are going to be seriously compromised.

Thank you very much for your consideration of my concerns.

Very truly yours,

*Kirk S. Fedder*

Kirk S. Fedder  
113 West Maple Street  
Alexandria, Va. 22301



Judy R. Guse-Noritake  
605 Prince Street  
Alexandria, Virginia 22314

*sent to  
cc, C.M., 4/27PF  
OMB,*

II  
4-27-98

April 27, 1998

✓ The Honorable Kerry Donley  
Vice Mayor William Euille  
Councilman William Cleveland  
Councilwoman Redella Pepper  
Councilman Lonnie Rich  
Councilman David Speck  
Councilwoman Lois Walker

Re: Ramsay Recreation Center

Dear Council Members:

I would like to follow up on my testimony before you last month relating to the FY 99 budget for the City of Alexandria as it relates to the Park and Recreation Department. At that time I offered my personal support for the proposed new recreation facility at the William Ramsay Recreation Center. I also understand that money is tight and the funds proposed for this project, though originally intended for both a recreation center and the nature center, now will accomplish only the first of these. At your hearing I supported the Manager's request this year for the \$2,404,5000 in prior year unallocated money and an additional \$620,000 in the FY 99 budget to accomplish the new construction at the William Ramsay Recreation Center. I want to underscore my support both for the City Manager's budget request for Ramsay and the conceptual plans at that location.

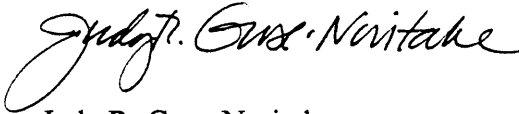
The Park and Recreation Commission had a chance to review the conceptual plans for Ramsay and discuss it's budget at our April 16<sup>th</sup> meeting. I would report to you that there is broad agreement on the Commission that the work on the William Ramsay Recreation Center is of critical importance to the population in the West End of our city. This part of Alexandria has been quite vocal about the need for additional recreational facilities in their neighborhoods and rightfully so. This part of the City has been underserved when it comes to recreational opportunities. The project has long been promised and the residents of the West End have every reason to expect that the Ramsay project will move forward now.

It is generally known that the School Board's Facilities Committee has recommended you rethink the allocation of these funds and consider targeting them more toward critical educational needs in the City. As I stated at the budget hearing, it is not a situation of having either schools or recreation. We must find a way to do both as the schools and the recreation centers must be partners in the growth of our children, not pitted against each other in times of fiscal scarcity. This is especially true in

neighborhoods like the one surrounding Ramsay where the need is so great and the promise has been long made. I ask that we stay on track with Ramsay. It is a great need and it will be a great asset.

Thank you for your consideration and if I may be of further help in this matter, please just call me or any other member of the Commission.

Sincerely,

A handwritten signature in cursive script, reading "Judy R. Guse-Noritake".

Judy R. Guse-Noritake

Chair

Park and Recreation Commission

