City of Alexandria Budget and Fiscal Affairs Advisory Committee

Report on the City Manager's Proposed Budget for Fiscal Year 2004

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Over the last six years the City has been making substantial investments in the future of Alexandria through an expanded CIP process leading to new construction, rehabilitation, restoration and replacement of the City's physical infrastructure. This year the proposed CIP calls for a massive increase in the city share of capital spending.

The City's portion of the proposed CIP funding is projected to increase from $183.8 million to $327.7 million—a $143.9 million or 78.3 percent increase. This large increase over the previous CIP is driven mainly by four projects which account for nearly all of the increase: (1) the reconstruction of T.C. Williams High School ($45.3 million increase); (2) the costs associated with the building of a new Police Center and the repair of the existing Public Safety Center ($65.5 million increase); (3) the renovation and expansion of the Chinquapin Recreation Center ($20 million increase); and (4) additional funding for sanitary and storm sewer repair and reconstruction ($12.7 million increase).

This large increase is not a surprise. Many of the expensive projects now recommended in the CIP have been on the "watch list" of previously deferred projects or were otherwise under review at the time of the approval of last year's CIP.

BFAAC believes the proposed CIP budget meets legitimate long term capital project needs financed through a reasonable mix of responsible levels of proposed borrowing, realistic contributions of cash capital from both past operating budget savings and current revenues, and anticipated state and federal grant funds. Most importantly, the proposed CIP appears affordable (as defined by the City's debt policy guidelines).

BFAAC, however, wishes to raise a significant warning. The rebuilding of T.C. Williams, sewer improvements, the repair of the existing Public Safety Center and the construction of a second Police facility, and the renovation and expansion of the Chinquapin Recreation Center—all of these major projects coming together at same time have pushed us to the City's current borrowing capacity targets.

The proposed CIP would now push closely against the target level for borrowing on several debt policy guidelines. By itself this is not cause for alarm. But reaching these target figures does mean that other deferred capital needs may have to be pushed back to FY 2009 or later. These projects can only be funded if the growth in the real property tax base of the City continues at or near its current historic pace, and/or the City increases its fiscal capacity, thus enabling it to provide significant funding for capital projects through larger cash capital contributions from current revenues. As the proposed CIP indicates, and BFAAC confirms, there remain a significant number of such deferred capital needs. In particular, BFAAC is concerned about the large amount of transit needs that are not included in the proposed CIP.

BFAAC supports the City Manager's goal to make the sanitary sewer system financially self-sufficient through the collection of additional fee revenues over the next three years as is the case with other jurisdictions in the region. However, BFAAC's calculations suggest that another 10 cent increase would be required in FY 2007 to make the sanitary sewer system self-sustaining.

BFAAC understands that there may be pressure to reduce the real property tax rate more than the 3 cent reduction proposed by the City Manager. If the City Council wishes to pursue this idea further, given the pressing capital needs of the City, it should look first to reductions to the operating budget of the City (including the school system operating budget) or by finding other new revenues, before it considers reductions to the cash capital contributions to the CIP. BFAAC also recommends that if the City Council wishes to consider further reductions to the real property rate, it should not do so by dipping into the undesignated fund balance by more than the City Manager has proposed.

The Proposed Operating Budget

BFAAC commends the City's successful efforts to contain health insurance cost increases. The City should continue to pursue health insurance cost containment strategies. The City should include more detailed analysis of health coverage in future budgets.

Compensation will absorb greater percentages of future Operating Budgets. The City Manager has remarked that keeping the City competitive "will create budget pressures" during FY 2004 and the out-years.

BFAAC fully supports the City Manager's proposed funding for the school's operating budget as necessary to meet the needs and challenges of a diverse student population. BFAAC recommends that the City ensure that future school operating budgets are in line with pupil population.

Although some questions have been raised about the wisdom of implementing the School System's new salary structure in FY 2004, BFAAC supports it. The new salary structure put in place by the School Board will have been on the drawing board for two years if implemented for FY 2004. It is the first revision of the compensation structure since the 1995 Mercer study. The City's 2002 Annual Report noted that the need to keep School employee compensation competitive "will create budget pressures" during the out-years. City Council and staff should bear that cautionary note in mind when discussing future implementation of the School Board's revised compensation plan.

BFAAC supports the proposed CIP, but notes that the CIP will also increase pressure on the operating budget. These additional demands on the operating budget will reduce the amount of funds available for other spending needs, maintenance of reserves and tax rate reduction.

The City faces a challenging task in funding affordable housing and acquiring open space in the face of many other demands on City resources. BFAAC endorses the approach of looking at a wide variety of potential funding sources for both programs, including developer contributions, private donations, federal and state funds, regional initiatives, innovative financing mechanisms, the CIP and the City's operating budget.

BFAAC has recommended that the City do all it can to encourage and facilitate homeownership opportunities for low- and moderate-income families and there does appear to be an effort to step up the realization of many of the Task Force recommendations. While there are programs available to families of modest means, it would appear that the word is not necessarily reaching the targeted market. BFAAC recommends that the City reach out to any organizations that can assist in spreading the word to their members and employees.

Despite some reservations, if City Council wants to pursue significant funding for open space acquisition, BFAAC believes that City Council should continue to explore Councilman Speck's proposed approach as a useful budgetary tool for beginning now to reach that goal.

Revenues and Long-Term Projections

To assess Alexandria's overall fiscal health, one must consider whether the City is well positioned to manage its longer-term fiscal challenges.

In looking at scenarios through FY 2009 as presented in the budget, BFAAC notes that in most years modest rates of increase in real property tax revenues should be sufficient to support the forecasted rate of growth in expenditures contained in the low-, mid- and high-growth scenarios. The revenue projections presented in the budget document incorporate the proposed reduction (to $1.05) in the real property tax rate.

The longer-term outlook for revenues and expenditures remains more troublesome. As BFAAC noted last year, changing City demographics, the Commonwealth's uncertain fiscal outlook, and accumulating specific deferred budget needs—all of these things will continue to put pressure on the expenditure side of the budget. On the other side of the fiscal equation, the City's ability to raise new revenue may be affected by the dwindling amount of available land for new development (not to mention the acquisition of land for open space) and limits on the rate at which residential real property taxes should continue to increase due to rising assessments.

City Council should keep one eye on the future as it works to meet these revenue and expenditure challenges. Decisions made in the context of FY 2004 should be sustainable in future years. Over the longer term, BFAAC is concerned that the City is especially vulnerable to economic downturns that affect its real property tax base given that nearly 52 percent of the City's revenue comes from real property taxes.

BFAAC again recommends that the City continue to explore ways to ways to bring greater diversity and equity to its revenue stream. BFAAC commends the City for working to increase the revenue it receives from a tobacco tax and sewer fees, but perhaps it's time to explore other sources, as well, including gasoline taxes, statewide revenue sharing (in anticipation of Virginia's eventual economic recovery) and regional taxing authorities.

While BFAAC does not recommend that the City try to place annual caps on aggregate real property tax increases, it might be appropriate to monitor more closely the proportion of personal income that goes to pay residential real property taxes. In doing so, the City should be mindful that there is not necessarily a correlation between housing value and household income which makes it very important to diversify its revenue sources and monitor residential real property taxes as a percentage of personal income.

I. THE PROPOSED CAPITAL IMPROVEMENT PROGRAM

Overview

Over the last six years the City has been making substantial investments in the future of Alexandria through an expanded CIP process leading to new construction, rehabilitation, restoration and replacement of the City's physical infrastructure. This year the proposed CIP calls for a massive increase in the city share of capital spending.

The City's portion of the proposed CIP funding is projected to increase from $183.8 million to $327.7 million—a $143.9 million or 78.3 percent increase. This large increase over the previous CIP is driven mainly by four projects which account for nearly all of the increase: (1) the reconstruction of T.C. Williams High School ($45.3 million increase); (2) the costs associated with the building of a new Police Center and the repair of the existing Public Safety Center ($65.5 million increase); (3) the renovation and expansion of the Chinquapin Recreation Center ($20 million increase); and (4) additional funding for sanitary and storm sewer repair and reconstruction ($12.7 million increase).

The following chart shows the approved 6-year Capital Improvement Program (CIP) totals (city-share) in the last seven approved CIP budgets:

Approved Six-Year CIP Budget
City Share
($ in millions)

Years Covered	97-02	98-03	99-04	00-05	01-06	02-07	03-08	04-09
City Share	$106.0	$123.8	$137.4	$118.0	$156.3	$197.3	$183.8	$327.7

This large increase is not a surprise. Many of the expensive projects now recommended in the CIP have been on the "watch list" of previously deferred projects or were otherwise under review at the time of the approval of last year's CIP.

BFAAC believes the proposed CIP budget meets legitimate long term capital project needs financed through a reasonable mix of responsible levels of proposed borrowing, realistic contributions of cash capital from both past operating budget savings and current revenues, and anticipated state and federal grant funds. Most importantly, the proposed CIP appears affordable (as defined by the City's debt policy guidelines).

BFAAC again commends the City Manager for conducting a well-managed process that sets reasonable priorities among competing projects within a realistic schedule. We support the CIP as proposed by the City Manager.

BFAAC, however, wishes to raise a significant warning. The rebuilding of T.C. Williams, sewer improvements, the repair of the existing Public Safety Center and the construction of a second

Police facility, and the renovation and expansion of the Chinquapin Recreation Center—all of these major projects coming together at same time have pushed us to the City's current borrowing capacity targets.

The proposed CIP would now push closely against the target level for borrowing on several debt policy guidelines. By itself this is not cause for alarm. But reaching these target figures does mean that other deferred capital needs may have to be pushed back to FY 2009 or later. These projects can only be funded if the growth in the real property tax base of the City continues at or near its current historic pace, and/or the City increases its fiscal capacity, thus enabling it to provide significant funding for capital projects through larger cash capital contributions from current revenues. As the proposed CIP indicates, and BFAAC confirms, there remain a significant number of such deferred capital needs. In particular, BFAAC is concerned about the large amount of transit needs that are not included in the proposed CIP. That is why we are raising this warning flag.

BFAAC supports the goal of the City Manager is to make the sanitary sewer system financially self-sufficient through the collection of additional fee revenues over the next three years as is the case with other jurisdictions in the region. However, BFAAC's calculations suggest that another 10 cent increase would be required in FY 2007 to make the sanitary sewer system self-sustaining.

BFAAC understands that there may be pressure to reduce the real property tax rate more than the 3 cent reduction proposed by the City Manager. If the City Council wishes to pursue this idea further, given the pressing capital needs of the City, it should look first to reductions to the operating budget of the City (including the school system operating budget) or by finding other new revenues, before it considers reductions to the cash capital contributions to the CIP. BFAAC also recommends that if the City Council wishes to consider further reductions to the real property rate, it should not do so by dipping into the undesignated fund balance by more than the City Manager has proposed.

A. School System Capital Improvement Program

The School Board Approved Capital Improvement Program budget for FY 2004 through 2009 requests a City appropriation of $130.5 million, an amount that is $43.8 million, or 50.5 percent, higher than last year's City-approved CIP budget. The increase is largely attributable to the projected costs associated with the design and construction of a new high school to replace T.C. Williams. The FY 2004 Alexandria City Public Schools (ACPS) capital budget requests a City appropriation of $38,716,352.

The City Manager's Proposed Capital Budget recommends full funding for the ACPS six-year capital budget. After reviewing the CIP through the lens of the debt service guidelines, we agree with the City Manager that the School Board's six-year CIP should be fully funded.

Major Forces Driving the School System CIP Budget

The School System is in the middle of what is, without question, the most ambitious capital improvement program in its history. The reasons for that are two-fold. One, the increase in student population has led to the need for middle and secondary school expansion. And two, the aging physical plant requires significant expenditures for maintenance and upkeep, including the replacement of windows, roofs and systems such as heating ventilation and air conditioning (HVAC), plumbing and electrical, as well as for the replacement of old furniture, fixtures and equipment.

1. *Major School System Expansion and Renovation Projects*

To remedy the need for additional space and to renovate and upgrade the middle and secondary school properties, the School System has undertaken the planning and construction of three major projects: the expansion and renovation of Francis Hammond Middle School, which has been completed; the expansion and renovation of George Washington Middle School, which will be completed this summer; and the on-going expansion and renovation of the Minnie Howard Ninth Grade Center, which will be completed in September 2005. These construction projects are scheduled for completion to meet the increase in student population that made its way through the elementary schools and is now beginning to reach the middle schools.

<u>Francis Hammond Middle School</u>. The renovation and expansion at Francis Hammond includes the construction of new classrooms, a new auxiliary gymnasium and a new elevator. The renovations included electrical and plumbing systems replacement and ADA upgrades. In FY 2005, Hammond's HVAC, central boilers and lighting system will be replaced in the older part of the building at an estimated cost of $3.8 million. In addition, the sprinkler system in the new building will be extended to the old building in FY 2005 at an estimated cost of $380,000. The cost of this project to date is not available to BFAAC due to pending litigation.

<u>George Washington Middle School (GWMS)</u>. GWMS is in the final months of construction, with completion slated for the summer of 2003. The project included funding for the renovation and modernization of the three buildings (main building, annex and gymnasium) at the GWMS campus. In addition to serving grades 6-8, the facilities also house a full-time Head Start center and city Recreation Department programs. The FY 2004 CIP includes $3.2 million to fund expenses for the completion of construction. This amount is $2.2 million more than was projected in last year's CIP. According to information provided BFAAC by ACPS staff, the additional expenses are for the following:

- Restoration of $867,800 for items within the original project scope that could not funded under the previous CIP budget because the construction bid was higher than expected.
- $165,000 for offsite water improvements required by Virginia American Water;
- $149,000 for the relocation of the electrical transformer required by Virginia Power;
- $450,000 for removal of unanticipated marine clay;
- $85,150 for unforeseen existing conditions that required relocation and reengineering of underground pipes; and
- $464,850 for additional contingencies.

As with Hammond, the GWMS construction involved the replacement of electrical and plumbing systems, the addition of new windows and a variety of other projects, including furniture, fixtures and equipment, and auditorium seating, sound and lighting system.

Minnie Howard Ninth Grade Center. The School Board Approved CIP includes $13.2 million for nearly 48,000 square feet of new construction, which includes a new two-story addition, enlargement of the media center, a new administration and guidance area, gymnasium, locker rooms, exercise and weight room and expansion of the cafeteria. The project also includes the replacement of the HVAC, electrical and plumbing systems, as well as the replacement of 100,000 square feet of the existing roof. The project, in its second year, has a total project cost of $14.4 million, with $5.0 million budgeted in FY 2004.

2. New High School Construction

In order to have adequate facilities to house and educate our students when they arrive at the door of T.C. Williams (T.C.), the School Board has approved the construction of a new high school to replace the current 38 year old facility. The decision to build a new structure instead of renovating the existing structure was arrived at for a variety of reasons, not the least of which was that necessary renovation and expansion would cost roughly 80 percent of the amount necessary to build an entirely new structure, one better capable of supporting the high school educational programs needed in the 21st century. The new 420,000 square foot structure, which will replace the existing 360,000 square foot structure, will include, among other things, a cafeteria that will be able to serve all students, thus enabling the administration to close the T.C. campus if they so choose so that students would not be permitted to leave the campus during lunch.

In raw numbers, the T.C. construction accounts for $74.5 million of the six-year CIP. The FY 2004 budget includes $17.5 million for the architectural/engineering master plan and the beginning of new construction at T.C. Williams. The four-year construction project is estimated to cost an additional $22.6 million in FY 2005, $30.5 million in FY 2006 and $3.8 million in FY 2007.

The BFAAC reviewed and discussed the proposed two-school idea currently being advocated by some members of the community. **The Committee agreed that, while there is intuitive appeal to having smaller schools, we are unanimous in our opposition to the two-school idea. For a number of reasons, both economic and educational, the Committee believes that one T.C., built on its existing site, makes the most sense.**

1) In purely practical terms, Virginia requires that a high school site have a minimum of 25 acres. To our knowledge, there is no 25 acre site available in the City of Alexandria.
2) The cost alone of buying a 25 acre site would make the cost of the entire project cost prohibitive. (A six acre site for a new Public Safety facility (see below) is estimated to cost $16.6 million. At that rate a 25 acre site would cost $66.4 million.)
3) The time required for the identification and purchase of the land as well as going back to the architectural drawing board to design two schools would delay the construction of the projects beyond the time when student overcrowding will be its most acute.
4) Two high schools would lose the cost effectiveness of economies of scale. Two schools would require significant capital expenditures because of the need for two of everything – two libraries, two media centers, two gymnasiums, two auditoriums, two cafeterias, etc.

5) Maintenance and upkeep costs for two schools would be expensive and unnecessary.
6) The two school concept would also require significant additional operating expenditures to fund a second set of administrators and non-teaching staff.
7) The school's diverse population is better served by having one school. The schools within a school concept for T.C. better serves the diverse population because it has the flexibility of separate offerings and individualized programs, such as Limited English Proficiency (ESL) and Advanced Placement (AP), while at the same time providing a single, unified school for the entire City.

3. Other School Renovation and Replacement Projects, Including Furniture, Fixture and Equipment (FF&E) and Vehicles and Buses

The renovation and replacement components of the projects at Hammond, G.W. and Minnie Howard are symptomatic of what has been and continue to be necessary across the school system. The ACPS schools on average are more than 50 years old, and their aging physical plant requires significant upkeep. For a number of years, from the mid-1980's to the mid-1990's, the School System was required by the City to maintain its $200 million in physical plant on $3 million a year. From 1989 to 2003, less than $50 million was spent on HVAC, roof work, modernization, renovation and architect services for the 19 buildings the School System is responsible for maintaining. Conversely, the FY 2004 budget includes approximately $11 million for those types of projects.

The Committee believes that for the past few years the City has been adequately funding the modernization and maintenance of the school facilities. The Committee recommends that it continue to do so. We believe it is illustrative of the importance of maintaining the school facilities that more than 25 percent of the ACPS FY 2004 CIP budget will be spent not on new construction, but on the ongoing modernization and maintenance needs of existing school facilities. The Committee recommends that the School Board and the City Council keep an eye in particular on the future adequacy of FF&E funding because it is much less than the amount recommended in the consultant's report and it does not factor in inflation.

The modernization needs of the schools also include the systematic replacement of furniture, fixtures and equipment. In 1997, a consultant's study on the system's FF&E found $11 million worth of FF&E in immediate need of replacement. To eliminate the backlog, the consultant recommended spending $1.9 million per year for a number of years until the FF&E replacement was complete and then an amount each year to fund a replacement schedule. While the school system has not spent anywhere near the recommended $1.9 million per year, it has nonetheless managed to make progress in FF&E replacement through the renovation and new construction at the middle and secondary schools and by funding FF&E replacement at the elementary schools. The Committee notes that the School Board recommends spending $500,000 per year on FF&E in FY 2004 through FY 2009.

The City's proposed CIP also recommends spending $3.6 million to replace school buses and other vehicles on a regular cycle. **The Committee supports the City Manager's funding of the School Board's request to maintain a regular replacement schedule for its school bus fleet.**

B. Chinquapin Recreation Center

The City Manager's proposed CIP includes a $20 million placeholder for maintenance and improvements to the Chinquapin Park and Recreation Center in FY 2007 as part of the plan to construct a new T.C. Williams on its existing site**.**

The Committee agrees that it makes sense to plan and begin the construction within the general time frame of the T.C. construction to provide for joint use. The Committee would like to note that, given the debt policy guidelines, construction at Chinquapin would likely preclude the construction of a separate multi-generational community center elsewhere in the City.

C. Public Safety Center

BFAAC recognizes the need for both repairing the existing Public Safety Center (PSC) building and constructing a separate new police facility to handle the growth in public safety officers, other staff and activities.

The staff of the Police Department at the PSC has increased from 335 to 435 since the PSC was opened in May 1987. The staff of the Office of the Sheriff has increased from 155 to 211. The police personnel are expected to increase further to 560 people by 2014. The total growth in law enforcement staff located at the PSC of 36 percent from 1987 to 2003, the expected continued growth of police personnel by an additional 29 percent by 2014, together with increased space needs for operations and equipment, have led the City Manager to recommend not only repair of the existing PSC, but construction of a second new facility for the Police department. We concur in this assessment.

D. Sewer Fee Increase

BFAAC supports the goal of the City Manager is to make the sanitary sewer system financially self-sufficient through the collection of additional fee revenues over the next three years as is the case with other jurisdictions in the region. However, BFAAC's calculations suggest that another 10 cent increase would be required in FY 2007 to make the sanitary sewer system self-sustaining.

In order to accomplish this goal, the City Manager has proposed an increase in sewer fees from the current 20 cents per 1,000 gallons by 20 cents per year for the next three years to 80 cents per 1,000 gallons by FY 2006. Each 20 cent increase raises an additional $1.1 million. This increase, with the combination of additional cash capital and debt financing, will enable much needed sewer improvements to be completed. City staff estimates that the revenues generated by these increases will be approximately sufficient to cover operating costs, as well as the costs of existing and new debt service and cash capital costs through FY 2009. BFAAC's calculations show a small deficit of $1.4 million to $2.3 million over this time period. If so, this would require another 10 cent increase in FY 2007 to make the sanitary sewer system self-sustaining. The ability of the sanitary sewer system to be self-sustaining allows the debt associated with the sewer program to be excluded from the city's debt ratios. BFAAC continues to support the use of user fees to cover costs and recommends these fees be reviewed in the future on a timely basis to ensure continuing self-sufficiency.

E. Deferred Capital Projects

A large number of potential capital projects still remain deferred despite the large increase in this year's proposed CIP.

Pages 6 and 7 of the CIP budget contain an extensive list of deferred CIP projects. Without repeating that list here, it is sufficient to say that delaying many of these items until FY 2009 or later will be disappointing to many in the City.

1. Deferred Transit Needs

In particular, BFAAC wishes to call City Council's attention to the deferred transit needs. The defeat of the regional transportation Sales Tax Referendum last November significantly affected the City's ability to meet a variety of important transportation needs, and funding for these needs is now uncertain. The City identified $190 million of transportation needs that were to be funded by the Sales Tax Referendum. Because the referendum did not pass, the City must find other means to fund these projects. These transportation projects are important to addressing the traffic concerns of the citizens of the City.

State aid is critical to meeting current planned transportation projects, but the future presents several specific fiscal challenges to the City. The City's projected share of the Washington Metropolitan Area Transit Authority (WMATA) capital program dedicated to infrastructure renewal totals $29.6 million over the next six years. Identified funding sources for meeting this obligation are: (1) City funds--State law requires the City to pay from local funds a minimum of $950,000 per year under "maintenance of effort" requirements, and (2) Reallocation Funds--$10.169 million of state funds will be reallocated from the cancellation of the King Street Underpass project. That leaves $13.731 million of financing that is currently not identified in the proposed CIP. The proposed CIP assumes that these funds will become available from some other sources than City revenue, such as federally earmarked funds or additional reallocations of urban highway funds from yet-to-be cancelled urban highway projects.

DASH currently operates a fleet of 49 buses. The useful life of a bus is 12 years. A total of $5.598 million has been budgeted over the next six years for replacement of 16 buses and the addition of one bus. Identified funding sources for meeting this obligation consist of $1.244 million in FY 2004 funding from the State Urban Highway Fund with the balance of funding in the remaining years of $4.354 million still to be identified.

To accommodate the expanded DASH bus fleet, the City purchased land for $5 million using state funds. The estimated $20 million cost to build the facility on this land is not included in the proposed FY 2004-2009 CIP. This project was included in the defeated State Transportation Sales Tax Referendum, which was not approved. As a result, no funding source has been identified.

The failed Sales Tax Referendum also included funds for expansion of the Eisenhower Metro Station and partial funding for the proposed Potomac Yard Metro station. These projects have not been included in the proposed CIP.

2. Other Deferred Needs

A variety of other projects may have to be deferred for a number of years including:

- Any additional major recreation center improvements not already funded in this plan—most notably a new, multi-generational community center at Cameron Station.

- A variety of less costly recreation facility improvements.

- Full funding for additional street and sewer reconstructions and flood mitigation projects not included in this CIP.

- New fire stations—As we pointed out in last year's BFAAC report, calls have been made for increased City fire services, particularly in the Potomac Yards and Eisenhower areas. While annual funding over the six-year period has been provided for critical renovations to existing fire stations, nothing has yet been included in the plan for new facilities.

- A new elementary school—Recent enrollment trends have led the School Board to remove from its proposed CIP budget placeholder funding for a new elementary school that would have cost an estimated $20.9 million. However, as a cautionary note, enrollment projections are an inexact science and the need for a new elementary school may yet arise at some point in the future. It does appear, though, that with elementary enrollment projected to be 661 students less than the capacity of the existing 13 elementary schools in FY 2007, the School Board and the City Manager have correctly removed placeholder funding for a new elementary school from the current CIP.

- Construction of a new City visitor center. Although funds are available for planning this project, the acquisition of a site or construction are not funded.

F. Debt Policy Guidelines

The proposed CIP would keep the City within all of its debt-related policy guidelines designed to maintain fiscal discipline as evidenced by the maintenance of the City's double triple A bond rating.

The City's debt-related policy guidelines include several benchmarks against which the magnitude of borrowing can be assessed for its likely impact on the City's fiscal condition. These debt-related policy guidelines were developed with an eye toward maintaining the City's double triple A bond rating. The maintenance of the double triple A bond rating has some slight economic savings for the City due to the lower interest rate afforded such bonds. **However, the maintenance of the double triple A rating is most significant as an independent assessment of the City's continuing success at maintaining fiscal discipline.**

BFAAC strongly supports efforts to live within all of the City's debt-related policy guidelines. Meeting the debt-related policy guidelines provides several necessary assurances:

1. The City's net borrowing does not exceed our fiscal capacity as measured by the wealth of our city (as measured by fair market real property values) and the income of our city residents (as measured by the per capita income of our residents);

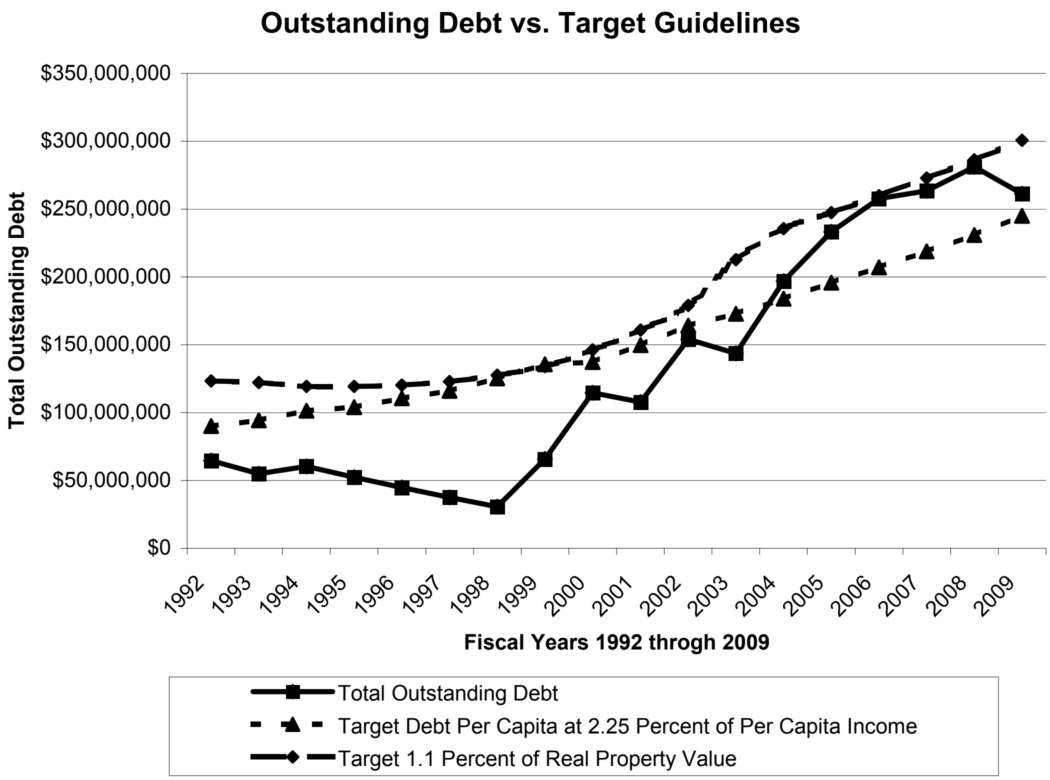
2. Debt service costs do not impose too great a burden on our future operating budgets (as measured by debt service as a percentage of total expenditures); and

3. Adequate fund balances are available to cope with unexpected financial problems or emergencies (as measured by fund balances as a percent of total revenues).

The target figures for the current guidelines were based on research in 1997 that set them at a level equal to the average of other jurisdictions with double triple A bond ratings. The key debt target chosen at that time was the one showing debt as a percentage of the fair market real property values. The target for that guideline was set at 1.1 percent to match the average of other jurisdictions with double triple A bond ratings. Alexandria's overall debt level and debt service continue to compare very favorably to other cities and counties rated triple A. The average of general obligation debt as a percentage of fair market real property values for 31 Standard and Poors triple A rated counties is 0.8 percent. The average for the four counties in Virginia is 1.6 percent; and the average for three counties in Maryland is 1.5 percent.

The target for the other indicator, debt per capita as a percent of per capita income, was set at 2.25 percent in 1997. Since comparable data were not available for other jurisdictions on per capita income, this guideline was set so that both guidelines produced a similar target for total debt issued. The limit for both indicators was set at a level approximately 50 percent above the target. Both of these targets and limits are dynamic and rise as real property values and per capita income rise. Since the two guidelines were established, however, they have diverged somewhat as increases in real property values in Alexandria have outpaced increases in per capita income.

To give more of an historical perspective, the following chart shows both the past and future performance of the City against these debt policy guidelines from FY 1992 through FY 2009 (estimated).



A number of observations can be made from this chart:

- The total outstanding debt is projected to increase above one target beginning in FY 2004, and nearly exceed the other target by FY 2006.

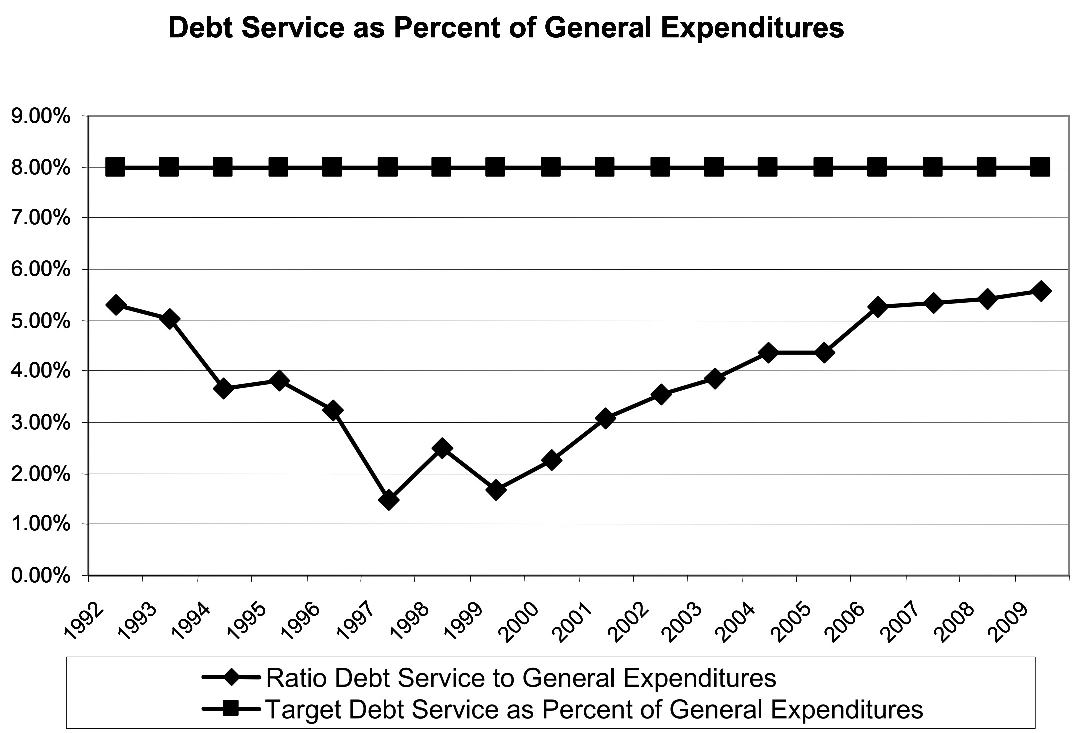
- The target amount for debt outstanding as a percentage of real property values increased dramatically in FY 2003 following the dramatic surge in real property assessments in CY 2002.

- The target amount for debt outstanding as percentage of per capita income shows a much more gradual and steady increase over the years.

- As a result of the different rates of growth in these two guidelines, they have now diverged from each other from when they were deliberately set to be in synchronization in late 1997. *City Council may wish to update the debt policy guidelines to resynchronize these two guidelines in the future based on comparable data from other double triple A jurisdictions.*

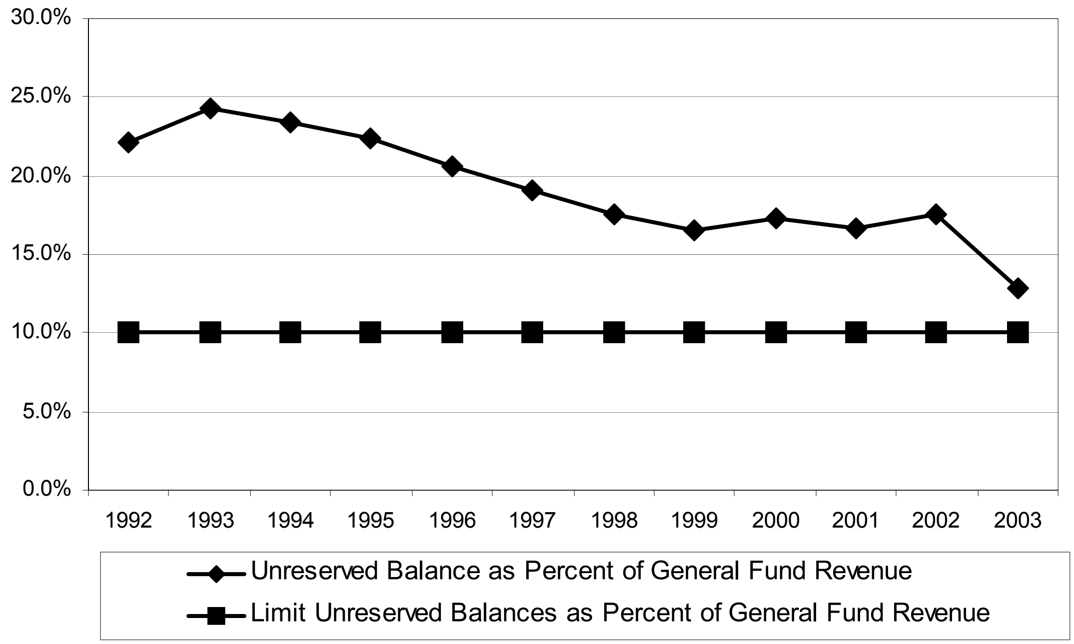
- Projections of the rate of increase in future real estate assessments and per capita income are crucial to whether outstanding total outstanding debt will continue to exceed these targets. The mid-range out-year projections assume that in calendar year 2003 real property assessments increase by five percent. This leads to the equivalent of a 10.7 percent increase in real property assessments in fiscal year 2004. Thereafter assessments increase by five percent a year through FY 2009. The out-year projections for per capita income assume that this value increases approximately five percent a year since FY 2000, the most recent year for which actual data are available.

The graph below shows Alexandria's past and predicted future performance against another guideline designed to ensure that the costs of debt service (principal and interest payments) that absolutely must be paid do not exceed the target of eight percent of the total of all general expenditures. This target was also set in 1997 to approximate the average of other jurisdictions with double triple A bond ratings. As one can see, the City is comfortably within this target for the foreseeable future. Future expenditures are those contained in the long range budget scenarios found in the City Manager's proposed operating budget.

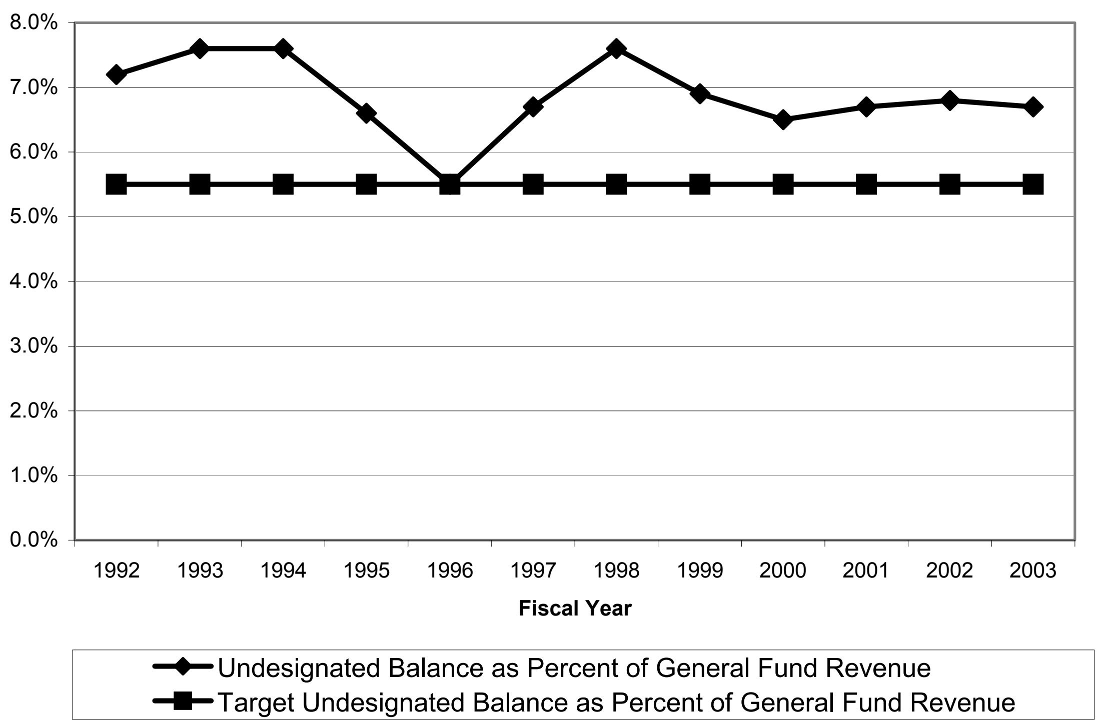


The Debt-Related Policy Guidelines also specify that the unreserved fund balance remain above 10 percent of the general fund revenues and that the undesignated fund balance remain above 4.0 percent and preferably above 5.5 percent of general fund revenues. The graphs below show that the current fund balances as a percent of general fund revenues would continue to remain above both the limit and the target percentages specified in the guidelines.

Unreserved Balances as Percent of General Fund Revenue



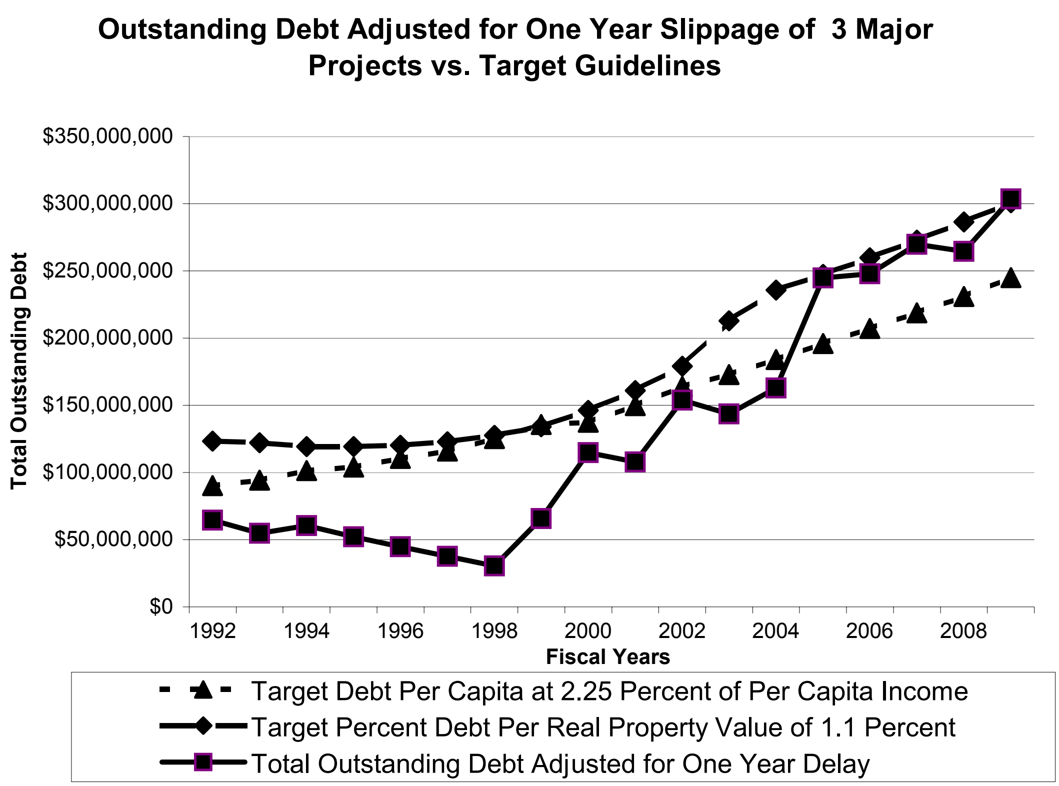
Undesignated Balance as a Percent of General Fund Revenue



G. Delay Options

Minor one year delays in the T.C. Williams, Public Safety Center, and Chinquapin projects will not give the City any significant flexibility to finance additional projects or to provide any more significant a "cushion" against debt policy guidelines. BFAAC, therefore, does recommend this course of action.

As demonstrated above, under current estimates the debt policy guidelines of debt per capita as a percent of per capita income and debt as a percent of the fair market value of real property would permit no new borrowing. BFAAC has examined the possibility of delaying three major projects by one year to see if that would have any material affect on compliance with the debt policy guidelines and perhaps allow other projects to be included in future CIPs. We looked at delaying by one year the T.C. Williams construction project, the Public Safety Center construction project (but not the slab repair or relocation costs), and the Chinquapin Recreation Center construction project. The results of our analysis indicate, however, that the debt policy indicators are only marginally affected by such delays.



II. THE PROPOSED OPERATING BUDGET

The proposed FY 2004 General Fund Operating Budget totals $398.6 million, an increase of $24.7 million or 6.6 percent over last year's budget. This increase is made up of $7.0 million for the School System operating budget, $13.2 million for the City's operating budget, and $4.5 million in debt service and cash capital contributions to the CIP. BFAAC focused its review of the proposed FY 2004 operating budget on several key areas – compensation and benefits, schools, impact of the capital budget on the operating budget, court employee supplemental funding, affordable housing, and open space.

Overview

BFAAC commends the City's successful efforts to contain health insurance cost increases. The City should continue to pursue health insurance cost containment strategies. The City should include more detailed analysis of health coverage in future budgets.

Compensation will absorb greater percentages of future Operating Budgets. The City Manager has remarked that keeping the City competitive "will create budget pressures" during FY 2004 and the out-years. Every dollar that is allocated to compensation and benefits means a dollar that cannot be spent on additional goods and services.

BFAAC fully supports the City Manager's proposed funding for the school's operating budget as necessary to meet the needs and challenges of a diverse student population. BFAAC recommends that the City ensure that future school operating budgets are in line with pupil population.

Although some questions have been raised about the wisdom of implementing the School System's new salary structure in FY 2004, BFAAC supports it. The new salary structure put in place by the School Board will have been on the drawing board for two years if implemented for FY 2004. It is the first revision of the compensation structure since the 1995 Mercer study. The City's 2002 Annual Report noted that the need to keep School employee compensation competitive "will create budget pressures" during the out-years. City Council and staff should bear that cautionary note in mind when discussing future implementation of the School Board's revised compensation plan.

BFAAC supports the proposed CIP, but notes that the CIP will also increase pressure on the operating budget. These additional demands on the operating budget will reduce the amount of funds available for other spending needs, maintenance of reserves and tax rate reduction.

The City faces a challenging task in funding affordable housing and acquiring open space in the face of many other demands on City resources. BFAAC endorses the approach of looking at a wide variety of potential funding sources for both programs, including developer contributions, private donations, federal and state funds, regional initiatives, innovative financing mechanisms, the CIP and the City's operating budget.

BFAAC has recommended that the City do all it can to encourage and facilitate homeownership opportunities for low- and moderate-income families and there does appear to be an effort to step up the realization of many of the Task Force recommendations. While there are programs available to families of modest means, it would appear that the word is not necessarily reaching the targeted market. BFAAC recommends that the City reach out to any organizations that can assist in spreading the word to their members and employees.

Despite some reservations, if City Council wants to pursue significant funding for open space acquisition, BFAAC believes that City Council should continue to explore Councilman Speck's proposed approach as a useful budgetary tool for beginning now to reach that goal.

A. Compensation and Benefits

BFAAC commends the City's successful efforts to contain health insurance cost increases. The City should continue to pursue health insurance cost containment strategies. The City should include more detailed analysis of health coverage in future budgets.

During the FY 2003 budget cycle, the City Manager noted that health insurance costs were expected to increase by 15 percent and that double-digit increases were predicted "for the foreseeable future."[1] Due to the institution of cost containment policies (such as substantially higher co-pays for prescriptions) and aggressive negotiations, the City kept health insurance cost increases *below* the double-digit level. BFAAC commends the City's cost containment strategy.

Last year in its Report on the City Manager's Proposed Budget for FY 2003, BFAAC suggested the City explore additional coverage options that may be more cost effective for both employees and the City. As noted above, the City has made great strides in containing short-term health insurance costs. But the City should continue to closely examine its health insurance programs for more cost savings, paying particular attention to premium sharing and optional forms of coverage, as well as retiree premium subsidy.

BFAAC last year urged the City to include "in its annual budget presentation a detailed analysis of the eligibility, coverage, current and projected cost of health care coverage." BFAAC again urges that such an analysis be included in future budgets, so that the costs are fully understood.

Compensation will absorb greater percentages of future Operating Budgets.

BFAAC agrees with the City Manager about "[t]he need to remain competitive in the area of employee compensation and benefits," and "the need to recognize members of the City's workforce for the outstanding work they do."[2]

Staff and City Council should bear in mind that remaining competitive often has the effect of driving up the costs of hiring new employees. There is some evidence that this phenomenon already is occurring: for example, the Proposed FY 2004 budget notes that personnel

[1] Budget Memo # 44, April 23, 2002.
[2] City of Alexandria, "Proposed FY 2004 Budget: Executive Summary," March 11, 2003.

expenditures for the Office of Housing was increased to fund "the hiring of new employees at higher step levels than previously budgeted."[3]

The City Manager has remarked that keeping the City competitive "will create budget pressures"[4] during FY 2004 and the out-years. Every dollar that allocated to compensation and benefits means a dollar that cannot be spent on other goods and services.

B. School System Operating Budget

BFAAC fully supports the City Manager's proposed funding for the school's operating budget as necessary to meet the needs and challenges of a diverse student population.

We include the following statistics as a reminder of just how diverse our student population is and the challenges that diversity brings to the school system. The ACPS operates and maintains thirteen elementary schools, two middle schools, one ninth-grade center, one high school and the Secondary Training and Education Program (STEP). As of FY 2003, eleven schools have reached or retained State accreditation and four more schools are provisionally accredited. It is estimated that next September approximately 11,300 will enter the ACPS, a decrease of about 50 students from 2002-03. Of those, 44.2 percent will be Black, 26.6 percent Hispanic, 22.5 percent White, 6.4 percent Asian/Pacific Islander and 0.3 percent American Indian/Alaskan Native. They represent 88 countries in addition to the United States and they speak 69 different languages. More than 2,400 children will require special services for ESL. The number of children who continue to require extraordinary services because they are at-risk will again be over 50 percent of the ACPS student body.

BFAAC last year fully supported full funding of the School Board's approved operating budget as recommended by the City Manager. BFAAC continues that support for FY 2004. The School Board's Approved Operating Budget for FY 2004 totals $142.9 million. Of that amount, the City's requested appropriation is $119.9 million, which does not include the cost of any COLA given school employees by the City. The balance of the School Board's Operating Budget will be funded by State Aid ($20 million), Fund Balance ($1.5 million) and Miscellaneous Federal Funds ($1 million). The City Manager's Proposed Operating Budget fully funds the School Board's Approved Operating Budget for FY 2004. Under the proposed budget, the City's General Fund appropriation to the ACPS is $122.4 million, which includes a 2.25 percent COLA for school employees. The City's appropriation is a 6.1 percent increase over the FY 2003 City appropriation of $115.3 million.

BFAAC recommends that the City ensure that future school operating budgets are in line with pupil population.

The City Manager's Proposed FY 2004 Operating Budget notes there is "the expectation that [Alexandria City Public Schools] enrollment will continue to decline."[5] Assuming that estimate proves true, it is incumbent upon future budgets to reflect the declining enrollment, while still

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[3] City of Alexandria, "Proposed FY 2004 Budget," p. 8-87.
[4] City of Alexandria, "Annual Report: 2002."
[5] City of Alexandria, "Proposed FY 2004 Budget," p. 9-7.

focusing on pupil development and progress on both the Standards of Learning exams and fulfilling Federal mandates contained with the "No Child Left Behind" law. To that end, BFAAC supports the school administration's use of formula-based staffing at the elementary level. The formula divides projected elementary enrollment by a Board-targeted average class size of 20. The use of formula-based staffing allows the Superintendent to allocate teachers based on the targeted average class size, as well as on school size, special needs, accreditation status and grade level.

School System Compensation and Benefits

Providing a quality public education is a labor-intensive business, so it should come as no surprise that 86 percent of the entire school operating budget is comprised of salaries and wages and employee benefits. For that reason, the increase in the City's proposed appropriation to the School System is largely attributable to compensation initiatives: a 2.25 percent COLA ($2.43 million), merit and step increases for all eligible teachers ($2.7 million), transition costs associated with moving teachers from the old to the new salary structure ($1.4 million), additional pay for lengthening the school year by three days ($600,000), and increased health insurance contribution to offset the rising cost of health insurance ($700,000).

Although some questions have been raised about the wisdom of implementing the new salary structure in FY 2004, BFAAC supports it. The new salary structure put in place by the School Board will have been on the drawing board for two years if implemented for FY 2004. It is the first revision of the compensation structure since the 1995 Mercer study, which was only implemented by the Board on a very limited basis. The new compensation system expands the salary structure to twenty steps from fourteen and is based on the new 192-day teacher work year. Under the existing system, a high percentage of teachers have already topped-out and are no longer eligible for step increases. The new model promotes teacher retention and recognizes that, according to academic research, optimum teaching occurs between a teacher's seventh and thirteenth years.

The City's 2002 Annual Report noted that the need to keep School employee compensation competitive "will create budget pressures" during the out-years. City Council and staff should bear that cautionary note in mind when discussing future implementation of the School Board's revised compensation plan.

C. Impact of Capital Budget on Operating Budget

BFAAC supports the proposed CIP, but notes that the CIP will also increase pressure on the operating budget.

Elsewhere BFAAC notes that the proposed CIP "meets legitimate long term capital project needs financed through a reasonable mix of responsible levels of proposed borrowing . . ." (see Chapter I).

As noted previously, BFAAC fully supports the proposed CIP; however, the growing capital program will increasingly absorb money that could otherwise be spent on operating expenses.

For example, between FY 2004 and FY 2009, the City will be spending nearly $116 million for bonds and interest, and an additional $85.7 million in cash capital.[6]

The proposed FY 2004 budget calls for a 20.1 percent increase in debt service and a 6.3 percent increase in cash capital costs over FY 2003 levels. These combined costs would grow from $28.3 million in FY 2002 to $36.4 million in 2004. They would grow from 6.6 percent of total expenditures in FY 2002 to 9.1 percent of total expenditures in FY 2004. The expenditure scenarios in the proposed budget suggest that the percentages of total expenditures attributable to combined debt service and cash capital costs will remain at close to this higher level for at least several years.

BFAAC notes that, over the life of the CIP, the City is facing additional pressures on the operating budget, including: (1) a possible downturn in the recent record rate of increases in real property assessments; (2) potential future reductions in both federal and state revenues; (3) continued increased expenditures for homeland security; (4) increased demand for services and programs; and (5) pressures for a reduction in the real property tax rate. These factors will place pressure on City Council to either scale back (or delay) the cash-capital contributions to the CIP, or decrease operating expenditures and services.

Maintenance. The City will have to assume maintenance costs for the new and expanded recreation centers, parks, athletic fields, playgrounds, open space, information technology infrastructure, planted trees and horticultural sites constructed under the CIP program.

Transitional Costs. The CIP includes $3.5 million to build out the 56,000 square feet of space needed to house police operations during construction of a new police facility. The City will have to pay about $1.1 million annually to lease that space until the new facility is completed in 2010.

These additional demands on the operating budget will reduce the amount of funds available for other spending needs, maintenance of reserves and tax rate reduction.

D. Court Employee Supplemental Funding

The City's supplemental funding for court employee salaries, which are typically covered by the State, may set a dangerous precedent.

The Proposed FY 2004 Operating Budget contains nearly $50,000 to fund salary and benefit increases for court employees.[7] These funds are "driven by the State's not granting of any raises to . . . employees statewide since December of 2000."[8] BFAAC notes that these increases are long overdue and well-deserved; however, we are concerned that by stepping in where the State has failed to allocate funding may cause the Governor and/or the General Assembly to assume that Alexandria will make up any future state budget cuts. That, in turn, could put the City in the position of absorbing more State functions.

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[6] City Manager's presentation at Work Session on CIP and Operating Expenditures, March 19, 2003.
[7] City of Alexandria, "Proposed FY 2004 Budget," pp. 6-12, 6-26.
[8] Id. at 6-12.

E. Affordable Housing and Open Space Acquisition Funding Issues

The City faces a challenging task in funding affordable housing and acquiring open space in the face of many other demands on City resources. **BFAAC endorses the approach of looking at a wide variety of potential funding sources for both programs, including developer contributions, private donations, federal and state funds, regional initiatives, innovative financing mechanisms, the CIP and the City's operating budget.** (See, for example, Budget Memo #28.) Pursuing multiple funding sources would maximize potential overall funding, reduce the demands on any one funding source and decrease the risks associated with over-reliance on a very small number of funding sources.

1. Affordable Housing

Given the City of Alexandria's latest dramatic increase in property values, affordable housing in the city will become less available and attainable to families and persons of modest means. Consequently, the need for assistance from the City to relieve the situation is more critical than ever.

Although affordable housing in Alexandria continues to be an issue, the City has taken steps to relieve the situation. The City Manager has recommended the establishment of an "Alexandria-based, non-profit housing development corporation" that would acquire, construct, and operate affordable housing in the city. This corporation would be funded "in part" by funds from the Housing Opportunities Fund and in part by other sources (for example, grant monies and development fees).

It has been proposed that the Housing Opportunities Fund receive an appropriation of $400,000 from the Housing Trust Fund. This fund provides "gap financing and development assistance to developers of affordable sales and rental housing." BFAAC is not sure how much of that appropriation will go to the establishment of the City Manager's proposal for the non-profit housing corporation and what the ramifications are to the Housing Opportunities Fund if there is a substantial reduction in the funds available to assist developers. Nevertheless, BFAAC feels that the formation of the corporation can be a positive action to help address the severe affordable housing shortage in the City.

BFAAC has recommended that the City do all it can to encourage and facilitate homeownership opportunities for low- and moderate-income families and there does appear to be an effort to step up the realization of many of the Task Force recommendations. The Appendix updates the actions taken by the City over the past year.

The estimated figure for 2002 for Homeownership Assistance Program (HAP) and Moderate Income Homeownership Program (MIHP) loans in the FY 2003 Proposed Operating Budget was $1.1 million and the actual total HAP and MIHP loans granted amounted to $453,763. In this year's proposed budget, the estimated outlay for 2003 and the projected outlay for FY 2004 are both $1.3 million. That is a significant increase of $846,147 over the "actual" FY 2002 figure. These enormous discrepancies would indicate that the City is greatly overestimating its outlay for these programs, unless the marketing of these programs improves.

While there are programs available to families of modest means, it would appear that the word is not necessarily reaching the targeted market. BFAAC recommends that the City reach out to any organizations that can assist in spreading the word to their members and employees, i.e., the Police Department, Fire Department, ACPS, and to work with the various organizations to educate and encourage their members to avail themselves of the assistance the City can provide.

2. Open Space

Despite some reservations, if City Council wants to pursue significant funding for open space acquisition, BFAAC believes that City Council should continue to explore Councilman Speck's proposed approach as a useful budgetary tool for beginning now to reach that goal.

We encourage the City to explore a wide variety of potential funding sources for open space acquisition. Other funding sources, however, have thus far been of limited value. As Councilman Speck has indicated, contributions to the City's open space preservation fund are voluntary, small and non-recurring. The Virginia Legislature seems disinclined to authorize localities to increase the recordation fee as a dedicated source of revenue for open space acquisition. Other demands on the CIP will make it difficult for the City to use the CIP as a major source of funding for open space acquisition in the near future.

In order to meet the goal of maintaining 7.5 acres of open space for every 1000 Alexandria residents (see the City's Strategic Master Plan for Open Space, Parks and Recreation), Alexandria will need to add 100 acres of open space by 2012. Infill development, however, is reducing the number of real estate parcels available for purchase, so City Council should be looking for innovative approaches to open space acquisition in the near term if they want to reach that goal.

The City should continue to explore other new sources of funding for open space acquisition, such as an open space conservancy. Although we have reservations with the Speck proposal, it is a bold approach that seeks to secure the advantages and avoid the disadvantages of a dedicated funding source (such as through "user fees" placed in a "trust fund"):

- It has the advantage of transparency, of declaring to the City's property owners that one cent of the tax rate on their property is intended for the exclusive use of open space acquisition. It is a clear statement to Alexandria taxpayers of City policy on where City tax dollars will be spent.

- On the other hand, it is not truly binding on future City Councils. It doesn't remove that one cent of tax rate from their control. It gives future City Councils the flexibility to provide more or less money for open space acquisition than that one cent would generate.

There are risks, however, with this proposal:

- It could inspire supporters of other, perhaps many other, funding programs to pursue similar set-asides of portions of the tax rate. That could lead to a balkanization of the City budget and limit the ability of the City Council to respond to changing circumstances and competing demands for City funds in the context of the overall budget, if future City Councils treat this and other designations as binding.

- On the other hand, this proposal's non-binding character might not be well-understood by the public. If future City Councils decide not to enforce it, even for the best of reasons, members of the public could view it as a breach of promise.

III. REVENUES AND LONG-TERM PROJECTIONS

Overview

To assess Alexandria's overall fiscal health, one must consider whether the City is well positioned to manage its longer-term fiscal challenges.

In looking at scenarios through FY 2009 as presented in the budget, BFAAC notes that in most years modest rates of increase in real property tax revenues should be sufficient to support the forecasted rate of growth in expenditures contained in the low-, mid- and high-growth scenarios. The revenue projections presented in the budget document incorporate the proposed reduction (to $1.05) in the real property tax rate.

The longer-term outlook remains more troublesome. As BFAAC noted last year, changing City demographics, the Commonwealth's uncertain fiscal outlook, and accumulating specific deferred budget needs—all of these things will continue to put pressure on the expenditure side of the budget. On the other side of the fiscal equation, the City's ability to raise new revenue may be affected by the dwindling amount of available land for new development (not to mention the acquisition of land for open space) and limits on the rate at which residential real property taxes should continue to increase due to rising assessments.

City Council should keep one eye on the future as it works to meet these revenue and expenditure challenges. Decisions made in the context of FY 2004 should be sustainable in future years. Over the longer term, BFAAC is concerned that the City is especially vulnerable to economic downturns that affect its real property tax base given that nearly 52 percent of the City's revenue comes from real property taxes. For this reason, BFAAC again recommends that the City continue to explore ways to ways to bring greater diversity and equity to its revenue stream. BFAAC commends the City for working to increase the revenue it receives from a tobacco tax and sewer fees, but perhaps it's time to explore other sources, as well, including gasoline taxes, statewide revenue sharing (in anticipation of Virginia's eventual economic recovery) and regional taxing authorities.

While BFAAC does not recommend that the City try to place annual caps on aggregate real property tax increases, it might be appropriate to monitor more closely the proportion of personal income that goes to pay residential real property taxes. In doing so, the City should be mindful that there is not necessarily a correlation between housing value and household income which makes it very important to diversify its revenue sources and monitor residential real property taxes as a percentage of personal income.

A. Five-Year Forecast

Over the next five years, City forecasts indicate that growth in real property assessments will probably not continue at the current rapid pace. The more modest rates of increase, however, should be sufficient to support the projected expenditures contained in the City's low-, mid- and high-growth forecast scenarios.

As the chart below shows, the percentages by which real property tax revenue needs to increase (assuming the proposed $1.05 assessment rate) in order to balance the City budget in each of the next five years is quite realistic, and consistent with our recent growth curve. Since 1997, real property assessments have grown by annual rates ranging from 2.17 percent to 18.9 percent. In this chart, the needed rates of annual increase range from 9.04 percent (in FY 2005) to 1.65 percent (in FY 2009).

This conclusion does not change significantly under the City's high- and low-growth scenarios. In these instances, the necessary rates of increase would range from 10.34 percent (in FY 2005) to 0.13 percent (in FY 2009).

Mid-Range Growth Forecast Scenario	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Projected Expenditures	$479,205	$500,182	$525,175	$547,945	$571,478	$586,582
Projected Revenues	$479,205	$491,968	$512,827	$534,009	$556,138	$579,258
Projected Shortfall	$ -	$ 8,214	$ 12,348	$ 13,936	$ 15,340	$ 7,324
Projected Real Property Tax Revenue	$203,167	$213,325	$223,992	$235,191	$246,951	$259,298
Real Prop. Tax Revenue Needed to Balance Budget	$203,167	$221,539	$236,340	$249,127	$262,291	$266,622
Annual Rate of Increase		**9.04%**	**6.68%**	**5.41%**	**5.28%**	**1.65%**

Several short-term indicators point to the continuation of a healthy residential real estate market in which the rate of growth will likely equal or exceed the necessary rates of increase in FY 2004 and FY 2005. For example:

- The average sales price for residential property sold during the first two months of CY 2003 had already increased by 8 percent over CY 2002. By comparison, the average sales price for residential property sold during CY 2002 increased by 15.4 percent over CY 2001.

- The assessment/sales ratio for residential properties sold in Alexandria during CY 2002 was only 76.5 percent. This suggests there is a lag in assessing residential properties at their full market value in the current real estate market. In the 3,401 sales that were examined, the average assessed value was $210,174 while the average sales price was $274,796. By comparison, the assessment/sales ratio for residential properties was much higher, 95.8 percent, in 1997.

As for the commercial real estate market, it too should help boost the City's tax base. For example, according to City staff the full build-out of PTO will be captured by January 1, 2006, adding around $800 million in assessed value to our real property tax base (about one-third of this amount has already been captured).

B. Demographic Issues

The City is engaged in certain long range planning initiatives to address various quality of life issues. Because the three major demographic trends identified below (influx of foreign born, growing disparity in wealth and aging of the baby-boomers) will affect many aspects of future budgets, those trends should be carefully analyzed and taken into account in any long range planning.

BFAAC observed last year that the release of data from the most recent census (year 2000) showed a City population that is growing in numbers and diversity. We highlighted the increase in numbers of children growing up in households at risk of poverty and pointed out the implications for spending decisions regarding affordable and low income housing, schools and human services.

Further analysis of the census data reveals other issues that impact Alexandria's fiscal future:[9]

Influx of foreign born residents. In the decade between 1990 and 2000, the City experienced a large increase in foreign-born population. New foreign-born residents accounted for almost all—85 percent—of the total population increase during that 10-year period. (The total population grew by 17,100; 14,602 were foreign born.) Alexandria's foreign-born population numbers 32,600, which means about 1-in-4 of us is now foreign born. This compares to 1-in-6 in 1990 and 1-in-10 in 1980. There are 75 countries represented, with 500 or more residents coming from each of 17 countries around the world, Central and South America, Africa, Near and Far East, Europe and North America. Census figures show that a language other than English is spoken in nearly one-third of Alexandria homes.

This incredible diversity makes it difficult to generalize except to say that Alexandria has become (along with other Northern Virginia jurisdictions) a popular destination for immigrants and this seems unlikely to change in the near future. This population trend should be taken into account for future school and human services funding decisions and further analysis of this segment of the population should be undertaken to identify needs.

Growing disparity in wealth. The 2000 census figures reveal that Alexandria is experiencing growth at both ends of the economic scale. Per capita income increased but so did the rate of poverty in the City, reflecting a widening gap between the better and less well off. On the plus side, Alexandria ranks in the top three percent of localities in the United States in terms of standard indicators of economic well-being. We are 9th in the nation in per capita income. One in five households (22 percent) reported an annual income of $100,000 or more. On the minus side, poverty increased in the City from seven percent to nine percent in the last decade. The data show increased poverty for youth, blacks, Hispanics as well as whites.

This growing wealth disparity has wide-ranging future budget implications, especially for affordable and low-cost housing, human services, and redevelopment plans.

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[9] Presentation to Agenda Alexandria by Dr. Ken Billingsley, Director of Demographic & Economic Analysis, Northern Virginia Regional Commission, January 27, 2003.

Aging baby-boomers. The trend in age composition in the census data shows very large increases in the numbers of Alexandrians aged 35 to 59. This reflects the aging of the baby-boom generation (generally those born between 1945 and 1965) into peak earning pre-retirement years. In the next decade, this large cohort will reach retirement age and the impact on the City could be felt in many ways that are difficult to predict. Will the boomers continue to work, perhaps part time, or will they live off fixed incomes? How will their spending habits change? Will they leave the City or age in place?

There are possible effects on real property values and real property tax revenues, needs for real property tax relief, local sales tax revenues, needs for recreational facilities, medical facilities, special transportation and other City services. The aging of the baby-boomers is a major population shift that the City must understand well in order to properly plan for the future.

C. State Revenues and Budget Priorities

Declining and uncertain state revenues could put pressure on the City to either close the revenue gap with local revenues or cut certain programs and services. If the gap is not closed with local revenues, BFAAC believes the City would have to first focus on and fund its core services--in education, public safety and municipal infrastructure--and then consider reductions in other, less-essential activities.

Budget cuts at the state level, coupled with a slow economy, have resulted in more reductions in state aid for the City. The net loss was $700,000 in FY 2003 and is estimated to be $3 million in FY 2004. Aid to the City is down in a number of major categories, including funding for law enforcement, tax collection, education and mental retardation and mental health. This situation is not likely to improve in the near term as the Commonwealth faces the worst fiscal crisis in its history, a $1.5 billion shortfall in the current biennium.

The City will have to contend with voids for certain services that have historically been funded at least in part by state aid. Meanwhile the state has increased unfunded mandates, for example, The Comprehensive Services Act. The pressure on the City will be to find local revenues to close the gaps left by the state or to cut programs and services. Hard choices likely will have to be made.

If revenues are limited, either by actions in Richmond or a declining economy, the City may have to first focus on and fund its core services—in education, public safety and municipal infrastructure—to the extent that the resulting revenue gap cannot be closed by local actions. As stated by Mayor Donley in the State of the City address on February 27, 2003: "Local government cannot be all things to all men and women. As state programs continue to be slashed and revenues reduced, we must realize we cannot fill every gap. ..."

D. Land Use Issues

1. Development and Redevelopment

The City must carefully review and consider the revenue and expenditure implications of its future development and redevelopment decisions.

Alexandria possesses unique attributes which contribute to the health of its real property tax base. Its history, historic resources, vibrant downtown and waterfront, healthy neighborhoods, diverse citizenry and proximity to Washington, D.C.[10] continue to keep Alexandria an attractive place to work and live.[11] In addition to these attributes, and notwithstanding the current sluggish national economy, low mortgage rates have continued to fuel the area's residential real estate market.

As already noted, however, appreciation of the existing real property tax base is likely to slow at some point from its current historic rate of growth. In fact, if they follow previous appreciation cycles, existing property values may eventually decline for a few years, or at least appreciate at a rate below that of inflation.[12] Given the dwindling amount of undeveloped real property in Alexandria, a reliance on new construction alone to expand the tax base and keep pace with growing expenditures will be difficult (without increasing the tax rate). The City, therefore, must more carefully review and consider the revenue and expenditure implications of its future development, redevelopment and open space decisions. For example, redevelopment of existing real property can greatly impact the tax base due to changes in the type of land use – from commercial to residential, or even from single-family homes to multi-family rentals.

The economic impact of future development and redevelopment projects, therefore, should be closely reviewed as part of the City's land use decisions. The revenues the City can anticipate (e.g., taxes based on real property, personal property, sales, lodging, etc.) must be evaluated in the context of expenses the City would have to incur to support such development (e.g., operating costs associated with police, fire, street maintenance, schools and capital costs associated with street improvements, lighting, etc.).

As noted in Budget Memo #34 (April 14, 2003), studies undertaken by other jurisdictions have concluded that new single-family detached-home development generally has a negative net fiscal impact on a community, whereas new commercial development has a positive net fiscal impact. In Alexandria, however, new single-family residential development has resulted in a net fiscal gain to the City, albeit at a lesser rate than commercial development. This is due to Alexandria's unique attributes, including its urban-style residential development and demographics (for example, there are few new children per residential unit).

By way of example, during consideration of the Eisenhower East Small Area Plan, City Council and the Planning Commission had access to detailed market analysis of commercial office and retail sales uses and the potential fiscal benefits to the City from future development.[13] BFAAC commends the City on following this approach. BFAAC notes, however, that the Eisenhower East Small Area Plan adopted by City Council did not address the costs and benefits of the potential residential market, and hopes that future analysis will do so. The balance of

[10] Alexandria's attractiveness as a community within a reasonable distance to major employment centers is demonstrated by the fact that 75 percent of its residents commute to work outside of Alexandria. Census Bureau, 2000 Census.

[11] See Department of Planning and Zoning , "Plan for Planning 2001-2005" dated June 8, 2001

[12] Washington Post, March 19, 2003 Real Estate Section

[13] Final Report – Analysis of Market Potentials for Office and Retail Space – Eisenhower East Corridor, prepared by Whitney & Whitney, Inc., December, 2002

residential, commercial and retail development is not just related to "quality of life" issues, but is a significant factor in the City's ability to project revenues and expenditures over the long-term. For that reason, BFAAC recommends that the City continue to examine the economic impact of development in formulating its land use decisions.

2. *Tax-Exempt Properties*

With nearly 12 percent of Alexandria's land owned by tax-exempt entities, a relatively large portion of the property within the City is excluded from the real property tax base. BFAAC suggests the City study the feasibility of a payment in lieu of taxes, and grant no additional tax exemptions without first conducting a thorough evaluation of the long-term impact on City tax revenues.

Approximately, 12 percent of Alexandria's land (by value) is tax-exempt, for example, schools, government agencies, religious groups and certain other nonprofits. (See Budget Memo #7, March 26, 2003.) The effect is that a relatively large portion of the property within the City is excluded from the real property tax base. The exempted properties require—and benefit from--City services, including police, fire, street improvements, lighting and others. Some Virginia localities have implemented a program for payment in lieu of taxes by some of the tax-exempt entities to help defray costs of municipal services.

Under a recently enacted amendment to the Commonwealth constitution, localities are given the authority to grant real property tax exemptions for properties within their borders. This means the City now has a degree of control over the number of exempted properties.

The revenue impact of real property ownership by tax-exempt entities should be examined. BFAAC suggests that the feasibility of a payment in lieu of taxes be studied. BFAAC further suggests that no additional tax exemptions be granted (i.e., the City should not expand the amount of tax-exempt property on the books), unless a thorough evaluation of the long-term impact on City tax revenues has been considered.

E. Sustainability of FY2004 Budget Decisions

City Council should keep one eye on the future as it works to meet next year's revenue and expenditure challenges. Decisions made in the context of FY 2004 should be sustainable in future years.

As noted in other sections of this report, Alexandria has many additional long-term expenditure challenges currently not reflected in the City's Operating Budget or CIP. BFAAC is concerned that (1) recurring revenues may not be able to keep pace with recurring operating expenditures; and (2) there is not much room in the out years (under the City's debt-policy guidelines) to add new capital projects and increase CIP spending.

If City Council wants to consider further reductions to the real property tax rate beyond the 3 cents proposed by the City Manager, it should do so by identifying new revenues, and/or cutting recurring expenditures—not by drawing down the fund balance by more than the City Manager has proposed.

For example, if the tax rate is cut another three cents, to $1.02, the City will need to identify an additional $5.8 million in alternative revenues and/or reduced expenditures in order to balance the FY 2004 budget. These additional revenues or spending reductions would have to continue in future years. Otherwise, to avoid increasing the tax rate back to $1.05 next year, real property assessments would have to increase by a range of 10.6 percent to 13.6 percent, depending on what happens to other revenue sources.

Based on Budget Memos #26 and #27 (April 11, 2003), there is now an additional $3.1 million available in FY 2004 (as a result of recent re-estimates of revenues and expenditures). These savings could be used to fund a tax rate reduction without changing any of the City Manager's recommendations. BFAAC would have no objection to this action because these revenue and expenditure adjustments mostly recur in future years. There is an additional $5.2 million available, as a result of one-time FY 2003 savings. This money, however, as per the Debt-Policy Guidelines recommended by BFAAC and previously adopted by City Council, should be designated for cash capital.[14]

F. Capping Aggregate Real Property Tax Increases

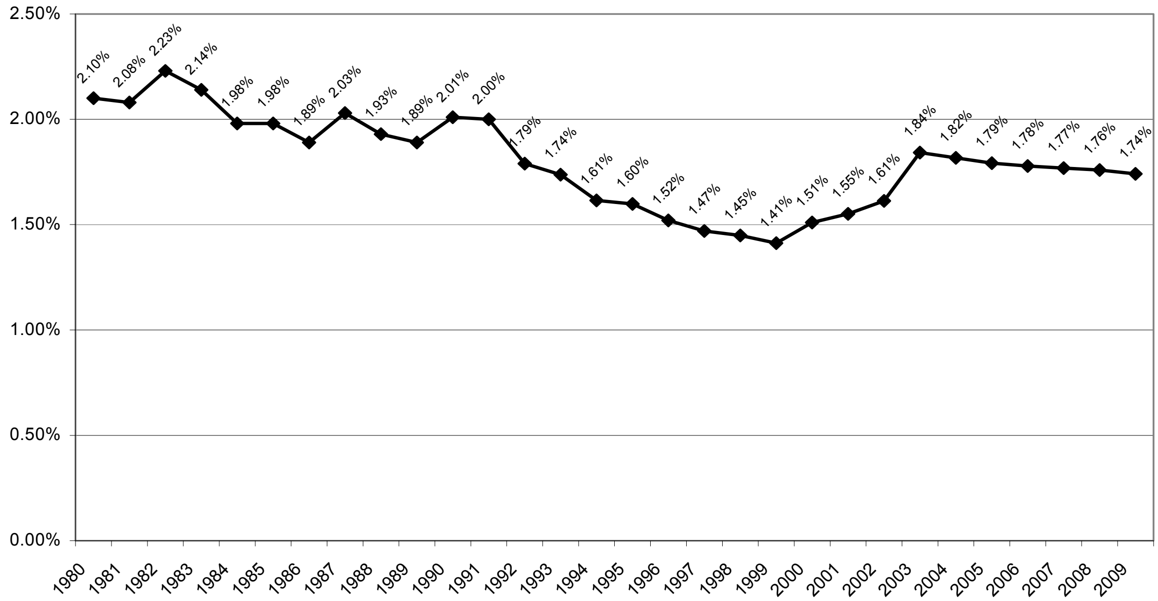
BFAAC does not recommend that the City try to place annual caps on aggregate real property tax increases. Instead, it might consider monitoring more closely the proportion of per capita income and personal income that goes to pay the real property tax.

The chart below tracks the percentage of per capita income paid for residential real property taxes from 1980 through 2003, projected out to 2009 using the city's CIP assumptions and a $1.05 tax rate. This chart includes commercial (multi-family) rental properties with residential assessments under the assumption that most landlords pass along rising property taxes to their tenants in the form of higher rents.

The ratio reached a high point of 2.23 percent in 1982 and gradually fell to 1.41 percent in 1999. Since then (as a result of the double digit assessment – and tax – increases of the last three years), it has been climbing, taking a big jump from 1.61 percent in 2002 to 1.84 percent in 2003. Thereafter, if parallel assumptions of 5 percent property tax/ assessment increases and 5 percent per capita income increases hold true, the ratio drops slightly (due to underlying population growth assumptions that increase total personal income faster than total real property taxes).

[14] "The priority to consider when additional General Fund revenues become available at the end of the fiscal year would be a designation within the General Fund fund balance for pay as you go capital." (See page 10-49 of the Proposed FY2004 Operating Budget.)

Residential Real Property Taxes as a Percentage of Per Capita Income
(Assuming $1.05 Tax Rate for 2004-2009)



In short, over the last 23 years since 1980 Alexandrians historically have paid from 2.25 percent to 1.41 percent of personal income for real property taxes. At the $1.05 rate, Alexandrians would pay between 1.84 and 1.74 percent of personal income through 2009.

BFAAC recommends that City Council monitor the real property tax burden using these historical ranges. For now, BFAAC recommends this type of analytical approach, rather than trying to place an arbitrary cap on real property tax increases.

G. Housing Values and Household Income

The City must be mindful that there is not necessarily a correlation between housing value in Alexandria and household income.

The burden of real property taxes in Alexandria does not always correspond with household income. For example, in the Chart below, Year 2000 census data (provided by Alexandria's Department of Planning and Zoning) shows that for families with homes valued between $300,000 and $500,000, 70 percent had household incomes over $100,000 whereas 7.2 percent had household incomes under $50,000. For this latter group, real property taxes (which are proportionate to housing value) represent a very high proportion of income.

Distribution of Household Income Level by Housing Value, 1999						
	Household Income Level					
Housing Value	Under $35,000	$35,000 - $49,999	$50,000- $74,999	$75,000- $99,999	$100,000 or more	Total
Under $100,000	45.7%	17.0%	15.4%	12.4%	9.4%	100%
$100,000-$199,999	17.6%	11.8%	29.2%	19.1%	22.4%	100%
$200,000-$299,999	7.6%	6.7%	15.1%	20.3%	50.3%	100%
$300,000-$499,999	3.8%	3.4%	9.6%	13.2%	70.0%	100%
$500,000 or more	2.3%	2.4%	5.3%	4.2%	85.9%	100%
All Houses	10.1%	7.2%	16.7%	16.1%	49.8%	100%

Source: 2000 US Census
Data provided by City of Alexandria Department of Planning and Zoning

Looked at another way, in the chart below, one can see that real property taxes vary significantly for families with the same household income. For example, for families with incomes between $50,000 and $75,000, 53.7 percent had homes valued at less than $200,000 whereas 19.1 percent had homes worth more than $300,000.

Distribution of Housing Value by Household Income Level, 1999						
	Housing Value					
Household Income	Under $100,000	$100,000- $199,999	$200,000- $299,999	$300,000- $499,999	$500,000 or more	Total
Under $35,000	14.5%	50.4%	22.5%	10.4%	2.2%	100%
$35,000 - $49,999	7.6%	47.6%	28.2%	13.3%	3.2%	100%
$50,000-$74,999	2.9%	50.8%	27.1%	16.0%	3.1%	100%
$75,000-$99,999	2.5%	34.5%	37.8%	22.7%	2.5%	100%
$100,000 or more	0.6%	13.1%	30.4%	39.1%	16.8%	100%
All Households	3.2%	29.2%	30.1%	27.8%	9.7%	100%

Source: 2000 US Census
Data provided by City of Alexandria Department of Planning and Zoning

H. Tax Relief Measures

To help address this potential burden, BFAAC supports expanded tax relief measures for the elderly and disabled, but feels that the proposed tax deferral program for others is an inefficient way to give a very small amount of tax relief. Instead, the City might explore ways to make payments more manageable, for example, by promoting monthly or quarterly tax payments.

Tax relief for elderly and disabled. BFAAC applauds the City's expansion of real property tax relief programs. State law permits localities to provide an exemption or deferral of real property taxes for persons who are at least 65 years or permanently and totally disabled, with certain income and asset restrictions. The City previously enhanced its tax relief program in 2001 and again in 2002 and is currently considering an ordinance to further expand the income and asset eligibility so that more taxpayers can qualify. Under the proposed program, income limits for exemption for all or part of the tax would be raised to $62,000 and the asset eligibility would be raised to the state limit of $240,000. Any part that is not exempted may be deferred and collected (with interest) at the time the property changes hands. The income limit for deferral under the program ($62,000) is the maximum permitted by law. The cost of the expansion is estimated to be $400,000 per year (for a total program expense of $1.4 million).

BFAAC believes this proposed expansion is warranted to provide some protection from rising real property tax bills for targeted populations who may be most in need.

Tax deferral for others. City Council is also considering whether to implement a tax deferral program for certain small business owners and residential property owners (other than the elderly and disabled) when real property taxes exceed 110 percent of the previous year's tax. State law has permitted such a program since 1990, but no jurisdiction could be identified that has enacted such deferrals for the general population.

While BFAAC supports the *principle* of helping residential property owners who are most in need, due to the complexities and expense of administration (caused by current state law), BFAAC would not recommend such a deferral program unless state law changes can be made in Richmond. Otherwise, the proposed deferral program appears to be an inefficient way to give a very small amount of tax relief to a much broader population.

Tax administration. BFAAC believes it might be possible to make paying the real property tax easier and more convenient for both residential and commercial property owners. For example, we understand that electronic filing is being considered, which may be a desirable option for some taxpayers. We also understand that City will accept tax payments at any time, although there is no formal program for paying other than semi-annually.

The City should look for ways to ease requirements for filing and paying real property tax. Electronic filing should be pursued. BFAAC also suggests that the City explore the possibility of formalizing a program for monthly or quarterly tax payments as an alternative to semi-annual ones. Such an option could make payments more manageable for those property owners who do not have mortgages or who otherwise pay taxes directly to the City.

I. Need to Diversify City Revenues

Alexandria's reliance on real property taxes to fund increases in its general fund operating budget makes the City especially vulnerable to the cyclical nature of the real estate market. For this reason, BFAAC again recommends that the City continue to explore ways to bring greater diversity and equity to its revenue stream.

Over the past couple of years, BFAAC has fully supported the City's efforts to diversify its revenue base, most recently by increasing the revenue it receives from a tobacco tax and sewer fees.

BFAAC has also supported the City's efforts to overhaul of many of its fee-based revenue sources to ensure that all City fees remain reasonable, fair and comparable to other jurisdictions. Furthermore, BFAAC previously recommended that the City place a priority on adopting a formal policy for periodic re-evaluation of its *entire* fee structure (as per the Government Finance Officers Association's statement on "Best Practices"). And, BFAAC again offers to participate in the development of such a policy should City Council desire it to do so.

Despite all of these efforts, however, Alexandria (like the rest of Northern Virginia) remains heavily reliant on real property taxes to fund increases in its general fund operating budget—these taxes currently represent nearly 52 percent of the City's revenue base, up from 45 percent in FY 2001. For this reason, BFAAC continues to recommend that the City explore ways to bring greater diversity and equity to its revenue stream, for example, through gasoline taxes, statewide revenue sharing (in anticipation of Virginia's eventual economic recovery) and regional taxing authorities. Notwithstanding the defeat of the Sales Tax Referendum last year, specific needs such as mass transit may be appropriately addressed through such initiatives.

APPENDIX: UPDATE ON RECOMMENDATIONS OF THE AFFORDABLE HOUSING TASK FORCE