City of Alexandria Budget and Fiscal Affairs Advisory Committee

Report on the City Manager's Proposed Budget for Fiscal Year 2005

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Table of Contents

EXECUTIVE SUMMARY

The Capital Improvement Program (CIP)

We support the Capital Improvement Program (CIP) as proposed but have several concerns and observations:

- The City will be at or near target borrowing capacity through FY 2008, even when measured against adjusted Debt Policy Guidelines. Should non-City funding sources fail to materialize, the projects covered in the CIP may have to be cut back or delayed. Significant unforeseen new capital requirements or cost overruns could force delays or cutbacks in other needed capital improvements.

- Because the Alexandria City Public Schools (ACPS) lease for its administration building expires in 2006, we urge the City and Schools to agree whether to lease space for school administrators or build a new facility. If the latter option is chosen, we recommend that the City and Schools begin work as soon as possible to determine how funding for the project will be incorporated into the CIP.

- BFAAC urges City Council and staff to continue discussions with WMATA officials concerning additional WMATA capital spending and to begin planning for a possible increase in the City contribution to WMATA.

- BFAAC believes that bonding for open space purchases is not appropriate at this time because operational guidelines are not yet in place and there is little, if any, room for additional borrowing under the Debt Policy Guidelines.

- BFAAC notes the high costs of the Public Safety Center project and encourages Council to be certain the final design is of appropriate scale and the selected site has adequate transportation access.

- We support moving the timing of the Chinquapin project back, but express concern about potential cost overruns in the T.C. Williams construction and the likely impact on the ability of the City to fund other capital projects.

- Assuming the City Council updates the debt-per-capita indicator (as we have recommended in Budget Memo #4), the proposed CIP would keep the City within all the targets of its debt-related financial policy guidelines. Beginning in FY 2009, the City should have additional capacity to borrow and still remain within its Debt Policy Guidelines.

The Operating Budget

Because BFAAC supports the proposed CIP and would oppose any significant reduction in the CIP budget, we believe that any spending reductions made by Council should be made in the Operating Budget. Personnel expenditures account for most of the Operating Budget and should be closely scrutinized for potential spending reductions.

BFAAC is concerned about the fiscal implications of Alexandria being a leader with regard to employee benefits. BFAAC recommends that the City investigate cost-containment strategies in its health insurance and retirement benefit programs, including increased employee cost-sharing.

We endorse the recommended COLA of 2 percent for City employees.

BFAAC recommends that Council closely scrutinize the proposed new hires in the Proposed Operating Budget because of the significant financial commitment the City undertakes when it hires additional personnel.

We encourage the City and the ACPS to initiate a long-term series of intensive audits of individual agencies and programs to identify potential cost savings, including possible savings through the reduction in the number of excess administrative personnel.

Because of unusual circumstances, BFAAC recommends that the City set aside for possible use undesignated reserve funds to make up for the shortfall in the School Board's Approved Operating Budget pending passage of a state budget.

We recommend that the City review its affordable housing programs in light of current market conditions.

BFAAC applauds the City for its efforts in using performance measurements in its budget documents and urges the City to fully implement such measurements, including qualitative indices.

We repeat our cautionary note from previous reports that the City's growing CIP increasingly will absorb funds that could otherwise be spent on operating expenses or tax reduction.

Revenues and Long-Term Projections

The City remains well positioned to manage its immediate fiscal challenges because of the continued dominance and strength of the real property tax base.

Consistent with last year's projections, 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, remain sufficient to support the projected six-year expenditures contained in the City's mid- and high-growth forecast scenarios.

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.

Continued reliance on the real estate tax base as the rate of growth in values appears to be slowing, as well as limits on the City's ability to further diversify its revenues sources, require the City to closely examine its ability to provide core services and still meet the demands of aging infrastructure.

Although commercial real estate revenues are generally experiencing a similar rate of increase to the residential tax base as a result of new construction and appreciation, the commercial office vacancy rate may be cause for concern in the future.

It is essential that the City Council work towards the development of a long-term Strategic Plan as it assesses the priorities of municipal government while working to meet these revenue and expenditure challenges. Decisions made in the context of FY 2005 must be sustainable in future years. Through such discipline, the City will help enhance our quality of life and realize its mission of delivering excellent services for all who live in, work in, or visit our City.

The uncertainty of state aid and federal aid contributions to the City budget continue to pose troublesome revenue forecast issues.

The growing wealth disparity continues to pose wide-ranging future budget implications, especially for affordable housing, education, human services, public transportation and redevelopment plans.

Nearly 12 percent of Alexandria's land is owned by tax-exempt entities. BFAAC endorses the policy that, as a general matter, all properties within the City should be subject to taxation; therefore, the City should be reluctant to expand the current exemptions. In this regard, we agree that the City should support the work of its many worthy charitable institutions in direct ways, such as grants and service contracts, rather than through indirect tax subsidies.

While BFAAC continues to urge the City to seek out measures that would help diversify its revenues and limit our dependence on the taxable real property base, it appears that we do not have the mix of property that would make Payments in Lieu of Taxes (PILOT) an effective and efficient mechanism for recoupment of cost for services to tax-exempt entities.

BFAAC supports the proposed Targeted Tax Relief Grant Program included in the FY 2005 budget.

I. THE PROPOSED CAPITAL IMPROVEMENT PROGRAM

Overview

The City's investment in capital improvements has generally been on an upward path over the past several years. The Capital Improvement Program (CIP) budget reached a high point of $340.1 million for the City share in last year's approved budget, representing an 85-percent increase over the previous 6-year budget period. The proposed budget for the current 2005-2010 cycle is $303.9 million for the City share, a decrease of 10.6 percent, compared to the year before. The decrease reflects the scheduled completion of a number of "big ticket" projects during the period, primarily the construction of a new T.C. Williams High School (2007) and other major school renovations.

The following chart shows the proposed CIP City share for 2005-2010 compared to the approved CIP budgets (City share) for the previous eight budgets, along with the total CIP for the same years.

Approved Six-Year CIP Budgets
($ in millions)

Years Covered	97-02	98-03	99-04	00-05	01-06	02-07	03-08	04-09	***05-10 proposed***
City Share	$106.0	$123.8	$137.4	$118.0	$156.3	$197.3	$183.8	$340.1	***$303.9***
Percent Change	–	16.8	11.0	-14.1	32.5	26.2	-6.8	85.0	***-10.6***
Total CIP	178.8	213.5	246.2	232.9	267.0	342.2	353.0	558.1	***566.7***

On the whole, BFAAC believes that the proposed CIP budget meets legitimate long-term capital project needs financed through a reasonable mix of responsible levels of borrowing, realistic contributions of cash capital and anticipated state and federal grants. We support the CIP as proposed and commend the City Manager and budget staff for setting reasonable priorities among competing projects and establishing a realistic funding timetable. Most importantly, the proposed CIP budget appears to be affordable under the City's Debt Policy Guidelines.

We have several concerns, however:

- As explained further below (see discussion in section H), BFAAC recently recommended an upward adjustment in one of the guidelines. **The City will be at or near target borrowing capacity through FY 2008, even when measured against the adjusted guidelines.**

- While the City share of the CIP is lower this year, the total CIP is actually higher, meaning that planned funding from non-City sources is increasing. The proposed budget calls for total spending of $566.7 million, with $262.8 million from non-City sources. Similar figures from the FY 2004 CIP show $558.1 million total CIP spending and $218 million from non-City sources. In significant part, non-City funding sources have been identified in this year's budget (with the exception of DASH bus replacements and WMATA contributions in the out-years). As an example, a large portion of the non-City funding ($35.3 million) will go to build improvements associated with the Woodrow Wilson Bridge urban deck. The funds for this project are expected to come exclusively from state and federal monies that were committed to the City as part of the Wilson Bridge settlement. **However, should non-City funding sources fail to materialize, as now seems likely at least with respect to a portion of expected transportation funding from VDOT, the projects covered in the current ambitious 6-year CIP may have to be cut back or delayed.**

- The City is entering a critical period for capital investment with a number of large projects funded during this budget cycle. **Significant unforeseen new capital requirements or cost overruns (for example, in the construction of the new T.C. Williams High School) could force delays or cutbacks in other needed capital improvements.**

- Cash capital contributions are critical to CIP. **Given the pressing capital needs of the City, BFAAC continues, as in past reports, to urge City Council not to reduce cash capital contributions to the CIP.** If Council wishes to consider further reductions in the real property tax rate over what the City Manager has recommended, Council should look first to fund any such reduction by reducing the operating budget of the City and the Alexandria City Public Schools (ACPS) or finding new revenue sources.

A. Alexandria City Public Schools Capital Improvement Program

The School Board Approved Capital Improvement Program budget for FY 2005 through 2010 requests a City appropriation of $105,767,748, which is $24.8 million, or 19 percent, less than last year's City-approved CIP budget for the Alexandria City Public Schools (ACPS). The decrease is largely attributable to the completion of a number of school construction projects, including the renovation and addition at the George Washington and Francis C. Hammond Middle Schools, as well as the completion of major infrastructure renovations at a handful of schools. There is $32 million in this year's CIP request to complete infrastructure replacement at the remaining schools.

Nearly $73 million of the $106 million requested in this year's ACPS CIP is attributable to the expansion and renovation of the Minnie Howard Ninth Grade Center and the construction of a new T.C. Williams High School. Rounding out the new construction piece of the school budget is the Maury media center and the James Polk gym addition, which together add another $1.3 million to the budget.

1. Major ACPS Expansion and Renovation Projects

To remedy the need for additional space and to renovate and upgrade the secondary school properties, the School System has undertaken the planning and construction of two major projects within this year's CIP: the expansion and renovation of the Minnie Howard Ninth Grade Center and the construction of a new T.C. Williams High School. These construction projects are designed for completion in time to meet the anticipated increase in secondary student population, based on the number of students now attending ACPS that made their way through the elementary schools and has now reached the middle schools.

Minnie Howard Ninth Grade Center. Last year, the City Council approved $5,012,222 for the first year of a three year renovation and expansion project at Minnie Howard. The ACPS CIP requests an additional $5,124,443 for FY 2005 and $3,642,520 for FY 2006. The Minnie Howard project calls for nearly 48,000 square feet of new construction, including a new two-story addition, an enlarged media center, a new administration and guidance area, a gymnasium, locker rooms, an exercise and weight room and an expanded 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 has a total projected cost of approximately $15 million.

T.C. Williams High School. The School Board's Approved Capital Budget includes $80.5 million for the construction of a new T.C. Williams High School. This represents an increase of $5.5 million (or 6.8 percent) over the amount for construction included in the FY 2004 budget. Last year, the City Council approved $17.5 million toward completion of the project. Funding for the remaining years include:

Proposed FY 2005	Proposed FY 2006	Proposed FY 2007	Proposed FY 2008
$22,274,295	$19,641,575	$17,271,790	$3,300,000

Although originally envisioned in the FY 2004 through FY 2009 CIP budget to be completed in four years, this year's CIP includes another year of construction. This year's School Board Approved CIP request also includes approximately $5.5 million in additional funding to complete the project. According to the School Board Approved CIP, the reasons for the increase are as follows:

- Square footage increases due to program and design refinement $1.7m
- Design elements certification (green T.C.) $1.5m
- Special foundations due to poor soil conditions $1.0m
- Addition of digital security system $150k
- Addition of second elevator $ 80k
- Items mandated as a result of City review process $1.1m

When completed, the new T.C. will be a 457,000 square foot structure that will completely replace the existing 39 year-old, 360,000 square foot structure. It will include, in addition to the new library and media center, an auditorium, classrooms and sports facilities, and a cafeteria that will be able to serve all students, thus enabling the administration--if they so choose--to close the campus so that students would not be permitted to leave during lunch.

Last year, BFAAC supported the construction of a new high school, one better capable of supporting the high school educational programs needed in the 21st century. We again support construction of a new T.C. Williams High School. That said, we would be remiss if we did not express our concern about ACPS' ability to stay within the proposed amount for the construction of T.C. Williams given the recent hikes in steel prices and other construction related costs as such additional costs would likely affect the City's ability to fund other capital projects. As noted elsewhere in this report, the City will be at or near the borrowing targets suggested by the City's Debt Policy Guidelines through 2008. ***If the City intends to remain within its target borrowing under the guidelines, there will be little room for movement if the T.C. (or any major City) project begins to incur cost overruns. City and ACPS staff have indicated to BFAAC that they have been meeting to discuss contingency planning in the event such cost overruns occur. BFAAC strongly supports such contingency planning and urges the City and ACPS to develop such plans.***

2. Other ACPS Projects, General Maintenance and Educational Support

The renovation and replacement components of the Minnie Howard project are symptomatic of what has been and continues to be necessary across the school system. The City's schools are, on average, more than 50 years old, and their aging physical plant requires significant upkeep. From 1989 to 2003, less than $50 million was spent on HVAC, roof work, modernization, renovation and architectural services for the 19 buildings the ACPS are responsible for maintaining. Conversely, this year's six-year School Board Approved CIP includes $18.5 million for school projects (e.g., HVAC, plumbing, electrical, windows, roofs); $5 million for general maintenance (e.g., renovations and landscaping); and $8.2 million for educational support (e.g., transportation, furniture, fixtures and equipment, and buses). This CIP includes modernization and maintenance for ten schools in the system (six have already been completed). ***BFAAC reiterates and supports the position it took in last year's report that for the past few years the City has been adequately funding the modernization and maintenance of the school facilities and we recommend that the City continue to do so.***

3. ACPS Administration Building

The City Manager's Proposed CIP budget includes the following under Projects Not Funded in the FY 2005 to FY 2010 CIP: "A new Alexandria City Public Schools Administration Facility in lieu of continued leasing." The ACPS Administration's current lease for office space expires in 2006. School officials indicate that they are discussing various scenarios that include either procuring a new lease at the same or a different site or constructing a new administration building.

As noted elsewhere in this report and in BFAAC's Report on Debt Policies delivered to the City Council on March 15, 2004, the CIP budget brings the City close to its bonding limit target amounts under some of its debt policy measures. Adding a new administration building to the CIP could force the City to choose between the following unattractive options: (1) delaying or eliminating current CIP projects; (2) increasing City contributions to cash capital to pay for the project; or (3) exceeding the City's debt policy targets, which could negatively affect the City's bond rating.

Elsewhere in this report, BFAAC has recommended against using the second or third options to finance any capital projects. ***Accordingly, we urge the City and ACPS to reach agreement on whether to lease space for school administrators, build a new facility, or renovate an existing building. If the latter option is chosen, we recommend that the City and ACPS begin working as soon as possible to determine how funding for the project will be incorporated into the CIP. With the lease expiring in 2006, time is of the essence. This matter needs to be resolved expeditiously before it becomes a funding emergency.***

BFAAC supports the City Manager's recommendation for full funding for the ACPS capital budget.

B. Chinquapin

Last year's City Budget included a $20 million placeholder for the planning, renovation and expansion of the Chinquapin Recreation Center. That budget assumed the Center would be constructed concurrently with the T.C. Williams construction project since they occupy adjacent sites. This year's City Budget maintains the $20 million placeholder but does not begin the construction until after the T.C. Williams project is completed. ***We support moving the timing of the project back, but again express our concern about potential cost overruns at T.C. Williams and the likely impact on the ability of the City to fund other capital projects.***

C. Transportation

Bus Replacement. The DASH Transit Development Program has proposed replacing 26 buses during the six-years of the CIP. At least some of the buses are beyond their useful life of 12 years. Last year's CIP approved $1,244,000 in funding in each year for FY 2004 – 2006. This year's CIP increases the funding for FY 2009 – 2010 by $1,555,000 in each year. The replacement plan is largely based on life cycle costing, which is good, because it provides for the systematic replacement of capital items which guards against budgetary fluctuations. BFAAC understands that there are on-going discussions about increasing the number of buses in the DASH fleet beyond its current 57. We note that at a cost of $311,000 per bus, any increase during the 6-year CIP would add to the current unfunded capital projects, so DASH should explore the type and size of bus needed on various routes in order to reduce this expenditure.

DASH Land Acquisition/Facility. $22,823,000 in VDOT State Urban Funds has been allocated for the DASH facility in the FY 2004 to FY 2006 time period subject to VDOT approval. The State has already provided DASH with $5 million for the acquisition of land for a new facility and that land has been purchased. According to the City Manager, although VDOT and the Commonwealth Transportation Board will not decide on Alexandria's request for funds for construction of the maintenance facility, early indications are favorable. However, the City recently was advised that the amount of VDOT funds earmarked for Alexandria's transportation projects, including the facility, may be reduced by about $3.3 million over six years from $110.5 million to $107.2 million. As a result, the City may need to revisit some of its transportation budget items. We also note that the $22.8 million in VDOT funds does not include the cost of an enclosed bus storage area. If the City determines that enclosing the bus storage area is desirable, it will likely have to be funded with City resources that are not currently allocated in the six-year CIP. The Committee recommends that consideration be given to equipping the new facility, whether enclosed or not, to accommodate vehicles that use alternative fuels, keeping in mind future environmental mandates.

Metrobus and Metrorail. Alexandria participates in the Washington Metropolitan Area Transit Authority's Capital Improvement Program (WMATA CIP). The most significant component of the WMATA CIP for Alexandria is the Infrastructure Renewal Program (IRP). The IRP is for the rehabilitation, replacement and preventative maintenance of bus and rail infrastructure, including fleet vehicles, facilities, track and tunnels, and information technology. Although the IRP is largely funded by the federal government, subsidies from localities are the second largest source of funding. The 2005-2010 City CIP includes $28.2 million to fund its share of WMATA's IRP.

WMATA has identified additional needs totaling about $1.5 billion region-wide for unfunded IRP items such as additional rail cars, bus fleet expansion, and other items. Staff has indicated that the City currently does not have adequate funds in the CIP to pay for additional WMATA capital spending. ***BFAAC urges Council and Staff to continue its discussions with WMATA officials over this issue, and to begin planning for a possible increase in the City contribution to WMATA, based on the transportation system's estimate of its CIP.***

D. Open Space

Background

The Alexandria City Council approved a comprehensive Open Space Master Plan in 2003. The plan establishes a framework for protecting existing open spaces and identifies additional open spaces for possible purchase by the City in the future. The Open Space Plan contains 15 goals, a series of priority actions, and a 7-year time line of suggested implementation steps. One of the goals is the acquisition of 100 acres for open space over the next 10 years.

As a part of the Open Space Plan, the City Manager appointed an Open Space Committee consisting of 12 persons who provide representation of interested parties as follows: Citizen Representatives, Planning Commission, Environmental Policy Commission, Parks and Recreation Commission, and Archeology Commission. The Parks and Recreation Department administers the plan.

The Alexandria Open Space Steering Committee is drafting a report identifying possible opportunities for preservation and is planning a report listing primary open space opportunities and additional easements, trails and reclamation opportunities.

In last year's budget, Council voted to dedicate the revenues derived from one cent of the City's real estate tax rate to the acquisition of open space beginning with 2003 real estate tax revenue. Also dedicated to the retention and acquisition of open space are funds paid by property owners securing vacation of right-of-way from the City. The two sources are producing over $2 million per year for this designated purpose, primarily from the one cent tax rate.

Although the City has always had the authority to purchase open space from operating revenues or through borrowing (utilizing general obligation bonds), the Council's 2003 decision for the first time designates a revenue stream for this purpose. We point out that the Council's decision does not bind future Councils to continue this policy.

In our FY 2004 report, BFAAC observed that the "one cent for open space" initiative was a useful budgetary tool but we also noted that it was not realistic to rely solely on the designated fund and that a wide variety of options should be explored, such as an open space conservancy. We further observed that other demands on the CIP would make it difficult to use the CIP as a major source of funding for open space acquisitions.

Funding-Related Questions

A number of funding-related questions arise from the creation of the Open Space Plan and Fund, some of which have been addressed by recent budget memos. For example:

- Should purchases be limited by the funding available from the Open Space Fund?
- Should the Fund balance be leveraged to secure general obligation bonds based upon all or a portion of the amount in the Fund?
- Should purchases in early years of the Fund be limited to cash purchases until the Fund becomes larger?
- Is one cent of the City's real estate tax rate enough or should additional revenues be dedicated to the Open Space Fund?
- What policies and procedures should be developed to prioritize the use of the Fund to ensure that the best open space properties are purchased, not simply those properties that come up first?
- Should the plan include affirmative steps to seek out owners of identified parcels and negotiate with them to preserve open land?
- How will open space acquisition affect funding of other current capital and operational needs of the City?
- Is a goal of adding 100 acres of open space in 10 years a realistic one? If so, what timeline and mix of resources would be necessary to achieve it?

Revenue and Bonding Capacity

Current projections for the Open Space Fund based on one cent of the City's real estate tax rate and revenue from right-of-way vacations, as explained above, are as follows:

Planned General Fund, Open Space Trust Fund:

FY 2005	$2,296,000	
FY 2006	$2,434,000	
FY 2007	$2,580,000	
FY 2008	$2,735,000	
FY 2009	$2,899,000	
FY 2010	$3,072,000	
Total	$16,000,000	(approx.)

Based on current estimates, about $35 million in general obligation bonds (using level debt service method of repayment) could be issued.

Comments on Bonding to Purchase Open Space. While borrowing against open space revenue could produce more funds for immediate acquisitions and could arguably allow the City to secure properties at lower current prices, there are a number of drawbacks in borrowing to accelerate purchases. First, such borrowing would preclude the purchase of other desirable parcels that may become available later, to the extent that open space funds are being used for debt service. Second, additional borrowing for this purpose affects the City's ability to fund other projects through the CIP. Additionally, as discussed elsewhere in this report, acquiring open space has associated costs, including maintenance expense and loss of tax revenues.

Since the Open Space Plan and Open Space Fund are new initiatives, BFAAC believes that the City should not acquire parcels until operational guidelines are in place for prioritizing purchases and planning necessary funding. Such guidelines should address the type of funding-related questions raised above and include a detailed analysis of the impact of purchases and funding decisions on other City capital and operational needs.

Once operational guidelines are established, open space purchases must still be viewed in the context of the Debt Policy Guidelines. Given the level of funding for current projects in the CIP and the more than 70 additional projects awaiting possible funding (discussed below in section G), the Council should use only the revenue in the Fund for the purchase of open space. We note that City staff estimated that fully bonding for open space at this time would exceed Debt Policy Guideline targets. Consequently, if City funds in excess of the available dedicated amount in the Open Space Fund are needed to purchase a parcel or parcels, cash capital should be used to augment the available cash in the Fund.

In sum, although using the revenue stream in the Open Space Fund as a basis for borrowing is a possible approach, BFAAC believes that bonding for open space purchases is not appropriate at this time because operational guidelines are not yet in place and there is little, if any, room for additional borrowing under the Debt Policy Guidelines. If Council wishes to consider open space borrowing in the future, any decision to do so should be made following established operational guidelines, taking into account overall capital and operational priorities of the City, and adhering to the City's Debt Policy Guidelines.

E. Public Safety Center

BFAAC recognizes the need to complete the slab correction work at the existing Public Safety Center (PSC) and construct a separate new police facility to alleviate the current overcrowded conditions. However, we would like to note the high expenses associated with this project and encourage Council to be certain the final design is of appropriate scale and the selected site has adequate transportation access. With construction not scheduled until FY 2008, the City should have ample time to plan wisely.

The current Public Safety Center (PSC) is shared by the City's Police Department, Office of Sheriff and Magistrate. The Police Department occupies 48,862 square feet, with a staff of 440 people. When it was built in 1987, the Police Department had a staff of 335 people.

The proposed new facility would house only the City's Police Department. It would be double the size (99,800 square feet) and accommodate a staff which might increase to as many as 560 people by the year 2014.

According to a Police Department presentation from last March, the price tag for this project is $65.41 million, making it the second most costly capital project, with costs derived as follows:

- $16.61 million for site selection and acquisition (a six-acre site at an estimated cost of $42/square foot)
- $5.75 million for site development
- $4.84 million for design
- $10 million for a parking garage (with approximately 600 spaces)
- $28.21 million for construction (at an estimated cost of around $300/square foot)

In addition, the City will be spending about $10 million over the next five years to lease ($1.4 million/year) and build out ($3.6 million) 47,000 square feet of office space in two interim facilities to be used while the new PSC is under construction. This temporary relocation is necessary to alleviate crowded conditions and to complete the first floor slab correction work. The total cost for slab correction is $7.6 million.

The Office of Sheriff and Magistrate would remain in the current facility, although it seems unlikely they would need all of the space formerly occupied by the Police Department. BFAAC therefore encourages Council to consider whether there might be room for other City agencies at the existing PSC site.

The City's site selection committee has begun to explore possible locations for the new PSC. It will likely be considering space in the Eisenhower Avenue, Duke Street or West End sections of Alexandria, all areas with rapidly increasing traffic congestion problems.

F. Sewers

The proposed budget provides continued and substantial needed funding of sanitary sewer reconstructions and extensions ($4.3 million over 6 years including unallocated funds from prior years) and various sewer rehabilitation and pollution abatement projects ($27.2 million over 6 years including unallocated funds from prior years and $1.5 million in EPA grants).

As we stated in our report last year, BFAAC supports the goal of making the sanitary sewer system financially self-sufficient through phased-in collection of additional fees. Current estimates are that sewer operating costs and debt service on borrowings for capital improvements will be fully fee-supported by FY 2007. In our report on the Debt Policy Guidelines (Budget Memo #4, March 2004), we concluded that the sewer fees and sewer capital projects funded by the fees may be excluded from the Debt Policy Guidelines at such time that the additional fees are completely phased in and the system is fully fee-supported.

G. Unfunded Capital Projects

Each year there are many capital project requests that are not able to be funded. More than 70 projects recommended through preliminary budget review are not included in the CIP in this budget cycle and must be deferred. We highlight below some of the major projects from the list on pages 7-9 of the proposed CIP budget.

- New ACPS Administration Building. Discussed above in section A.3.

- Lower King Street. Flood mitigation solutions may be requested following completion of the currently funded planning study.
- Design and construction of a Citywide Sports Complex. This project is still in the conceptual stage. It appears that some private funding may be available.
- Improved Visitor Center. Improvements may be made to Ramsey House or 132 North Royal Street.
- Construction of a new fire station. As we noted in prior reports, calls have been made for increased fire services, particularly in the Potomac Yards and Eisenhower areas.
- Construction of a covered DASH storage facility including roof over buses. Discussed above in section C.
- Metrorail and Metrobus Infrastructure Renewal and additional needs. Discussed above in section C.
- Landmark Mall infrastructure improvements. These improvements would be undertaken in connection with the planned major redevelopment of Landmark Mall.
- Replacement of City Emergency-911 System. The replacement would follow completion of the currently funded planning study.
- Additional DASH buses at $311,000 per bus, plus additional costs for staffing maintenance, fuel, etc. Discussed above in section C.

We observe that Council previously approved initial funding for the Alexandria Capital Development Foundation. The Foundation was incorporated as a Virginia non-profit and has begun organizing for the purpose of raising private money to be used for capital projects in the City. It is too early to tell what impact the Foundation might have, but it is possible that it could one day serve as a non-City source of needed capital funds, enabling the City to undertake projects that would otherwise go unfunded.

H. Debt Policy Guidelines

Assuming Council updates the debt-per-capita indicator (as recommended below), the proposed CIP would keep the City within all the targets of its debt-related financial policy guidelines. These guidelines were designed to help the City maintain fiscal discipline as evidenced by the maintenance of its double triple A bond rating.

The City's Debt 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 guidelines were developed with an eye toward maintaining the City's double triple A bond rating. The double triple A rating gives the City some slight economic savings due to the lower interest rate afforded such bonds; however, the rating is most significant as an objective, independent marker of the City's creditworthiness and fiscal discipline.

BFAAC strongly supports efforts to remain within all of the City's Debt Policy Guidelines. Meeting the guidelines provides several necessary assurances:

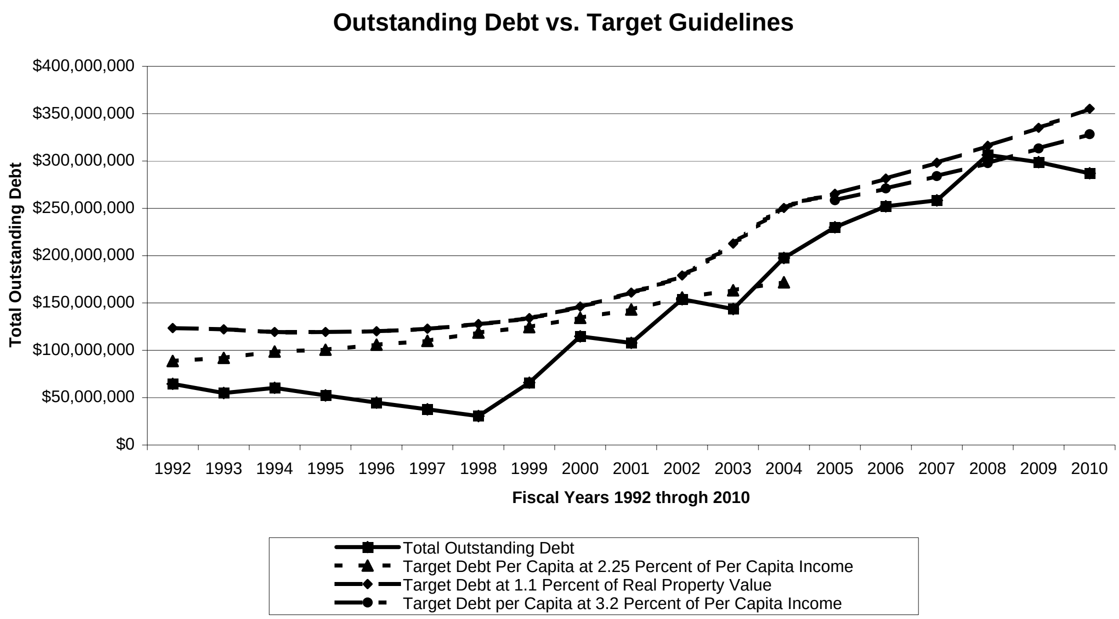
- The City's net borrowing does not exceed our fiscal capacity as determined by the wealth of our City (as measured by fair market real property values) and the income of our City residents (as measured by their per capita income);
- Debt service costs do not impose too great a burden on our future operating budgets (as measured by debt service as a percentage of total expenditures); and
- Adequate fund balances are available to cope with unexpected financial problems or emergencies (as measured by fund balances as a percent of total revenues).

BFAAC recommends that Council revise its guidelines, as described in Budget Memo #4, to resynchronize two of the indicators—debt as a percentage of fair market real property value and debt per capita as a percentage of per capita income. Furthermore, BFAAC continues to recommend that Staff periodically survey other double triple-A jurisdictions to ensure that the City's Debt Policy Guidelines remain in line with the average of these jurisdictions.

The target figures for Alexandria's Debt Policy Guidelines were based on research in 1997 that set them at levels equal to the average of other jurisdictions with double triple A bond ratings. The key target chosen at that time was the one showing debt as a percentage of fair market real property value. It was set at 1.1 percent to match the average of other jurisdictions with double triple A bond ratings. Since comparable data was not available at that time with respect to debt per capita as a percentage of per capita income, this guideline was set at 2.25 percent so that both guidelines produced a similar target for total debt issued. The limit for these 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 FY 2000, however, the two guidelines have diverged as increases in real property values in Alexandria have greatly outpaced increases in per capita income.

During the FY 2004 budget process, BFAAC noted this growing divergence and recommended that Council update the City's Debt Policy Guidelines to resynchronize them. To do so, BFAAC recommends setting the target debt per capita at 3.2 percent of per capita income, and the limit at 4.5 percent. (Rates tentative pending ongoing staff review of other jurisdictions.)



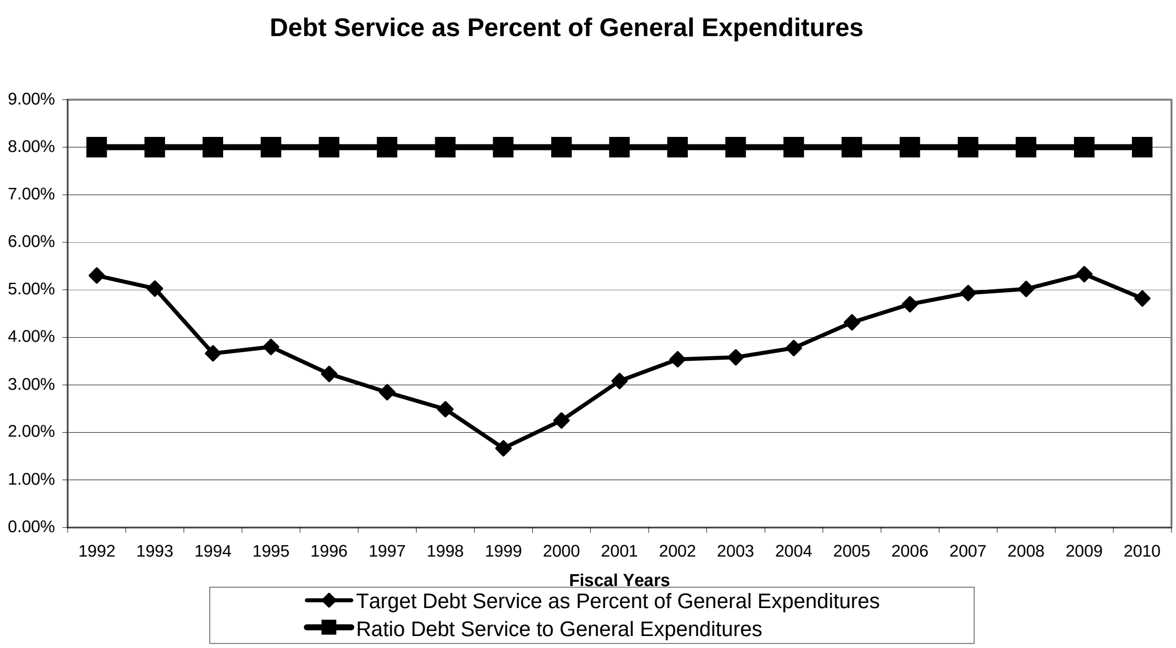
A number of observations can be made from the above chart:

- The target amount of debt as a percentage of real property value increased dramatically between FY 2000 and FY 2004 thanks to the remarkable surge in real property assessments.
- The target amount of debt per capita as a percentage of per capita income shows a much more gradual and steady increase over the years. (The jump in FY 2005 is a result of increasing the target debt per capita from 2.25 percent of per capita income to 3.2 percent).
- The total outstanding debt in this chart excludes sanitary sewer capital debt beginning in FY 2007, as per BFAAC's recommendation that sanitary sewer debt may be exempted from debt limits once sanitary sewer costs are fully fee-supported. According to Staff estimates, this exemption frees up $3.37 million in FY 2007, $5.14 million in FY 2008, $7.55 million in FY 2009 and $8.45 million in FY 2010.
- Even with the revised guidelines, and the exclusion of sewer debt, the total outstanding debt is projected to bump up against both targets in FY 2008. Without the revised guidelines, the outstanding debt would be in excess of the per capita income target, and up against the per capita income limit. A declining real estate market or cost over-runs on current projects could be especially troublesome.
- Projections of the rate of increase in future real estate assessments and per capita income are crucial to whether total outstanding debt will continue to remain under these targets. The out-year projections for real property value assume that assessments will increase by 6 percent per year through FY 2010. The out-year projections for per capita income assume that income will increases by 4.2 percent per year through FY 2010. These rates of increase represent historical averages for the prior ten years.

Given the scope of the projects which have not been included for funding in the 2005-2010 CIP, the demand for capital spending is likely to exceed the $227.6 million identified in the out-years of the proposed CIP. Beginning in FY 2009 the City should have additional capacity to borrow (approximately $15 million in FY 2009 and $50 million in FY 2010) and still remain within its Debt Policy Guidelines.

The graph below shows Alexandria's past and predicted future performance against another debt-related financial policy guideline. This one is designed to ensure that debt service costs (principal and interest payments) that absolutely must be paid do not impose too great a burden on our future operating budgets (as measured by debt service as a percentage of total expenditures). This target was set at 8 percent in 1997 to approximate the average of other jurisdictions with double triple A bond ratings.

Because the City has used pay-as-you-go cash capital to finance a large share of its CIP, the City's debt service levels are comfortably below the 8 percent target for the foreseeable future. (Predictions of future debt-service expenditures come from the City Manager's long-range budget scenarios.) Assuming the fiscal capacity of the City continues to increase (in other words, assuming property values and per capita income continue to rise), the City is well positioned to borrow additional funds after FY 2009 (approximately $15 million in FY 2009 and $50 million in FY 2010) and still remain within all of its Debt Policy Guidelines.



Over time, the City has been spending an increasing amount on cash capital and debt service. BFAAC urges Council to continue to weigh its financing choices carefully—the timing of borrowings, the maturity of bonds to be offered and the amount to be funded through cash capital contributions—so as to consider the CIP's impact on the operating budget and current residents, while at the same time, preserving the City's sound financial condition.

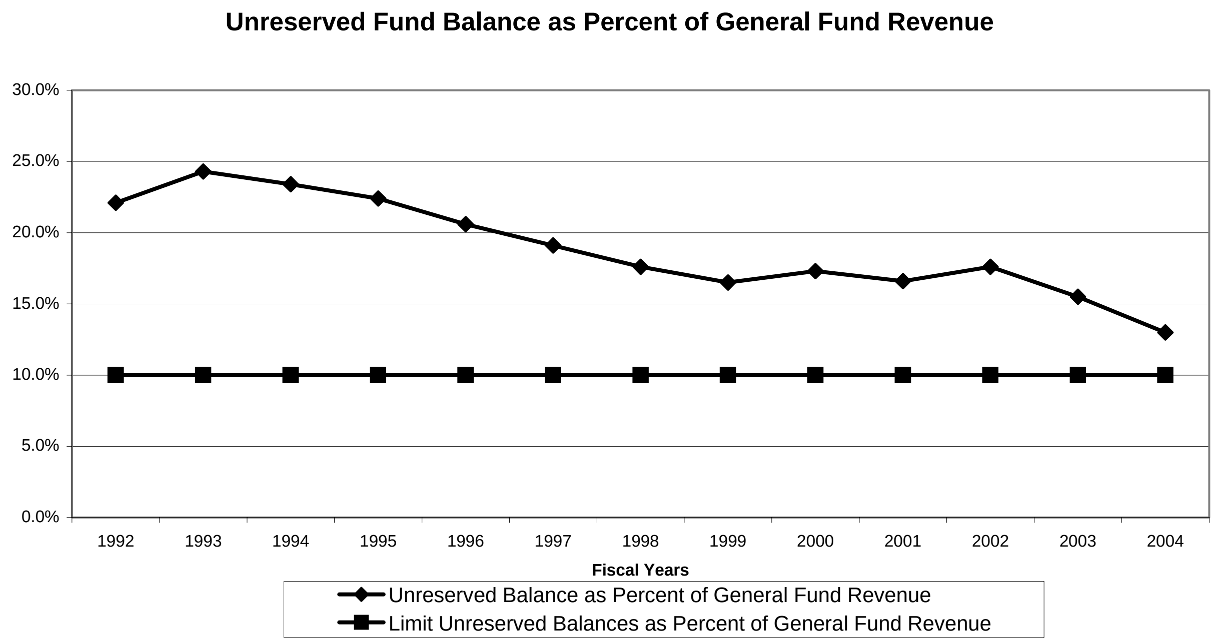
To give a more complete picture of the CIP's impact on the City's operating budget, the following chart examines the combined debt service and cash capital contributions as a percentage of the total operating budget, including cash contributions from fund balance which result from prior year budget surpluses. As long as real estate values continue to increase at rates higher than those predicted in proposed budgets, these budget surpluses are a real possibility. (They have averaged nearly $10 million per year since 1995.) BFAAC continues to prefer designating these surpluses for future cash capital contributions— "one-shot" revenues should not be used to pay ongoing and recurring expenses.

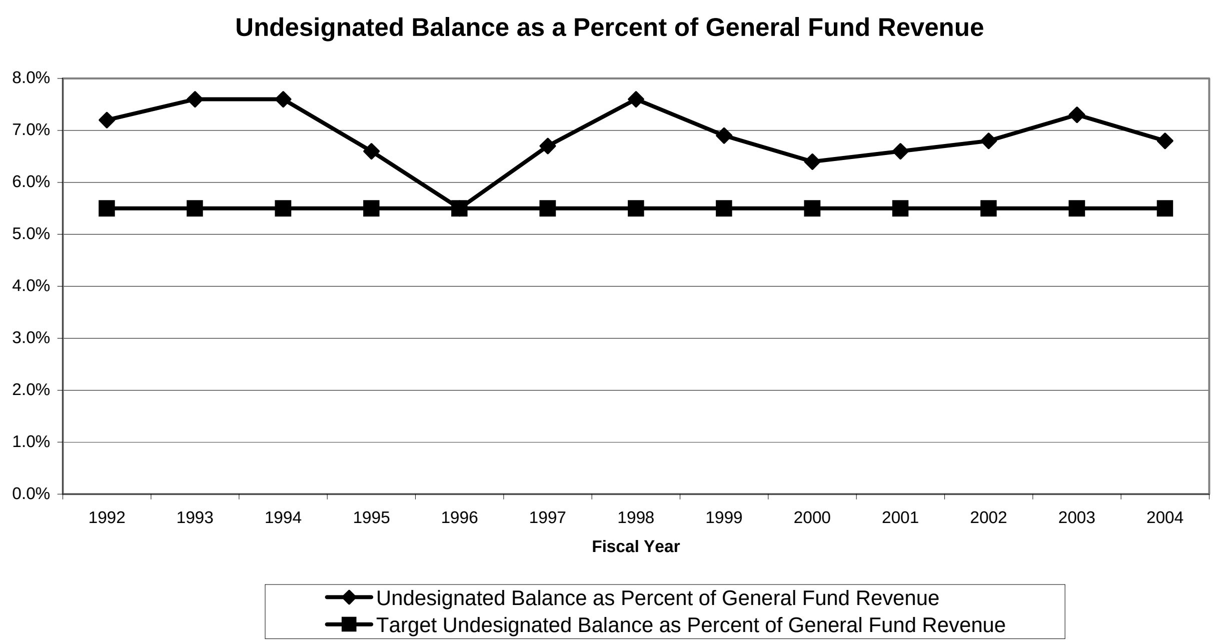
In future years, the City may be able to plan larger cash capital contributions and still balance the operating budget. This approach does not commit the City to actually making these cash capital contributions until later, so if the City's economic outlook unexpectedly deteriorates, the contributions could be directed to meet other needs (and the City could reduce or postpone planned capital projects).

There are several benefits to funding a significant portion of the CIP using pay-as-you-go cash capital. It helps keep debt low and it provides financial flexibility in the event of a sudden revenue shortfall.

FY	General Expenditures	Debt Service Expenditures	Planned Cash Capital Contributions	Additional Contrib from Fund Balance	Total Cash Contribution	Cash Plus Debt Service	Cash+Debt Svc as % of Gen Exp
1993	$271,404,113	$13,640,181	$6,903,140	$0	$6,903,140	$20,543,321	7.57%
1994	$280,836,633	$10,283,070	$4,355,516	$15,048,645	$19,404,161	$29,687,231	10.57%
1995	$290,760,163	$11,050,739	$0	$13,641,592	$13,641,592	$24,692,331	8.49%
1996	$312,902,626	$10,112,095	$0	$9,869,533	$9,869,533	$19,981,628	6.39%
1997	$326,248,912	$9,289,745	$0	$5,435,196	$5,435,196	$14,724,941	4.51%
1998	$354,805,740	$8,827,610	$0	$5,615,893	$5,615,893	$14,443,503	4.07%
1999	$380,736,909	$6,350,549	$2,477,063	$8,682,202	$11,159,265	$17,509,814	4.60%
2000	$393,588,056	$8,866,071	$7,351,063	$14,512,259	$21,863,322	$30,729,393	7.81%
2001	$401,555,221	$12,382,315	$9,846,000	$17,451,193	$27,297,193	$39,679,508	9.88%
2002	$452,671,072	$16,015,996	$12,000,000	$7,920,000	$19,920,000	$35,935,996	7.94%
2003	$488,044,085	$17,483,024	$14,200,000	$11,900,000	$26,100,000	$43,583,024	8.93%
2004	$499,069,857	$18,842,371	$16,955,000	$4,200,000	$21,155,000	$39,997,371	8.01%
2005	$524,023,350	$22,620,329	$19,496,000	$7,536,116	$27,032,116	$49,652,445	9.48%

At the same time, the City must be mindful that today's taxpayers should not have to pay more than their share for benefits which will also be enjoyed by future residents. In previous years, BFAAC has recommended using debt financing for assets with a useful life of more than five years and cash capital to pay for short-lived and maintenance-oriented projects. This way, taxpayers who are benefiting from the asset would more likely be the taxpayers who are paying for the asset.





Current fund balances continue to remain above the targets specified in the City's Debt Policy Guidelines. Maintaining these balances is prudent, as well as necessary; therefore BFAAC cautions against planning to use these reserves to fund operating expenses or debt payments.

To make certain the City maintains adequate fund balances to cope with emergencies or unexpected financial problems (like revenue shortfalls or unanticipated expenditures), the City's Debt Policy Guidelines also specify that (1) the unreserved fund balance remain above 10 percent of the general fund revenues and (2) the undesignated portion of the unreserved fund balance remain above 4 percent and preferably above 5.5 percent of general fund revenues. This undesignated balance is the equivalent of the checkbook balance of the City of Alexandria.

The graphs above show that current fund balances as a percent of general fund revenues continue to remain above the target percentages specified in the guidelines. Maintaining this balance is prudent, as well as necessary, therefore BFAAC cautions against planning to use these reserves to fund operating expenses or debt payments; doing so would only postpone the inevitable need to solve structural budget problems—that ongoing expenditures are exceeding recurring revenues. In fact, Council has adopted a policy to not finance operations from fund balances for periods longer than two years.

II. THE PROPOSED OPERATING BUDGET

The proposed FY 2005 General Fund Operating Budget totals $433 million, an increase of $35.1 million, or 8.8 percent, over the Approved FY 2004 Operating Budget. Of this increase, $19.0 million is for City operations, $11.4 million for public schools, $4.1 million for debt service and cash capital, and $0.6 million for contingent reserves. BFAAC focused its review of this year's operating budget on the following areas---personnel expenditures generally, benefits generally, retirement plans, COLAs, new hires, contracting-out/hiring-in, agency audits, schools, affordable housing, performance measurements, across-the-board spending reductions, the impact of the capital budget on the operating budget and the Small Business Development Center.

A. Personnel Expenditures Generally

Overview

Compensation of City and public school employees, including both salaries and benefits, accounts for most of the City budget and that percentage is increasing. If the City Council chooses to look for opportunities to reduce proposed spending, personnel expenditures should be examined. That examination should include benefit changes, proposed new hires and a review of whether some agencies have excess administrative personnel.

Discussion

Personnel expenditures account for 71.7 percent of the total proposed FY 2005 budget---84.5 percent of the ACPS budget and 64.3 percent ($334.9 million) of the City budget. Nearly $7 million of the increase in the Proposed FY 2005 budget, when compared to the FY 2004 budget, is attributable to personnel-related expenditures.[1]

BFAAC has noted in its reports on the FY 2002, 2003 and 2004 proposed budgets that compensation and benefit costs continue to absorb an increasingly large percentage of the operating budget. Recent figures provided by the City Manager to Council buttress that contention: over the last five fiscal years, personnel-related costs increased by an annual average of 3.2 percent for existing staff; ACPS compensation increases accounted for 6.1 percent of its budget rises over the same period.[2]

More importantly for the City's financial outlook, those costs are expected to rise for the foreseeable future, both in absolute amounts and as a percentage of the operating budget. The City Manager recently stated that City personnel costs are expected to increase by 3.5 percent and ACPS personnel costs are expected to increase by 8.0 percent in FY 2005 just to maintain current services and programs.[3]

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[1] Budget Memo #16 (March 26, 2004).

[2] Budget Memo #21 (April 1, 2004).

[3] Id.

Increasing real estate tax bills create understandable public support for reductions in the real estate tax rate and, as noted elsewhere in this report, the prospects for inter-governmental payments to the City are highly uncertain. These developments naturally compel the City to look at City expenditures for possible reductions.

As noted elsewhere in this report, BFAAC supports the proposed Capital Improvement Program for FY 2005 and would oppose any significant reduction in the CIP budget.

Conclusions and Recommendations

BFAAC therefore believes that any spending reductions considered by Council in the proposed FY 2005 budget should be focused on the Operating Budget.

BFAAC also believes that, as by far the largest component of the Operating Budget, personnel expenditures should be closely scrutinized for potential spending reductions.

B. Benefits Generally

Overview

BFAAC is concerned that Alexandria is a leader when it comes to employee benefits. Providing fully City-funded health, retirement and disability benefits to all non-public safety employees puts dramatic pressure on the City's operating budget, and will continue to do so for the foreseeable future.

The City has reduced the rate of health insurance cost increases through negotiations with providers. However, BFAAC believes the City needs to undertake more cost-containment measures. Some members of Council expressed the same concern at the March 16, 2004 budget work session, questioning whether the City should explore employee cost-sharing. BFAAC agrees and recommends that Council and Staff investigate and pursue cost-mitigation strategies including employee cost-sharing. BFAAC does not take a position on whether that cost-sharing should come in the form of employee contributions to retirement and/or health insurance, increased out-of-pocket expenses and/or health insurance premiums, or other strategies.

Discussion

The major driving forces behind the increases in personnel expenditures are compensation increases (in the form of merit pay and cost-of-living adjustments) and the costs of employee and retiree health insurance. The latter is increasing faster than compensation: During FY 2002 health insurance costs increased by 21 percent; the City Manager's Proposed FY 2005 Operating Budget anticipates another 12 percent rise in the costs of City employee and retiree health insurance. The City Manager proposes to spend an additional $1.7 million in FY 2005 for City-provided health insurance to employees and retirees.[4] The cost of providing health insurance to ACPS employees is expected to increase by 10 percent, or $640,000 in FY 2005 alone.[5]

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[4] Id.

[5] Budget Memo #17 (March 25, 2004).

The City's overall compensation philosophy when it comes to salaries often has been summed up as: "Neither a laggard nor leader be." As a general rule, that is an excellent philosophy, and one which BFAAC has endorsed in the past and continues to do so. It enables the City to attract qualified candidates for vacant and new positions, to keep its attrition rates below those of neighboring jurisdictions, and helps improve employee morale and, thus, productivity. The City has done an admirable job of neither leading nor trailing when it comes to compensation.

That having been said, BFAAC is concerned that Alexandria is in fact a leader in the field of City-funded employee benefits, as contrasted with pay. An assessment of medical benefits offered to City employees compared with that of neighboring jurisdictions conducted by the City's benefit consultant, Buck Consultants, which indicated that: Alexandria employees pay a lower percentage of medical premiums; the rate of City-paid premium subsidies are the highest; and Retiree premium subsidies are higher than average.[6]

There are indications that this trend is continuing. The City Manager recently told employee representatives that, while the City strives to maintain comparability with neighboring jurisdictions when it comes to pay, we lead in terms of benefits. In fact, the City pays the entire cost of basic employee health insurance, disability insurance and retirement.[7]

Several members of Council recently questioned the City's policy of providing fully-funded health insurance and other benefits. Some members implicitly suggested that the City explore employee cost-sharing. BFAAC agrees with those questions and comments, and recommends that the City investigate such cost-containment strategies.

In that respect, the City is not only leading among nearby public sector employers, but also is leading among private employers as well. BFAAC acknowledges that there are fundamental differences between private- and public-sector employers. However, the City does target some recruitment efforts at people currently employed by private-sector companies. Thus, it is instructive to examine benefit policies among that potential pool as well.

The most recent Kaiser Family Foundation survey of employer health benefits found the following:

- Workers generally face higher health insurance premiums and higher cost sharing[8]
- The average single premium costs range from a low of $3,268 for POS to a high of $3,576 for conventional coverage; family rates range from $8,514 for an HMO to $9,317 for a PPO.[9]
- The average monthly employee contribution to health insurance coverage during 2003 was $42 for single coverage and $201 for family coverage.[10]

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6 BFAAC Report on the City Manager's Proposed Budget for Fiscal Year 2003, p. 18.
7 City Manager Sunderland, Budget Work Session, March 16, 2004.
8 Kaiser Family Foundation, "Employer Health Benefits: 2003 Summary of Findings," p. 1.
9 Id.
10 Id., p. 2.

- 96 percent of all employees make co-payments; 92 percent contribute to their family premium; 86 percent of plans had tiered cost-sharing for prescription drugs; 79 percent of plans have a deductible; 76 percent require worker contributions to single coverage premiums; 44 percent have a separate deductible for hospitals.[11]

BFAAC recognizes that the City's larger benefits package helps attract and retain staff. Therefore, it cannot be viewed strictly as a fiscal issue, but also must be considered in the context of employee recruitment and morale.

Conclusion and Recommendations

Recognizing that the rapid increase in insurance rates for employee benefits is a part of a much larger problem of rising health care costs nationwide, BFAAC recommends that the City investigate health insurance cost-containment strategies, including employee cost-sharing.

BFAAC recommends the City include in the budget a detailed analysis of the current and future projected costs of employee health care coverage.

In its report on the FY 2003 budget, BFAAC recommended that the City "include in its annual budget presentation a detailed analysis of the eligibility, coverage, current and projected cost of [employee] health care coverage."[12] That language was repeated virtually verbatim in the report on the proposed 2004 budget.[13] Including such a presentation will allow Council to see the long-term fiscal implications of the City's generous benefit policy, and to plan for such costs accordingly.

BFAAC once again strongly recommends that the City include in its budget a detailed analysis of employee health care eligibility, employee health care coverage, and both current and future projected costs of such coverage.

C. Retirement Plans

Overview

The recent decision to change the retirement plan for Alexandria police and firefighters goes against the recent nationwide trend away from "defined benefit" retirement plans and towards "defined contribution" retirement plans. BFAAC urges caution before implementing any further changes towards defined-benefit plans because those plans impose a greater financial risk to the City in the long term.

Discussion

The trend in private and public sector retirement plans in recent years has been steadily away from "defined benefit" plans and towards "defined contribution" plans. Defined-contribution

[11] Id., p. 3.
[12] BFAAC Report on the City Manager's Proposed Budget for Fiscal Year 2003, pp. iv, 15.
[13] BFAAC Report on the City Manager's Proposed Budget for Fiscal Year 2004, p. 15.

plans give more power to employees to decide how their retirement funds will be invested, but transfers the risk of poor investment decisions from employers to employees.

Some state and local governments have recently begun to rethink their decision to favor defined-contribution plans. As the stock market boom turned into a downturn, a declining number of public employees have chosen defined-contribution plans when offered an option and many public employees are asking to return to a defined-benefit plan. Many public employees found that the investment return on their retirement savings declined when they began using a defined-contribution plan and no longer wanted to make those investment decisions.

Alexandria is one of the governments that has responded to these concerns by switching from a defined-contribution plan to a defined-benefit plan for its police and firefighters. City Finance Director Daniel Neckel was quoted in Governing Magazine as saying: "With the changes in the stock market, we started asking ourselves, why do the employees have the investment risk. Why doesn't the city have the investment risk?"

BFAAC appreciates the City's consideration of its employees' wishes on this issue. Such consideration could boost employee morale and make Alexandria a more appealing place to work. On the other hand, defined-benefit plans can impose greater financial risk to the City in the long term than do defined-contribution plans if there isn't fair cost-sharing of increased retirement costs.

Most Alexandria City and public school employees are obliged to participate in the Virginia Retirement System (VRS) defined-benefit plan, although the City funds a supplemental plan in addition to the VRS plan. State legislation would be required for Alexandria to opt out of the VRS plan.

Employees of the Sheriff's office and emergency rescue technicians have a mixed defined-benefit/defined-contribution plan. Alexandria police and firefighters now have a mixed plan, but new hires cannot participate in the old defined-contribution plan.

Conclusions and Recommendations

BFAAC is concerned about the City expanding defined-benefit retirement plans for City employees because of the long-term financial risk to the City from such plans. BFAAC encourages the City to offer employees a mix of retirement plans that includes defined-contribution plans to reduce the City's financial exposure and give more power over their retirement investments to City employees.

BFAAC also encourages the City to explore increasing the employee contribution share towards all retirement plans for the reasons discussed in the previous section on "Benefits Generally."

D. Cost of Living Adjustments (COLAs)

Discussion

BFAAC believes that cost-of-living adjustments (COLAs) should be given on a regular basis and that they should correspond as closely as possible to actual increases in the cost of living. These adjustments are designed to keep the buying power of compensation constant and City employees have a legitimate expectation that they will receive them and that they will be set at a reasonable level.

In 1990-93, the City's COLAs were well below the inflation rate at the time (see page 4-81 of the Proposed Operating Budget), but since then, the City has done a reasonable job of matching the inflation rate. The City Manager has once again set a reasonable rate of 2.0 percent this year. The City conducts a benchmark study every five years (and will do so again next year) in which it compares how well Alexandria has been keeping pace with nearby jurisdictions in keeping compensation levels in line with increases in the cost of living and adjusts City pay scales if we have fallen behind.

Conclusion and Recommendations

BFAAC recommends that the City Council approve the COLA of 2 percent in the City Manager's proposed budget.

E. New Hires

Discussion

The City Manager's Proposed Operating Budget proposes the hiring of 23 new personnel and the elimination of four positions, for a net increase of 19 employees, from 4,391 employees in FY 2004 to 4,410 employees in FY 2005. This increase follows a net increase of 180 employees over the last three years, from 4,211 employees in 2001 to 4,391 in FY 2004. These new hires include six positions in the Fire Department, six positions in the Mental Health, Mental Retardation and Substance Abuse Department, three positions in the Police Department, two in the Library System, two in Planning and Zoning, and one each in Finance, Transportation and Environmental Services, Human Services and the Sheriff's office.

BFAAC shares the concerns expressed by some Members of Council about whether all of these positions need to be filled by new, outside hires. City agencies may have expertise among existing staff who could perform the tasks envisioned for some of these new hires. City agencies could be encouraged to intensify their efforts to redesign their work systems in ways that make greater use of labor-saving technologies and to engage in closer cooperation with other City agencies. The performance measurements in the Proposed Budget could help indicate if the workload of these departments suggests the need for additional staffing.

BFAAC reminds Council that new hires cost the City far more than their base pay. These costs include health benefits (which, as noted earlier, have risen sharply and will probably continue to rise in the coming years), retirement benefits, training costs, increased office space and support, new equipment and increased workers' compensation, to name but a few.

Conclusion and Recommendations

BFAAC recommends that City Council closely scrutinize the proposed new hires in the Proposed Operating Budget because of the significant financial commitment the City undertakes when it hires additional personnel.

F. Contracting Out/Hiring-In

Overview

The City Manager has proposed to contract-out the City's household recycling collection program and to take in-house the Alexandria Health Department's mosquito prevention program. Both proposals will apparently result in cost savings to the City.

Discussion

The City Manager estimates that contracting-out the recycling program will result in a net cost to the City of $497,000 in FY 2005, while saving the City a net cost of $534,000 as a result of the elimination of 12 equipment operator and refuse collector positions, for a net saving in the FY 2005 Operating Budget of $37,000.[14] In addition, the City will realize additional long-term savings because it will no longer need to replace and maintain its fleet of three recycling vehicles and acquire a fourth crew and vehicle to handle the increased travel times for delivering recycled materials to a new, more distant facility that the City would be required to use. Contracting-out this service will also allow the City expand service to new residential developments at an incremental contract rate instead of having to add new City personnel and vehicles.

The City Manager has stated that taking the mosquito prevention program in-house will save the City $72,262 in FY 2005. The approved FY 2004 budget for Environmental Health is $353,603, which includes $346,253 for the annually-negotiated contract with Clarke Mosquito Control. The Health Department proposes to perform this service in-house in FY 2005 at a total cost of $281,341.[15]

BFAAC believes that all decisions about contracting-out versus performing services in-house should be decided by a careful cost-benefit analysis. That analysis should look not only at one-year savings but also at long-range considerations. Contracting out the recycling program will save the City the cost of purchasing an additional recycling vehicle and operating and maintaining four such vehicles. On the other hand, having more work performed by City employees increases the liability risk to the City from actions performed by City employee-"agents" rather than by "independent contractors." BFAAC believes that the contracting-out of the recycling program and the taking-in-house of the mosquito prevention program both appear to be cost-effective initiatives.

Conclusion and Recommendations

BFAAC recommends that the City Council approve the City Manager's proposals to contract-out the household recycling collection program and to take in-house the mosquito prevention program.

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14 Budget Memo #57 (April 19, 2004).

15 Budget Memo #22 (April 1, 2004)..

G. Agency Audits

Discussion

BFAAC is concerned about repeated suggestions that some City agencies have excessive numbers of administrative and supervisory personnel. The financial burden to the City of extra personnel, discussed earlier, is especially acute in the case of administrative and supervisory personnel because they tend to be more senior and highly-compensated than most City employees.

BFAAC is not in a position to assess the accuracy of these concerns. We believe that any cursory analysis of this question would run a great risk of being misleading. The relative need for significant numbers of administrative personnel would vary greatly among various agencies and departments. Attempts to compare Alexandria agencies with the agencies of other jurisdictions would probably encounter great difficulties in collecting truly comparable data.

In recent years, several City programs, including youth programs and mental health services, have undergone intensive audits, with the active engagement of agency employees, interested citizens, Council Members and outside experts. BFAAC believes that the best way to determine if some City agencies have excess administrative personnel would be through individual, one-at-a-time, intensive audits of those agencies, with the assistance of expert, outside counsel. Such intensive audits could also identify other possible cost-savings through program efficiencies.

Conclusion and Recommendations

BFAAC encourages the City and ACPS to initiate a long-term series of intensive audits of individual City agencies and programs to identify potential cost savings, including possible savings through the reduction in the number of excess administrative personnel.

H. ACPS Operating Budget

Background

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), a total of 18 institutions. As of FY 2004, 12 of the 16 schools (the State counts T. C. Williams, Minnie Howard, and STEP as 1) reached or retained State accreditation and 4 more schools are provisionally accredited. Of these 4 schools, George Washington Middle and Patrick Henry Elementary narrowly missed and are expected to attain accreditation soon. Students improved their passing rates in 18 of 25 categories on the SOL tests in 2003. Eighty-one percent of T.C. Williams graduates attend post-secondary education at more than 110 universities and colleges.

School Board Approved Operating Budget

The School Board's Approved Operating Budget for FY 2005 totals $156.1 million. Of that amount, the City's requested appropriation is $131.2 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 ($21.7 million), Fund Balance ($2.4 million) and

Miscellaneous Federal Funds ($0.7 million). The School Board's budget focuses on student achievement and includes $365,105 for a modified school calendar at Samuel W. Tucker Elementary School; $1,828,464 for expansion of the laptop initiative at T.C. Williams to grades 10-12; and $318,732 to provide math specialist services at all elementary schools.

City Manager's Proposed Funding for the ACPS

Under the City Manager's proposed budget, the City's General Fund appropriation to the ACPS is $132.6 million, which includes a 2 percent COLA for school employees. The City's appropriation is an increase of $11.4 million over FY 2004, which represents a 9.4 percent increase over last years' City appropriation of $121.2 million. The City Manager's proposed budget funds 99.3 percent of what the School Board requested. The City Manager withheld $960,000 from the School Board's request and in Budget Memo #17 (March 25, 2004) explained that the School Board would have to prioritize the $4 million in new initiatives within the $3.1 million the City Manager's budget allocates to fund them.

Virginia Retirement System Calculation and Its Impact on the Budget

What the City Manager proposes to take away, Budget Memo #17 says the State will give back. The School Board's approved budget included $3.52 million to cover an estimated increase in the VRS contribution rate from the current rate of 3.77 percent to 7.82 percent. The higher rate was one originally proposed by Governor Warner, but one that is no longer "on the table" in the current round of negotiations over the State's budget. The Senate and the Governor have proposed a rate of 6.56 percent; the House has proposed a rate of 6.03 percent. The net effect of either rate would be to lower the amount the School Board has to contribute to VRS by more than $1 million. As stated in Budget Memo #17, "The City Manager has proposed to the City Council that it allow the ACPS to keep up to the $960,184 in savings should this lower rate materialize." BFAAC supports the City Manager's position.

The Committee is also mindful of the fact that the schools may need to make programmatic funding decisions before the House, Senate and Governor resolve their differences and pass a budget. This is a highly unusual situation that calls for creativity on the part of City Council. If it appears likely to Council (as it does to the City Manager) that the VRS rate ultimately included in the State budget will be lower than that in the ACPS budget, then Council should create a way for the schools to be treated as fully funded so that the schools do not have to make programmatic cuts now that could be moot tomorrow.

Because the VRS contribution rate ultimately agreed to by the State will likely result in a savings of more than a million dollars in the ACPS budget, BFAAC recommends that the City set aside for possible use undesignated reserve funds to make up the shortfall in the School Board's Approved Operating Budget pending passage of a State budget.

Enrollment and Staffing

The FY 2005 budget is based upon an average daily membership (ADM) of 10,704, a decrease of 58 students compared to the ADM of 2002-2003. Of those students, the demographics are: 43.04 percent Black; 26.97 percent Hispanic; 23.04 percent White; 6.70 percent Asian/Pacific Islander and 0.28 percent American Indian/Alaskan Native. The number of students enrolled in ESL continues to increase and now comprises 24.4 percent of the student body. The number of students requiring extraordinary services continues to be over 50 percent of the ACPS student body.

The City Manager's Proposed FY 2005 Operating Budget notes there is "expectation that [Alexandria City Public Schools] enrollment will continue to decline."[16] As this appears to be the trend, and assuming that enrollment continues to decline, it is incumbent that future budgets reflect this fact, while still focusing on pupil development and progress on both Standards of Learning exams and fulfilling Federal mandates contained with the "No Child Left Behind" law.

Together with compensation and benefits, staffing levels should be reviewed. BFAAC supports the formula-based staffing system with the Board-targeted classroom size of 20. Since the program was initiated in fall 2002, BFAAC recommends that analysis of the data regarding actual class size be undertaken and compared with the reserve requirements. Also, it appears that whereas instructor staffing levels have decreased along with decreasing enrollment, non-instructor administrative staff levels have not decreased. This is particularly true at ACPS headquarters. BFAAC recommends those staffing levels also be analyzed.

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

BFAAC supports the formula-based staffing system, but recommends that ACPS analyze administrative staffing levels, particularly at ACPS headquarters, in light of recent enrollment decreases.

Compensation

Providing a quality public education is a labor-intensive business. Eighty-six percent of the entire school operating budget is comprised of salaries and benefits. As such, the increase in the City's proposed appropriation to ACPS is largely attributable to compensation initiatives: a 2 percent COLA ($2.3 million), merit and step increases ($3.2 million), realignment of support staff salaries to market standards ($500,000), Virginia Retirement System contribution ($3.52 million), and increased health insurance contribution to offset the rising cost of health insurance ($640,000).

BFAAC has expressed its concern about the growing costs of compensation and benefits for City workers. This concern also exists with ACPS. These cost items accounted for a substantial part of the 9.4 percent increase given the schools in the FY 2005 Proposed Budget. The major driving forces behind the increases in personnel expenditures are compensation increases (in the form of merit pay and cost-of-living adjustments) and the costs of employee and retiree health insurance plans, with the latter increasing faster than compensation. The City's 2002 Annual Report noted that the need to keep ACPS employees' compensation competitive "will create budget pressures" during the out-years. The new salary structure put in place by the School Board in FY 2004 largely addressed the need of "comparability." BFAAC sends a

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[16] City of Alexandria, "Proposed Operating Budget FY 2005," p. 9-8.

cautionary note to the City regarding growing compensation costs during its discussions of implementing the School Board's compensation plan.

BFAAC endorses the Performance Evaluation Program.

BFAAC applauds the continuation of the Performance Evaluation Program (PEP) and the expansion to include all professional staff on the same evaluation system. With the concern of compensation and benefits pressure on the current and future budgets, staff performance must be evaluated against a qualitative and quantitative performance measurement system.

I. Affordable Housing

Overview

Although the City offers numerous affordable homeownership programs, there appear to be not enough properties in our market to meet the need. As a result, BFAAC recommends that the City review all relevant programs for their effectiveness in light of the current housing and real estate market.

Discussion

Last year BFAAC endorsed the proposed expansion of Tax Relief Grants as a way to alleviate the challenging task of funding affordable housing in the face of many other demands on City resources. In conjunction with these Tax Grants, the City also offers several alternatives to promote affordable housing including financial assistance to income-eligible, first time homebuyers funds through the HAP (Homeownership Assistance Program) and MIHP (Moderate Income Homeownership Program) and The American Dream down payment initiative, all of which have received increased funding in recent years.

The Employer Assisted Housing Program implemented in 2002 in conjunction with the Alexandria Chamber of Commerce, the Alexandria Economic Development Partnership and the FannieMae Northern Virginia Partnership Office promotes homeownership. Individual employers will determine the type of homeownership benefit to be provided. The City will support the program by offering targeted homeownership counseling services to employees of financially participating employers at their work site or at another convenient location. Eligible employees can also participate in the HAP and MIHP programs unless they are ineligible. Then the City will match on a 1:2 basis contributions to participating employers who provide financial assistance to their employees. At this time, according to the Office on Housing, only one employer in Alexandria is participating in this program.

The City continually offers Housing Counseling Program providing counseling thru the application process as well as to educate applicants on all City programs.

Lastly, the City markets annually at the Homeownership Fair in a continued effort to bring together lenders, realtors, affordable housing providers, applicants and City staff.

Rather than rely solely on funding from tax relief measures or affordable housing programs, BFAAC endorses a continued approach of looking at a wide variety of potential funding sources for programs, including developer contributions, private donations, federal and state funds, regional initiatives, and innovative financing mechanisms.

Given the City of Alexandria's recent dramatic increases in property values, affordable homeownership in the City is becoming even less available and attainable to families and persons of modest means. While the need for assistance from the City to relieve the situation is more critical than ever, so perhaps is assistance in locating properties that qualify for the guidelines that are set forth in the parameters of the existing programs. BFAAC encourages City Council to review and support any legislation that will encourage developers to participate in providing affordable set aside units in any new or existing developments constructed in the City of Alexandria, rather than the historical cash contribution accepted in lieu of units.

Conclusion and Recommendations

BFAAC recommends that the City review its affordable housing programs, specifically the income and purchase price ceilings, in light of current market conditions.

While BFAAC has continually recommended that the City do all it can to encourage and facilitate homeownership opportunities for low and moderate income families, there does appear to be a dearth of properties that qualify for any of the City programs. Current data reflect that the average residence value is $361,040 and the City programs cap for purchase price is $225,000, a 61 percent difference on assessed value only. As a result, BFAAC recommends that the current programs (HAP and MIHP) caps be reviewed for their effectiveness relative to current market trends.

BFAAC recommends the City closely monitor the effectiveness of the housing development corporation during its first full year of operations.

BFAAC applauds the creation of an Alexandria based, non-profit housing development corporation whose purpose is to acquire, construct, and operate affordable housing in the City. We strongly advise that the City closely monitor the new Corporation as it begins it first year of existence to measure its effectiveness.

J. Performance Measurements

Overview

For much of the past six years, BFAAC has urged the City to fully adopt performance measurement standards − using both quantitative as well as qualitative indices − as a method of assisting in the budgetary process, better informing citizens of how their tax dollars are being spent and how those expenditures are improving the quality of life, and as a way of freeing managers and all employees to focus on results rather than micro-managing lower-level employees.

As noted last year, the City has made strides toward including such measures throughout the budget. But the City apparently is focused more on quantitative measurements rather than on qualitative measures. Officials of jurisdictions that use qualitative measurements have told a

BFAAC representative that such measures are extremely difficult to articulate and even harder to put into use.

The City Manager and the new Budget Director both have stated that they are interested in designing and implementing both quantitative and qualitative measurements. Council recently discussed a Proposed Resident Survey at a budget work session. Staff indicates that, while the survey is not in and of itself part of true performance measurements, it likely will be used in the process of designing and implementing a system of quantitative and qualitative indices.

BFAAC strongly supports the City's efforts in this area, and urges the City to develop and implement a full set of performance measurement standards. Understanding that it is difficult to design and put in place such standards, BFAAC stands ready and able to assist staff in developing and implement performance measurements.

Discussion

Performance measurements are the wave of the future when it comes to municipal budgeting. Jurisdictions as diverse as Prince William and Arlington Counties, New York City, and Sunnyvale (CA) have adopted performance measurement standards.

There essentially are two types of performance measurements: Quantitative standards, which provide Council, staff and citizens with a mathematical indication of how City agencies are performing (i.e., number of trees pruned, students graduating at grade-level, police and/or fire response times, etc.); and qualitative standards, which help with "assuring public funds are expended for the purposes intended" and for "improving the quality and efficiency of service delivery."[17]

In either case, performance measurements help improve government transparency, allow officials and the public to improve the way City services are provided, as well as help City officials manage resources. In addition, performance standards can assist both managers and line employees by granting them "greater freedom and flexibility to focus on results."[18]

> The power of articulating results clearly and holding people accountable for results unleashes the talent and commitment that people have when they are clear about what they are to accomplish. [True performance measurements and performance budgeting provides] not only tremendous efficiency and productivity improvement, but also tremendous quality improvement and much greater customer orientation and satisfaction . . . [19]

In addition to the benefits listed above, the Government Finance Officers Association (GFOA) has recommended that jurisdictions adopt such standards that are tied to a mission statement for each program, provide measured program outcomes, allow for

[17] City of Sunnyvale (CA), "An Overview of the City of Sunnyvale's Planning and Management System," p. 13.
[18] Id.
[19] Id., p. 14.

resource allocations over time, and measure efficiency and effectiveness for continuous improvement.

In nearly every report on the City Manager's proposed budget issued over the past six years, BFAAC has addressed performance measurements. It has recommended performance reporting as a means of establishing budget priorities (1998), establishment of a working group for reviewing ongoing services using performance reporting (1999), endorsed Council support for performance reporting (2000), reiterated BFAAC support for the concept (2001), and encouraged the City to follow the GFOA recommendations (2004).

The City Manager and new Budget Director have stated in meetings with BFAAC that they share the committee's opinion as to the importance of performance measures, and are committed to developing and implementing over time a full set of such indices.

The City has developed some performance measurements, and included those in the budget document. But those indices are quantitative and not qualitative. Discussions between BFAAC representatives and officials of neighboring jurisdictions that have fully implemented performance measurements (including qualitative standards) reveal that it is difficult to articulate adequate measurements for some public services, and it is even harder to fully implement those indices. Those officials also indicated that a first step in undertaking such a process is a citizen survey, measuring satisfaction with City services. At its March 30, 2004 budget work session, Council discussed a proposed resident survey, along the lines of the one described above.

Conclusion and Recommendations

BFAAC applauds the City for its efforts in designing and integrating performance measurements into the budget documents.

As noted in the BFAAC report on the FY 2004 proposed budget, the City has increased its use of measurements, standards and indicators in budget documents. The proposed FY 2005 budget continues that progress, by including such measures and indicators for more agencies and programs. BFAAC fully supports the City's continuing efforts to provide Council and citizens with more information about City programs and services in the form of measurements, standards and indicators.

BFAAC urges the City to fully implement performance measurements, including qualitative indices.

The City has made much progress in developing quantitative measures, but has not done so when it comes to qualitative measurements. BFAAC understands that developing, let alone implementing, such indices is extremely difficult and time consuming. Nonetheless, it is necessary to fully utilize performance measurements and, ultimately, performance budgeting.

The proposed citizen survey is a stride toward developing and implementing true performance measurements, and BFAAC praises the City for undertaking it. The City also is planning to integrate performance measures into its developing strategic plan as a means of measuring progress in accomplishing desired goals and objectives. BFAAC urges the City to fully implement performance standards.

K. Across the Board Cuts

Discussion

Across-the-board cuts are a crude budgetary tool that, if overused, can lose much of their limited effectiveness, because department managers will anticipate them when preparing their budget requests.

While using such cuts in preparing the FY 2005 Proposed Budget, the City Manager sought to avoid the dangers of this technique using innovative tools:

- He did not seek fixed reductions in City departments and agencies. Rather, he requested proposed cuts from the FY 2004 appropriations. That enabled managers to identify existing programs that could be trimmed, rather than encouraging them to build a "cushion" into their budget to avoid across-the-board cuts.
- He asked each department to provide at least half their reductions through efficiency savings, thereby sparing services, and required agencies and departments to provide no more than half of their target by reducing non-essential services. This forced department managers to be innovative, instead of proposing cuts in popular or essential programs as a way of avoiding absorbing budget reductions.
- Finally, he sought to provide an incentive for departments and agencies to save by designating a future-years' allowance of 50 percent of departmental efficiency savings, provided agencies and departments did not request significant supplemental increases in FY 2005. Managers legitimately fear that any proposed budget cuts will be absorbed into their new baseline budget, effectively punishing them for current actions. The City Manager's designated reserve reduced, if not eliminated, those fears.

Discussion and Recommendations

BFAAC recommends the City sparingly use across-the-board spending reductions, especially late in the budget process.

BFAAC believes the City Manager's technique of implementing such reductions is an interesting approach, subject to an evaluation of its impact.

L. Impact of CIP on Operating Budget

Discussion

As stated in the Capital Improvement Plan section, BFAAC fully supports the proposed CIP. We, however, repeat our cautionary note from previous reports regarding the fact that the City's growing capital program increasingly will absorb funds that could otherwise be spent on operating expenses or tax reductions.

The Proposed FY 2005 Budget calls for an 11 percent increase in debt service costs over the FY 2004 figures (from $21,299,500 to $22,876,399). It also anticipates a 12 percent increase in cash-capital costs over the same time period (from $16,995,000 to $19,496,000). In addition, future expenditure scenarios project a steady increase in both debt service and case capital costs for the next several fiscal years.

BFAAC notes that, in addition to the costs outlined above, the City will have to assume maintenance and operating costs for new and expanded schools, recreational facilities, DASH buses, information technology infrastructure and horticultural sites contained in the CIP.

A detailed review of the funding options for open space acquisition is discussed in the Proposed Capital Improvement Program portion of this report. However, once again, the long-term implications of the acquisition of open space sites include more than an assessment of the required cash capital contributions and debt service over time. The City currently has 809 acres of City-owned open space that includes 127 parks, 17 dog parks and 45 playgrounds. The cost for maintaining these sites is significant: In FY 2001, the City had 613 acres of open space and a Park Operations budget of $4.89 million. For FY 2005, the same division's proposed budget, with the additional 196 acres, is $5.86 million. BFAAC recommends that the City plan for the increased operating costs associated with maintenance of its open space acquisitions.

The CIP will put even further demands on the operating budget. Specifically, it will reduce the amount of funds available for all other governmental operations: maintaining current services and programs, expanding services and programs, creating new services and programs, maintaining or expanding employee or retiree compensation, the reserve fund, or tax rate reduction.

M. Small Business Development Center

BFAAC supports the Small Business Development Center (SBDC) and its proposed increase in funding from $40,000 to $60,000. According to a recent report by the Alexandria Chamber of Commerce, Small businesses make up the core of Alexandria's business community and the SBDC has helped local companies create 161 new jobs and retain 231 jobs in 2003. In the same year, SBDC assisted 550 businesses, which is more than one-fifth of the 2500 total businesses assisted in the last seven years. Companies they have assisted have increased their payrolls by $1.8 million, increased sales by $6.4 million and made capital investments of $10.5 million. The SBDC not only helps people start a new business but helps them arrange financing of SBA loans and holds training events year-round. The City gained over three dollars of tax revenue for every dollar invested in the SBDC, according to the Chamber report, so this is a good investment in the City's economic development strategy.

III. FY 2005 REVENUES AND LONG-TERM PROJECTIONS

Overview

As BFAAC observed in its FY 2004 report, because of the continued dominance and strength of the real property tax base, the City remains well positioned to manage its immediate fiscal challenges. The uncertainty of the Commonwealth's state aid and the federal aid contributions continue to pose troublesome revenue forecast issues. In a related matter, the long-term effects of the Commonwealth's inability to pass a balanced budget are unknown at this time. Furthermore, the continued reliance on the real estate tax base as the rate of growth in values appears to be slowing, as well as limits on the City's ability to further diversify its revenues sources, require the City to closely examine its ability to provide core services and still meet the demands of aging infrastructure.[20]

It is essential that the City Council work towards the development of a long-term Strategic Plan as it assesses the priorities of municipal government while working to meet these revenue and expenditure challenges. Decisions made in the context of FY 2005 must be sustainable in future years. Through such discipline the City will help enhance our quality of life and realize its mission of delivering excellent services for all who live in, work in, or visit our City.

A. Five-Year Forecast

While the requisite multi-year revenue and expenditure forecast scenarios provide and excellent benchmark for the City's debt-related financial policies, the continued reliance on real property revenues over the long-term is cause for concern. Currently, 54 percent of the City's revenues are attributable to real property tax receipts. Although the tax base (new construction and appreciation of existing property) increased 18.4 percent over CY 2003, it is noteworthy that this was the first time in 10 years that the rate of growth has decreased. Although it has been projected that we are likely to experience a 5-7 percent increase in growth next year, reliance on a sustained rate of double-digit growth over the long term would be misplaced.[21]

As expenses for core service needs (Public Safety, Public Health, Human Services, Education) continue to grow,[22] the additional pressures of aging infrastructure and equipment, open space acquisition, recreation facilities, etc. pose long-range challenges that must be constantly

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[20] By way of example, the Health Department (517 N. St. Asaph), the Community Services Board Clubhouse (115 N. Patrick) and Historic Alexandria (405 Cameron) are all sites that will be vacant due to physical moves. Renovations will clearly be required. Additionally, BFAAC notes that the Information Technology Services Department must continuously assess the focus of its IT Plan as the technology environment changes. New hardware, additional space, disaster recovery procedures and developing software pose significant budget issues over the long-term.

[21] In addition to Alexandria's unique attributes, the affect of historic low mortgage interest rates on the property tax base should not be underestimated. Many buyers are able to afford homes of higher value because the monthly payments are affordable; as mortgage rates rise, it would not be unexpected for high-end housing prices to stabilize as sales slow. On the other hand, if the demand for housing continues as the supply declines, prices (and assessed values) may be expected to rise. These key indicators should be monitored closely.

[22] E.g., the FY 2005 budget includes 2 additional motorcycle officers to handle increased traffic volume, 6 full-time positions to handle the 24/7 Safe Haven Program, and 2 additional positions attributed to the expansion and renovation of the Duncan Library. Moreover, the costs of maintaining current services and policies change each year due to forces outside the City's control. The additional cost for maintaining current services in FY 2005 amounts to $27.0 million or 6.8% of the FY 2004 budget.

assessed. Over a period of 10 years, the operating budget has increased by 44 percent from $300.5 million (FY 1996) to $432.8 million (FY 2005-proposed).

Consistent with last year's projections, 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, remain sufficient to support the projected six-year expenditures contained in the City's mid- and high-growth forecast scenarios.

As the chart below shows, the minimum percentage by which real property tax revenue needs to increase (assuming the proposed $1.005 assessment rate) in order to balance the City budget in each of the next five years is quite realistic in light of the growth of the real property tax base over the last 10 years. Since 1995, real property assessments have grown steadily by annual rates ranging from .8 percent to 11.2 percent in 2002 followed by a precipitous increase of 19.9 percent in 2003 and 18.4 percent in 2004.[23]

Mid-Range Growth Forecast Scenario	2005	2006	2007	2008	2009	2010
Projected Expenditures (in millions)	$518,951	$544,287	$569,390	$594,774	$614,079	$637,045
Projected Revenues	$518,951	$544,244	$570,321	$598,336	$626,093	$657,520
Projected Shortfall/Surplus	$ -	$ (42.7)	$ 931	$ 3,563	$ 12,014	$ 20,474
Projected Real Property Tax Revenue	$231,010	$244,870	$259,563	$275,136	$291,644	$309,143
Real Prop. Tax Revenue Needed to Balance Budget	0	$244,913	$0	$0	$0	$0
Projected Annual Rate of Increase = 6%						

One cautionary note, however, is in order for anticipated commercial office space revenues. Although commercial real estate revenues are generally experiencing a similar rate of increase to the residential tax base as a result of new construction and appreciation, the commercial office vacancy rate may be cause for concern in the future. Currently Alexandria is experiencing a vacancy rate of 11.1percent with an average "asking" rate of $25.25 per square foot. If vacancy rates do not improve, the lease rates, and hence the assessed value, can be expected to decline.[24] Notwithstanding the positive impact of the PTO's addition to the real property tax base, BFAAC recommends that vacancy trends in available commercial office space be monitored closely over the long-term

B. Demographic Issues

Changing demographics should continue to be carefully analyzed and taken into account in any long range planning.

23 In the low-growth scenario, however, the amount of real property tax revenue required to balance the budget would require an additional $11.5 million (FY 2006) to $36.8 million (FY 2010).

24 This point is best illustrated by a comparison of the regional office vacancy rates and average asking rents. In the District of Columbia, which has an 8 percent vacancy rate, the average asking rent is $39.78 per square foot. In the Northern Virginia area, the vacancy rate is 15.1% and the average asking rent is $25.34 per square foot. Costar Group, Inc.

While no significant changes have been observed in the demographic issues that we commented upon last year, the continued trends are worth noting. While the City's total land area remains unchanged, our population continues to grow. At the current rate of increase, the population at the time of the next census will have increased by 30,000 people. Remarkably, the average household size (2.04 persons) remains unchanged since the 1990 census. In excess of 25 percent of our population are foreign born. Nearly 10 percent of the population are 65 years old or over.

These population trends should continue to be taken into account for future school and human services funding decisions.

Growing Disparity in Wealth

The 2000 census figures reveal that Alexandria is experiencing growth at both ends of the economic scale. As we noted last year, per capita income continues to increase but so does the rate of poverty in the City. This is indicative of the City's challenges in addressing our affordable housing needs. The average assessed value of residential property for CY 2004 was $362,000, yet the estimated median family income is $74,091. [25] At the time of the 2000 census, Alexandria ranked 9th in per capita income. Based on 2004 estimates, our per capita income is $56,063. This growing wealth disparity continues to pose wide-ranging future budget implications, especially for affordable housing, education, human services, public transportation and redevelopment plans.

Aging Population

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. Nearly 10 percent of the population is age 65 or older. As the population ages the need for health care, human services, property tax relief and changes in disposable income must be factored into the City's long-term revenue and expense projections.

C. Non-City Revenues and Budget Priorities

Declining and uncertain State revenues continue to put pressure on the City to either close the revenue gap with local revenues or cut certain programs and services. As with last year, if anticipated State revenues do not materialize, BFAAC urges that the City focus on funding core services and then consider reductions in less essential activities.

In any year, anticipated budget cuts at the State and federal levels pose immediate and long-term fiscal management issues for the City. The problem this year is exacerbated by the current budget impasse in Richmond. Clearly, a budget will be passed at some point but there are immediate and long-term implications if it is not passed soon. The hiring and retention of ACPS teachers for the next school year is dependent upon the City's availability of appropriated funds. Teachers, who are not advised that their contract is not being renewed, are automatically

[25] The affordability issue is more acute for families. One half of the median household income for a family of four is $43,000.

renewed for next year. The City will be forced to choose between reallocating money from proposed operating expenditures or dismissing teachers with the hopes of being able to rehire in the future. Furthermore, General Fund Intergovernmental Revenues[26] constitute 11.4 percent of the proposed FY 2005 budget. Viewed in terms of a percent of the City's overall budget, the rate has diminished in recent years, but the actual dollar amount of Intergovernmental Revenues continues to rise. State Aid through Special Revenue Funds has also declined in recent years, but the FY 2005 budget assumes a $2.0 Million increase. While the multi-year forecast scenarios assume no growth for Intergovernmental Revenues in the "Low Growth Scenario," 4 percent growth in the "Mid-Range Growth," and 5 percent in the "High Growth Scenario," our dependence on State revenues will continue to force the City to make informed choices in establishing its expenditure priorities. As noted in our discussion of the Proposed Capital Improvement Program, maintenance of adequate fund balances is essential to our ability to cope with unexpected revenue shortfalls or unanticipated expenditures.

D. Land Use Issues

1. Development and Redevelopment

The revenue and expenditure implications of development and redevelopment remain important factors in land use decisions that affect the real property tax base.

In addition to the Planning and Zoning Department's responsibilities of ensuring compliance with applicable zoning ordinances, urban design guidelines and planning procedures, the Department has the capability of providing valuable analysis of demographics, market activity and economic insight into the effects of the planning process on the City's land use decisions. BFAAC commends the Department of Planning and Zoning for its ongoing planning initiatives and its continued assessment of the economic impacts of development projects within the City.

The planning efforts for FY 2005 as reflected in the "Plan for Planning" include, in part, studies of the Landmark Mall area,[27] Alexandria Waterfront Area and Braddock Road Metro Station area. Additionally, it is noted that the King Street Retail Study is in progress. These projects are only a portion of some of the land use initiatives that are essential to achieving the Council's adopted "Long Term Vision" and will significantly affect the real property tax base. The City Manager's recognition of this is reflected in this year's proposed budget for the Planning and Zoning Department. In addition to the $283,649 supplement over the FY 2004 approved budget, an additional $445,000 has been earmarked for professional consulting services to study key areas in the City. Given the significant and continued reliance on the real property tax base, BFAAC believes that this represents a good investment in the preservation and expansion of that base.

BFAAC recommends that the City also examine Arlington's "incentive" approach to development in problematic areas of the City. Arlington County passed incentives and

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[26] E.g., State assistance for road maintenance, law enforcement, personal property tax reimbursement, Compensation Board reimbursements, State prisoner per diem and ABC taxes.

[27] Landmark Mall redevelopment will have a significant effect on the surrounding areas and has the potential for a positive impact on the City's tax base.

expedited development review processes to help transform Columbia Pike from a car and strip mall-based suburban area to a pedestrian-friendly commercial and residential center. This approach has fueled a number of desirable mixed-use projects that benefit the residential and commercial real estate tax base.[28]

2. Tax-Exempt Properties

Nearly 12 percent of Alexandria's land is owned by tax-exempt entities, therefore, a relatively large portion of the property within the City is excluded from the real property tax base.

Payments in Lieu of Taxes (PILOT)

Even though a relatively large portion of the property within the City is excluded from the real property tax base, these properties require, and benefit from, City services including police, fire, transportation, general City infrastructure and others. To help defray some of the cost of these services, some municipalities have, pursuant to State law,[29] implemented a program for payments in lieu of taxes (PILOT) by tax-exempt entities. PILOT is used in only 12 cities and 8 counties in the Commonwealth. Inasmuch as not all tax-exempt properties are subject to PILOT treatment, the actual amount that a city or county can recoup is dependent upon the type of tax-exempt property within the jurisdiction. For example, Commonwealth property is excluded from PILOT treatment unless the total value of the property within the jurisdiction exceeds 3 percent of the tax base.[30] Also excluded from the imposition of a service charge are land and buildings of churches used exclusively for nonprofit private educational or charitable purposes. Properties that qualify for PILOT treatment in Alexandria are limited to hospitals and faculty housing. Thus, Alexandria INOVA hospital, and portions of the Protestant Episcopal Theological Seminary and St. Stephens & St. Agnes School would qualify for PILOT treatment.

Even if a property is subject to such a service charge, the City's ability to recoup its costs is substantially limited. Determination of the applicable service charge rate requires the complex calculation of the total assessed value of all real property, divided by the total cost of police, fire and trash collection services and public school education, where applicable, and applying that rate to the assessed value of the particular property. However, pursuant to VA. Code § 58.1-3401 C, the calculated fee is further subject to a limit not in excess of 20 percent of the real estate tax rate. Thus, applying the CY 2004 assessments, if the total real property tax base is valued at $22.7 billion and the total reimbursable costs for services is calculated at $62.6 million[31] the resulting PILOT rate would be approximately $0.27 per $100 of assessed value. That rate, however, is further limited by the limit of 20 percent of the proposed CY 2005 Real Estate Tax rate of $1.005 which results in a PILOT rate of $0.20 per $100 of assessed value. Finance and

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[28] Washington Business Journal, p.3, 53 (April 1, 2004).

[29] Sections 58.1-3400 through 58.1-3407, Code of Virginia authorize localities to impose a service charge on otherwise tax-exempt property. However, the services that are subject to assessment are limited to police, fire protection, collection of refuse, and, public school education costs for faculty and staff housing associated with a tax-exempt educational institution.

[30] The City of Richmond is the only Commonwealth locality able to impose the service fee because of the 3 percent threshold. Additionally, Commonwealth operated hospitals, educational institutions, public roadways and property held for future construction of public highways are not subject to the service charge. §58.1-3403 Code of Virginia.

[31] Estimates are based on information provided during BFAAC subcommittee meeting with Department of Real Estate Assessments staff.

Administration staff has estimated that the service fee for CY 2004 would have resulted in additional $295,161 in revenues.

While BFAAC continues to urge the City to seek out measures that would help diversify its revenues and limit our dependence on the taxable real property base, it appears that we do not have the mix of property that would make PILOT an effective and efficient mechanism for recoupment of cost for services to tax-exempt entities. This is best demonstrated by an examination of what the City would realize in revenue from services charges to INOVA Alexandria. Of the estimated $169,826,500 assessed value of property subject to PILOT, INOVA Alexandria Hospital accounts for 74.1 percent of the value. Application of PILOT in CY 2004 would have resulted in a service charge of approximately $251,761. Remarkably, the City's FY 2005 budget includes a $700,000 payment to INOVA Alexandria for the maintenance of indigent care services. A request for an additional $200,000 contribution to the subsidy was not recommended by the City Manager.[32]

BFAAC recommends that the City periodically review the assessments of properties subject to PILOT and monitor any trends that would affect the mix of property that would qualify for PILOT treatment. At this time, however, it is neither efficient nor cost-effective to calculate and seek PILOT from qualifying properties because the major affected payor of the service fee receives substantial subsidies from the City.

Tax Exempt Property Policy

BFAAC supports the pending resolution affirming the City's policy in support of taxation of all real estate and personal property, including that of not-for-profit property owners.

In our FY 2004 report, BFAAC noted that the revenue impact of real property ownership by tax-exempt entities should be reviewed. BFAAC further suggested that no additional tax exemptions be granted unless a thorough evaluation of the impact on City tax revenues has been undertaken. Examined in the context of the fair market value of all real estate within the jurisdiction, 13 percent of Alexandria is exempt from taxation compared to 12 percent for Arlington, 7.6 percent for Fairfax County, 18 percent for Charlottesville and 20.27 percent for Richmond.

As reflected in our discussion of PILOT, the effect is that a relatively large portion of the property within the City is excluded from the real property tax base. Under a recently enacted amendment to the Commonwealth constitution, localities now have the authority to grant real and personal property tax exemptions for properties within their borders. This means that the City now has the ability to control the number of exempted properties. However, in light of our reliance on tax revenues, particularly real estate tax revenues, BFAAC supports the resolution and urges Council to preserve the City's revenue sources.

We further endorse the policy that, as a general matter, all properties within the City should be subject to taxation. In this regard, we agree that the City can support the work of its many worthy charitable institutions in direct ways, such as grants and service contracts, and these

[32] FY 2005 Proposed Budget, page 8-38.

direct ways are preferable to ongoing, indirect tax subsidies. Decisions regarding direct support can be made as required, taking into account the City's needs and priorities, whereas tax exemptions commit resources for the long term.

We also endorse the proposed resolution's procedure for considering exemptions in exceptional circumstances as part of the budget process. The proposed resolution comports with our prior recommendation for a thorough evaluation of any proposed additional tax exemptions. Consideration during the budget process provides a framework for sound Council decision-making based on analysis by City staff of a requested exemption's revenue impacts, in the context of the City's overall fiscal planning.

While BFACC is not unmindful of the valuable contribution and services that many charitable and not-for-profit entities provide for Alexandrians, this is a matter of maintaining sound fiscal management policies in light of our dependence on tax revenues.

Ordinance to Amend the Minimum Acreage That May Be Dedicated to Open Space

BFAAC is currently reviewing the fiscal impacts of this proposal. Upon completion of our analysis, we will provide Council with our recommendations.

3. Tax Relief Measures

BFAAC endorses the proposed Targeted Tax Relief Grant Program included in the FY 2005 Proposed Budget. This program brings welcome relief to those households most severely affected by the tax consequences of rising property values and helps homeowners to continue to afford their existing homes.

BFAAC does recognize the initial limitations of this pilot program. There are not many homeowners with a household income of $43,500 or less, or homebuyers at this income level who can afford to live in Alexandria. As well, the cap of $362,000 on the homes' assessed valued may exclude long-time homeowners who have seen the values of their homes escalate.

BFAAC urges the City to use this first year as a learning period and investigate expanding this program in the future. Future tax relief initiatives should include a mix of modest across-the-board tax rate reductions with an expansion of the tax grant program.

BFAAC recognizes an expansion of the grant program will require a better understanding of the number of eligible homeowners who would apply for the grants as well as the administrative challenges.

E. 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.

BFAAC has repeatedly supported the City's efforts to diversify its revenue base. Recent efforts include increased revenue from a tobacco tax and sewer fees. BFAAC has also recommended that the City periodically reassess its fee-based revenue sources to ensure that all City fees remain reasonable, fair and comparable to other jurisdictions.[33]

For example, decal fees and residential parking permit fees have not changed since the early 1980s. As far back as 1992, staff recommended an increase in parking fees. Given the available revenue options and Council control over fees, BFAAC recommends reviewing these fees.

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"). BFAAC again offers to participate in the development of such a policy should City Council desire it to do so.

Revenue Options

Due to restrictions established by the Virginia General Assembly, Alexandria has limited choices to diversify its revenue sources beyond real property taxes.

Tobacco Tax

Although the tobacco tax was recently raised in Alexandria, BFAAC believes that there is still room for that tax to be increased before it creates an incentive for purchasers to go to a lower tax jurisdiction to make their purchases. The tobacco tax is one of the few options available to the City under current law to raise additional revenues. BFAAC believes that a further increase in the tobacco tax may be reasonable.

Action by the General Assembly could present a potential barrier to Council action in this area. Early in the session, the General Assembly appeared to be moving in the direction of capping the tax rate set by local governments. However, the most recent budget compromise does not appear to include a cap.

Admissions Tax

The City Manager has referred this issue to BFAAC for FY 2006 study.[34] Under current State law, the permitted levy of an admissions tax requires that it be applied to all entertainment events, not just movie theaters. Inasmuch as not-for-profits and charitable fundraisers may be subject to the tax, the City would have to fashion a program that does not penalize these organizations and cause the City to fill the gap by increasing its support for a particular program or organization. BFAAC welcomes the opportunity to participate in the study of this possible revenue source and will provide Council with our recommendations.

Commercial Parking Tax

The City Council may also wish to study a possible tax on commercial parking facilities in the City. BFAAC recommends that any such study should address the economic benefits and possible conflicts with the City's economic development polices and initiatives.

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[33] The City Council's general user fee guidelines were adopted in 1994.

[34] Budget Memo #6 (March 15, 2004).

Alexandria Capital Development Foundation

Last year the City established a non-profit agency to raise money from private sources for the public good. This endeavor has just begun, but may provide an opportunity to raise the funds necessary to achieve specific goals that are currently outside the financial ability of our government.

BFAAC recommends that the Council look for ways to use public-private partnerships, such as the Capital Development Foundation, to support initiatives, such as to purchase open space, and that Council and City staff take all needed steps to assist this organization in moving forward as quickly as possible.