

City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 15, 2003

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: PHILIP SUNDERLAND, CITY MANAGER

SUBJECT: BUDGET MEMO #35 : MULTI-YEAR REVENUE AND EXPENDITURE FORECAST SCENARIOS - TAX REVENUE REQUIREMENTS (COUNCILWOMAN WOODSON'S REQUEST)

In discussions about the real estate tax rate, and the long-term impact of a rate reduction on the City's budget, Councilwoman Woodson asked that City staff review this issue and provide a response to City Council.

This issue is one of the most important issues for Council to consider as it sets the FY 2004 budget and real estate tax rate for 2003. The importance of taking the long-term fiscal view is something that Council has historically been concerned with, and has influenced City Council's annual budget, tax rate and capital funding decisions. This is evidenced by the adoption of the City's Debt Related Financial Policies in 1987 and their subsequent strengthening. These City policies also guide the City staff in the development of recommendations for Council consideration. These policies (which include the requirement for the annual production of multi-year revenue and expenditure projections) are always included in the City's Proposed and Approved budget documents (see page 10-48 of the Proposed FY 2004 Operating Budget).

These Financial Policies are also considered model policies by the bond rating agencies. As an example, Standard & Poor's periodically refers other cities to the Alexandria written policy document as a model to use in developing their long-term fiscal policies. Fitch Investor's Service, also a bond rating agency, has identified the production of long-term projections as one of the top twelve fiscal management actions which a city should have in place. The City's Budget and Fiscal Affairs Advisory Committee also looks carefully at the multi-year forecasts as part of their annual review of the proposed operating and capital budgets.

These forecast scenarios, while a useful decision making tool in the short term (i.e., two to three years), have less utility in subsequent years. This is because of the number of variables which influence both the City's expenditure demands, as well as its revenue situation. Many of these variables are either micro-economic or macro-economic in nature and often are driven by externalities in the regional or the national economy that are difficult to predict, or close to impossible for the City to influence. This is one of the reasons that three different multi-year scenarios are run as they set more of a "banding" of the future fiscal picture (i.e., best-case to worst-case fiscal scenarios), rather than a single fiscal projection.

The expenditure side of the scenarios all make the assumption that the same general level of City policies and programs continue into the future, without any major reductions or additions, with the exception of the inclusion of the fiscal impact (debt service and cash capital) of the proposed capital improvement program. As Council is aware, new federal or state mandates, citizen desires and needs, or trends (such as regional pay competition) outside of the City's control tend to create more demand for expenditures. Not knowing what these are or when they may occur or what level of spending may be involved, these expenditure increases are not included in the forecasts.

For the Proposed FY 2004 Operating Budget the multi-year revenue and expenditure scenarios (pages 4-67 to 4-74 of the Proposed FY 2004 Operating Budget) show varied results depending on whether the City experiences low, mid-range or high growth in revenues over the next six years. The low growth forecast shows a \$45 million deficit by the year FY 2009 (the proposed \$1.05 real estate tax rate is assumed), and the mid-range growth forecast (Attachment I) shows only a small \$1.3 million deficit (out of a total \$586 million projected budget) in FY 2009. This shows that a \$1.05 rate, under the more probable mid-range growth conditions, can be sustained as long as the expenditure side of the budget does not increase substantially beyond what is projected.

The mid-range is often labeled the more probable scenario, and is based on moderate overall revenue growth, which has been the City's general pattern since the mid-1990s. It is likely that this will continue as the City is likely to be the beneficiary of the region's continuing growth, and will, for the next decade, fiscally benefit from new development in Alexandria (e.g., in Eisenhower-East and at Potomac Yard).

One of the variables which is the most difficult to predict long term (and also one of the most important) is the rate of growth in the real estate tax base. While real estate appreciation tends to be cyclical, it is not sufficiently predictable over the long term. As you are aware, mortgage interest rates, regional job growth, and demographics are key external variables which influence the real estate market and therefore the tax base. While there is more certainty in the short term (FY 2004 and FY 2005) than the long term (FY 2006 and beyond), some uncertainty still remains. A year ago many would have considered it highly speculative that the average residential property in Alexandria would increase by 24% in value in a single year. Fortunately, history shows that real property values tend not to decrease as much on the down side as they increase on the up side. This provides some comfort in the analysis of the long-term City financial situation.

The Proposed FY 2004 Budget's proposed real estate tax rate of \$1.05 is used in all the scenarios as the assumed tax rate through FY 2009. If the rate is lowered below \$1.05, then the future year revenue projections would need to be reduced. At the same time, additional revenue and expenditure adjustments need to be made as per Budget Memos #26 and #27, which increased revenue projections by \$1.3 million and reduced expenditures by \$1.1 million in FY 2004.

Before the real estate tax rate is reduced below \$1.05, Council must consider the future effect of the revenue and expenditure "structure" it will need to establish in order to achieve a balanced FY 2004 budget with the less-than-\$1.05 real estate rate. If the "structure" (i) results from reductions in the proposed budget's operating expenditures or in proposed FY 2004 capital expenditures (and those reductions are not of a nature which requires that they be restored in the next few years), (ii) does not result from unreasonable or inflated FY 2004 revenue projections, and (iii) does not rely on an excessive appropriation from Fund Balance (an appropriation of \$6 million was in the proposed budget), then (and only then) would the lower tax rate be consistent with sound long-term fiscal management of the City. Stating it in another way, such a revenue and expenditure "structure," established to achieve the lower tax rate, would enable budgets in FY 2005 and FY 2006 to be put together without a major disruption to City programs, policies or capital plans.

Finally, of course, lowering the real estate tax rate does not mean it cannot be raised in the future. In fact, since 1981, the City Council has raised the tax rate on four occasions (for 1981, 1983, 1993 and 1998), and kept it level or dropped it in all other years (see Attachment II). However, raising the tax rate is politically difficult to do. As a result, lowering the real estate tax rate too much may have serious long-term negative financial consequences because, in the future when there is a genuine need to restore some of the earlier rate reduction for operating or capital purposes, there will not be the ability to do so. This makes it all the more important that Council be sure, if it reduces the tax rate below \$1.05, that the revenue and expenditure "structure" it establishes to achieve the further rate reduction will support sound City budgets in the next few years.

Attachments:

- I. Mid-Range Growth Forecast Scenario
- II. Real Estate Tax Rates by Calendar Year

Mid-Range Growth Forecast Scenario

	FY 2004 Proposed (1)	FY 2005 Forecast (2)	FY 2006 Forecast (3)	FY 2007 Forecast (4)	FY 2008 Forecast (5)	FY 2009 Forecast (6)
1 General Fund						
2 General property tax revenue						
3 Real property tax	203,167,100	213,325,400	223,991,600	235,191,200	246,950,800	259,298,300
4 Personal property tax	31,684,000	33,268,200	34,931,600	36,678,200	38,512,100	40,437,700
5 Penalties and interest	1,100,000	1,133,000	1,167,000	1,202,000	1,238,100	1,275,200
6						
7 Total general property tax revenue	235,951,100	247,726,600	260,090,200	273,071,400	286,701,000	301,011,200
8						
9 Other Local Tax Revenue	88,113,000	91,325,400	94,681,600	98,188,500	101,853,300	105,683,300
10						
11 Other Non-Tax Revenue	67,975,500	70,539,900	72,656,000	74,835,700	77,080,800	79,393,200
12						
13 Total General Fund Revenues	392,039,600	409,591,900	427,427,800	446,095,600	465,635,100	486,087,700
14 Other Financing Sources (Uses)						
15 Appropriation from Fund Balance						
16 for Operating Budget	6,583,600	6,000,000	6,000,000	6,000,000	6,000,000	6,000,000
17						
18						
19 Total General Fund revenues and other	398,623,200	415,591,900	433,427,800	452,095,600	471,635,100	492,087,700
20 sources						
21 Special Revenues & Other Funds						
22 Appropriation from Schools Fund Balance	1,592,300	0	0	0	0	0
23 Other Special Revenue (donations/charges)	74,612,700	76,851,100	79,156,600	81,531,300	83,977,300	86,496,600
24 New Sewer Fee Revenues	0	1,600,000	1,600,000	1,600,000	1,600,000	1,600,000
25 Equipment Replacement Fund	4,377,000	4,508,300	4,643,500	4,782,800	4,926,300	5,074,100
26						
27 Total Special Revenue & Other Funds	80,582,000	82,959,400	85,400,100	87,914,100	90,503,600	93,170,700
28						
29 Total Revenues, All Funds	479,205,200	498,551,300	518,827,900	540,009,700	562,138,700	585,258,400
30						
31 EXPENDITURES & OTHER USES						
32						
33 City Personnel	172,938,800	180,894,000	189,215,100	197,919,000	207,023,300	216,546,400
34 City Non-personnel, including Transit	112,169,200	115,727,600	119,402,400	123,197,700	127,117,400	131,166,000
35 Debt service	21,299,500	22,979,700	27,788,800	29,551,600	31,219,500	32,961,700
36 Cash capital	15,100,000	16,000,000	17,000,000	18,000,000	19,000,000	10,600,000
37						
38 Schools Personnel	134,505,700	140,693,000	147,164,900	153,934,500	161,015,500	168,422,200
39 Schools Non-personnel	23,192,000	23,887,700	24,604,400	25,342,500	26,102,800	26,885,800
40						
41 Total Expenditures	479,205,200	500,182,000	525,175,600	547,945,300	571,478,500	586,582,100
42						
43 Excess/(Shortfall) of Revenues and Other	0	-1,630,700	-6,347,700	-7,935,600	-9,339,800	-1,323,700
44 Sources over Expenditures and Other Uses						
45 Note: In reality, the projected deficits would not occur.						
46 Actions would be taken to reduce expenditures or increase revenues.						
47						
48 DEBT SERVICE INDICATORS						
49						
50 Debt as a % of Real Property Assessed Value	1.0%	1.1%	1.2%	1.2%	1.2%	1.1%
51 Debt per capita as a % of per capita income	2.4%	2.7%	2.8%	2.7%	2.7%	2.4%
52 Debt Service as % of General Fund Estimated Expenditures	4.4%	4.6%	5.3%	5.4%	5.5%	5.6%
53 Unreserved Fund Balance as a % of General Fund Revenue	12.8%	Not projected	Not projected	Not projected	Not projected	Not projected

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Summary Tables
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Attachment I

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Real Estate Tax Rates by Calendar Year

Shown below is a comparison of real estate tax rates from selected Northern Virginia jurisdictions over the past eighteen calendar years. In Virginia, the tax and calendar years coincide. Rates listed are per \$100 of assessed value.

In Alexandria for tax year 2003 (FY 2004), the estimated fiscal impact of the proposed three cent reduction on the real property tax rate was \$5.8 million for a tax rate for the 2003 calendar year only, and \$8.6 million for a tax rate that carries until the end of FY 2004 (i.e., three payment periods of June 2003, November 2003, and June 2004).

REAL ESTATE TAX RATES*

YEAR	City of Alexandria	Arlington County	Fairfax County	Loudoun County	Prince William County
1981	1.37/1.35	.96	1.51	1.02	1.40
1982	1.37	.98	1.47	1.13	1.45
1983	1.41	.99	1.47	1.13	1.42
1984	1.41	.97	1.46	1.10	1.39
1985	1.39	.95	1.39	1.13	1.42
1986	1.38/1.37	.94	1.35	1.02	1.42
1987	1.34	.92	1.32	.88	1.30
1988	1.25	.89	1.30	.95	1.38
1989	1.10	.78	1.19	.88	1.38
1990	1.045	.765	1.11	.85	1.36
1991	1.045	.765	1.11	.94	1.36
1992	1.045	.82	1.16	.96	1.36
1993	1.07	.86	1.16	1.00	1.36
1994	1.07	.897	1.16	1.02	1.36
1995	1.07	.94	1.16	.99	1.36
1996	1.07	.96	1.23	1.03	1.36
1997	1.07	.986	1.23	1.06	1.36
1998	1.11	.998	1.23	1.11	1.36
1999	1.11	.998	1.23	1.11	1.36
2000	1.11	1.023	1.23	1.08	1.34
2001	1.11	1.023	1.23	1.08	1.31
2002	1.08	.993	1.21	1.05	1.23
2003 proposed	1.05	.993	1.19	1.105	1.19

*Does not reflect additional special tax district (fire, leaf collection, etc.) or town real estate tax rates (Arlington County, Fairfax County, Prince William County and Loudoun County).