City of Alexandria, Virginia

MEMORANDUM

DATE: April 19, 2004

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: PHILIP SUNDERLAND, CITY MANAGER

SUBJECT: BUDGET MEMORANDUM # 50 : COST OF OPEN SPACE AND IMPACT ON DEBT LIMITS

Councilman Krupicka, joined by Councilman Smedberg, and Councilwoman Woodson have asked questions relating to the Open Space Fund.

Councilman Krupicka has asked for information on the impact on our debt ratios, bond rating and the "status" quo cost of government (see Budget Memorandum # 21) if we were to issue $35 million in bonds for open space acquisition and pay the debt service with the annual cash capital funds produced by the one cent "open space" levy on real estate. The $35 million bond issuance is discussed in the attached March 12, 2004 memorandum "Open Space Fund – Fiscal Analyses." The memorandum says that the currently estimated $2.5 million open space income stream from the 1 cent "open space" levy could support the issuance of $35 million in general obligation bonds using a level debt service method (like a home mortgage) where annual debt service payments would be about $2.5 million each year. Councilman Krupicka also has asked what constraints might exist on the usage of these bond proceeds. Councilman Smedberg has joined in these requests.

Councilwoman Woodson has asked a related question about the cost to the real estate taxpayer if the City were to buy the Second Presbyterian site outright at a price that likely would be significantly higher than the reported $5.5 million contract sale price, assuming that money for the purchase is taken from the Open Space Fund and other city sources as needed to complete the purchase now. She also has asked if this purchase would exhaust the Open Space Fund until it is replenished in FY 2006.[1]

Effects on Debt Service Guidelines and Bond Rating: If $35 million were borrowed in FY 2005 and the level debt service method used, the City would exceed, in fiscal year 2006, its target that

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[1]Additional questions on other possible debt financing scenarios for open space acquisition have since been requested by Councilmen Macdonald and Krupicka. Those questions will be answered in another budget memorandum.

debt be less than 1.1 percent of the assessed value of real property. The City also would exceed both its current target and limit for debt per capita (to be below 2.25 and 3.25 percent of per capita income, respectively) from FY 2005 through FY 2009. Even if this debt per capita target and limit were adjusted to 3.2 percent and 4.5 percent, respectively, as recently recommended by the Budget and Fiscal Affairs Advisory Committee (see Budget Memorandum #4), the City would exceed the target in FY 2005 through 2009; we would not, however, exceed the limits. The following table shows estimated outstanding debt, including $35 million in additional debt issued in FY 2005 to acquire open space, against these guidelines under current estimates.

Outstanding General Obligation Debt Compared to Debt Policy Guidelines
Assuming Additional $35 Million Debt Issued in FY 2005

<table>
<tr><th colspan="4">Guidelines</th><th>FY 2005</th><th>FY 2006</th><th>FY 2007</th><th>FY 2008</th><th>FY 2009</th><th>FY 2010</th></tr>
<tr><td>Target</td><td colspan="2">1.1%</td><td rowspan="2">Debt as % of Assessed Fair Market Value of Real Property</td><td rowspan="2">1.10%</td><td rowspan="2">1.12%</td><td rowspan="2">1.08%</td><td rowspan="2">1.18%</td><td rowspan="2">1.08%</td><td rowspan="2">0.98%</td></tr>
<tr><td>Limit</td><td colspan="2">1.6%</td></tr>
<tr><td rowspan="2">Current Guidelines</td><td>Target</td><td>2.25%</td><td rowspan="2">Debt Per Capita as % of Per Capita Income</td><td rowspan="2">3.28%</td><td rowspan="2">3.38%</td><td rowspan="2">3.28%</td><td rowspan="2">3.64%</td><td rowspan="2">3.36%</td><td rowspan="2">3.08%</td></tr>
<tr><td>Limit</td><td>3.25%</td></tr>
<tr><td rowspan="2">Proposed Guidelines (excluding sanitary sewer debt in FY 2007 and beyond)</td><td>Target</td><td>3.2%</td><td rowspan="2">Debt Per Capita as % of Per Capita Income</td><td rowspan="2">3.28%</td><td rowspan="2">3.38%</td><td rowspan="2">3.25%</td><td rowspan="2">3.60%</td><td rowspan="2">3.33%</td><td rowspan="2">3.05%</td></tr>
<tr><td>Limit</td><td>4.5%</td></tr>
</table>

These debt limit guidelines are set to help maintain our triple-A bond ratings. While this $35 million in debt would push us over or closer to our current targets and limits, City staff do not see this level of additional debt <u>by itself</u> as necessarily endangering our triple-A bond ratings. However, over the time period of the CIP, we would expect this extra debt would likely preclude borrowing for future City or School capital projects that are not now included (or that are estimated at a lower cost) in the proposed CIP. The potential danger arising from this additional $35 million in debt is that it reduces greatly our flexibility to meet anticipated and unanticipated future capital spending needs that are not included in the proposed CIP.

<u>Effects on Maintaining a Status Quo Budget:</u> The annual cost of the extra debt service attributable to borrowing $35 million would be approximately $2.5 million or a 0.6 percent increase over the FY 2004 General Fund operating budget. If the Open Space 1 cent were used to finance this debt service, there would be no additional future impact on the General Fund budget.

Constraints on Using the Proceeds of a Bond Issuance: According to federal law, when the City issues bonds it must have a reasonable expectation that it will use the borrowed funds for capital purposes within 36 months of receiving the proceeds. As a result, issuing $35 million at once is not recommended as the timing and amount of major and minor land purchases are not known at this time. Rather, if Council decided to issue bonds for open space, it would be better to spread that bond issuance out over a number of years, with some of the bonds issued in FY 2005 and the balance in FY 2006 (and possibly FY 2007). The amounts to be issued in FY 2006 would be based upon how much of the FY 2005 bond issuance was used for open space by the time a FY 2006 bond issuance occurred. Similarly, a FY 2007 bond issuance for open space would be sized based on the use of FY 2005 and FY 2006 bond proceeds. Also, in the event the need for open space bonds exceeded the amount of bonds initially sold, the City could (with the Federal tax exempt rules) incur the expense and then get be reimbursed from the next bond sale.

Effects of Second Presbyterian Purchase on Current Real Estate Taxpayers: Another way to pay for any open space site (e.g., Second Presbyterian) that Council determines is a priority would be to take the current balance in the Open Fund CIP account, $3.3 million, and combine it with the FY 2005 expected revenues of $2.3 million. This combination would provide about $5.6 million. It is unlikely that $5.6 million would be sufficient to purchase the Second Presbyterian site. Even if it were sufficient, it would use 100 percent of the City's Open Space funding until FY 2006.

As previously indicated to Council, the City retained an independent appraiser to provide a market valuation for the Second Presbyterian site now under contract to Elm Street Development. The appraiser has indicated that the market value of this site is $6,350,000.

If the $5.6 million in current open space funds (as of June 30, 2004) is insufficient to acquire the Second Presbyterian site, and assuming no borrowed funds are available, the cash capital contribution to the CIP would have to be increased. One cent on the real property tax rate is worth $3.4 million if applied in June 2004 and in FY 2005 (i.e., three payments). Thus, a price of $6.35 million for Second Presbyterian would require another $0.75 million, which, if coming from real estate tax revenue only, would equate to a 0.22 cent increase in the real estate tax rate, or about $12 city-wide for the average homeowner (over three real estate tax payments). A price of $7.5 million (a hypothetical amount so the potential tax impact can be calculated and given) would equate to a 0.56 cents increase in the real estate tax rate, or about $30 city-wide for the average homeowner (over three real estate tax payments).

Attachment

cc: Open Space Steering Committee Members
Kirk Kincannon, Director, Recreation, Parks and Cultural Activities

City of Alexandria, Virginia

MEMORANDUM

DATE: MARCH 12, 2004

TO: COUNCILMAN ROB KRUPICKA

THROUGH: ROSE WILLIAMS BOYD, DIRECTOR OF CITIZEN ASSISTANCE

FROM: MARK JINKS, ASSISTANT CITY MANAGER ml
BRUCE JOHNSON, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET BJ

SUBJECT: OPEN SPACE FUND - FISCAL ANALYSES (COUNCIL REQUEST NO. 04-45K)

In response to your request for information on the value of the open space fund over time, a number of calculations have been run. A note of caution should be exercised in the use of these numbers, as they depend upon the continuation by future Councils of the 1-cent dedicated real estate rates and a 6% average tax base growth (the City's average over the last decade) which may or may not occur. This is an important qualification, as the City is just coming down from a major growth period in the real estate cycle.

The following addresses your request:

Q: What is the net present value of the open space fund over a 20-year period?

A: The net present value (NPV) of the fund over a 20-year period is approximately $56 million based upon a 6% annual growth assumption on the current $2.3 million income from the 1-cent, as well as an estimated $0.2 million in right-of-way vacations (also assumed to grow at a 6% rate). A discount rate of 4.5% is also used, as that is estimated to be the City's average cost of money during the next 20 years. The NPV calculation is important because the nominal income from the 1-cent will be higher over time, and the cost of land to be purchased will also inflate at a similar or higher rate; therefore the NPV represents a "today's dollar" calculation.

Q: How much borrowing could be done today from the current open space income stream?

A: The currently estimated $2.5 million open space income stream could support the issuance of about $35 million in general obligation bonds where a level debt service method is used (the City normally uses a near-level principal repayment method which represents a more desirable repayment policy).

Q: What are the legal or other constraints to issuing bonds?

A: Based on state law and the City Charter, bonds could be issued if authorized by City Council. The primary issuance constraints are financial in nature. Given that the basis for the open space fund is more than 90% real estate tax revenues, then the best bond instrument to use to raise the funds would be general obligation (GO) bonds. This is because the cost of borrowing is the lowest with GO bonds, and the fact that real estate taxes would be the primary income used to finance repayment. There are no advantages in issuing revenue bonds for open space - just disadvantages. City revenue bonds would have a higher interest rate in comparison to City GO bonds (GO bonds would be rated AAA/Aaa). Revenue bonds would also mean separate additional bond issuance costs. Also, the right-of-way vacation annual revenues are too variable and too small to issue investment-grade revenue bonds for.

From a bond rating agency viewpoint, a bond (revenue bond or GO bond) which uses real estate or other general taxing powers of a government as its payback source represents a government using its general property taxing powers and, as a result, the rating agencies would consider such debt in the same way they view general obligation debt. As a result, any open space related bonds issued would use City debt capacity and would count against the City's debt ratios and debt related financial policy guidelines. By doing so, they may, over the long run, displace borrowing for other future City or Schools capital projects.

As part of the FY 2005 budget work session presentations, staff is planning on doing a presentation in regard to how the City's proposed FY 2005 to FY 2010 Capital Improvement Program (CIP) will impact the City's debt ratios. With that explanation, Council will be able to put the issuance of additional debt for open space (or for other capital purposes) in context.

Q: Does the fact that the open space fund is at the discretion of each Council create any limitations on bond payments?

A: If the City were to issue revenue bonds or other bonds which were not legally binding on future Councils, then the City would pay higher borrowing costs, as the bonds would be considered higher risk and would be rated lower by the bond rating agencies. Failure to repay these types of bonds would cause the City's bond ratings to be downgraded. However, if general obligation bonds were issued, then a legally binding pledge would be placed on the bonds by Council. This would bind future Councils (as well as future budget debt service payments) until the bonds were fully repaid. The disadvantage of issuing open space bonds would also be the locking up of open space annual tax revenues for 20 years. This reduces the flexibility for future City Councils due to potential fiscal crisis reasons or for policy reasons to not continue the 1-cent for open space.

In conclusion, bonding some of the open space tax revenue income stream through the issuance of general obligation bonds has merit given that the parcels desired to be purchased may increase in value faster than the increase in the supporting real estate tax revenues. However, before consideration of issuing bonds or keeping on a pay-as-you-go cash basis in undertaken, it would be important to have in hand, and approved by Council, a specific list of priority open space acquisitions with costs estimated. Then a financing plan could be developed which seeks to balance various interests and concerns. At this time, it is too early in the process to determine or fix on a specific method and amounts of financing, rather priority setting as is underway with the Open Space Steering Committee should come first.

cc: The Honorable Mayor and Members of City Council
Philip Sunderland, City Manager
Open Space Steering Committee
Kirk Kincannon, Director, Recreation, Parks and Cultural Activities
Barbara Ross, Deputy Director, Planning & Zoning