City of Alexandria Budget and Fiscal Affairs Advisory Committee

Report on the City Manager's Proposed Budget for Fiscal Year 2006

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EXECUTIVE SUMMARY

The following are some highlights of our views on the City Manager's Proposed Budget for FY2006.

Revenues and Tax Relief

- BFAAC cautions City Council against over-reliance on any long-term assumptions about real property values and the taxes they would generate.
- BFAAC believes that a decrease in the real property tax rate is the broadest way for Council to help keep Alexandria affordable for all its residents and businesses.
- BFAAC recommends that City Council consider defining and employing a "current services budget" as a tool for both determining the appropriate real property tax rate and for improving the dialogue between Council and its constituents on City budget issues.
- In considering all tax relief and revenue increase options, BFAAC urges City Council to avoid raising City measures to the maximum levels allowed by state law in order to preserve flexibility to address urgent circumstances in future years.
- City Council should consider the relative merits of tax relief vs. affordable housing programs in making Alexandria more affordable. BFAAC encourages Council to carefully balance the need to target the Affordable Home Ownership Preservation (AHOP) Program to the most deserving recipients with the need to keep the program easy to understand and administer.
- BFAAC recommends that the City Council continue to closely monitor the activities and needs of the Alexandria Housing Development Corporation to ensure the success of its mission, especially its ability to compete effectively against private developers for scarce housing resources.
- If City Council chooses to set aside spending for affordable housing programs, either from the tax rate or the recordation tax, BFAAC recommends that the Council place a "sunset" on that set-aside.
- BFAAC supports creation of an admission tax and a cell phone tax, an increase in the City tobacco tax of at least 20 cents per pack of cigarettes and an acceleration of the increase in the sanitary sewer user fee. BFAAC has repeatedly stressed the importance of diversifying City revenues and reducing the City's dependence on real property taxes, and notes that all of these revenue increases serve those goals.

Staffing

- The City should closely scrutinize personnel expenditures for potential spending reductions. To help accomplish this, the City should consider productivity measurement analysis along with analysis of total compensation compared to other local jurisdictions.

- Total compensation costs, including benefits, should be part of any future salary benchmark studies.

- BFAAC supports the two percent COLA and step increases for City and ACPS employees.

- City Council should examine the proposed ACPS initiatives to assure that requests are based upon needs, and that monies are well spent.

- Council should 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. ACPS new hires should receive the same scrutiny as City hires.

- The City should offer employees a mix of retirement plans that includes defined-contribution plans to reduce the City's financial exposure and give City employees more power over their retirement investments. We also recommend that the City and ACPS explore increasing the employee share of contributions in all retirement plans to lessen the increasing City share.

- BFAAC remains concerned about the dramatic pressure being put on the operating budget by fully funding employee health insurance premiums and repeats its belief stated last year that the City and ACPS need to undertake more cost-containment measures, including employee cost-sharing, when it comes to health insurance.

- The City and ACPS should continue to seek efficiencies in retirement and health care plans and coverage.

Capital Improvement Program

- The City share of the CIP has grown again this year despite substantial down payments on several "big ticket" projects, primarily the construction of a new T.C. Williams High School and the new public safety center.

- BFAAC recommends that City Council carefully consider how best to use State Urban Funds since this large pool of money may no longer be used to fund the City's mandatory WMATA contribution.

- The City Manager's proposed CIP includes $94.6 million to fund the ACPS adopted CIP, or 88 percent of the requested amount. Most of the reduction is the result of funding the Minnie Howard renovation and construction at FY2005 levels. BFAAC finds the Manager's approach to be reasonable. It confirms the City's commitment to the Minnie Howard project but also takes into account the fact that changes in enrollment could change the overall nature of the project.

- If the Public Safety Center can be built on the City-owned Wheeler Avenue site, the City might realize some savings on project costs. In anticipation of possible project savings, BFAAC recommends the City move a small portion of the $21.16 million that has already been banked for this project into later years to help fund the additional four-cent tax rate reduction in FY2006. BFAAC also recommends the City consider pushing the final ($43.17

million) construction phase of the PSC until FY2009 or beyond, to better space the timing of its large capital improvement projects.

- BFAAC recommends moving the timing of Chinquapin and the All-City Sports Facility so the bulk of the costs occur in 2010 or beyond. This would give the City more flexibility (under its Debt-Policy Guidelines) in borrowing money to pay for these projects which will benefit future generations of Alexandrians.

- The City has a long list of unfunded capital needs which are not included in the current CIP, including a new fire station, infrastructure improvements related to the planned major development at Landmark Mall, and the widening of Eisenhower Avenue.

- Alexandria's budget carries forward $81.8 million in unallocated resources from prior-year CIPs. BFAAC recommends that the City review these projects carefully and push back or eliminate any projects that the City will not be able to complete within the next few years. BFAAC cautions, however, that if the City does tap into prior-year unallocated funds, the money will no longer be available to spend on the program for which it was originally budgeted (unless it is replaced in subsequent budget years), and all of these projects have been approved by Council in previous CIPs.

- Cash Capital contributions to the CIP have been steadily increasing since FY1997-2002, and now have a considerable impact on the City's operating budget as well as a family's pocketbook, especially when combined with the City's debt-service costs. The City must be mindful that today's taxpayers should not have to pay more than their share for benefits that will also be enjoyed by future residents. Unlike past years, BFAAC urges City Council to reduce planned cash capital contributions to the CIP and spread the burden out more equitably to future generations of Alexandrians.

- Under the City's current Debt-Policy Guidelines, there is little room to incur additional debt until after FY2009. Alexandria is well within its target borrowing capacity when measured against the value of the City's real property tax base; however, Alexandria exceeds its target borrowing capacity (through 2011) when measured against the income of its residents.

- While it may be tempting to fund a tax rate reduction using large cuts in cash capital, this "one-shot" decrease would not help the City next year when it comes time to pay for ongoing and recurring expenditures. Instead, BFAAC recommends that to fund reductions in the real property tax rate, beyond the four cents proposed by the City Manager, City Council should look first to reduce the operating budget of the City and ACPS or find new, on-going revenue sources.

I. REVENUES AND TAX RELIEF

The Strategic Plan adopted by City Council last fall included the goal of "a caring community that is diverse and affordable." The recent dramatic rise in real property assessments has raised legitimate concerns in our community about real property taxes and whether Alexandria can remain an affordable community, especially for people with low and medium incomes. City Council will inevitably address these issues through the decisions it makes on the real property tax rate, tax relief and affordable housing programs.

A. Real Property Tax Rate

BFAAC cautions City Council against over-reliance on any long-term assumptions about real property values and the taxes they would generate. On the one hand, Alexandria's obvious desirability as a place to live and locate a business and its location in the heart of a fast-growing metropolitan area will probably result in continuing upward pressure on real property values for many years to come. On the other hand, there are signs of increases in interest rates and real estate markets are notoriously volatile. As recently as 1995-1999, the average assessed value of residential property in Alexandria increased by only 4.5 percent and the average assessed value of commercial property increased by only 6.6 percent over the four-year period. (Budget Memo #8)

BFAAC agrees with the City staff's expressed concern that current commercial real estate values, in particular, probably cannot be sustained. For example, last year at this time, Alexandria had a commercial office vacancy rate of 11.1 percent with an average "asking" rate of $25.25 per square foot. Currently, Alexandria has a 13 percent vacancy rate and an asking rate of $27.39 per square foot. The average vacancy rate for the Metro area is 10.3 percent and the average asking rent is $30.40 per square foot. (CoStar Group) Therefore, if Alexandria vacancy rates do not improve, rents, and therefore assessed commercial values, will not grow.

Perhaps most importantly, there are clear indications of interest at the state level in curbing real property tax increases. The two leading candidates to be the next Governor of Virginia have both highlighted property tax relief proposals in their campaigns. Similar restrictions have been imposed at the state and local level throughout the United States. If Virginia adopts such legislation, the City could be limited in its ability to tax growth in real property values in the coming years.

BFAAC believes that **a decrease in the real property tax rate is the broadest way for City Council to help keep Alexandria affordable for all its residents and businesses.** City Council obviously needs to weigh many factors in determining the appropriate real property tax rate.

One understandable approach in determining that rate is to begin with the revenues that would be generated by the new property assessments at the current tax rate, plus other anticipated revenues, and then look for ways to reduce the tax rate from that point. BFAAC recommends **that City Council also consider the alternative approach of assuming a "current services budget" of City expenditures and other anticipated revenues and then calculating the real property tax rate to generate the additional revenues that would be required to balance the budget.** Under this approach, any new "discretionary" spending would then require a real property tax rate increase, other revenue increases, or offsetting reductions in current service budget expenditures either through new program efficiencies or reductions in services. Similarly, any real property tax rate lower than the rate needed to maintain current services would require reductions in the current services level of expenditures or offsetting revenue increases.

Clearly articulating the components of a "current services budget" could also improve the dialogue between City Council and its constituents on the City budget and appropriate real property tax rates. A current services budget should probably include not only an inflationary adjustment, but also adjustments for City population growth, fluctuations in the CIP budget, newly-mandated spending and additional City spending required to make up for declining or stagnant federal and state funding for essential City services (Budget Memo #3), but the specific components would be a fair subject of debate. BFAAC believes that many City taxpayers would appreciate a better understanding of what the Council believes a current services budget should include and why.

B. Tax Relief

Although a general tax rate decrease is the broadest tool to keep Alexandria affordable, more targeted tax relief efforts can help advance the City's strategic objective to keep Alexandria affordable for low- and medium-income families, seniors and persons with disabilities at a lower cost to the City.

Affordable Home Ownership Preservation (AHOP) Program. The City Manager has proposed a five-fold increase in the AHOP program. Instead of a flat $250 tax reduction grant for households with income below $62,000 and a residence value of $364,000, the City Manager has proposed that home owners with annual household income below $62,000 and homes assessed at less than $442,000 would be eligible for tax reduction grants from $275 to $675 depending on income. Members of Council and others have discussed ideas for targeting the AHOP program even more carefully at perceived needs, e.g. taking into account the rate of increase in the assessment of a particular home, considering a homeowner's tenure in their home, distinguishing between condominiums and single-family homes, etc. BFAAC notes that the Commonwealth gives localities broad discretion in how they construct their AHOP programs. If the City establishes a very complex program, however, it could discourage participation in the program and sharply increase the program's administrative costs. BFAAC encourages City Council to carefully balance the need to target the AHOP program to the most deserving recipients with the need to keep the program easy to understand and administer.

Tax Relief for Seniors and Permanently/Totally Disabled. City Manager has proposed $2.7 million in real estate tax relief under this program. His proposal still falls short of the ceilings established by the Commonwealth for localities in Northern Virginia. For example, the maximum income could be raised from $62,000 to $72,000 and a family's maximum net worth could be raised from $240,000 to $340,000.

In considering all tax relief and revenue increase options, BFAAC urges City Council to avoid raising City measures to the maximum levels allowed by state law. Because of the uncertainties mentioned earlier of the real estate market, the economy generally and potential new state limits on local real property taxation authority, the City should preserve flexibility to address urgent circumstances in future years.

Real Estate Tax Deferral. No locality in Virginia has implemented the deferral program allowed by state law because of its complexity. The idea of deferring some real estate taxes until time of sale seems like a useful tax relief tool for localities. City Council should consider supporting reform of the state law on tax deferral, especially if the Commonwealth imposes new restrictions on the powers of localities to collect real property taxes.

Business License Tax Relief and Reform. The City Manager has proposed reducing and simplifying business license taxes for small- and medium-sized businesses in their critical first two years of operations. He estimates that 100 businesses would benefit from this program in 2005 at a cost to the City of $200,000 and that 200 businesses would benefit from this program in 2006 at a cost of $400,000. This proposal appears to advance the City's strategic goal of "a strong local economy that is growing in varied small businesses and job opportunities" at a modest cost.

C. Affordable Housing Programs

In addition to targeted tax relief, City Council can also seek to make Alexandria a more affordable city through affordable housing programs like the Housing Opportunity Fund and the new, independent non-profit Alexandria Housing Development Corporation recently created by Council. **City Council should carefully consider the relative merits of tax relief vs. affordable housing programs in making Alexandria more affordable.** For example, tax relief programs may be especially effective at keeping Alexandria affordable for current residents while affordable housing programs may be more effective at making Alexandria affordable for new residents. Which programs are more expensive to administer? Are affordable housing funds going to be spent as promptly as recipients will receive their tax relief? Which programs can be targeted more precisely at the intended beneficiaries?

Housing Opportunity Fund and the New Alexandria Housing Development Corporation. The purpose of the Housing Opportunities Fund is to provide local resources to support the development and preservation of affordable rental and sales housing in the City. The Fund is financed by the City through federal Home Investment Partnership (HOME) Program funds, the City Housing Trust Fund and General Funds.

Housing Opportunities Fund funds are available to the newly-organized Alexandria Housing Development Corporation, the mission of which is to produce and preserve affordable housing, primarily, but not limited to, multi-family rental housing. The City intends that housing provided through the efforts of this organization will remain affordable in perpetuity.

The Alexandria Housing Development Corporation competes with private for-profit developers that are also seeking opportunities to conduct business in the City. As discussed in our report last year, there continues to be not enough supply in the Alexandria housing market to meet the need. At this time, there are approximately eight apartment complexes in the City that are in the process of being converted into condominiums, resulting in a further reduction of the already limited supply of affordable rental units in the City. **BFAAC recommends that the City Council continue to closely monitor the activities and needs of the Development Corporation** to ensure the success of its mission, especially its ability to compete effectively against private developers for scarce housing resources.

BFAAC also reminds City Council of the budgetary effect on the Bush Administration's proposed elimination of the Community Development Block Grant Program. If enacted, this would result in a net reduction of 33 percent in funding for several ongoing City programs that touch our affordable housing initiatives, the Home Ownership Assistance Program (HAP) and the Home Rehabilitation Loan Program (HRLP). These activities could be funded at reduced levels with HOME funds, but this would be at the expense of HOME funding for the City's affordable housing programs. (Budget Memo #7)

Dedicated Funding Source for Affordable Housing. The City Manager has proposed setting aside the additional revenue generated by a recent increase in the local recordation tax ($1.65 million in FY2005 and $2.0 million in FY2006 in the original budget estimate) for possible dedication by City Council to affordable housing programs. Some affordable housing advocates have suggested setting aside one or two cents of the real property tax rate for affordable housing, as Council has chosen to do for open space acquisition.

When the open space acquisition tax rate set-aside was proposed two years ago, BFAAC described some of the advantages and disadvantages of such an approach. Those same advantages and disadvantages apply to creating a dedicated funding source for affordable housing, whether it is a set-aside from the tax rate or from local recordation tax revenue:

> *On the one hand,* it has the advantage of transparency---it is a clear statement to Alexandria taxpayers of City policy on where City tax dollars will be spent. It does so, however, without truly binding future City Councils. It gives future Councils the flexibility to provide more or less money for affordable housing than the dedicated funding source would provide.
>
> *On the other hand,* it could inspire supporters of other funding programs to pursue dedicated funding sources, which has happened in this case in response to the tax rate set-aside for open space. That could lead to a balkanization of the City budget and limit the ability of the City Council to respond to changing circumstances and competing demands for City funds in the context of the overall budget, if future Councils treat this and other designations as binding.
>
> In addition, the set-aside's non-binding character might not be well-understood by the public. If future City Councils decide not to enforce it, even for the best of reasons, members of the public might view it as a breach of a promise. Future Councils might therefore be reluctant to modify or terminate it, even if they believe it is time for a change.

If City Council chooses to set aside spending for affordable housing programs, either from the tax rate or the recordation tax, BFAAC recommends that the Council place a "sunset" on that set-aside. The set-aside should be given a few years to work, but that authority should automatically expire after 3-5 years unless explicitly renewed by Council. A sunset provision would address the concern that set-asides are difficult to terminate or modify. With a sunset, the burden of proof is on the proponents of continuing the set-aside, which will reduce the risk of set-asides being perpetuated beyond the point when they are needed and useful.

In determining the timing of the sunset, City Council should consider: 1) the identified need for affordable housing in the coming years; 2) how long it will take for the efficacy of the new Alexandria Housing Development Corporation to become clear; and 3) the risks to the City of accumulating unspent affordable housing funds that could be spent on other priorities.

D. Other Revenue Options

BFAAC has repeatedly stressed the importance of diversifying City revenues and reducing the City's dependence on real property taxes - real property tax revenues have increased from 40 percent of General Fund revenues in FY1997 to 56 percent in the FY2006 City Manager's budget. State law would allow the City to increase numerous taxes and fees above their current rates. As noted earlier, BFAAC urges Council to avoid raising taxes and fees to the maximum levels allowed by state law, so that future Councils will have the flexibility to address urgent circumstances. It should be noted though that none of the specific taxes or fees considered below have state maximums.

In assessing these taxes and fees, City Council should consider several questions:

1) Is the current service fee sufficient to cover the costs of providing that service?
2) How long has the current tax rate been in place?
3) What rates do nearby jurisdictions assess on comparable services or products?
4) Who would be most impacted by the imposition of such fees or taxes?
5) Can the impact of newly imposed fees or taxes be targeted?
6) Should the benefits of such fees or taxes be restricted in all or part to the communities from which they are raised.
7) Are there societal benefits to be gained by a change in the tax rate or fee amount?

BFAAC unanimously supports the principle of progressive taxation and urges City Council to examine all its options with that in mind. We recommend the following revenue options, which are discussed in order of projected revenue, from most to least.

Cell Phone Tax

BFAAC supports a tax on cell phones. It should be noted that such phones are sometimes purchased to have a way to communicate in case of an emergency. It is more likely though that most cell phone owners consider their cell phone a luxury and would not be burdened by this tax.

As reported in Budget Memo #16, a tax of 10 percent of the first $30, or a maximum of $3.00 per phone, per month, would likely generate $2 million per year. Jurisdictions like Fairfax, Prince William and Loudoun Counties, along with 110 other smaller communities, are already raising this money. In addition, the memo states that it would provide land line equity as some cell phone owners no longer own a land line and are not paying the 911 tax.

FY2006 Potential Value: $2 million

Admission Tax

By a 9-2 vote, BFAAC supports creating an Admission Tax. Please refer to our special section on the Admission Tax for a more detailed explanation of how it would work and why BFAAC supports it. Budget Memos #16 and 17 spell out the details of a staff proposed increase of 50 cents per ticket and is based upon a BFAAC recommendation. It is estimated that such a tax would produce $1.3 million.

FY2006 Potential Value: $1.3 million

Sanitary Sewer User Fee

BFAAC reiterates its standing view that the goal of making the sanitary sewer system financially self-sufficient through phased-in collection of additional fees is a wise economic course. 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 self-supported.

In Budget Memo #16, City staff provides a revenue enhancement plan. It notes that if the original plan to raise the fee to $1.00 per 1000 gallons by FY2007 were stepped up to FY2006, it would increase revenues by "$1.2 million in FY2006 and place sanitary sewer operating, capital and debt service expenses on a 100 percent fee supported basis one year earlier than planned." While BFAAC had supported the slow-as-you-go approach of 20 cents a year in the past, BFAAC supports this slight acceleration considering the significant benefit gained both financially and, more importantly, to our debt structure.

FY2006 Potential Value: $1.2 million

Tobacco Tax

While Alexandria has a tax rate that is above nearby localities, the proposed level is still below many jurisdictions in other parts of the nation. In fact, according to the Campaign for Tobacco-Free Kids, the current national average is 84.5 cents. Moreover, while increasing revenues may be the primary reason for raising this tax, raising the tax also produces the societal benefit of reducing demand. Again, according to the Campaign for Tobacco-Free Kids, studies show that every 10 percent increase in the price of cigarettes reduces youth smoking by about seven percent and overall cigarette consumption by about four percent. In recent years, every state that has significantly increased its cigarette tax has enjoyed significant increases in revenue even while reducing cigarette sales.

Of course, a reduction in sales is a reduction in taxes raised. Budget Memo #16 points out that the City estimates that a 6 percent reduction in sales would occur with a 20 cent rise in the tax, from 50 to 70 cents. On the other hand, even with that, the staff predicts an increase in revenue of $0.8 million. A slight additional increase might push a few more people to smoke less while adding a few dollars more to the City's general fund.

In addition, it should be noted that City-wide health costs will be reduced if fewer Alexandrians smoke. This is so well-accepted a proposition that, in order to reduce health care costs, some American companies are now requiring their employees not to smoke even when they are not on company time.

In summary, BFAAC believes that it is wise to raise the tax by, at least, the 20 cents proposed by staff.

FY2006 Potential Value: $0.8 million

FY2006 Total Potential Value: $5.3 million

II. STAFFING

A. Personnel Expenditures

Personnel expenditures account for 63 percent ($357.7 million) of the total proposed FY2006 budget; 85 percent of the ACPS budget ($140.6 million).

Of the 8.7 percent increase in City General Fund Operating Budget ($37.9 million) spending, compensation accounts for 28 percent, or $10.5 million. Of the $7.5 million increase in ACPS spending, compensation accounts for $5.6 million, or 75 percent.

1. Proposed Funding for City Personnel

BFAAC has repeatedly noted in past reports that compensation and benefit costs continue to absorb an increasingly large percentage of the operating budget. That remains true in FY2006. The proposed budget includes a $10.9 million increase for City employee compensation (29 percent of the total $37.9 million increase). Personnel costs increased by 7.3 percent in FY2006 to total $357.7 million.

The proposed budget includes a two percent COLA for City employees (cost of $3.6 million) as well as a step increase (cost of $3.4 million). Compensation of City and ACPS employees, including both salaries and benefits, accounts for most of the City budget, and that percentage is increasing. Staffing is a prime area for the City Council to look for opportunities to reduce proposed spending. This should include benefits, new hires and a review to see if agencies have excess personnel.

The City just completed its Benchmark Salary Survey in which it compared salary data with five comparator jurisdictions; Arlington County, Fairfax County, Prince William County, Montgomery County, and Prince William County. The mid-point salary ranges of similar job descriptions were compared. The City's policy is to be no less than 90 percent of the average midpoint of these jurisdictions. Net result is to increase the pay ranges of 221 employees, at a cost of $0.9 million, which is included in the FY2006 proposed budget.

Although the benchmark study is important in assuring that the City of Alexandria is competitive in attracting good employees, the benchmark looks only at salary and, thus, does not take into account benefits.

As noted in the FY2005 BFAAC report, the most recent benefits analysis conducted by the City's consultant indicates that the City of Alexandria provides a benefits package that is comparable, if not superior, to these jurisdictions. The former City Manager confirmed that in conversations with City employee groups last year.

BFAAC recommends that total compensation, including benefits, be included in any future benchmark analyses. The benchmark study also does not evaluate job performance (i.e. comparisons of employee output). Such an analysis may yield large returns in terms of cost savings.

For example, in comparing Alexandria's Police Department with the County of Arlington, these factors emerge:

City of Alexandria and Arlington County Police Departments Comparison
2006 Proposed Budgets

	City of Alexandria	Arlington County
Proposed Expenditures	$45,677,284	$41,865,714
Population	137,809	198,267
Police per 1,000 population	2.2	1.8
FTE	467	472
Cost per FTE	$97,810	$88,699
Cost per citizen	$331	$211
No. of households	66,562	92,145
Cost per household	$686	$454
No. of calls for service	79,200	96,500
Area Covered (sq. miles)	15.75	25.8

Note: Alexandria's Police Department budget includes its own emergency communication function; Arlington's Police Department shares the emergency communication function with its Fire Department.

While it is important to the citizens of Alexandria to feel safe and secure, it is also important that this be accomplished in an efficient and cost effective manner. The above comparisons, while not very sophisticated, indicate variances that City Council and staff should analyze further. They raise the possibility that the police department could function in a more effective manner, saving the citizens of Alexandria costs, while providing them with the high level of security they now enjoy.

To be fair, this example cannot be characterized as "apples to apples." Rather, they are base comparisons and require further analysis. However, this broad look suggests that the City should engage in productivity measurement analysis to see if equal to or better results can be obtained with a reduction in costs.

BFAAC supports the two percent COLA and step increases for City employees.

BFAAC believes that, as the largest component of the Operating Budget, personnel expenditures should be closely scrutinized for potential spending reductions. To accomplish this, BFAAC recommends that the City consider productivity measurement analysis along with analysis of total compensation compared to other local jurisdictions.

BFAAC also recommends that total compensation costs, including benefits, be made part of any future salary benchmark studies.

2. *Proposed Funding for ACPS Personnel*

Education is a labor-intensive endeavor and this year's operating budget once again reflects that reality. Eight-five percent of the entire school operating budget is comprised of salaries and benefits – as previously noted the increase in the City's proposed appropriation to ACPS is largely attributable to compensation initiatives: a two percent COLA ($2.54 million), merit and step increases ($3.4 million), realignment of support staff salaries ($0.5 million), an increase in the VRS contribution rate ($0.6 million), and increased costs associated with revisions to the ACPS health insurance plan ($1.74 million). These cost items accounted for a substantial part of the 7.5 percent increase given the ACPS in the FY2006 Proposed Budget.

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 FY2004 largely addressed the need of "comparability."

As BFAAC has noted with respect to the compensation of City employees, we support the two percent COLA and step increases for school employees.

Technical Adjustments

Under the City Manager's proposed budget, the City's General Fund appropriation to the ACPS is $139.9 million. The City's appropriation is an increase of $9.8 million over FY2005, which represents a 7.5 percent increase over last year's City appropriation of $130.1 million. The City Manager's proposed budget funds 99.4 percent of what the School Board requested. The City Manager's proposed budget reduced the School Board's request by $900,000 for what it terms "two non-programmatic technical adjustments."

The first adjustment of $620,000 reflects a City re-estimate of the projected savings that ACPS should experience from changes in personnel (vacancy and turnover savings) due to normal attrition and turnover. BFAAC understands that conversations between City and ACPS staff over this particular cut have taken place and that the ACPS generally agree with the formula used by City staff to calculate vacancy savings. However, ACPS disagrees with its implementation because said monies also are used to fund more unpredictable items such as replacement teachers and substitutes. BFAAC is mindful of the ACPS concern on this reduction.

The second adjustment of $280,000 has to do with anticipated additional State aid that can be applied toward planned teacher salary increases for 2006.

BFAAC concludes that the since the underlying calculation for vacancy savings in apparently accurate and its budgetary impact is less than 0.05 percent of the City's contribution to the ACPS operating budget, BFAAC supports the City Manager's recommendation.

As it appears very likely that the funding from the State will come though, BFAAC agrees with the adjustment.

B. New Hires

The City Manager's Proposed Operating Budget contains, in the City's portion of the budget, the creation of 59 new full-time positions and the elimination of 20.17 position reductions for a net increase of 38.83 positions. The new positions are as follows:

Fire	3
Police	17
MHMR & Substance Abuse	8
Human Services	6
General Services	4
Information Technology Services	3
Recreation, Parks & Cultural Activities	4
Registrar of Voters	2
Real Estate Assessments	2
Transportation & Environmental Services	2
City Clerk	1
Finance	1
Library	1
Health	1
Personnel	1
Clerk of Court	1
Commonwealth Attorney	1
Court Service Unit	1

Within these numbers however, are several consolidations or conversion of part-time or over-hire positions to create new permanent positions, the addition of full-time positions rather than contracting out for services and, conversely, the elimination of a few current positions.

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. The performance measurements in the Proposed Budget could help indicate if the workload of these departments suggests the need for additional staffing.

The School Board's Adopted FY2006 budget reflects a net increase of 39 new positions for FY2006. Of those, 30 can be considered as instructional, of which 14 are reserve teachers. The remaining 8 positions are administrative.

The ACPS budget includes 3.4 personnel deletions and other changes in personnel that will account for $968,308 in savings from the Revised FY2005 budget to the approved FY2006 budget. The School Board's budget includes 39.45 personnel additions that will account for an increase over the Revised FY2005 budget of $3,342,470. It should be noted, however, that of the 39.45 new positions, the 14 teacher reserve positions will only be filled if the need arises. The use of teacher reserve positions has been an accepted and useful budgetary practice in that if the need does arise because more students show up at the school house door, funding is available to make the necessary hires. The 14 teacher reserve positions account for $714,803 of the Approved Budget. The City Manager's Proposed Budget fully funds the School Board's Approved Operating for all but $900,000 in technical adjustments described above.

BFAAC encourages City Council to look into the proposed ACPS initiatives to assure that requests are based upon needs, and that monies are well spent.

BFAAC notes that the ACPS budget has increased by a substantial amount, 7.5 percent, even though the student population served is projected to decrease by 87.

BFAAC also recommends that the ACPS new hires receive the same scrutiny as City hires. Coordination between the City Council and the School Board on staffing and benefits issues need to be addressed cooperatively to assure a balanced approach to staffing of the various City and ACPS priorities and basic functions.

BFAAC reminds City Council that new hires cost the City far more than their base pay. These costs include health and retirement benefits costs (both which are addressed below), training costs, new equipment and increased workers' compensation, to name but a few.

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. ACPS new hires should receive the same scrutiny.

C. Fringe Benefits

Fringe benefits in the proposed FY2006 budget total $87.745 million, with $35.856 million of that total for ACPS employees. That amounts to 9.8 percent over the current year figures of $79.898 million, with $32.645 million of that total for ACPS employees.

1. Retirement Benefits

BFAAC has noted in the past that the City should offer employees a mix of retirement plans that includes defined-contribution (DC) plans to reduce the City's financial exposure and give more power over their retirement investments to City employees. We also have encouraged the City to explore increasing the employee share of contributions toward all retirement plans to lessen the increasing City share.

Both City and ACPS employees are covered by the statewide Virginia Retirement System, a defined benefit (DB) plan. The City provides supplemental plans to some employees.

A recent analysis by the Personnel Department reveals that retirement costs to the City for a typical City general employee (see below) is 9.25 percent of salary, higher than all but one of the other jurisdictions in the study (Arlington County, Fairfax County, Prince William County in Virginia and Prince George's County and Montgomery County in Maryland). For public safety employees, who have a mixed defined-benefit/defined/contribution plan, retirement costs are 22.35 percent of salary (including a disability income plan), topped only by the two Maryland counties at more that 24 percent and 28 percent, while Virginia counties ranged from 10.5 percent in Arlington to 21.79 percent in Fairfax. These data are based on an employee with a salary in the mid-range at $48,000.

For school employees, once again Alexandria is tops at 13.81 percent of salary, with all but one of the other jurisdictions ranging from 9.35 percent to 12.95 percent. All Virginia jurisdictions in the study are above 11 percent and Fairfax County is also at 13.81 percent. This study compared the same jurisdictions, using data from the Washington Area Board of Education consortium, based on an employee with a salary in the mid-range at $48,000.

As noted in last year's report, these benefits are at the high end of the scale and, when added to the rising costs of health benefits, fuel the continuing increases in the City's budget.

National Comparative Data on Public Retirement Plans

Below are data from a paper by the National Conference of State Legislatures posted on their website in February 2005. (http://www.ncsl.org/programsfiscal/defineretire.htm)

Historically, most public employee and teacher retirement systems have been defined-benefit plans and most still are. However, since the 1990's, with smaller private sector companies moving to defined-contribution plans due to tax law changes, a more mobile workforce, and the cost of defined-benefit plans, some public sector plans have created hybrid defined-benefit/defined-contribution plans or allow certain employee groups or new-hires more options.

Defined benefit plans generally favor career employees, those with substantial pay increases over a career, with longer life expectancy, those who die or become disabled early in their career, and those who retire early. Defined contribution plans generally favor employees who terminate employment at a young age, those with modest pay increases over a career, those with short life expectancy, those who achieve a higher rate of investment return through personal investment selection, and those hired at very young ages.

Current arguments against defined-benefit plans are that they are archaic and very expensive, that a change to defined-contribution plans would save money for employing jurisdictions and would give employees more control over their investments

Defenders of defined-benefit plans claim that such an approach attracts and retains qualified employees, that defined-contribution plans will not necessarily reduce the cost to government employers, that the DB plans perform better in times of economic downturn and the official that administer public retirement plans investment officials give preference to investment of the pension funds in the locality or state economy, thus producing an overall benefit for the state or locality.

Defined-Benefit Plans as Primary Plans

More than 40 states have defined-benefit plans for all or nearly all public and school employees both state and local. There are some options beyond the DB plan in some states as explained below.

Defined-Contribution Plans as Primary Plans

Only the District of Columbia (defined-contribution plan and Social Security) and the states of Michigan, Nebraska and West Virginia have had or currently have DC plans. Michigan's DC plan is for employees hired since 1997, and Nebraska had a DC plan from 1867 to 2002 but now has a cash-balance plan with an approximate 2 to 1 contribution by employer-employee going to an employee account with a certain guaranteed return.

Hybrid Defined-Benefit/Defined-Contribution Plans

Four states have hybrid DB/DC plans, where the employee must participate in both types:

- Florida employees hired before 2000 may elect to split their benefits between the two approaches. New employees have no option and are covered by a DC plan.

- Indiana has a long-standing hybrid plan with employer contributions going to a DB plan and the employees' share to a saving plan, a type of DC component of the overall plan.

- Ohio teachers may choose between DB and DC and a hybrid plan as a third option for these employees

- Oregon has a mixed system for state employees with individual accounts for the employee's share of contributions.

Washington made changes between 1998 and 2000 for teachers and public employees that is option for those employed at time of change, but new teachers must join the hybrid plan, with other options for other public employees.

Conclusion and Recommendations

The City and ACPS cost of retirement benefits for employees equals or exceeds that of surrounding jurisdictions.

The City should 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. We also recommend that the City and ACPS explore increasing the employee share of contributions in all retirement plans to lessen the increasing City share.

2. *Health Insurance Benefits*

BFAAC is concerned about the increasing cost of employee health insurance and its effect on the City's operating budget. While the annual costs have slowed somewhat when compared with previous fiscal years, they are continuing to increase at rates that exceed inflation -- during FY2005, health insurance costs rose for City employees by 12 percent; and the FY2006 projected increase is 7 percent.

The proposed FY2006 budget plans spending $1,470,957 on health insurance. That figure does not include ACPS employee health insurance (which increased by $1,300,000 over FY2005).

In an effort to contain future health insurance increases, BFAAC last year recommended that the City investigate and pursue cost-mitigation strategies including employee cost-sharing. We did 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. BFAAC reiterates both of those recommendations here: the City should pursue cost-mitigation strategies, a part of which is employee cost-sharing. The recommendation also applies to the ACPS.

ACPS Approved Insurance Plan

Last year, BFAAC recommended that the City and ACPS open talks aimed at merging the two separate health insurance plans in an effort to contain premium increases.

BFAAC credits the City and ACPS for their efforts to combine health insurance plans in an effort to contain costs. That having been said, BFAAC is concerned that the ACPS effort to constrain health insurance costs by combining with the City programs, while laudable, does not address the underlying issue of finding ways to lessen the overall rate of increase in the cost of health benefits. In fact, the combination of ACPS health insurance with that of the City will cost ACPS an additional $581,698 in FY2006 to hold harmless school employees from any increase in MAMSI premiums.

Health Care Costs of New Employees

A recent analysis by the City of Alexandria Personnel Department reveals that health insurance benefits for a typical City employee, both general and public safety, is 17.57 percent of salary, ranking in the middle of the jurisdictions in the study (Arlington County, Fairfax County, Prince William County in Virginia and Prince George's County and Montgomery County in Maryland). These data are based on an employee with a salary in the mid-range at $48,000.

For school employees, with an add-on of 11.97 percent of salary, Alexandria is at the low end of the jurisdictions, with only Prince George's County lower at 11.4 percent. Other Virginia jurisdictions range from 17.3 percent to 22.07 percent of salary. This study compared the same jurisdictions, using data from the Washington Area Board of Education consortium, based on an employee with a salary in the mid-range at $48,000.

Conclusions and Recommendations

BFAAC credits the City and ACPS for their efforts to combine health insurance plans in an effort to contain costs. BFAAC is concerned, however, that the ACPS effort to constrain health insurance costs by combining with the City programs does not address the underlying issue of finding ways to lessen the overall increase in the cost of benefits, and could, in fact cost more.

Conclusions and Recommendations on Combined Fringe Benefits

Health insurance and retirement benefits costs for the typical mid-range employee making $48,000 are a combined 25.78 percent of salary for City employees and 32.81 percent to 35.81 percent for ACPS employees, depending on the health care plan selected by the school employee. BFAAC remains concerned about the dramatic pressure being put on the operating budget by fully funding employee health insurance premiums and by the higher comparative level of retirement costs paid by the City and repeats its belief stated last year that the City and ACPS need to look at the entire compensation and benefits package when making decisions on pay raises and benefits increases.

The City and ACPS should continue to seek efficiencies in retirement and health care plans and coverage:

- By continued attention to plan benefits and economies in plan selection and administration,
- By exploring increasing the share of contribution by employees to payment of premiums,
- By closely monitoring the need for new hires who will receive benefits, and
- By mounting a major study of the benefits area with the goal over a multi-year period of possible significant reductions or slowing of increases in the percentage of overall compensation devoted to employee benefits.

III. THE PROPOSED CAPITAL IMPROVEMENT PROGRAM

A. Overview

Over the last six years, the City has made substantial investments in the future of Alexandria through new construction, rehabilitation, restoration and replacement of the City' physical infrastructure. The proposed Capital Improvement Program (CIP) would continue on that course.

The following chart shows the growth of the CIP over the past ten years (the City share as well as the total CIP). This growth has been possible as a result of the City's rapidly expanding real property tax base which has (1) given the City room to step up its borrowing while staying within its Debt-Policy Guidelines; and (2) increased the City's tax revenues thus allowing for larger cash capital contributions from current revenues.

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	06-11 proposed
City Share	$106.0	$123.8	$137.4	$118.0	$156.3	$197.3	$183.8	$340.1	$318.2	$325.0
Percent Change	–	16.8	11.0	-14.1	32.5	26.2	-6.8	85.0	-6.4	2.1
Total CIP	178.8	213.5	246.2	232.9	267.0	342.2	353.0	558.1	566.7	568.0

The City's share of the CIP budget reached a high point of $340.1 million in the FY2004-2009 budget, representing an 85-percent increase over the previous 6-year budget period. It decreased slightly for FY2005-10, but then turned upward again for FY2006-11, primarily because of increased contributions to transit costs.

On the whole, BFAAC believes the proposed CIP budget meets legitimate long-term capital project needs. BFAAC wishes, however, to raise a significant warning. The building of a new TC Williams, the construction of a new public safety center, the increased contribution to transit costs, the renovation and expansion of Chinquapin Recreation Center and construction of an All-City Sports Facility puts the CIP on the verge of becoming unaffordable, as defined by the City's Debt-Policy Guidelines. More specifically BFAAC is concerned with the following:

1. The City share of the CIP has grown again this year despite substantial down payments on several "big ticket" projects, primarily the construction of a new T.C. Williams High School and the new public safety center (both of which are scheduled for completion by 2008). Furthermore, the City has a long list of unfunded capital needs which are not included in the current CIP, including a new fire station, infrastructure improvements related to the planned major development at Landmark Mall, and the widening of Eisenhower Avenue. It will be difficult to sustain an expanding CIP and remain within

the City's Debt-Policy guidelines unless the City is careful to set reasonable priorities among competing projects and establish a realistic funding timetable.

2. The total CIP relies on non-City sources for $161 million in funding most of which is for streets and bridges ($54.4 million), traffic improvements/rapid transit ($50.4 million) and the Wilson Bridge Project ($35.5 million). In significant part, non-City funding sources have been identified in this year's budget, primarily from State Urban Funds and other money contained within the Virginia Department of Transportation (VDOT) six-year plan. Should these non-City funding sources fail to materialize, the projects covered in the current ambitious six-year CIP may have to be cut back or delayed. Another $20 million in funding has not yet been identified, including $11 million for WMATA contributions in the out years of the CIP.

3. Cash capital contributions have been critical to expanding the CIP, however, they have remained at very high levels for several years and may have reached a point where today's taxpayers are paying more than their share for benefits that will also be enjoyed by future residents. Unlike past years, we urge City Council to reduce planned cash capital contributions to the CIP and spread the burden out more equitably to future generations of Alexandrians. To do this, the City might need to better space some of its larger capital improvement projects; for example, defer projects such as Chinquapin or the All City Sports Facility (or even the new Public Safety Center), until 2010 or beyond, when the City would have more flexibility (under its Debt-Policy Guidelines) in borrowing money to pay for these projects.

4. Under the City's current Debt-Policy Guidelines, Alexandria is well within its target borrowing capacity when measured against the value of the City's real property tax base; however, Alexandria exceeds its target borrowing capacity (through 2011) when measured against the income of its residents. Even if the Debt-Policy Guidelines are adjusted (as per BFAAC's recommendation last year), the City will be near target borrowing capacity through FY2009, and above target levels in FY2008. In other words, there is little room to incur additional debt until after FY2009.

5. While it may be tempting to fund a tax rate reduction using large cuts in cash capital, this "one-shot" decrease would not help the City next year when it comes time to pay for ongoing and recurring expenditures. Instead, to fund reductions in the real property tax rate, beyond the four cents proposed by the City Manager, City Council should look first to reduce the operating budget of the City and ACPS or find new, on-going revenue sources.

B. Specific Findings

The City-share of this year's proposed CIP contains $325 million in planned expenditures, just a 2.1 percent increase over last year's CIP. A year-by-year comparison, however, shows substantial annual increases of planned expenditures in four of the five years covered by both plans. This is despite substantial down payments on several "big ticket" projects, primarily the construction of a new T.C. Williams High School and a new public safety center (both of which are scheduled for completion by 2008). As the City gets closer to the out-years of the CIP, these increases are likely to grow larger.

Approved CIP Expenditures for FY2005-2010 Compared to Proposed CIP Expenditures for FY2006-2011
($ in millions)

	FY05	FY06	FY07	FY08	FY09	FY10	FY11	Total
Prev. CIP	$88	$61.7	$45.9	$87.9	$18.0	$16.7	NA	$318.2
Prop. CIP	NA	$70.7	$62.2	$83.5	$52.3	$31.1	$25.3	$325.0
Difference	NA	$9	$16.3	($4.4)	$34.3	$14.4	NA	$6.8
% Change	NA	14.5%	35.5%	-5%	190%	86.2%	NA	2.1%

Four specific areas of spending drive the proposed CIP, representing over 80 percent of the City's share of CIP expenditures: (1) Traffic Improvement/Rapid Transit, $39.8 million; (2) School facilities, $94.5 million; (3) Public Safety Center $48.8 million; (4) Recreation facilities, including the Chinquapin Recreation Center and the All-City Sports Facility, $56.2 million; and (5) Information Technology Plan, $20.9 million.

1. The current CIP proposes a significant increase for transit projects.

Washington Metropolitan Area Transit Authority. The most significant increase in capital spending in the proposed CIP is for the City's share of traffic and transit projects, $39.85 million, up from $10.98 million last year. Eight-five percent of this money ($33.9 million) is to pay for the City-share of the Washington Metropolitan Area Transit Authority's Capital Improvement Program (WMATA CIP). In prior years, the City has funded a large portion of its WMATA contribution using State Urban Funds from the Virginia Department of Transportation (VDOT). This year, however, that will not be possible—State Urban Funds now contain federal funds, which cannot be used to pay for Metro.

BFAAC notes that Alexandria's contribution to the WMATA CIP is actually $44.9 million, however, the City has indicated it will try to find State funding sources to cover $11 million of this contribution. If the City is not able to secure outside funding, it will have to pay the additional $11 million beginning in FY2007. (The $11 million is spread out over four years, from FY2007 through FY2011.)

Bus Replacement. The DASH Transit Development Program has proposed spending $8.68 million to replace 27 buses during the six-years of the CIP. Most of these buses will have reached their useful life of 12 years. Funding for the new buses will come from $6.2 million in VDOT State Urban Funds (reprogrammed from WMATA) and $1.3 million in DASH retained earnings.

BFAAC understands there are on-going discussions about expanding the DASH fleet beyond its current 57. We take no position on the merits of an increase in the number of buses but simply point out that at a cost of $321,250 per bus, any increase during the 6-year CIP would add to the current unfunded capital projects.

DASH Facility. The City has reprogrammed $22.8 million in VDOT State Urban Funds from other projects to build a new DASH facility; however, this amount will not be sufficient to pay for an enclosed bus parking area. If the City determines that enclosing the bus parking area is desirable, it will have to secure additional State funding, or use City resources that are not currently allocated in the six-year CIP. The total cost for the DASH Facility will likely approach $30 million.

BFAAC recommends that City Council carefully consider how best to use State Urban Funds. Since this large pool of money may no longer be used to fund the City's mandatory WMATA contribution, should it be used mainly for DASH? Or are there other worthwhile projects to consider?

2. ***The City Manager's proposed CIP includes $94.6 million to fund the ACPS adopted CIP, or 88 percent of the requested amount.***

The School Board Approved Capital Improvement Program budget for FY2006 - FY2011 requests a City appropriation of $107.8 million, an increase of 1.9 percent over the six-year period adopted last year. The City Manager's proposed CIP includes $94.6 million to fund the ACPS adopted CIP, or 88 percent of the requested amount.

The discrepancy in funding between the City Manager's proposed CIP and the School Board's approved CIP begins to come into play in 2009 (FY2006, 2007 and 2008 are all fully-funded by the proposed CIP). The ACPS adopted CIP requested $10.1 million in FY2009 and $10.1 million in FY2010 for the renovation and expansion of Minnie Howard Ninth Grade Center. In last year's CIP, the City approved $15 million in funding for the three-year project. This year, however, primarily as the result of concerns over the increasing cost of the TC Williams construction project, the School Board agreed to delay the project until FY2009/2010. The City Manager's proposed CIP includes $4.8 million in funding for each FY2009 and FY2010, which essentially provides the same level of funding that the Council approved in last year's CIP. By way of explanation, the Manager's budget states that: "[a]s the project nears initiation, trends in construction costs and enrollment are better known, funding will be identified in a future CIP.

BFAAC finds the Manager's approach to be reasonable. It confirms the City's commitment to the project but also takes into account the fact that changes in enrollment could change the overall nature of the project. BFAAC notes, however, that with the current trend in construction costs, the ACPS requested funding is likely a more realistic number if the nature of the project does not change between now and FY2009.

The City Manager's proposed CIP also removes $2.5 million in FY2011 for the educational contingent reserve fund. It is unclear at this time whether that reserve, which was originally established to ameliorate the funding issues attendant to the rising cost projections of the TC Williams construction, will need to continue beyond 2010 so BFAAC agrees with this deletion.

Fully-Funded School Projects

The City Manager's budget includes $14 million in funding for school projects (e.g., roof repair, windows), $8.8 million in educational support (e.g., FF&E, bus replacement, maintenance and transportation facility), $5.4 million in general maintenance (e.g., renovations, landscaping renewal, building systems), $55.1 in new construction (all but $3 million for TC), and $4.2 million for miscellaneous (e.g., rowing facility, city mandates).

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 ACPS facilities and we recommend that the City continue to do so.

3. *If the Public Safety Center can be built on the City-owned Wheeler Avenue site, the City might realize some savings on project costs.*

Last year, BFAAC provided City Council with a more extensive analysis of the high costs associated with the new Public Safety Center (PSC). The City has already set aside $21.16 million for the project with another $48 million in the current CIP. This year BFAAC would like to re-emphasize the need for City Council to be certain the final design is of appropriate scale and the selected site has adequate transportation access. With construction not scheduled until FY2008, the City should still have ample time to plan wisely.

The original budget for the PSC assumed $16.61 million for land acquisition costs and $5.75 million for site development. If the City is able to build the PSC on the City-owned Wheeler Avenue site, it should be able to save a portion of this money. The savings, however, would be substantially less than $22.36 million since the City would have to pay for industrial clean-up at the Wheeler Avenue site, and relocate the current facilities.

BFAAC recommends the City consider pushing the final ($43.17 million) construction phase of the PSC until FY2009 or beyond, to better space the timing of its large capital improvement projects. Also, in anticipation of possible project savings, BFAAC recommends the City move a small portion of the $21.16 million that has already been banked or planned for this project into later years to help fund the additional four-cent tax rate reduction in FY2006.

BFAAC notes that the City has spent $3.5 million to build-out an interim (off-site, leased) Police Department facility. Pushing construction of a new PSC beyond FY2008 would also allow the City to recoup more of its investment in this interim facility.

4. *The City is planning to make a substantial investment in its recreation facilities.*

Chinquapin. The Budget continues to include a $20 million placeholder for the planning, renovation and expansion of the Chinquapin Recreation Center with construction scheduled to begin in FY2009, after the T.C. Williams project is completed. Project details have yet to be worked out.

All-City Sports Facility. The CIP also includes $10 million for an All-City Sports Facility to be constructed in FY2007, $5 million of which is to come from private fundraising efforts (via the Alexandria Capital Development Foundation). Projected final costs, however, are already in excess of $17 million, and the source of these additional funds has not yet been determined. Is the balance to come from City sources? Or will any amount in excess of $10 million come from private fundraising efforts? Or, will it be a 50/50 match?

BFAAC has some additional concerns over the planning of the project, especially the lack of parking—the planned facility will house a 4,000-seat stadium, yet only offer 103-472 parking spaces. Furthermore, the proposed location is on a portion of Eisenhower Avenue that is not metro-accessible.

Finally, BFAAC cautions that a new project of this nature could have a sizeable impact the City's annual operating budget—in terms of additional personnel and maintenance requirements.

Patrick Henry and Charles Houston Recreation Centers. The current budget includes $4.3 million to complete needed improvements to these two facilities. BFAAC cautions, however, that the actual price tag could be much higher than is currently planned. (The City recently completed renovations on the Durant Center at a cost of $3.46 million.)

BFAAC recommends moving the timing of Chinquapin and the All-City Sports Facility so the bulk of the costs occur in 2010 or beyond. This would give the City more flexibility (under its Debt-Policy Guidelines) in borrowing money to pay for these projects which will benefit future generations of Alexandrians. Deferring these projects might also allow the City to reduce planned cash capital contributions by $2 - $3 million over each of the next two or three years and give the Alexandria Capital Development Foundation additional time to raise the necessary funds.

5. ***The City's Information Technology Plan contains $1.5 million in FY2006 expenses that can be reprogrammed to FY2007.***

The City's Information Technology (IT) Department prepared a list for City Council of ten projects that could be reprogrammed to FY2007, including the replacement of its Personal Property Tax System ($400,000), the replacement of its Payroll/Personnel System ($500,000), and the replacement of Police/Fire Computer-Aided Dispatch equipment ($200,000). These FY2006 reductions total $1.5 million.

BFAAC appreciates the IT staff's decision to delay these projects, but cautions that it's not a long-term budgetary reduction—all but $100,000 of this expense is likely to be included in the Proposed FY2007-2012 CIP.

6. ***The City has a long list of unfunded capital needs which are not included in the current CIP.***

We highlight below some of the major projects from the list of unfunded capital needs that appears on pages 9-11 of the proposed CIP budget.

- Full funding of the School Board's request for the renovation and expansion of Minnie Howard Ninth Grade Center.
- Construction of a new fire station. The FY2006 Budget includes $3.6 million for design and land acquisition, but not construction.
- Alternate revenue sources to fund expanded Metrorail and Metrobus capital programs. At least $11 million will be needed in the out years.

- Landmark Mall infrastructure improvements, which would be undertaken in connection with the planned major redevelopment of Landmark Mall.
- Widening of Eisenhower Avenue. The City estimates project costs of at least $18 million.

BFAAC recommends that the City be very careful to set reasonable priorities among competing projects and establish a realistic funding timetable. Otherwise, it will be difficult to sustain an expanding CIP and remain within the City's Debt-Policy Guidelines.

7. *Alexandria's budget carries forward $81.8 million in unallocated resources from prior-year CIPs (FY2005 and earlier).*

These unallocated funds include $21.1 million for the Public Safety Center, as well as $60.7 million for dozens of smaller projects—for example, $8,000 for a nursery trailer at Fort Ward Park and $89,000 for Visitor Center improvements.

To help fund the four-cent tax rate cut in FY2006, the City might review these projects carefully and push back or eliminate any projects that the City will not be able to complete within the next few years. For example, the CIP includes $1.4 million in unallocated prior-year funds for the undergrounding of utilities in Old Town, plus an additional $2 million in the budget for FY2006. This might be a prime project for deferral.

The City might conduct a similar review of new projects in the CIP and postpone those that are not essential and would require new hires to complete; for example, the Coordinated Sign and Wayfaring System which would cost $400,000 in FY2006 and $2.3 million in total.

BFAAC recommends this type of review, but cautions that if the City does tap into prior-year unallocated funds, the money will no longer be available to spend on the program for which it was originally budgeted (unless it is replaced in subsequent budget years), and all of these projects have been approved by City Council in previous CIPs.

8. *Cash Capital contributions to the CIP have been steadily increasing since FY1997-2002, and now have a considerable impact on the City's operating budget as well as a family's pocketbook, especially when combined with the City's debt-service costs.*

The City-share of CIP expenditures is financed by a combination of cash capital contributions from current revenues and fund balance (resulting from prior-year budget surpluses), additional borrowing, and other resources (for example, sewer fees and bond interest earnings). As the following chart shows, cash capital contributions have been critical to expanding the CIP, and have increased steadily since FY2000-2005, coinciding with the surging real estate market.

Planned CIP Funding Sources
($ in millions)

	97-02	98-03	99-04	00-05	01-06	02-07	03-08	04-09	05-10	06-11
Cash Capital	$35.1	$28.8	$39.1	$38.0	$79.5	$99.3	$102.6	$111.1	$125.3	$151.9
Bonds	$70.9	$95.0	$98.3	$80.0	$65	$93.0	$79.2	$212.1	$159.5	$148.5
Other	--	--	--	--	--	$5.0	$2.0	$16.9	$33.4	$24.6
Total City Share	$106.0	$123.8	$137.4	$118.0	$156.2	$197.3	$183.8	$340.1	$318.2	$325.0
%Cash Capital	33.1%	23.2%	28.4%	32.2%	50.9%	50.3%	55.8%	32.7%	39.4%	46.7%

To give a more complete picture of the CIP's impact on the City's operating budget, and a family's pocketbook, the chart on the next page examines the combined debt service and cash capital contributions as a percentage of the total operating budget, and on a per capita basis. It includes cash contributions that come from prior-year fund balance. As long as real estate values continue to increase at rates higher than those predicted in proposed budgets, budget surpluses are a real possibility. (Contributions from fund balance have averaged nearly $10 million per year since 1995.)

Beginning in 2000, cash capital contributions increased considerably as a percentage of General Expenditures, and as a per capita expense.

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. (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.)

At the same time, the City must be mindful that today's taxpayers should not have to pay more than their share for benefits that 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.

Unlike past years, BFAAC recommends that City Council reduce planned cash capital contributions to the CIP and spread the burden out more equitably to future generations of Alexandrians. To do this, the City may need to defer some projects to 2010 or beyond when the City would have more flexibility (under its Debt-Policy Guidelines) in borrowing money to pay for these projects.

FY	Debt Service Expenditures	Total Cash Capital Contribution	Cash Plus Debt Service	Cash Cap as % of Gen Exp	Cash+Debt Svc as % of Gen Exp	Cash Cap per Capita	Cash+Debt Svc per Capita
1997	$9,289,745	$5,435,196	$ 14,724,941	1.67%	4.51%	$46	$125
1998	$8,827,610	$5,615,893	$ 14,443,503	1.58%	4.07%	$47	$121
1999	$ 6,350,549	$11,159,265	$ 17,509,814	2.93%	4.60%	$92	$144
2000	$ 8,866,071	$21,863,322	$ 30,729,393	5.55%	7.81%	$170	$240
2001	$12,382,315	$27,297,193	$ 39,679,508	6.80%	9.88%	$209	$304
2002	$16,015,996	$19,920,000	$ 35,935,996	4.40%	7.94%	$153	$277
2003	$17,483,024	$26,500,000	$ 43,983,024	5.43%	9.01%	$198	$328
2004	$18,682,768	$24,060,000	$ 42,742,768	4.66%	8.28%	$178	$317
2005	$22,999,862	$27,124,176	$ 50,124,038	5.21%	9.62%	$199	$367
2006	$27,714,883	$27,114,778	$ 54,829,661	4.79%	9.69%	$197	$398
2007	$29,572,309	$24,225,423	$ 53,797,732	4.07%	9.05%	$174	$387
2008	$32,469,901	$25,420,998	$ 57,890,899	4.07%	9.28%	$181	$412
2009	$35,983,564	$26,622,099	$ 62,605,663	4.06%	9.56%	$188	$442
2010	$35,792,749	$27,271,384	$ 63,064,133	3.99%	9.23%	$191	$441
2011	$34,311,094	$21,318,476	$ 55,629,570	3.02%	7.89%	$148	$386

Appendix:
Debt-Policy Guidelines

The proposed CIP keeps the City within all the limits of its debt-related financial policy guidelines, except for FY2008 when it exceeds the recommended ceiling for debt per capita as a percentage of per capita income. (It exceeds the target for this particular guideline in every year of the CIP.) 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 financial policy guidelines. Meeting the guidelines provides several necessary assurances:

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

- Debt service costs do not impose too great a burden on future operating budgets as measured by debt service as a percentage of total expenditures. See Chart 2; 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. See Charts 3 and 4.

BFAAC has previously recommended that City Council revise its Debt-Policy Guidelines to resynchronize two of the indicators – (1) debt as a percentage of fair market real property value and (2) debt per capita as a percentage of per capita income. BFAAC has also recommended 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.

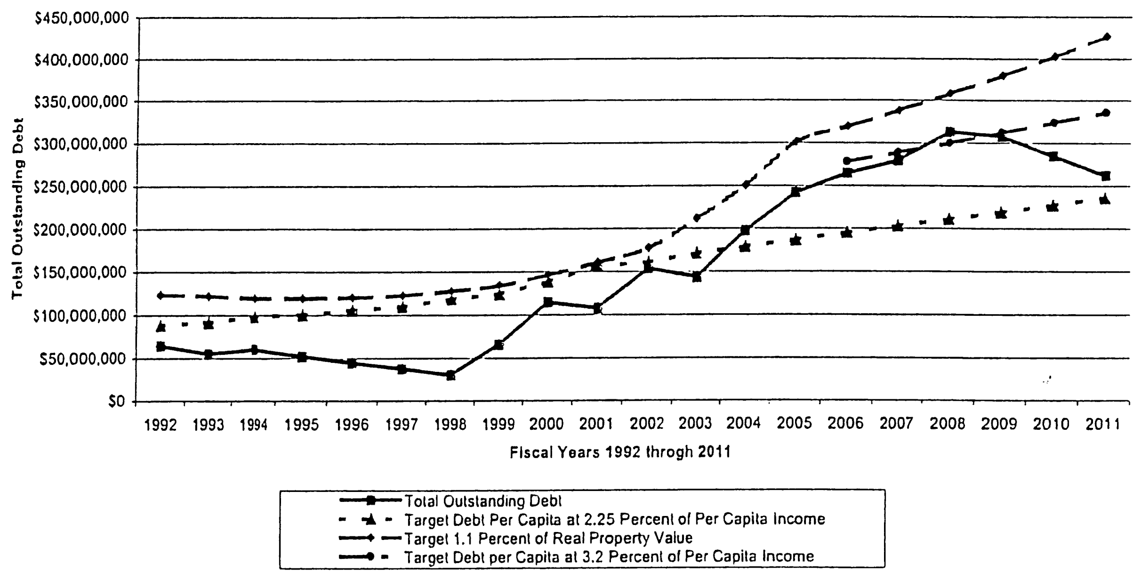
The target figures for Alexandria's Debt-Policy Guidelines were based on research in 1997 that set them at levels equal to the average of other jurisdictions with double triple-A bond ratings. The key target chosen at that time was the one showing debt as a percentage of fair market real property value. 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 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; 1.6 percent and 3.25 percent respectively.

Both of these targets and limits are dynamic and rise as real property values and per capita income rise. Since FY2000, however, the two guidelines have diverged as increases in real property values in Alexandria have greatly outpaced increases in per capita income.

During the FY2004 budget process, BFAAC noted this growing divergence and recommended that City Council update the City's financial policy guidelines to resynchronize them. To do so, BFAAC recommended setting the target debt per capita at 3.2 percent of per capita income, and the limit at 4.5 percent. BFAAC noted, however, that these rates were tentative pending ongoing staff review of other double triple-A jurisdictions. If the current guidelines are reflective of these other jurisdictions, an adjustment to Alexandria's guidelines might not be warranted.

Alexandria is well within its target borrowing capacity when measured against the value of the City's real property tax base, however, Alexandria exceeds its target borrowing capacity when measured against the income of its residents.

Chart 1: Outstanding Debt vs. Target Guidelines



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

- The target level of debt as a percentage of real property value increased dramatically between FY2000 and FY2005 thanks to the remarkable surge in real property assessments. The City remains comfortably below this measurement of debt capacity throughout the six-year CIP.

- The target level of debt per capita as percentage of per capita income shows a much more gradual and steady increase over the years, as incomes have risen by an average of only three- to four-percent per year. The City will remain above this target measurement of debt capacity through FY2011, and bump up against the limit through FY2009 (and actually exceed the limit in FY2008).

- The total outstanding debt in this chart excludes sanitary sewer capital debt beginning in FY2007, as per BFAAC's recommendation that sanitary sewer debt may be exempted from debt limits once sanitary sewer costs are fully fee-supported. If City Council votes to accelerate sanitary sewer fees, the City could begin excluding sanitary sewer debt beginning in FY2006.

- Even if the City revises its Debt-Policy Guidelines to reflect BFAAC's recommendations, Alexandria's total outstanding debt puts it near target borrowing capacity (as measured against per capita income) through FY2009 and above target levels in FY2008. In other words, even under revised guidelines, Alexandria has little room to incur additional debt until after FY2009.

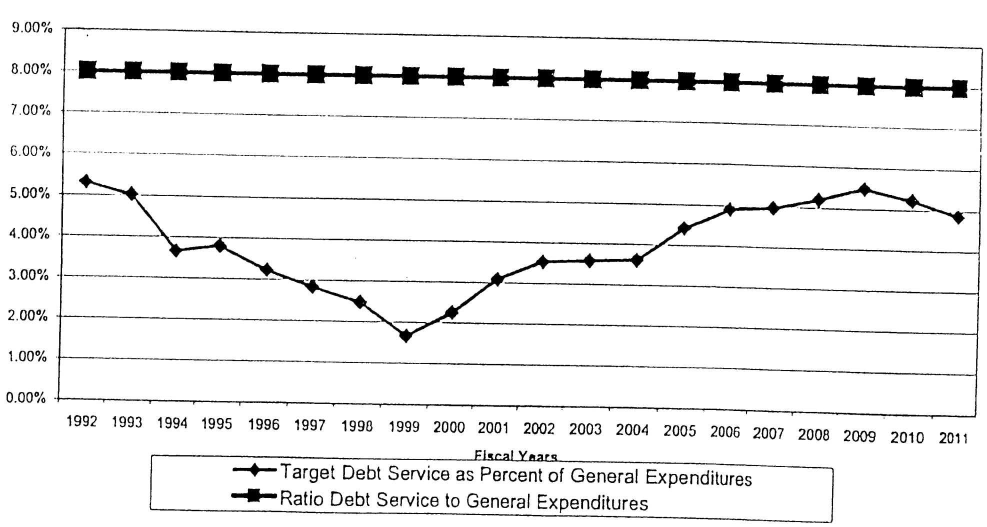
- Assuming the fiscal capacity of the City continues to increase (in other words, assuming property values and per capita income continue to rise), the City is in better position to borrow additional funds after FY2009 (approximately $44 million in FY2010 and $79 million in FY2011) and still remain within the limits (but not necessary the targets) all of its Debt-Policy Guidelines. Given the scope of the projects that have not been included for funding in the FY2006-2011 CIP, the City will likely need this flexibility.

- 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 the City's established targets. The out-year projections for real property value assume that assessments will increase by six percent per year. The out-year projections for per capita income assume that income will increase by around three percent per year. These rates of increase are slightly lower than historical averages for the prior ten years.

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 do not pose too great a burden on the City's operating budget.

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 the City's future operating budgets (as measured by debt service as a percentage of general government expenditures). This target was set at eight percent in 1997 to approximate the average of other jurisdictions with double triple-A bond ratings. Alexandria is comfortably below this level for the foreseeable future.

Chart 2: Debt Service as Percent of General Expenditures



Current fund balances continue to remain above the targets specified in the City's Debt-Policy Guidelines. Maintaining theses balance is prudent, as well as necessary; therefore BFAAC cautions against planning to use these reserves to fund operating expenses or debt payments, which could happen if the City adopts too large a tax rate cut.

To make certain the City maintains an adequate fund balance to cope with emergencies or unexpected financial problems (like revenue shortfalls or unanticipated expenditures), the City's Financial 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 general fund balance is the equivalent of the checkbook balance of the City of Alexandria.

The graphs below 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. For example, a sizeable decrease in the real property tax rate could drive the current year budget into deficit forcing the City to use the fund balance to pay operating costs. City Council has adopted a policy to not finance operations from fund balances for periods longer than two years.

Chart 3: Unreserved General Fund Balance as Percent of General Fund Revenue

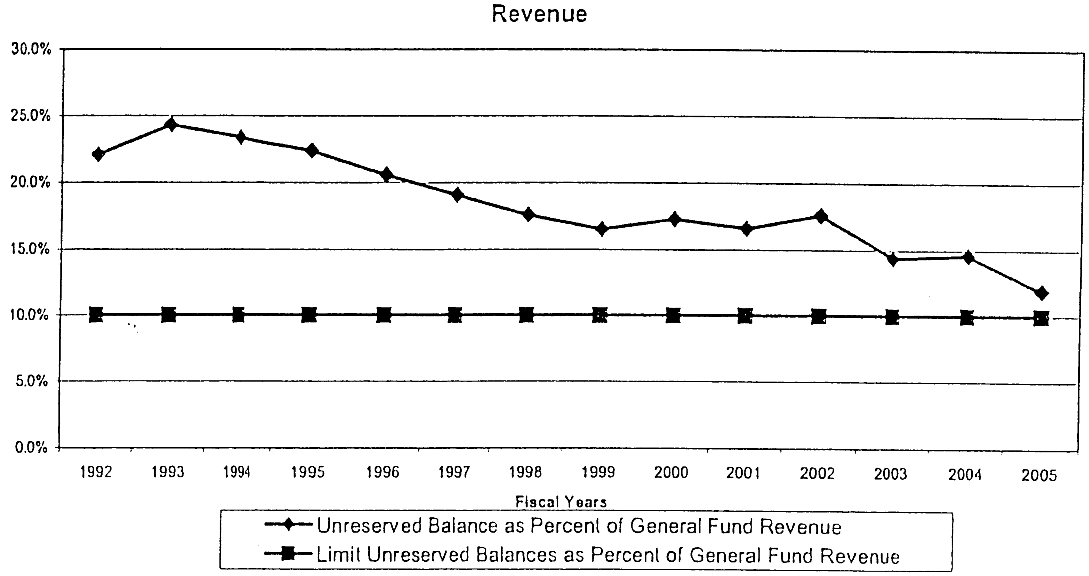
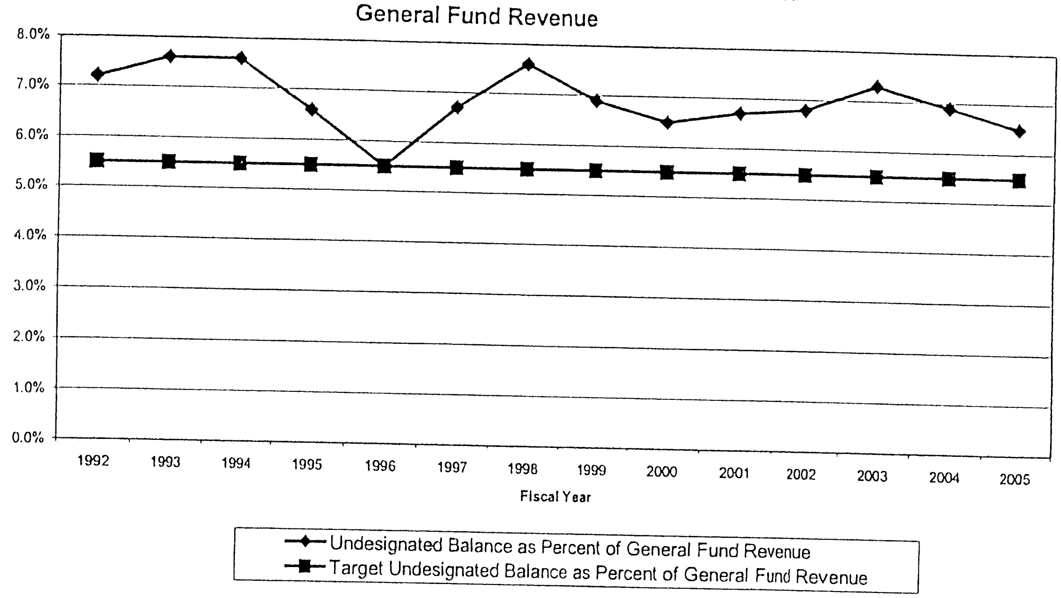


Chart 4: Undesignated General Fund Balance as a Percent of General Fund Revenue



City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 16, 2005

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER

SUBJECT: BUDGET MEMO #52: BUDGET AND FISCAL AFFAIRS ADVISORY COMMITTEE (BFAAC) REVIEW OF THE FY 2006 PROPOSED BUDGET

The Budget and Fiscal Affairs Advisory Committee (BFAAC) has completed its analysis of the FY 2006 Proposed Budget for Council's consideration. This is in accordance with the Committee's mission to advise and support City Council by reviewing future revenue and expenditure forecasts and evaluating tax, fee, revenue, and expenditure levels in Alexandria. BFAAC will discuss this report (attached) with City Council at the budget work session on April 27, 2005.

Attachments

City of Alexandria, Virginia

MEMORANDUM

DATE: SEPTEMBER 22, 2005

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER

SUBJECT: ACTIONS BEING TAKEN TO IMPROVE CITY-WIDE ADMINISTRATIVE PROCESSES

On June 3, 2005, I provided City Council a copy of my instructions to City departments and agencies on FY 2007 budget planning. Part of that instruction was to develop ideas concerning improvement to City administrative processes.

I wanted to let you know of our progress on this task. By August 2, I received approximately 200 ideas for improvement from City departments. After review, I have directed staff to follow up and report to me on more than 70 percent of those ideas in the following administrative areas:

I. Personnel (e.g., classification, recruitment, selection, training, automated systems, benefits administration)
II. Budget (e.g., assistance to smaller departments, account structure, grant management)
III. Purchasing (e.g., automated systems, delegation of authority, work flow)
IV. Accounting (e.g. processing receipts, reimbursements)
V. Information Technology (e.g., telephones, website, e-mail, hardware, software, internet access, planning, work flow)
VI. Facilities Management (e.g., facilities maintenance, warehouse and storage, space planning and utilization)
VII. Fleet Management (e.g. fleet size, composition, maintenance)
VIII. Mail Room/Print Shop (e.g., organization and work flow)
IX. Other Ideas (e.g. departmental coordination or consolidation, miscellaneous suggestions)

As stated in my June 3 memorandum to you, I anticipate that these administrative improvements, as well as the other FY 2007 budget activities, will lead to a more responsive and efficient City government. However, we have only begun this journey.

My message to staff is that continuous improvement is everyone's responsibility. These administrative process improvement efforts will require in the short term (in order to be successful) a significant dedication of organizational staff capacity. A wide range of City employees will be involved in leading these improvement efforts.

Seven teams have been created and are staffed by a variety of members from throughout the Senior Management. Although we have tasked the members with the initial fact finding and analysis to support a recommendation, I fully expect this effort to carry on well into the future. Your support and encouragement will also help.

Then on September 2, we received additional requested budget material from all departments regarding areas of improvement, service changes or alternate methods of production from within each department. Although we have just begun that review, the response from the departments has been good. Again, I expect this effort to generate many ideas for discussion throughout the budget session and into the next few years.

I am very pleased with the organization's willingness to think differently regarding how we do business.

I will describe these activities more completely to you at the Fall Budget Retreat.

cc: Michele Evans, Assistant City Manager
Mark Jinks, Assistant City Manager
Bruce Johnson, Director, Office of Management and Budget