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4-24-07

EXHIBIT NO. 1

City of Alexandria Budget and Fiscal Affairs Advisory Committee

Report on the City Manager's Proposed Budget for Fiscal Year 2008

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EXECUTIVE SUMMARY

The New Budget Process

- **We support the budget process as adopted, including the setting of targets for expenditure growth for both the City and the ACPS.**
- **We support budget targets that are challenging to achieve and believe the FY 2008 targets set by Council for both the City and ACPS, designed to equal expected revenues under current tax rates, meet this criterion.**
- **We believe that the self-imposed requirement of a super-majority for exceeding the budget targets will enforce budgetary discipline.**
- **We support the MFRI and believe the progress in implementing the initiative is commendable.**
- **We urge continuing refinement and standardization in the development of metrics and the adoption of uniform criteria and methodology to measure customer satisfaction.**
- **We believe that applying performance measures to the spending in the CIP would provide greater accountability.**
- **We believe that an effort similar to the MFRI would be useful in lending transparency and discipline to the ACPS budget.**
- **We believe that MFRI should be applied to all affiliated organizations that receive primary funding from the City.**
- **We support the practice of including targets for COLAs for both the City and the ACPS within the overall targets for expenditure growth.**
- **We support City policy to provide identical COLAs for the City and ACPS employees.**
- **We believe that the City and ACPS should continue to work for greater communication and trust on budget matters—at both the Council/School Board level and the staff level.**

- **In order to protect the integrity of the target-setting process, Council would be justified, in our view, in funding the ACPS budget at the target amount.**

- **Council should encourage ACPS to adopt a similar budget process as used by the City for greater overall transparency and discipline.**

- **We oppose the advance dedication of portions of tax revenue as a budgetary tool.**

- **We make no judgment on the relative importance of expenditures for both open space acquisition and affordable housing preservation, but we believe that any such expenditure should be funded through the annual General Fund and CIP budget process.**

The Proposed Operating Budget

- **The City should continue to conduct performance and benchmark studies across all departments and develop appropriate Activity Costs for all departmental functions.**

- **The City should move toward implementation of a system including both pay-for-performance principles and a response to market factors for the schedule and for ranking of specific positions.**

- **The City should focus on leadership training and develop a more effective performance review process.**

- **The City should focus on improving productivity, and use the performance metrics developed as part of the budget process to drive that improvement.**

- **The City should explore greater cooperation and information exchange concerning pay schedules with the surrounding jurisdictions.**

- **The City should shift the ratio of its overall spending on compensation away from fringe benefits and toward salary.**

- **The City should not adopt the proposed "Q" step, and should instead utilize bonuses for those employees who have reached the top of their pay scale.**

- **The City should continue analysis of merging the City and ACPS health care plans. The City should also study the option of self-funding, including ways to mitigate the cost of catastrophic loss through the purchase of catastrophic loss reinsurance.**

- **The City should include all benefits in salary benchmark studies, and include benefit information in the Personnel Summary section of the Budget document.**

- **BFAAC recommends that the City continue to work with WMATA, the State of Virginia and the other affected jurisdictions to establish a uniform, stable source of revenue for WMATA.**

- **BFAAC recommends that the City Council support the City Manager's proposal to continue pre-funding the City's OPEB obligations.**

- **BFAAC recommends that the City Council develop and commit itself to a non-binding schedule of future pre-funding contributions, with the goal of pre-funding an actuarially sound portion of the OPEB obligation.**

- **BFAAC encourages the creation of an irrevocable OPEB Trust Fund to be used in lieu of a fund balance to save for OPEB obligations.**

- **BFAAC strongly urges City Council to work with the School Board to begin pre-funding the ACPS OPEB obligations.**

- **BFAAC recommends that the City evaluate its targeted real estate tax relief programs for efficacy and alignment with the Council's Strategic Goals.**

- **BFAAC recommends that Council consider implementing a real estate tax deferral program to be used either in lieu of, or in conjunction with, its existing targeted real estate tax relief programs.**

The Proposed Capital Improvement Program (CIP)

- **BFAAC is concerned about the City's ability to fund everything that is currently planned for the FY 2008-2013 CIP.**

- **BFAAC recommends that a new framework for assessing CIP projects be adopted to make it possible for the Council to make careful and reasoned decisions on which projects to potentially scale back, slow down, or eliminate.**

- **BFAAC recommends the Council set targets for the CIP on an annual basis.**

- **BFAAC recommends that each project in the CIP be linked more clearly to the City's strategic plan.**

- **BFAAC recommends that each project demonstrate its ability to maintain or enhance a service level as identified by the relevant department through the MFRI.**

- **BFAAC recommends that the City implement MFRI for its capital projects using a "stage-gate" review process focusing on efficiency (cost/schedule), technical performance, and impact (in a project's early stages) metrics.**

Revenues and Outlook

- **We renew our recommendation that the City continue to track the percentage of per capita income that is applied to residential real property tax to determine the impact on our residents.**

- **We continue to believe that arbitrary caps on expenditure growth or on tax increases are not useful and we do not recommend them. We do, however, urge City Council to be especially cautious in setting property tax rates that result in tax/personal income ratios above historical ranges.**

- **Any revision in the debt policy guideline on personal income and changing property values should not be adjusted primarily to justify additional borrowing.**

- **The City should plan for the possible enactment of the proposed homestead exemption should the General Assembly confirm its vote in 2008, subject to passage of the requisite referendum.**

- **In view of recent transportation funding legislation, the City should continue to analyze its transportation needs and allocate the anticipated revenues to the future transportation-associated operating and CIP budget projections.**

- **We encourage the City to look carefully at new opportunities that might allow us to capitalize on hotels as an increased source for diversification of revenue.**

- **We encourage City Council to continue a proactive role in planning the major Landmark redevelopment, including strategies identified in the ULI Washington Report.**

- **BFAAC believes that economics, to the full extent allowed by law, should be an essential consideration in any land use decision.**

- **Goals and performance measures for economic development activities should be clearly defined as part of the budget process.**

- **The City should take prompt action to develop an overall economic development strategy, and within that strategy, provide for necessary planning, policy guidance, oversight and control of City spending on economic development activities.**

- **Economic development planning, policy guidance and oversight should be a City staff function, reporting to the City Manager, so that economic development activities are subject to the same type of management, control and budgetary review as other important City functions.**

- **Performance measures, current economic data and other metrics are essential to an understanding of the needs, benefits and effectiveness of economic development investments.**

- **Since reimbursement from the Commonwealth covers an ever-shrinking portion of personal property tax revenues, BFAAC continues to support increased collections to cover the shortfall. We urge the City to fully explain the causes for any resulting tax increases.**

- **BFAAC believes that the City should begin a transition to alternate forms of enforcement for payment of the personal property tax and eliminate the use of the existing decal. We further recommend that the City explore administrative changes to the collection of the personal property tax, including automatic vehicle registration and semiannual payments.**

- **BFAAC recommends the creation of a fee compendium detailing all fees currently collected by City departments for inclusion in future budgets as well as periodic review by Council.**

- **BFAAC urges Council to review each fee periodically to ensure the recapture of associated operating costs.**

I. THE NEW BUDGET PROCESS

In BFAAC's view, the deliberation and adoption of the City's budget is the manifestation of Council's most important role – wise stewardship of the City's resources to balance the needs of the community with the City's ability to fund programs to meet those needs. In its new budget process, the Council recognized the burden of residential real estate taxes and stated its commitment to managing the growth of operating and capital expenditures to help address increased residential real estate taxes while at the same time providing quality City services.

A. Background and Description of Process

In Spring 2005, Council passed Resolution 2150 and adopted a new budget process, which: established the concept of a baseline services budget as an initial discussion point; set alternative targets for General Fund budget growth with options to reach the lower target; and, increased transparency throughout the budget process by providing greater opportunity for community involvement. As detailed in its Report for FY 2007, BFAAC viewed this new budget process favorably.

Following Council's approval of the FY 2007 budget, the City Manager announced that the City would transition from an organizational-based budget process to a program- and activity-based budget process, entitled the "Managing for Results Initiative," as discussed further below. As BFAAC has long recommended the use of performance measures in the budget process, we were pleased by the City's decision.

Upon the expiration of Resolution 2150 in fall 2006, Council passed Resolution 2205. In adopting Resolution 2205, Council reiterated and extended its commitment to wise stewardship of the City's resources to ensure a proper balance between needs and funding. In its establishment and formalization of the process for planning and adopting the City's Operating Budget and Capital Improvement Program, Resolution 2205 builds and expands upon the procedural changes that were initially implemented in Resolution 2150.

A notable addition to the budget process is the requirement of a "super-majority" vote (5 of 7 Council votes) to exceed the City or Alexandria City Public Schools (ACPS) budget target, to propose appropriation from the General Fund balance of more than that recommended by the City Manager, or to initiate an "add" of more than $50,000 with less than ten days before a Spring public budget hearing.

There was a public hearing on October 24, 2006, which provided an opportunity for community input on the City's proposed FY 2008 Operating Budget and Capital Improvement Program. Following the public hearing, the City Manager and the ACPS Superintendent presented their respective preliminary budget forecasts of revenues, expenditures, and capital needs to Council at a retreat held on November 4, 2006.

At the direction of Council, the City Manager prepared Resolution 2211 to guide the formulation of the proposed FY 2008 Operating Budget and the FY 2008-2013 Capital Improvement Program. Resolution 2211, which was adopted by Council on November 14, 2006, set a target of $353.4 million for General Fund expenditures and a target of $155.5 million for the ACPS.

Council, pursuant to Resolution 2211, requested that the City Manager submit the City's proposed budget by the first legislative session in February and that ACPS approve its FY 2008 budget by January 31st. Like Resolution 2150, Resolution 2205 directed the City Manager and ACPS to clearly identify what operating programs and activities and capital projects would be funded if additional funding was requested above the targets.

As it did during the FY 2007 budget process, the City staff held three "Community Pre-Budget Briefings" in January and February 2007. These briefings provided residents with an explanation of the budget process, an understanding of budget challenges and issues facing the City, and an opportunity to express their suggestions and concerns. Furthermore, the City continued its practice of making information regarding the proposed budget available to residents on the City's website.

On February 15, 2007, the City Manager presented Council with his FY 2008 Operating Budget and the FY 2008-2013 Capital Improvement Program. The framework delineated in Resolutions 2205 and 2211 provided Council and the community additional time to consider the City Manager's proposed FY 2008 budget. The spring budget calendar, which will be marked by twelve public work sessions and two public hearings, will culminate with the adoption of the budget by Council on May 7th.

B. Our General Views

The new budget process builds upon and expands the procedural changes that were introduced last year and were welcomed by BFAAC at the time. BFAAC supports the budget process as adopted. We have long advocated greater transparency and more opportunity for community participation. We have previously recommended that budget decisions be made in the context of a long-term strategic plan and based on a current services budget concept. The adopted procedures incorporate all of these features.

We support the setting of targets for expenditure growth for the City General Fund and for ACPS. We continue to believe that the targets should be set at a challenging level to promote restraint in spending. The targets established by Council for the 2008 budget, designed to equal expected revenues under current tax rates, meet this criterion in our view. We believe credible targets should incorporate all substantial expenditures, including, for example, cost-of-living adjustments (COLAs) for employees, as discussed further below.

We also support the new requirement for a super-majority vote of Council (5 of 7) to exceed the established targets for the City or ACPS, to propose appropriation from fund balance greater than recommended by the City Manager, or to propose a significant addition (more than $50,000) later than 7 days in advance of the public budget hearing in the spring. In our view, the super-majority provision should serve as a useful tool for budgetary discipline and the 7-day requirement should militate against last minute budget changes, which, as we have previously observed, work against the dual goals of transparency and community input.

We have the following observations and recommendations:

- **We support the budget process as adopted, including the setting of targets for expenditure growth for both the City and the ACPS.**
- **We support targets that are challenging to achieve and believe the FY 2008 targets set by Council for both the City and ACPS, designed to equal expected revenues under current tax rates, meet this criterion.**
- **We believe that the self-imposed requirement of a super-majority for exceeding the budget targets will enforce budgetary discipline.**

C. Managing for Results Initiative (MFRI)

BFAAC has long supported a citywide move to programmatic budgeting coupled with performance measures across all program areas. Accordingly, we are pleased to see the efforts of City departments as they implement the City Manager's MFRI.

We recognize that the Manager's initiative represents a major change for an organization of this nature. We further recognize that for many organizations, this type of change can take years to be fully implemented. The progress that the City has made in such a short period of time is commendable. We believe that the MFRI has created a more readable, understandable, and comprehensive budget document for all stakeholders. We are hopeful that as the initiative continues to mature, the budget process will become even more transparent to the public.

As with any process in its infancy, we believe there are a number of opportunities for improvement. Overall, we believe the metrics selected for inclusion in the proposed budget will accurately depict the performance of the selected processes. However, there were a number of performance metrics that appeared to be of lesser validity, and we believe the process of metric development and measurement may need refinement and standardization. We agree that all performance metrics should be specific, measurable, acceptable, realizable, and thorough.

Many of the metrics rely upon a measure of customer satisfaction to gauge achievement. We applaud the efforts to closely align performance and the satisfaction of the customers being served. In order to ensure that this measure remains meaningful, we urge the City to adopt uniform criteria and methodology to measure customer satisfaction throughout the organization.

We also believe that customer satisfaction should not remain the sole measure by which the performance of a program is measured. Customer satisfaction is an important measure, but it should be considered in conjunction with other objective measures and the achievement of tangible goals.

While we also recognize that this effort is just beginning, we believe that applying performance measures to the spending in the Capital Improvement Program (CIP) is just as important as the effort begun with the operating budget. We recognize the fundamental differences between the Operating budget and the CIP, but believe that measuring efficiency and the performance of CIP spending is both feasible and important.

We believe that the same performance measurement and programmatic budgeting that has been implemented on the City portion of the budget would be useful in lending transparency and discipline to the School Board's proposed budget as well as the budgets of other entities who receive their primary funding from the City. We urge the Council to work with all affiliated entities with the goal of achieving transparency and discipline in the expenditure of all City tax dollars (e.g., DASH, ACVA, AEDP, SBDC, etc.).

We have the following observations and recommendations:

- **We support the MFRI and believe the progress in implementing the initiative is commendable.**
- **We urge continuing refinement and standardization in the development of metrics and the adoption of uniform criteria and methodology to measure customer satisfaction.**
- **We believe that applying performance measures to the spending in the CIP would provide greater accountability.**
- **We believe that an effort similar to the MFRI would be useful in lending transparency and discipline to the ACPS budget.**
- **We believe that MFRI should be applied to all affiliated organizations that receive primary funding from the City.**

D. Cost-of-Living Adjustments

In Resolution 2211, Council requested that the City Manager and the School Board include any COLA in their respective targets. They also asked the Manager and the School Board to assume no COLA in their FY 2008 proposals.

We strongly support Council's action to include COLAs in the targets. We feel this change will increase transparency in the budgeting process and allow for a more comprehensive consideration of overall spending.

It has been long-standing City policy to provide the City and ACPS employees the same COLA. Our concerns about the overall compensation policies of the City notwithstanding, to the extent COLAs are granted, we support the practice of keeping the COLA the same for all employees. Recognition of the diminishing value of salaries due to inflation (which affects everyone) should not be different based on which organization an employee works for.

We are cognizant that Council's procedural change to include the COLA in the proposed budgets presents challenges to ensuring parity between the two organizations. Therefore, we are fully supportive of Council's action to set a target for City and ACPS employee COLAs at the same time as the setting of overall expenditure growth targets.

We are concerned that as with the expenditure target, the School Board has chosen to disregard the COLA target set by the Council. We urge Council to place greater emphasis on this COLA-setting exercise in future years, and consider the adoption of a separate resolution making that determination.

We have the following observations and recommendations:

- **We support the practice of including targets for COLAs for both the City and the ACPS within the overall targets for expenditure growth.**

- **We support City policy to provide identical COLAs for the City and ACPS employees.**

E. Schools

As noted above, in the spring of 2005, Council changed the budget process effective for the 2007 budget cycle by introducing the concept of budget targets. BFAAC was generally supportive because we thought it brought more transparency and predictability to the budget process in that the Schools no longer had to guess what the City Manager would recommend to Council or what Council anticipated the City's contribution to be. BFAAC saw benefit in the fact that the City and Schools would communicate throughout each Fall and that the target (which now includes any COLA) would be set by the City prior to the presentation of the Superintendent's proposed operating budget.

The setting of the target is crucial to the ACPS budget process for a number of reasons: (1) It is the amount Council requests the School Board "seek not to exceed"; (2) It is the amount that the City Manager includes as the City's contribution in the City Manager's Proposed Operating Budget, which has significant consequences for the add/delete process if the target is exceeded; (3) It informs the Schools and the community what Council believes the City can afford to spend on the Schools; and (4) It informs ACPS employees what they should anticipate for a COLA since the COLA is included in the target amount.

On October 10th of last year, the City Council requested that the Superintendent provide Council with a budget forecast for FY 2008. That forecast, which included preliminary operating and CIP budget forecasts as well as an overview of federal programs and state grants, was delivered to Council on October 31st. On November 4th, Council had its annual retreat, where City staff presented its revenue projections and the Superintendent presented her budget forecast. On November 14th, Council passed budget Resolution 2211 which established an operating budget target for the Schools of $155.5 million. That target amount assumed no COLA. On December 19th, the Superintendent presented a proposed operating budget that requested a City contribution of $162.3 million, and included a 2% COLA. On January 3rd, Mayor Euille sent a letter to School Board Chairman Arthur Peabody that reviewed the budget process, stated that funding for a COLA for School employees "would not come on top of the target," and informed the Chairman that "[t]he City Council is expecting the School Board to comply with these provisions [of the Budget Resolutions]." On January 31st, the School Board approved an Operating Budget that requests a City contribution of $162.3 million, which is $6.8 million over the target.

The Superintendent's Proposed Operating Budget and, more importantly, the School Board's Approved Operating Budget are, in theory, supposed to meet the target. We note that last year, for example, the School Board's Approved Operating Budget was within the target range set by Council. This year, the School Board not only disregarded the target amount, it disregarded the process. As required by Resolution 2205, the School Board's Operating Budget should clearly describe what programs and activities would be funded if the City's contribution exceeds the target, clearly describe what programs and activities could be funded within the target, and explain what the impact will be on those programs if funds above the target are not provided. The School Board's approved Operating Budget provided none of this information. Instead, the School Board came forward with the type of information sought by Resolution 2205 at the City Council/School Board work session on March 28th, some two months after the Board approved the Operating Budget. In BFAAC's view, that is two months too late. In any year where the Board's Approved Operating Budget exceeds the target, the dialogue between Council and the Board needs to begin as soon as the Board approves the budget because of how the excess is treated in the budget process.

Resolution 2205 and 2211 essentially require the City Manager to use no more than the Schools' target amount in the City Manager's Proposed Operating Budget. As a result, any amount in the School Board's Approved Operating Budget that exceeds the target amount automatically becomes part of the City's add/delete process, which requires a super-majority to approve individual line items. By not complying with the process set forth in Resolution 2205, specifically, by not indicating in its Approved Budget what could be funded by the target and what would be funded if they received funds above the target, the School Board placed the Council in an untenable position vis-à-vis the School Board's budget. On what basis is Council to determine what, if any, amount they should fund above the target? Simply put, the add/delete process requires a specificity that the Schools failed to provide to Council in its Approved Budget. The information provided by the School Board at the work session is a good first step toward meeting the requirement of Resolution 2205.

The budget process continues to evolve and BFAAC believes the process is improving. We already have to overcome the fact that funding for our public schools has a structural disconnect. The City, which is responsible for funding the schools doesn't get to decide how those funds are spent, while the School Board, which does get to decide how the funds are spent, has no authority to raise revenue. With this structure, communication and trust between the two institutions are essential to the budget process. The goal should be for City Council to have confidence in the processes and analyses presented by the ACPS in its budget request. Council should encourage ACPS to adopt a similar budget process as used by the City as an aid for overall budgetary transparency and discipline.

BFAAC was hopeful that the initial challenges faced by the Schools in adapting to the new budget process last year would be transitional in nature and that appropriate adjustments could made in the Schools' own budgeting process to accommodate the new process. What we learned from the Schools' budget process for 2008 is that problems remain and we don't know whether the process issues are transitional or not.

We have the following observations and recommendations:

- **We believe that the City and ACPS should continue to work for greater communication and trust on budget matters—at both the Council/School Board level and the staff level.**
- **In order to protect the integrity of the target-setting process, Council would be justified, in our view, in funding the ACPS budget at the target amount.**
- **Council should encourage ACPS to adopt a similar budget process as used by the City for greater overall transparency and discipline.**

F. Dedicated Revenues

In FY 2004, the City dedicated one cent of the real estate tax rate to be transferred to the Open Space Trust Fund for the acquisition and preservation of open space. In FY 2006, the City dedicated one cent of the real estate tax rate to be transferred to the Affordable Housing Trust Fund for the preservation and expansion of the City's affordable housing stock. In FY 2007, while maintaining its dedication of one cent of the real estate tax rate to the Affordable Housing Trust Fund, the City changed its dedication for the Open Space Trust Fund to one percent of the total real estate taxes collected.

We reiterate our concerns with respect to the dedication of tax revenues for specific purposes. While in the past we have discouraged the use of set-asides and indicated that they should be reviewed annually and "sunset" after a period of years, we now wish to express clearly our general opposition to such budgetary device. We continue to believe that automatic designations of revenue, outside of the general fund and CIP budget processes, runs counter to the transparency and flexibility Council has been striving for. By design, these dedications attempt to "insulate a government function from the vagaries of the appropriations process."[1] Transparency is only hindered by such efforts.

We observe that the dedications of revenue easily inherit inertia and become difficult, if not impossible, to modify. We believe that the example of California, where discretionary spending hovers below 10% of the overall budget, due to the proliferation of these revenue dedications, offers a cautionary, if not extreme, tale. Thus, set-asides that are expedient in one year may be difficult to reverse when conditions change. In our view, important budget decisions should not be put on "automatic pilot." There is no substitute for the annual analysis required to match community needs with available funds.

We believe that Council's decision to bond against future contributions from these dedicated revenue sources clearly demonstrates the danger inherent in them. Such borrowing commits future Councils in a way that we believe is counter to best practice and the Council's stated fiscal priorities as articulated in their 2004-2015 Strategic Plan.

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[1] The Civic Federation, "Dedicated Revenue Sources for State Pension Funds," February 14, 2007.

We have the following observations and recommendations:

- **We oppose the advance dedication of portions of tax revenue as a budgetary tool.**
- **We make no judgment on the relative importance of expenditures for both open space acquisition and affordable housing preservation, but we believe that any such expenditure should be funded through the annual General Fund and CIP budget process.**

II. THE PROPOSED OPERATING BUDGET

The FY 2007 BFAAC Report on the Proposed Operating Budget focused on two cost drivers, Personnel and Health Care. The recommendations for containment of personnel costs were that the City should conduct performance and benchmark studies, fully justify any new positions, combine all compensation costs for reporting and comparison, and examine its pay program.

The recommendations for health care cost containment included merging the City and ACPS health care systems, studying self-funding, and adopting a balanced approach to change over time. We are pleased that the City has made substantial moves in the direction of these recommendations.

This year's report will focus on the following cost drivers: Personnel (Compensation and Benefits), WMATA, GASB 45, and Targeted Real Estate Tax Relief.

A. Compensation

Probably the most significant impact in the FY 2008 Proposed Budget is the implementation of the MFRI. Its effect is broad, and reaches into every aspect of the City's operation.

BFAAC applauds the City's adoption and implementation of this management process. The new format of the Budget document allows for significantly more transparency than was available in previous budgets. The ability to look at 153 programs and 507 activities this year, with their costs measured by results, is a significant step in being able to support and successfully employ MFRI. BFAAC believes that the core of the Budget document, specifically the activity data with its measurable activity costs, is a key component in instilling the concept of productivity in operations.

BFAAC congratulates the City in its efforts to emphasize proficiency and productivity among the City workforce. BFAAC believes that the net reduction of 15.3 FTE positions demonstrates that the City is truly focusing on creating an environment where doing the City's business is more efficient. However, in future headcount reductions, we caution the City to avoid simply shifting the work of eliminated FTE positions to indefinite contract support—unless such a shift results in sustainable savings to the taxpayers.

In future budgets, we would like to see greater transparency in the size and scope of the contract support which the City currently employs.

While BFAAC understands a reluctance to eliminate the positions of current employees, we are opposed to using a vacancy in a particular position as the primary consideration in deciding whether it should be eliminated. In situations where employees are serving in positions no longer deemed necessary, targeted transfers or buyout offers should be utilized to avoid involuntary separation—but ultimately unnecessary positions should be eliminated regardless of their vacancy status.

As proposed, this would be the third time in 20 years that the City would not have given a COLA.[2] BFAAC supports moving to a system based primarily on merit, while remaining competitive with surrounding jurisdictions. We believe that the current pay system, comprised of multiple levels of pay increases needs some reworking. Compensation should be based on job category, merit performance and market factors. In concert with this, the City will need to support development of its management functions. Any population produces a bell shaped curve when performance is evaluated. However, a system that produces 97% ratings of "satisfactory" is not representative of a true merit system. Managers need to develop the skills of administering effective performance reviews, and as a result, award an appropriate salary adjustment.

BFAAC also believes that use of a bonus, in lieu of another step, should be the solution for employees who have reached the top of the scale. Accordingly, we oppose the proposed addition of the "Q" step. We believe that market factors should drive the composition of the salary scale—not solely the longevity of the employees.

BFAAC is mindful that the marketplace for skilled municipal employees in the DC Metropolitan region is competitive. We recognize that while overall the City's salary compensation philosophy strives to adhere to regional mid-points for comparable positions, we note that our fringe benefit levels place the City as a regional leader. We recognize the powerful retention effect these fringe benefits have for employees with significant tenure and experience, but we are concerned that the lower salary levels leave the City unable to win the battle for younger workers primarily focused on salary.

This concern becomes more pronounced as BFAAC has continued to note the inflexibility and counter-cyclical nature of increases in fringe benefit costs, as compared to salary costs.

We believe that a shift of compensation costs from fringe benefits to salary will allow the City to become more competitive in hiring workers, as well as provide more budget flexibility in future years. We also believe that it is imperative for the City to aggressively move forward on MFRI improving productivity. Achieving lower overall personnel costs, while raising the reward of productive employees, is essential.

[2] City of Alexandria, FY 2008 Proposed Budget, pages 4-58.

We have the following observations and recommendations:

- **The City should continue to conduct performance and benchmark studies across all departments and develop appropriate Activity Costs for all departmental functions.**
- **The City should move toward implementation of a system including both pay-for-performance principles and a response to market factors for the schedule and for ranking of specific positions.**
- **The City should focus on leadership training and develop a more effective performance review process.**
- **The City should focus on improving productivity, and use the performance metrics developed as part of the budget process to drive that improvement.**
- **The City should explore greater cooperation and information exchange concerning pay schedules with the surrounding jurisdictions.**
- **The City should shift the ratio of its overall spending on compensation away from fringe benefits and toward salary.**
- **The City should not adopt the proposed "Q" step, and should instead utilize bonuses for those employees who have reached the top of their pay scale.**

B. Benefits

During FY 2007, health care costs rose by an estimated $17.1 million. The proposed FY 2008 Budget projects these costs to be $18.1 million. As we indicated in our FY 2007 Report, there is no single solution to containing health care costs. BFAAC outlined a series of steps for Council to consider.[3] These were self-funding—health savings accounts, health education, and plan design changes. BFAAC applauds the City's efforts in making plan changes that included greater employee cost sharing. BFAAC also notes, however, that several other strategies remain for Council to evaluate.

As indicated in last year's report, we believe that the City should continue to aggressively pursue the advantages of the economies of scale that it has at its disposal. Specifically, we feel the City should explore any potential savings that might be realized by combining the existing City and ACPS health care risk pools into one, selecting a single health-care provider, and self-funding/self-insurance of health risk.

Finally, BFAAC reiterates its previous recommendation that health care and other benefits be included in any future salary benchmark studies, as the City pays both salaries and benefits, and prospective employees consider the overall compensation package (salary and benefits) when choosing between job offers. In addition, we ask that disclosure of these benefits to be included in the personnel summary section of the budget.

[3] BFAAC FY 2007 Budget Report, page 9.

We have the following observations and recommendations:

- **The City should continue analysis of merging the City and ACPS health care plans. The City should also study the option of self-funding, including ways to mitigate the cost of catastrophic loss through the purchase of catastrophic loss reinsurance.**
- **The City should include all benefits in salary benchmark studies, and include benefit information in the personnel summary section of the budget document.**

C. WMATA

The City is a partner in the Washington Metropolitan Area Transit Authority (WMATA) and yearly must contribute funds for operations, capital expenditures and debt service for the rail and bus system that provides transit services in DC and surrounding Maryland and Virginia jurisdictions. Since federal workers are major users of the system, the federal government made the major contribution to the construction of the system with the requirement that local jurisdictions provide a stable and reliable source of revenue for operation and maintenance.

WMATA has a yearly budget of about $1.5 billion. State and local governments pay for operations and capital improvements from their yearly budgets (Alexandria contributed $4.6 million for its FY 2006 share of WMATA operations, $5.2 million for FY 2007, and proposed $6.3 million for FY 2008).

The current primary issue is a shortfall of $64 million in WMATA's proposed operating fund budget for the coming year. The best-case scenario would be for WMATA to find sufficient expenditure reductions, meaning no net increase in local subsidies. The worst-case scenario would be for WMATA to approve no fare increases and no expenditure reductions. Then the $64 million problem would fall on participating jurisdictions, with the City's share an additional $2.56 million on top of the nearly $1.67 million increase for FY 2008 already anticipated and included in the City Manager's proposed budget. If the additional funding amount is known prior to the May 7 budget adoption, the amount will need to be added and deletions found to pay for it. If not known until later, Council will have to formally appropriate from the contingent reserve or transfer from elsewhere in the budget for this purpose.

The City is only one member of the WMATA compact. The final decision is up to the WMATA Board of Directors (Alexandria has a non-voting seat on the WMATA Board). City staff is working with WMATA staff and the other jurisdictions to consider all available options. At this time, City staff do not expect any significant increase in the City subsidy to WMATA above that already contained in the proposed budget. However, funds must be provided to cover whatever the City's actual portion of the possible shortfall will be. (Support for increased WMATA capital improvements for the coming year but not beyond, is already included in the City's current FY 2008 CIP proposal.)

BFAAC believes that reliance on annual appropriations hampers multi-year planning, predictable investment strategies and planned growth of the system. Within the last year, several members of

Congress from districts within the WMATA operational area have introduced federal legislation to provide $1.5 billion in federal funds to WMATA, contingent on the creation of a regional dedicated funding source for the system.

We have the following recommendation:

- **BFAAC recommends that the City continue to work with WMATA, the State of Virginia and the other affected jurisdictions to establish a uniform, stable source of revenue for WMATA.**

D. GASB 45

In our FY 2007 report, we noted the City's efforts to begin implementing Government Accounting Standards Board (GASB) Standard 45. "GASB 45 establishes uniform reporting standards for other post employment benefits (OPEB)—which include health insurance, life insurance, and other benefits provided to retirees other than pension benefits."[4]

While the standard itself is modest and merely requires the calculation, reporting and recognition of these obligations[5] (which previously have been paid as pay-as-you-go expenditures) the significance of GASB 45 is magnified exponentially by the attention that the bond rating agencies have paid to this requirement.

Standards & Poor's indicated their intention to "... analyze any OPEB obligations in the same way it currently evaluates pension obligations."[6]

In the adopted FY 2007 Operating Budget, the Council included $8.7 million to be set aside to partially offset the $82 million[7] obligation currently estimated for the City employees. In the Manager's FY 2008 Proposed Budget, he has included an additional $2 million from the FY 2007 surplus to continue the process. The retiree health and life (OPEB) fund balance will reflect $10.7 million, if Council chooses to adopt this proposal.

We strongly support the Manager's proposal to continue increasing the size of the OPEB designated fund balance, and urge the Council to continue to be aggressive in pre-funding our accrued obligations. We recommend that Council adopt a non-binding, funding schedule to set targets for annual contributions with the intention of funding an actuarially sound portion of the overall obligation.

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[4] City of Alexandria Budget & Fiscal Affairs Advisory Committee. Report on the City Manager's Proposed Budget for Fiscal Year 2007, pages 23-25.

[5] Governmental Accounting Standards Board, "Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions," June 2004.

[6] Standard & Poor's Rating Services, " Reporting & Credit Implications of GASB 45 Statement on Other Post Employment Benefits," December 1, 2004.

[7] James Hartmann, "Budget Memo #8: Accounting for Post-Employment Retiree Benefits New Mandates from the Governmental Accounting Standards Board (GASB 45)," March 3, 2006.

In our FY 2007 report, we urged the creation of an irrevocable trust fund to save the dollars currently being set aside in the OPEB fund balance. We understand the reluctance to do so in recognition of the fluidity in the regulatory environment. Nonetheless BFAAC continues to believe that the creation of an irrevocable trust fund, analogous to those set up for defined benefit pension plans, offers the best savings vehicle for these obligations.

The current actuarial estimate of $82 million in OPEB obligations for the City is based on the use of a trust fund. Using a fund balance, that obligation rises to $153 million.[8] For the ACPS, the obligation of $39 million, using a trust fund, rises to $66 million in a fund balance.[9]

It is currently estimated that the City is forgoing 3.0% of earnings by using a fund balance to save for these obligations.[10]

Unfortunately, the ACPS is behind the City in addressing this issue. At this point the Schools have made no effort to begin pre-funding their obligation. As a component unit of the City, we are concerned at the lack of progress in this important effort, particularly because such inaction could have a negative effect on the City's bond rating. We note that the Arlington Public Schools began pre-funding their obligations with a $1.4 million set aside in FY 2007, and their Superintendent has now proposed adding $2.35 million to that initial allocation.[11] Fairfax County Public Schools made an initial down payment of $10 million in FY 2007 and their Superintendent has proposed an additional $18 million in FY 2008.[12] We believe it is critical to begin this effort in FY 2008 and adopt a schedule for continuous pre-funding contributions.

Standard & Poor's also believes that "...increasing net OPEB obligation would be a negative rating factor..."[13] Accordingly, we are supportive of the City's efforts to freeze the existing reimbursement of retirees at the $3,120 per year maximum and urge the City to work with ACPS to bring the ACPS reimbursement into conformity with City reimbursement levels.

We urge the City to continue to explore efforts to reduce OPEB costs. While we would not support efforts that would adversely affect the promises made to existing employees and current retirees, we urge the City to examine changes that might apply to future employees hired by the City.

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8 City of Alexandria, "Comprehensive Annual Financial Report, FY 2006," page 30.
9 ibid
10 ibid
11 Arlington Public Schools, "Superintendent's Proposed Budget Fiscal Year 2008," February 22, 2007.
12 Fairfax County Public Schools, "Proposed Budget," January 11, 2007.
13 Standard & Poor's Rating Services, " Reporting & Credit Implications of GASB 45 Statement on Other Post Employment Benefits," December 1, 2004.

We have the following observations and recommendations:

- **BFAAC recommends that the City Council support the City Manager's proposal to continue pre-funding the City's OPEB obligations.**
- **BFAAC recommends that the City Council develop and commit itself to a non-binding schedule of future pre-funding contributions, with the goal of pre-funding actuarially sound portion of the total OPEB obligation.**
- **BFAAC encourages the creation of an irrevocable OPEB Trust Fund to be used in lieu of a fund balance to save for OPEB obligations.**
- **BFAAC strongly urges City Council to work with the School Board to begin pre-funding the ACPS' OPEB obligations.**

E. Targeted Real Estate Tax Relief

In the FY 2005 budget, the City Council became the first locality in Virginia to offer targeted real estate tax relief for moderate and low income homeowners.[14] The program, the Affordable Home Ownership Preservation Grant Program (AHOP) rests on authority granted by the City Charter. In 2006, AHOP provided an average of $800 (ranging from $200 - $1200) to over 1,300 AHOP grantees, for a total of $1.1 million in grants.[15]

In addition, the City continues its real estate tax relief program for the elderly and disabled, which in 2006 provided an average of $3,050 to nearly 1,100 people, saving taxpayers a total of $3.3 million[16]. This program rests on authority granted by the Commonwealth.[17] Combined, these two efforts serve 2,400 homeowners—or 6% of the Alexandria homeowners.[18]

As the City experienced the rapid growth in the assessed value of real estate, it continued to increase the income and net worth thresholds for homeowners wishing to participate in the AHOP program. For FY 2008, the Manager proposed $1.2 million in expenditures to cover the grants eligible under this program.[19] The City's elderly and disabled tax relief program has escalated in cost from $970,677 in CY 2002 to proposed cost of $3.67 million in CY 2008.[20]

Combined, these two programs now cost the City $4.87 million—the equivalent of nearly 1 cent of real estate tax revenue of the real estate tax in CY 2007 and the first half of CY 2008.[21]

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[14] James Hartmann, "Budget Memo #134: Restructured Real Estate Tax Relief," April 21, 2006.
[15] City of Alexandria, FY 2008 Proposed Budget, pages 2-11.
[16] ibid
[17] Code of Virginia, Section 58.1-3200.
[18] ibid
[19] City of Alexandria, FY 2008 Proposed Budget, pages 7-75.
[20] City of Alexandria, FY 2008 Proposed Budget, pages 4-15.
[21] City of Alexandria, FY 2008 Proposed Budget, pages 4-14.

With the rapid escalation in residential assessments seemingly abating, BFAAC suggests that it is a good time to evaluate these two programs for efficacy and alignment with the Council's Strategic Goals.

As noted when it was adopted, AHOP was a "pilot" program,[22] and as such, an evaluation of its efficacy in achieving its original goals of preserving affordability has not been performed.

At the lowest $200 grant level, AHOP serves homeowners with an average age of 42, who have had an average tenure as an Alexandria homeowner of 5 years. At the $375 grant level, the average age is 42 and the average tenure, 6 years. At the $875 grant level, the average age is 42 and the average tenure 6 years. At the $1,200 grant level, the average age is 47 and the average tenure 9 years.

While the programs do help preserve the affordability of housing in Alexandria, these programs will continue to grow in cost and could eventually become unsustainable. If changes are deemed necessary it may be an opportune time to consider such changes.

As an alternative, the City may want to consider exercising its authority under the Code of Virginia[23] to defer real estate tax increases until the transfer or sale of the property. This will allow long-time homeowners to be cushioned from the double-digit increases that often accompany an overheated local real estate market, while not creating additional cost for other taxpayers.

The City has the authority under the Code to craft such a deferral program using whatever criteria it feels important to achieving its strategic goals.

We have the following observations and recommendations:

- **BFAAC recommends that the City evaluate its targeted real estate tax relief programs for efficacy and alignment with the Council's Strategic Goals.**

- **BFAAC recommends that Council consider implementing a real estate tax deferral program to be used either in lieu of, or in conjunction with, its existing targeted real estate tax relief programs.**

[22] City of Alexandria, FY 2005 Adopted Budget, page 8.
[23] Code of Virginia, Section 58.1-3219.

III. THE PROPOSED CAPITAL IMPROVEMENT PROGRAM (CIP)

A. Overview

In past years, BFAAC has evaluated individual projects to identify potential areas of savings. It also has sought to determine whether the City is funding the right number and mix of capital projects.

The size of recent capital budgets and the number of essential projects indicates that the City did not invest enough in capital improvements during the 1990's. As a result, the City must now fund several critical projects at once, such as the new public safety center, the new high school, and the new DASH facility.

During the first half of the current decade, rising property values created a powerful income stream. This allowed the City to begin to redress the under-investment of the 1990's. The City was able to fund significant increases in the operating and capital budgets by "sharing" the increased property tax revenue with homeowners by decreasing the tax rate at a slower percentage than the average increase in property values.

During 2006, City property values increased very little. Unfortunately, as budget projections show, to achieve the CIP goals currently planned, the City will require either a considerable increase in taxes, additional borrowing (which could impact our double AAA bond rating), or a decrease in operating expenses, beginning in the next budget.

According to the FY 2008-2013 CIP Overview:

> The FY 2009 and FY 2010 years of the CIP include $85.3 million in 'funding to be determined' as the dollar volume of proposed projects in those two years is more than the City can likely accommodate...

BFAAC notes and commends the City Council for setting aside time this fall to address this difficult funding issue.

In advance of that, while BFAAC offers no specific policy proposal, we assert that City Council should begin addressing this issue now. Two possible options are: accelerating funding of the CIP to spread out the impact; or changing, deferring, or canceling planned capital projects.

If the City Council chooses to scale back or slow down projects that have already been identified as beneficial for the future of our community, it would decrease the need to borrow or raise taxes in the short-run. The result, however, could undermine the steps that City Council has taken to address high priority infrastructure needs, such as building a new public safety center, providing a proper environment for the education of our children, and keeping the community operating well and looking good so that it remains a desirable place to live. It could also increase the ultimate costs for achieving these goals.

To address this concern, BFAAC, in keeping with the new budget process, suggests a new framework for assessing each project under consideration so that the City Council and the community can better evaluate the need and relative priority of each project that is a part of the CIP. The suggested framework consists of: spending targets; linkages to the City's strategic plan through the application of MFRI to capital projects; and "stage-gate" reviews.

We have the following observations and recommendations:

- **BFAAC is concerned about the City's ability to fund everything currently planned for the FY 2008-2013 CIP.**
- **BFAAC recommends that a new framework for assessing CIP projects be adopted to make it possible for the Council to make careful and reasoned decisions on which projects to potentially scale back, slow down, or eliminate.**

B. CIP Targets

The Council set targets for the FY 2007 and FY 2008 operating budgets. As BFAAC has observed in other sections of this report, we believe that setting budget targets provides the needed fiscal discipline for the City to live within its means. We recommend that the practice of setting budget targets be extended to the CIP.

Targets for the CIP should be set on an annual basis. The annual targets should consider the amount of funding available for cash capital over the life of the CIP, other long-term commitments such as the effect of GASB 45 on the City's long-term cash needs, and the maximum amount of available borrowing authority, consistent with maintenance of a double AAA bond rating. Budgeting to the targets would provide a point of departure that the Council could use to begin a meaningful discussion between the trade-offs of deferring or eliminating capital projects and enhancing revenue.

We have the following recommendation:

- **BFAAC recommends the Council set targets for the CIP on an annual basis.**

C. Linkages Between the CIP, the City's Strategic Plan and MFRI

The FY 2007 CIP budget document provides good visibility into the details of each capital project. We believe that visibility would be enhanced by more clearly linking the CIP projects to the city's strategic plan. The strategic plan is the City's value statement of what is important to the Community. The CIP should first and foremost fund two things: infrastructure that is essential to the operation of the City, such as police stations, firehouses, water and sewer systems, and road maintenance; or that which is consistent with our value system, such as open space and affordable housing. Linking the CIP to the strategic plan would be a good first step to ensure that projects remain relevant to the needs and values of the City.

As BFAAC discussed in other portions of this report, we commend the City's Managing for Results Initiative. MFRI is an outstanding effort to determine the cost of service in every city department. BFAAC believes that there is a natural linkage between the operating budget and the CIP. The operating budget funds service delivery. The CIP funds the infrastructure for service delivery. Therefore, CIP funding should serve to either maintain or enhance delivery of the services funded by the operating budget, recognizing that such projects may ultimately reduce or increase operating costs.

BFAAC believes that departments proposing capital projects should be required to make a business case for the project, explicitly stating how the project will enhance or maintain services provided by a City program.

We have the following recommendations:

- **BFAAC recommends that each project in the CIP be linked more clearly to the City's strategic plan.**
- **BFAAC recommends that each project demonstrate its ability to maintain or enhance a service level as identified by the relevant department through the MFRI.**

D. Implementing MFRI for Capital Projects: "Stage-Gate" Reviews

Measuring "results" for capital projects, which often have sunk costs spread out over a multi-year execution cycle, can be challenging both in conception and implementation. As discussed above, we believe that the City should extend MFRI to capital programs, focusing on three measurement "results" categories: efficiency (using cost and schedule metrics); technical performance (using service-level metrics for IT projects and, where practical, non-IT projects); and impact (using qualitative metrics to capture mission achievement).

Like ongoing operating activities, capital project "results" can be assessed at specific times during a project's lifecycle; for these projects, we suggest that City departments conduct assessments at the conclusion of major lifecycle phases or "stages" (plan-design-develop-deploy-maintain-retire for IT projects, plan-design-execute-maintain for non-IT projects) using a formal "stage-gate" review process.

In a prototypical "stage-gate" process, projects need to meet specific efficiency and technical performance (and, in early stages, impact) benchmarks to proceed to the next stage (thus the review itself becomes a "gate" through which the project must pass). Implementing such a review process would provide the City needed visibility into capital project performance and provide greater control over the management of the entire capital project portfolio.

Efficiency (cost/schedule) and technical performance metrics tend to be fairly straightforward, and validated benchmarks are readily available from public and private sector sources. Measuring the impact of capital projects proves to be more problematic; these assessments must by necessity be qualitative (and thus open to interpretation and debate), and are really useful for management purposes at the early plan and design stages before a project experiences major sunk costs.

BFAAC commends the City for linking CIP categories to Alexandria's Strategic Plan Goals 2009, and for priority-ranking each project as essential, highly desirable, or desirable; this provides a transparent "line-of-sight" between the city's strategic objectives and individual projects. We suggest that the City consider leveraging this "line-of-sight" to develop impact metrics that can be used in combination with efficiency and technical performance "stage-gate" reviews at the early plan and design stages.

In closing, BFAAC suggests that the City may wish to continue using its current project governance structures as much as possible to conduct "stage-gate" reviews. In some cases, charters may need to be changed or current project governance structures may need to be supplemented with technical expertise to best accomplish a "stage-gate" approach. By taking such a structured project evaluation approach, BFAAC hopes that the City can retain the most important projects as it enters into a more restrictive financial era.

We have the following recommendation:

- **BFAAC recommends that the City implement MFRI for its capital projects using a "stage-gate" review process focusing on efficiency (cost/schedule), technical performance, and impact (in a project's early stages) metrics.**

IV. REVENUES AND OUTLOOK

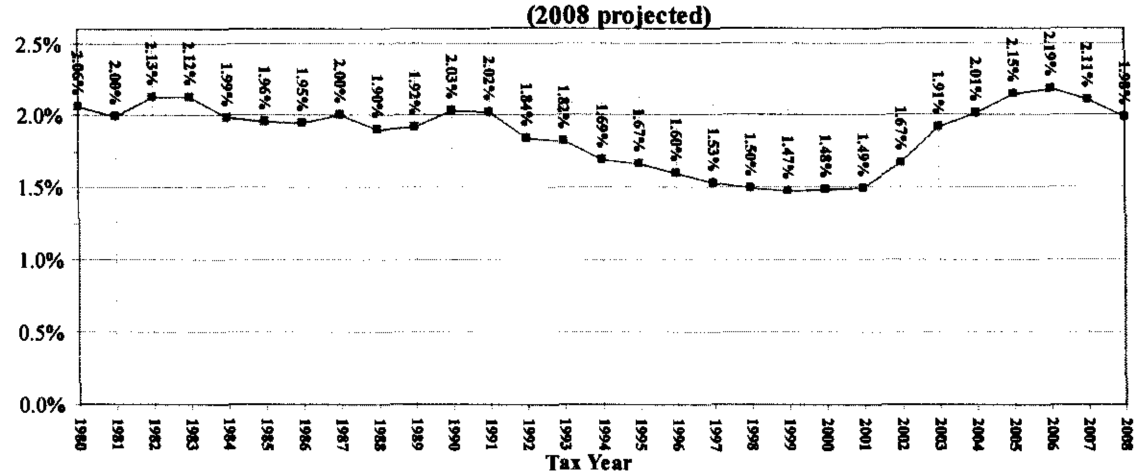
BFAAC has the following observations and recommendations regarding revenues and the outlook for the future.

A. Tax Rate Issues

Commencing with BFAAC's report on the FY 2004 budget, we tracked the percentage of per capita income that goes to pay the residential real property tax, including taxes on multi-family apartment units otherwise classified as commercial properties. The data below indicates that Alexandrians historically have paid in the range of 1.47% to 2.19% of personal income for real property taxes. We recommend that the City Council continue to monitor the real property tax burden using these historical ranges instead of applying arbitrary caps of any kind.

The updated chart below shows that for the first time in five years the projected percentage of per capita income that goes to pay the residential real property tax has fallen below 2%. While the percentages for FY 2005 and FY 2006 were above historical highs and gave us cause for concern last year, the current FY 2008 projected level is clearly a reflection of the decrease in real property values and is likely to remain below 2% if there is no increase in the real property tax rate.

Residential RE Tax Revenue Compared to Per Capita Income 1980-2008
(2008 projected)



We have the following observations and recommendations:

- **We renew our recommendation that the City continue to track the percentage of per capita income that is applied to residential real property tax to determine the impact on our residents.**
- **We continue to believe that arbitrary caps on expenditure growth or on tax increases are not useful and we do not recommend them. We do, however, urge City Council to be especially cautious in setting property tax rates that result in tax/personal income ratios above historical ranges.**

B. Debt Policy Guidelines

BFAAC has long advocated that the City's debt policy remain within the established guidelines. While the primary purpose of this policy is to ensure maintenance of our bond ratings, it is also a reflection of our creditworthiness and fiscal discipline.

The marked increase in real property values in recent years was the basis for our prior recommendation that the debt guidelines related to personal income be recalibrated. Although the decline in residential real property assessments is projected to be partially offset by appreciation and new construction of commercial property, we continue to urge the City to examine the need to recalibrate the established benchmarks. BFAAC is advised that staff will recommend that City Council meet in the fall to revisit the previous recommendations and other CIP issues.

We have the following observation:

- **Any revision to the debt policy guideline on personal and changing values should not be adjusted primarily to justify additional borrowing.**

C. Revenue Diversification

BFAAC remains committed to maintaining a long-term perspective in budget matters. We renew our concern about the dangers of the City's continued heavy reliance on inherently volatile real property taxes, acutely highlighted by the realization of flattening real estate assessments. While the real property tax base increased 4.4% to $33.4 billion in 2007, half of this increase was the result of new construction ($424 million residential; $292 million commercial). Existing residential real property values actually decreased by 2.9% on average, while existing commercial property values increased approximately 10%. Assuming the tax rate remains the same as last year, this will result in only $5 million additional real estate tax revenue for FY 2008. Our focus on revenue diversification is intended to reflect an opportunity to reduce the burden on property owners and to offset the volatility of real property tax revenues. This is not intended as a formula for raising additional revenues.

There are also several developments which do not necessarily affect the proposed FY 2008 budget, but may have an impact on out-year budgets. One such development was the Virginia General Assembly's recent approval, by a nearly unanimous vote, of a constitutional amendment that, if enacted, would provide most homeowners in Virginia a significant break on their real estate taxes. SJ354 would allow cities and counties to exempt as much as 20% of the real estate taxes paid by homeowners on their primary residence. While this amendment must be passed by both houses of the General Assembly again in 2008 and approved by voters in a referendum, it could have an impact on future budgets. If residential real property assessed values continue to remain flat, or decline, the shortfall in revenue could prove significant unless the City diversifies revenue sources, increases tax rates or reduces expenditures. Using the numbers from the FY 2008 budget (this would occur in 2009 at the earliest) an exemption of the full 20% would result in about a $32 million reduction[24] in revenue. This amendment would provide some tax relief for homeowners by creating, in effect, a differential residential/commercial real estate tax rate. The amendment could also have a significant negative impact on City revenues.

We have the following recommendation:

- **The City should plan for the possible enactment of the proposed homestead exemption should the General Assembly confirm its vote in 2008, subject to passage of the requisite referendum.**

Also of significance is the 2006 and 2007 General Assembly sessions' focus on establishing dedicated revenue streams to fund transportation improvements around the Commonwealth.

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[24] This estimate is high, as not all residential property is homestead property.

While the proposed legislation has been varied, many of the bills considered during the 2007 session proposed the creation of several optional local funding mechanisms for the Northern Virginia Transportation Authority—the so-called "self-help" proposals. On April 4, 2007 Governor Kaine's specified amendments of HB 3202 (the Transportation Bill) were adopted by the General Assembly.[25]

In addition to what the Northern Virginia Regional Transportation Authority can raise for the region, 40% of which is returned to the participating jurisdictions according to a pro rata formula, the amended plan will allow Alexandria to increase commercial real estate taxes up to 25 cents per $100 of assessed value.[26] Under current assessments the full $.25 would raise $25.1 million a calendar year. The City could also levy a local $10 vehicle registration fee which could generate about $1.0 million annually.[27] With over $12 million of transportation costs currently programmed for FY 2008 in the proposed CIP, and another $30 million of transportation costs currently proposed in the FY 2008 Operating budget, we believe that the Transportation Plan that affords Alexandria the ability to receive a share of the region's projected revenues provides an option worthy of consideration.

We have the following recommendation:

- **In view of recent transportation funding legislation, the City should continue to analyze its transportation needs and allocate the anticipated revenues to the future transportation-associated operating and CIP budget projections.**

D. Economic Development

In recent years BFAAC has stressed the importance of economic development in maintaining a sustainable and predictable revenue source, noting that revenue diversification reduces the real estate tax burden on homeowners.[28] In prior reports to Council, BFAAC has also acknowledged the City's efforts in supporting and expanding our economic development activities.[29] In addition to these efforts, the following table illustrates the City's substantial investment in these activities.

[25] The existing provision, Code of Virginia, § 58.1-540 allows Alexandria to impose a local income tax of a minimum of ¼% to a maximum of 1% of the Virginia taxable income for individuals, estates, trusts and corporations. This authority, which has not been utilized could, after a successful referendum, have generated as much as $200 million over the established five-year sunset period. The enactment of the Governor's amended Transportation Bill gives Alexandria the choice between utilizing the new revenue authority, or the existing income tax authority.

[26] Apartment dwellings are excluded from this definition of commercial real estate for this assessment.

[27] Alexandria could also levy a commercial/residential impact fee, the details of which remain to be fully analyzed. These developer-paid fees will be appropriate only in limited circumstances and the potential revenues are very situational specific.

[28] FY 2007 BFAAC Report; April 2005 Report on Economic Development Activities.

[29] E.g., Alexandria Strategic Plan 2004-2015; Economic Development Sustainability Summit 2006; 2006-2007 Economic Sustainability Workgroup.

Table 1: City Economic Development Expenditures by Fiscal Year

2008*	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
$2.86M	$2.80M	$2.69M	$2.56M	$2.25M	$2.16M	$2.05M	$1.77M	$1.64M	$1.27M	$1.41M
*Proposed										

In his presentation of the proposed FY 2008 Operating Budget on February 15, 2007, the City Manager reviewed the City's commitment to economic development recognizing that additional investment in related economic development infrastructure was required, noting that the established budget target remains a constraint. While BFAAC acknowledges the dedication and efforts of the City subsidized Alexandria Economic Development Partnership, the Alexandria Convention and Visitors Bureau, the Eisenhower Partnership, the Small Business Development Center, the Marketing Fund, the Holiday Marketing Program and the other groups and organizations that operate independently of City funding, BFAAC renews the concerns identified in our prior reports to Council. Funding alone without a comprehensive and coordinated approach and in the absence of direct City Manager oversight is inefficient and ineffective. Unless this responsibility is to be assumed by a currently funded City position, the absence of this position from the proposed FY 2008 Operating Budget raises our concern.

In updating our review of the City's economic development activities and investments, we examined the programs and tax dollar contributions[30] of some of our neighboring jurisdictions. The following table indicates the proposed FY 2008 economic development budgets in jurisdictions with comparable economic development activities.

FY 2008 Proposed Economic Development Funding Comparisons

Arlington	Fairfax County	Loudon County	Prince William Co.	Alexandria
$3,184,142	$6,673,818	$1,845,000	$2,276,062	$3,155,144

As demonstrated above, notwithstanding jurisdictional differences in demographics, Alexandria is clearly making the investment in Economic Development but, as noted below, may not be reaping comparable benefits. [31]

[30] For purposes of promoting valid comparisons, we did not include grants or intergovernmental revenues (e.g., BRAC funds) earmarked for specific economic development functions.

[31] In general, Alexandria appears to invest more in tourism promotion and marketing, but less in the area of economic development activities such as business retention, office occupancy and job growth.

The Economic Sustainability Work Group has not completed its analysis and recommendations as of this date, but their preliminary observations have highlighted several areas of concern which are shared by BFAAC:

(1) Job Growth

While the Washington Metropolitan area, and more particularly Fairfax County,[32] has experienced remarkable job growth, Alexandria has not shared in the private sector job growth. The jobs transferred with the move of the Patent and Trademark Office from Crystal City did, however, add approximately 8,000 jobs to the City. Also of significance is the impact of the potential loss of 7,330 jobs and the associated vacancy of 1,279,248 square feet of office space due to implications of BRAC.[33]

(2) Hotel Occupancy Rates

Notwithstanding improvement in the post September 11th hotel occupancy rates, current ACVA projections demonstrate a problematic year for hotel revenues. The economic cycle is demonstrating signs of reaching its peak with room rates beginning to flatten and record amounts of new construction in the pipeline. There are likely two to three years remaining in the cycle.[34]

According to the recent progress report from the Economic Sustainability Work Group, hotel revenue adds the largest percentage of profit by property type to the City.[35] It is assumed that we will see an increase in our occupancy rates based on regional new development; however, there is no data currently forecasting any increase in potential revenue.

(3) Landmark Mall

Landmark Mall has been characterized as the single most significant land use activity in the City's West End.[36] However, the real estate assessment for Landmark Mall continues to plummet. The property is currently appraised at 59% of the CY 1991 assessed value. Landmark Mall's reduction in value is costing the city valuable revenue. The City's other 28 shopping centers continued to be strong with high occupancies and stable operating positions. The current value of these centers increased 12.52% or approximately \$62.8 million from \$501.3 million in CY 2006 to \$564 million for CY 2007. The growth is attributed to both appreciation and new growth. Over a one-year period, gross receipts increased 5.98% (from \$592,600,309 to \$628,048,539) in the third quarter 2006, based on the numbers from the Department of Finance and the Virginia Department of Taxation.[37]

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[32] Notwithstanding nominal advances by neighboring jurisdictions including Alexandria, Fairfax County emerged as the powerhouse in the region's job growth. In addition to the attraction of the Fairfax County school system, proximity to the federal government, access to Dulles International, Fairfax vigorously recruits companies in a business-friendly environment. Washington Post, January 30, 2007, A1

[33] AEDP Data of August, 2006.

[34] Budget Memo #2, February 13, 2007.

[35] March 1, 2007 Town Hall Presentation by the Economic Sustainability Work Group.

[36] Technical Assistance Panel Report, ULI Washington, September 29-30, 2004.

[37] FY 2008 Budget Memo #2, February 13, 2007.

Landmark Mall's assessment decreased another $22,000,000 from CY 2006 to CY 2007, representing a 20.7% decline and a loss of tax revenue based on the current rate of 81.5 cents of approximately $179,300. The mall has been in decline for several years and had in 1991 been assessed at $ 204,900,000. If the property were still assessed at that amount today assuming no change in the property tax rate, we would be gaining $1,669,935 annually in revenue on the center.

In addition to the lost real estate tax revenue, the City is also losing tax revenues from gross receipt sales, business licensing, and restaurant/food tax. Currently, there are no projections on the extent of the lost revenue. Notwithstanding the project impediments due to the merger of General Growth Properties and the Rouse Company or the issues associated with the new ownership interests of Sears and Macy's, the City must continue a proactive role in the planning and developmental process in order to protect its economic interests.

The success of the proposed redevelopment may also require the City to explore the feasibility of contributing to the financing of the project.[38]

(4) National Harbor

The Economic Sustainability Work Group's preliminary report has recognized the need to evaluate the challenges and opportunities for Alexandria associated with this project. Recognizing the significance of this project, the City Manager's FY 2008 Budget proposed $300,000.00 from the designated fund balance to address some of the anticipated issues, including Old Town transit and others unspecified. While BFAAC recognizes the rationale for such an initiative, there is an absence of supporting data and the requisite identifiable goals and measures associated with this expenditure. Given the nature of the development, it is imperative that the City undertake a thorough analysis of the projected economic impacts prior to making additional significant expenditures.

(5) Economic Impact of Development – The need for data

In our FY 2004 Budget Report, BFAAC observed that the revenues that the City can anticipate must be evaluated in the context of the expenses the City would have to incur to support such development and that as a general rule, commercial development reflects a positive net fiscal impact.[39] The Economic Sustainability Workgroup restated the findings, adjusted for inflation, as a "Percentage of Profit [to the City] by Property Type," but as of this date the data has not been updated. Current economic impact data and demographic trends are essential to economic development considerations.

Although economic impact of development is not part of the Planning Commission's review of land use applications in the context of the City's Master Plan, it is an important component of economic development considerations and it provides an opportunity to gather essential data to assist the City in undertaking a cost/benefit analysis.

[38] ibid

[39] Delta Associates 1999 Report; Budget Memo #34 (April 14, 2003).

(6) Performance Measures

BFAAC observes that the current budget documentation for City-supported economic development activities has not yet been adopted to reflect the City's Managing for Results Initiative. The development of performance information and cost data systems is intended to provide a framework that will enable the City to define the major programs and activities it provides, to assign and track costs, and to measure the quantity, quality and impact of these services.[40] While the individual organizations may have identified the requisite programs and activities in the FY 2008 budget, there is a conspicuous absence of identifiable performance measures essential to accountability, service improvement, and measurement of results. The City would be well served by an analysis of economic indicators in justifying and prioritizing its economic development activity investments in future budgets. BFAAC has been informed that City budget staff intends to do so next year working with the economic development organizations.[41]

We have the following observations and recommendations:

- **We encourage the City to look carefully at new opportunities that might allow us to capitalize on hotels as an increased source for diversification of revenue.**
- **We encourage City Council to continue a proactive role in planning the major Landmark redevelopment, including strategies identified in the ULI Washington Report.**
- **BFAAC believes that economics, to the full extent allowed by law, should be an essential consideration in any land use decision.**
- **Goals and performance measures for economic development activities should be clearly defined as part of the budget process.**

Unfortunately, Alexandria continues to function without an overall plan or strategy for economic development. Economic development activity appropriations continue on an *ad hoc* basis without the requisite level of City oversight and coordination. Therefore, the challenges and opportunities identified at the prior economic summits and the preliminary Economic Sustainability Work Group report are of no benefit until such time as the City takes steps to enact a comprehensive and coordinated approach to management of essential economic development activities.

We have the following observations and recommendations:

- **The City should take prompt action to develop an overall economic development strategy and, within that strategy, provide for necessary**

[40] FY 2008 Budget Memo #4, March 6, 2007.

[41] The Proposed FY 2008 Economic Development Budgets for Fairfax County, Arlington County and Prince William County contain identifiable objectives and measurable performance indicators.

planning, policy guidance, oversight and control of City spending on economic development activities.

- **Economic development planning, policy guidance and oversight should be a City staff function, reporting to the City Manager, so that economic development activities are subject to the same type of management, control and budgetary review as are other important City functions.**
- **Performance measures, current economic data and other metrics are essential to an understanding of the needs, benefits and effectiveness of economic development investments.**

E. Personal Property Taxes

With the adoption of the Personal Property Tax Relief Act (PPTRA) in 1999, the Commonwealth has reimbursed Alexandria for a portion of the vehicle Personal Property Tax assessed. Beginning in CY 2006, due to General Assembly action, this reimbursement became fixed at $23.6 million, which covered 69% of the City's overall assessment in CY 2006.[42] Barring further action by the General Assembly, this reimbursement level will not change in future years and will continue to cover an ever-shrinking percentage of the tax revenue.

In our FY 2007 report, BFAAC had anticipated that this shortfall would not occur until FY 2008 and recommended that, when that time came, the City collect additional revenues from taxpayers to ensure the collection of the full assessment. With the difference in reimbursement from the Commonwealth occurring a year early, we were pleased to see Alexandria implement this policy.

BFAAC reiterates its recommendation from FY 2007 that the City dispense with the requirement that its residents purchase and display a decal signifying the payment of the vehicle personal property tax.[43] As noted in our FY 2007 report, there are a variety of alternate collection methods and administrative changes that the City can employ to aggressively collect vehicle Personal Property Tax revenue. Alexandria should join Fairfax County and many other jurisdictions around the Commonwealth and no longer rely on the decal as the primary method of enforcement for the Personal Property Tax.[44]

We have the following observations and recommendations:

- **Since the reimbursement from the Commonwealth covers an ever-shrinking portion of personal property tax revenues, BFAAC continues to support increased collections to cover the shortfall. We urge the City to fully explain the causes for any resulting tax increases.**

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[42] City of Alexandria, "FY 2008 Proposed Operating Budget," pages 4-28.

[43] In its 2006 session, the General Assembly passed HB 1284 and unanimously endorsed and clarified the ability of jurisdictions to eliminate the decal requirement.

[44] Given the Commonwealth's aversion to differing tax/licensure policies between jurisdictions, it is not unreasonable to anticipate that Fairfax County's decision to dispense with the decal requirement will hasten the elimination of the decal as an enforcement method across the Commonwealth.

- **BFAAC believes that the City should begin a transition to alternate forms of enforcement for payment of the Personal Property Tax and eliminate the use of the existing decal. We further recommend that the City explore administrative changes to the collection of the Personal Property Tax, including automatic vehicle registration and semiannual payments.**

F. Fees

Recently the City began a review of some of its fee for service structures. BFAAC has advocated periodic review of fees and comparisons with neighboring jurisdictions to help assure a best effort to recapture related operating costs. In reviewing some of the various fees we observed that the City lacks a comprehensive listing of the fees as well as any regular scheduled fee review and adjustment.[45] The City staff indicates that this option is being explored.

We have the following observations and recommendations:

- **BFAAC recommends the creation of a fee compendium detailing all fees currently collected by City departments for inclusion in future budgets as well as periodic review by Council.**
- **BFAAC urges Council to review each fee periodically to ensure the recapture of associated operating costs.**

[45]The City of Roanoke has established a Fee Compendium that lists all fees charged. Inasmuch as all fees are located in the listing, Code amendments are not required to change the fee structure. During the annual budget process their department managers review the fees for their respective areas of operation. The fees are also easily searchable on their website. http://www.roanokeva.gov/DeptApps/FeeComp.nsf/DocsOnWeb?OpenForm.

GLOSSARY

ACPS	Alexandria City Public Schools
ACVA	Alexandria Convention and Visitors Association
AEDP	Alexandria Economic Development Partnership
AHOP	Affordable Home Ownership Preservation Grant Program
CIP	Capital Improvement Program
COLA	Cost of Living Adjustment
DASH	Alexandria Transit Company
GASB 45	Government Accounting Standards Board [Standard] 45
MFRI	Managing For Results Initiative
OPEB	Other Post-Employment Benefits
PPTRA	Personal Property Tax Relief Act
SBDC	Small Business Development Center
WMATA	Washington Metropolitan Area Transit Authority