BUDGET OUTLOOK

By controlling the growth of expenditures and reducing the City's outstanding debt, the City has been able to maintain services and address high priority needs during the past five years despite difficult economic times.

Expenditure and Revenue Trends

Since FY 1992, average annual growth in the City's total General Fund Budget has been held to 1.8% per year - less than the average rate of inflation during this period.

There are, however, important expenditure trends in specific areas of the budget that differ significantly from this overall figure. As shown in the table below, General Fund expenditures for transit services, health and welfare programs, and the Schools have increased annually at a much greater rate than all other City programs, and the City's debt service expenditures have declined steadily during this period.

EXPENDITURE TRENDS (FY 1992-FY 1997)

PROGRAM AREA	Approved FY 1992 General Fund Budget	Approved FY 1997 General Fund Budget	Percent of FY 1992 General Fund Budget	Percent of FY 1997 General Fund Budget	Average Annual Rate of Change in the Budget
Schools (includes Special Education)	$64.8 million	$80.9 million	28.2%	32.2%	up 4.5% per year
Health & Welfare	$18.6 million	$24.6 million	8.1%	9.8%	up 5.8% per year
Transit Services (Metro, DASH Bus& DOT paratransit)	$4.5 million	$7.0 million	1.9%	2.8%	up 9.2% per year
Debt Service	$14.9 million	$9.3 million	6.5%	3.7%	down 9% per year
All other City Programs	$127.3 million	$129.3 million	55.3%	51.5%	up 0.3% per year

Total General Fund Budget	$230.1 million	$25.1 million	100%	100%	up 1.8% per year

General Fund Revenue Trends. Since FY 1992, the City's General Fund revenues from all local sources of revenue have grown at approximately 2% per year, despite the loss of $1.2 billion, or 10%, in assessed value of real property. Growth in other local revenue sources, such as personal property taxes, offset the reduction in real property tax revenues during this period; however, it is uncertain if this growth, particularly in personal property taxes, will be sustained in the coming years.

Real estate values began to stabilize in 1995, but 1996 was the first year since 1991 that both total residential and total commercial assessed values increased. Property values for existing residential properties appear stable through the first half of 1996, but the regional market for residential and commercial properties remains sluggish. The FY 1997 Approved Budget projects a modest 1% increase in the total assessed value of all real property in the City in 1997.

Capital Needs for City and Schools - Future Debt Service and Operating Budget Impacts

Five years ago, in FY 1992, the City paid nearly $14.9 million in principal and interest on its outstanding debt, or about 6.5% of the City's annual General Fund budget, and debt per capita stood at $561 at June 30, 1992. By this year, principal and interest payments declined to $9.3 million, or 3.7% of the General Fund budget, and debt per capita will total $320 at June 30, 1997. This trend of declining debt service, however, will be reversed over the next three to five years, and the debt service savings of the past five years, which helped the City to escape significant increases in tax rates while increasing funding for Schools and other priority needs, will be gone. The six-year Capital Improvement Program (FY 1997-FY 2002) approved by Council on May 7 totals $106.1 million, an increase of approximately $11.8 million, or 12.6%, compared to the FY 1996-FY 2001 CIP. The City's six-year CIP has not exceeded $100 million for 14 years, since FY 1983, when the capital budget totaled $109.6 million.

The FY 1997-FY 2002 capital program reflects, in part, the cyclical nature of capital facilities planning and maintenance. Buildings and major systems generally require renovation or replacement within 12- to 15-year cycles. Major capital projects included in the FY 1997-FY 2002 Capital Budget include:

- $20.5 million for the Schools' capital facilities maintenance needs and completion of the capital portion of the Schools' multi-year Technology

Plan;

- $11 millon for the planning, design and construction of the City's new main library in the West End;

- $9.2 million for the phased, multi-year replacement and upgrade of the City's public safety radio system; and

- $8.6 million for major renovations and improvements to many of the City's heavily-used recreation facilities.

(See "Budget, Finance and Administration," for a listing of major capital projects included in the FY 1997-FY 2002 Capital Improvement Program.)

Financing this ambitious six-year capital program will require that the City return to the municipal bond market because the City will not be able to fully fund the capital program on a pay-as-you go, or cash capital, basis as it has done in eight of the last ten years. The current funding plan for the City's $106.1 million, six-year capital program calls for the City to borrow a total of $62.5 million through the issuance of new general obligation bonds, beginning with a $25 million issue in FY 1998. The City expects to issue additional bonds in FY 2000 and FY 2002.

The impact of this new debt on the City's operating budget in future years will be significant. For each $25 million the City borrows, the first-year debt service payment (principal and interest) is currently estimated at $2.75 million. Besides these added debt service costs, new or expanded facilities may incur additional operating expenses associated with staffing and other costs.

Future School Facilities. Last year, the School Board commissioned a study of student enrollment projections. The consultant's report was reviewed by Schools and City staff and presented to the School Board and City Council in May. The consultant's projections suggest that public school enrollment will continue to grow during the next ten-year period. Capacity in the School facilities to handle this enrollment growth is an issue that will need to be addressed over the next three to five years. City Council and the School Board held a joint work session in June to discuss the Schools' future facilities needs. The Superintendent presented three options with cost estimates to address the projected enrollment growth:

- build a new middle school (est. cost: $13 million);

- build a new elementary school and convert an existing elementary school to a middle school (est. cost: $19 million); and

- build both a new middle school and a new elementary school (est. cost: nearly $22 million).

Members of the School Board suggested a fourth alternative - to build an elementary school, and further review the student enrollment projections. The cost to acquire a site for a new school facility is not included in the Superintendent's preliminary construction cost estimates, but the cost of land in the City could range from $500,000 to $1 million per acre.

In the FY 1997 Budget, City Council provided funding for the Schools to complete a comprehensive facility needs study. The study is underway this summer. The facility consultant will be reviewing the Schools' facilities, demographic and enrollment data, and the options outlined by the Superintendent and discussed at the joint School Board and City Council work session in June.

Funding to address these additional School facility requirements is not included in the City's current $106.1 million six-year capital program. In addition, the future annual operating costs of a new school facility will be significant. While the actual operating budget impact will depend upon student enrollment, attendance zones, and staffing decisions, the additional cost to operate a new 75,000-square-foot, 600-student elementary school could approach $1.5 million, based on cost estimates from the Education Research Service annual survey of school district budgets. The additional operating costs for a new 117,000-square-foot, 900-student middle school could approach $2.0 million.

Outlook

The capital needs of the next three to five years will result in significant pressure on the City's annual operating budget. The City will not be able to rely on debt service savings to offset expenditure growth in other areas of the General Fund budget. And, unfortunately, the Washington area economy remains sluggish, most notably in the real estate market, which is the prime source of tax revenue for area local governments. Trends to date in the City's real estate market are similar to those in the region.

The near term outlook is for only modest revenue growth, possibly slightly below the rate of inflation. Combined with increasing capital costs, this means that City Council will face significant expenditure choices, future tax and fee increases, or a combination of both, to fund increased debt service payments, and to fund future operating costs when new or expanded facilities come on line after FY 1998.