City of Alexandria, Virginia

Five-Year Financial Planning Model Report

November 2015 Update

Alexandria's Five Year Financial Planning Model

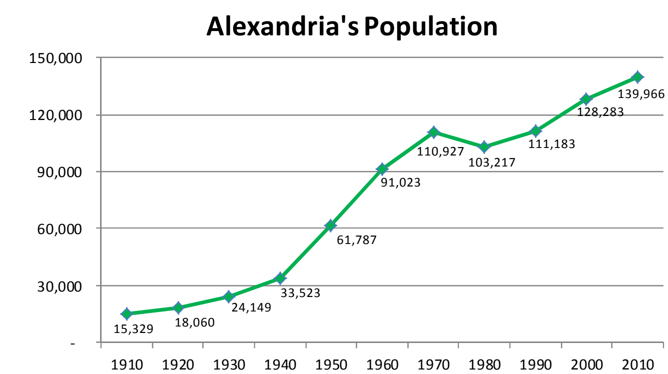
The City of Alexandria has long used multi-year financial forecasting as a planning and communication tool. In calendar year 2014, as part of the FY 2015 budget process, the City developed its forecast model from a static estimate of future revenues and expenditures based on current services to a multi-layered forecasting tool that allowed for more dynamic modeling of a greater number of variables and scenarios. Staff updated the model for the FY 2016 budget and has most recently updated it for FY 2017—2025 preliminary estimates for the November 2015 City Council annual retreat.

The results are highly consistent with last year's findings. The City's economy is sound and slowly growing while expenditure needs are projected to continue growing at a higher rate than revenues despite low inflation due to population growth, City workforce costs, Alexandria City Public Schools (ACPS) student enrollment, aging infrastructure capital improvement needs, and regional public transit costs.

Alexandria's Economy

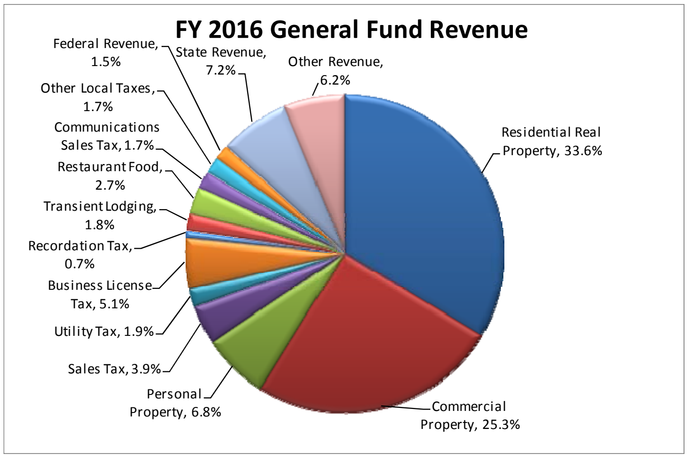
Alexandria is a prosperous city that benefits from its proximity to Washington, DC, the Pentagon, Reagan National Airport, and its location at the intersection of I-495, I-95, and I-395. Except for a period in the 1970's, the City's population has grown steadily for the last hundred years. In 2013, the Census Bureau estimated the City's population as 148,892.

On many statistical measures, the City fares well compared to the rest of the country. In 2013, the City of Alexandria had a per capita income of $81,078 which is 181% of the national average. The City's average household income is about 60% above the national average. The City also has a low unemployment rate relative to state and national averages and a high percentage of residents with a college degree. A large percentage of the City's workforce is in the professional and technical services (20%) and public administration (16%) fields, which include well paid and highly educated professionals. The City's largest employers are The Patent and Trademark Office, the Department of Defense, the City of Alexandria, Alexandria City Public Schools, and Inova Alexandria Hospital, all of which are stable employers. The City has a thriving tourism industry based around Old Town Alexandria and its proximity to Washington, DC and Mount Vernon. Despite these positive indicators, the City's economic growth, like that of the rest of the Washington, DC metropolitan area, has been sluggish since the 2008 recession. The Federal government significantly influences the regional economy, and while its stimulus activities helped sustain the area through the recession, federal spending has declined since the recession, curtailing government contracting and business travel. Development and redevelopment opportunities in Potomac Yard, the Beauregard corridor, the east and west ends of Eisenhower Avenue, Landmark, and the Waterfront position the City economically well in the future; however, the most significant of this development is expected to occur outside the five-year timeframe of the financial planning model.

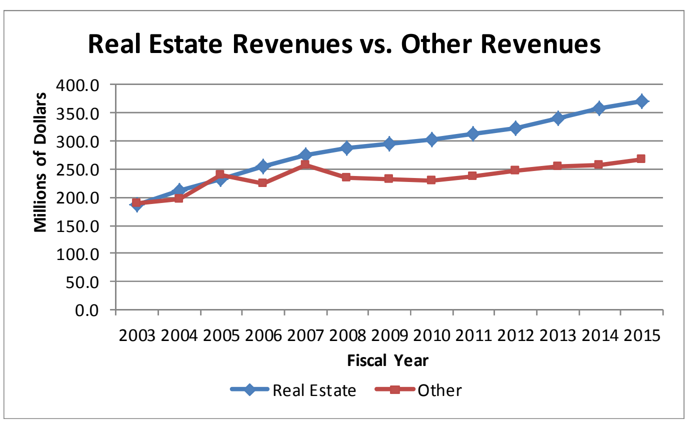


Alexandria's Revenues

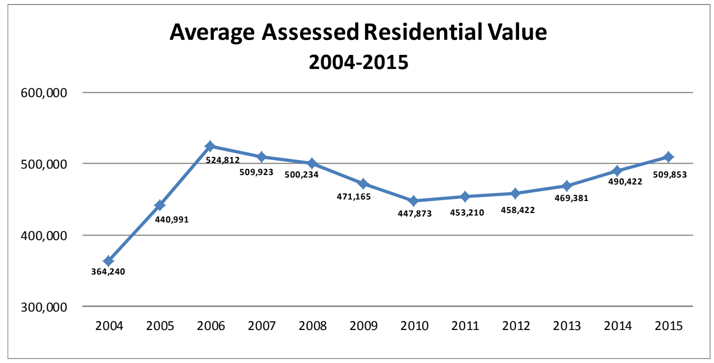
The City's primary source of revenue is the real estate property tax, comprising nearly 60% of the City's General Fund budget in FY 2016.



Prior to the 2008 recession, real estate taxes and all other sources of revenue contributed roughly equal portions of the City's revenue. While other economically sensitive revenues such as sales, business licenses, restaurant meals, and transient lodging (hotel) taxes have grown slowly since the 2008 recession, real estate taxes have become a comparatively larger portion of the City's resources.



Residential real estate taxes comprise approximately 57% of total real estate taxes and approximately 75% if apartment buildings are counted as residential. Residential property values have grown by an average of 3.2%, including assessments of existing properties and new construction since a five-year low in 2010, but have yet to return to 2006 levels. Calendar year 2015 was the first year the average assessed value achieved the $500,000 mark since 2008.



The November 2014 forecast cautioned that an interest rate increase could slow home sales and growth in values. This has not occurred in calendar year 2015; however, an interest rate increase seems even more likely in the near future than it did one year ago. Recent year-over-year percent changes in median home sales prices reported by the City's real estate assessment staff showed increases as high as 17% in August 2015 and 10% in May but also showed decreases of 11% in April and 7% in July. Based on the past five years of assessment growth, the five-year financial planning model assumes real estate values will continue to grow over the next five years, but with no data to suggest a coming surge in values and the potential for an interest rate hike in the near-term, the model's baseline assumption is that they will grow at a rate of 2.0% in FY 2017 and 2.3% annually in FY 2018-2021, excluding any significant new development. Other sources of revenue such as personal property, sales, business license, transient lodging, and restaurant meals taxes are anticipated to grow at rates between 1% and 3%, resulting in an overall revenue growth rate of 2.2%.

Alexandria's Expenditures

Approximately 57% of the City's FY 2016 General Fund budget pays for government services such as public safety, public works, human services, and recreation. Approximately 35% pays for Alexandria City Public Schools (ACPS) operations, maintenance and construction projects, and approximately 8% pays for City government capital improvements such as transportation, sewers, recreation facilities, and public buildings.

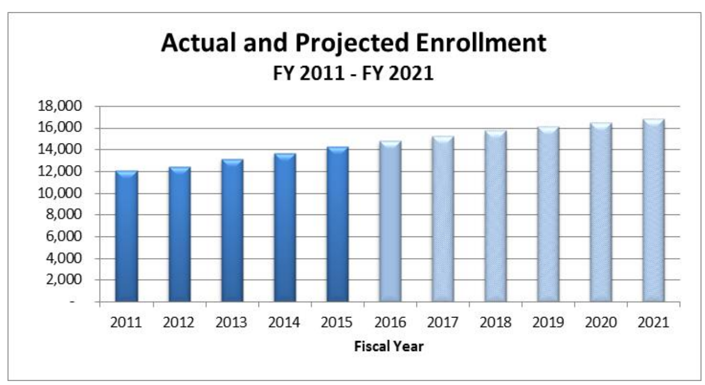
City Government Services

In the FY 2016 budget, 58% of City operating expenditures are salary and benefit costs for the employees who deliver the services. Since FY 2007, the number of City employees has been reduced by approximately 4.0%. There are fewer positions budgeted in FY 2016 than there were in FY 2007.

On average, employee salary costs increased by 3.5% annually from FY 2011 to FY 2014. This includes annual salary increases, career advancements, market pay adjustments for public safety pay, and employee turnover, which can result in the hiring of new employees at potentially higher or lower salaries. In the five-year financial planning model, employee salaries are projected to continue growing at a rate of 3.4% annually. City contributions to employee retirement and health insurance benefits are the next largest workforce costs behind salaries. Retirement contributions are estimated to remain constant over the next five years; however, health insurance contributions are estimated to grow by 7% annually due to the rising cost of healthcare. The result is an overall personnel cost increase of 3.0% including salaries and benefits which equates to approximately $7 million in FY 2017. City non-personnel related costs associated with contracts, supplies, and materials are projected to grow at a rate of 2.4% in FY 2017-2021 based on past history and planned expenditures.

Alexandria City Public Schools

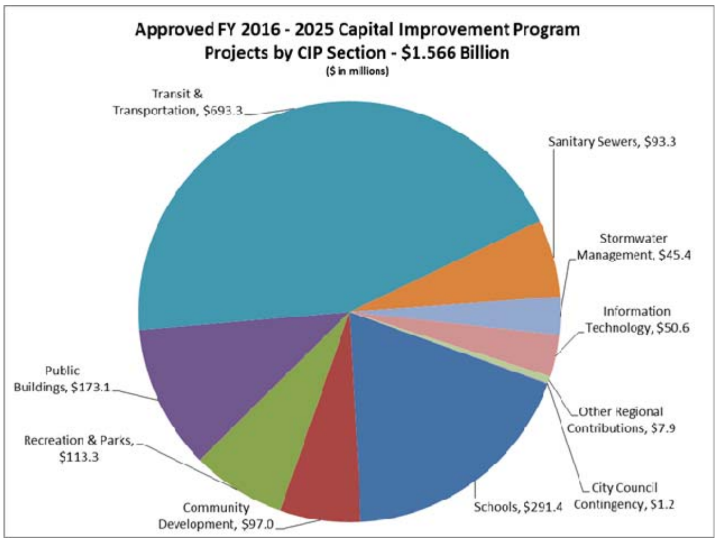
From FY 2011 to FY 2015, the City's ACPS contribution increased at an average of about 3.4% annually. ACPS enrollment has increased by approximately 19% from FY 2011 to FY 2015, and ACPS staff anticipate enrollment will increase by an additional 18% through 2021. The five-year financial planning model assumes that ACPS enrollment will grow at a rate of 3.3% in FY 2017, 3.1% in FY 2018, and 2.2% in FY 2019 through 2021. The ACPS five-year forecast includes a $6 million increase in the City's appropriation based on enrollment growth only and a $15 million gap between revenues and expenditures. The City five-year financial planning model includes a similar increase for enrollment growth plus an additional $5 million placeholder in non-enrollment related cost increases strictly for forecasting purposes.



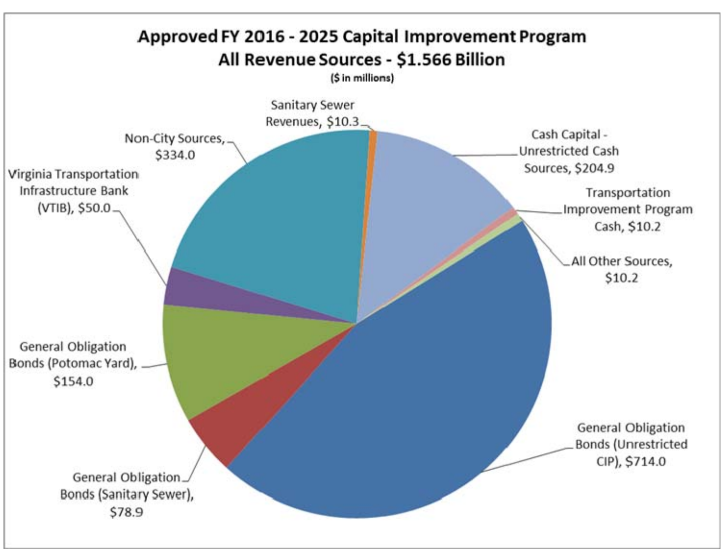
Alexandria's Expenditures (cont'd)

Capital Improvement Program

The City's FY 2016-2025 Approved Capital Improvement Program (CIP) is $1.6 billion over ten years for construction and implementation of projects related to public education, parks and recreation, transportation, sewers, information technology, and other City infrastructure.



CIP projects are funded from a combination of non-City sources, such as developer contributions and state and federal grants, and City debt financing and pay-as-you-go cash capital. The current ten-year approved CIP is funded with $1.2 billion in City sources.



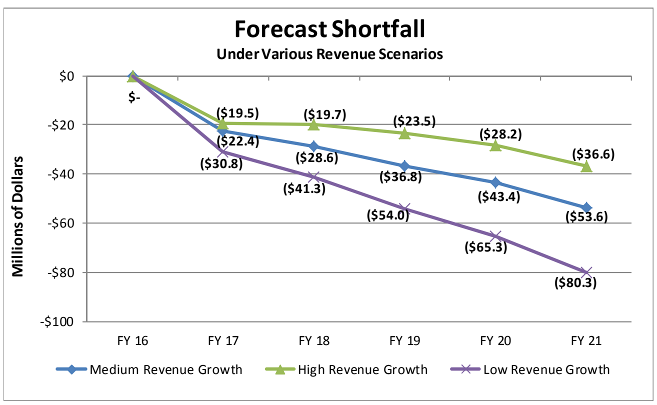
The five-year financial planning model includes $74.1 million in planned General Fund debt service and $16.7 million in planned General Fund cash capital in FY 2017. Total General Fund cash capital and debt service funding for the CIP grows by an average of 6.0% per year over the next five years as planned in the current CIP.

Transit Subsidies

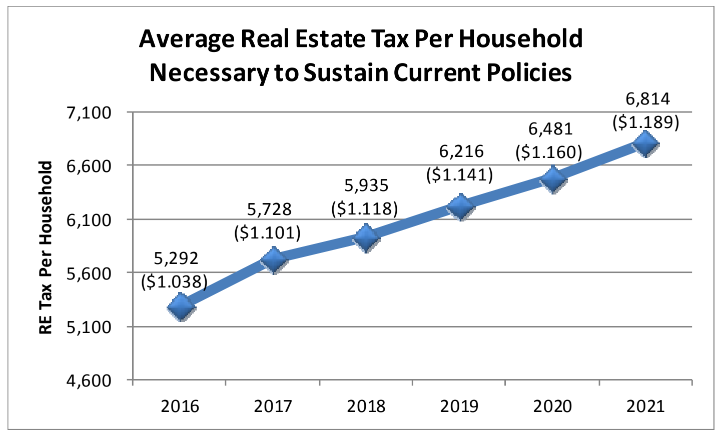
In addition to services provided to residents directly by the City government, the City also contributes to separate regional and local authorities to provide transit services to City residents. These include the Washington Metropolitan Area Transit Authority (WMATA), provider of Metrobus and Metrorail services, the local DASH bus system, the Virginia Railway Express (VRE) commuter rail system, the local DOT paratransit service for residents with disabilities, and the King Street Trolley. While a relatively small portion of the City's General Fund budget, the transit subsidies area is the fastest growing. Its 8.5% average annual rate of growth over the past five years exceeds that of the City government, ACPS, and the CIP as well as the rate of revenue growth. The five-year financial planning model assumes that the City's share of WMATA funding will grow by 10% annually, which equates to a $3.4 million increase in FY 2017.

Alexandria's Five-Year Outlook

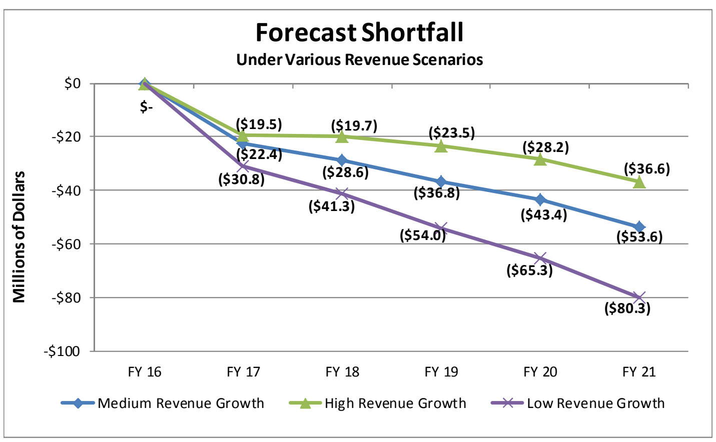
The five-year financial planning model allows the City to forecast a variety of revenue and expenditure scenarios in order to assess their impact on its near-term financial future. While the City's revenues and expenditures are balanced in the FY 2016 approved budget, the current baseline scenario projects that the rate of expenditure growth will exceed that of revenues, resulting in future budget shortfalls in each of the next five years. It is worth noting that none of these shortfalls will actually occur because the City adopts a balanced budget each year. The purpose of this model is to illustrate, on an order of magnitude, the amount of revenue increases and/or expenditure reductions need to balance the budget in future years with no other changes in the scenario.



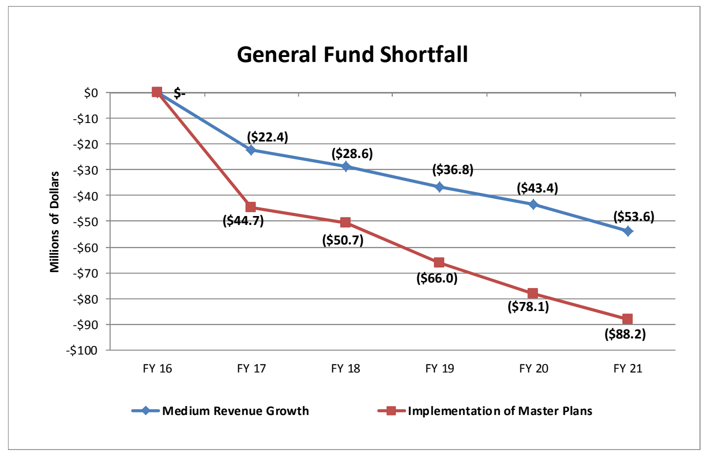
As discussed in the previous pages of this report, the current baseline scenario combines assumptions about revenue growth, based on recent historical trends, and the current state of the economy; City personnel expenditure growth, based on recent salary trends and market-based benefit information; City non-personnel, based on trend analysis; Alexandria City Public Schools funding expenditure growth based on enrollment growth; and capital financing costs, based on cash capital and debt service amounts planned in the FY 2016-2025 Capital Improvement Program. In addition, it includes planned future budget changes resulting from policy decisions such as the future savings to be realized beginning in FY 2018 as a result of the City's decision to withdraw from participation in the Peumansend Creek Regional Jail due to lack of need. Based on this set of assumptions, if the City were to balance future budgets by increasing the real estate property tax in each year, the rate would increase from the current $1.038 per $100 of assessed value to $1.189 in FY 2021, and the average residential tax bill would increase from $5,292 per year to $6,814. It is worth noting that since the City would likely balance its budget in future years at least in part through expenditure reductions, the projected tax rate and average tax bill needed to balance the budget for that year and any subsequent year would be reduced.



The model also allows for the ability to illustrate the potential future impact of a variety of economic scenarios and/or policy choices. In addition to the baseline scenario, staff has developed higher and lower growth scenarios to demonstrate how fluctuations in the economy and changes in development patters can impact the City's financial situation. The higher growth scenario assumes that the real estate property value rate of increase is one-half of one percent higher than the baseline as a result of more new construction than assumed in the baseline scenario and that other economically sensitive taxes such as sales, meals, and transient occupancy (hotel) taxes grow at a higher rate as a result of the increased development. The lower growth scenario assumes a lower rate of real estate property value growth, in case of reduced development and/or a downturn in either the housing or commercial property markets and that all other sources of revenue would remain flat due to a lack of economic growth.



While the financial planning model's baseline scenario includes the future cost impact of current policy decisions, there are community needs beyond the programs and services the City currently provides which have been identified but not yet addressed and are, therefore, not included in the baseline scenario. They can, however, be illustrated as layers beyond the baseline to demonstrate their cumulative effect. Examples of some of the community needs identified but yet fully addressed could be found in some of the master plans adopted by City Council or other City boards, committees, or commissions. These include, but are not limited to, the Environmental Action Plan, Transportation Master Plan, Strategic Plan to Prevent and End Homelessness, the Library Five-Year Plan, the Housing Master Plan, the Public Art Implementation Plan and Policy, the Athletic Fields Master Plan, the Urban Forestry Master Plan, and the Waterfront Small Area Plan. With expenditure growth projected to exceed revenues over the next five years, the cost of implementing just some elements of some of these master plans without increased revenues or reduced expenditures in other areas adds to the overall shortfall.



Summary

There are no significant changes to the City's financial outlook from November 2014. The City's economy is healthy, but the region's growth is slow. The cost of providing current services is growing, and there are additional unmet needs to be addressed, resulting in a projected future budget imbalance which will need to be addressed through some combination of either cost reductions, economic development, or tax and fee increases.