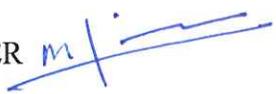


City of Alexandria, Virginia

Memorandum

DATE: FEBRUARY 18, 2015

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: MARK B. JINKS, ACTING CITY MANAGER 

SUBJECT: REPORT ON FIVE-YEAR FINANCIAL PLAN FROM BUDGET AND
FISCAL AFFAIRS ADVISORY COMMITTEE (BFAAC)

Attached you will find BFAAC's report and recommendations concerning the Five –Year Financial Plan issued by City staff this past November. This will be discussed at the BFAAC worksession with Council on April 21, 2015.

Attachment

City of Alexandria, Virginia

MEMORANDUM

DATE: FEBRUARY 13, 2015
TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL
FROM: BUDGET AND FISCAL AFFAIRS ADVISORY COMMITTEE
SUBJECT: REPORT OF OBSERVATIONS AND RECOMMENDATIONS ON THE CITY'S FY 2016-2020 FIVE-YEAR FINANCIAL PLAN

As stated in our memo to City Council dated November 5, 2014, the Budget and Fiscal Affairs Advisory Committee (BFAAC) intends to provide three separate reports on different topical areas in lieu of one large annual report. This report is our second planned report to City Council in FY 2015 and discusses our observations and recommendations on the City's Five-Year Financial Plan put out this past November. BFAAC intends to write our third and last report this fiscal year on the City Manager's Proposed FY 2016 Operating Budget and FY 2016-2025 Capital Improvement Program which will be delivered in mid-April. We look forward to discussing all three of these reports and their observations and findings with you at our annual budget worksession in April.

The Five-Year Financial Plan FY 2016 – FY 2020

Alexandria continues to face challenging fiscal circumstances impacting both short-term and long-term operations and capital investments. The City is expecting a decrease in revenue coming from the State due to anticipated cuts in spending. Currently the City expects a \$16.1 million shortfall in FY 2016, without including costs of implementing various master plans and assuming the ACPS FY 2016 budget request will stay level with its FY 2015 request¹. With the cost of current service expenditures, this imbalance is expected to grow to \$33.8 million by FY 2020 or 4.4% of projected expenditures. Over the period FY 2016 to FY 2020, the City projects the cumulative deficit will total over \$128 million.² To address the short-term need to balance the FY 2016 budget: 1) Council guidance left open the possibility of a residential tax rate increase³; 2) Council shifted the terms of the debate on cash capital versus debt financing of certain capital expenditures⁴; and 3) the Acting City Manager directed department heads to identify an additional 2% cost reduction in departmental expenditures⁵. The annual need to address what has emerged as a longer-term structural fiscal imbalance also introduces less-than-optimal policy

¹ BFAAC is aware that the revised budget shortfall in FY 2016 according to City staff is now projected at over \$30 million.

² City of Alexandria, "Five-Year Financial Plan FY 2016 – FY 2020," Section 5.1 – Revenue and Expenditure Forecast.

³ Item 14-3289, "Setting Guidance for FY 2016 General Fund Operating Budget and Capital Improvement Program for FY 2016-FY2025, November 11, 2014.

⁴ City of Alexandria, "Minutes of the City Council Legislative Meeting, January 13, 2015."

⁵ Internal memo to Department Heads and Agency Directors, "Request for 2% FY 2016 Budget Reduction Options", January 5, 2015.

choices, such as reallocations from the City's Fund Balance to address ongoing operational needs, into Council deliberations.

Observations and Recommendations on Using the Plan for Policy and Operational Decisions

The upcoming budget year demonstrates the City's continuing need to correct annually for deficits. BFAAC commends the Acting City Manager and Staff for the development of the Five-Year Financial Plan ("the Plan"), which provides needed analysis of policy and operational decisions designed to achieve short-term balanced budget requirements. The Plan will provide Council with a greater ability to make policy decisions understanding true, multi-year lifecycle costs. The Plan also offers a more complete picture of the true cost of capital investments, including often poorly-understood associated operational costs. With this more complete "total cost of ownership" picture, Council will be able to make more informed tradeoffs across investments as well as better gauge the need for additional debt and/or cash capital for specific capital investments.

From an operational standpoint, BFAAC notes that the Plan also supports proactive planning across budget years by the Acting City Manager and Staff. BFAAC notes that the Plan's explanation of the benefits structure for City employees provides a greater level of certainty on projected compensation and benefits decisions. BFAAC recommends that the Council direct the Acting City Manager to develop a complementary compensation and benefits strategy to further inform policy and operational decisions and better understand impacts on employee retention and morale.

Although the Plan provides important data and an analytical framework for assessing policy decisions (including two potential policy decision analyses), BFAAC cautions Council not to rely on the Plan for a quantification of the human costs of certain service reductions. As we stated in our FY 2015 Report⁶, should a policy and/or operational decision be made that cuts human services provision, BFAAC recommends that Council direct the Acting City Manager to conduct a service reduction impact on vulnerable populations consistent with our previous recommendation.

The Plan also underscores the long-term structural fiscal challenges Alexandria, along with its neighboring jurisdictions, face and offers the opportunity to engage the public in candid discussion about these challenges and resulting impacts. With the larger economic development challenges facing Northern Virginia, as recently noted by Dr. Stephen Fuller of George Mason University's Center for Regional Analysis⁷, the Plan also provides City leaders with needed data and analysis to engage in regional discussion and cooperation in specific policy areas. BFAAC recommends that Council direct the Acting City Manager to identify for potential regional cooperation to assist in addressing structural fiscal challenges.

Plan Model and Assumptions

⁶ FY 2015 BFAAC Report to City Council, p. 22.

⁷ Fuller, Stephen, "What Will Drive Regional Growth Going Forward?" Cardinal Bank/GMU Annual Economic Conference, January 15, 2015.

The Plan employs a dynamic forecasting model which BFAAC notes is a significant advancement over previously-used static models. Staff refreshes the model based on additional available data and understanding of the impact of major capital projects, such as Potomac Yard development, on the General Fund budget.⁸ Despite the relative sophistication of the forecasting model, some level of analytical uncertainty will persist. Staff has accounted, in part, for this uncertainty by developing impact scenarios (baseline/optimistic/pessimistic), commonly used in long-term financial planning.⁹ BFAAC recommends that the forecasting model be further enriched by the increased use of benchmarking data from similar municipal jurisdictions across the United States to reduce the level of analytical uncertainty. Benchmarking data would be especially valuable for those policy options requiring investment to generate a longer-term revenue benefit, such as the Business Tax Reform Task Force's recommendation to reduce business license tax rates.¹⁰

As for the Plan's assumptions, BFAAC believes that the assumptions as a whole appear reasonable to establish a baseline for policy option assessment. Revenue disruptions caused by unforeseen events, such as a federal government shutdown, or cost impacts resulting from higher-than-projected service requirements, such as unexpected ACPS enrollment growth, are not included. Given the outlier nature of these events, BFAAC believes that the Plan's Revenue and Expenditure Forecast reflects the most-likely scenarios that can be reasonably expected. Yearly updates to the Plan will allow for additional fidelity in both estimates and assumptions. To further reduce the probability of these outlier events, BFAAC recommends that the Acting City Manager and ACPS leadership work together to agree on most-likely school enrollment scenarios.

Plan Communication and Public Engagement

BFAAC commends the Acting City Manager and Staff for structuring the Plan in a way that effectively communicates the City's current economic position, revenue and expenditure forecasts, and individual policy options. With respect to the City's current economic position, the Plan accurately outlines the City's strengths through easily understood statistics in an effort to detail that the City's local government is stable and prospering. Yet, the Plan throws caution that the slow economic growth experienced in recent years limits the supply of revenue available at current tax rates from keeping up with increasing costs and demand for services.¹¹ The Plan also effectively communicates projections of future revenues and expenditures in a revamped financial forecast model based on historical analysis and economic indicators with planned or expected changes such as approved CIP out-year funding, the ACPS five-year financial forecast, the expiration of grants, and future changes in programmed service delivery.¹² Finally, the Plan thoroughly examines individual policy options for potential financial impacts within the next five years.¹³

⁸ City of Alexandria, "Five-Year Financial Plan FY 2016 – FY 2020," Section 5.1 – Revenue and Expenditure Forecast.

⁹ City of Alexandria, "Five-Year Financial Plan FY 2016 – FY 2020," Section 2.3 – Introduction.

¹⁰ FY 2015 BFAAC Report to City Council, pp. 12-13.

¹¹ City of Alexandria, "Five-Year Financial Plan FY 2016 – FY 2020," Section 4.1-4.6 – Economic Position.

¹² City of Alexandria, "Five-Year Financial Plan FY 2016 – FY 2020," Section 5.1-5.16 – Revenue and Expenditure Forecast.

¹³ City of Alexandria, "Five-Year Financial Plan FY 2016 – FY 2020," Section 6.1-6.8 – Business Tax Reform Task Force Review.

BFAAC understands that the City expended a large amount of resources in developing the Plan and commends the Acting City Manager and Staff for taking a critical step to ensure that the City continues to prosper. Nonetheless, the City should not stop their efforts with respect to communicating the City's current and forecasted fiscal health with the Plan's publication. The City can leverage the Plan's content to communicate strengths and foreseeable challenges to all City stakeholders. BFAAC encourages Council, the Acting City Manager, and Staff to develop a communication plan to ensure the Plan is properly vetted throughout the community and feedback is received in a timely manner.

BFAAC suggests a two-pronged approach for the communication plan. First, BFAAC recommends Council, the Acting City Manager, and Staff to make a commitment to communicate the Plan to key constituencies (e.g., boards and commissions) in an effort to develop broad support for potential policy changes and receive feedback on how to address fiscal challenges. We suggest that the Acting City Manager and Staff meet with *all* boards and commissions to discuss the Plan in detail and answer questions. A meeting with all boards and commissions will provide key City stakeholders with a venue to appropriately provide the City with feedback on the Plan and for the City to describe the impact that potential economic occurrences in the future may have on board and commission planning. These meetings should be appropriately advertised on the City's website along with email notifications via the City's eNews service. This will provide an opportunity for citizens not on a board or commission to attend and ensure their voice is heard.

Second, BFAAC recommends Council, the Acting City Manager, and Staff constructively engage with citizens in an effort to expand awareness of fiscal challenges and gain support for policy changes. We recommend that this be primarily accomplished, although not solely, through the *What's Next, Alexandria* initiative. Specifically, the City should develop a webpage for the Plan on the *What's Next, Alexandria* website similar to that of the existing ones for AlexEngage and Chinquapin Aquatics Facility Expansion. Staff should develop a plan to only discuss certain sections of the Plan at a time. For example, the City could discuss the Economic Position section over a two week period and focus on the City's strengths one week and the City's challenges the other week. This will prevent "information overload" and break the Plan into easily consumable portions. In addition to engaging with citizens through *What's Next, Alexandria*, BFAAC recommends that the Acting City Manager and Staff develop a "roadshow" to communicate the Plan and address citizens' concerns. This "roadshow" should include the following:

- Microsoft PowerPoint presentation which details the Plan, its assumptions, and its findings
- Marketing collateral that can serve as "leave-behinds"
- Training for presenters through the Center for Civic Participation
- Engagement with local businesses through the Chamber of Commerce
- Engagement with Alexandria City Public Schools and the Alexandria PTA Council

- Engagement with citizens during the budget development process (similar to the budget development process meetings on January 26, February 5, and February 9, 2015)
- Engagement with civic and homeowner associations
- Engagement with citizens through the annual budget preparation process
- Town hall-type meetings, which can be organized through civic and/or homeowner associations as well as parent-teacher associations

The City's communication plan should not only target one specific audience. Rather, BFAAC recommends that the communication plan be structured in a way where civic engagement is inclusive of all the City's diverse groups. Each group will inevitably have a different view of how the City should invest its resources, and may provide a different or unique viewpoint not previously considered. While meaningful feedback can be gained by speaking with homogenous groups, BFAAC encourages the City to engage different and diverse groups together in constructive discussion. City stakeholders should be encouraged to present how they think the City should invest its resources over the next five years, and to work with different groups to come up with compromises.

As with most publications similar to the Plan, structure and content will likely evolve in future years. A robust communication plan will inevitably provide the City with critical feedback necessary to facilitate the Plan's evolution. BFAAC encourages the Acting City Manager and Staff to not only obtain feedback from boards, commissions, and City stakeholders, but also communicate general themes back. Communication should be two-sided. The City should also include general feedback themes in subsequent publications of the Plan, and detail how the Plan has evolved since its prior publication.

The Need for a Multi-Year Revenue Strategy and Plan

BFAAC's FY 2013, FY 2014, and FY 2015 reports noted the continued and growing imbalance between residential and commercial property tax revenues. In CY 2014, commercial assessments accounted for only 25.9 percent of total real estate assessments, which means the primary burden to fund the City's operations falls on residents. As noted in the Plan, assuming no changes in City services and limited commercial growth, the average tax per household will increase from approximately \$5,100 in 2015 to \$6,200 in 2020.¹⁴ BFAAC is concerned this trend is not sustainable and urges Council to take action to grow the commercial base. Even a small boost in commercial activity can have a major impact. It is estimated that a one percent increase in economic growth above the baseline would cut the five-year financial gap by more than half by FY 2020.¹⁵

For all of its benefits, BFAAC notes the Plan, in its current form, is in fact a necessary component of a fiscal strategy, and builds the foundation for such a strategy through a revenue and expenditure forecast and an analytical framework used to assess the revenue and cost

¹⁴ City of Alexandria, "Five-Year Financial Plan FY 2016 – FY 2020," Section 5.2 – Revenue and Expenditure Forecast.

¹⁵ Ibid.

impacts of two specific policy and operational decisions (the recommendations of the Business Tax Reform Task Force and financing of stormwater sewer upgrades). A “Plan” in its truest sense would articulate a vision, strategy, and goals, along with associated performance metrics designed to measure success against outcomes. While the Plan produced by City Staff is a good first step and provides a valuable snapshot of the City’s fiscal health, the document does not include long-term revenue goals or recommendations for actions Council can take to boost the commercial base.

As stated in our FY 2015 report, BFAAC recommends Council direct the Acting City Manager and Staff to develop a multi-year, long-term revenue strategy and plan.¹⁶ In developing this strategy and plan, BFAAC recommends Council set five-year and ten-year revenue goals and work with City staff to develop an action plan that evaluates the costs and benefits of various actions the City could take to boost the commercial base, including reducing the business license tax, otherwise known as the BPOL tax; investing in transportation and other infrastructure projects; identifying strategies to develop additional class A office space; promoting Alexandria as a business-friendly city; and targeting specific industries where the City may have a competitive advantage.

BFAAC recognizes any action Council takes to boost the commercial sector will likely incur a significant cost in the short-term. For example, the current Plan’s analysis of the Business tax Reform Task Force’s recommendations estimates the cost of reducing BPOL tax rates to one cent below Arlington County’s rates over two years would cost the City \$21 million in lost revenue over the next five years.¹⁷ If the BPOL tax rate reduction results in significant commercial growth, the policy may raise revenue in the long-term, but Council lacks sufficient data to make an informed decision.

The Plan notes that Council could decide to request a review of a range of tax incentives that may be more likely to trigger business growth in the City. BFAAC encourages Council to request this review and consider implementing pilot programs in FY 2016 and FY 2017 to test out various strategies. For example, Council could consider a targeted BPOL tax rate reduction for certain types of businesses or look at the feasibility of reducing BPOL tax rates for businesses that move into targeted areas of the City. The cost of a pilot program would be substantially less than implementing the full policy and may provide Council valuable data to inform long-term efforts.

Before looking at the policy options, BFAAC encourages Council to set long-term revenue goals. What is the ideal split between commercial and residential real estate tax revenue? Is the goal still a 50-50 split? Is Council willing to consider policies that incur a cost in the short-term in order to improve the long-term revenue picture of the City? BFAAC encourages Council to start to address these issues and solicit feedback from residents. The bottom line is if action is not taken now, Council will be forced to significantly scale back city services or ask residents to bear an even greater tax burden.

¹⁶ FY 2015 BFAAC Report to City Council, p. 13.

¹⁷ City of Alexandria, “Five-Year Financial Plan FY 2016 – FY 2020,” Section 6.2 – Business Tax Reform Task Force Review.

Staying the Course to Address the City's Fiscal Challenges

BFAAC encourages Council to make a public commitment to addressing the City's longer-term structural fiscal challenges. The Five-Year Financial Plan provides the data and analysis to make better-informed decisions, particularly for those short-term decisions with longer-term impacts. The BFAAC-proposed Multi-Year Revenue Strategy and Plan will articulate a critically necessary revenue strategy with an action plan and metrics. But the City will only realize the benefits of these efforts if the political will is there to stay the course.

SUMMARY OF OBSERVATIONS:

- **BFAAC commends the Acting City Manager and City Staff on the development on the Five-Year Financial Plan FY 2016 – FY 2020. The Plan will provide Council with a greater ability to make policy decisions understanding true, multi-year lifecycle costs. The Plan also offers a more complete picture of the true cost of capital investments, including often poorly-understood associated operational costs.**
- **BFAAC cautions Council not to rely on the Plan for a quantification of the human costs of certain service reductions.**
- **BFAAC observes that the Plan's Revenue and Expenditure Forecast reflects the most-likely scenarios that can be reasonably expected, and recommends that the Forecast be updated on an annual basis to refine estimates and assumptions.**
- **BFAAC observes that the Plan, in its current form, is in fact a necessary component of a fiscal strategy, and builds the foundation for such a strategy through a revenue and expenditure forecast, with an analytical framework used to assess the revenue and cost impacts of two specific policy and operational decisions. While the Plan is a good first step, the document is an assessment of the City's financial health, rather than a plan that outlines goals and recommends specific actions.**

SUMMARY OF RECOMMENDATIONS/ACTIONS:

- **BFAAC recommends that the Council direct the Acting City Manager to develop a complementary compensation and benefits strategy to further inform policy and operational decisions and better understand impacts on employee retention and morale.**
- **BFAAC recommends that Council direct the Acting City Manager to conduct a service reduction impact any policy or operational decisions made that would affect vulnerable populations.**
- **BFAAC recommends that Council direct the Acting City Manager to identify additional areas for potential regional cooperation to assist in addressing structural fiscal challenges.**

- **BFAAC recommends that the forecasting model be further enriched by the increased use of benchmarking data from similar municipal jurisdictions across the United States to reduce the level of analytical uncertainty.**
- **BFAAC recommends that the Acting City Manager and ACPS leadership work together to agree on most-likely school enrollment scenarios.**
- **BFAAC recommends Council, the Acting City Manager, and Staff to develop a communication plan to engage with City stakeholders.**
- **BFAAC recommends Council, the Acting City Manager, and Staff to make a commitment to communicate the Plan to key constituencies (e.g., boards, commissions, and City stakeholders) in an effort to develop broad support for potential policy changes and receive feedback on how to address fiscal challenges.**
- **BFAAC recommends Council, the Acting City Manager, and Staff constructively engage with citizens in an effort to expand awareness of fiscal challenges and gain support for policy changes.**
- **BFAAC encourages the Acting City Manager and Staff to not only obtain feedback from boards, commissions, and City stakeholders, consistent with policy in the City's Civic Engagement Handbook, but also communicate general themes back to these stakeholders and to citizens at large. The City should also include these general feedback themes in subsequent publications of the Plan, and detail how the Plan has evolved since its prior publication.**
- **BFAAC recommends that Council direct the Acting City Manager and Staff to develop a multi-year, long-term revenue strategy and plan, with specific long-term revenue goals, an action plan to achieve the goals, and a set of metrics.**
- **BFAAC recommends Council request a review of a range of tax incentives and other actions that will be likely to trigger business growth in the City.**
- **BFAAC encourages Council to consider implementing pilot projects in FY 2016 and FY 2017 to test different approaches to grow the City's commercial base.**
- **BFAAC encourages Council to make a public commitment to addressing the City's long-term structural fiscal challenges.**

CC: Mark Jinks, Acting City Manager
 Emily Baker, Acting Deputy City Manager
 Debra Collins, Deputy City Manager
 Laura Triggs, Deputy City Manager
 Kendel Taylor, Acting Director, Finance Department
 Nelsie Birch, Director, Office of Management and Budget
 Alex Braden, Management & Budget Analyst, Office of Management and Budget