The request for additional debt issuance for ACPS comes at a time when state and local governments are under increased scrutiny by the bond rating agencies in regard to their overall finances, future pension fund projections, as well as existing debt and bond issuance plans. Some Wall Street analysts are also predicting a historic record volume of municipal defaults in the coming year. While the City's finances and economy are in better shape than most other local governments, the City's existing and planned debt have increased substantially in the last decade for City and School projects. This has resulted in the City meeting or exceeding the targets set in its adopted debt policy guidelines, as well as nearing the policy guideline debt limits. These debt policy guidelines were first adopted in 1987 (amended in 1997 and 2008) and are considered a "best practices" model by the bond rating agencies. These guidelines have assisted the City in obtaining and maintaining its AAA/Aaa ratings. As a result, the guidelines cannot be ignored or violated without negative consequences.

Funding Options Considered

In order to analyze and model the impact of this additional $214.5 million in projects, one could assume exclusive bond financing or a combination of bonds and cash. This memo will model both possibilities, with the combination of bonds and cash being a 75% / 25% mix. This bonds-to-cash ratio is equal to that of the overall existing City capital program. These two different financing options have differentiated and serious impacts on the City's long-term operating budget (and tax rates) and debt policy guidelines.

A third financing option that could be considered is the exclusive use of cash capital (i.e., "pay-as-you-go") to fund the full ACPS Approved FY 2012 – FY 2021 CIP. This option could also be considered to finance just the first three CIP years plus Patrick Henry, if that program was approved by City Council. Over the long-term a full cash option is the least costly financing option for the City, but all of the costs would be borne within the next ten years, rather than spread over the next thirty years. This option also has the most dramatic impact on the real estate tax rate over the next ten years since the costs are not being spread over the useful life of the ACPS capital assets.

The City could not afford a 100% cash capital option to fund ACPS capital needs. The impact on the real estate tax rate would be both annually volatile and extreme. In some of the larger program years, the tax rate would need to increase by between 10 and 16 cents to fund the additional projects and then drop to 4 or 5 cents the next year. Also, adopting such a strategy would go against the philosophy of generational equity (i.e., "pay-as-you-use"), which posits that the cost of capital assets should be spread over time to better align with those members of the public who are benefitting. In other words, a new school constructed in FY 2014 will benefit the community for upwards of 40 years or more, so the costs of that school should also be spread somewhat over time.

The following pages include numerous graphs illustrating the impacts on the City's Operating Budget and debt policy guidelines that various mixes of expenditure and financing options yield. In all these options, the impact in the early years is relatively minimal. However, it is very important to consider that the full impact of issuing bonds is felt over many years. For that reason, decisions should be focused on a multi-year analysis rather than simply the fiscal impact in the immediate one or two budget years. Another important consideration is that the assumed borrowing in these graphs does not include any Transportation Add-On Tax funded bonds, which would only serve to further increase the City's general obligation debt ratios in the next ten years.

Summary of Results for Different Options

	Total 10-year Additional Debt	10-year Additional Debt Service & Cash Capital	FY 2012 Increase in Operating Budget	FY 2021 Increase in Operating Budget	Peak of % of Assessed Value Debt Ratio (Year)	10-year Average Additional Real Estate Tax Rate
Funding Full ACPS CIP						
Option 1: 100% Bonds	$214.5 million	$68.5 million	$0.3 million	$13.6 million	1.66% (2015)	2.1 cents
Option 2: 75% Bonds / 25% Cash	$160.9 million	$106.1 million	$4.3 million	$9.6 million	1.59% (2015)	3.3 cents
Funding FY12-FY14 ACPS CIP[1,2]						
Option 3: 100% Bonds	$94.6 million	$36.1 million	$0.3 million	$4.8 million	1.62% (2015)	1.1 cents
Option 4: 75% Bonds / 25% Cash	$71.0 million	$51.8 million	$4.3 million	$3.7 million	1.56% (2015)	1.6 cents

[1] This option includes the FY 2015 funding to complete the Patrick Henry new school project and excludes the FY 2014 funding for the Minnie Howard classroom additions, MacArthur HVAC replacement, and Polk exterior play area. These are the four projects that have funding overlapping FY 2014 and FY 2015 that needed to be either fully included or excluded from the model.

[2] The assumptions used for Options 3 & 4 -- an increase over the C.M. Proposed CIP in fiscal years 2012 - 2014 and amounts below the School Board's request in fiscal years 2015 - 2021 -- do not imply School Board, School Staff, or City Staff agreement. This memo is simply giving Council an analysis that was requested on the multi-year impact of such options.

There are a few key figures to focus on in the table. First, for both expenditure options (full ten years or first three years), using 100% bonds as the funding source would result in the City exceeding its debt policy guideline limits for Debt as a Percent of Real Property Value. This is the most important debt ratio statistic. Next, all of these options would result in a 10-year average real estate tax rate increase of at least 1.1 cents, and all but one option (Option 3) would have a peak real estate tax rate impact of over 4 cents. Finally, while both options using 100% bond financing cost less in the next ten years, the options using a mix of cash and bonds are significantly less expensive over the full life of the bonds (30 years).

Overall, for whatever ACPS CIP funding Council approves, City staff would recommend a financing plan that mixes cash and bonds (25% / 75%) because it is both less expensive in the long run and more in line with the City's practice of using diverse funding sources to maintain its AAA/Aaa bond ratings. This somewhat lesser dependence on borrowing would also allow the City's debt ratios to recover and again drop below the target levels in a more expedited manner. That being stated, while this memo details the financial impact of different project plans and financing strategies, City staff is not endorsing or making any recommendations on any of the options in this memorandum. This information is simply intended to provide information to City Council by modeling the impacts on future operating budgets and the debt policy guidelines of certain potential actions. Additional discussion on the merits of specific projects and specific year-to-year financing choices needs to occur before a final 10-year CIP is approved.

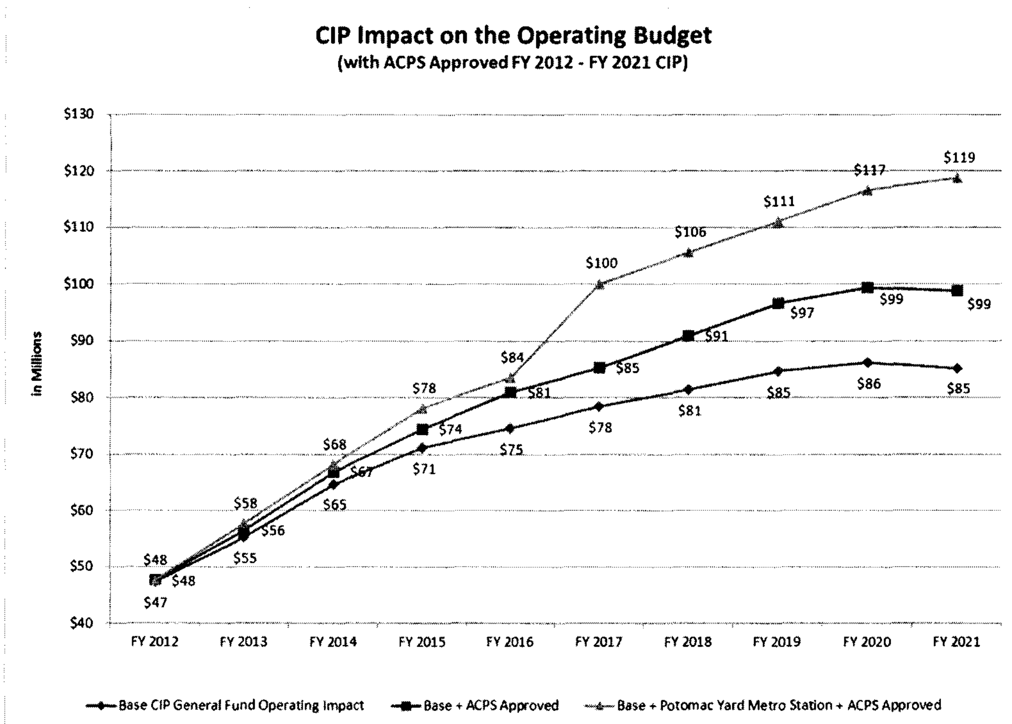
It should be noted that the City's current CIP does not reflect the potential capital needs impact (i.e., sports fields and recreation centers) of the ACPS current enrollment projections. These projections are driving much of the request for a substantial increase in ACPS capital funding over the next decade. At some point there will need to be a true-up of those youth-related City CIP needs, as City-wide planning will need to incorporate a larger rate of growth in school age population over the next few decades.

In viewing the various debt ratio charts in this memorandum the focus should be on the "Base CIP Debt" and "Base plus ACPS Approved" graph lines. The lines containing the planned debt issuance for the Potomac Yard Metrorail Station are not relevant to the ACPS capital analysis because that debt is considered outside the City's core debt and debt ratio policy targets and limits. The Metrorail Station debt is self-financed and does not draw upon existing general tax revenues to be repaid.

OPTION 1 - ACPS APPROVED FY 2012 – FY 2021 CIP (100% BOND FINANCING):

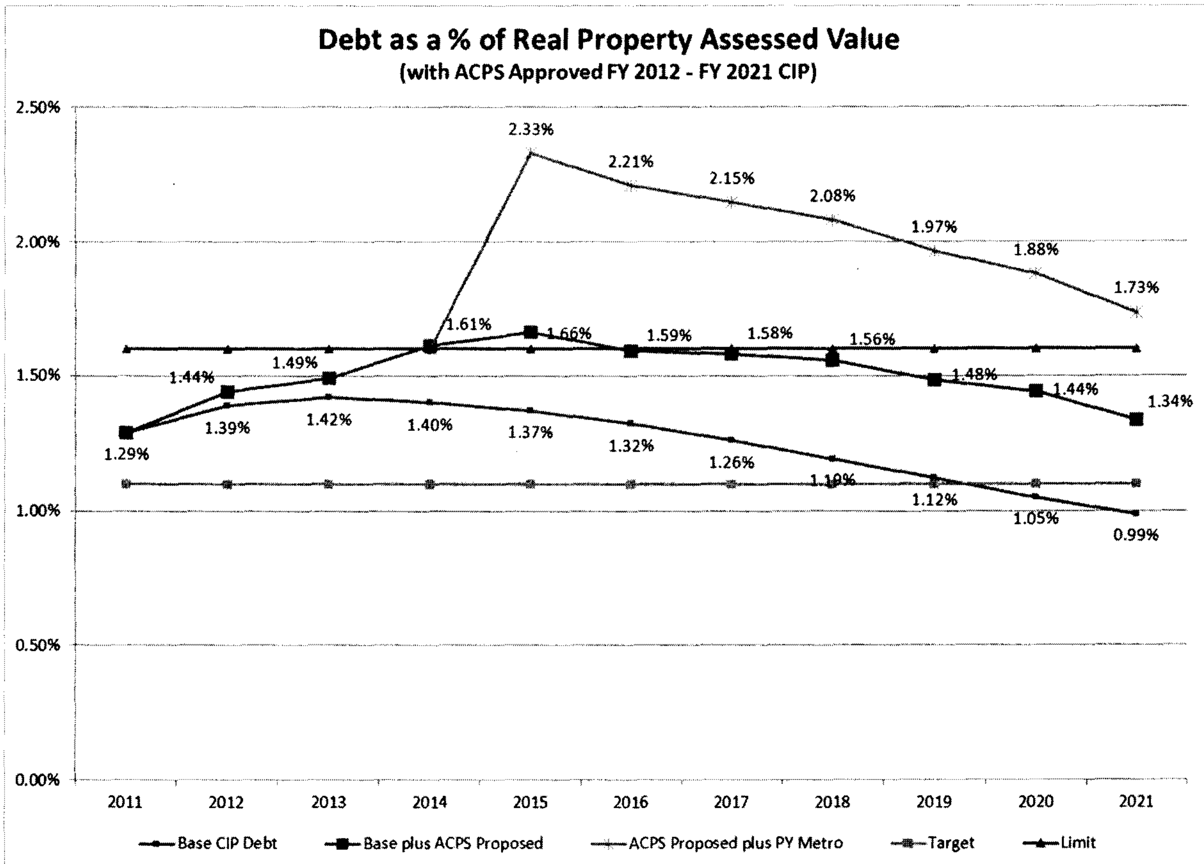
The first option for financing the additional ACPS projects in FY 2012 – FY 2021 would use entirely General Obligation Bond funding. These additional bonds would total $214.5 million over the ten years. Over the ten years, this debt would cost the City's Operating Budget a total of $68.5 million in additional debt service.

This method of financing would steadily increase the amount of funding needed in the City's operating budget. The middle line on the graph below represents the operating budget costs of implementing this financing option. By FY 2021, an additional $13.6 million would be needed for debt service payments over those required for the base capital program. The short-term impact of this option is relatively minor as it takes a few years for the full level of debt service payments to work their way into the budget.



In FY 2012, the additional operating budget expense would only be about $300,000, or 0.1 cents on the real estate tax. However, that number quickly grows and would require about 0.5 cents in FY 2013; 1 cent by FY 2015; 3 cents by FY 2018; and over 4 cents more on the real estate tax rate by FY 2020.

Beyond simply impacting the City's Operating Budget, this funding decision would negatively impact the City's debt guidelines and cause the debt limit ceiling to be breached. The graph below shows how the most important ratio, Debt as a % of Real Property Assessed Values, is impacted by this increase in planned borrowing.



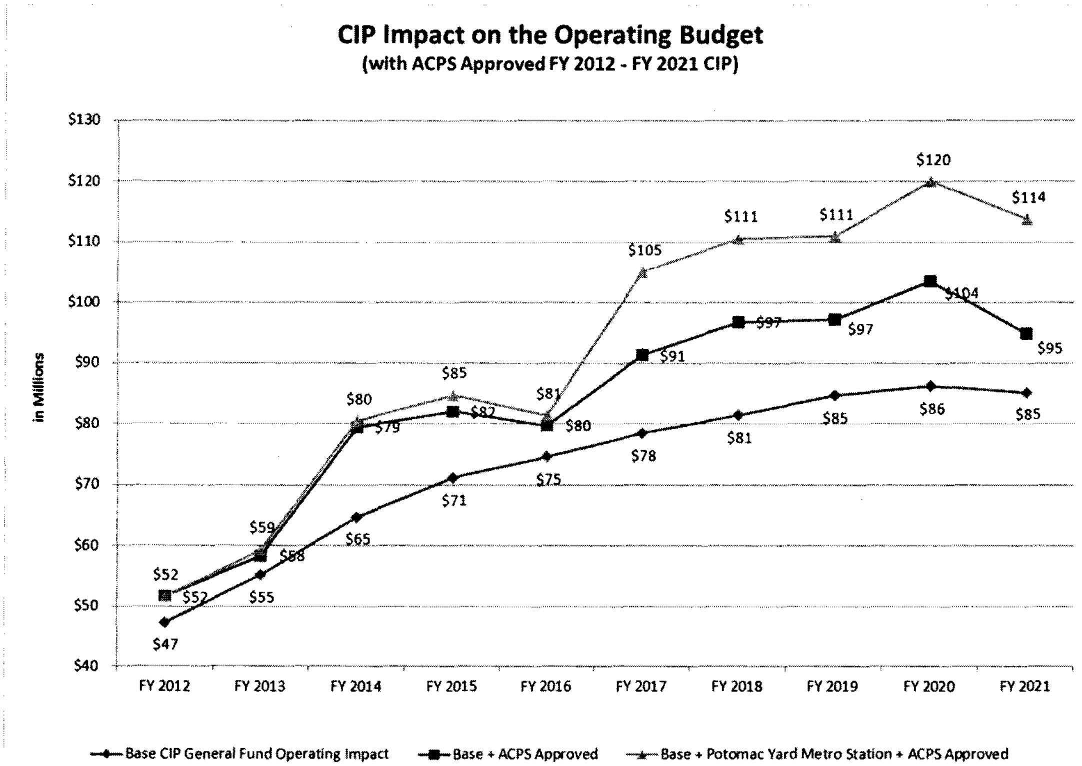
The middle line in this graph represents that impact of funding the base CIP and the additional ACPS capital projects. In FY 2014 and FY 2015 this plan would result in the City exceeding the limit for this ratio. Overall, this additional debt would increase this ratio fairly drastically through FY 2021 and beyond.

The other two debt guidelines, Debt as a % of Personal Income and Debt Service as a % of General Governmental Expenditures, are also negatively impacted by this additional debt. Neither guideline exceeds the City's limit in any year, but they are pushed much closer to the limits than the City would be otherwise. These two graphs can be found in Attachment 1 to this memo.

OPTION 2 - ACPS APPROVED FY 2012 – FY 2021 CIP (75% BOND FINANCING; 25% CASH):

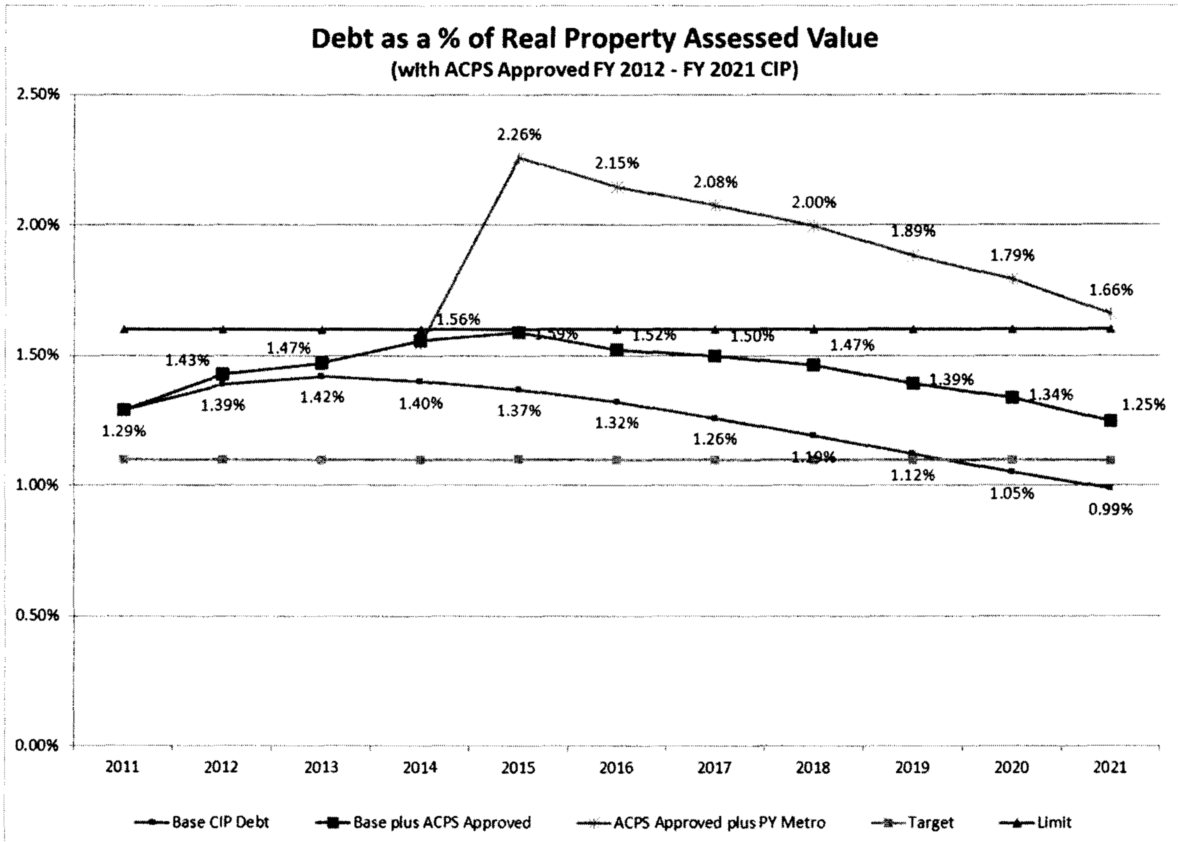
This option would include full funding of the ACPS Approved FY 2012 – FY 2021 CIP, but would use a financing combination of 75% bonds and 25% cash capital in each year of the plan. As is apparent in the graph below, this funding mechanism results in a somewhat more erratic, or volatile, impact on the City's Operating Budget. It is unlikely that the City would strictly use a financing strategy like this (would likely seek a smoother operating budget impact), but it is useful to model and examine the results. A more likely scenario would use the same overall amount of bonds and cash capital, but would more evenly distribute the cash across the ten years to smooth out this impact. The long-term cost to the City would not be significantly impacted.

This option would require additional 10-year debt issuances of $160.9 million. The overall cost to the City's Operating Budget over the next ten years would be $106.1 million, which is about $37.6 million more than if the additional projects were 100% bond-financed (due to more cash capital). However, looking over the next thirty years this combination of bonds and cash would be significantly less costly on a budgeting basis because there is less interest paid due to a lower amount of bonds being issued. By FY 2021, the impact on the City's Operating Budget would be $9.6 million.



Because the annual impact on the Operating Budget varies from year to year, the impact of this option on the City's real estate tax rate is also rather varied. FY 2012, the first year of the plan, would require an additional 1.3 cents on the tax rate. That number drops to 1 cent in FY 2013, but increases to 4.5 cents in FY 2014. In FY 2015 and beyond, the rate varies from 1.5 cents to 5.4 cents, but averages about 3.7 cents per year. Again, this option is more expensive that 100% borrowing in the first ten years, but less expensive over the full 30 year lifecycle of this debt.

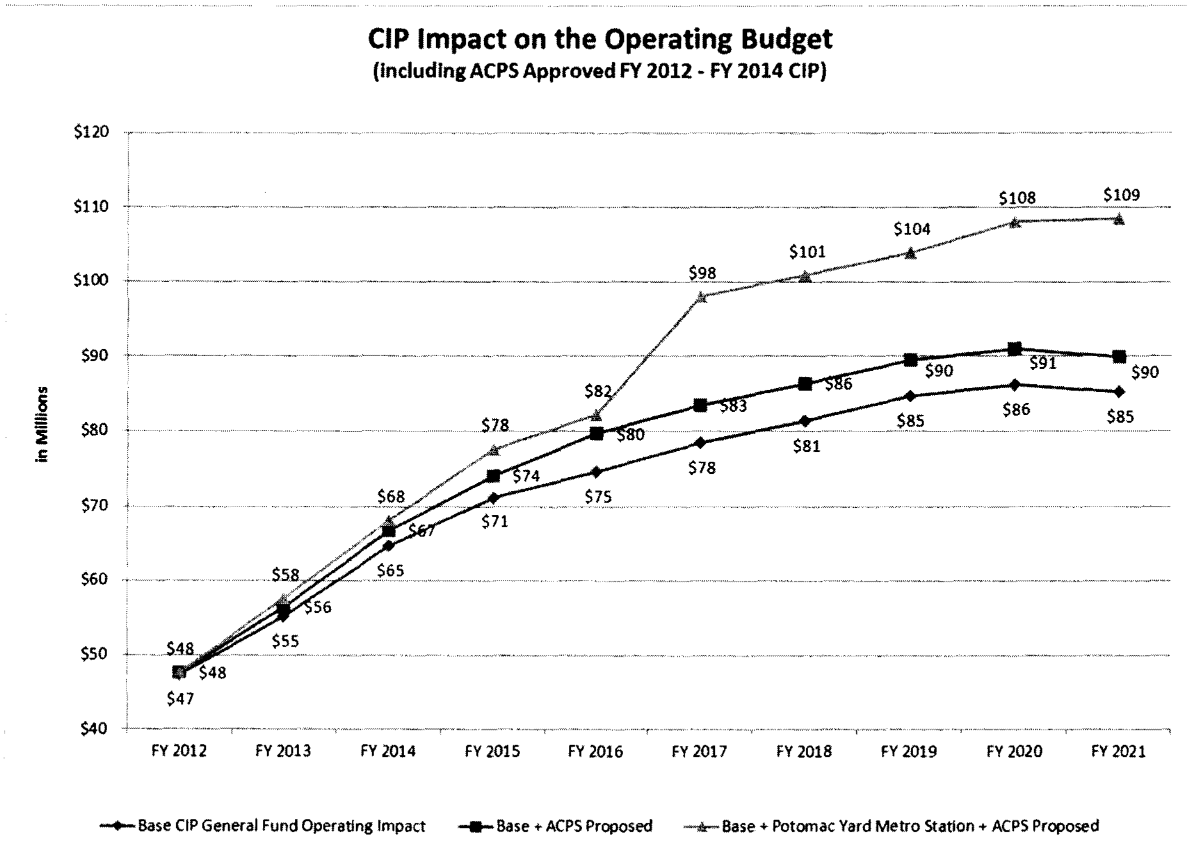
Unlike financing these projects completely with bonds, using this mix of 75% bonds and 25% cash does not push the City beyond the debt policy guideline limits. Debt as a % of Real Property Assessed Value bumps up just slightly below the limit in FY 2015 at 1.59% (limit is 1.6%). The real impact is keeping the City above the target ratio for a longer period of time (i.e., the entire 10-year period).



The graphs showing the other two debt ratios, Debt as a % of Personal Income and Debt Service as a % of General Governmental Expenditures, using this financing model can be found in Attachment 2 to this memo.

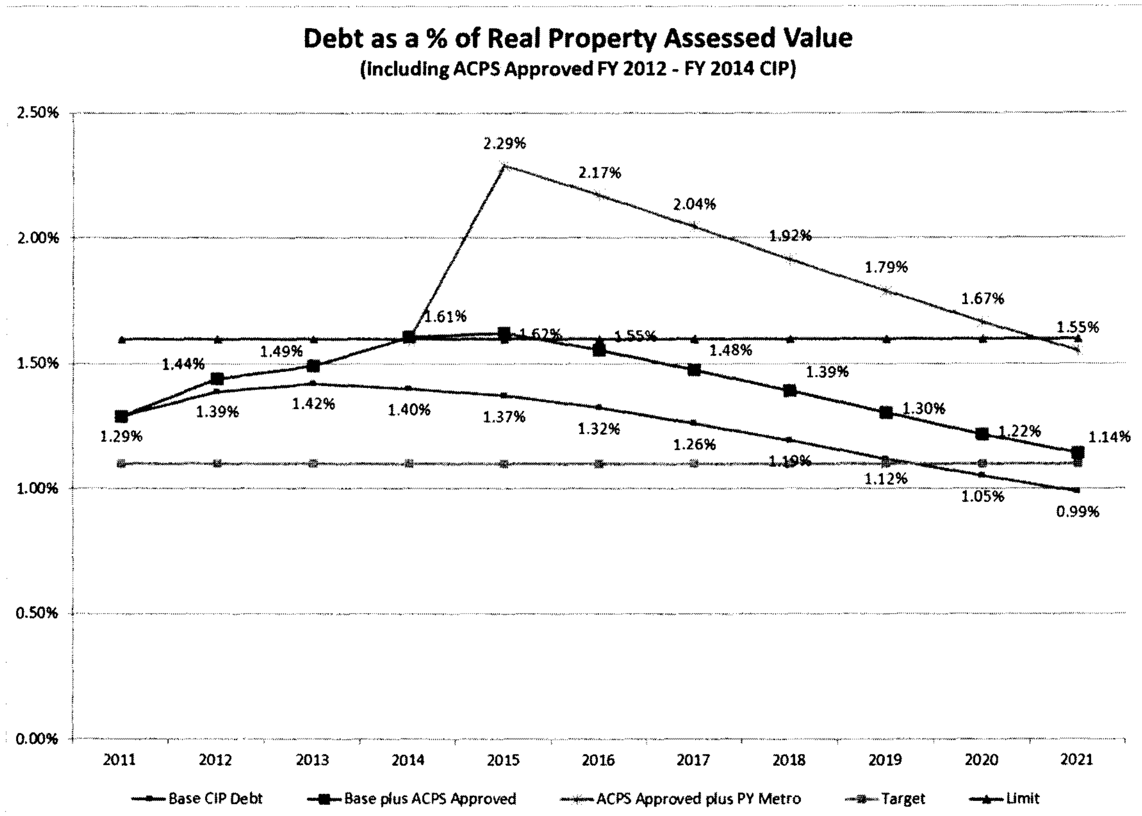
OPTION 3 - ACPS APPROVED FY 2012 – FY 2014 CIP + PATRICK HENRY NEW SCHOOL (100% BOND FINANCING):

If instead of funding the full ten-year CIP approved by ACPS, the assumption only included funding for the first three years (FY 2012 – FY 2014) of the ACPS plan plus the funding to finish the Patrick Henry new school in FY 2015, the total increment to debt finance is reduced from $214.5 million to $94.6 million. The total cost to the City's Operating Budget (increased debt service) over the next ten years would be $36.1 million. By FY 2021, the City's Operating Budget would increase by $4.8 million in this option. The graph below illustrates the impact that this option would have on the City's Operating Budget over the next ten years.



This option has almost the same impact on the City's Operating Budget and real estate tax rate through FY 2014 as funding the entire ten-year ACPS Approved CIP. This impact is about 0.1 cents in FY 2012 and grows to 0.6 cents in FY 2014. Starting in FY 2015, the impact is somewhat lessened. The approximate impact on the real estate tax rate would be about 1 cent in FY 2015 and 1.5 cents in FY 2016 through FY 2021.

The graph below shows the impact of funding the first three years of the ACPS Approved CIP plus the Patrick Henry new school in FY 2015 on the City's Debt as a % of Real Property Assessed Values. The impact through FY 2016 is very similar to funding the full ACPS ten-year plan, but in FY 2017 and beyond the negative impact is somewhat lessened. Ultimately, this borrowing would put the City in excess of the current limit for this policy in FY 2014 (1.61%) and FY 2015 (1.62%).



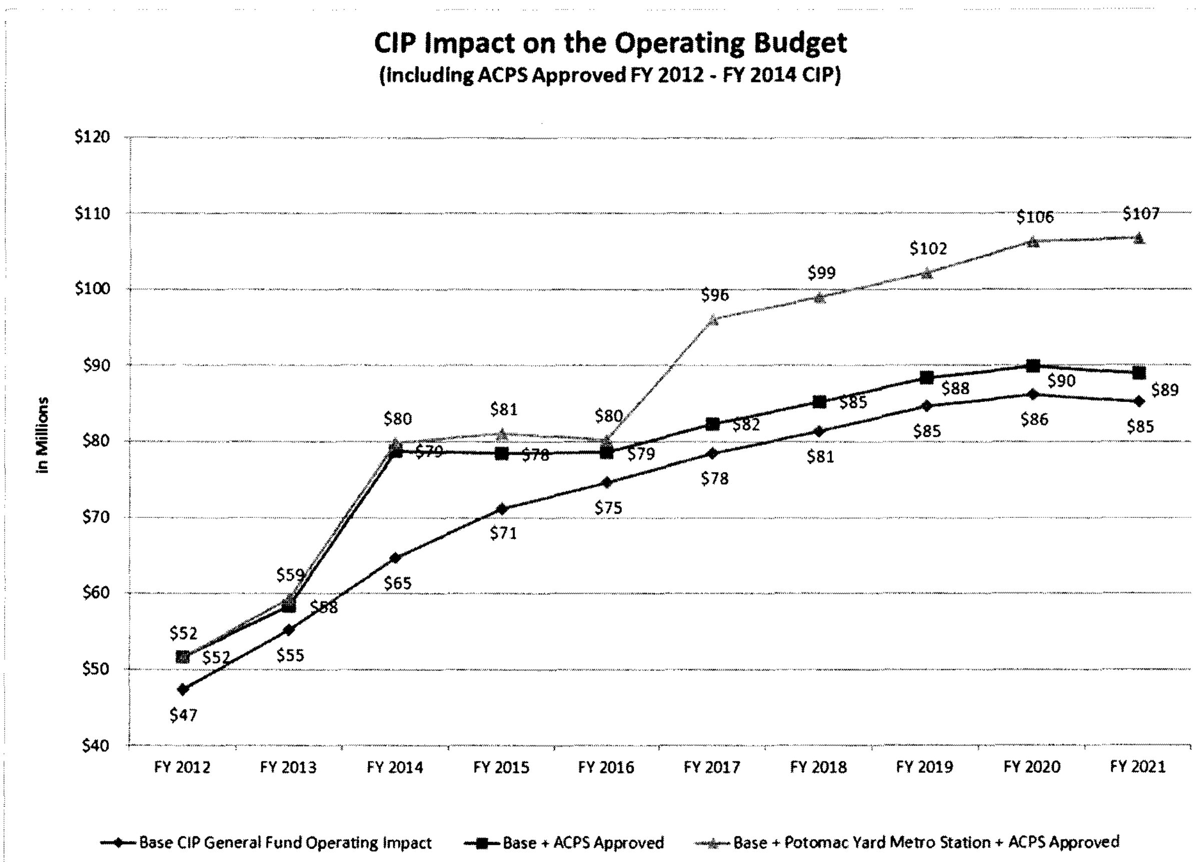
The other two debt ratios, Debt as a % of Personal Income and Debt Service as a % of General Governmental Expenditures, are also negatively impacted by this additional debt. Neither is projected to exceed the debt policy limits in the next ten years, but would be result in a somewhat weaker position. Both these graphs can be found in Attachment 3 to this memo.

It is important to note that the expenditure assumptions used for Options 3 & 4 -- an increase over the C.M. Proposed CIP in fiscal years 2012 - 2014 and amounts below the School Board's request in fiscal years 2015 - 2021 -- do not imply School Board, School Staff, or City Staff agreement. These Options are simply giving Council an analysis that was requested on the multi-year impact of such spending and financing choices.

OPTION 4 - ACPS APPROVED FY 2012 – FY 2014 CIP + PATRICK HENRY NEW SCHOOL (75% BOND FINANCING; 25% CASH):

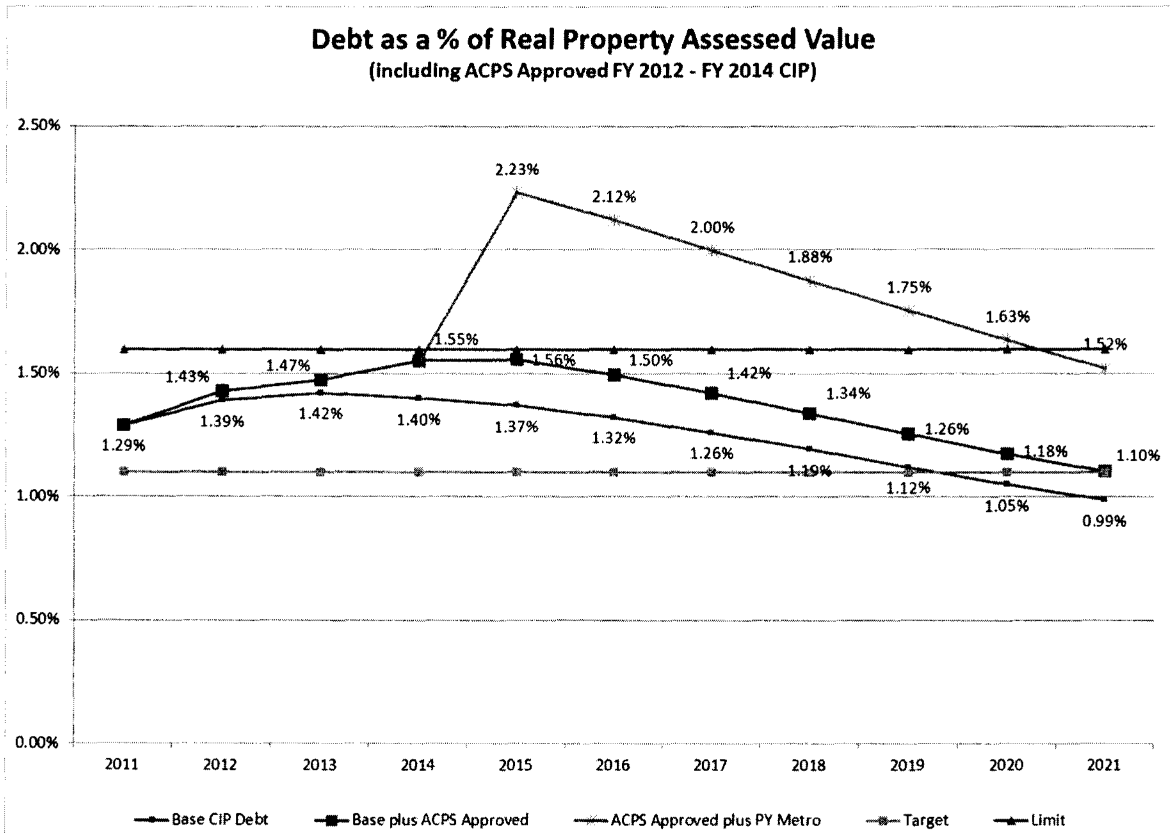
This next option again assumes that the City would only fund the first three years (FY 2012 – FY 2014) of the ACPS Approved plan plus the Patrick Henry new school in FY 2015. The financing strategy would include 75% bonds and 25% cash capital. Again, it is unlikely that the City would ultimately use a financing strategy that results in such a bumpy Operating Budget cost, but it is still a good exercise to model the results. A more likely scenario would spread the cash capital more evenly across the ten years to smooth out this impact. This option would require additional bond issuances totaling $71.0 million over ten years. The additional cost to the Operating Budget over these ten years would be $51.8 million. By FY 2021, the Operating Budget would be $3.7 million larger.

The graph below shows the impact on the City's Operating Budget using these expenditure and financing assumptions.



Because this financing involves combined cash and bonds, the impact on the Operating Budget and corresponding real estate tax rate is inconsistent from year to year. Over the ten years that tax rate would range from 1 cent (FY 2013) to 4.3 cents (FY 2014), and would average about 1.6 cents.

The graph below illustrates Debt as a % of Real Property Assessed Value assuming the first three years of the ACPS Approved plan plus the Patrick Henry new school in FY 2015 are funded using a combination of 75% bonds and 25% cash capital. This option results in a new peak for this ratio of 1.56% in FY 2015. Because there wouldn't be additional borrowing after FY 2015, the ratio begins recovering more quickly than if the full 10-year ACPS CIP was funded.



The graphs showing the other two debt ratios, Debt as a % of Personal Income and Debt Service as a % of General Governmental Expenditures, using this financing model can be found in Attachment 4 to this memo.

ATTACHMENTS:

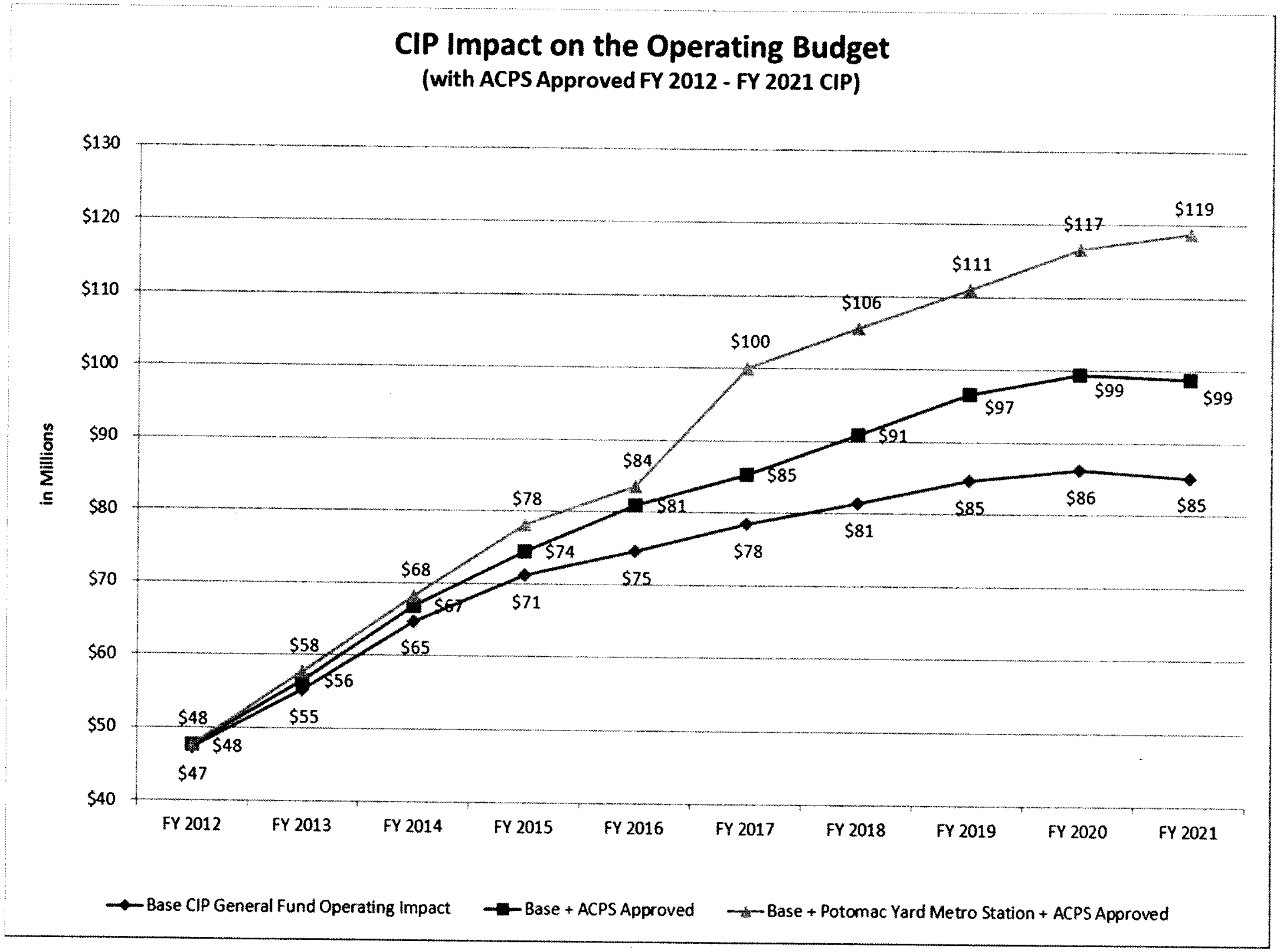
Attachment 1: Option 1 - Operating Impacts and Debt Ratios of funding the total ACPS Approved FY 2012 – FY 2021 CIP with 100% General Obligation Bonds

Attachment 2: Option 2 - Operating Impacts and Debt Ratios of funding the total ACPS Approved FY 2012 – FY 2021 CIP with 75% G.O. Bonds & 25% Cash Capital

Attachment 3: Option 3 - Operating Impacts and Debt Ratios of funding the first three years of the ACPS Approved FY 2012 – FY 2021 CIP with 100% G.O. Bonds

Attachment 4: Option 4 - Operating Impacts and Debt Ratios of funding the first three years of the ACPS Approved FY 2012 – FY 2021 CIP with 75% G.O. Bonds & 25% Cash Capital

ATTACHMENT 1: OPTION 1 - FUNDING THE ENTIRE ACPS APPROVED FY 2012 – FY 2021 CIP; 100% BOND FINANCING



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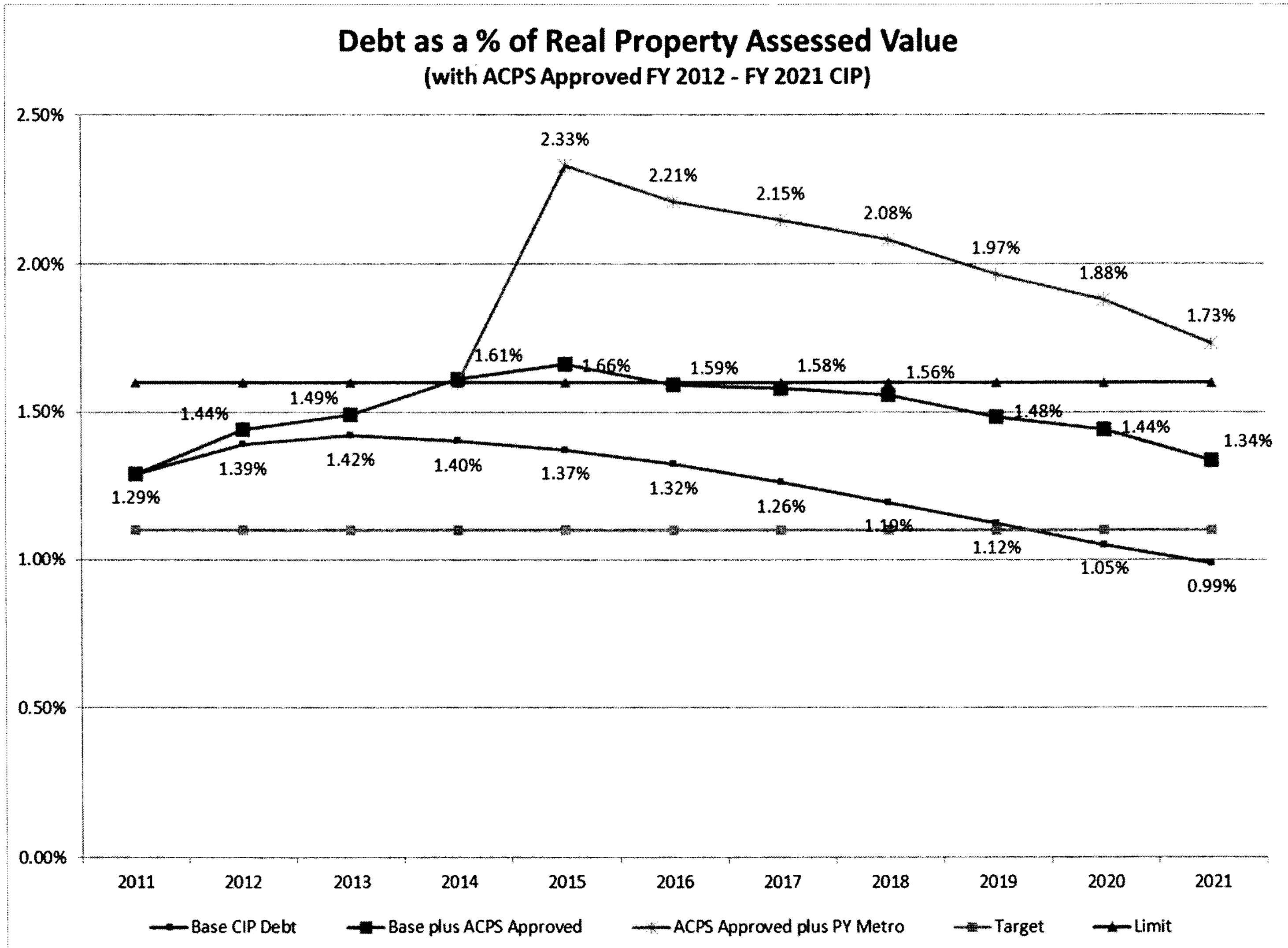
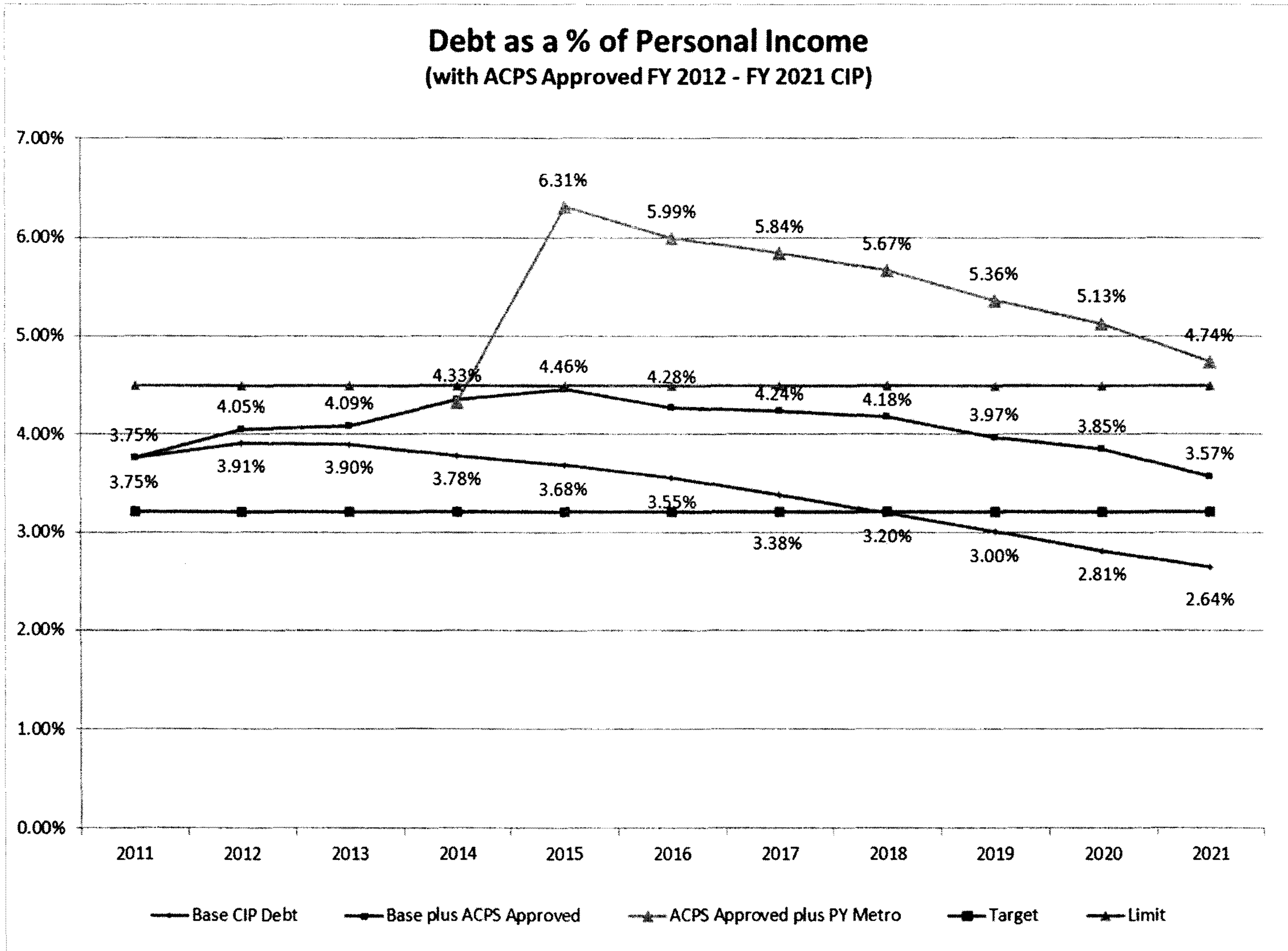
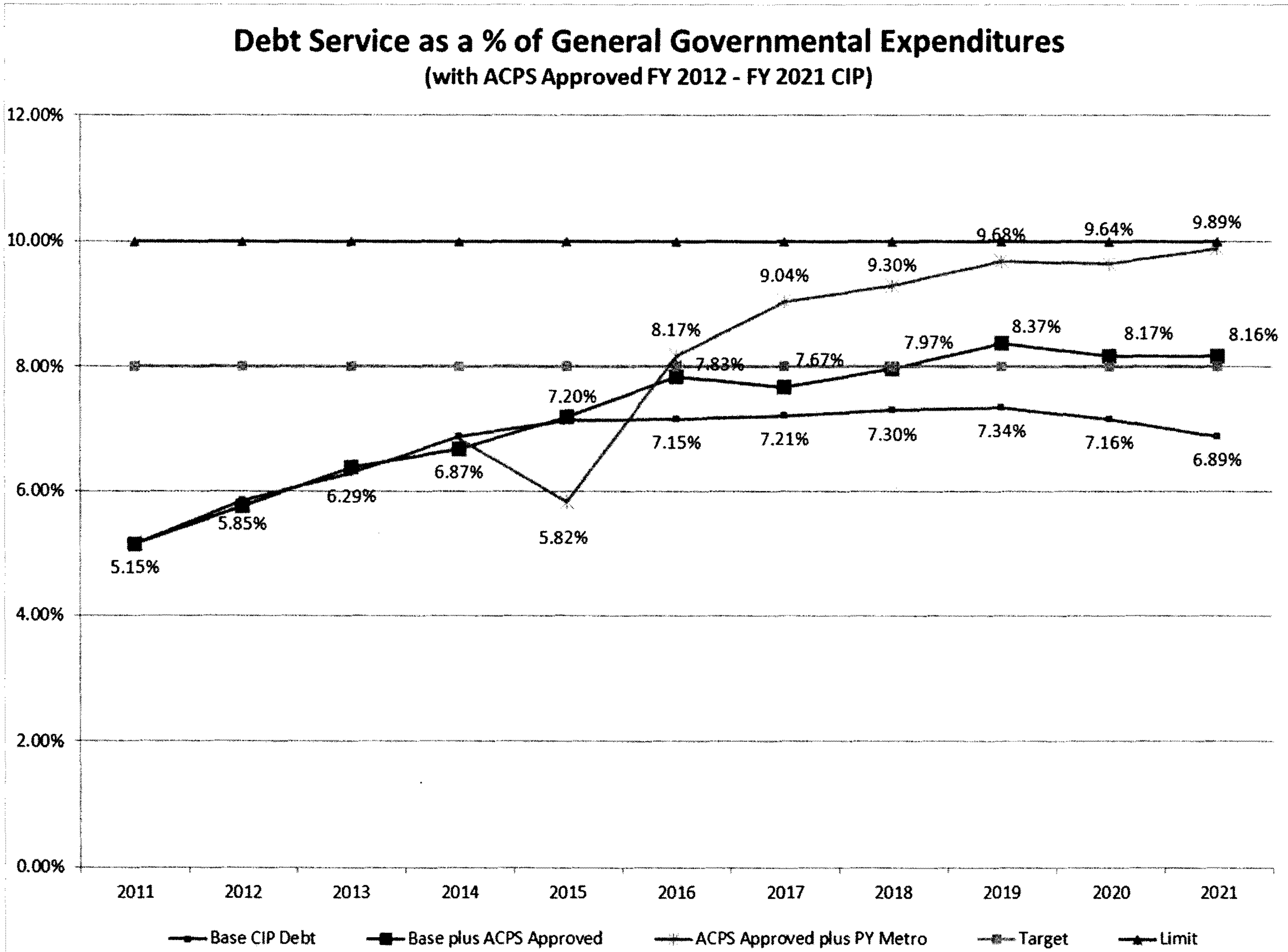


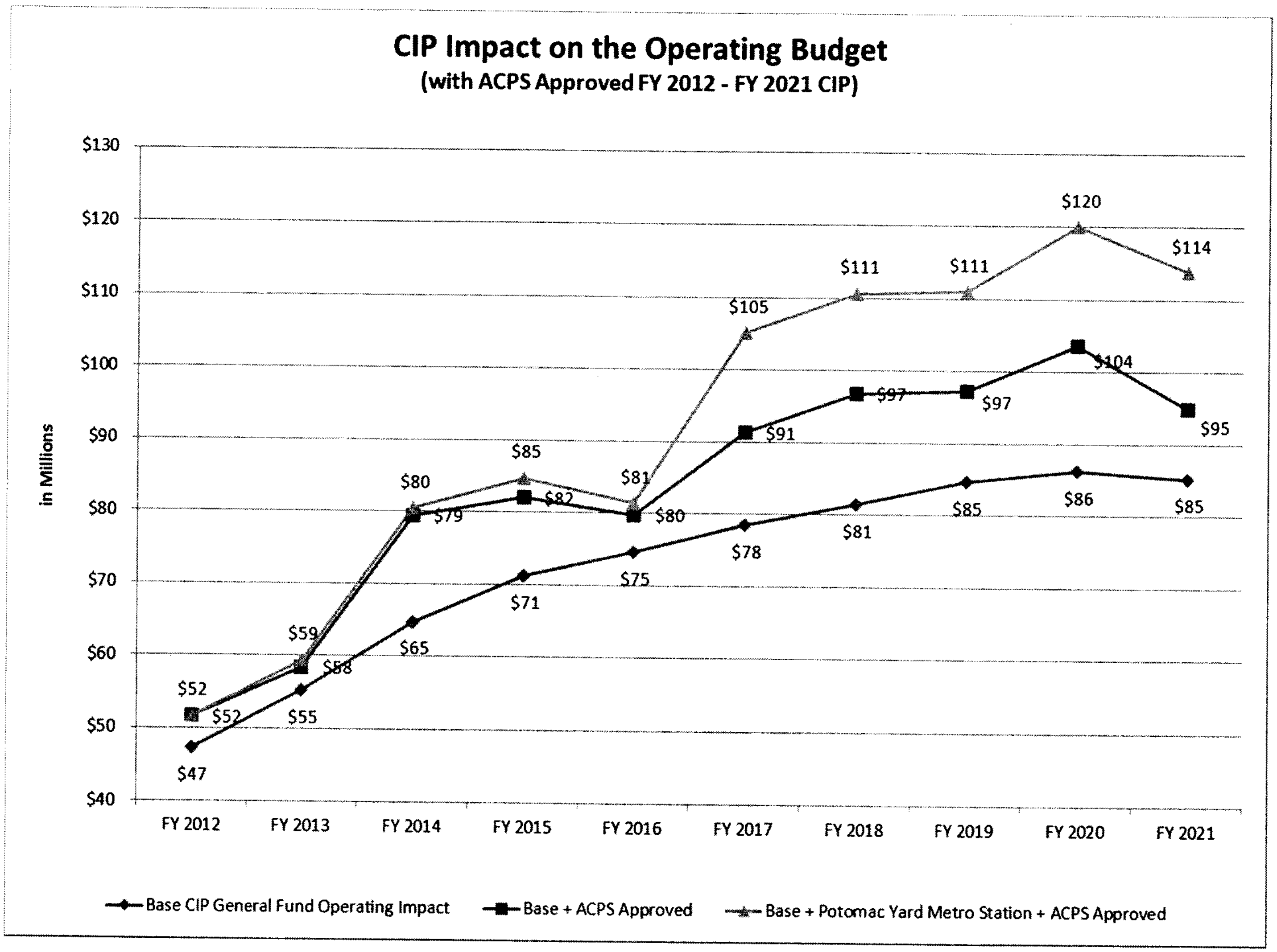
ATTACHMENT 1: OPTION 1 - FUNDING THE ENTIRE ACPS APPROVED FY 2012 – FY 2021 CIP; 100% BOND FINANCING



ATTACHMENT 1: OPTION 1 - FUNDING THE ENTIRE ACPS APPROVED FY 2012 – FY 2021 CIP; 100% BOND FINANCING



ATTACHMENT 2: OPTION 2 - FUNDING THE ENTIRE ACPS APPROVED FY 2012 – FY 2021 CIP; 75% BONDS, 25% CASH CAPITAL



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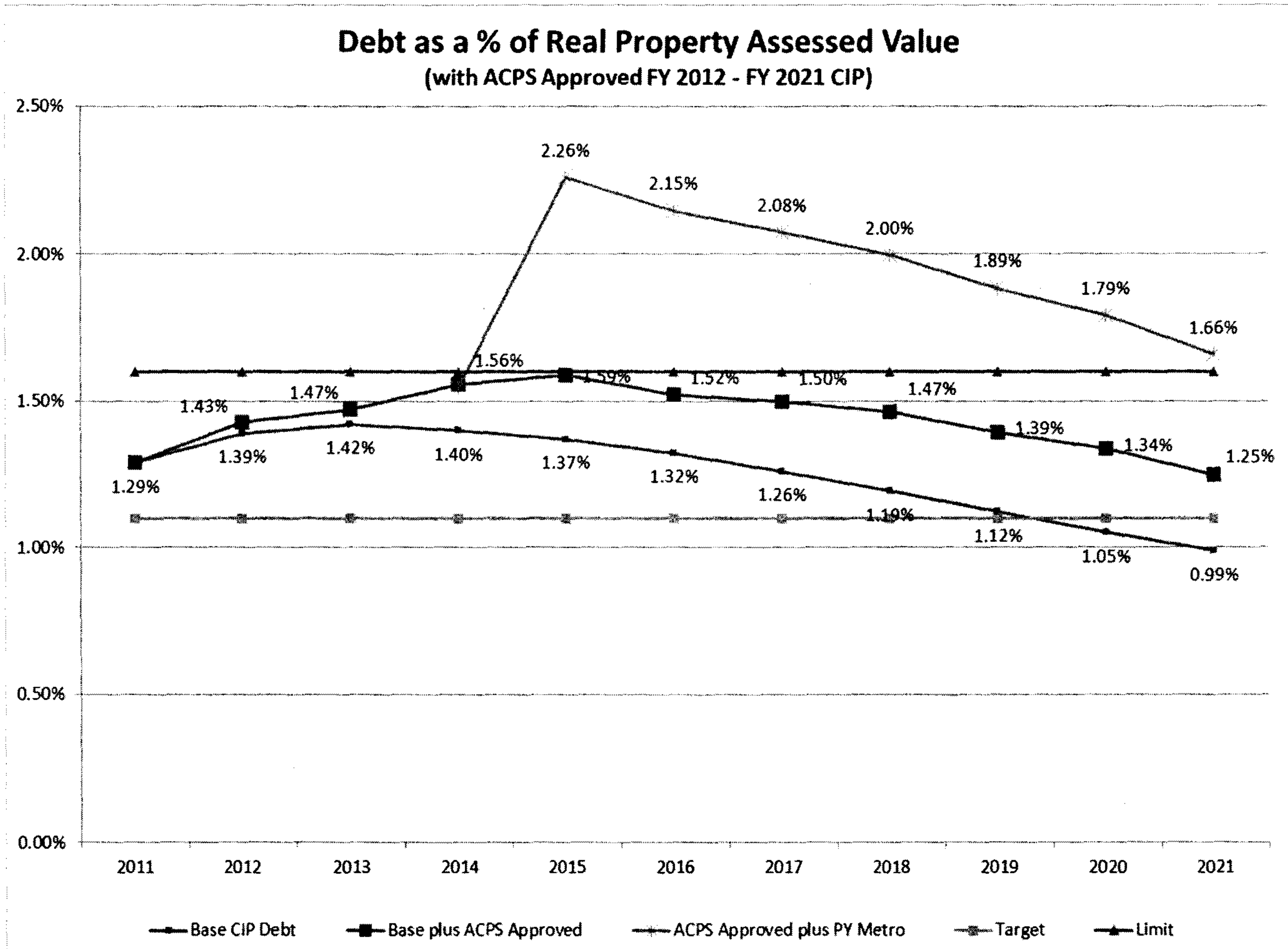

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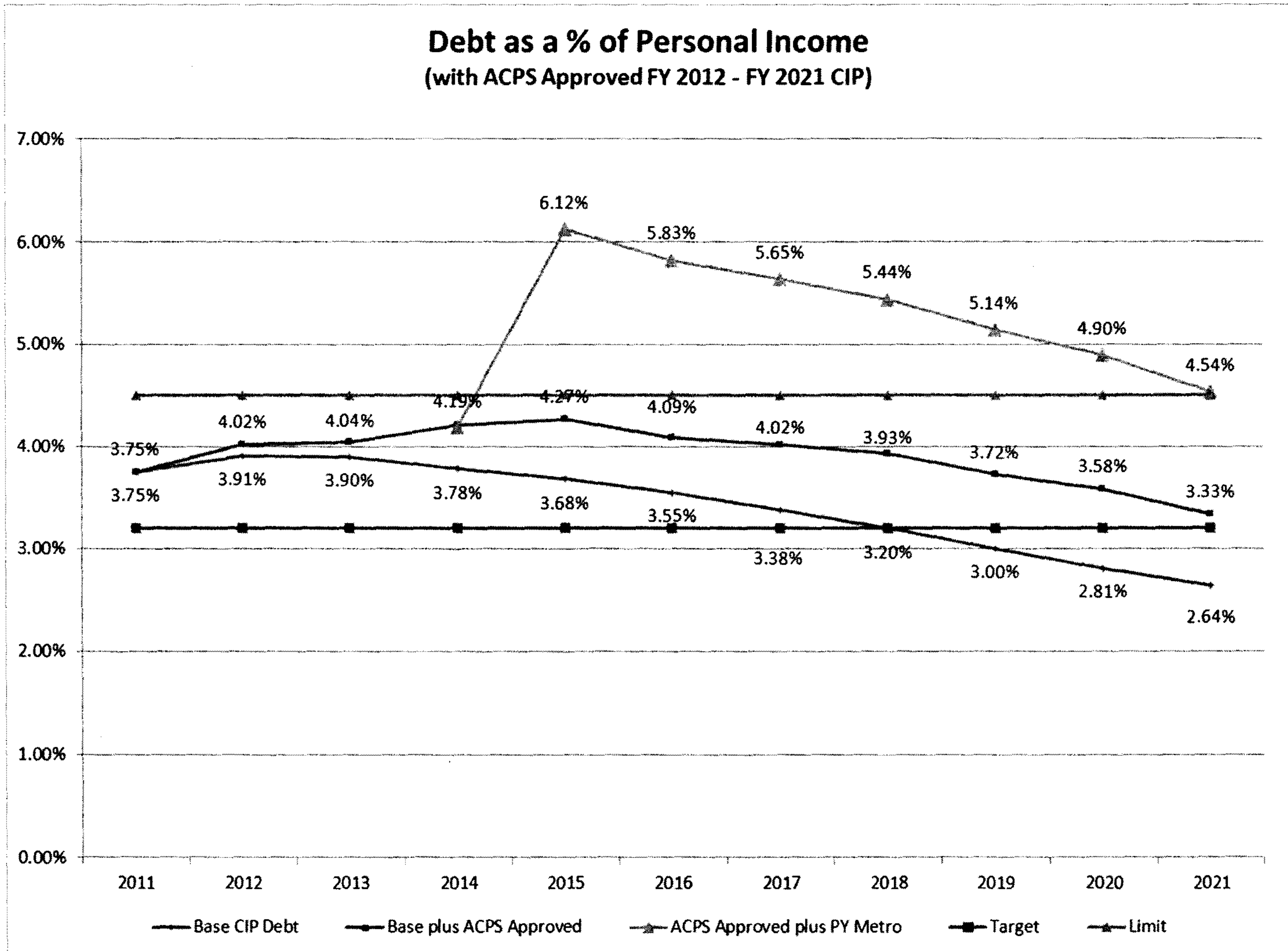

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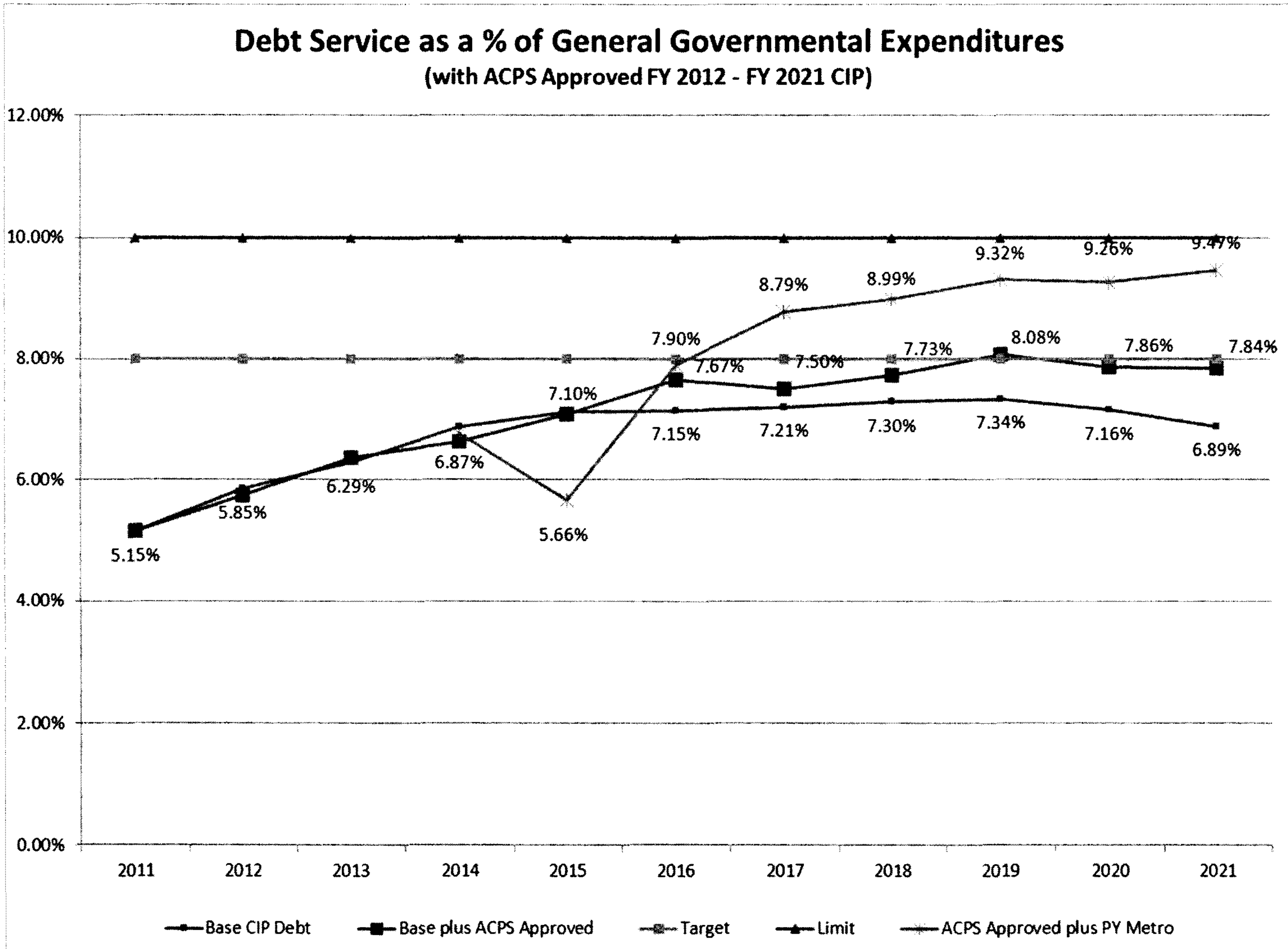
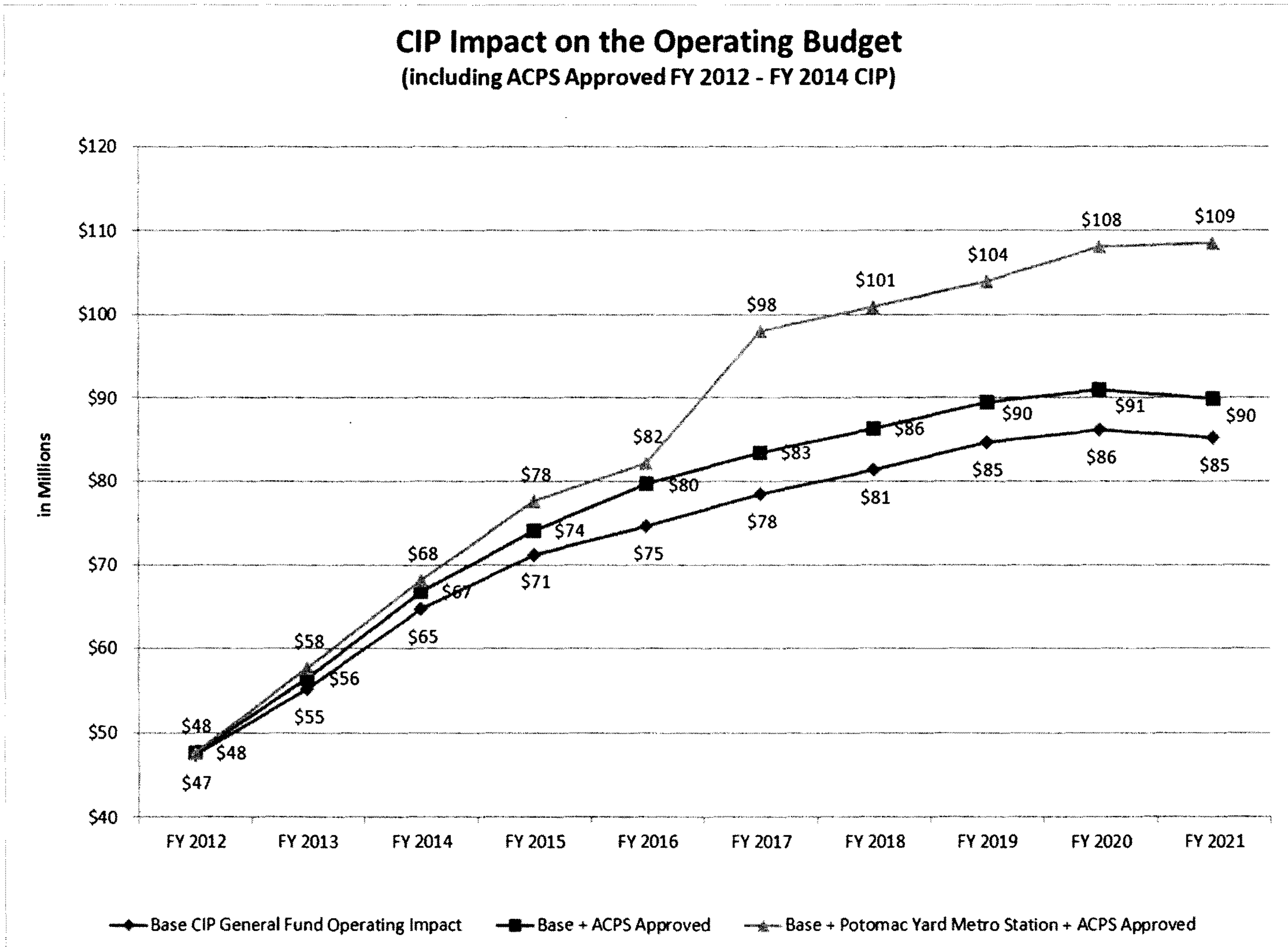
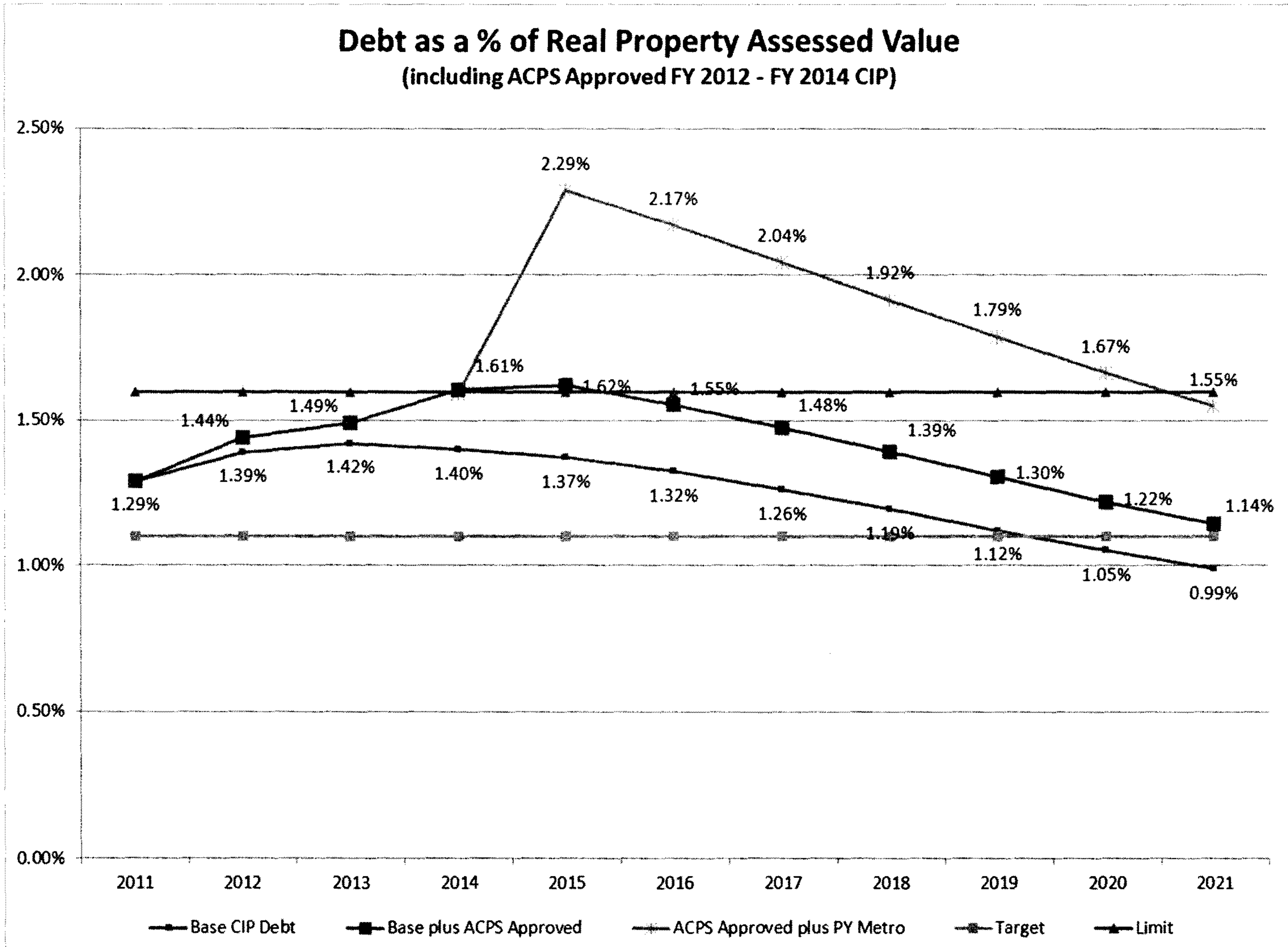


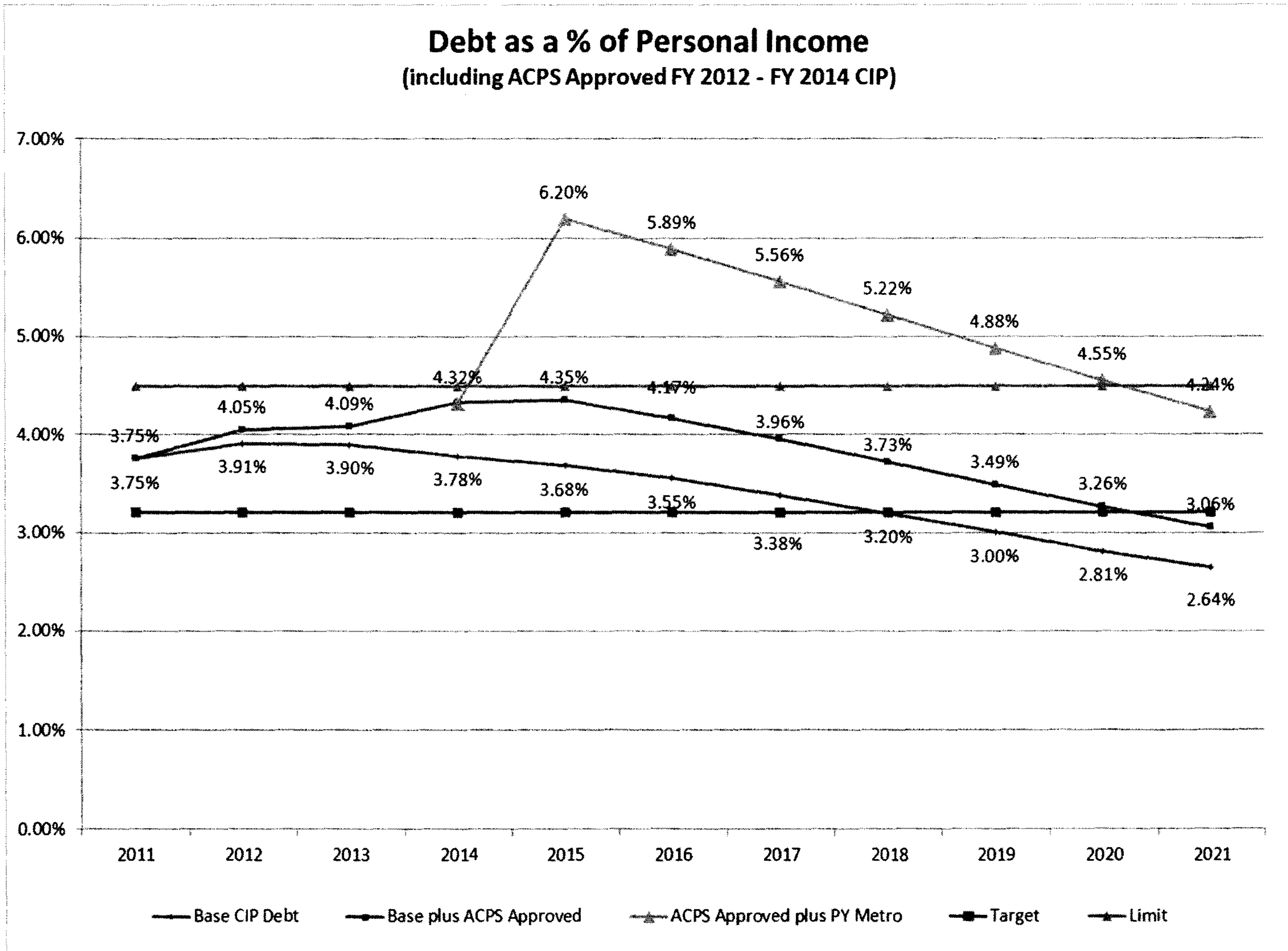
ATTACHMENT 3: OPTION 3 -FUNDING ACPS APPROVED FY 2012 – FY 2014 CIP + PATRICK HENRY SCHOOL; 100% BOND FINANCING



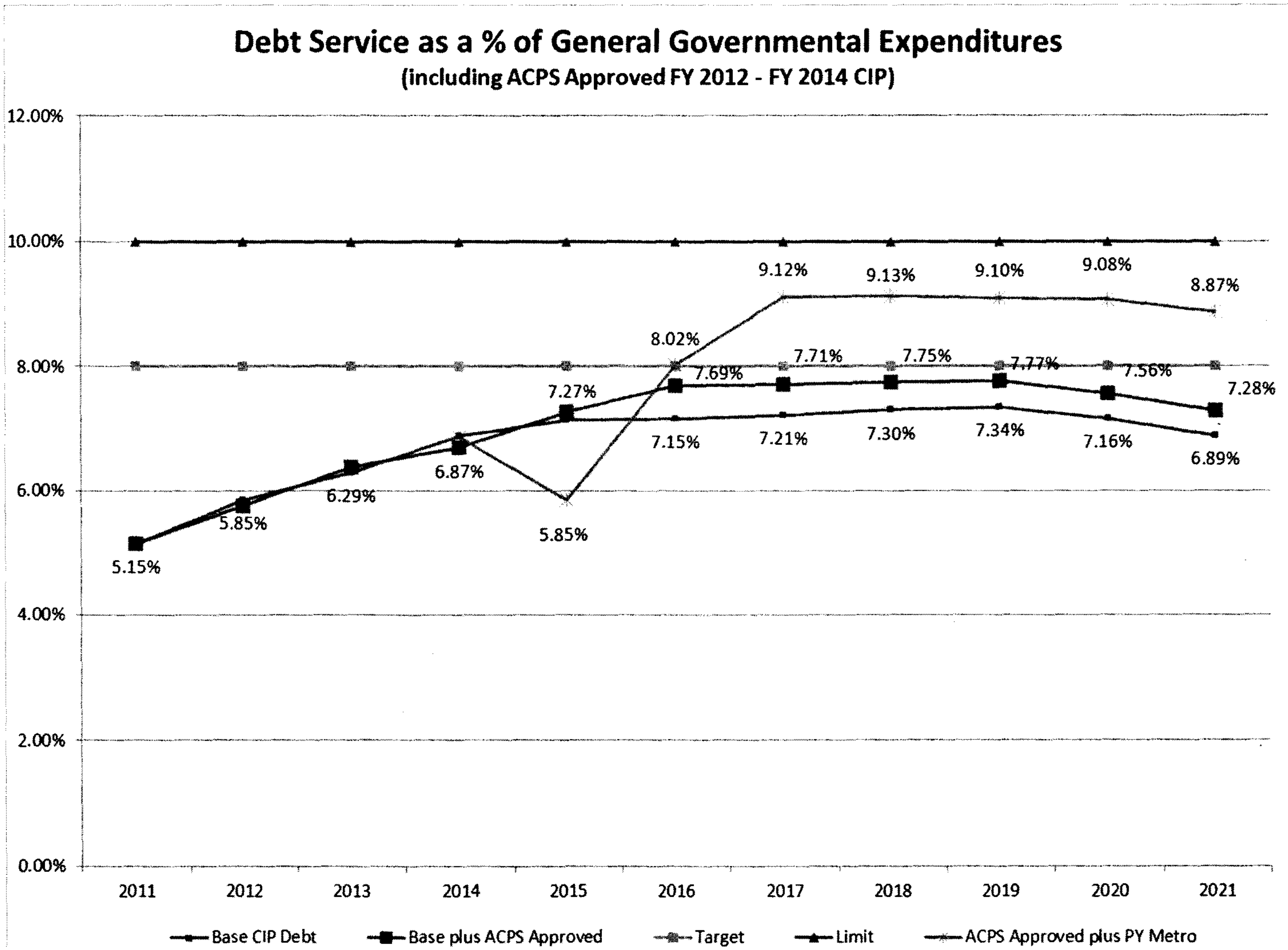
ATTACHMENT 3: OPTION 3 -FUNDING ACPS APPROVED FY 2012 – FY 2014 CIP + PATRICK HENRY SCHOOL; 100% BOND FINANCING



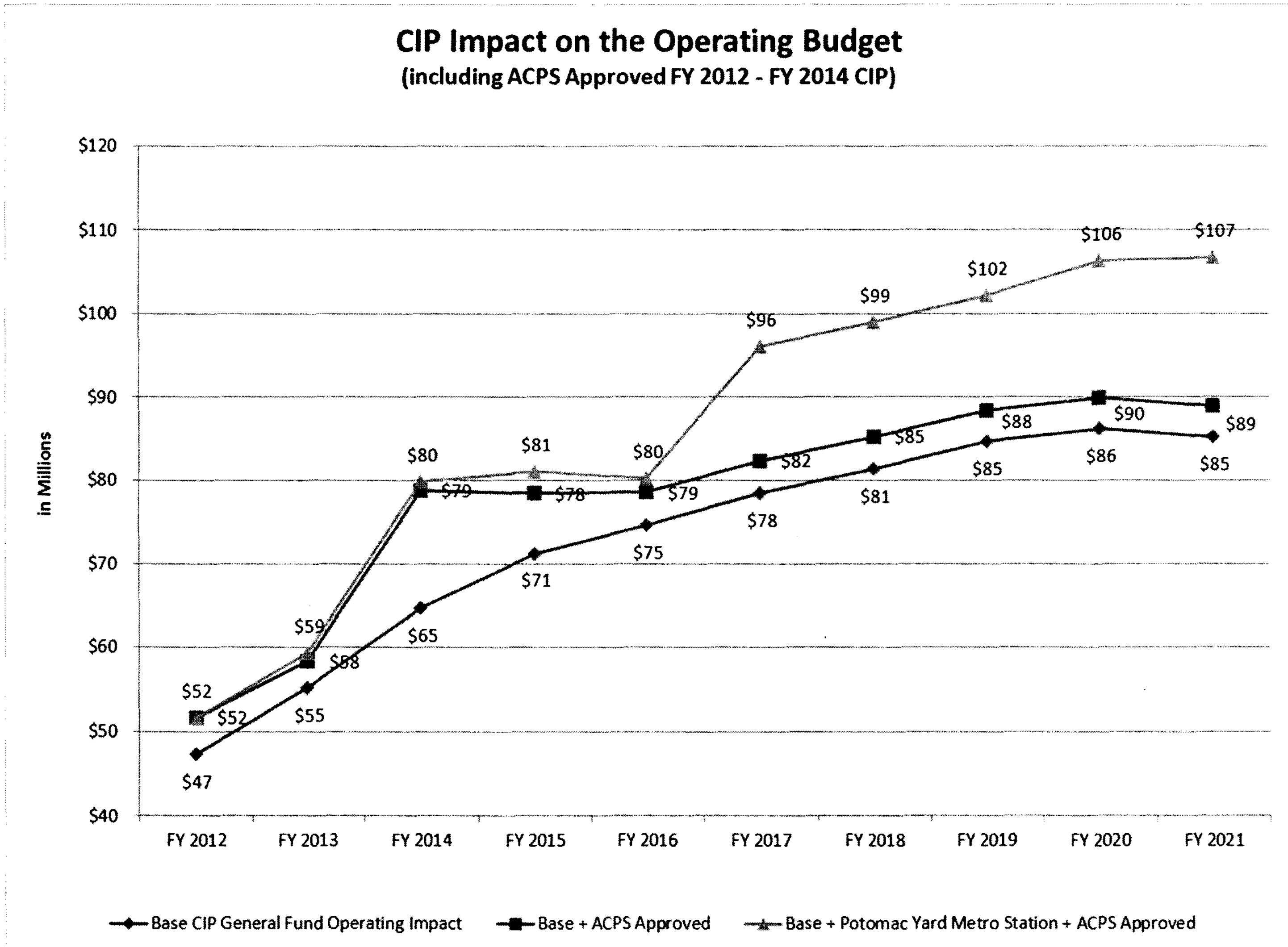
ATTACHMENT 3: OPTION 3 -FUNDING ACPS APPROVED FY 2012 – FY 2014 CIP + PATRICK HENRY SCHOOL; 100% BOND FINANCING



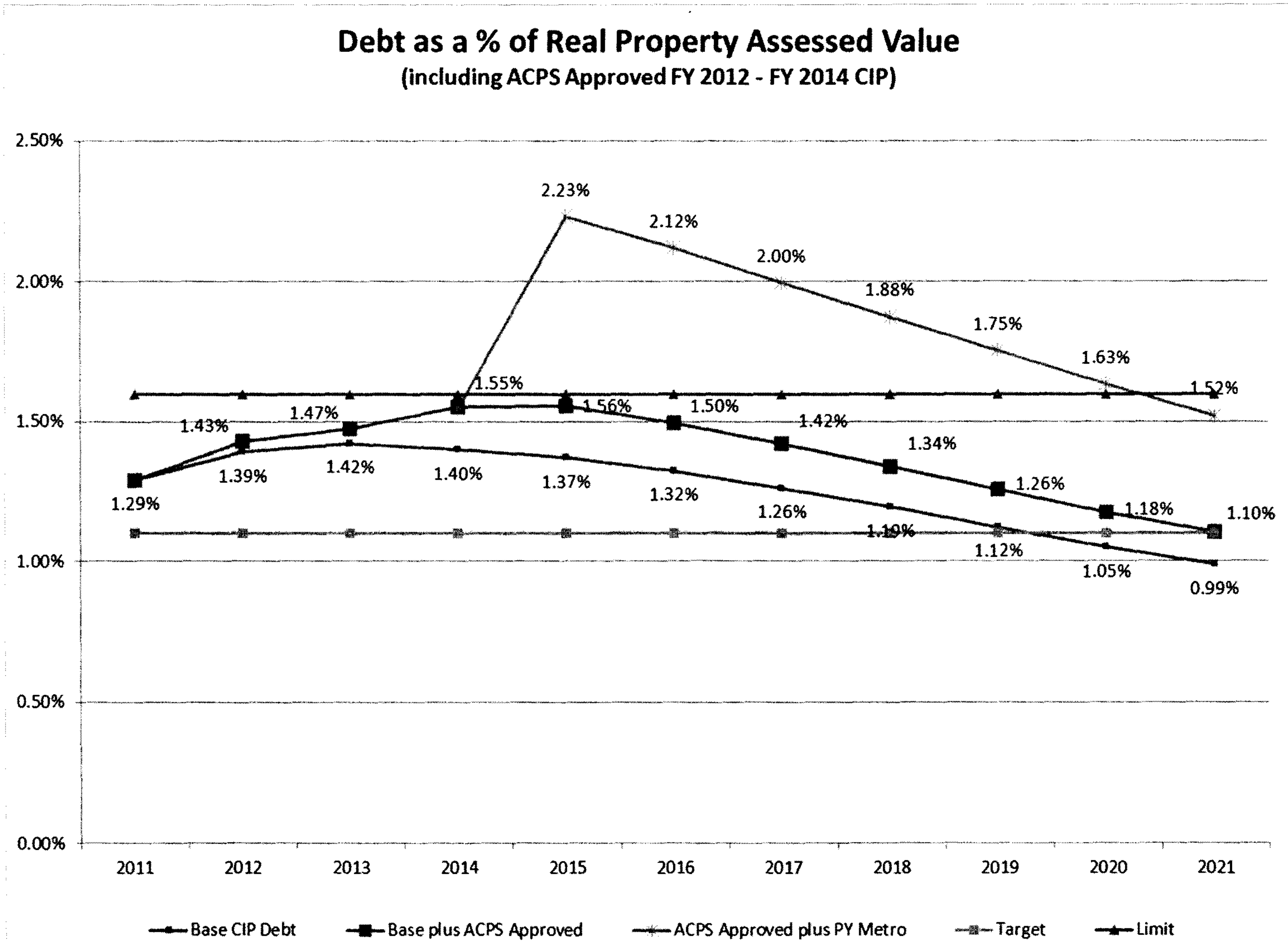
ATTACHMENT 3: OPTION 3 -FUNDING ACPS APPROVED FY 2012 – FY 2014 CIP + PATRICK HENRY SCHOOL; 100% BOND FINANCING



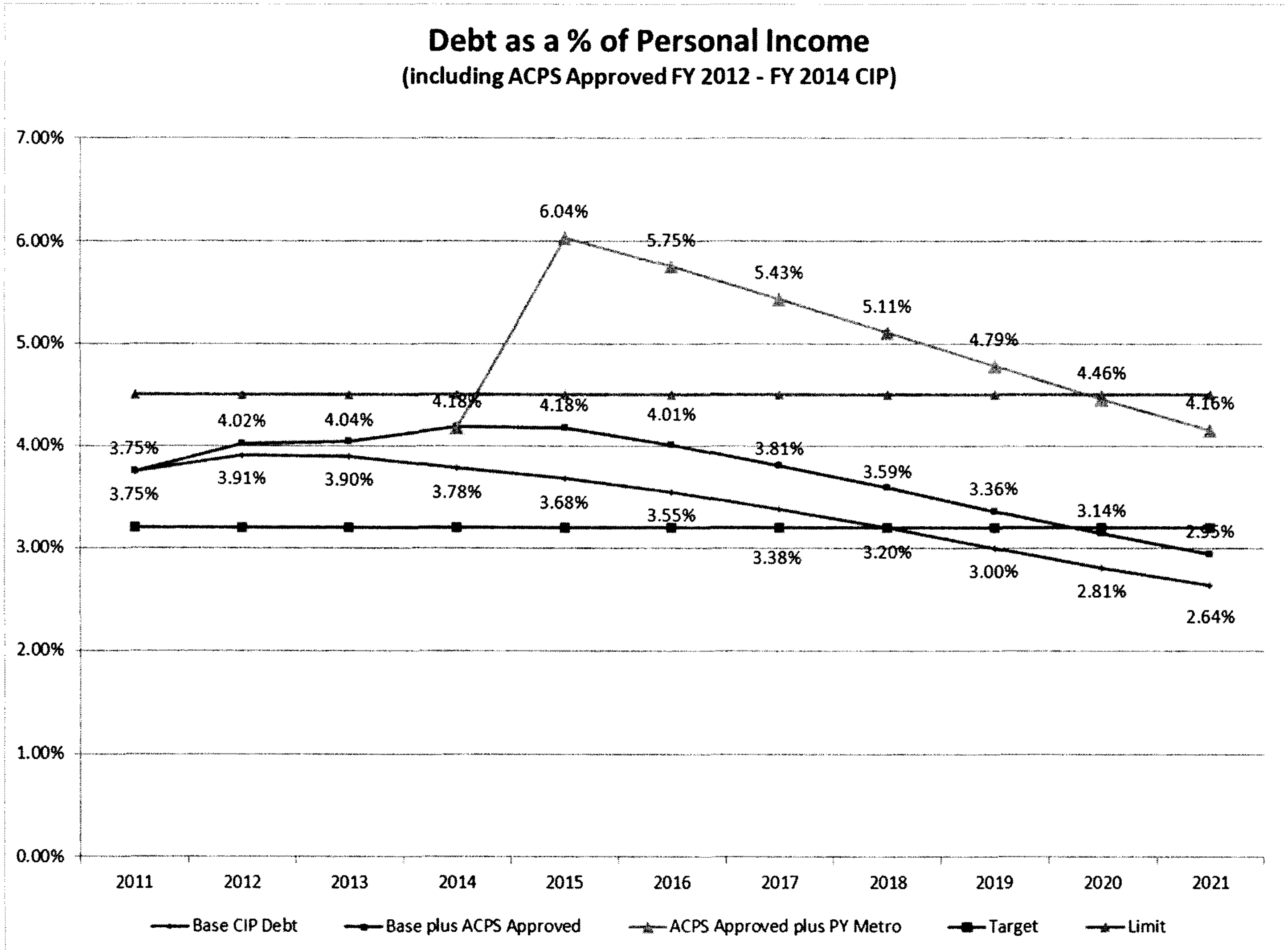
ATTACHMENT 4: OPTION 4 - FUNDING ACPS APPROVED FY 2012 – FY 2014 CIP + PATRICK HENRY SCHOOL; 75% BONDS, 25% CASH



ATTACHMENT 4: OPTION 4 - FUNDING ACPS APPROVED FY 2012 – FY 2014 CIP + PATRICK HENRY SCHOOL; 75% BONDS, 25% CASH



ATTACHMENT 4: OPTION 4 - FUNDING ACPS APPROVED FY 2012 – FY 2014 CIP + PATRICK HENRY SCHOOL; 75% BONDS, 25% CASH



ATTACHMENT 4: OPTION 4 - FUNDING ACPS APPROVED FY 2012 – FY 2014 CIP + PATRICK HENRY SCHOOL; 75% BONDS, 25% CASH