City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 5, 2012

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: RASHAD M. YOUNG, CITY MANAGER BJ for

SUBJECT: BUDGET MEMO #27: BUDGET AND FISCAL AFFAIRS ADVISORY COMMITTEE (BFAAC) REVIEW OF THE FY 2013 PROPOSED BUDGET

The Budget and Fiscal Affairs Advisory Committee (BFAAC) has completed its analysis of the FY 2013 Proposed Budget for Council's consideration. This is in accordance with the Committee's mission to advise and support City Council by reviewing future revenue and expenditure forecasts and evaluating tax, fee, revenue, and expenditure levels in Alexandria. BFAAC will discuss this report (attached) with City Council at the budget work session on April 11, 2012.

City of Alexandria Budget and Fiscal Affairs Advisory Committee

Report on the City Manager's Proposed Budget for Fiscal Year 2013

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EXECUTIVE SUMMARY

THE BUDGET PROCESS

- **BFAAC applauds the City Manager's continued "cautious optimism" and believes that continued restraint is the desired approach.**

- **Due to several factors, including increasing personnel costs and equipment replacement needs, the cost of running the City of Alexandria is rising and expenditures are outpacing revenues.**

- **BFAAC believes that cost containment must become an important part of the City's overall financial strategy and encourages the City to seek out additional areas for cost containment as it strives toward additional efficiencies in citizen service delivery.**

- **BFAAC believes that in order to maintain current levels of service, the City will have to consider a variety of financial strategies, which may include: 1) cost containment initiatives; 2) tax increases; 3) spending reductions; and 4) expansion of the tax base. Comprehensive application of these four strategies will ensure the financial health of Alexandria and BFAAC encourages careful examination of all strategies equally.**

- **City Council's new election schedule will have an impact on the consideration of the annual budget. BFAAC believes the movement of the election requires a critical examination of the traditional process used by Council of providing historically beneficial guidance to the City Manager in developing an annual budget.**

- **The City Manager should be given the maximum flexibility possible within the budget guidance in creating a budget for City Council's consideration during election years.**

- **Alexandria should examine the budget process and best practices of other jurisdictions in Virginia that have similar budget process challenges to identify the best process possible for Alexandria.**

- **BFAAC believes that an approved ACPS budget should be received for consideration in the context of an overall City budget in order for all involved in the budget process to remain accountable and for the process to remain transparent to Alexandria taxpayers.**

- **BFAAC is concerned about the process and the timeline by which ACPS delivers a capital improvement program and an operating budget to City Council and strongly reiterates its observations and recommendations from FY 2012.**

- **BFAAC recommends that City Council not proceed with any school budget deliberations in future fiscal years without the receipt of a capital improvement**

program and an operating budget from ACPS by the City Manager before he presents his budget to Council.

THE PROPOSED OPERATING BUDGET

- **BFAAC concurs with the decision to adjust the general salary schedule to be competitive with surrounding jurisdictions in keeping with the Towers-Watson consulting firm report.**

- **BFAAC concurs with the separate effort by the City, unrelated to the mid-point changes, in its proposal to ensure, that under the new merit pay approach, compensation to employees is fair.**

- **We believe that management, for reasons of employee morale, must continue its education effort with employees and employee groups to explain the changing approach to compensation and make the transition as smooth as possible.**

- **BFAAC restates its support for a move to merit pay for all employees, emphasizing a properly designed and administered program. We commend the Administration for beginning this process during the current year by moving senior management into this process, with the intent of expanding the reach of a well-designed merit system to other employees beginning in FY 2013.**

- **The success of a merit pay approach will rest on principles of understanding and trust, plus safeguards throughout the process that insure fair implementation. Extensive training of both evaluators and those being evaluated must precede and continue throughout the process.**

- **The entire merit pay program implementation needs to be transparent, relatively simple and open to dialogue in group settings about the process, such as within departments, and between the parties involved in individual evaluation sessions.**

- **BFAAC is pleased to see the end of varying percentages of sharing in health benefit costs based upon year of employment. We suggest that the City not propose any additional employee sharing beyond the current 20% in the foreseeable future.**

THE PROPOSED CAPITAL IMPROVEMENT PROGRAM

- **BFAAC commends the cooperation between the City and ACPS to meet the capacity needs of Alexandria's burgeoning public school population.**

- **The additional capital necessary to accommodate the projected enrollment increases in the years FY 2017 through 2022 would likely strain the City's funding and borrowing capacity, given the other capital projects slated for the same period.**

- **The City should, in consultation with ACPS, be mindful of the likely impact on student population of any land-use planning proposal considered in the next several years.**

- **The Council should consider reducing the funding to a wider range of projects to "share the pain" of overall reduced resources and funding.**

- **City Staff should furnish a more detailed explanation in the project plans to provide greater transparency of the specific factors that the City Staff considered and applied in determining that it was appropriate to reduce the funding of specific CIP projects based on "available resources," "available funding," and "project prioritization."**

- **BFAAC recommends that Council consider requesting, for future budgets, that each department or agency provide a standard type of benefit analysis information.**

REVENUES AND OUTLOOK

- **For the past 4 years, non real estate taxes and fees have accounted for a substantial part, about 18%, of the overall resident tax/fee burden. We will continue to work with Staff on new metrics that provide a more comprehensive measure of the tax and fee burden on households/residents and businesses.**

- **BFAAC reminds Council of the Economic Sustainable Work Group recommendation to rebalance the real estate tax base to 50% residential and 50% commercial. Including the multifamily properties as part of the commercial base can be misleading, in particular since these properties do not generate the same net gain to the City as other commerical properties and in fact align closer to the net gain of a residential property.**

- **To diversify our commercial base, Council should set a goal for the types of business the City wishes to attract. A strategic plan should be developed that includes the necessary incentives to attract and retain such businesses.**

- **The City's current debt policy targets and limits should not be raised.**

- **Given the Potomac Yard development's very unique features—including being self-financed, projected impact on economic development and estimated long-term revenue stream for the City—BFAAC can make a reasoned case for borrowing as a part of the project's financing as an acceptable temporary exception to the debt policy guidelines. However, we recommend against additional borrowing for any other projects that would cause the City's debt to be further in excess of debt policy limits.**

- **BFAAC emphasizes that FY 2013 debt policy projections do not assume several high profile projects that have been approved and are being executed. We caution that additional borrowing to implement these additional projects would significantly**

deteriorate the City's performance relative to its debt policy guidelines and adversely impact our AAA/Aaa bond rating.

I. THE BUDGET PROCESS

A. Long Range Budget Outlook

"Cautious optimism."[1] In the FY 2012 City Manager's message to the Alexandria City Council, then-Alexandria City Manager Jim Hartmann told Council that "we can expect at least three, maybe four more years of difficult financial prospects calling for significant spending restraint."[2] In the FY 2012 BFAAC report, we concurred with the City Manager, believing that "restraint should continue to be the approach."[3]

In the FY 2013 Manager's Message, BFAAC observes that new City Manager Rashad Young has adopted the same long-term outlook, noting that "we are continuing to see an economic recovery that enables us to be cautiously optimistic."[4] BFAAC concurs that cautious optimism should continue to guide the City's budget development process and that Alexandria should continue to show fiscal restraint.

While we believe in cautious optimism, BFAAC would like to stress more "caution" than "optimism." That caution originates from one word: cost. As the City Manager notes, "rising personnel costs, maintenance agreement obligations and equipment replacement needs result in increased expenditures for providing the same level of service."[5] Simply put, it is getting more expensive to run the City of Alexandria and the revenues the City relies on to deliver services to its citizens are not keeping pace with the associated costs. Therefore, BFAAC believes that cost containment must become an important part of the City's overall financial strategy.

Cost containment, however, does not necessarily mean cuts in services. In fact, the City has already identified areas where cost containment measures have been implemented, including elimination of the City's Risk Management positions and the decentralization of its functions and the cost savings associated with the opening of the new Police Department headquarters. BFAAC encourages the City to seek out additional areas for cost containment as it strives toward additional efficiencies in citizen service delivery.

In this and future budget years, BFAAC believes that in order to maintain current levels of service, the City will have to consider a variety of financial strategies, which may include: 1) cost containment initiatives; 2) tax increases; 3) spending reductions; and 4) expansion of the tax base. Comprehensive application of these four strategies will ensure the financial health of Alexandria and BFAAC encourages careful examination of all strategies equally.

[1] FY 2012 Proposed Budget, City Manager's Message, p. 2-1.
[2] *ibid*.
[3] FY 2012 BFAAC Report, p. 7.
[4] FY 2013 Proposed Budget, City Manager's Message, p.2-1
[5] *ibid.*

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC applauds the City Manager's continued "cautious optimism" and believes that continued restraint is the desired approach.**

- **Due to several factors, including increasing personnel costs and equipment replacement needs, the cost of running the City of Alexandria is rising and expenditures are outpacing revenues.**

- **BFAAC believes that cost containment must become an important part of the City's overall financial strategy and encourages the City to seek out additional areas for cost containment as it strives toward additional efficiencies in citizen service delivery.**

- **BFAAC believes that in order to maintain current levels of service, the City will have to consider a variety of financial strategies, which may include: 1) cost containment initiatives; 2) tax increases; 3) spending reductions; and 4) expansion of the tax base. Comprehensive application of these four strategies will ensure the financial health of Alexandria and BFAAC encourages careful examination of all strategies equally.**

B. Election Year Budget Guidance

In 2009, the Alexandria City Council modified the date of election for Mayor and City Council from May to November. Since Alexandria's fiscal year runs from 1 July to 30 June, budget development by City Staff typically occurs in late summer and throughout the fall, leading to the adoption of budget guidance in November and the presentation of the Manager's proposed budget in February. Initial budget public hearings will now occur at the height of election season during election years.

BFAAC notes that during election years, should the traditional budget process be maintained, one Council will approve budget guidance while the next Council will have the responsibility for passing the budget developed via the budget guidance. Thus, it appears that one of the unintended consequences of moving the elections from May to November is that the traditional budget process used by the City will now be divided between two different Councils. As a result, BFAAC believes the movement of the election requires a critical examination of the traditional process used by Council of providing historically beneficial guidance to the City Manager in adopting an annual budget.

BFAAC recognizes the dilemma in this situation. While each Council is elected to govern for its entire term, there must be some recognition that priorities identified in the budget guidance may be modified as a result of a Council election. This circumstance creates a situation whereby the City Manager should be given the maximum flexibility possible, allowing for the incoming Council to make changes as it deems necessary.

OBSERVATIONS AND RECOMMENDATIONS

- **City Council's new election schedule will have an impact on the consideration of the annual budget. BFAAC believes the movement of the election requires a critical examination of the traditional process used by Council of providing historically beneficial guidance to the City Manager in developing an annual budget.**

- **The City Manager should be given the maximum flexibility possible within the budget guidance in creating a budget for City Council's consideration during election years.**

- **Alexandria should examine the budget process and best practices of other jurisdictions in Virginia that have similar budget process challenges to identify the best process possible for Alexandria.**

C. Receipt of the Alexandria City Public Schools (ACPS) Budget

In the FY 2012 BFAAC report, we wrote:

> *Overall, BFAAC is concerned about the process and timeline by which ACPS delivers a capital improvement program and an operating budget to City Council. While we acknowledge some of the constraints on the development of an annual operating budget by ACPS, we believe those constraints should not necessarily preclude the timely preparation of a school budget.* [6]

The FY 2013 budget process for ACPS seems to be playing out exactly the way the FY 2012 played out. Two separate budget processes are occurring at similar times by both the City Council and the School Board. Given the recent revelations of problems within the capital improvement program budget at ACPS, BFAAC strongly reiterates its observations and recommendations from FY 2012. Further, we recommend that City Council not proceed with any school budget deliberations in future fiscal years without the receipt of a capital improvement program and an operating budget from ACPS by the City Manager before he presents his budget to Council.

It should also be noted that the School Board election calendar now mirrors the City Council election calendar as described in section B. Thus, BFAAC acknowledges that many of the same challenges associated with the budget development process for City Council will also be felt by the School Board and encourages a critical examination of the ACPS budget development process to ensure that public monies are appropriately budgeted and expended.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC believes that an approved ACPS budget should be received for consideration in the context of an overall City budget in order for all involved in the budget process to remain accountable and for the process to remain transparent to Alexandria taxpayers.**

[6] FY 2012 BFAAC Report, p. 10.

- **BFAAC is concerned about the process and the timeline by which ACPS delivers a capital improvement program and an operating budget to City Council and strongly reiterates its observations and recommendations from FY 2012.**

- **BFAAC recommends that City Council not proceed with any school budget deliberations in future fiscal years without the receipt of a capital improvement program and an operating budget from ACPS by the City Manager before he presents his budget to Council.**

II. THE PROPOSED OPERATING BUDGET

A. Salary Schedule: Changes to Achieve Market Comparability

We concur with the decision to adjust the general salary schedule to be competitive in keeping with the Towers-Watson consulting firm report on comparability pay with surrounding jurisdictions. It appears that the method used (dropping two lower salary steps and adding one at the top of the schedule) does, in fact, accomplish the objective by moving the midpoint of the schedule (on paper) to provide such comparability.

However, there is concern by many employees that a mid-point change does not provide some salary adjustment for all employees. The study revealed that the mid-point of the schedule was comparatively low; but the study did not address the salaries of individual employees or merit raises. The proposed budget provides an actual salary change only for those employees found to be lagging in salary related to competitiveness with nearby jurisdictions: on the first two steps (occupied by none on step one and very few on the second step) and many long-term employees on the highest seniority step for their respective job designations. Newly hired employees will benefit by being employed at a higher entry level salary. Although BFAAC expresses this concern, it also notes that the Human Resources Department does have a separate process for addressing salaries of individual job classes through the use of periodic benchmarking studies.

Separately, unrelated to the study and resulting adjustments, merit raises for all employees will occur. There is $3 million in the proposed budget for merit raises for employees who are evaluated as satisfactory or better. Each employee will receive these salary increases on their individual employment anniversary dates at a rate of 5%, 3.5% or 2.3% depending on their placement on the seniority schedule.

In addition, we also understand that the City Manager will begin moving toward the implementation of pay bands in FY 2013. This will continue the City's move away from the current pay schedule to an approach more closely tied to rewarding individual performance.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC concurs with the decision to adjust the general salary schedule to be competitive with surrounding jurisdictions in keeping with the Towers-Watson consulting firm report.**

- **BFAAC concurs with the separate effort by the City, unrelated to the mid-point changes, in its proposal to ensure, that under the new merit pay approach, compensation to employees is fair.**

- **BFAAC believes that management, for reasons of employee morale, must continue its education effort with employees and employee groups to explain the changing approach to compensation and make the transition as smooth as possible**

B. A New Evaluation and Pay System Based on Merit; New Performance Evaluation System

As stated in prior BFAAC reports, we support a move to a merit pay system for all employees if properly designed and administered. We commend the Administration for beginning this process during the current year by moving department heads into this system, with the intent of expanding the reach of a well-designed merit system to other employees in the future. As we understand the preliminary design of the program, replacing the current "step" schedule, pay "bands" for position levels will be established, with movement within those bands to be determined by performance/merit.

As stated in prior discussions with city administrators and Council, success of a merit pay approach will rest on principles of understanding and trust, plus safeguards throughout the process that insure fair implementation. Extensive training of both evaluators and those being evaluated must precede and continue throughout. We also believe that performance objectives for a specific job should relate directly to the Managing-for-Results Initiative (MFRI) for that area of work.

The entire implementation needs to be transparent, relatively simple and open to dialogue in group settings about the process, such as within departments, and between the parties involved in individual evaluation sessions. If the evaluation of an individual is negative, an evaluator should outline opportunities for growth to the employee if he or she is to remain in the position.

This year the City has developed the format and specifications of the new performance evaluation system, in cooperation with an employee work group. This is a commendable forward step. The forms are online for use in self-evaluation followed by formal evaluations on a schedule once the new process is formally put into practice FY 2014.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC restates its support for a move to merit pay for all employees, emphasizing a properly designed and administered program. We commend the Administration for beginning this process during the current year by moving senior management into this process, with the intent of expanding the reach of a well-designed merit system to other employees beginning in FY 2013.**

- **The success of a merit pay approach will rest on principles of understanding and trust, plus safeguards throughout the process that insure fair implementation. Extensive training of both evaluators and those being evaluated must precede and continue throughout the process.**

- **The entire merit pay program implementation needs to be transparent, relatively simple and open to dialogue in group settings about the process, such as within departments, and between the parties involved in individual evaluation sessions.**

C. Cost Sharing of Employee Health Benefits

The Committee is pleased to see the end of varying percentages of sharing in health benefit costs based upon year of employment. Now that all employees are sharing at 20% of cost, we suggest that the City not propose any additional employee sharing in the foreseeable future.

OBSERVATION AND RECOMMENDATION

- **BFAAC is pleased to see the end of varying percentages of sharing in health benefit costs based upon year of employment. We suggest that the City not propose any additional employee sharing beyond the current 20% in the foreseeable future.**

THE PROPOSED CAPITAL IMPROVEMENT PROGRAM

A. Overview

The CIP budget summary states that:

> *[i]n November 2011, City Council provided staff with guidance for the preparation of the Proposed FY 2013 – FY 2022 Capital Improvement Program. The guidance directed that cash capital from current revenues and general obligation debt be equal to the levels included in the Approved FY 2012 – FY 2021 CIP. Allowances were made for increases to the plan where special revenue sources (e.g. state or federal grants, sewer funds, etc.) or one-time City funding sources (e.g. prior year operating budget surpluses, sale of assets, etc.) could be identified.*[7]

As a result, the CIP increased by a net amount of approximately $38.2 million. The net change reflects an increase in sanitary sewer funding of $64.3 million from $38.1 million in the FY 2012 CIP to $102.4 million in the FY 2013 CIP and decreases of $33.7 million in other CIP areas. The majority of the reductions are in the Transportation Improvement Program ($28.2 million). The sanitary sewer funding will be provided by a dedicated revenue source.

As a whole, the CIP reflects very little departure from the baseline established in the FY 2012 CIP. BFAAC believes that this is an appropriate strategy for the City, given a tepid economic recovery and the uncertainty created by the national discussion on the size and scope of the Federal government. The FY 2012 CIP contained significant commitments to the improvement of the City's infrastructure and current economic conditions do not provide a reason to change course.

BFAAC also notes the City Staff under the leadership of the interim City Manager honored the previous City Manager's commitment to refine the CIP development process. This year's CIP development process included further efforts to integrate the capital plan with City's Strategic Plan.[8] Also, in this submission, BFAAC recognizes the continued progress in describing the CIP's impact on the operating budget. The CIP acknowledged the City Manager's commitment to develop a more quantitative project scoring system to support project prioritization. It also discussed the obstacles to developing such a prioritization scheme. Despite these obstacles, BFAAC encourages the City Manager to pursue a more quantitative methodology to assist with project prioritization. The FY 2013 CIP continues to balance future capital needs and fiscal responsibility.

The FY 2013 CIP sizes and shapes the three very expensive, but strategic, capital investments set forth in the FY 2012 CIP: the Alexandria City Public Schools CIP; various transportation projects; and the Potomac Yard Metro Station. The transportation projects portfolio has been resized to be consistent with 2.2 cents of the base real estate tax rate and additional General Fund cash capital for continuation of the City's Transportation Improvement Program approved by City Council in FY 2012. The Metro Station funding is consistent with the sources set forth in

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[7] City of Alexandria – FY 2013 Proposed CIP, p. 2-3
[8] *Ibid*, p. 2-5

the FY 2012 CIP. The City and ACPS have achieved consensus on the CIP from FY 2013 through FY 2016. There remain significant differences between the City and ACPS over the remaining six years of the CIP.

B. Alexandria City Public Schools

School capacity issues continue to challenge Alexandria's Capital Improvement Budget. The official enrollment for the current school year is 12,395 students, an increase of 396 students or 3.3% over last year.[9] Student population growth has averaged 3.8% per year for the past six years, and current projections show annual increases in student population of around 3% per year continuing until at least FY 2018.[10] Such projected increases would add 2,450 students to ACPS by FY 2018, more than the current population at TC Williams High School.[11]

In March 2012, the School Board approved a 10-year CIP budget totaling $357.8 million for FY 2013 through FY 2022.[12] The City Manager's proposed CIP appropriations for ACPS during that time period totaled $202.7 million. Continuing the discussions between city and ACPS staffs begun during last year's budget process, the City Manager's proposed 10–year CIP budget fully funds the ACPS CIP request for FY 2013 through FY 2016, but leaves a $155.1 million deficit in the out-years, FY 2017 through FY 2022.[13] The City Manager is committed to continue working with ACPS staff to stay informed of its capital needs in the out-years.[14]

BFAAC remains concerned about the potential impact of the ACPS estimated capital needs in the out-years. As noted in our FY 2012 report, if increases in student population continue at this pace, then the City would potentially have to fund the additional $155.1 million of ACPS's CIP budget for the Fiscal Years 2017 through 2022. That level of capital spending would strain the City's funding and borrowing capacity, potentially crowding out other capital projects.[15]

BFAAC commends the cooperation between the City and ACPS over the past year on these important issues, and we encourage the City and ACPS to continue working collaboratively on these issues going forward. In particular, we encourage the City to consider likely impacts on ACPS as land-use planning decisions are made.[16] The Potomac Yard development, the likely redevelopments of the Beauregard Corridor and Landmark, along with possible development in the Eisenhower Valley, each have the potential to impact school populations in the City.

BFAAC also encourages the City to work with ACPS on creative funding alternatives for increasing school capacity.

[9] ACPS FY 2013 – 2022 CIP Budget, p. 11.
[10] *Ibid.*
[11] *Ibid.* p. 13.
[12] FY 2013 ACPS CIP Budget, approved March 8, 2012.
[13] Proposed FY 2013 CIP Budget p. 2-5.
[14] *Ibid.*
[15] FY 2012 Budget Memo #34, City of Alexandria Budget and Fiscal Affairs Advisory Committee, *Report on the City Manager's Proposed Budget for Fiscal Year 2012*, p. 22.
[16] *Ibid.* p. 23

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC commends the cooperation between the City and ACPS to meet the capacity needs of Alexandria's burgeoning public school population.**

- **The additional capital necessary to accommodate the projected enrollment increases in the years FY 2017 through 2022 would likely strain the City's funding and borrowing capacity, given the other capital projects slated for the same period.**

- **The City should, in consultation with ACPS, be mindful of the likely impact on student population of any land-use planning proposal considered in the next several years.**

C. Process Transparency

As previously discussed in the section of this report regarding the Proposed FY 2013 Operating Budget, BFAAC is also concerned with the lack of "process transparency" in the proposed FY 2013 – 2022 CIP Budget. The proposed CIP budget provides detailed information on each of the approximately 180 proposed capital improvement projects. This detail identifies projects for which the City Manager recommends changes in relation to the Approved FY 2012 – 2021 CIP.

Of those approximately 180 capital improvement projects, only six had their funding reduced. The justifications given for recommending reductions to these projects were "available resources," "available funding," or "project prioritization."

The six projects were:

- Tree and Shrub Capital Maintenance - Priority: Essential, reduced $25,500 and 75,000 for FY 2013, 2014 and 2015 respectively, p. 9-11
- Open Space Acquisition and Parks - Priority: Desirable, reduced $250,000, p. 9-31
- Expanded Trolley Service – Priority: Desirable, reduced $700,000, p.11-22
- Transit Corridor "A" Streetcars – Priority: Desirable, reduced $2.5 million, p. 11-30
- Reconstruction and Expansion of Sanitary Sewers – Priority: Essential, reduced by $4.28 million, p.12-13
- Storm/Combined Sewer Assessment and Remediation – Priority: Essential, reduced by $3.67 million, p. 12-28.

BFAAC is concerned with the recommendations to reduce funding to these six projects on two levels. First, the CIP documents do not adequately explain why the funding for these particular projects was reduced. For example, if the projects were to be funded from a designated revenue source that was reduced—such as federal funding that was no longer available—that designated source was not identified. If the funding for these projects was from general revenue, the specific criteria for determining these six projects warranted reductions due to a lack of "available resources," "available funding," or sufficient "project prioritization" were not clearly stated. In the interest of increasing transparency in future CIP budgets, BFAAC recommends that all bases behind a recommendation to reduce funding for a previously approved project be detailed.

Second, and more generally, the City's CIP documents do not uniformly include a benefit analysis for proposed capital improvement projects. As a result, when, as this year, the City's fiscal outlook necessitates making hard choices among capital projects, Council, as well as the public, does not have adequate information to evaluate the cuts proposed by the Manager. Similarly, Council and the public lack sufficient information to determine whether there are additional projects over which the pain of funding cuts should appropriately be shared. BFAAC recommends that Council consider requesting, for future CIP budgets, that each department or agency provide a standard type of benefit analysis for projects within its purview.

The detailed information on each of the approximately 40 Information Technology ("IT") projects in the current CIP budget provides a good example of the type of information BFAAC believes would be useful to Council and would improve transparency. For each IT project, the CIP budget documents include the following information:

- Project Description: What does this project do?
- Critical Drivers: Why is this project needed now?
- Performance Expectation: How can we measure the project success?
- Alignment with Mission: How does this project fulfill the City's mission?

This information provides a clear and concise explanation of the rationale used by City IT staff in developing its proposed budget. Although the analysis of and information provided for these projects include many IT-specific aspects, the four central tenets of the analysis included is not limited to IT. The benefit analysis for each project specifies what the project does, why it is needed now, how success is to be measured, and the specific City mission the project advances. Armed with this information, Council is better prepared to determine if a specific project is appropriate for funding in a given fiscal year, and the public is better able to evaluate Council's funding decisions.

OBSERVATIONS AND RECOMMENDATIONS

- **The Council should consider reducing the funding to a wider range of projects to "share the pain" of overall reduced resources and funding.**

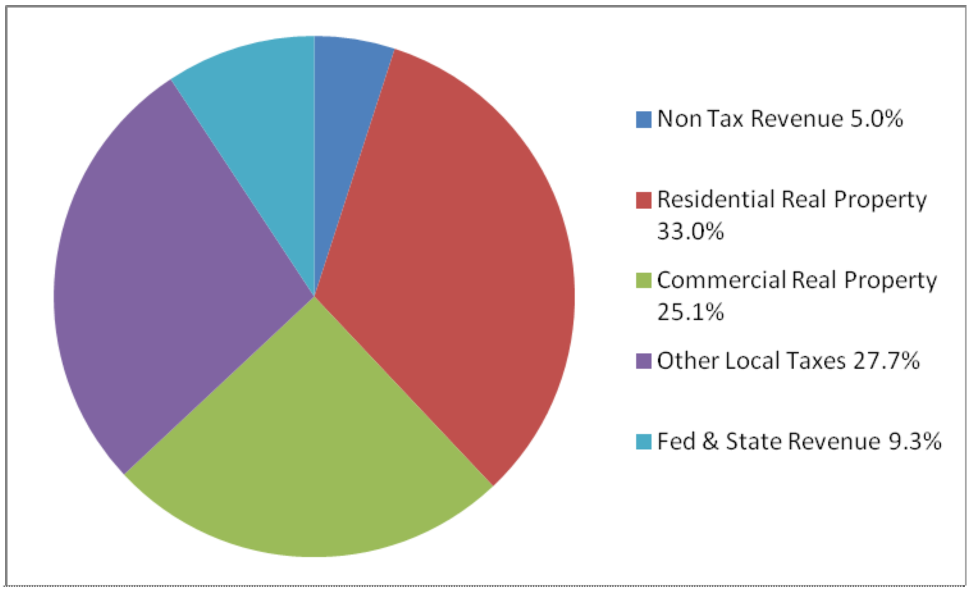
- **City Staff should furnish a more detailed explanation in the project plans to provide greater transparency of the specific factors that the City Staff considered and applied in determining that it was appropriate to reduce the funding of specific CIP projects based on "available resources," "available funding," and "project prioritization."**

- **BFAAC recommends that Council consider requesting, for future budgets, that each department or agency provide a standard type of benefit analysis information.**

IV. REVENUES AND OUTLOOK

Historically, the City has relied on the following sources of revenue: Residential Real Estate Tax; Commercial Real Estate Tax; Other Local Taxes; Non-Tax revenue; and Federal and State revenue. (See Chart I.) For years, the City has attempted, with limited success, to diversify the non-tax revenue. The City continues to rely upon Real Estate taxes to fund the majority of the budget. This revenue is derived from residential as well as commercial properties. We will address each of these sources separately.

Chart I: City of Alexandria Revenue Sources by Percent



A. Residential Tax and Fee Burden Issues

Council requested that BFAAC work with City Staff to explore the development of new metrics to measure the tax and fee burden for residents and businesses. These new metrics would more fully track the City-imposed financial burdens on residents *and* businesses.

For the past two budget cycles, we have been working with City Staff to develop these new metrics, but more time to collect and assemble the data is needed. The data in Table I below show that for the past four years, non real estate taxes and fees accounted for approximately eighteen percent of the overall resident tax/fee burden.

Table I: Tax and Fee Burdens as a Percent of Household Income[17]

	FY 2008	FY 2009	FY 2010	FY 2011
Mean Household Income*	$110,677	$107,925	$110, 485	$113,026
Fees and Taxes				
Real Estate Tax	$ 4,232	$ 4,227	$ 4,255	$ 4,380
Personal Property Tax	$ 279	$ 277	$ 212	$ 241
Trash Removal Fee	$ 264	$ 301	$ 331	$ 331
Decal Fee	$ 57	$ 59	$ 50	$ 53
Utility tax on Natural Gas	$ 24	$ 24	$ 22	$ 22
Utility tax on electricity	$ 33	$ 32	$ 29	$ 29
Utility tax on water	$ 22	$ 23	$ 22	$ 25
Communication Sales and Use Tax	$ 168	$ 149	$ 141	$ 142
Sanitary Sewer Maintenance Fee	$ 69	$ 69	$ 69	$ 95
Total Fees and Taxes	$5,149	$5,161	$5,132	$5,319
Percentage of total household income	4.7%	4.8%	4.6%	4.7%

*Data from the American Community Survey, published by the Census Bureau.; FY 2011 is a projected value, based on an assumption of 2.3% growth from FY 2010

[17] Source: OMB email communication to BFAAC, March 13, 2012.

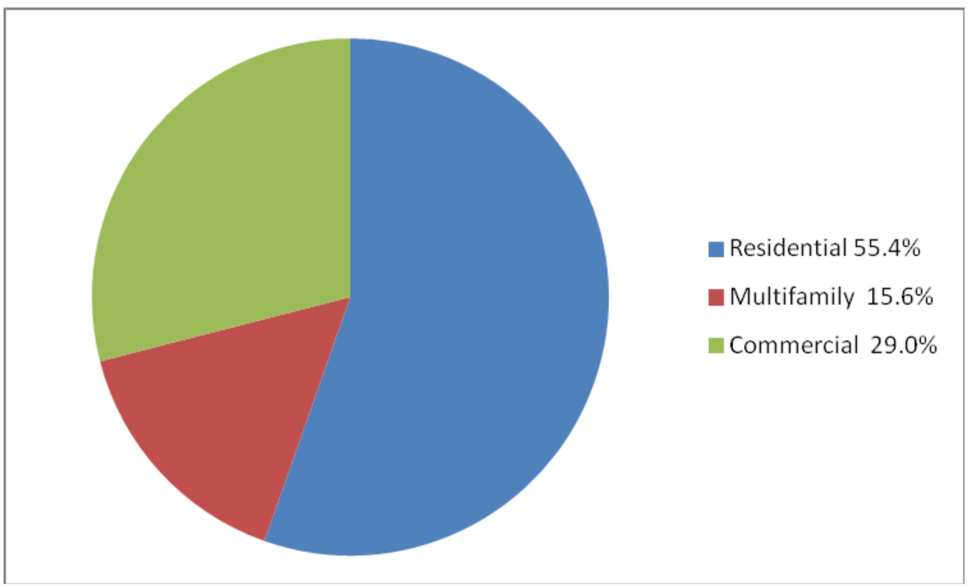
OBSERVATION

- **For the past 4 years, non real estate taxes and fees have accounted for a substantial part, about 18%, of the overall resident tax/fee burden. We will continue to work with Staff on new metrics that provide a more comprehensive measure of the tax and fee burden on households/residents and businesses.**

B. Commercial Real Estate Tax

Between 1984 and 2000, residential and commercial assessments each accounted for approximately 50 percent of the City's tax base. However, since 2000, residential assessments have begun to significantly increase as a share of the tax base. At this time, the commercial share (including multifamily residential properties) is 43.2% and residential is up to 56.8%. If we were to remove the multifamily share from the commercial total, the commercial share represents only 29.0% of the total assessed value. The chart below is a representation of the current assessment mix.

Chart II: Real Estate Tax Assessments by Property Type



One of the challenges facing the City, as it looks to rebalance the real estate tax base, is to understand what mix of properties might be best for the City. Hotels have the highest net gain to the City, and multifamily and residential properties have the lowest. In fact, 71.0% of the tax revenue is generated by properties that have the least net gain to the City. The recommendation of the Economic Sustainability Work Group was to realign our base to a 50/50 balance.[18] When multifamily properties are excluded from the commercial category, the City is much further away from the goal than many realize.

[18] Source: Recommendations from the Mayor's Economic Sustainability Workgroup, October 27, 2007, p.4

It should also be noted that with rebalancing to a 50/50 commercial and residential tax base, additional revenue from gross receipt sales, business licensing and restaurant/food tax would be realized as well.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC reminds Council of the Economic Sustainable Work Group recommendation to rebalance the real estate tax base to 50% residential and 50% commercial. Including the multifamily properties as part of the commercial base can be misleading, in particular since these properties do not generate the same net gain to the City as other commerical properties and in fact align closer to the net gain of a residential property.**

- **To diversify our commercial base, Council should set a goal for the types of business the City wishes to attract. A strategic plan should be developed that includes the necessary incentives to attract and retain such businesses.**

C. Federal and State Revenue

The chart on page 17 reflects the revenue sources for the operating budget. However, there are substantial additional federal and state funds not reflected in these numbers. When including the Grant Funding and Special Revenue Funds as part of the City's total budget, federal and state revenue accounts for 20% of that total.

Given the certainty of additional state and federal budget cuts, the City lacks an accurate picture of its financial health in FY 2013 and beyond. Federal and state budget cuts will reduce the City's revenue but will also have a substantial indirect affect on the City's finances. For example, a shrinking federal workforce will likely reduce the tax base of the City, depress home values, and reduce revenue from businesses that are dependent on federal contracts and grants.

D. Debt Burden Issues

BFAAC has long supported adherence to City debt policy guidelines as an important tool in promoting financial discipline and ensuring maintenance of Alexandria's AAA/Aaa bond rating. The guidelines include three benchmarks against which the magnitude of borrowing can be assessed for its impact on the City's fiscal condition: 1) debt service as a percent of general government expenditures; 2) debt as a percent of real property assessed value; and 3) debt as a percent of personal income. For each of these benchmarks, the City sets both targets and limits.

Since the start of the Great Recession in 2008, the City's short-term projections for two of the three benchmarks (debt as a percent of real property assessed value and debt as a percent of personal income) have exceeded the debt policy targets, but not the limits. In its last two reports, BFAAC noted that at some point over the ten-year budget window, all three of the metrics exceeded the targets and approached the limits, and raised concerns that this borrowing trajectory could crowd out the operating budgets.

Whether the Potomac Yard development is or is not included greatly impacts the City's adherence to these debt policy guidelines.

Excluding Potomac Yard Development: With the costs of the Potomac Yard development excluded, FY 2013 budget projections for two of debt policy benchmarks—debt as a percent of personal income and debt as a percent of general governmental expenditures—show deterioration relative to the FY 2012 budget. These two benchmarks have moved closer to the limit compared to last year's budget projections. Two of the metrics—debt as a percent of real property assessed value and debt as a percent of personal income—meet or exceed the targets for the entire budget window, until FY 2022. Last year, these metrics were below targets in several of the out-years.

Including Potomac Yard Development: The City's adherence to its debt policy guidelines in the FY 2013 budget deteriorates with the inclusion of the Potomac Yard development. For both benchmarks—debt as a percent of real property assessed value and as a percent of personal income—the City not only exceeds the target levels, it exceeds the limits between FY 2015 and FY 2021 as well.

The appendix provides a table that compares the City's FY 2013 projections for these three debt policy benchmarks to the FY 2012 projections (which include the impact of the Potomac Yard Metro), as well as to the targets and limits. We call attention to the red shaded areas in the last column, which represent the years in which the relevant debt burden metric exceeds the City's prescribed limits.

For each graph below, we call attention to the blue thick line, which represents the FY 2013 debt percentage for that particular metric without the impact of the Potomac Yard Metro. Note the significant increase in these percentages in both the 2012 and 2013 estimates with the cost of the Metro included, and how inclusion of the Metro moves these metrics either above or closer to the City's debt limits.

Table II: Debt Service as a Percent of Real Property Assessed Value

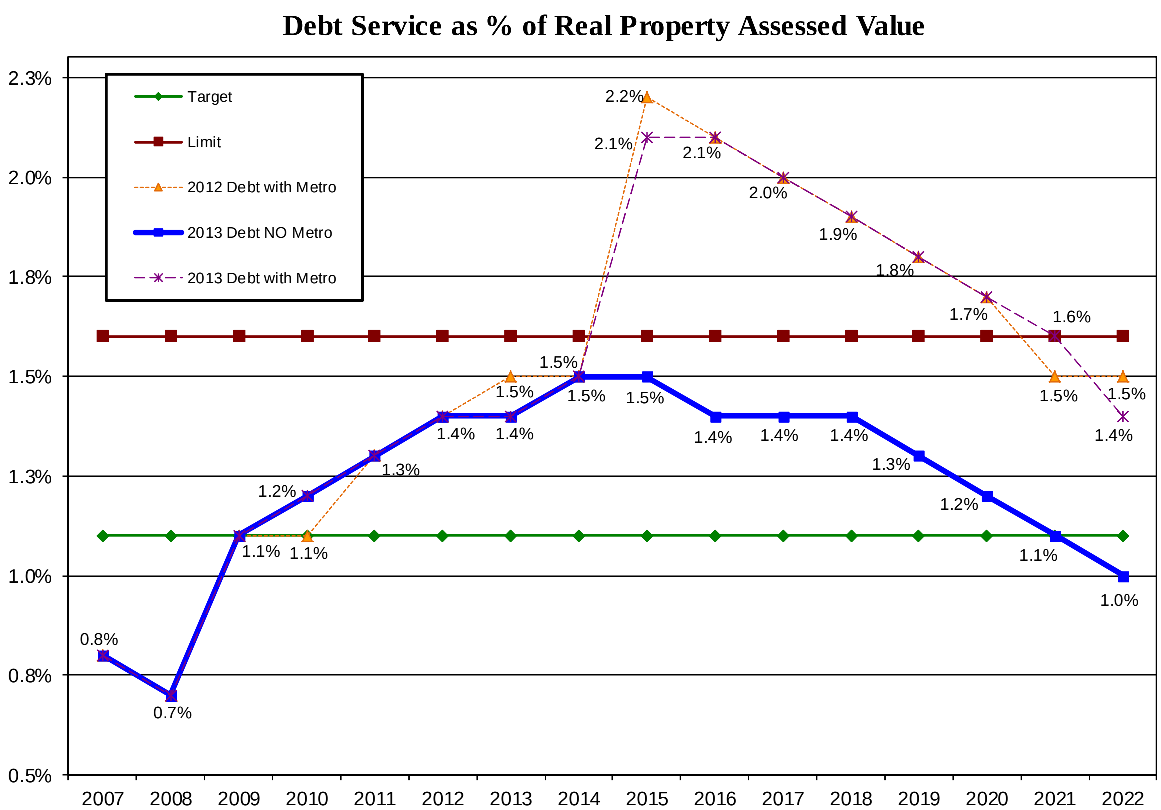


Table III: Debt Service as a Percent of Personal Income

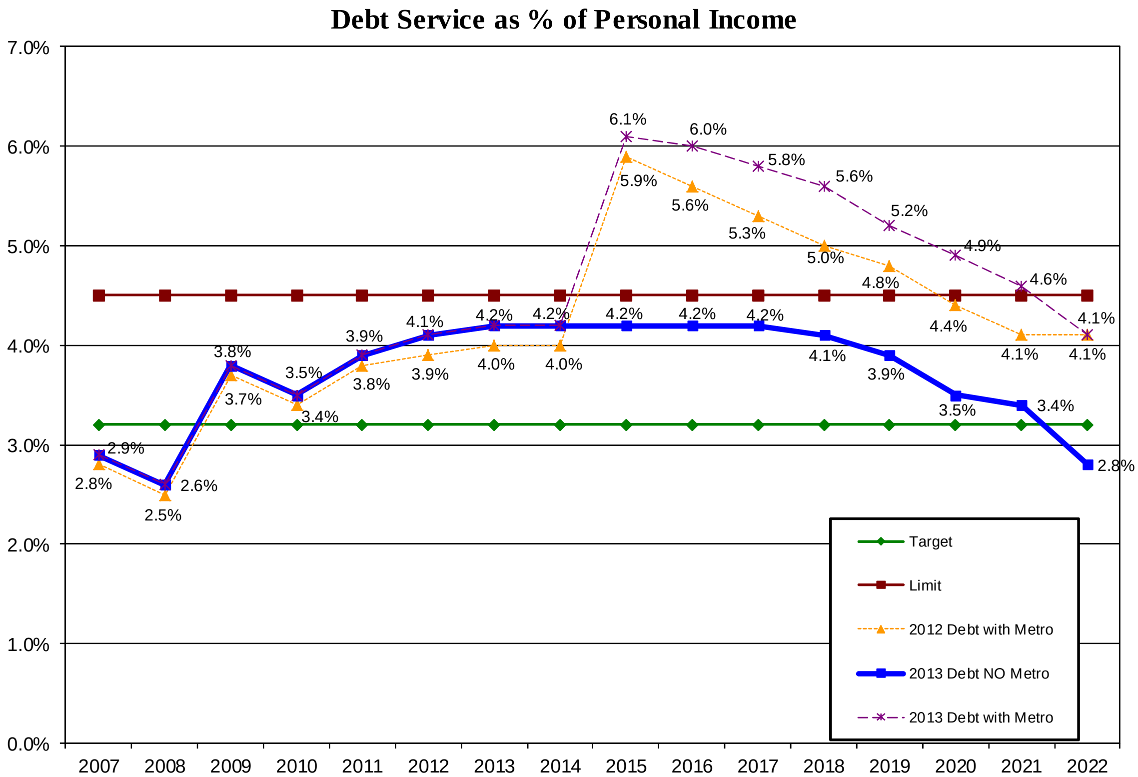
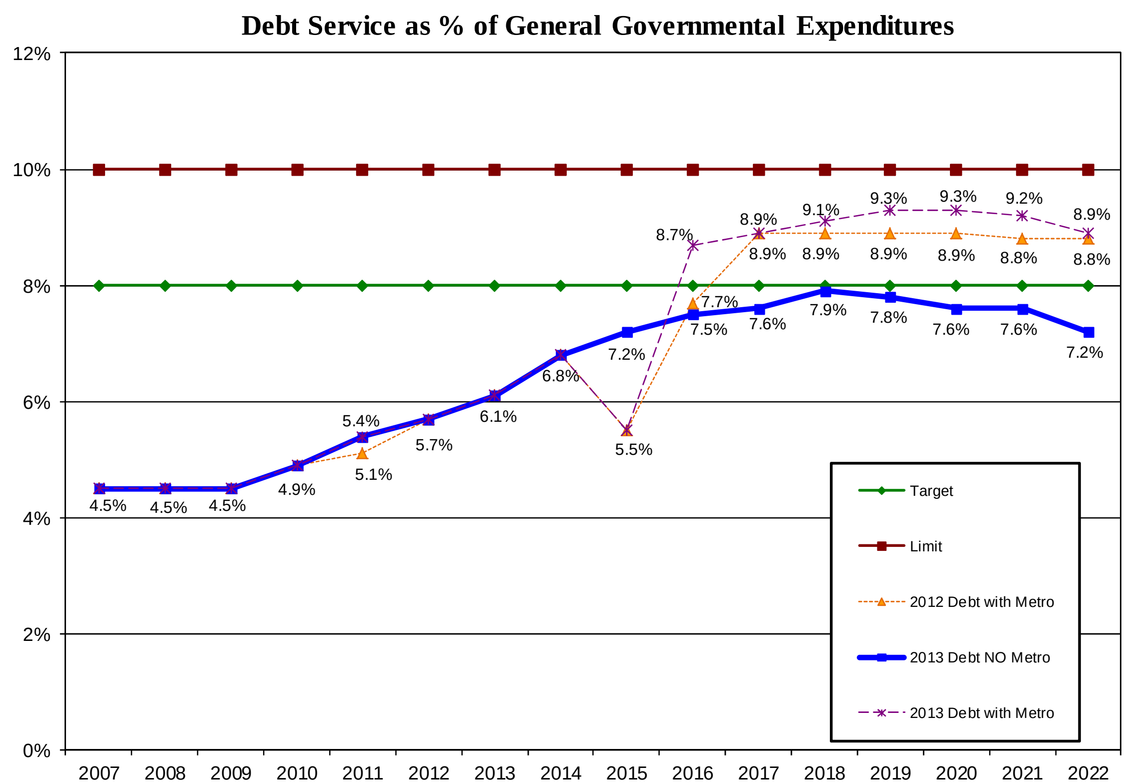


Table IV: Debt Service as a Percent of General Governmental Expenditures



BFAAC cautions that while the debt policy projections in the FY 2013 budget include the impact of the Potomac Yard development, they do not include the full impact of several other planned, high-profile projects that could involve significant amounts of additional borrowing: the full out-year CIP request for the ACPS; the Waterfront Plan; the Landmark/Van Dorn Plan; and the Master Transportation Plan. OMB has informed BFAAC that the impact of these projects is excluded from its debt projections because the costs, including the combination of developer financing and City revenue, are simply not known at this time. The costs of any one of these projects would likely further weaken the City's financial position as measured by the debt policy guidelines.

BFAAC has found borrowing in excess of the City's debt policy guidelines acceptable only if the projects to be funded are essential under strategic goals and result in significant long-term benefit to the City, or represent the City's commitment to fulfill a prior obligation.[19]

OBSERVATIONS AND RECOMMENDATIONS

- **The City's current debt policy targets and limits should not be raised.**

- **Given the Potomac Yard development's very unique features—including being self-financed, projected impact on economic development and estimated long-term revenue stream for the City—BFAAC can make a reasoned case for borrowing as a part of the project's financing as an acceptable temporary exception to the debt policy guidelines. However, we recommend against additional borrowing for any other projects that would cause the City's debt to be further in excess of debt policy limits.**

- **BFAAC emphasizes that FY 2013 debt policy projections do not assume several high profile projects that have been approved and are being executed. We caution that additional borrowing to implement these additional projects would significantly deteriorate the City's performance relative to its debt policy guidelines and adversely impact our AAA/Aaa bond rating.**

[19] Budget Memo #48, BFAAC Report on the City Manager's Proposed Budget for Fiscal Year 2011, p. 30.

APPENDIX

CITY OF ALEXANDRIA DEBT BURDEN METRICS:

2013 Budget Projections Compared to 2012 Budget, City Targets, and City Limits

DEBT AS PERCENT OF REAL PROPERTY ASSESSED VALUE:

				2013 Budget Estimates		Comparisons:		
	Target	Limit	2012 Approved CIP (with Metro)	Without Potomac Yard Metro	With Potomac Yard Metro	2013 Vs 2012 Estimates WITH METRO	2013 Estimate Vs Target WITH METRO	2013 Estimate Vs Limit WITH METRO
2012	1.1%	1.6%	1.4%	1.4%	1.4%	0.0%	+0.3%	-0.2%
2013	1.1%	1.6%	1.5%	1.4%	1.4%	-0.1%	+0.3%	-0.2%
2014	1.1%	1.6%	1.5%	1.5%	1.5%	0.0%	+0.4%	-0.1%
2015	1.1%	1.6%	2.2%	1.5%	2.1%	-0.1%	+1.0%	**+0.5%**
2016	1.1%	1.6%	2.1%	1.4%	2.1%	0.0%	+1.0%	**+0.5%**
2017	1.1%	1.6%	2.0%	1.4%	2.0%	0.0%	+0.9%	**+0.4%**
2018	1.1%	1.6%	1.9%	1.4%	1.9%	0.0%	+0.8%	**+0.3%**
2019	1.1%	1.6%	1.8%	1.3%	1.8%	0.0%	+0.7%	**+0.2%**
2020	1.1%	1.6%	1.7%	1.2%	1.7%	0.0%	+0.6%	**+0.1%**
2021	1.1%	1.6%	1.5%	1.1%	1.6%	+0.1%	+0.5%	**+0.0%**
2022	1.1%	1.6%	--	1.0%	1.4%	--	+0.3%	-0.2%

DEBT AS PERCENT OF PERSONAL INCOME:

				2013 Budget Estimates		Comparisons:		
	Target	Limit	2012 Approved CIP (with Metro)	Without Potomac Yard Metro	With Potomac Yard Metro	2013 Vs 2012 Estimates WITH METRO	2013 Estimate Vs Target WITH METRO	2013 Estimate Vs Limit WITH METRO
2012	3.2%	4.5%	3.9%	4.1%	4.1%	+0.2%	+0.9%	-0.4%
2013	3.2%	4.5%	4.0%	4.2%	4.2%	+0.2%	+1.0%	-0.3%
2014	3.2%	4.5%	4.0%	4.2%	4.2%	+0.2%	+1.0%	-0.3%
2015	3.2%	4.5%	5.9%	4.2%	6.1%	+0.2%	+2.9%	**+1.6%**
2016	3.2%	4.5%	5.6%	4.2%	6.0%	+0.4%	+2.8%	**+1.5%**
2017	3.2%	4.5%	5.3%	4.2%	5.8%	+0.5%	+2.6%	**+1.3%**
2018	3.2%	4.5%	5.0%	4.1%	5.6%	+0.6%	+2.4%	**+1.1%**
2019	3.2%	4.5%	4.8%	3.9%	5.2%	+0.4%	+2.0%	**+0.7%**
2020	3.2%	4.5%	4.4%	3.6%	4.9%	+0.5%	+1.7%	**+0.4%**
2021	3.2%	4.5%	4.1%	3.4%	4.6%	+0.5%	+1.4%	**+0.1%**
2022	3.2%	4.5%	--	2.8%	4.1%	--	+0.9%	-0.4%

DEBT AS PERCENT OF GENERAL GOVERNMENTAL EXPENDITURES:

				2013 Budget Estimates		Comparisons:		
	Target	Limit	2012 Approved CIP (with Metro)	Without Potomac Yard Metro	With Potomac Yard Metro	2013 Vs 2012 Estimates WITH METRO	2013 Estimate Vs Target WITH METRO	2013 Estimate Vs Limit WITH METRO
2012	8.0%	10.0%	5.7%	5.7%	5.7%	0.0%	-2.3%	-4.3%
2013	8.0%	10.0%	6.1%	6.1%	6.1%	0.0%	-1.9%	-3.9%
2014	8.0%	10.0%	6.8%	6.8%	6.8%	0.0%	-1.2%	-3.2%
2015	8.0%	10.0%	5.5%	7.2%	5.5%	0.0%	-2.5%	-4.5%
2016	8.0%	10.0%	7.7%	7.4%	8.7%	+1.0%	+0.7%	-1.3%
2017	8.0%	10.0%	8.9%	7.6%	8.9%	0.0%	+0.9%	-1.1%
2018	8.0%	10.0%	8.9%	7.9%	9.1%	+0.2%	+1.1%	-0.9%
2019	8.0%	10.0%	8.9%	7.8%	9.3%	+0.4%	+1.3%	-0.7%
2020	8.0%	10.0%	8.9%	7.6%	9.3%	+0.4%	+1.3%	-0.7%
2021	8.0%	10.0%	8.8%	7.6%	9.2%	+0.4%	+1.2%	-0.8%
2022	8.0%	10.0%	--	7.2%	8.9%	--	+0.9%	-1.1%