City of Alexandria, Virginia

MEMORANDUM

DATE: MARCH 30, 2006

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER

SUBJECT: BUDGET MEMO #49: BUDGET AND FISCAL AFFAIRS ADVISORY COMMITTEE (BFAAC) REVIEW OF THE FY 2007 PROPOSED BUDGET

The Budget and Fiscal Affairs Advisory Committee (BFAAC) has completed its analysis of the FY 2007 Proposed Budget for Council's consideration. This is an 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 3, 2006.

Attachment

City of Alexandria Budget and Fiscal Affairs Advisory Committee

Report on the City Manager's Proposed Budget for Fiscal Year 2007

Dennis Auld
James Butler, Secretary
Mark Feldheim
Paul Friedman
Margaret Gullen
Holly Hemphill, Vice Chair
Scott Johnson
Dennis Jones
Tim Lovain
Tracy Rickett, Vice Chair
Matt Tallmer
Justin Wilson

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EXECUTIVE SUMMARY

The New Budget Process

BFAAC views the new budget process as an important positive step, with the following observations and recommendations:

- In setting targets for budget growth, we believe that a low target should be set at a level so as to challenge the City Manager to propose innovative ways to restrain spending.
- We suggest that the budget documents provide a more detailed overview of how a current services budget is determined, including all underlying assumptions.
- We generally favor extending the new budget process into future years.

The Operating Budget

- The City should conduct performance and benchmark studies across all departments, and move toward implementation of a pay-for-performance compensation system.
- We recommend that the City carefully scrutinize all new positions for justification of hire.
- The City should combine its compensation policies and reports to include compensation *and* benefits, and these combined data should be made part of any future salary benchmark studies.
- Since compensation increases now include COLA, merit, and adjustments, the City should clearly show these collective impacts in all future budgets.
- We suggest that the City examine the creation or expansion of pay programs, such as bonuses, that do not raise the salary base.
- The City and ACPS should complete the health care consolidation process. The City should also study the option of self-funding for health insurance, including ways to mitigate the cost of catastrophic loss through the purchase of catastrophic loss insurance.
- A priority for both the City and ACPS should be to study measures to contain increasing costs for employee health insurance, but take a balanced approach to change over time.

The Capital Improvement Program (CIP)

- The City should study the feasibility of storm sewer user fees to help cover the cost of storm sewer reconstructions and extensions and to address the ground contamination at the Oronoco Sewer Outfall. The goal should be to have storm sewer costs fully-funded by user fees in the same manner that the City's sanitary sewer line maintenance fees cover those costs.

- The City should look first at utilizing a current City-owned building for relocation of the school administration.

- Given the likelihood that the cost of the proposed new police headquarters will exceed the estimated cost of $44 million, BFAAC urges Council to be especially vigilant regarding oversight of this project to ensure that sound financial decisions are made as it goes forward.

Revenues and Outlook

- We believe that arbitrary caps on expenditure growth or on tax increases are not useful and we do not recommend them. We do, however, urge City Council to be especially cautious in setting property tax rates that result in tax/personal income ratios above historical ranges.

- We suggest that, if Council wishes to consider further reductions in the real property tax rate over what the City Manager has proposed to reach the lower growth increase target, Council should look first to fund any such reduction by reducing the operating budget of the City and Schools or finding new, on-going revenue sources.

- The City should take prompt action to develop an overall economic development strategy and, within that strategy, provide for necessary planning, policy guidance and oversight of City spending on economic development activities. There is no reason to delay implementation of the direct City Manager oversight recommended herein.

- Economic development planning, policy guidance and oversight should be a City staff function, reporting to the City Manager, so that economic development activities are subject to the same type of management, control and budgetary review as are other important City functions.

- The City needs to take a close look at the funding of outside economic development organizations to assure that the City is getting an appropriate benefit for the costs incurred.

- BFAAC acknowledges that the use of decals as the primary enforcement mechanism for personal property taxes may need to be phased out. The City should prepare to make the transition to primary enforcement using methods other than decals.

- BFAAC encourages the City to consider all available forms of enforcement in collection of personal property tax revenues. We further recommend that the City explore administrative changes to the Personal Property Tax—including automatic vehicle registration using DMV data and semiannual payments.

- At such time (FY 2008 or later) as state reimbursement of the Personal Property Tax revenues fall below the capped threshold of 70% of value for vehicles $20,000 and less, BFAAC supports a City policy of using additional Personal Property Tax collections to fill the gap.

- BFAAC strongly supports the City Manager’s proposal to begin the process of saving for other post-employment benefits (OPEB) obligations for City employees. We support the reprogramming of $8.7 million and urge the creation of an irrevocable trust fund invested in compliance with the City’s investment guidelines.

- BFAAC urges the ACPS to complete an actuarial study to determine ACPS OPEB obligations and work towards the creation of an irrevocable trust fund to begin saving for these obligations as soon as FY 2007.

- BFAAC suggests that the City may wish to examine the sale of OPEB obligation bonds to fund an OPEB trust fund if feasible and prudent.

- BFAAC cautions against any changes to current retiree health insurance benefits at this time, but urges future vigilance should OPEB funding costs become unsustainable in future budget years.

- The one cent set-asides for open space and affordable housing should be reviewed annually in the context of other needs and priorities.

- BFAAC renews its recommendation that the Council place a “sunset” on any adopted set asides. The set-aside should be given a period of time (3-5 years, for example) to establish efficacy, but should expire unless explicitly renewed by Council.

I. THE NEW BUDGET PROCESS

Last Spring, following Council's approval of the FY 2006 budget, Council adopted Resolution 2150, establishing a new framework for future budget planning. The resolution, applicable to the FY 2007 budget process, established the concept of a baseline services budget as an initial discussion point. In establishing this new process, Council recognized the rising real property tax burden on City residents and affirmed Council's commitments to managing the growth of both City operating and capital expenditure budgets. Under the new framework, more time for Council and community deliberations on budget issues was built in.

In accordance with the new framework, the City Manager presented a preliminary budget forecast in the fall, taking into account the Council's established strategic objectives and the expenditures needed to maintain current services. The Council then adopted a budget resolution to guide the City Manager's preparation of the FY 2007 proposed operating budget and the FY 2007-2012 capital improvement program budget. For the first time, Council provided targets for expenditure growth. Council set a high target of 8.5% and a low target of 6.0% for growth in total expenditures.

In January and February 2006, the City staff held a series of three Community Pre-Budget Briefings to enable residents to better understand budget challenges and issues facing the City, to explain budget processes and schedule, and to listen to suggestions and concerns of residents. More helpful information regarding the budget has been included on the City website.

Further pursuant to Resolution 2150's framework, the City Manager presented a proposed budget on February 14, 2006, about three weeks earlier than in the past. The proposed budget presented alternatives at 7% and 6% General Fund budget growth, with options set forth to reach the lower target. A series of hearings was set for Council consideration of the proposal and for community input, including a work session with this Committee, culminating with the adoption of the budget by Council on April 24.

BFAAC views this new budget process as an important positive step. This Committee has long advocated greater transparency in the budget process and more opportunity for community participation. We had previously recommended that budget decisions be made in the context of a long-term strategic plan, and based on a current services budget. We are pleased that these features have been incorporated into the new process. We believe that the additional time provided should result in fuller deliberations. While representatives of the Alexandria City Public Schools have expressed some reservations about the new budget cycle because it requires forecasting and planning during a busy time in the school year and at a time when not all relevant information is known, we trust that these reservations will prove to be transitional in nature and that appropriate administrative adjustments can be made in the Schools' own budgeting process to accommodate the new schedule. We view the setting of targets for expenditure growth as a good tool to manage spending.

We have the following observations and recommendations:

- **In setting targets for budget growth, we believe that a low target should be set at a level so as to challenge the City Manager to propose innovative ways to restrain spending.** Many observers do not view a 6% growth increase as being in the "low" range. The range between the high and low targets should be sufficiently wide so as to allow for consideration of a number of feasible budgetary options.

- We believe that one advantage of a current services budget is its potential to improve the dialogue between the Council and constituents on the budget and real property tax issues. As we noted in our report last year, we think taxpayers would appreciate understanding what a current services budget includes and why. **We suggest that the budget documents provide a more detailed overview of how a current services budget is determined, including all underlying assumptions.**

- **The new budget process appears promising and we generally favor its extension into future years.** The effectiveness of the process should be continuously reviewed. BFAAC points out that the dual goals of transparency and community input would be better served if significant last-minute changes to the budget or budget process were kept to a minimum.

II. THE PROPOSED OPERATING BUDGET

The FY 2007 Proposed Operating Budget contains several cost drivers. Among them are staff compensation, transit subsidies, debt service, rent and facility maintenance, and grant match increases. BFAAC focused this year's Operating Budget review on Personnel and Health Care Cost Containment.

A. Personnel

1. New Hires

Although the City Manager's Proposed FY 2007 Budget is a "current services budget," meaning services are maintained at the previous year's level, the City is still asking for 6.75 new Full Time Equivalent (FTE) positions. This is on top of the FY 2006 increase of net 39 FTE positions, also a "current services" budget.

BFAAC notes that taxpayers may find it difficult to understand how a budget that ostensibly does not increase service delivery should require new personnel. As we have stressed in past reports, because of the impact on costs, new hires should be carefully scrutinized for justification of need. Although the City gets good marks for not adding new services, it must also check the growth of existing services and personnel.

2. Compensation

The Proposed FY 2007 Budget includes several pay adjustments to remain competitive with other jurisdictions. These include: 3% COLA ($5.7 million); merit increases of $2.8 million; and an adjustment equal to $4.0 million (mostly for non-sworn public safety personnel), for a total increase of $12.5 million in City revenue allocated to compensation. This is equivalent to a 6.6% increase. Such an increase is more than inflationary. A counter check to this pressure is to either improve productivity, and/or develop a compensation component that does not raise the salary base.

The City consistently expresses the opinion that it will lose employees to surrounding jurisdictions if it cannot compensate equally. This may be a justifiable position. While studies show that the City is not the leader in salary compensation, it is an area leader in benefits. BFAAC believes that the City should address the salary compensation issue (which is controllable), and reduce its benefits compensation (which is not controllable).

In order to be competitive, yet affordable, we believe that the City should incorporate a pay-for-performance system. It should look to increase the productivity of staff, thereby achieving greater output on less input.

It should also look at compensation measures that do not raise the base, such as the use of a more frequent and extensive bonuses for outstanding work. By shifting emphasis from uncontrollable factors, to controllable ones, the City will significantly enhance its ability to control this budget driver. The City Manager has told Council that he will not submit a pay-for-performance plan that is not fair and objective. One major way to ensure that such a plan is, in fact, fair is for the

City to begin benchmarking jobs and departments, thus allowing it to have an objective method of analyzing employee performance. BFAAC endorses the City's moves in that direction, and encourages further action. BFAAC supports the City's efforts in soliciting and obtaining suggestions from departmental staff as to how to improve City services with greater efficiency and quality. BFAAC also supports the City's efforts in departmental performance reviews and benchmarking studies (currently on-going for the Fire, Administrative, and Transportation and Environmental Services Departments) and strongly encourages the City to be aggressive in implementation of the consultant's recommendations.

Recommendations:

- **The City should conduct performance and benchmark studies across all departments, and move toward implementation of a pay-for-performance compensation system.**

- **The City should carefully scrutinize all new positions for justification of hire.**

- **The City should combine its compensation policies and reports to include compensation *and* benefits, and that these combined figures be made part of any future salary benchmark studies.**

- **Since compensation increases now include COLA, merit, and adjustments, the City should clearly show these collective impacts in all future budgets.**

- **The City should examine the creation or expansion of pay programs, such as bonuses, that do not raise the salary base.**

B. Health Care Cost Containment

1. Analysis

Health care costs for both City and School employees are a major and growing portion of the City's budget. During FY 2007, health care costs are projected to rise by 17.6% or $18.3 million. Not only are these costs rising year to year, but more importantly, they are taking a larger portion of the City's "non-discretionary" budget. Between FY 2000 and FY 2004, health care costs went from 2.9% of the General Fund Budget (not including ACPS) to 4.0%. Over that same period, the cost of total benefits went up 43%.

Of the 2,203 active employees who use City health insurance, 1,885 pay no premiums; only 318 opted for a health insurance program that requires employee premium contributions. In addition, 647 retirees currently have health insurance, with 425 in City health plans, and 222 in non-City plans—but those retirees are currently reimbursed up to $260 per month.

Health Insurance Premium Cost Sharing ($ per month)*

	Kaiser				Optimum Choice			
	HMO		POS		HMO		POS	
	Ind.	**Fam.**	**Ind.**	**Fam.**	**Ind.**	**Fam.**	**Ind.**	**Fam.**
Employee Share	$ 0	$ 0	$152	$358	$ 0	$ 0	$ 49	$ 109
% of Total	0%	0%	32%	32%	0%	0%	14%	13%
City Share	$323	$762	$323	$762	$314	$740	$314	$740
% of Total	100%	100%	68%	68%	100%	100%	86%	87%

* Part-time employees pay between 50% and 66% of premium costs

Comparison with Neighboring Jurisdictions of Health Benefits for Active Employees

	Alexandria	Fairfax	Arlington	Montgomery	Prince Georges
% of Premium Paid by Govt.					
Full-time Employee	68% to 100%	75% to 85%	80%	76% to 80%	75% to 80%
Part-time Employee	50% to 66%	75% to 85%	80%	76% to 80%	75% to 80%
Co-Pays					
Physician Visits	$15 for in plan services	$10	$10 to $20	$5 to $20	$15 to $20
Prescriptions	$10 to $35	$10 to $40	$13 to $40	$4 to $35 with CareMark	$6 to $100 (with $50 annual deductible
Emergency Room (waived if admitted)	$50	$50	$50	$30	NA

As indicated in the Personnel section, although the City is not a leader in salary compensation, it is an area leader in benefits. Because of the inability to control costs, BFAAC strenuously opposes a policy that strives to be a leader in benefits.

Neither the City nor major corporations can control health care and benefit costs, and, as a result, cannot predict the year-to-year expenses or growth rates. The only thing the City can control is its' salary levels (and thereby retirement benefit costs).

Finally, BFAAC reiterates its previous recommendation that health care and other benefits be included in any future salary benchmark studies, as the City pays both salaries and benefits, and perspective employees consider the overall compensation package (salary and benefits) when choosing between job offers.

2. Health Care Cost Containment Strategies

In response to Council's request, BFAAC issued an Interim Report on October 29, 2005, at the City Council Retreat. We stand behind that report and its recommendations. It is important for Council to understand that there is no single solution to containing health care costs. Rather, the City should undertake a series of steps, some of which are outlined below, to slow the growth of health care costs and insurance premiums.

Self Funding

In our October 2005 report on health care, we recommended the City explore fully combining its health plan with that of ACPS and self-funding those programs. Under self-funding, the City would hire an insurance company to administer the plan, but the City would continue its relationship with the health insurance companies, but the City would pay the claims out of a fund credited from the operating budget payments. The risk to the City in self-funding is that if claims costs surpass the allocations, the City would have to draw down the difference from the current year's operating budget or from reserves. This year, it appears that neither MAMSI/United HealthCare nor Kaiser is prepared to administer a plan that the City would self fund.

We once again recommend the City and ACPS explore fully combining health insurance programs and self-funding, but note that even if the City and ACPS combine and self-fund their health insurance programs, the savings from this arrangement will be minimal—on the order of a few percent.

Health Savings Accounts

Consumer-driven health care funding options, such a Health Savings Accounts (HSAs) have the potential to power costs and stem the tide of double-digit future premium increases. Both United Healthcare (MAMSI) and Kaiser either have current consumer-driver plans or plan to offer one in the future. These options include an HSA coupled with a high-deductible medical insurance plan. These accounts enable employees to use pre-tax money saved in the HSA to pay medical expenses, including deductibles, co-pays, out-of-pocket prescription expenses, eyeglasses, etc., or to save such funds for medical emergencies in future years while employed. BFAAC recommends that the City monitor public sector adoption of consumer-driven health funding plans, and explore future implementation as appropriate.

Changes in Plan Design

Another method of reducing health care costs could involve changing the plan design, either through increasing premiums or co-payments, or banding – which could involve establishing a sliding scale of premiums and/or co-payments based on an employee's salary. One way to accomplish this would be by establishing multiple premium tiers. A higher level of packaging and presenting the plans to the employees such that lower-cost, good-quality plans are selected can aid in lowering costs. By working with the insurers to analyze claims data, the City could potentially lower costs by structuring more effective tiers and co-pays.

We believe that efficiencies and cost-cutting measures not directly involving employee premiums should be the focus of early efforts on cost reductions; however, the City and ACPS may at some point, probably sooner rather than later, require employees to pay a share (and likely an increasing share) of the premium of coverage that is now paid entirely by the employer. BFAAC recommends that such a review should begin now. The study should involve responsible City and ACPS officials, employee representatives, insurance consultants for the City and ACPS, and include a survey of comparable costs and approaches in nearby jurisdictions.

Any action, as opposed to study, should avoid changing many facets of insurance plans, carriers or coverage all at once. Wholesale and sudden attempts to improve the City's fiscal condition in this regard may be disruptive to overall operation and relations with employees. Also, rapid changes may take a great deal of time to produce significant results, and in fact, may not be a straight-line improvement. Taking action is necessary, but action should be carefully planned, with a multi-staged approach to any changes.

Health Education

The City could also realize savings by making employees more sensitized to health care costs, and providing them with more information to make informed decisions. We applaud the City's efforts to conduct fitness activities, providing limited amounts of exercise equipment and encouraging employees to take preventive measures. Expanded programs of this nature should be explored as a means of improving health and assisting in reduction of health care costs for employees and the City. In addition to such programs as health fairs and fitness seminars, there could be incentives for participation (or disincentives, such as increased premiums for non-participation), or expanding the current wellness programs. We note that similar programs currently used by other municipalities and counties have produced minimal cost savings, due largely to a federal law that restricts revealing personal health care information.

Recommendations:

- **The City and ACPS should complete the health care consolidation process. The City should also study the option of self-funding, including ways to mitigate the cost of catastrophic loss through the purchase of catastrophic loss insurance.**

- **A priority for both the City and ACPS should be to study measures to contain increasing costs for employee health insurance, but take a balanced approach to change over time.**

III. THE PROPOSED CAPITAL IMPROVEMENT PROGRAM

A. Overview

For a number of years now, the City has made substantial investments in the future of Alexandria through the maintenance, upkeep and renovation of our existing physical infrastructure as well as through the planning, construction and purchase of major new facilities and systems. The proposed Capital Improvement Program (CIP) would continue on that course.

The following chart shows the growth of the CIP over the past ten years (the City's share as well as the total CIP).

Approved Six-Year CIP Budgets
($ in millions)

Years Covered	1998-2003	1999-2004	2000-2005	2001-2006	2002-2007	2003-2008	2004-2009	2005-2010	Approved 2006-2011	Proposed 2007-2012
City Share	$123.8	$137.4	$118.0	$156.3	$197.3	$183.8	$340.1	$318.2	$326.8	$331.5
Percent Change	16.8	11.0	-14.1	32.5	26.2	-6.8	85.0	-6.4	2.7	1.4
Total CIP	213.5	246.2	232.9	267.0	342.2	353.0	558.1	566.7	566.8	574.4

The FY 2007-FY 2012 CIP totals $574.4 million, of which $331.5 million is the City's share, an increase of 1.4% in the City's share of the CIP and a 1.4% increase in the total amount of the CIP.

On the whole, BFAAC believes the Proposed CIP meets legitimate long-term capital project needs. However, as with last year's report, BFAAC wishes once again to raise a significant warning. The building of the new high school and a proposed new police headquarters on Wheeler Avenue, the increased contribution to transit costs, the proposed renovation and expansion of Chinquapin Recreation Center, the significant increase in proposed sewer projects, and the proposed construction of a new All-City Sports Facility keeps the CIP on an upward trajectory.

As a result, the City continues to be challenged to find ways of keeping its capital spending within the City's Debt-Policy Guidelines. Last year, the City's Approved CIP pushed back the completion date for the new Public Safety Center from FY 2008 to FY 2009 so as to keep the City within the Guidelines. This year's CIP moves the completion date for Chinquapin from FY 2008 to FY 2010. While BFAAC finds the City's decisions on those issues to be sound, it nonetheless highlights just how large the CIP budget has become and how mindful the City has to be not to implicate the Debt-Policy Guidelines. BFAAC is concerned about the following:

1. The City share has grown again this year despite a long list of unfunded capital needs that are not included in the current CIP. For example: a new public school administration building although the Schools' lease runs out in 2010; full-funding for

the renovation and expansion of the Minnie Howard Ninth Grade Center; a new fire station beyond the $3.6 million allocated for initial design and land acquisition; renovation of the current public safety center to provide much-needed relief from the overcrowding currently occurring on a daily basis at the Detention Center; and the myriad renovation, refurbishing and improvement projects needed throughout the City. It will be difficult to sustain an expanding CIP and remain within the City's Debt-Policy Guidelines unless the City is careful to set reasonable priorities among competing projects and establish realistic funding timetables.

2. The CIP relies on non-City funding sources for $145 million in funding, much of which is for traffic improvements/rapid transit ($55.9 million); streets and bridges ($31.5 million); community development, including Woodrow Wilson Bridge improvements ($37.7 million); parks and recreation ($11.9 million); and information technology plan ($7.2 million). Should these non-City funding sources fail to materialize, the projects covered in the current six-year CIP may have to be cut back or delayed.

3. Cash capital contributions have been critical to expanding the CIP. For the first time in a number of years, the cash capital contributions to the CIP have actually declined. BFAAC agrees with the reduction in cash capital contributions to the CIP from $28 million last year to $12 million this year and the annual increase of $3 million per year through 2012. For the last few years, Alexandria's taxpayers were paying more than their share for benefits that will also be enjoyed by future residents and this move by the City will ensure that the cost of the CIP projects is shared more equitably between today's Alexandrians and future generations.

4. Under the City's current Debt-Policy Guidelines, Alexandria is well within its target borrowing capacity when measured against the value of the City's real property tax base; however, Alexandria comes near its target borrowing capacity through 2011 when measured against the income of its residents even after postponing funding for the new police headquarters until 2010. Even if the Debt-Policy Guidelines are adjusted (as per BFAAC's recommendation two years ago), the City will be near the target borrowing capacity for each year of this budget under one of the three guidelines BFAAC considers critical in evaluating the budget. Simply put, the City should feel constrained about incurring additional debt for the duration of this CIP under the current guidelines.

5. In order to meet the Alternative Budget Target set forth by the Council, the CIP lists a total of $3.8 million in "Desirable" and "Highly Desirable" projects that can be postponed to 2008 or eliminated altogether [p. 21.] Traditionally, BFAAC has taken the position that in order to fund reductions in the real property tax rate, Council should first reduce the Operating Budget of the City and Schools or find new, on-going revenue sources. In this instance, however, BFAAC agrees with the City's proposal. If the City Council wants to budget less than the 7% increase recommended by the City Manager, then it should also take a serious look at proposed projects in the CIP budget, in particular, those projects set forth on pages 21-24 of the CIP described as "Desirable Projects to be Postponed or Eliminated."

B. Specific Findings

The City-share of this year's proposed CIP contains $331.5 million in planned expenditures, just a 1.4% increase over last year's CIP. A year-by-year comparison, however, shows substantial annual increases of planned expenditures in nearly every year of this budget over the Approved CIP for FY 2006-2011.

Proposed FY 2006 Six-Year CIP City Share
vs.
Proposed FY 2007 Six-Year CIP City Share
($ in millions)

	2006	2007	2008	2009	2010	2011	2012	Total**
Approved FY 2006-FY2011	$67.8	$66.8	$83.4	$52.2	$31.1	$25.2	n/a	$326.8
Proposed FY 2007-FY 2012*	n/a	$67.5	$99.9	$49.8	$48.7	$34.7	$30.6	$331.5
Percent Change	n/a	1.0%	19.7%	-4.6%	56.6%	37.7%	n/a	1.4

* These numbers reflect the City Manager's Proposed FY 2007-FY 2012 CIP budget presented on February 14, 2006.
** Totals amounts differ due to rounding up formulation.

1. City Transit Projects

Washington Metropolitan Area Transit Authority. The WMATA Board of Directors approved "Metro Matters" and "Beyond Metro Matters" Capital Improvement Program which identified $1.1 billion in urgent capital needs of the region's bus and rail transit system over the next six years. Alexandria's share of that in this CIP is $49.1 million. Unless the City can find State funding sources, an additional $11 million in City revenues may be needed to fully fund Alexandria's share of the WMATA six-year CIP.

Bus Replacement. The DASH Transit Development Program has proposed spending $9.7 million to replace 29 buses during the six-years of the CIP. That is nearly half of the 59 buses in DASH's fleet. Each of the buses will have reached their useful life of 12 years. The additional cost in this CIP over last year's has to do with the increase in the cost of a bus from $321,250 to $334,750.

Dash Facility. The estimated cost to build a new DASH facility (without an enclosed bus storage area) is $22.8 million. A total of $23.3 million in unallocated prior year VDOT monies remain in this CIP for the construction of the new facility. The remaining VDOT funds are inadequate to build the facility with an enclosed bus storage area; however, the City believes that it will be able to work out a financing plan with VDOT that will allow it to construct such a facility that will have a total cost of approximately $35 million. The budget does not include a discussion of how the City intends to proceed if those additional VDOT funds do not materialize.

2. Sewers

Sanitary and Storm Sewers. Beginning in 2004, as the result of a review of the City's sanitary sewer line maintenance fee charge, the City decided to begin implementing a $0.20 increase per year for five years until the fee reached $1 per 1,000 gallons of water consumption. As a result, the revenue generated, at least for now, fully funds the City's sanitary sewer maintenance requirements. This budget includes $28.7 million in sanitary sewer projects, of which $14.5 million is allocated to projects not yet determined. On the storm sewer-side, which currently has no user fees like those for sanitary sewers, the City has $5.7 million allocated for storm sewer reconstructions and extension and $1.5 million in funding to address the ground contamination at the Oronoco Sewer Outfall.

Recommendation:

- **Council should ask staff to study the feasibility of storm sewer user fees to help cover the cost of storm sewer reconstructions and extensions and to address the ground contamination at the Oronoco Sewer Outfall. The goal should be to have storm sewer costs fully-funded by user fees in the same manner that the City's sanitary sewer line maintenance fees cover those costs.**

3. Recreation, Parks and Open Space

Chinquapin Park and Recreation Center. As with last year's CIP, $20 million has been budgeted for the expansion and renovation of the Chinquapin Recreation Center. The timetable for completing the project, however, has changed as a result of the time it will take to design and construct the expansion and renovation following the completion of the TC Williams project. The first piece of the project will be the construction of the new parking lot facility. That phase was once scheduled to be completed in FY 2007, but will now be completed by the end of FY 2008. The actual renovation and expansion project on Chinquapin, which was originally slated to begin and end in FY 2009, is now spread out over both FY 2009 and 2010.

Open Space. This year the $0.01 levied on each $100 of the assessed value of all real property in the City will amount to a contribution to the Alexandria Open Space Trust Fund account of $3.3 million, up from $2.8 million last year. If no expenditures are made in FY 2007, the fund will end with a balance of $15.7 million, after being reduced by, among other things, $864,373 in debt service costs. We refer you to page 25 of the Revenue Section of our report for our observations and recommendations on Dedicated Revenue Sources.

All City Sports Facility. This year's CIP has allocated $11.2 million to fund an All-Sports Facility in Eisenhower Valley, which is an increase of $1.2 million over last year's budget. In addition, the timing of the project has once again moved back a year. It is now scheduled to be completed in FY 2008. Private funds are to make-up $5 million of the total cost of the project. BFAAC supports the agreement reached between the Alexandria Capital Development Foundation and the City that requires that 75% of the money secured by private fund raising efforts be in hand prior to the City going to bid for construction of the facility. We are concerned that the current time line for completion is unrealistic given the requirement for private funds.

4. Alexandria City Public Schools

The School Board's Approved Capital Improvement Program budget for FY 2007-FY 2012 requests a City appropriation of $97,893,285, a decrease of 9.2% over the six-year period adopted last year. The City Manager's proposed CIP includes $87,201,035 to fund the Schools' adopted CIP, or 89% of the requested amount.

Minnie Howard Ninth Grade Center. The discrepancy in funding between the City Manager's proposed CIP and the School Board's approved CIP begins to come into play in FY 2009 and continues though 2012 (FY 2007 and 2008 are fully-funded by the proposed CIP). What's at issue is the renovation and expansion project at the Minnie Howard Ninth Grade Center. The City budget has left placeholder amounts in FY 2009 and 2010, which are $10.6 million less than the amount requested for that project by the School Board. As with last year's proposed budget, the Manager states by way of explanation that: "[a]s the project nears initiation, trends in construction costs and enrollment are better known, funding will be identified in a future CIP." BFAAC finds the Manager's approach to be reasonable.

Fully-Funded School Projects. The City Manager's proposed budget includes $27.1 million for School projects (e.g., roof repair, window replacement), $8.4 million in educational support (e.g., FF&E, bus replacement, maintenance and transportation facility), $5.5 million in general maintenance (e.g., renovations, landscaping renewal, building systems), $44 million in new construction, and $1.7 million for miscellaneous (e.g., rowing facilities, City mandates). BFAAC reiterates and supports the position it took in last year's report that for the past few years the City has been adequately funding the modernization and maintenance of the Schools' facilities and we recommend that the City continue to do so.

School Administration Building. For a number of years now we have expressed concern over the lease arrangement of the school administration. The cost of building a new facility could be expensive and could further negatively impact the City's debt policy guidelines. We generally recommend that the City look first at utilizing City-owned property for its real estate needs, including relocation of the school administration.

Recommendation:

- **Council should look first at utilizing a current City owned building for the relocation of the school administration.**

5. Proposed New Police Headquarters

This year's CIP includes $4.8 million in architectural expenses for the proposed new police headquarters on Wheeler Avenue. Authorizing the $4.8 million to move forward on this project and, in particular, taking other related actions regarding City property on Eisenhower Avenue, means, in the words of the City Manager's office, "there is no turning back." The proposed facility, when built, will house the City's police force, which is currently divided among three separate leased office spaces in addition to the public safety center. One of the leased spaces–the one at Hoffman–is not expected to be available to the City after 2012. As a result, Council should be aware that this is a critical year in the life of this project.

BFAAC does not take a position on the necessity or desirability of having a single police facility. However, BFAAC is concerned about the potential impact on the City's budget of the proposed project. Given the significant increases in the cost of construction over the last few years, the new police headquarters could end up costing far more than $44 million, which was the estimated cost a number of years ago. The impact of the project on the City's debt policy guidelines is already considerable. Revised cost estimates could further reduce the City's borrowing flexibility.

Recommendation:

- **Given the likelihood that the cost of the proposed new police headquarters will exceed the estimated cost of $44 million, BFAAC urges Council to be especially vigilant regarding oversight of this project to ensure that sound financial decisions are made as it goes forward.**

6. Information Technology

The FY 2007-2012 CIP includes $18 million in City funds and $5.8 million in outside funds for the City's IT Plan. For FY 2007, the CIP includes $4.6 million in City Funds and $2.3 million in outside funds. Of particular note, the budget includes $1.5 million for replacement of the City's E-911 system, including both software and hardware, to ensure continued operation of the communication and response network for the City's emergency services**.** BFAAC supports a life cycle replacement plan for keeping the City's information technology infrastructure up to date.

IV. REVENUES AND OUTLOOK

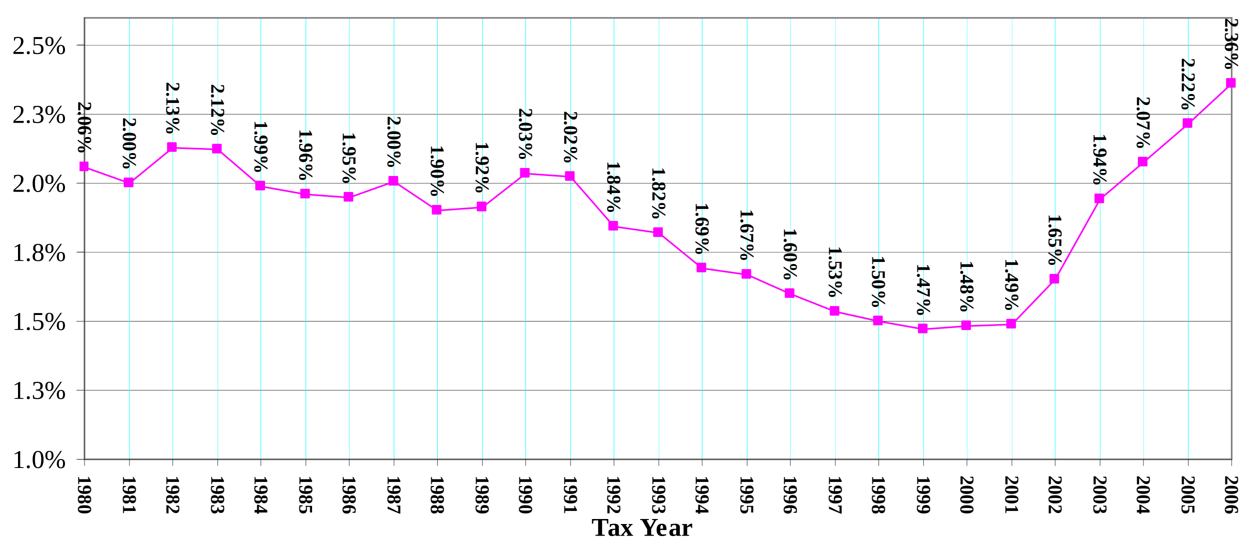
BFAAC has the following observations and recommendations regarding revenues and the outlook for the future.

A. Tax Rate Issues

In BFAAC's report on the FY 2004 budget, we tracked the percentage of per capita income that goes to pay the residential real property tax. At that time data indicated that Alexandrians historically have paid in the range of 2.25% and 1.41% of personal income for real property taxes. We recommended that the City Council monitor the real property tax burden using these historical ranges instead of applying arbitrary caps of any kind.

The updated chart below shows that since 1980 the proportion of City resident personal income that goes to pay the residential real property tax has rarely been above 2.00%.[1] In 19 of 26 years, the ratio of taxes to income was 2.00% or below. Since 2001, however, the ratios have been on a steep upward trajectory, increasing to 2.36% in 2006. The percentages for FY 2005 and FY 2006 are above historical highs and should be cause for concern. City staff estimates that at the 7% and 6% growth rates proposed by the City Manager, the percentages of real property tax to personal income would increase again in FY 2007, continuing to be well outside the historical range.

Residential RE Tax Revenue Compared to Per Capita Income 1980-2006



[1] The chart includes multi-family rental properties, as well as single family, under the assumption that most landlords pass along rising property taxes to tenants in the form of higher rents.

Recommendations:

- **We continue to believe that arbitrary caps on expenditure growth or on tax increases are not useful and we do not recommend them. We do, however, urge City Council to be especially cautious in setting property tax rates that result in tax/personal income ratios above historical ranges.**

- **As we have in the past, we suggest that, if Council wishes to consider further reductions in the real property tax rate over what the City Manager has proposed to reach the lower growth increase target, Council should look first to fund any such reduction by reducing the operating budget of the City and Schools or finding new, on-going revenue sources.**

While it may be tempting to fund a tax rate reduction using cuts in cash capital or other "one-shot" approaches, such schemes will not help the City next year when it comes time to pay for ongoing and recurring expenses.

B. Debt Policy Guidelines

BFAAC strongly supports efforts to remain within the City's Debt Policy Guidelines. These guidelines include several benchmarks against which the magnitude of borrowing can be assessed for its likely impact on the City's fiscal condition. The guidelines were developed with an eye toward maintaining the City's double triple-A bond rating. The double triple-A rating gives the City some slight economic savings due to the lower interest rate afforded such bonds; however, the rating is most significant as an objective, independent marker of the City's creditworthiness and fiscal discipline.

For the past 2 years, BFAAC has recommended revising the debt guidelines related to personal income to recalibrate it in relation to the marked increases in real property values. We do so again. This is not to raise the ceiling to accommodate additional borrowing. Rather, it is to preserve the integrity of the guidelines and provide an accurate historical record of the guideline metrics.

C. Revenue Diversification

BFAAC has long urged Council to maintain a long-term perspective in budget matters. We renew our concern about the dangers of the City's heavy reliance on real property taxes. After many years of growth in the real estate tax base, mostly due to appreciation, values are now showing signs of slowing. We urge the City to continue efforts to diversify its revenue sources. City staff has advised BFAAC that a new source of revenue that raises $3.3 million would be equal to the amount raised by one cent of the real estate tax on an annual basis in FY 2007.

1. Economic Development

The importance of economic development in maintaining a sustainable and predictable revenue source to the City has been well recognized in the annual budget process. However, in light of the City's limited ability to pursue revenue diversification through a variety of fees and taxes that have been considered herein, the attraction and retention of commercial activity is essential to a city government that is financially sustainable. As noted in our Report on Economic Development Activities submitted to Council last April, BFAAC observed that City funding for economic development activities had increased three-fold over the past 10 years. The proposed FY 2007 funding for economic development activities ($2,798,072) represents a 3.9% increase over the FY 2006 approved budget.

The adopted Alexandria Strategic Plan for 2004-2015 also recognized the significance of economic development and established as one of its stated goals "a strong local economy that is growing in varied small businesses and job opportunities." Towards this end, the recent Economic Development Sustainability Summit held on January 28, 2006 helped identify a number of challenges and opportunities to our efforts in attracting and retaining commercial activities. While a number of visions, goals and suggested procedures were identified at the recent Summit, the primary purpose of economic development is the expansion and diversification of the tax base upon which the City is dependent for its revenues.[2] Significantly, one of the identified objectives was the establishment of a "clear, shared vision among businesses, residents, and government that provides the proper balance to increase the tax base."[3] Viewed from another standpoint, economic development reduces the real estate tax burden on homeowners.

Last year at this time, BFAAC observed that Alexandria is lagging behind the Northern Virginia region and the state as a whole with respect to growth in taxable restaurant food sales and taxable retail sales and that our share of taxable restaurant meals and taxable retail sales had declined. Budget Memo #29 (FY 2006). Compared to other Northern Virginia jurisdictions, Alexandria's three year sales tax revenue growth (CY 2002-CY 2004) was the lowest at a mere 8.67%.[4] If you examine Alexandria's Sales Tax, Transient Lodging Tax, and Restaurant Food Tax revenues as a percentage of the General Fund Revenue Distribution between FY 1998 and FY 2007 (estimated), it appears that there has been a reduction in the tax base.

Real Estate and Sales Tax Receipts as a Percentage of General Fund Revenues[5]

Fiscal Year	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
Local Sales	5.2%	5.3%	5.4%	5.5%	5.6%	5.6%	6.2%	6.4%	6.6%	6.4%
Restaurant Food	2.1%	2.1%	2.2%	2.2%	2.3%	2.4%	2.5%	2.6%	2.5%	2.3%
Transient Lodging	1.6%	1.6%	1.6%	1.5%	1.4%	1.4%	1.7%	1.7%	1.5%	1.3%
Total Real Prop.	55.4%	54.4%	53.0%	51.7%	48.5%	45.6%	45.3%	46.1%	46.4%	46.9%

[2] In our FY2004 Budget Report, BFAAC observed that the revenues that the City can anticipate (e.g., taxes based on real property, personal property, sales, lodging, etc.) must be evaluated in the context of expenses the City would have to incur to support such development (e.g., operating costs associated with street improvements, lighting, etc.). As a general rule, commercial development reflects a positive net fiscal impact. Budget Memo #34 (April 14, 2003).

[3] City of Alexandria Economic Sustainability Summit Draft Documentation (January 28, 2006).

[4] Staff Presentation, Budget Work Session (February 22, 2006).

[5] Data taken from the Comprehensive Annual Financial Report (CAFR) of the specified fiscal year. Figures for FY 2007 are projected.

Other troublesome indicators include the minimal growth of local sales tax revenues[6] and the reduction of Landmark Mall's real estate assessment,[7] all of which underscore the need for a managed approach.

Unfortunately, Alexandria continues to function without an overall plan or strategy for economic development. Economic development activity appropriations continue on an *ad hoc* basis with little City oversight and coordination.[8] Therefore, the challenges and opportunities identified at the summit are of no benefit until such time as the City takes steps to enact a comprehensive and coordinated approach to management of essential economic development activities.

BFAAC urges the City to implement a comprehensive and coordinated approach to economic development and reaffirms our prior recommendations, including:

- **The City should take prompt action to develop an overall economic development strategy and, within that strategy, provide for necessary planning, policy guidance and oversight of City spending on economic development activities. There is no reason to delay implementation of the direct City Manager oversight recommended herein.**

- **Economic development planning, policy guidance and oversight should be a City staff function, reporting to the City Manager, so that economic development activities are subject to the same type of management, control and budgetary review as are other important City functions.**

- **The City needs to take a close look at the funding of outside economic development organizations to assure that the City is getting an appropriate benefit for the costs incurred.**

2. New Tax and Fee Structures

We note that Council has adopted our recommendations to establish a tax on cell phone usage and on entertainment admissions, resulting in an additional $2.2 million and $1.3 million in FY 2006 revenue, respectively. House Bill 568, passed by both Houses of the legislature and currently before the Governor for signature, would completely restructure telecommunication taxes statewide, putting a flat 5% tax (going to the State and then provided to localities) on cell phones, satellite television and radio, voice over Internet protocol phones, etc. This proposed new tax regime would replace all similar local taxes, including the City's current cell phone tax. While this legislation is projected to be revenue-neutral for localities, should it become law (to be effective January 1, 2007), BFAAC suggests that City staff carefully monitor the revenue stream provided by this restructured tax.

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6 FY 2007 Proposed Budget (page 5-28).

7 The reduction of the assessment, in part, reflects a loss of retail sales. FY2007 Budget Work Session (February 22, 2006).

8 The participation of some City Council members and/or City staff on the boards of various economic development activities does not provide the requisite oversight and coordination.

The City also accelerated the phase in of sewer fees to the maximum level and increased the cigarette tax, in accordance with our recommendations. We are pleased that the City has recently adopted a revised schedule of planning and zoning fees as well as increased fees for Code Enforcement permits, revisions and inspections. Periodic review of these fees and comparisons with neighboring jurisdictions will help assure that the City's fee structure reflects a best effort to recapture related operating costs. BFAAC emphasizes that our objective in recommending new taxes and fees as other sources of revenue is to relieve the real property tax burden, not to provide sources for additional spending over and above what the real property tax brings in.

The City's ability to levy additional taxes and fees to diversify revenue is largely controlled by the Virginia legislature and State Code. BFAAC continues to support the City's efforts in lobbying the Virginia legislature to gain additional authority and flexibility in revenue diversification. This year, BFAAC investigated several ways of further diversifying revenue. We considered establishing a progressive structure (increasing for each additional vehicle) to replace the $25 vehicle decal fee, but State Code limits the fee collected to $25 per passenger vehicle.[9]

BFAAC also investigated raising the pet license fees, but again, State Code sets the maximum fee for dogs and cats at $10.[10] The City should consider raising the annual cat license fee to $10 from the current $2 and doing away with all prorating of license fees.[11] With only 3049 dogs and 1222 cats licensed with the City according to Alexandria Health Department records, the impact would be negligible. However, there is recent legislation awaiting the Governor's signature that should significantly impact the number of pets actually registered. The pending legislation will require veterinarians to report unlicensed dogs to local treasurers.

BFAAC also investigated the feasibility of alarm application fees (and potential annual renewal fees). The Fire Department estimates that it spent approximately $1.7 million in 2005 responding to 2019 false alarm calls. The Police Department responded to 6524 alarm calls in 2005, 2559 of which were cited as being false. The Police Department reports that it does not have the data to support an estimation of the cost of responding to these false alarms, but City Code Section 4.4-4 does allow for some false alarm charges. Some neighboring jurisdictions, including Arlington County, charge alarm permit fees on commercial establishments. However, we do not have the data to make a determination of the impact of these fees on an overall City budget at this time. The City may wish to consider it in future-year budgets.

BFAAC suggests that the City should consider raising the cigarette tax. In setting the rate, the City might examine what the market will bear.

3. Personal Property Taxes

The Personal Property Tax is assessed on both individual personal property (primarily vehicles) and business personal property (which includes motor vehicles, machinery, computers, and

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[9] Code of Virginia Section 46.2-753.

[10] Code of Virginia Section 3.1-796.87.

[11] Under the City's current cat license schedule, it is possible for one to pay as little as $0.17 for an animal license (from http://www.alexandriaanimals.org/~awla/fee.pdf).

furniture). The vehicle portion of the tax accounts for a projected $15 million in locally collected revenues in FY 2007 and $24.5 million in intergovernmental revenues from the Commonwealth. The rate itself is 4.75% of value. That rate has remained fixed since 1989.

The Personal Property Tax has long been administered and enforced using decals issued by the City once the tax has been paid, which are then affixed to the windshield of vehicles by the owner. The City currently uses a variety of methods to enforce registration and subsequent taxation of vehicle personal property. These collection efforts of the Personal Property Tax (including business personal property tax) resulted in $415,323 in penalties and $64,701 in interest in FY 2005. Enforcement of the vehicle decals has resulted in the collection of $2,814,667; of which $189,814 is from ticket fines and $2,624,853 is the unpaid taxes themselves. Currently $940,533 of tax revenues are realized from the 2,591 vehicles bearing out-of-state license plates registered with the City.[12]

BFAAC observes that many Virginia localities have chosen to do away with the requirement for a vehicle decal to be displayed as proof of payment of the personal property tax. These localities have found that the DMV database of registered vehicles provides sufficient data to collect the tax, making enforcement customer friendly and easier to administer.

Some localities have also chosen to do away with the decal fee as well, which is currently capped at $25 per year for most vehicles. In a speech this year, the Chairman of the Fairfax County Board of Supervisors proposed that Fairfax County discontinue use of the decals. With Fairfax as the largest locality in the region, this change would have significant changes on enforcement of decals throughout the Commonwealth.

Those that have not removed the fee, charge the fee along with the annual Personal Property Tax assessment. In addition to the elimination of use of decals, the City of Danville has transitioned to semiannual payments of the Personal Property Tax—coinciding with the billing of the residential real estate tax.

We have the following observations and recommendations:

- **BFAAC acknowledges that the use of decals as the primary enforcement mechanism may need to be phased out. The City should prepare to make the transition to primary enforcement using methods other than decals.**

- **BFAAC encourages the City to consider all available forms of enforcement in collection of personal property tax revenues. We further recommend that the City explore administrative changes to the Personal Property Tax—including automatic vehicle registration using DMV data and semiannual payments.**

[12] D. A. Neckel, "Questions on Personal Property Tax Collection/Decals." February 28, 2006.

- **At such time (FY 2008 or later) as state reimbursement of the Personal Property Tax revenues fall below the capped threshold of 70% of value for vehicles $20,000 and less, BFAAC supports a City policy of using additional Personal Property Tax collections to fill the gap.**

D. Future Liabilities for City Retirees

As noted by BFAAC in previous reports, one of the largest drivers of the operating budget increases over the past decade has been the consistent double-digit increases in premiums for employee health insurance. As these increases have severe effects on current budget cycles, the visibility of the obligations public sector employers have undertaken to provide health insurance for retirees in the future has increased as well.

Current accounting methods reflect these costs as pay as you go costs recognized when they are paid for. This presents a number of deficiencies in the financial reporting of those expenses; as the reader of a financial report is unable to realize the true financial state of the entity. To attempt to correct this deficiency, the Governmental Accounting Standards Board (GASB) adopted a standard GASB 45 in June 2004.

GASB 45[13] establishes uniform reporting standards for other post employment benefits (OPEB)—which include health insurance, life insurance and other benefits promised to retirees other than pension benefits. It requires the recognition of OPEB cost on an accrual basis over the course of the employee's years of service. This standard also requires an annual determination as to the state of funding of those long term obligations.

This standard, as well as the attention paid to it by the bond rating agencies, will require Alexandria to determine the long-term financial liabilities and begin to fund that obligation accordingly. In preparation for the implementation of this accounting standard, the City has already performed an actuarial study which valued the City's retiree health insurance obligation at $82 million.[14] This number is a year old and will likely be understated due to recent healthcare cost inflation. It also does not include ACPS costs.

In the Proposed FY 2007 Operating Budget, the City Manager included $8.7 million ($7.2 million previously designated for compensated absences and $1.5 million from estimated FY 2006 revenue surpluses) to be set aside to partially offset the $82 million obligation, as currently estimated. Many governments that have also tackled this issue have begun placing these funds in a designated trust fund analogous to a pension fund, which can then be used to generate income to reduce the overall liability.[15]

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[13] Governmental Accounting Standards Board, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions," June 2004.

[14] James Hartmann, "Budget Memo #8: Accounting for Post-Employment Retiree Benefits New Mandates From the Governmental Accounting Standards Board (GASB 45)," March 3, 2006.

[15] Milt Freudenheim and Mary Williams Walsh, "The Next Retirement Time Bomb," *The New York Times*. December 11, 2005.

In addition to making annual contributions from revenue, some governments have pursued the sale of OPEB obligation bonds,[16] which would allow the trust fund to be funded using bond proceeds. An arbitrage situation can then be created where the trust fund is invested with the goal of exceeding the bond interest costs. In addition to the risk of lower than expected investment returns, this borrowing also has implications for the City's debt capacity guidelines. However, with the City's AAA/Aaa bond rating, this scenario can be particularly effective.

While addressing this long-term funding need will certainly cost the City additional funds, it will also have the positive result of bringing predictability to the outlays required for retiree health insurance.

In addition to the cost of funding these obligations, many public sector employers have used this as an opportunity to attempt to scale back or eliminate the long term obligations to provide retiree health insurance.[17] Some employers have reduced or eliminated retiree health insurance for active employees. This would create a significant workforce problem inasmuch as retiree health insurance is often a powerful employee retention tool. Other employers have reduced or eliminated retiree health insurance for current retirees. This would be a method that is questionably legal in Virginia. Twenty states have constitutional prohibitions against scaling back current retiree benefits.

Many public sector employers have changed their policy so that any new employees are provided with limited or no retiree health insurance. This would have implications on the City's competitive position for recruiting new employees, but would avoid the morale and retention concerns of affecting current employees.

The City has already employed the use of the one of the most effective methods of gaining control over retiree health insurance costs by capping the benefit costs. The City currently caps those costs at $3,120 per year, per retiree.[18] This cap has been increased annually by the City to partially offset premium increases.

Some employers have experimented with shifting their retiree health insurance obligations from a defined benefit basis to one of a defined contribution. In this situation, the employer would make a set contribution to the OPEB trust fund in order to save for the employee retiree health insurance costs; however the risk of fulfillment lies with the employee/retiree.

Finally, other employers have created cost sharing with the employee, where both employee and employer make contributions to the trust fund to save for the cost of these obligations.

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[16] Parry Young, "Funding OPEB Liabilities," Government Finance Review, December 2005.
[17] Milt Freudenheim and Mary Williams Walsh, "The Next Retirement Time Bomb," *The New York Times*, December 11, 2005.
[18] City of Alexandria, "FY 2007 Proposed Operating Budget," Page 8-45. February 14, 2006.

We have the following observations and recommendations:

- **BFAAC strongly supports the City Manager's proposal to begin the process of saving for OPEB obligations. We support the reprogramming of $8.7 million and urge the creation of an irrevocable trust fund invested in compliance with the City's investment guidelines.**

- **BFAAC urges the ACPS to complete an actuarial study to determine ACPS OPEB obligations and work towards the creation of an irrevocable trust fund to begin saving for these obligations as soon as FY 2007.**

- **BFAAC suggests that the City may wish to examine the sale of OPEB obligation bonds to fund an OPEB trust fund if feasible and prudent.**

- **BFAAC cautions against any changes to current retiree health insurance benefits at this time, but urges future vigilance should OPEB funding costs become unsustainable in future budget years.**

E. Dedicated Revenue Sources

Currently the City dedicates one cent of the real property tax rate for open space acquisition and a one cent for affordable housing initiatives. BFAAC has previously observed that as a policy matter, the dedicated revenue from these set-asides is a clear indication of the Council's spending priorities. The set-asides are not, however, binding on future Councils, but may, as a practical matter, operate to limit Council's ability to respond to changing circumstances.

One dynamic is the dominance and strength of the real property tax base. As assessed values have increased, so have the dedicated revenues. While BFAAC is not unmindful of the comparable increases associated with open space and affordable housing acquisitions, the set-asides should be periodically evaluated in relation to the taxpayers' total real property tax burden.

We have the following observations and recommendations:

- **The one cent set-asides should be reviewed annually in the context of other needs and priorities.**

- **BFAAC renews its recommendation that the Council place a "sunset" on any adopted set asides. The set-aside should be given a period of time (3-5 years, for example) to establish efficacy, but should expire unless explicitly renewed by Council.** A sunset provision would shift the burden of proof of effectiveness on the proponents and reduce the risk of set-asides being perpetuated beyond the point when they are needed and useful.