City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 5, 2011

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER

SUBJECT: BUDGET MEMO # 34 : BUDGET AND FISCAL AFFAIRS ADVISORY COMMITTEE (BFAAC) REVIEW OF THE FY 2012 PROPOSED BUDGET

The Budget and Fiscal Affairs Advisory Committee (BFAAC) has completed its analysis of the FY 2012 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, 2011.

City of Alexandria Budget and Fiscal Affairs Advisory Committee

Report on the City Manager's Proposed Budget for Fiscal Year 2012

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Dak Hardwick, Vice-Chair
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John Renner
Len Rubenstein

EXECUTIVE SUMMARY

THE BUDGET PROCESS

- **BFAAC is encouraged to see the City Manager be cautious in evaluating requests for resources and believes restraint should continue to be the City's approach in FY 2012.**

- **BFAAC believes the City has done well in weathering the recent "Great Recession" by making approximately $70 million dollars in spending reductions over the past three fiscal years.**

- **The City has made progress in aligning the City's budget with the seven goals in the Strategic Plan but BFAAC believes more can be done, especially in terms of strategic goal alignment and priority setting among the goal areas.**

- **BFAAC agrees with the City Manager that "cautious optimism" is in order for Alexandria and advises continued fiscal prudence as the economy returns to full strength.**

- **BFAAC welcomes increased specificity in the FY 2012 budget guidance and believes the detail found in the guidance not only better guides the City Manager in the preparation of the budget but also more accurately represents the intent of Council.**

- **BFAAC commends Council for addressing City workforce issues directly, aggressively and in great detail in the budget guidance.**

- **BFAAC believes a transfer to ACPS on a percentage increase basis without analysis potentially reduces both transparency and accountability of public monies.**

- **BFAAC believes that, considering the ACPS transfer is the largest transfer of funds done by the City, understanding by Council of how that money is to be expended is warranted.**

- **BFAAC believes the cost of Capital Program Funding and Transit Subsidies should not be factored into a funding increase for ACPS as ACPS does not incur those costs in its operating budget.**

- **BFAAC urges Council and City Staff to continue early budget development discussions for FY 2013 and ensure the execution of Section 21 of Resolution 2426 to continue to link the City's Strategic Goals to its budget.**

- **BFAAC suggests that City Council consider assembling future budget guidance resolutions by strategic goal rather than by specific topic area.**

- **BFAAC believes that by providing guidance by goal area, a more comprehensive budget guidance resolution may emerge, leading to the development of a City Manager's proposed budget that is more reflective of Council's intent.**

- **BFAAC is concerned about the process and timeline by which ACPS delivers a capital improvement program and an operating budget to City Council.**

- **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 the process to remain transparent to Alexandria taxpayers.**

THE PROPOSED OPERATING BUDGET

- **BFAAC commends City Staff for completing the major tasks of reviewing and reclassifying positions in the General Schedule, completing the benchmarking process, and making adjustments where required to assure that City employees are paid comparably to those performing similar jobs in neighboring jurisdiction.**

- **BFAAC also commends City Staff for putting a new performance evaluation system for senior staff into effect and for preparing to implement a new system for all other employees by July 2011.**

- **BFAAC supports the initiative to review job classifications of public safety employees to take account of skills, competencies and duties.**

- **BFAAC recommends that the City Manager revisit the manner in which salary increases are determined in order to take level of performance into account.**

- **BFAAC supports the City's approach in completing the process of requiring employees to share health care benefit costs.**

- **BFAAC has reviewed the increases in General Schedule and public safety contributions to retirement and disability funds and finds the approach the City Manager has proposed to be reasonable.**

- **BFAAC recommends that in the future the City Manager conduct outreach about proposed changes in benefit structure with employees before a budget is proposed to Council.**

- **BFAAC urges caution in trying to mitigate the effects of the additional 1% share in retirement contributions for public safety employees. All of the options are costly, could result in further inequities among employees, and would set an unwise precedent. If the City mitigates the impact of this instance of cost-sharing, it will need to consider mitigating the impact of the increased employee share of health premiums in FY 2012.**

There were sound reasons for the City to require greater sharing of benefit costs by employees, with an inevitable effect on net pay, and it should adhere to the policy.

- **BFAAC recommends that Council establish criteria for determining priorities within and among Strategic Plan areas, which the City Manager can employ in making decisions on spending and the public can use to judge decisions to choose spending in one area rather than another. These criteria are particularly important in making decisions to add or reduce services. The public should have input into the determination of these criteria.**

- **BFAAC recommends that Council ask the City Manager to review and report on the impact of service reductions since FY 2009 on those in need of services as a basis of identifying priority for restoration of services or other programmatic increases, if warranted, when resources allow.**

- **The City Manager and Chief Financial Officer should develop a systematic method to inform Council on a regular basis, through the budget process or separately, of ongoing consultant agreements and those that are completed, with a short summary of status and/or outcomes.**

- **BFAAC recommends a report be issued at least annually at a time that informs budget deliberations for the next fiscal year. Council may wish to set a minimum threshold on what is reported, most likely by dollar value of contract. We believe this will give Council sufficient detail on most consultant arrangements and allow sufficient transparency for taxpayers.**

- **BFAAC does not recommend that Council institute a prior approval process for consulting contracts. With the availability of the consultant reporting we have recommended above, Council would have additional information on such contracts in a usable format, and members of Council can highlight specific issues as they may wish during the budget adoption process.**

- **Council should consider developing guidelines for the use of Contingent Reserves for projects that may be presented for funding outside the rigors of the annual budget process. Guidelines could include, for example, consideration of whether the funds are for a one-time only purpose or for a continuing need (with impact on future budgets) and whether there are new circumstances that indicate need for special, separate treatment or whether the project may be more appropriate for consideration as part of the regular budget process.**

- **While Council should retain some degree of flexibility in using Contingent Reserves, having guidelines in place would provide greater transparency in how decisions to use those funds are made and greater confidence that the funds are directed for purposes that warrant exceptional treatment.**

THE PROPOSED CAPITAL IMPROVEMENT PROGRAM

- **BFAAC commends the cooperation to date between the City and the Schools to meet the need for additional school capacity without putting the City's strong credit rating at risk.**

- **BFAAC encourages the Council and City Staff to continue their ongoing conversations with the School Board and ACPS staff regarding the assumptions underlying future enrollment projections.**

- **The City should finalize its Master Plan so that the ACPS can incorporate it into school planning.**

- **BFAAC also encourages the City to work with ACPS on creative funding alternatives to address the need to increase school capacity.**

- **It is readily apparent that current debt policy guidelines will not support much, if any, of the $350 million in unfunded capital projects without significant amendment of the guidelines, which BFAAC does not support.**

- **The Council should consider reprioritizing and delaying capital projects.**

REVENUES AND OUTLOOK

- **The percentage of per capita income that goes to pay the residential real property tax should continue to be monitored. Council should be especially cautious during the current economic environment in setting tax rates that would result in ratios significantly above historic ranges.**

- **For the past three 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 to track taxes and fees on households/residents and businesses and plan to include them as part of our FY 2013 budget report.**

- **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.**

- **We continue to support a commercial real estate add-on tax for transportation, but we do not endorse the additional borrowing that is part of the City Manager's proposal. If**

incurring debt is considered essential to the success of this proposal, we urge that it be kept to a minimum and in all events at a level that would fit within the limits of the City's debt policy guidelines.

- **We continue to believe that an add-on tax for commercial properties should ideally be coupled with some kind of tax relief targeted to small businesses. However, we have concerns that the BPOL tax relief mechanism as proposed may be perceived as unfair.**

- **We considered but rejected a suggestion that the add-on tax be phased in over a period of 3-5 years because the City's transportation funding needs are so great. We believe that the revenues raised from this new source for transportation funding should be sufficient to begin to address long term transportation needs of the City. As we suggested last year, projects selected for funding from the add-on tax revenues should be ones that are significant in nature and readily seen by commercial real property taxpayers as producing demonstrable, positive impacts for the City.**

I. THE BUDGET PROCESS

A. Long Range Budget Outlook

One year ago, as budget deliberations began for FY 2011, the City's Manager's message to City Council included this statement: "We can expect at least three, maybe four more years of difficult financial prospects calling for significant spending restraint."[1] In examining Alexandria's FY 2012 budget, BFAAC observes that the City Manager's FY 2011 message continues to hold true, even in the face of requests to expend additional resources to satisfy community desires. BFAAC is encouraged to see the City Manager state that "we are circumspect in our requests for resources and mindful of the fact that we are only now beginning to see the early signs of growth and expansion."[2] In FY 2012, BFAAC believes restraint should continue to be the approach.

BFAAC notes that the economic condition of the greater Washington region appears to have stabilized to some degree. In fact, according to Clear Capital, a national provider of data for residential real estate asset valuation, the Washington, DC-Alexandria-Arlington region is expected to see a 6.5% year-over-year price increase in residential real estate in calendar year 2011. This represents the highest projected year-over-year price increase in residential real estate of any region in the United States. Compared to regions like Virginia Beach and Norfolk, which are projected to have negative year-over-year price reductions of 12.8%, the worst in the United States, Alexandria and the greater Washington, DC region continues to perform well in these challenging but improving economic times.[3]

The City Manager's proposed FY 2012 budget reflects many of the same projections as noted above, albeit with "cautious optimism" and goes on to say that "we are optimistic that the financial tide has turned. We are cautious in that we cannot project a rapid recovery. Rather we must base our plans on an expected slow and measured improvement in our local economy."[4]

BFAAC believes the City has done well in weathering the recent "Great Recession" by making approximately $70 million in spending reductions over the past three fiscal years.[5] BFAAC also notes that, during the course of the recent economic downturn, the City has made progress in aligning the City's budget with the seven goals in the Strategic Plan but believes more can be done. The greatest area of improvement in aligning the budget to the City's strategic goals can be found in setting priorities among the stated goals and building a budget against those goals. BFAAC looks forward to working with City Council and City Staff in improving these areas.

Finally, BFAAC would like to note the changing political landscape regarding support for Federal spending and its potential effect on Alexandria and the greater Washington region. A significant number of Alexandria's residents and businesses depend either directly or indirectly on Federal spending for their livelihood. Whether it's a military service member, Federal civil

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[1] FY 2011 Proposed Budget, City Manager's Message, p. 2-1.
[2] FY 2012 Proposed Budget, City Manager's Message, p. 2-1.
[3] "Clear Capital Recaps Record Setting Volatility of 2010: U.S. Home Prices Down; Forecasts Additional Drop in 2011" January 2011, p. 4, 5 and 7.
[4] FY 2012 Proposed Budget, City Manager's Message, p. 2-1.
[5] FY 2012 Proposed Budget, City Manager's Message, p. 2-2.

servant, contractor or business that is patronized by anyone receiving a paycheck tied to Federal spending, these are uncertain times. Thus, BFAAC agrees with the City Manager that "cautious optimism" is in order for Alexandria and advises continued fiscal prudence as the economy returns to full strength.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC is encouraged to see the City Manager be cautious in evaluating requests for resources and believes restraint should continue to be the City's approach in FY 2012.**

- **BFAAC believes the City has done well in weathering the recent "Great Recession" by making approximately $70 million dollars in spending reductions over the past three fiscal years.**

- **The City has made progress in aligning the City's budget with the seven goals in the Strategic Plan but BFAAC believes more can be done, especially in terms of strategic goal alignment and priority setting among the goal areas.**

- **BFAAC agrees with the City Manager that "cautious optimism" is in order for Alexandria and advises continued fiscal prudence as the economy returns to full strength.**

B. City Council Budget Guidance for Fiscal Year 2012

In order for the City Manager to prepare a budget for City Council's consideration, City Council first provides the Manager certain instructions on budget priorities. These instructions come in the form of a budget guidance resolution passed by Council in the fall.

As compared to the FY 2011 budget guidance from City Council, the FY 2012 guidance is significantly more detailed in its focus areas and specific about certain policy issues. For example, the FY 2011 budget resolution provided guidance on 12 specific topics.[6] In comparison, the FY 2012 budget resolution provides guidance on 21 topics. BFAAC welcomes this increased specificity and believes the type of detail found in the FY 2012 budget guidance not only guides the City Manager better in the preparation of the budget but also more accurately represents the intent of Council.

It should be noted that, of the 21 topics in the FY 2012 budget guidance, seven topics (or one-third of the guidance) deal specifically with issues involving management of the City's workforce. As local and state governments throughout the United States struggle with public sector pay and benefits, including health care and pension costs, it is important for Alexandria to address these issues without hesitation to assure the long-term fiscal strength of the City.

[6] FY 2011 Proposed Budget, FY 2011 Budget Resolution No. 2371, p. 23-10 – 23-12.

BFAAC commends Council for addressing City workforce issues directly, aggressively and in great detail in the budget guidance.

In addition to the significant focus on the City's workforce, the FY 2012 budget guidance also included a notable change in the ACPS funding transfer from FY 2011 to FY 2012. In FY 2011, City Council's guidance included a specific dollar amount ($167.8 million) to be transferred to ACPS. However, the FY 2012 budget resolution instructs the City Manager to transfer to the Alexandria City Public Schools (ACPS):

> *An amount equal to the transfer provided in the approved FY 2011 General Fund Operating Budget increased by the same percentage as the percentage increase in General Fund revenues available under the provisions of this resolution and proposed in the City Manager's FY 2012 General Fund Base Operating Budget.*[7]

While BFAAC believes education funding is one of the most critical uses of public funds, simply transferring an amount from last year increased by a percentage of the City's approved FY 2012 General Fund Operating Budget without further analysis may not necessarily reflect the demands for school funding in Alexandria. Just because the General Fund increases or decreases may not mean the need for education funding follows a similar financial path. While BFAAC understands the decision on the actual expenditure of school funding is the responsibility of the ACPS School Board, we believe a transfer without analysis potentially reduces both transparency and accountability of public monies. We also believe that, considering the ACPS transfer is the largest transfer of funds done by the City, understanding by Council of how that money is to be expended is warranted.

In addition, BFAAC notes the City's operating budget also includes Capital Program Funding, which has seen a significant increase in the last two budget cycles as a result of increased borrowing for capital projects, as well as Transit Subsidies. Although BFAAC advises against a percentage increase as noted in the previous paragraph, should Council choose to transfer on a percentage increase basis in FY 2012, we believe the cost of Capital Program Funding and Transit Subsidies should not be included in the final percentage increase to ACPS. If ACPS were responsible for Capital Program Funding and Transit Subsidies in its operating budget, it may be appropriate to include those in the final transfer. However, because ACPS does not incur those costs, we do not believe such costs should be factored in to any ACPS increase in funding.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC welcomes increased specificity in the FY 2012 budget guidance and believes the detail found in the guidance not only better guides the City Manager in the preparation of the budget but also more accurately represents the intent of Council.**

- **BFAAC commends Council for addressing City workforce issues directly, aggressively and in great detail in the budget guidance.**

[7] FY 2012 Proposed Budget, FY 2012 Budget Resolution No. 2426, p. 23-10.

- **BFAAC believes a transfer to ACPS on a percentage increase basis without analysis potentially reduces both transparency and accountability of public monies.**

- **BFAAC believes that, considering the ACPS transfer is the largest transfer of funds done by the City, understanding by Council of how that money is to be expended is warranted.**

- **BFAAC believes the cost of Capital Program Funding and Transit Subsidies should not be factored into a funding increase for ACPS as ACPS does not incur those costs in its operating budget.**

C. Institutionalizing Early Budget Development

In order to generate the information necessary for City Council's fall budget work sessions, BFAAC understands that the City Manager and OMB staff begin working with City departments in the summer to solicit feedback about the budget prior to the budget guidance being developed. These early discussions are held primarily at the staff level at the direction of the City Manager, are part of the larger Managing for Results Initiative (MFRI) and are done to outline the challenges and opportunities for the next year's budget deliberation.

In addition, Section 21 of Resolution 2426 provides:

> *The City Manager shall submit to City Council, in time for consideration before June 30, 2011, a proposed multi-year plan for linking the Strategic Plan to Operating Budgets and the Capital Improvement Programs through FY 2021. Such a plan shall be consistent with the long range financial outlook under current tax rates and policies (including any changes under consideration for FY 2012 as allowed or specified above) and any operational considerations that may require a particular scheduling or sequencing of action items in support of strategic initiatives, objectives and goals.*

With the departure of City Manager Hartmann this spring, BFAAC believes the hiring of a new City Manager should not delay the required inputs being received from City departments for the FY 2013 budget. BFAAC urges Council and City Staff to continue early budget development discussions for FY 2013 and to ensure the execution of Section 21 to continue to link the City's Strategic Goals to its budget.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC urges Council and City Staff to continue early budget development discussions for FY 2013 and ensure the execution of Section 21 of Resolution 2426 to continue to link the City's Strategic Goals to its budget.**

D. Aligning Budget Guidance with Strategic Goal Areas

The budget guidance resolution is the basis of preparation for the City Manager's proposed budget, which as directed by City Council, attempts to align City spending with the Strategic Goals. In keeping with BFAAC's focus on aligning the City's strategic goals with the budget, BFAAC feels City Council should consider assembling future budget guidance resolutions by strategic goal rather than by topic area.

By providing budget guidance by goal and not just by topic, Council could provide guidance on the entire budget, making the guidance resolution more holistic. To illustrate this point, in examining the FY 2012 budget guidance, one-third of the guidance focuses on the City's workforce which is an element of Goal Five. As a result, since Council focuses extensively on the City's workforce, citizens may conclude that Goal Five is the most important goal for City Council this year.

Overall, BFAAC believes that providing guidance by goal area, a more comprehensive budget guidance resolution may emerge, leading to the development of a City Manager's proposed budget that is more reflective of Council's intent.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC suggests that City Council consider assembling future budget guidance resolutions by strategic goal rather than by specific topic area.**

- **BFAAC believes that by providing guidance by goal area, a more comprehensive budget guidance resolution may emerge, leading to the development of a City Manager's proposed budget that is more reflective of Council's intent.**

E. Receipt of the Alexandria City Public Schools Budget

BFAAC is aware that, as City Council deliberates the FY 2012 budget, the ACPS School Board did not pass a final operating or capital improvements program budget prior to the delivery of the City Manager's proposed budget to Council. BFAAC notes that, in 2009, City Council passed Resolution No. 2368 Section (a)(8) stating:

> *That the Board of the Alexandria City Public Schools is requested to approve an Operating Budget and Capital Improvement Program no later than the week of the first legislative meeting of the Council in February, prior to the upcoming fiscal year. Such budget, if it shall exceed or otherwise not comply with the guidance provided by City Council, shall clearly identify what operating programs and activities would be funded, if additional funding were provided above that guidance, and the reasons therefore.*[8]

[8] FY 2011 Proposed Budget, FY 2011 Budget Resolution No. 2368, p. 23-16.

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.

BFAAC observes that there appear to be two separate budget processes ongoing at similar times – one by Council and one by the School Board. We recognize that staff-level discussions between OMB and the ACPS budget staff occur before and after the receipt of the City Manager's budget by Council. We also recognize that the City Council and the School Board held two work sessions during the FY 2012 budget deliberations in order to discuss the schools capital improvements and operating budgets. Nevertheless, BFAAC continues to believe that an approved ACPS budget should be received for consideration in the context of an overall City budget. This allows for all involved in the budget process to remain accountable and the process to remain transparent to Alexandria taxpayers.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC is concerned about the process and timeline by which ACPS delivers a capital improvement program and an operating budget to City Council.**

- **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 the process to remain transparent to Alexandria taxpayers.**

II. THE PROPOSED OPERATING BUDGET

A. Compensation

The City Manager's proposed budget calls for total staff compensation of $257.2 million. This figure represents a 3.6% increase over FY 2011, almost double the percentage increase from FY 2010. The increase is a product of: a) $3.3 million in projected merit increases for FY 2012; b) ongoing costs of a merit-based step increase in the FY 2011 budget; c) a new "R" step for staff who have reached the top of the pay scale; and d) $0.7 million to begin implementation of the salary and benchmarking process based on the recommendations of the Watson Wyatt (now Towers Watson) consulting firm. No market rate adjustment is included for the fourth consecutive year.[9]

The increase in the budget for compensation is not due to increased staffing. The net number of City personnel remains flat, ending the decline of 4.7% from FY 2009-2011 from a high of 2,664.8 Full Time Equivalents (FTEs) to the current 2542.3 FTEs. The number is lower than it was six years ago, before increases in personnel took place during a period of economic growth.[10]

BFAAC commends the actions taken by the City Manager and the Human Resources Director to reform the City's employee compensation system after a study by Towers Watson. We note that they have:

- Changed the classification system to focus on skills and competencies needed to fulfill the needs of each position;
- Conducted a benchmarking study and analysis to determine whether the City's employees' salaries are competitive with other jurisdictions (The study found that on the whole for general schedule employees, the City was 7% behind other jurisdictions and for public safety employees the differential was 1%);
- Made adjustments in pay scales as a result of the benchmarking study to bring the midpoint salary for each position into line with that of other jurisdictions;
- Included funds in the proposed FY 2012 budget to account for the pay adjustments needed as a result of the benchmarking study;
- Initiated a process of moving from a step system within grades to a band system that provides greater flexibility to recognize competencies; and,

[9] FY 2012 Proposed Budget, Personnel and Compensation Summary, p. 8-1.
[10] FY 2012 Proposed Budget, Personnel and Compensation Summary, p. 8-8.

- Instituted a new performance evaluation system for general schedule senior staff and are preparing to put a new system into place for all general schedule staff by July 2011.[11]

BFAAC notes that, according to City Staff, benchmarking will occur periodically to assure that City salaries remain competitive.

BFAAC has long recommended that the City switch to a performance-based system for salary increases. The City Manager's budget proposes to increase the salary of each employee whose performance is found to be satisfactory by one of the three designated percentage increases ranging from 2.3% to 5.0%, depending on an employee's position on the pay scale.[12] Almost all of the employees will receive the merit increase. In the future, the City Manager proposes to replace the three-tiered system with a single percentage amount applicable to all employees.

BFAAC does not believe that, despite the names, either the current or proposed revised system constitutes a true merit-based system because they do not differentiate increases based on variations in performance. BFAAC understands the view that pay-for-performance systems are complex and require extensive supervisory training, and may be more difficult to administer in a fair and consistent manner. We believe, however, that the City should revisit the concept of a flat and virtually automatic raise for all employees irrespective of variations in performance.

Finally, the benchmarking study found only a 1% difference between pay for public safety employees in comparable positions in other jurisdictions. Nevertheless, the exercise revealed a need to review the match between classifications and competencies in public safety positions, and we commend the City Manager for committing to such a review.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC commends City Staff for completing the major tasks of reviewing and reclassifying positions in the General Schedule, completing the benchmarking process, and making adjustments where required to assure that City employees are paid comparably to those performing similar jobs in neighboring jurisdiction.**

- **BFAAC also commends City Staff for putting a new performance evaluation system for senior staff into effect and for preparing to implement a new system for all other employees by July 2011.**

- **BFAAC supports the initiative to review job classifications of public safety employees to take account of skills, competencies and duties.**

- **BFAAC recommends that the City Manager revisit the manner in which salary increases are determined in order to take level of performance into account.**

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[11] FY 2012 Proposed Budget, Personnel and Compensation Summary, pgs. 8-13 and 8-14 and personal communication with Cheryl D. Orr, City of Alexandria Human Resources Director.

[12] FY 2012 Proposed Budget, Personnel and Compensation Summary, p. 8-1.

B. Benefits

The proposed budget continues the path toward greater cost-sharing of benefits by employees. For FY 2012, employees hired before FY 2010 will contribute a minimum of 16% of health care premium costs, up from 13% last year; employees hired after July 1, 2010 are already paying 20%. This year the change saves the City $600,000.[13] By FY 2013, all employees will pay 20% of health care premiums. BFAAC has supported this cost-sharing.

The proposed budget also anticipates greater cost sharing for retirement benefits. As a result of decisions taken in years past, retirement contributions of General Schedule staff vary from zero to 6% depending on when the person was hired. The City Manager is recommending that all employees, no matter when hired, pay at least 1% of the City's supplemental retirement benefit, though employees already paying 2-6% would not be subject to any further increase. The City Manager also has proposed to increase the percentage firefighters and police officers pay for their retirement by a percentage point to 9%.[14]

BFAAC believes that, with respect to general City employees, requiring modest staff contributions to retirement funds is consistent with the approach taken with other benefits and is reasonable. For general employees hired before FY 2010, even with the contribution, the employee's combined contribution to the Virginia Retirement System (VRS) and supplemental retirement will amount to 1% of costs, and for general employees hired in FY 2011 or later, the employee's percentage will be about 6%.

For public safety employees, the choices are more complex because of the high expense and escalating costs of their retirement and disability contributions. In FY 2012, the total cost of retirement benefits will amount to 36.7% of pay for FY 2012, up from 33.6% in FY 2011.[15] While BFAAC believes it would have been better practice for the City Staff to have conducted outreach with public safety employees before proposing it in the budget, we feel the proposal is reasonable. Because of its relatively strong benefits, the cost of the plan has grown to more than one-third of annual salary and represents a major cost to the City in difficult economic times. BFAAC recognizes the burdens of the extra 1% of pay on public safety employees but believes that the increased costs of the plan need to be shared.

At the request of Council, the City Manager has presented options to mitigate the impact of this change. Declining to implement the increased contribution would cost the City $1.6 million, which would mean budget reductions in other areas. Another proposal, to postpone the time when the increase is implemented to the date of anniversary merit increase, would cost less than half that amount, $700,000, but would still require reductions in other areas.[16] A third option, to increase salaries by 1% to offset the increased share of retirement benefit costs would require an additional $2.4 million in City funds, and would defeat the purpose of the original proposal.

[13] FY 2012 Proposed Budget, Personnel and Compensation Summary, p. 8-18.
[14] FY 2012 Proposed Budget, Personnel and Compensation Summary, p. 8-17.
[15] FY 2012 Proposed Budget, Personnel and Compensation Summary, p. 8-17.
[16] Budget Memo #15, "Options to Mitigate the Impact on Employees Take Home Pay of Proposals in the FY 2012 Proposed Budget to Increase the Employee Share of the Costs of Retirement and Health Insurance Costs," March 11, 2011.

Apart from the cost to the City of these proposals, BFAAC is concerned that mitigating the impact of an increase in benefit costs to employees sets an unwise precedent, as next year employees will be required to pay another 4% of the cost of health insurance premiums, and we see no principled distinction between mitigation in one case and not the other. Finally, Council has decided that it is reasonable to increase employees' share of benefits, which has an inevitable impact on take-home pay, and BFAAC agrees.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC supports the City's approach in completing the process of requiring employees to share health care benefit costs.**

- **BFAAC has reviewed the increases in General Schedule and public safety contributions to retirement and disability funds and finds the approach the City Manager has proposed to be reasonable.**

- **BFAAC recommends that in the future the City Manager conduct outreach about proposed changes in benefit structure with employees before a budget is proposed to Council.**

- **BFAAC urges caution in trying to mitigate the effects of the additional 1% share in retirement contributions for public safety employees. All of the options are costly, could result in further inequities among employees, and would set an unwise precedent. If the City mitigates the impact of this instance of cost-sharing, it will need to consider mitigating the impact of the increased employee share of health premiums in FY 2012. There were sound reasons for the City to require greater sharing of benefit costs by employees, with an inevitable effect on net pay, and it should adhere to the policy.**

C. Priority Setting

Last year, BFAAC noted that while the proposed budget properly made reference to the Strategic Plan, there existed no guidelines or criteria for determining priorities for services within and among Strategic Plan categories. As a result, we noted that citizens cannot determine how decisions were made to fund one service and not another. In FY 2011, there were major differences in reductions in services within the Strategic Plan and it was not possible to assess the rationale for choosing to reduce one service rather than another. To address this lack of transparency, BFAAC suggested establishing standards and guidelines for allocating funds among and within Strategic Plan categories to enable Council and citizens to understand better the priorities of the City Manager.[17]

The same lack of transparency is present in this year's budget regarding restoration of services. The proposed budget contains a group of about 20 new or expanded services or initiatives and

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[17] Budget Memo #48, BFAAC Report on the City Manager's Proposed Budget for Fiscal Year 2011, p. 17.

associated costs for FY 2012, along with a second group of priorities that will only be funded if additional resources become available.[18]

The first group, with a total value of $1.3 million includes advertising ($300,000) and group sales ($75,000) for economic development, tree and watering crews ($65,000) and a general services fleet management position ($85,000). The second group, of services not funded, with a total value of $2.2 million, includes $150,000 for a court services gang prevention project, $300,000 for increased sidewalk maintenance, and $30,000 for a web site to support economic development.

The proposed budget notes that the second list is presented in priority order, but the criteria for setting those priorities, as well as for determining which services were included in the first (funded) list, are not stated. There may be sound reasons for selecting items for each list and ranking them within the list, but citizens should have an opportunity to know how the decisions were made through a statement of priority-setting criteria. Simply referencing the Strategic Plan is insufficient.

We recognize that establishing and applying explicit standards or guidelines is difficult. In their absence, however, decisions on preservation, expansion or reductions in services will be made with insufficient information available to the public to know the basis for the decision.

As noted earlier in the report, BFAAC commends the City Manager and Council for exercising fiscal discipline during the economic turndown. From FY 2009 to the present, the total number of City FTEs has decreased by 4.7%. BFAAC believes that review of the impact of the service reductions resulting from the decrease in personnel, particularly among the most vulnerable citizens, is warranted. This would allow Council, consistent with MFRI findings, the opportunity to establish priorities for future service restoration where such action is warranted.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC recommends that Council establish criteria for determining priorities within and among Strategic Plan areas, which the City Manager can employ in making decisions on spending and the public can use to judge decisions to choose spending in one area rather than another. These criteria are particularly important in making decisions to add or reduce services. The public should have input into the determination of these criteria.**

- **BFAAC recommends that Council ask the City Manager to review and report on the impact of service reductions since FY 2009 on those in need of services as a basis of identifying priority for restoration of services or other programmatic increases, if warranted, when resources allow.**

[18] FY 2012 Proposed Budget, Personnel and Compensation Summary, p. 8-1.

D. Contracts and Consultant Services

At its May 2, 2010 meeting, City Council assigned BFAAC the task of working with City Staff to examine the use and disclosure of City contracts and consultant services. The following represents the BFAAC response to Council's request.

We note that, in working through the Council request on contracts and consultant services, BFAAC did not analyze all contract services employed by the City. Rather, in accordance with our understanding of Council's primary interest in consultant services, we focused our analysis on consultant rather than on contracted services. We considered consultant services generally to be those where a firm or individual is contracted to provide professional advice, with no responsibility to perform City services. As an example, we consider a study by experts to advise the City Staff on best practices in a subject area to be consultant services, but a contract for landscaping in City parks is considered contracted services.

BFAAC formed a subcommittee to examine consultant services in-depth. The subcommittee reviewed the full list of consultants and other contracts presented to Council last fall and met with City Staff. The subcommittee reported findings to the full Committee in January 2011. The full Committee then discussed the transparency of the use of consultants, the information available to Council regarding the use of consultants, and whether Council should consider a formal prior approval process for consultant contracts.

We learned that information about the intended use of consultants has been available through the budget process. Specific studies and research are identified in the budget documents. However, the references are scattered throughout the budget documents and some of the consultant arrangements may not be included.

Throughout the year, Council receives information and reports about ongoing or completed consultant contracts or studies, informally or in regularly scheduled Council meetings. However, information about the full array of consultant services and the outcomes of the work performed by consultants is not reported systematically or in full to Council. BFAAC believes that the City's use of consultants should be more transparent and reported regularly to Council. We understand that staff of the Office of Management and Budget is already working on producing information on the extent of use of consultants and the status of consultant projects that would better inform Council and be available to the public.

Further, BFAAC believes that prior approval of consulting contracts is not necessary or desirable. Such prior approval would mean added administrative costs in staff preparation time and more items for Council dockets that are already full, without countervailing benefits. Additional and systematic reporting to Council on the use and outcomes of consultants should provide the necessary oversight of the use of consultants without interfering in what should be a normal management function of the City Manager.

OBSERVATIONS AND RECOMMENDATIONS

- **The City Manager and Chief Financial Officer should develop a systematic method to inform Council on a regular basis, through the budget process or separately, of ongoing consultant agreements and those that are completed, with a short summary of status and/or outcomes.**

- **BFAAC recommends a report be issued at least annually at a time that informs budget deliberations for the next fiscal year. Council may wish to set a minimum threshold on what is reported, most likely by dollar value of contract. We believe this will give Council sufficient detail on most consultant arrangements and allow sufficient transparency for taxpayers.**

- **BFAAC does not recommend that Council institute a prior approval process for consulting contracts. With the availability of the consultant reporting we have recommended above, Council would have additional information on such contracts in a usable format, and members of Council can highlight specific issues as they may wish during the budget adoption process.**

E. Use of Contingent Reserves

BFAAC has observed that a variety of expenditure-related items have been considered by Council on an ad hoc basis outside the normal budget process. For example, Council recently considered additional expenditures for lights on King Street and for one additional hot meal day for Meals on Wheels. For these and other types of in-cycle expenditures, Council has either used or considered using Contingent Reserves.

Although BFAAC does not dispute the value of lights on King Street or one additional hot meal day for Meals on Wheels (or other worthwhile projects), BFAAC believes that, if Contingent Reserves are to used for projects like this, Council should consider developing guidelines to evaluate what projects are appropriate for funding from Contingent Reserves, outside the rigors of the regular annual budget process. Guidelines could aid Council in objectively evaluating competing demands for funds that may arise during the course of the budget execution year. Established parameters for Contingent Reserves would also provide greater transparency in spending taxpayers' funds.

Overall, BFAAC believes that Council should retain some degree of flexibility in how it may choose to utilize Contingent Reserves, but establishing some basic guidelines would give the public greater confidence that funds are being used in situations that warrant exceptional treatment.

OBSERVATIONS AND RECOMMENDATIONS

- **Council should consider developing guidelines for the use of Contingent Reserves for projects that may be presented for funding outside the rigors of the annual budget process. Guidelines could include, for example, consideration of whether the funds are for a one-time only purpose or for a continuing need (with impact on future budgets) and whether there are new circumstances that indicate need for special, separate treatment or whether the project may be more appropriate for consideration as part of the regular budget process.**

- **While Council should retain some degree of flexibility in using Contingent Reserves, having guidelines in place would provide greater transparency in how decisions to use those funds are made and greater confidence that the funds are directed for purposes that warrant exceptional treatment.**

III. THE PROPOSED CAPITAL IMPROVEMENT PROGRAM

A. Overview

The CIP budget summary states that the "FY 2012-FY 2021 proposed CIP also continues to struggle with important issues as the City looks at the future capital needs of Alexandria." [19] The proposed 10-year CIP funds $956.9 million in capital projects. This plan represents a decrease in the previous year's CIP of 2.6% or $25.2 million.

CIP development has continuously matured into a disciplined, transparent process that attempts to prioritize program expenditures and link them to the City's strategic goals within an evolving framework. BFAAC is pleased to see that the City has adopted a number of recommendations from last year's report in whole or in part. These changes include: a clear delineation in the budget of which programs fall at the margins of funding, both above and below the resourced CIP; use of a criteria-based scoring system to assist with the final prioritization of projects; development of a glossary for the CIP submission; and a presentation of the CIP's impact on the City's operating budget within the CIP submission.

BFAAC also notes the City Manager's commitment to continuously refine the CIP development process. This year's CIP development process included an initial effort to integrate the capital plan with City Council's new Strategic Plan.[20] Also, in this submission, the City Manager discussed future plans to better describe the CIP's impact on the operating budget and plans to develop a more quantitative project scoring system to support project prioritization. On balance, the CIP is a responsible attempt to balance future capital needs and fiscal responsibility. It is consistent with Council guidance of November 23, 2010 to the City Manager on the sources of CIP funding.

The FY 2012 CIP considers three very expensive, but strategic, capital investments: the Alexandria City Public Schools (ACPS) CIP; various transportation projects, and the Potomac Yard Metro Station. The CIP calls for the transportation projects and the Metro Station to be funded from dedicated sources. The transportation projects would be funded by a proposed 12.5 cent add-on tax on commercial real estate. The Metro Station would be funded by developer contributions and revenue from a special tax district. While both of these projects will have dedicated funding sources, the cost and timing of these projects will have an impact on the City's borrowing capacity. The ACPS CIP as currently structured would compete with other capital projects funded by cash capital and the City's bonding capacity. Our report addresses the issues raised by these projects below.

B. Alexandria City Public Schools

For FY 2010 – FY 2021, there is a substantial gap between the CIP Budget adopted by the Alexandria School Board and the CIP funding for ACPS proposed in the City Manager's budget.

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[19] FY 2012 Proposed Capital Improvement Program Budget, p. 2-4.
[20] *Ibid.*

This may be due, in part, to the difference in timing between the development of the City Manager's budget and the School Board's budget.[21]

On March 3, 2011, the Alexandria School Board approved a 10-year CIP request of $372.6 million. The City Manager has recommended CIP funding of $158.1 million for the schools for FY 2012 to FY 2021. The ACPS FY 2012 – FY 2021 CIP request has increased $213.3 million over the comparable FY 2011- FY 2020 budget period approved last year by Council and the School Board. The majority of the difference results from the addition of two capacity-related projects at the elementary level, the expansion of the FY 2012 CIP to ten years versus the six covered by the previous CIP, and added secondary school capacity. Based on current ACPS forecasts of enrollment, additional capacity will be required over the next 10 years.

According to the School Board, the primary needs driving the ACPS' 10-year CIP request are: the need for additional classroom space; required facility maintenance for the system's aging building stock (median age of ACPS school buildings is approximately 54 years[22]); and certain other big-ticket expenses that are reaching critical status such as replacement school busses and additional elevators in larger schools with only one. Other items that are less critical to ACPS's core mission but which fall within the City's and ACPS's strategic goals are Greenovation / EcoCity projects and shared program priorities such as more space for preschool programming, additional artificial turf fields, and space for community programs in the schools such as health clinics, adult education programs currently in leased space, senior citizen programs, and other activities sited within school buildings.[23]

Of these, the perceived need for additional classroom space over the next 10 years is the biggest budget item – at $199.3 million (53.5%). Facility maintenance totals $75.1 million, and includes an additional $4.4 million in maintenance for an elementary school slated to be replaced in the last year's approved CIP budget, but which ACPS now deems necessary to keep open to accommodate ACPS's projected increased enrollment.[24]

ACPS's CIP request is large, and if fully funded over the next 10 years could strain the City's funding and borrowing capacity and crowd out other capital projects, as discussed below.[25] Moreover, the School's CIP request is not the only major capital item in the City's FY 2012 CIP.

On March 14, 2011, City Council and the School Board held a joint work session at which the large discrepancy between ACPS's 10-year CIP request and the City Manager's proposal was addressed.[26] As a result of that meeting, City Staff and ACPS staff have worked together to develop a CIP plan for the near term that satisfies the immediate school capacity issues with minimal impact on the City's operating budget and debt policy guidelines.[27] According to two recent budget memoranda from City Staff, the working group has reached agreement on a CIP plan for ACPS for FY 2012 – FY 2015 that meets those goals.[28] There continues, however, to be

[21] Budget Memo #28, Impact of Funding the Joint Staff Proposed ACPS Capital Improvement Program, March 25, 2011.
[22] ACPS FY 2012 Proposed CIP Budget, p. 18.
[23] *Ibid.*, p. 2.
[24] *Ibid.*, Table 1, p. 3.
[25] Budget Memo #13, Impact of Fully Funding the ACPS Approved FY 2012-FY 2021 CIP, March 10, 2011.
[26] Budget Memo #28, Impact of Funding the Joint Staff Proposed ACPS Capital Improvement Program, March 25, 2011, p. 1.
[27] Budget Memo #23, Report on City/Schools Staff Discussions on Short Term Schools Capital Improvement Program Request, March 23, 2011, p. 1.
[28] See, Budget Memo #23 and Budget Memo #28.

a large gap between ACPS's request and the City Staff's recommendations for CIP funding in the out years, FY 2016 – FY 2021.[29] BFAAC understands the working group's proposal for near-term CIP funding for the schools and funding for the out years will be the subject of continuing discussions between Council, the School Board, and their staffs that may continue beyond the completion date of BFAAC's FY 2011 report.

Since the compromise proposed by the City and Schools staff was reached very close to our deadline for preparing this report to City Council, BFAAC has not undertaken a detailed evaluation of the Joint Staff Proposal. We do note, though, that it appears to meet Council's charge to develop a plan that in the short term "satisfies immediate school capacity issues with minimal impact on the City's Operating Budget and debt policy guidelines."[30] BFAAC commends the cooperation between the City and Schools to date on these important issues, and we encourage the City and the Schools to continue working cooperatively on these issues going forward.

In particular, as BFAAC noted last year, after falling about 10% between 2000 and 2007, ACPS's student population has been increasing rapidly since 2007.[31] With the additional students this year, ACPS now has 11,999 students, a 16% increase in just 5 years.[32] ACPS projects these increases to continue over the 10-year CIP term resulting in an additional 3,700 students by 2021.[33] Since these forecasts are the principal driver of the School's 10-year CIP request, BFAAC encourages the Council and City Staff to continue their ongoing conversations with the School Board and ACPS staff regarding the assumptions underlying the enrollment projections.

Moreover, as BFAAC noted last year, City planning decisions have an impact on student population in the schools. The Potomac Yard development and the possible redevelopments of Landmark, the Beauregard corridor and the former Winkler properties could have a significant impact on the school population, particularly in the West End. BFAAC commends the City's and now the Schools' move towards 10-year CIP budgeting cycles and notes that the elongated cycle increases the importance of communication between the City and the Schools on planning decisions that may impact student population in the City.

BFAAC also encourages the City to work with ACPS on creative funding alternatives for increasing school capacity. Although the proposed public-private partnership for a new school on the Jefferson-Houston site has currently been shelved, we encourage ACPS and the City to seek potential creative funding opportunities in the future.

OBSERVATIONS AND RECOMMENDATIONS

- **BFAAC commends the cooperation to date between the City and the Schools to meet the need for additional school capacity without putting the City's strong credit rating at risk.**

[29] Budget Memo #23, Table B.
[30] Budget Memo #28, p. 1.
[31] City of Alexandria Budget and Fiscal Affairs Advisory Committee Report on the City Manager's Proposed Budget for Fiscal Year 2011, p. 16.
[32] ACPS FY 2012 Proposed CIP Budget, Table 4, p. 9.
[33] *Ibid.*

- **BFAAC encourages the Council and City Staff to continue their ongoing conversations with the School Board and ACPS staff regarding the assumptions underlying future enrollment projections.**

- **The City should finalize its Master Plan so that the ACPS can incorporate it into school planning.**

- **BFAAC also encourages the City to work with ACPS on creative funding alternatives to address the need to increase school capacity.**

C. Potential Impacts of Unfunded CIP Requirements on the City's Borrowing Capacity

Unfunded capital project requests exceed $350 million. Of that $350 million, $127.5 million represent projects to be funded by the proposed transportation add-on tax. $214 million represent the difference between the City Manager's CIP and the ACPS CIP. Of the three strategic investments that are to be considered by Council this year, only the Potomac Yard Metrorail Station is included in the base CIP. The Metrorail Station estimate is $275 million. The base CIP will be funded by $206.1 million in cash, of which $117 million is comprised of cash capital, and $728.9 million of general obligation bonds, of which $448 million will be repaid from the General Fund, and $21.8 million in grants and other special revenue.

Assuming that only the core CIP is funded, the General Fund will be able to support increases in debt service and the planned growth in cash capital without jeopardizing the City's AAA/Aaa bond rating. However, without considering the projects to be funded by the transportation add-on tax, the $230 million in unfunded requirements cannot be financed at proposed tax rates.

As part of the City's fiscal discipline, City Council has established certain guidelines with respect to debt. The City measures debt as a percentage of real property assessed value, debt as a percentage of personal income, and debt service as a percentage of general governmental expenditures. The City has established both targets and limits for each of these measures. Assuming that only the core CIP budget is funded, over the course of the CIP, these measures are often above their targets but generally within their limits. The only exception to this observation occurs in FY 2015 when debt is issued to fund the Potomac Yard Metrorail Station. The issuance of this debt causes debt as a percentage of personal income to rise above the guideline of 4.5% to a value of 5.6%. Debt as a percentage of personal income gradually returns to 4.5% in FY 2019 and is below the debt limit for FY 2020 and FY 2021. A similar pattern can be seen for the measurement debt as a percentage of real property assessed value. The effect on the debt policy guidelines is discussed further in the Revenues section of this report.

The City will be required to make a temporary exception to its conservative debt policy guidelines to account for funding the Potomac Yard Metrorail Station. It is readily apparent that current debt policy guidelines will not support much, if any, of the $350 million in unfunded capital projects without significant amendment to the Guidelines. The City has the following choices: trade capital projects in the core CIP budget for unfunded projects, thus reprioritizing or delaying projects; increase the tax rate to raise significantly greater amounts of cash capital; change the debt guidelines and issue more bonds at the potentially at the expense of its AAA/Aaa credit rating. Council could consider a combination of these approaches to rebalancing the CIP. BFAAC believes that to amend the City's debt guidelines to allow for greater borrowing, possibly at the expense of the City's superior credit rating is an unacceptable approach to funding the CIP. BFAAC believes that the City should reprioritize and delay capital projects to live within the City's means.

OBSERVATIONS AND RECOMMENDATIONS

- **It is readily apparent that current debt policy guidelines will not support much, if any, of the $350 million in unfunded capital projects without significant amendment of the guidelines, which BFAAC does not support.**

- **The Council should consider reprioritizing and delaying capital projects.**

D. Cash Capital

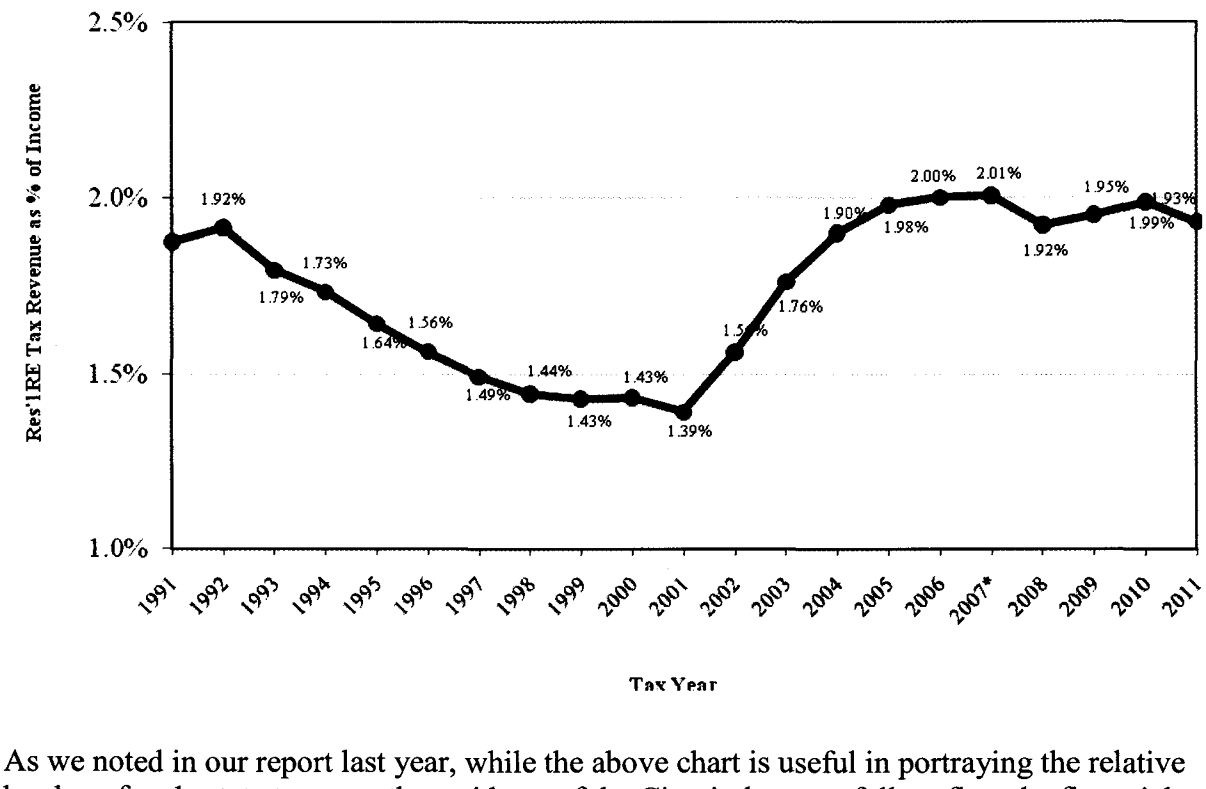
In last year's report, BFAAC noted that cash capital funded by the operating budget, when expressed as a percentage of the CIP, varied from year to year. BFAAC suggested to Council that guidelines on the amount of cash capital that is funded on an annual basis be established. Council requested that BFAAC work with City Staff to develop recommendations for cash capital guidelines. BFAAC continues to work with City Staff to address this issue. BFAAC's goal is to finalize a recommendation in May 2011 and submit it to Council for consideration before the end of the legislative year.

IV. REVENUES AND OUTLOOK

A. Tax and Fee Burden Issues

BFAAC has been tracking the percentage of per capita income that goes to pay the residential real property tax for several years. This measure may be an indication of taxpayers' ability to pay. We have observed that on average, Alexandrians have typically paid less than 2.0% of their income for this tax; we have cautioned against setting rates that would result in tax/personal income ratios above historic ranges. As shown in the chart below (page 7-7 of City Manager's Proposed FY 2012 Budget), after declining in the 1990s when personal income outpaced appreciation in property values, the ratio began a steep rise in 2001, reflecting a strongly appreciating real estate market relative to personal income. The ratio has leveled off in the last five to seven years, with a more constant ratio that is expected to hold into the current year, at just under 2.0%. This measure should continue to be monitored, particularly in the current economic environment.

Table I. Residential Real Estate Tax Revenue as a Percent of Per Capita Income[34]



As we noted in our report last year, while the above chart is useful in portraying the relative burden of real estate taxes on the residents of the City, it does not fully reflect the financial burden posed by the City on the citizenry. For this reason, Council requested that BFAAC work

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

with City Staff to explore the development of new metrics for residents and businesses. These new metrics would more fully track the City-imposed financial burdens on residents and businesses. This is particularly highlighted in recent years by the segregation of some additional fees from the real estate tax. The trash collection fee ($331 per residential household in FY 2010) and the sanitary sewer fees are two fees that were once part of the real estate tax.[35] These fees can add significantly to the average tax/fee bill. Personal property taxes, licenses, and other fees add further to this burden. We do not advocate including fines in these metrics, as they are avoidable.

We have been working with Staff for several months in development of these new metrics, but we have not yet finished. The initial information on the residential tax and fee burdens is illustrative at pointing out the need to track the overall burdens, not just real estate taxes. The data in the table below show that for the past three years, non real estate taxes and fees accounted for a substantial part, approximately eighteen percent, of the overall resident tax/fee burden. If in future years, additional taxes and fees (e.g., storm water fee) are removed from the real estate tax, BFAAC recommends adding them to this metric.

Table II. Tax and Fee Burdens as a Percent of Household Income[36]

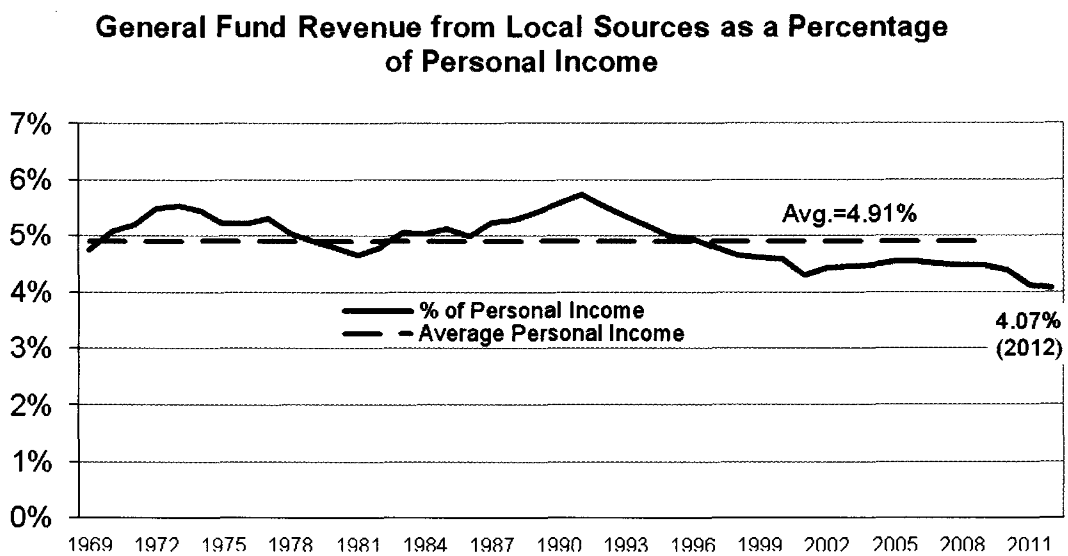
	FY 2008	FY 2009	FY 2010
Mean Household Income	$110,677	$107,925	$110,407
Fees and Taxes			
Real Estate Tax	$ 4,232	$ 4,227	$ 4,255
Personal Property Tax	$ 279	$ 277	$ 224
Trash Removal Fee	$ 264	$ 301	$ 331
Decal Fee	$ 57	$ 59	$ 61
Utility Tax on Natural Gas	$ 24	$ 24	$ 23
Utility Tax on Electricity	$ 33	$ 32	$ 31
Utility Tax on Water	$ 22	$ 23	$ 24
Communication Sales and Use Tax	$ 168	$ 149	$ 149
Sanitary Sewer Maintanance Fee	$ 69	$ 69	$ 69
Total	$5,149	$5,161	$5,166
Percentage of Total Household Income	4.7%	4.8%	4.7%

We expect to be able to have metrics developed and reviewed in the coming months and will plan to include them as part of our report on the FY 2013 budget. For this reason, we have again included the City's budget chart tracking General Fund revenues from local sources[37] as a function of personal income (page 7-6 of City Manager's Proposed FY 2012 Budget). While we

[35] Council included the storm water fee as part of the real estate tax in the adoption of the FY 2011 budget.
[36] Source: OMB Staff email to BFAAC, 10 March 2011; data through 2009 are from the American Community Survey, published by the Census Bureau; data for FY 2010 assumes an increase in personal income of 2.3%, consistent with the assumed increase in average personal income used in the City Manager's budget text.
[37] Local sources include everything except intergovernmental revenues (e.g., State funding).

understand that not all local fund revenues are borne by residents (e.g., transient lodging), this is one metric which provides insights into the total burden on residents.

Table III. General Fund Revenue from Local Sources as a Percentage of Personal Income



OBSERVATIONS AND RECOMMENDATIONS

- **The percentage of per capita income that goes to pay the residential real property tax should continue to be monitored. Council should be especially cautious during the current economic environment in setting tax rates that would result in ratios significantly above historic ranges.**

- **For the past three 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 to track taxes and fees on households/residents and businesses and plan to include them as part of our FY 2013 budget report.**

B. 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 last year's report, 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 operating budgets.

For FY 2012, our observations about the City's adherence to these debt policy guidelines varies depending on whether the Potomac Yard development is or is not included in the projections. To provide proper context, the Potomac Yard project will be self-financing through a combination of sources, including developer contributions, special taxing district assessments, and net local tax revenues, as well as additional City borrowing in the short-term.

Excluding Potomac Yard Development: With the costs of the Potomac Yard development excluded, FY 2012 budget projections for the three debt policy benchmarks all show improvement over the estimates in the FY 2011 budget. While the metrics for debt as a percent of real property assessed value and as a percent of personal income are still over the City's targets over the budget window, relative to last year, the metrics are all moving closer to the target level, and fall below the target in the furthest outyears. In fact, debt service as a percent of general government expenditures is projected to be below the target levels for the entire ten-year budget window, whereas last year, it began to exceed the targets in the latter half of the projection period.

Including Potomac Yard Development: The assessment of the City's adherence to its debt policy guidelines changes dramatically in the FY 2012 budget when the costs of the Potomac Yard development are included in the projections. For two 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 starting in FY 2015 and continuing for five years out.

The Appendix provides a table that compares the City's FY 2012 projections for these three debt policy benchmarks to the FY 2011 projections, as well as to the targets and limits.

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

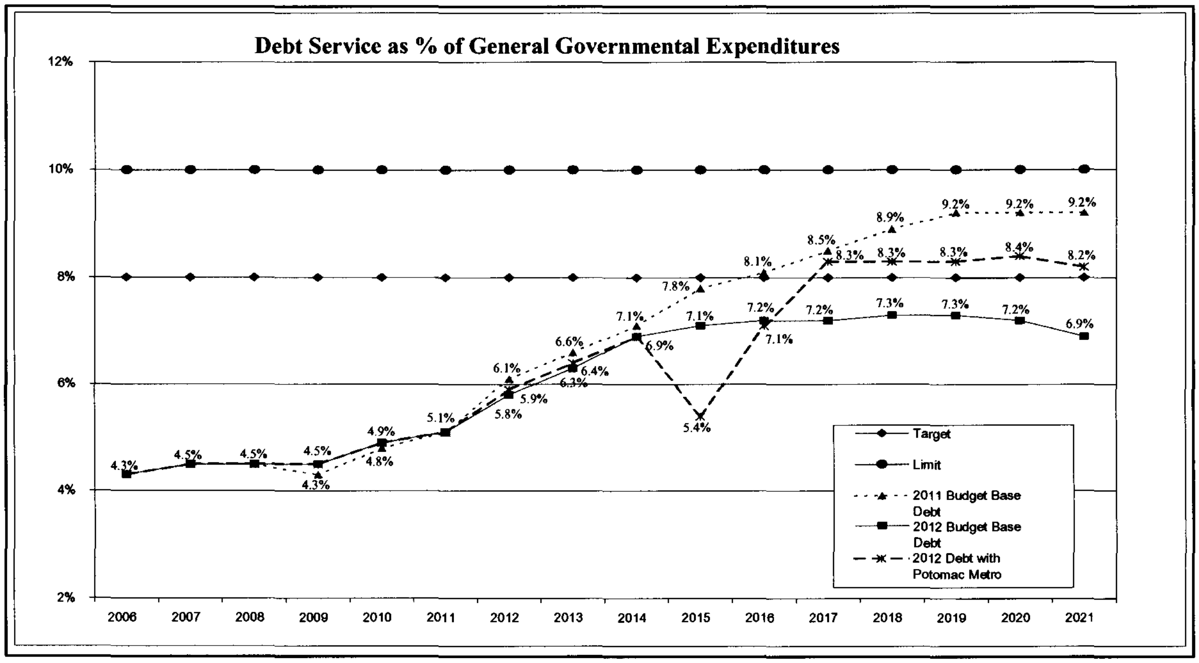


Table V: Debt Service as a % of Personal Income

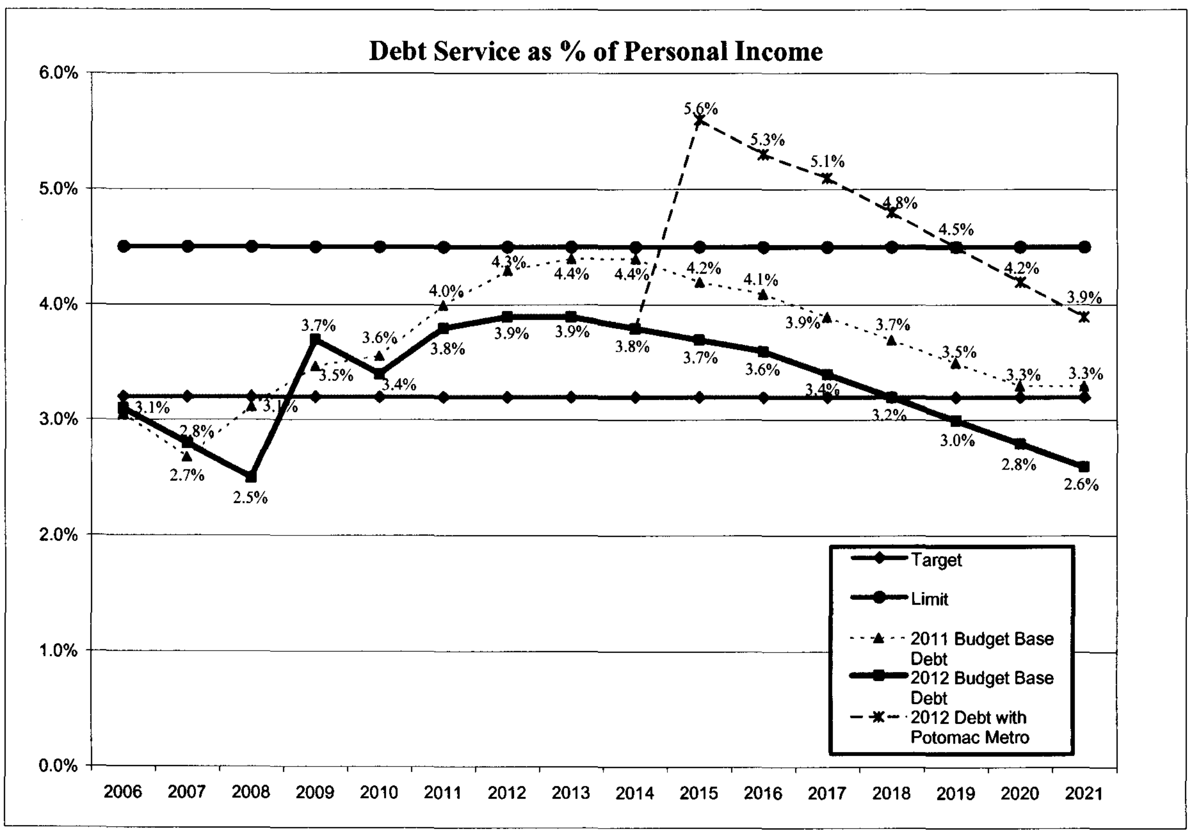
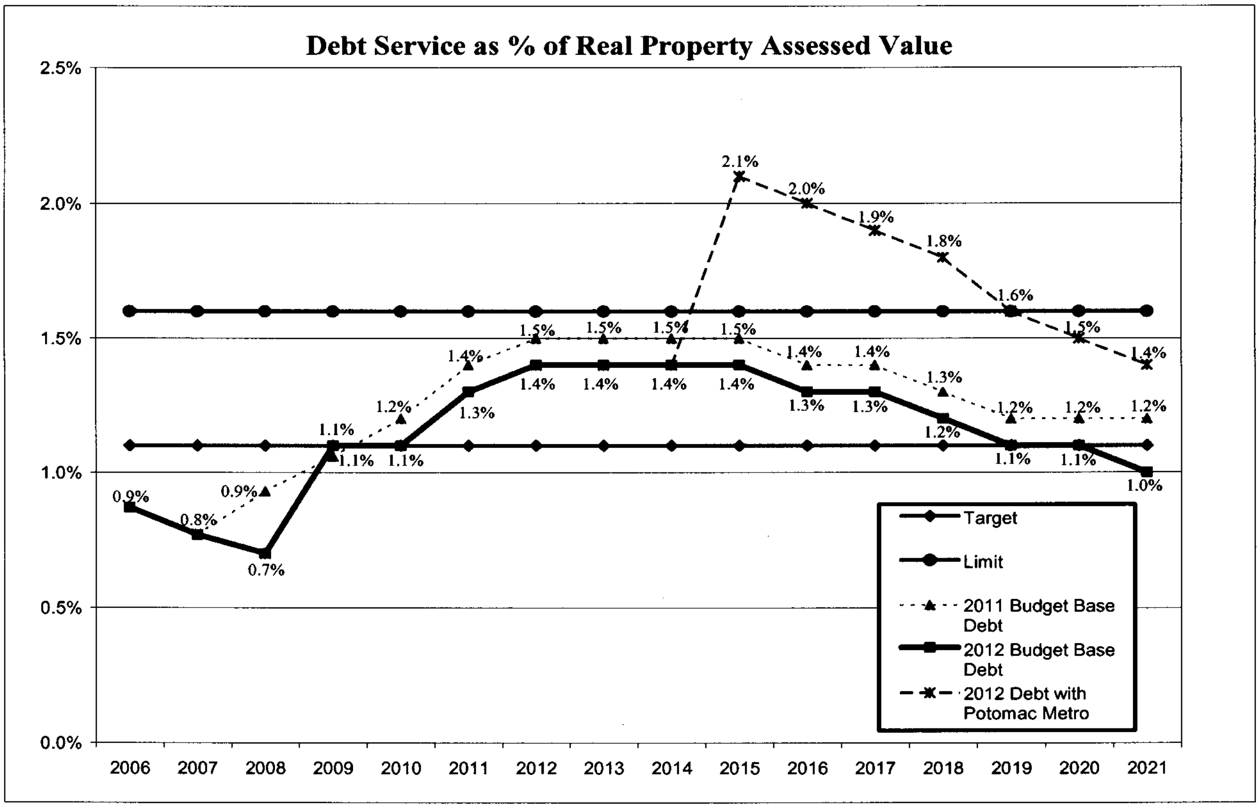


Table VI: Debt Service as a % of Real Property Assessed Value



BFAAC cautions that while the debt policy projections in the FY 2012 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 Waterfront plan, Landmark/Van Dorn Plan, the full CIP request for the Alexandria City Public Schools (ACPS), and the Master Transportation Plan. The costs of any one of these projects would further weaken the City's financial position as measured by the debt policy guidelines. In fact, a recent analysis by OMB shows that when the full costs of the ACPS' CIP request is included in addition to the Potomac Yard project, debt as a percentage of real property assessed value and personal income exceed the limits by a higher percentage and over a longer period of time. Further, this analysis shows that debt service as a percentage of government expenditures moves precariously closer to the 10% limit.[38]

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.[39]

The Committee was concerned about statements in the FY 2012 budget document that seemed to indicate a need to revise the City's debt policy guidelines, an action that we would not endorse.[40] Upon further clarification from OMB, we understand these statements did not mean a change to

[38] Budget Memo #13, March 10, 2011, attachments 1-4.
[39] Budget Memo #48, BFAAC Report on the City Manager's Proposed Budget for Fiscal Year 2011, p. 30.
[40] FY 2012 Proposed Budget, p. 2-25 and p. 2-26.

the debt policy guidelines was being advocated, but rather would allow for exceptions to the guidelines for select projects under limited circumstances.[41]

We are heartened by statements in the FY 2012 budget document that the City's projected debt ratios are below other AAA/Aaa jurisdictions and planned borrowing should not threaten our AAA/Aaa bond rating.[42] Nevertheless, we continue to advocate close monitoring of our performance against the three debt policy benchmarks.

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.**

C. Commercial Real Estate Add-on Tax for Transportation and BPOL Offset

Background: The General Assembly in 2007 passed legislation enabling Alexandria (and other jurisdictions in Northern Virginia and Hampton Roads areas) to adopt a differential real estate tax rate on non-residential commercial property as a source of new local transportation funding. In the fall of 2007, City Council formed an *ad hoc* study committee to review the options and recommend whether to adopt such an "add-on tax" for commercial properties and, if so, at what rate.[43] The Study Committee, noting Alexandria's growing transportation needs, recommended in its 2008 report that Council adopt an add-on tax at the rate of 2-4 cents per hundred dollars of valuation, that the rate be reviewed annually in the context of existing market and economic conditions, and that small retailers be afforded special tax relief.[44]

In FY 2009, BFAAC had reviewed and generally approved of the concept of a commercial add-on tax for transportation and last year endorsed the proposed 3 cent add-on tax proposal.[45] However, Council did not adopt add-on taxes as part of the FY 2009 and FY 2011 budgets.

Arlington County adopted an add-on tax of 12.5 cents and Fairfax County adopted a commercial real property add-on tax for transportation of 11 cents beginning with CY 2008. The current maximum rate established by law is 12.5 cents.

[41] OMB Memo to BFAAC, March 3, 2011, p. 1.
[42] FY 2012 Proposed Budget, p. 2-27.
[43] Resolution No. 2259, November 27, 2007. The Study Committee was composed of five members, including two members of BFAAC.
[44] Memorandum from the City Manager to Council, Subject: Report of the Ad Hoc Commercial Real Estate Tax Option Study Committee, March 6, 2008 (Study Committee Report).
[45] Budget Memo #48, April 9, 2010 and Budget Memo #93, April 14, 2008.

Current Proposal: For the current budget year, Council budget guidance in Resolution 2426 directed the City Manager to propose as an option outside the base budget an add-on tax for transportation purposes on commercial real estate as allowed under Virginia law, along with proposed reductions in the Business, Professional and Occupation License (BPOL) tax as a partial offset to the proposed add-on tax. The City Manager's budget contains a detailed proposal in accordance with this guidance.

The proposed add-on tax would be set at the maximum rate of 12.5 cents per $100 of assessed value on non-residential commercial property. Such a tax would generate $12-18.4 million annually that would be directed to 5 areas of transportation priority: high capacity transit corridors, peak period bus service, transit station improvements, non-motorized transportation initiatives, and street enhancements and additions. The total raised would be $127.5 million over 10 years. The City Manager originally proposed to use these funds plus an additional $40.6 million in borrowing over 10 years to produce about $188.8 million available for transportation purposes (including the capital costs, operating expenses and debt service).[46] A revised transportation add-on tax multi-year project plan changes the projects identified for funding and reduces the amount of borrowing from $40.6 million to $24 million, with planned expenditures decreasing from $188.8 million to $171.1 million.[47]

Projects to be funded by the proposed add-on tax were developed by the Transportation Commission following a public hearing and community meetings, taking into account the City's Strategic Plan and the Transportation Long Range Plan. The projects identified would not be possible without an additional source of funds.[48] The project list was revised, based on discussions with Council and considering land use and economic development issues.[49]

The City's Transportation Commission and Planning Commission have both endorsed adoption of an add-on tax to fund priority transportation projects.[50] Alexandria's Environmental Policy Commission (EPC) has also endorsed the concept of a commercial add-on tax, welcoming the fact that the funds raised could be used for improvements and additions to the City's transit infrastructure.[51] The Chamber of Commerce opposes the add-on tax as proposed by the City Manager.

We observe, as we have in previous reports, that for a number of years the largest portion of the real property tax burden has been shouldered by residential owners. Between 1984 and 2000, residential and commercial assessments each accounted for about 50% of the City's real property tax base. But residential values (including new construction rezoned from commercial to residential) began to increase at a faster pace than commercial values starting in 2000 and today the residential share is 56.5%.[52] An additional tax on commercial properties would serve to increase the share of the real property tax base represented by commercial property. The additional revenue would, however, be explicitly dedicated to addressing traffic and

[46] Proposed FY 2012 CIP, Appendix B.
[47] Budget Memo #10, March 4, 2011.
[48] Proposed FY 2010 CIP, Appendix B.
[49] Budget Memo #10, March 4, 2011.
[50] Budget Memo #11, Commercial Add-On Tax for Transportation—Resolutions, March 7, 2011.
[51] Letter to Mayor Euille and Members of City Council from Jennifer Hovis, Chair of the Environmental Policy Commission Re: FY 2012 City Budget (EPC Letter), November 9, 2010.
[52] FY 2012 Proposed Budget, p. 7-3.

transportation issues--issues the business community has long espoused as needing capital investment.[53]

As a partial offset to the add-on tax, the City Manager has proposed a BPOL tax reduction targeted to provide relief to smaller businesses in Alexandria, totaling $1.625 million annually. The BPOL tax is levied on gross receipts. Under the proposal, the threshold to pay the tax would be raised from $100,000 to $350,000. Businesses with receipts under $350,000 would pay the minimum of $50 for their business license. This would benefit 1,440 small businesses. Businesses with receipts between $350,000 and $750,000 would see their BPOL tax reduced by half, benefiting approximately 800 businesses. The tax relief proposal would not apply to commercial property owners (who would likely pass on any added tax to tenants), residential rental property owners (who are not subject to the add-on tax), and public utilities.[54] The average benefit of the BPOL tax reduction would be $723, ranging from $100 to $2,175 and would affect 45% of the businesses that currently pay the tax. The BPOL tax reduction is paired with the add-on tax proposal; if the proposed add-on tax is not adopted, there would be no change in the BPOL tax and the $1.625 million value of the proposed relief, which otherwise would reduce revenues available to the General Fund, would be available in the base budget for transportation projects this year.[55]

Another part of the proposal would allocate $375,000 to promote economic development tourism, i.e., destination marketing and meetings attraction (which is projected to produce millions of dollars in spending in the City's hotels, restaurants and retail stores).[56]

We endorse the adoption of a commercial real estate add-on tax for transportation, but have concerns about certain aspects of the proposal.

Support for the proposal:

- This add-on tax for commercial properties would be used solely to pay for needed transportation improvements that could not otherwise be funded. These improvements would have the effect of reducing traffic congestion and boosting the overall business environment to the benefit of business owners and residents alike, and ultimately producing added revenues for the City. As noted in the Study Committee Report, the reason behind the creation of this add-on tax on commercial properties is that transportation improvements benefit businesses first and foremost in terms of access by employees and customers.[57] As noted by the Alexandria Environmental Policy Commission, these funds from the add-on tax can provide improved transit and the entities that pay this tax will benefit though increased customer volume; other benefits include reduced traffic congestion and parking frustration in retail areas.[58] The

[53] BFAAC is currently working with City Staff to determine the total tax and fee burdens levied on businesses (analogous to the metric developed for residents—tax and fees as a percentage of personal income), so that the City will have a metric it can track (see discussion above under Tax and Fee Burden Issues). The business metric is still being developed. Once established, we envision it could be used to make comparisons with tax and fee burdens of surrounding jurisdictions and to identify best practices.

[54] FY 2012 Proposed Budget, at 7-27 and Budget Memo #4, Proposed Business License Tax Relief, February 14, 2011.

[55] Budget Memo #4, February 14, 2011. *See also* Budget Memo #14, Alternative Business License (BPOL) Rate Reduction Options, March 10, 2011.

[56] FY 2012 Proposed CIP, p. 2-29.

[57] Study Committee Report, p. 8.

[58] EPC Letter November 9, 2010.

Transportation Commission and Planning Commission also support an add-on tax as an additional source of funds for priority transportation projects.

- Our neighboring jurisdictions have adopted this tax (12.5 cents in Arlington; 11 cents in Fairfax). Neither paired the adoption of the tax with a reduction in other taxes. As noted in the Study Committee Report, Alexandria's overall business tax burden is low to moderate such that the City is business-competitive, and with the proposal to offset the added tax by BPOL tax reductions for smaller businesses, that posture would not change. Even with an add-on tax at the highest rate, real property tax rates in Alexandria will continue to be one of the lowest among major Northern Virginia jurisdictions, for both residential and commercial property taxpayers.[59]

- Last year we were concerned that small retailers, which generally operate on a low margin, may be less able to absorb added tax costs and we urged Council that if an add-on tax were to be adopted, tax relief should be provided for smaller businesses, for example, through adjustments to the business gross receipts tax (i.e., BPOL). We appreciate that the proposal incorporates an offset feature.

Concerns about the proposal:

- While we continue to agree generally with the premise that an add-on tax for commercial properties is a sound idea, we are concerned that the proposal as put forward contains provisions for additional borrowing to leverage the amounts raised through the added tax. If the City moves forward with the Potomac Yard Metro Station project, which we see as an acceptable temporary exception to the City's debt policy guidelines, additional borrowing for the identified transportation projects would further inflate the City's debt burden to unprecedented levels. We do not believe that additional debt at these levels would be desirable. We cautioned last year against borrowing in connection with the add-on tax and we do so again this year. We assume that without additional borrowing not all of the projects identified could be funded and/or some would have to be postponed.

- We are concerned that the proposed BPOL offset mechanism may be perceived as unfair. For example, there may be different views on what size businesses may be seen as "small" so as to warrant relief for this purpose. Moreover, the BPOL, as a levy on gross receipts, is a separate taxing system from the real property add-tax. Accordingly, it is possible that certain businesses could be eligible for a BPOL reduction under the proposal (because of their size) but not be subject to the add-on tax (say, for example, because the business does not operate out of commercial premises), thus affording relief to unintended beneficiaries and defeating the aim of the relief measure.

OBSERVATIONS AND RECOMMENDATIONS

- **We continue to support a commercial real estate add-on tax for transportation, but we do not endorse the additional borrowing that is part of the City Manager's proposal. If**

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[59] See Budget Memo #8, March 4, 2011, comparing real property tax rates in comparator jurisdictions.

incurring debt is considered essential to the success of this proposal, we urge that it be kept to a minimum and in all events at a level that would fit within the limits of the City's debt policy guidelines.

- **We continue to believe that an add-on tax for commercial properties should ideally be coupled with some kind of tax relief targeted to small businesses. However, we have concerns that the BPOL tax relief mechanism as proposed may be perceived as unfair.**

- **We considered but rejected a suggestion that the add-on tax be phased in over a period of 3-5 years because the City's transportation funding needs are so great. We believe that the revenues raised from this new source for transportation funding should be sufficient to begin to address long term transportation needs of the City. As we suggested last year, projects selected for funding from the add-on tax revenues should be ones that are significant in nature and readily seen by commercial real property taxpayers as producing demonstrable, positive impacts for the City.**

APPENDIX

Glossary:

ACPS	Alexandria City Public Schools
BFAAC	Budget and Fiscal Affairs Advisory Committee
BPOL	Business Professional and Occupational License Taxes
CIP	Capital Improvement Program
CY	Current Year
EPC	Alexandria's Environmental Policy Commission
FTE	Full Time Equivalents
FY/FYE	Fiscal Year/ Fiscal Year End
MFRI	Managing For Results Initiative
MRA	Market Rate Adjustment
OMB	Office of Management and Budget
VRS	Virginia Retirement System

CITY OF ALEXANDRIA DEBT BURDEN METRICS:
2012 Budget Projections Compared to 2011 Budget Projections, City Targets, and City Limits

DEBT AS PERCENT OF REAL PROPERTY ASSESSED VALUE:

				2012 Budget Estimates		Comparisons:		
	Target	Limit	2011 Budget Estimates	Without Potomac Yard Metro	With Potomac Yard Metro	2012 Vs 2011 Estimates NO METRO	2012 Estimate vs Target WITH METRO	2012 Estimate vs Limit WITH METRO
2011	1.1%	1.6%	1.4%	1.3%	1.3%	-0.1%	+0.2%	-0.3%
2012	1.1%	1.6%	1.5%	1.4%	1.4%	-0.1%	+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%	1.4%	1.4%	-0.1%	+0.3%	-0.2%
2015	1.1%	1.6%	1.5%	1.4%	2.1%	-0.1%	+1.0%	[redacted]
2016	1.1%	1.6%	1.4%	1.3%	2.0%	-0.1%	+0.9%	[redacted]
2017	1.1%	1.6%	1.4%	1.3%	1.9%	-0.1%	+0.8%	[redacted]
2018	1.1%	1.6%	1.3%	1.2%	1.8%	-0.1%	+0.7%	[redacted]
2019	1.1%	1.6%	1.2%	1.1%	1.6%	-0.1%	+0.5%	0.0%
2020	1.1%	1.6%	1.2%	1.1%	1.5%	-0.1%	+0.4%	-0.1%
2021	1.1%	1.6%	--	1.0%	1.4%	--	+0.3%	-0.2%

DEBT AS PERCENT OF PERSONAL INCOME:

				2012 Budget Estimates		Comparisons:		
	Target	Limit	2011 Budget Estimates	Without Potomac Yard Metro	With Potomac Yard Metro	2012 Vs 2011 Estimates NO METRO	2012 Estimate vs Target WITH METRO	2012 Estimate vs Limit WITH METRO
2011	3.2%	4.5%	4.0%	3.8%	3.8%	-0.2%	+0.6%	-0.7%
2012	3.2%	4.5%	4.3%	3.9%	3.9%	-0.4%	+0.7%	-0.6%
2013	3.2%	4.5%	4.4%	3.9%	3.9%	-0.5%	+0.7%	-0.6%
2014	3.2%	4.5%	4.4%	3.8%	3.8%	-0.6%	+0.6%	-0.7%
2015	3.2%	4.5%	4.2%	3.7%	5.6%	-0.5%	+2.4%	[redacted]
2016	3.2%	4.5%	4.1%	3.6%	5.3%	-0.5%	+2.1%	[redacted]
2017	3.2%	4.5%	3.9%	3.4%	5.1%	-0.5%	+1.9%	[redacted]
2018	3.2%	4.5%	3.7%	3.2%	4.8%	-0.5%	+1.6%	[redacted]
2019	3.2%	4.5%	3.5%	3.0%	4.5%	-0.5%	+1.3%	0.0%
2020	3.2%	4.5%	3.3%	2.8%	4.2%	-0.5%	+1.0%	-0.3%
2021	3.2%	4.5%	--	2.6%	3.9%	--	+0.7%	-0.6%

DEBT SERVICE AS PERCENT OF GENERAL GOVERNMENTAL EXPENDITURES:

				2012 Budget Estimates		Comparisons:		
	Target	Limit	2011 Budget Estimates	Without Potomac Yard Metro	With Potomac Yard Metro	2012 Vs 2011 Estimates NO METRO	2012 Estimate vs Target WITH METRO	2012 Estimate vs Limit WITH METRO
2011	8.0%	10.0%	5.1%	5.1%	5.1%	0.0%	-2.9%	-4.9%
2012	8.0%	10.0%	6.1%	5.8%	5.9%	-0.3%	-2.1%	-4.1%
2013	8.0%	10.0%	6.6%	6.3%	6.4%	-0.3%	-1.6%	-3.6%
2014	8.0%	10.0%	7.1%	6.9%	6.9%	-0.2%	-1.1%	-3.1%
2015	8.0%	10.0%	7.8%	7.1%	5.4%	-0.7%	-2.6%	-4.6%
2016	8.0%	10.0%	8.1%	7.2%	7.1%	-0.9%	-0.9%	-2.9%
2017	8.0%	10.0%	8.5%	7.2%	8.3%	-1.3%	+0.3%	-1.7%
2018	8.0%	10.0%	8.9%	7.3%	8.3%	-1.6%	+0.3%	-1.7%
2019	8.0%	10.0%	9.2%	7.3%	8.3%	-1.9%	+0.3%	-1.7%
2020	8.0%	10.0%	9.2%	7.2%	8.4%	-2.0%	+0.4%	-1.6%
2021	8.0%	10.0%	--	6.9%	8.2%	--	+0.2%	-1.8%