City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 22, 2005

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER J

SUBJECT: BUDGET MEMO #105 CASH CAPITAL

The following two related budget questions have been asked. Mayor Euille has asked what is the minimum amount of cash capital which should be maintained in the CIP. Councilman Macdonald has asked a related question about what the impact of reducing cash capital would be on borrowing.

Answer: The amount of cash capital used to fund the City's six-year Capital Improvement Program (CIP) can vary based upon a number of factors including:

(1) total size of the CIP
(2) existing and projected debt ratios and debt capacity
(3) economic cycles
(4) City bond rating
(5) dedicated funding programs

Currently the City-funded CIP totals $325.0 million, which is a large CIP given the City's overall size, budget and historical capital funding levels. The CIP has been able to grow by increasing use of cash capital, as well as bond funding. If cash capital had not been increased, more debt would have been incurred and the City's Debt Related Financial Policies (which set debt limits) would likely have been violated and significant debt capacity (needed in the future for projects beyond the current CIP) used. Cash capital has increased from $2.5 million in FY 1999 to $21.0 million in FY 2006. It should be noted that $2.7 million of this increase is due to the dedicated one cent for open space acquisition, and $2.5 million of this increase represents using the savings derived from higher state school aid for T.C. Williams construction financing.

It has been a conscious decision to build cash capital funding of the CIP over the last seven years as a way of capturing a portion of tax revenues generated by the "up" portion of the economic cycle and building that cash capital funding level structurally into the budget so that it represents a 4.5% portion of the General Fund budget. This is a large percentage and will provide budget flexibility during the likely future "down" portion of the economic cycle. During the "down" portion of the cycle when revenues are tight and budgets will need to be cut or held to small increases, having the starting point of a large cash capital budget means that the overall budget can be cut without negatively impacting operating programs, building and infrastructure maintenance, or without making major service cuts. It also helps temper the need for future tax rate increases. While the timing of the "down" portion of the economic cycle is not certain, it appears that it could start as early as FY 2007 or FY 2008. Cash capital is in effect a fiscal structural insurance policy which provides long term structural budget stability. It has grown in the good revenue years and it is available to be cut in negative revenue years.

Current General Fund provided cash capital equates to 47% of the six-year CIP. The bond rating agencies consider this a very healthy CIP General Fund cash share. How much this could be reduced without raising bond rating agency concerns is not something the rating agencies provide specific guidance for, but having the City-funded CIP be constituted by no less than 25% annual cash capital contribution to the CIP would likely be acceptable to the bond rating agencies. This, however, assumes that the 75% funding of the balance of the CIP did not include so much new debt that it resulted in the City's Debt Related Financial Policies being violated. For the CIP currently in front of Council, if the cash capital amounts were reduced substantially, then there should also be a substantial reduction in planned projects.