

City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 18, 2008

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER

SUBJECT: BUDGET MEMO #101: THE NEED TO FOCUS ON FUTURE BUDGET CHALLENGES AND EXPENDITURE REDUCTIONS

This budget memo responds to Mayor Euille's written request of April 9, 2008 "The Need to Focus on Future Budget Challenges and Expenditure Reductions" (attached).

The Mayor raises an important issue: namely how should the City prepare for the uncertainties presented by the economic outlook for the nation, the region and the City. These uncertainties are considerable as the City faces challenges posed in the real estate market, the financial sector, the retail business market, and the hospitality business market. Most importantly, the City must be cognizant of the economic challenges facing our residents in the form of inflation, employment and wages. The challenge is not just how to manage the City's finances in the face of short term economic uncertainties, but as the Mayor's says, these economic challenges may continue for several more years. They may require, if budgeted resources are far less than planned, for us to build upon our ability to respond either quickly or over a longer period of time with reductions in planned spending, if necessary. The long term budget challenge raises the question whether or not the City should be looking at transformational changes in our service delivery strategies, and whether or not the City should consider more significant changes in the role of City government.

Before answering the specific questions posed by the Mayor, I want to say that the City has been preparing for this moment for several years.

- We have restructured the City's budget through the Managing for Results Initiative to show approximately 150 programs and 500 activities. For each activity the cost, and number of employee positions are shown, as well as measures of output, efficiency and quality of service. We believe this transparent display of budget information allows City Council and the public to see and evaluate the relative value of City programs and activities at a level of detail that would permit, if necessary, the hard choices that may need to be made if the City's revenue outlook deteriorates.

- City Council has reformed the budget process in order to provide guidance to City staff in the fall of each year that sets clear expectations and provides a transparent process. The reformed budget process, first adopted in May of 2005, gives Council a mechanism to review the budget outlook in the fall and set specific parameters for the City staff in development of the proposed budget and Capital Improvement Program. These reforms have been fine tuned over the last few budgets and are working well as we come to the conclusion of the Fiscal Year 2009 budget process. These policies and procedures should help us address future budget challenges. If the City Council wants to instruct City staff to reduce services and programs, including personnel levels in future budgets, specific guidance can be given to City staff on the areas to reduce, and/or the areas not to reduce.
- We have been conducting efficiency and best practices studies of individual departments and programs through outside consultants. These studies have identified some relatively modest efficiency savings (in the range of hundreds of thousands of dollars in each study) as well as program improvements (sometimes costing nearly as much). We have reviewed and reported on a portion of the Transportation and Environmental Services Department, the City's Fleet Management program, and the Fire Department. A report is nearing completion on a review of the Recreation, Parks and Cultural Activities Department, and a study of the Personnel Services Department is underway. We also are working with consultants on a study of combining our public safety communications operations, and we are in the process of improving the processing of City building permits. We will begin this spring a study of the Purchasing Office in the Department of Finance, as well as a study of the Information Technology Services Department and information technology operations citywide. These studies are all important priorities for City staff, but unfortunately to be comprehensive they require time and considerable consultant and City staff resources to do properly. These studies, and others to come, allow us to examine each department and program in the depth required to find true efficiencies and to benchmark ourselves against best practices found in other comparable jurisdictions.
- A key study is underway of the City's Personnel Classification and Compensation policies and procedures. The pay and benefits provided to City and Schools employees constitute the single largest type of expense of City government. We must ensure that pay and benefits are adequate to attract and keep an excellent workforce, but our future financial sustainability requires us to be prudent in our pay and benefits decisions so that we both compete in the regional labor market for our employees and recognize our financial limitations. This study of City employee pay and benefits should be ready to inform Council in its deliberations on the FY 2010 budget.

- We are closely monitoring our revenues, expenditures and staffing levels during the fiscal year. City staff has provided Council with detailed monthly expenditure and revenue status reports for many years. Given its transitional nature and high degree of uncertainty, we will be more closely monitoring sales and values in the real estate market, as well as other key revenue trends, such as interest earnings. We have internal reports that monitor citywide and departmental on-board staffing levels compared with authorized staffing levels. We also ask departments to periodically project their spending through the end of the fiscal year and have measures in place to ensure orderly year-end spending practices.
- We have already been increasing the amount of vacancy savings captured in our budget process. In the FY 2009 proposed budget we have reduced department budgets by \$5.94 million to reflect expected vacancies during the fiscal year. This compares with \$3.1 million taken out of the FY 2005 budget. These vacancy savings have been taken very precisely to reflect both the size and past experience of each department with turnover and actual vacancy savings in prior years.
- City Council has the ability through the monthly Capital Improvement Program allocation docket items to control capital spending. Each of the months that Council is in session, City Staff presents a request for Council to release funds for upcoming CIP projects that are ready to go. As City Staff begin to adopt the discipline required by the phased approval process for major CIP projects, City Council will find that it has the ability to slow down the pace of capital spending if that is necessary to respond to changing economic circumstances.
- We continue to maintain adequate undesignated fund balances that are available to ensure a final backstop against an unexpected major decline in revenues in FY 2009. Our current undesignated fund balance of \$27.9 million is 5.4 percent of FY 2008 General Fund Revenues. This is close to City Council's Target of 5.5 percent and well above the limit of 4.0 percent. This balance is sufficient protection, in the highly unlikely case the above measures, or other measures which may be needed to be crafted and implemented, are not sufficient to protect us against further deterioration in the economy. Using this fund balance is not intended to cover revenue losses. It would be a last resort, and ultimately will make sure there are no major, sudden dislocations of services. The bond rating agencies consider a major or ongoing drawdown in undesignated fund balance to be one of the most serious concerns.

Mayor Euille's memo asked several specific questions. Those questions and Staff's response are below:

Question: “What will it cost to utilize the expertise of outside consultants like a McKinsey & Company? How long will it take to begin and complete such review/study of the entire city operations?”

Answer: I believe the best course is to continue to engage consultants who specialize in examining particular local government programs, and to look at individual departments and programs on a rotating basis. A global management consulting company such as McKinsey & Company has public sector offerings but generally works for the private sector and charges premium rates. We would anticipate that the cost of such a comprehensive study covering the entire range of City operations would cost several million dollars. It would probably take several months to develop and competitively acquire such management services and take at least a year, and probably more time to examine, and in some cases reexamine, all aspects of City operations. Such a study would be unlikely to discover significant opportunities for savings without transformational changes or the whole scale elimination of programs.

Question: “Do we implement a job freeze soon?”

Answer: I do not recommend a job freeze at this time. Although preparing for such an action as a contingency is a good management practice, such a measure should be taken only when necessary, and we do not believe the revenue outlook at the moment requires such action. However, we will continue to monitor the economy and revenue outlook and report on it to Council monthly. We have recently asked all departments to report on the specific vacancies in each department, the cost of those vacancies and the status of filling those vacancies. A report on vacancies will be available to City Council within a week. We will continue to ask Departments for a monthly report on their vacancies and the status of filling those vacancies. A “hard” freeze on filling all vacant City positions randomly affects those departments with a higher proportionate number of vacancies. If such a freeze were necessary, we would recommend a “soft” freeze that allows the City Manager to consider the need for filling each position on a case-by-case basis so that essential services are not adversely affected. In fact, if we need to cutback on planned and budgeted spending during FY 2009 because it becomes clear that revenues will not meet expectations, it may work better to tell departments to reduce spending and to turn back a certain percentage of their approved budget. Departments can then freeze hiring as necessary to meet this target, as well as reduce expenditures for non-personnel items.

Question: “As an alternative, do we assign such a task to the Mayor’s Economic Sustainability Work Group to develop a strategy plan for what major areas, i.e., personnel levels, worker’s compensation, fringe benefits, programs, etc. should be undertaken?”

Answer: I think the City Manager’s Advisory Group would be a better alternative. We should depend on the Economic Sustainability Work Group for economic development advice, which is their area of expertise. The Mayor’s Economic Sustainability Work Group has performed a valuable service in identifying economic challenges facing the City and strategies for meeting those challenges. That group, however, was not chosen for its expertise in government management, but rather for its expertise in business and economics. Three of the members of this work group are also part of the Implementation Monitoring Committee.

I have asked the City Manager’s Advisory Group¹, a group composed of distinguished government management experts who are residents of Alexandria for their advice. In response to the Mayor’s memo, this group had provided the following comments:

- The management actions and contingency plans outlined above should be sufficient preparations to handle the short term economic uncertainties facing the City.
- Based on results to date and experience with other such traditional management efficiency studies in other venues, these studies, whether done one department or program at a time as planned by City staff, or as a citywide study by a company like a McKinsey & Company, will not yield efficiency savings of great magnitude. These studies typically identify some marginal savings, but also are likely to identify some other actions that should be taken based on best practices to improve service delivery that would have costs that offset those efficiency savings.
- The group, however, does see the need to examine transformational changes that focus on the appropriate roles that various sectors play in delivering needed services to the public – City government, non-profits, other civic groups, business organizations and the private sector – and how to pay for those services either through general taxes on all or targeted taxes or user fees on segments of the community or geographical areas receiving the primary benefits of those services.
- The City’s Managing for Results Initiative provides a platform for dealing with both the short term budget challenge of economic uncertainty and the long term challenge of transformational change. The Council, City Staff and the community can use the information provided in the budget document to assess the relative value and cost of

¹ The members of the City Manager’s Advisory Group are Lisa Chimento, Executive Vice-President, the Lewin Group; Allen Lomax, consultant and recently retired from the U.S. Government Accountability Office; Mark Abramson, Chairman of Leadership Inc. and former Executive Director of the IBM Center for the Business of Government; Lynwood Campbell, Director, Securities Filings and Review, Office of Thrift Supervision; Laura Machanic, President and CEO, New Target, Inc.; John Renner, President and CEO, Renner and Company.

various programs and activities and to identify specific candidates for transformational change.

- City Council can begin such a dialogue over the coming months, solicit citizen input and establish a basis for the next Council, which takes office in July 2009 to reexamine the Strategic Plan and make appropriate adjustments to address this long term financial challenge.
- I expect to keep this group involved in our budget process, MFRI, best practices studies, and especially transformational changes as we address these financial and management challenges.

Conclusion: I share the Mayor's concern about the need to be cautious about the near term economic future (FY 2009), and I offer the following observations:

- We have contingency plans that can be implemented quickly to reduce spending, if necessary because revenues drop below estimates upon which the budget is based. We have in place a system to institute a soft hiring freeze if that becomes necessary, and we can slow down non-personnel spending by controlling major purchases, or by setting targets for departments to return part of their budgeted funds as a result of needed spending reductions. Each of these actions will reduce our ability to maintain current output and outcome measures.
- We can and will take timely action if our expected revenues decline by monitoring the revenue situation closely and reducing hiring and other spending as soon as that might become necessary.
- We will look closely at planned capital project implementation and spending so as to ensure the construction of a number of projects are not initiated in FY 2009 until after at least mid-year in FY 2009, when we know what our FY 2009 real estate assessments will be.
- We have sufficient undesignated fund balances in place as the final backstop in the highly unlikely case that the above contingency plans are not sufficient. While these funds are in hand, any revenue shortfall should be handled by multiple actions to reduce spending in order to keep the budget in balance.

I also share the Mayor's concern about the need to be cautious about the longer term economic future (FY 2010 and beyond), and I offer the following observations:

- We have been willing and able to meet whatever expenditure guidance that Council has provided as we prepare each budget. This process has been challenging for City staff, but the discipline it has imposed on the process has allowed Council and staff together to formulate responsible and responsive budgets.
- We will continue to produce efficiency and best practices studies of individual departments and programs.
- We will launch an efficiency awareness campaign and use the knowledge and creativity of our employees to help identify further efficiencies and economies. For example, we have started that already in the energy area. This campaign also will assist departmental staff in using program, activity and performance information in the budget to identify possible budget reduction options.
- Furthermore, we will continue to provide Council information and options for making the difficult policy choices that might be required in future budgets through continuing improvement of our Managing for Results budget format and better management and prioritization of the projects in the Capital Improvement Program.
- Now that the MFRI process is institutionalized within the government, we stand ready to reexamine Alexandria's City government with an eye toward transformational change, as opposed to incremental change, and focus on the appropriate roles that various sectors play in delivering needed services to the public – City government, non-profits, other civic groups, business organizations and the private sector – and how to pay for those services.

I believe these actions will provide the leadership that is required to face our economic challenges today and in the future.

BUDGET MEMO REQUEST

To: City Council
Jim Hartmann
Bruce Johnson
Mark Jinks

From: Bill Euille

Date: April 9, 2008

Re: The need to focus on future Budget Challenges and
Expenditure Reductions

As the economy continues to struggle, which very well may last for several more years, we must find ways to further reduce services and programs, including personnel levels city-wide in order to achieve some measurable efficiency and cost savings, exclusive of what we are presently considering, and exclusive of the economic sustainability study recommendations.

I honestly believe that we need to advocate for such a process NOW, in order to show our taxpayers that we are both responsive and responsible to the economic challenges we face together, not only today, but in subsequent budget cycles. This is what Leadership is all about.

What will it cost to utilize the expertise of outside consultants like a McKenzie & Company?

How long will it take to begin and complete such review/study of the entire city operations?

Do we implement a job freeze soon?

As an alternative, do we assign such a task to the Mayor's Economic Sustainability Work Group to develop a strategy plan for what major areas, i.e.: personnel levels, worker's compensation, fringe benefits, programs, etc, should be undertaken.

Please provide a response as soon as possible.