ARLINGTON COUNTY, VIRGINIA

County Board Agenda Item
Meeting of November 15, 2005

DATE: November 7, 2005

SUBJECT: Fiscal Year (FY) 2007 Budget Guidance

C. M. RECOMMENDATIONS:

Provide guidance on the FY 2007 budget.

ISSUE: Continuing to provide fiscally sustainable programs and services at a good value for citizens, while maintaining Arlington's relatively low tax burden within the region.

SUMMARY:

SUMMARY: Arlington continues to be in a strong economic position, with continued development and reinvestment in the community, and low unemployment that is expected to continue into FY 2007. However, the strong real estate market -- combined with the expense pressures facing the County – places us in a position in which we must make difficult choices.

The continued strength in Arlington's residential real estate market – which translates into higher real estate assessments – is itself a double-edged sword. Because the Commonwealth mandates a single tax rate for both residential and commercial real estate (and restricts the County's ability to raise revenues in other ways), the strong real estate market has led to greater and greater financial burdens placed on homeowners. Cutting the real estate tax rate provides a disproportionate benefit to the commercial sector and maintains a higher percentage burden on the residential homeowner.

Expense pressures: At the same time, Arlington maintains robust programs, services, and infrastructure. Key expense drivers include:

- Personnel. Maintaining competitive pay in an extremely competitive environment.
- Operating expenses. Like everyone else, the County is subject to market increases for gasoline and natural gas, etc.
- Metro. An important part of Arlington's success, Metro will cost Arlington 13.1% more next year.
- Debt service and capital expenses. New community facilities have increased debt service at a rate greater than inflation and leads to a need for additional maintenance and operating costs for new and existing facilities.

County Manager: ______________

Staff: Barbara M. Donnellan, Deputy County Manager
Chuck Gubisch, Budget Director, Department of Management and Finance
Richard Stephenson, Revenue Analyst, Department of Management and Finance

Arlington needs to be positioned to deal with the future by continuing to build a fiscally sustainable budget today. Providing sufficient, ongoing resources to maintain the County's basic infrastructure must be addressed. These high cost budget components are escalating at a much faster rate than normal inflation.

The formidable challenge that Arlington faces is balancing competing interests for tax relief and maintaining a competitive tax burden within the region, while providing sufficient resources for personnel, operating and capital costs necessary to achieve the County Board and community vision.

Budget Drivers

Revenue. Arlington's real estate market continues to be very strong. Average residential real estate assessment growth for Calendar Year 2006 is projected to exceed 20%, the sixth year in a row with double digit growth. Although Arlington has lowered the real estate tax rate for the past four years in a row and has maintained the lowest overall tax burden among the major jurisdictions in Northern Virginia, providing additional tax relief for homeowners will be challenging. Providing general tax relief, however, is extremely difficult given limitations imposed by the State, the most constraining of which is the requirement of a unitary tax rate - a rate that is the same for both residential and commercial properties regardless of different assessment increases.

At this time, total local tax revenues for FY 2007 are projected to increase approximately 11.9% over the FY 2006 Approved Budget. A majority of this increase is due to the increase in estimates to the real estate assessment tax base for CY 2006. Growth in real estate assessments is again projected to be double digit growth in CY 2006 with residential assessment growth similar to the last four years. Several other tax revenues including sales, transient occupancy, and meals tax are showing strong gains. Arlington's second and third largest tax sources, personal property and B.P.O.L., are projected to be flat relative to the FY 2006 Adopted budget.

Non-tax revenues show slower growth primarily due to estimates for revenue from the state and federal government. It is assumed that most new revenue from the state and federal government will be tied to grant money where there is a corresponding expenditure. For the purposes of these budget planning estimates, the federal revenue is projected flat and there is no corresponding expense increase. County local fees and charges are showing normal inflationary growth. These charges are increased at periodic intervals to offset the cost of providing the services.

Preliminary revenue forecasts project 9.5% growth in General Fund revenue for FY 2007, generating an additional $72.1 million.

Expenses. Over recent years, Arlington has had the good fortune of being able to make strategic investments in services to enhance the community. These include more affordable housing support, expanded local transit options, extensive community infrastructure investment, support for those in need, and a strong commitment for a high-performing public education system. While the community has strongly supported these improvements, they have resulted in General Fund expenditures growing by an average of 7.1% a year over the last six years. This level of

growth will not be sustainable for the long-term, especially when real estate assessment growth slows. Still, in order to maintain our competitive advantage as an employer of choice, satisfy our contractual commitments, provide for adequate capital investment and fund the higher costs for utilities and new facilities in FY 2007, additional resources will be necessary. If these commitments exceed resources available, targeted reductions may be considered. The following summarize the major expense pressures:

- **Personnel.** The largest item in the County's budget is for personnel. Pay and benefits for staff support Arlington's Employer of Choice philosophy and help to maintain our ability to attract and keep a high quality workforce.

  The challenge is to develop a responsible budget that attracts and retains talented staff. The tight personnel market in this region is making competitive pay an issue. The typical budget would include a step pay plan which would increase the budget by 3-3.5% ($7.7 million to $9.0 million) and a market pay line increase around 2% ($5.1 million). However, an additional evaluation of the county pay line estimated the pay line is off by a minimum of 4.6% ($11.7 million) based on County Board policy. Maintaining competitive pay and benefits in a Pay-for-Performance program at 4.0% would cost $10.2 million, exclusive of the market pay line increase. One goal for pay for performance is to reward staff based on performance and secondly, to begin addressing the discrepancy in the pay line difference. Without having enough funds to support the pay for performance program we will only exacerbate the pay line difference. The pay-for-performance program components have not been finalized. This program would replace the current step system, based on years of service. The 4% amount is being used for budget planning; however, this would not fully fund the County Board's pay policy.

  - Public Safety pay enhancements $3.0 million
  - Health insurance $2.5 million, 10% increase in premiums
  - Meet employer retirement requirements as recommended by the actuarial report. Retirement $4 million, 19.6% increase in employer contributions

  Implementation of the public safety pay enhancements was included in the Closeout report for implementation beginning in January, 2006. These pay enhancements were based on an assessment of our pay comparability with neighboring jurisdictions for our uniformed staff in the Police and Fire Departments and Sheriff's Office. The $3.0 million represents full-year costs for FY 2007.

  The health insurance premium will increase to keep pace with medical inflation and medical claims for our self-insured health care program. The employer contributions for the defined benefit retirement system have been recommended for an increase based on actuarial recommendations for attaining normal cost recovery.

- **Other Expenses.** Operating expenses, in some instances, are controlled by multi-year contracts that require inflationary increases. Other expenses are affected by inflationary market increases beyond the control of the County agencies, such as gasoline and natural gas, which are projected to increase substantially over the next year. Preliminary projections for operating expenses would include inflation on certain categories of non personnel expenses

and the full year impact of new and renovated facilities budgeted in FY 2006 for only a partial year. Additionally, the County is projecting to retain contingency accounts at current base levels (e.g., general contingent and affordable housing investment fund) and continue with the set-aside of incremental recordation taxes for affordable housing programs.

- **Metro.** The County's subsidy is based on the size of the Metro budget, and revenue support from user fees, state aid and gasoline taxes. The County's share will be revised based on additional budget review by the Metro Board. The estimated costs for FY 2007 is $14.7 million, compared to $13.0 million for FY 2006 (13.1% increase)

- **Debt service.** For FY 2007, County debt service is projected to increase by $3.7 million to $47.5 million, based on bonds already sold and those anticipated to be sold during FY 2006. It also includes the debt service for the IDA bonds issued in July.

- **Pay-As-You-Go Capital.** In recent years, one-time revenue sources, such as prior year fund balance, have been a primary source of capital funding. Better revenue forecasting has reduced the amount of these one-time funds available at year-end. For FY 2006, incremental tax revenue from the commercial utility tax rate increase and increases in ambulance fees were also used for capital investment. These revenues can again be used for capital investment, together with other available funds (including fund balance from FY 2006); however, these may not be sufficient to support the capital needs identified in the CIP.

Subject to Appropriation Leases. The County enters into short term and long term leases for a number of different County purposes. These leases are subject to annual appropriation. Unlike a typical lessee, the County Board is not able to legally bind future Boards. However, the County has always paid its debt obligations and is committed to meet these commitments each year.

New Initiatives. Any new, strategic and emerging needs will need to be evaluated and will compete against existing programs and tax relief.

Schools Revenue Sharing Agreement

The County Board and School Board have operated under a Revenue Sharing Agreement since Fiscal Year 2002. The current formula for FY 2006 allocates 48.1% of net local County tax revenue to the Schools. The current agreement is not year specific and serves as an ongoing agreement until modified by the Boards. Based on revisions to the revenue sharing agreement last year, the percentage formula is adjusted based on changes in school enrollment each year. Based on the most recent enrollment data, the revenue sharing percentage for FY 2007 would be 47.7% to the Schools.

Conclusion. Overall, Arlington is in a strong economic position. The County's diverse tax base, fiscal restraint, and business stability allow Arlington to provide a high level of service for its citizens at a good value. At the same time, residential homeowners have seen significant increases in annual assessments since 2000 and many residents have consistently advocated for increased public services across a range of policy areas. As the Board approaches its annual challenge of balancing these competing demands, I will be preparing the FY 2007 Proposed

Budget that attempts to address these issues in a fiscally sustainable way that continues to provide good value for our residents and businesses in a fair and equitable way.