ARLINGTON COUNTY, VIRGINIA

County Board Agenda Item
Meeting of November 27, 2007

DATE: November 21, 2007

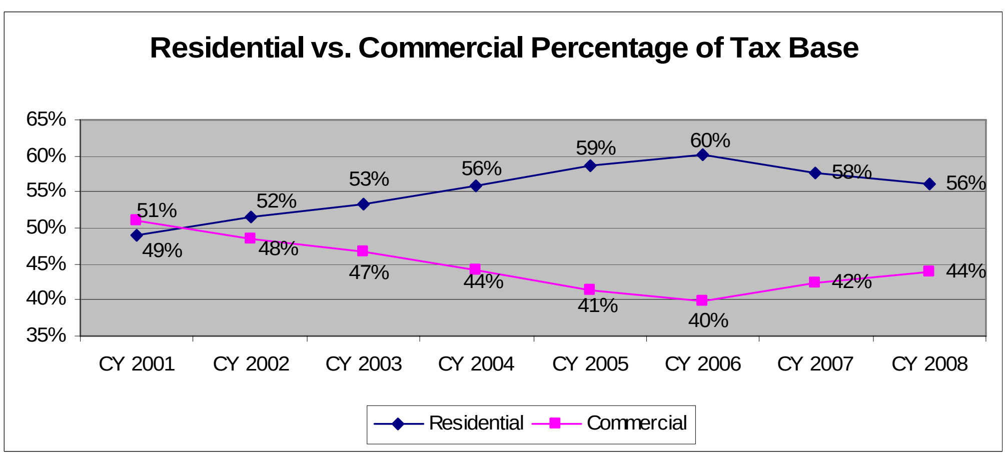
SUBJECT: Fiscal Year (FY) 2009 Budget Guidance

C. M. RECOMMENDATION: Provide guidance on the FY 2009 budget.

ISSUE: Continuing to achieve the vision for the community by providing fiscally sustainable programs and services at a good value.

SUMMARY: Compared with other Northern Virginia jurisdictions, Arlington's fiscal outlook is relatively bright. Some nearby jurisdictions are projecting steep drops in real estate assessments for the upcoming tax year, and flat growth for other revenues, including personal property and sales tax. However, Arlington's diverse and balanced economy continues to grow at a healthy long-term rate. The balance in Arlington's real estate market between residential and commercial properties has allowed the County to weather the significant change in real estate values affecting the region and nation at large. Arlington continues to maintain historically low unemployment and high wages.

Real estate tax revenue is projected to grow 4.1%. With slightly positive residential assessment growth, continued commercial market strength, and new construction, Arlington is in a positive position moving into FY 2009. Other local tax revenue shows similar strength with anticipated growth of just under 4%. Local fee and intergovernmental revenue growth will be lower with growth projected to be approximately 1%. This is largely due to state and federal revenue not keeping pace with inflation. Overall, Arlington revenues are expected to increase 3.6% in FY 2009, details of which are provided later in this report.



County Manager: ______________

Staff: Mark Schwartz, Director, Department of Management and Finance
Richard Stephenson, Acting Budget Director, Department of Management and Finance

There are two areas that will create especially strong pressure on the Arlington budget in FY 2009 and beyond and must be addressed for the long-term stability of the County:

- Employee Compensation, and
- Maintaining County Infrastructure

Employee compensation includes salaries, healthcare, and retirement. With full employment in the Washington region, all employers are challenged to be competitive in salaries and benefits. Arlington has traditionally distinguished itself by providing excellent healthcare for both active and retired employees. Rapid escalation in healthcare costs combined with long-term potential liabilities for retirees create a challenge.

The County has made a strong investment in recent years in long-term, bond-supported infrastructure. These investments require a base of funding necessary to sustain that investment. Maintenance capital expenditures will require significant demands on fiscal resources in order to maintain all County infrastructure. Over the last five years the County has opened/renovated a substantial County facility each year. These facilities include Barcroft Sports & Fitness Center, George Mason Center, Greenbrier Park, Fenwick building, Walter Reed Community Center, the Parks, Recreation and Cultural Resources headquarters building, Shirlington Library, and Lee Community Center. Adequately funding a base maintenance capital budget is necessary to properly ensure the upkeep of all County facilities.

Arlington's strong economic climate, highly-skilled workforce, and proximity to our nation's capital insulate Arlington from many of the uncertainties in the broader national economy. Still, we must make critical and strategic choices that provide for sustainability, a mix of services that supports our vision for the community, and good value.

DISCUSSION: In the early preparation of the FY 2009 budget, I have operated from the following principles based on past guidance from the County Board:

- Present a balanced and sustainable base budget within existing tax rates.
- Fully fund all debt, lease, and other contractual commitments including those that are "subject to appropriation" in the base budget.
- Add no new positions or programs supported by local tax revenues.
- Continue to increase our commitment to maintain infrastructure (maintenance capital).
- Provide the most sustainable compensation plan possible while retaining competitiveness in the region.
- Adjust fee and grant funded programs up or down, relative to available revenues.
- Comply with the Revenue Sharing Agreement with the Schools.
- Prudently increase our budget reserves to continue to maintain our AAA bond rating.

Adhering to these principles, particularly maintaining existing tax rates, will present challenges.

Similar to last year, a budget that maintains all current services at current levels should not be assumed.

Recommendations for service reductions or eliminations will be explicit so that the policy choices for the County Board are clear. Any revenue enhancements or service increases supported by new or expanded fees will be presented as policy choices for the County Board outside of the base budget.

Departments will continue to identify efficiencies that lower costs without reducing services. Current projections, assuming we do nothing but continue with business as usual, would lead to a projected gap between revenues and expenditures of $17.4 million – without a market compensation adjustment for employees ($2.8 million for each 1%), without increasing the retiree healthcare reserve, and reducing the maintenance capital back to the base funding level of $5.2 million ($16.4 million adopted in the FY 2007 – FY 2012 Capital Improvement Program).

It is recommended in the FY 2007 Closeout board report that $9.6 million be set-aside for the FY 2009 budget. These are one-time funds that could be used toward PAYG capital, reserves, or the retirement of debt and are not currently included in the budget planning estimates.

BACKGROUND: The following provides current expense and revenue assumptions for FY 2009. Assumptions will continue to be revised until the County Manager's Recommended Budget is presented in late February. After that, the County Board will receive two updates: the mid-year assessment in March and the third quarter assessment in April, which form the basis for County Board actions.

Revenues

As previously noted, Arlington relies on a balanced and diverse mix of revenues. The working assumptions and most recent projections for each are outlined below.

REVENUE CHANGE
FY 2008 TO FY 2009

LOCAL TAXES	**% Change**	**$ Change (millions)**
Real Estate Tax	4.1%	$18.4
Personal Property	2.9%	$2.8
Business Tax (BPOL)	4.0%	$2.1
Sales Tax	3.8%	$1.3
Transient Occupancy Tax	4.5%	$0.9
Meals Tax	5.0%	$1.4
Other Taxes	5.6%	$2.1
Sub-total taxes	**4.1%**	**$29.0**
NON-TAX REVENUE		
License, Permits & Fees	3.0%	$0.1*
Fines, Interest, Misc.	1.7%	$0.9
Charges for Services	3.0%	$0.3
State	1.0%	$0.7
Federal	0.0%	$0.0
Sub-total non-taxes	**1.3%**	**$2.0**
TOTAL	**3.6%**	**$31.0 million***

*Net of $6.2m permit revenue moved to CPHD Enterprise Fund for FY09

- Real Estate Tax: Real estate assessment growth has slowed, a trend that began last year. The projection for CY 2008 real estate assessment growth is 4%. Residential real estate assessment growth is expected to be slightly positive, while commercial real estate assessment growth is projected at 8%.

- Personal Property Tax: Current FY 2009 projections of personal property tax revenue are 2.9% over the adopted FY 2008 level, reflecting a gradual leveling of personal property assessments. Close to 90% of all personal property tax revenue is received by the County through the first part of November. Once assessment and revenue analysis is complete for the first four months of FY 2008, the personal property tax revenue estimates will be revised in the Manager's proposed budget.

- Business, Occupational, & License Tax (BPOL): BPOL tax revenue is generated by taxes levied on entities doing business in the County and is based on a percentage of gross receipts or fixed fee. This revenue source has been a generally positive but fluctuating revenue source over the last few years. For FY 2009, preliminary projections inflate BPOL revenue by 4% over FY 2008.

- Sales Tax: Sales tax revenue is the County's 4th largest revenue source. Arlington receives a local option tax of 1% on all items sold in the County. This tax has shown steady growth over the last several years. For FY 2009, sales tax is being projected to grow by 3.8%, which is equal to its 7-year average.

- Transient Occupancy Tax: A 5.25% local tax is levied on the amount paid for hotel and motel rooms in the County. Current average daily room rates are approaching all time highs. For FY 2009, it is projected that this growth will be 4.5%, reflecting an additional 160 hotel rooms that are expected to come on line in the next year.

- Meals Tax: A 4% tax is charged on most prepared foods offered for sale. Growth in the economy and in the number of establishments in Arlington has positively impacted the revenue generated by this tax in the County. For FY 2009 it is projected that revenue will grow 5%.

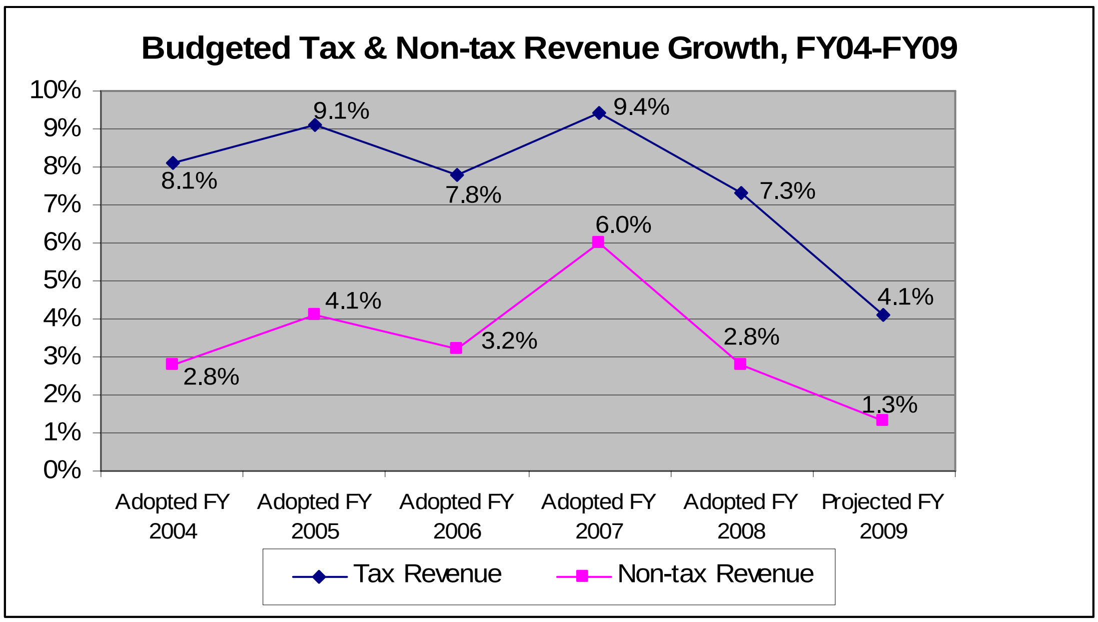
- Other Taxes: Other taxes collected by the County include cigarette, car rental, recordation, estate, consumption, and commercial utility taxes. Growth in these other taxes is projected to average 5.6%.

- License & Fees: Revenues in this category are levied to offset the cost of licensing certain trades and providing related services. For FY 2009 this category is expected to be reduced by roughly 6.1% reflecting the transfer of fee revenue from the general fund to the CPHD Enterprise fund. After adjusting for the effect of the transfer, license and fees revenues are projected to increase by $1.3 million, or 1.9%.

- Fines, Interest, & Miscellaneous: Fine revenue from tickets and court fees, interest income on bond and general fund investments, and other miscellaneous revenue sources are included in this category. For FY 2009, this category is expected to increase by 1.7% or roughly $900,000.

- Charges for Services: This category encompasses revenues received for a variety of County services. Service charges are structured so that the users of a particular service are the ones to pay for a majority of its costs, as opposed to using general tax dollars to fund services that benefit a small segment of the population. For FY 2009, growth in this category assumes inflationary growth of these services provided.

- Intergovernmental Revenues: This category includes state and federal revenue received by the County. Arlington receives funds from the Commonwealth of Virginia for a variety of state-mandated and supported functions and services. The County also receives a portion of some revenues collected by the state. Most federal revenue is received in the form of grants. In FY 2009, intergovernmental revenue is expected to lag behind inflation, reflecting the governor's recent budget cuts and flat growth in federal funds.



Expenses

As a full service local government, Arlington provides an extremely wide range of services that differ greatly in nature. We provide basic public works service including water distribution, wastewater treatment, street maintenance, and storm sewers. We provide a full array of public safety services, comprehensive and integrated human services, and extensive education and leisure services. Consistent with this diversity of services, there is a diversity of expense pressures ranging from the cost of fuel and asphalt to the cost of software licenses. Most of these pressures can be managed in the normal course of events. Outlined below are the major pressures that apply to most of what we do.

Personnel: The County has 3,436.7 full-time equivalent employees approved in the FY 2008 General Fund budget, the cost of which is 35% of the budget (56% if the school transfer is excluded).

- Salary: A typical budget would include step increases that would increase the personnel budget by 3.0%-3.5% (roughly $8.1 million to $9.4 million, including FICA and retirement). Additional increases in the market pay line would cost $2.8 million per 1% increase.

- Health Care: A 10% increase in health care premiums (to keep pace with higher claims costs) would require an additional $2.9 million in resources.

- Retiree Health Care: If no changes are made to the County's benefit package, current actuarial estimates would require significant annual funding to meet the future liability of our retiree health care costs, currently projected at $50.1 million per year. An update to the actuarial valuation of our current and future liabilities will be completed in the beginning of CY 2008.

- Defined-Benefit Retirement Plan: Employer retirement requirements as recommended by the most recent actuarial report calls for an increase in employer contributions from 9.8% of salary to 10.6% salary for General employees, and from 19.4% of salary to 20.9% of salary for Uniformed employees. These increases require an additional $4.4 million (from $32.8 million to $37.2 million).

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 County agencies. Preliminary projections for operating expenses include inflation in certain categories of non-personnel expenses and the full-year impact of new and renovated facilities budgeted in FY 2008 for only a partial year. Additionally, the County is assuming that contingency accounts remain at current base levels (i.e., general contingent and affordable housing investment fund) and a continuation of the set-aside of incremental recordation taxes for affordable housing programs. Additional expenses include:

- **Metro.** The County's contribution 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 determined based on the budget adopted by the Metro Board. The estimated costs for FY 2009 is $20.0 million, compared to $17.4 million for FY 2008 (14.9% increase).

- **Debt service.** For FY 2009, County debt service is projected to increase by $9.2 million to $56.9 million (19.3% increase), based on bonds already sold and those anticipated to be sold during FY 2008.

- **Maintenance Capital (Pay-As-You-Go).** For FY 2009, the County Board has adopted a Capital Improvement Plan (CIP) that plans $16.4 million for Pay-As-You-Go Capital spending. In recent years, one-time revenue sources, such as prior year fund balance, have been a primary source of capital funding. Beginning in FY 2006, an on-going source of funding was provided in the base budget. The FY 2008 base budget now has $5.2 million of on-going PAYG funding. An additional $11.2 million would be required to meet the CIP target (388% increase).

- **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 2008 allocates 47.8% of net local County tax revenue to the Schools. Based on a school enrollment increase of 233 students, the proposed agreement shares 48.1% of local tax revenues with the Schools for FY 2009.

- **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 appropriations. 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 meeting these commitments each year.

Excluded from the budget planning estimates are expansions above the FY 2008 adopted budget for stormwater and transportation infrastructure. It is recommended that any expansions to the base level of funding for stormwater or transportation infrastructure be funded with new dedicated revenue sources.

SUMMARY: Every year the development and adoption of the County's operating budget is challenging. The budget is where the County Board translates the vision, values and polices of the community into action. The discussion is always about striking a balance: obviously a financial balance, but also a service balance. Fiscal Year 2009 will be no different.