

Charlottesville 2005 budget issues – Executive Summary – by Kevin Lynch

During the past several months there has been much discussion between City Council and City Staff as we work to create a budget which balances the priorities for City residents against the costs to City taxpayers. This work has been informed by the input from many interested citizens, and I hope that many will see their concerns reflected in the City's preliminary budget, which was just released.

In preparing for this year's budget, I have spent several months analyzing the budgets of the past seven years. I would like to share my conclusions with City Councilors, City Staff and interested citizens:

- Many homeowners are feeling financial strain from rising real estate assessments. If we take a disciplined approach to budgeting City services we should be able to reduce the tax impact of rising assessments. First steps to do this include a four cent reduction in the real estate tax rate for this year, which will reduce the total budget increase to 5 _ percent for this year.
- Rising incarceration costs account for the largest percentage increase by far in City spending over the past seven years. These costs are not obvious to most residents, but they have a significant impact on the tax rate. We can and must take steps to lower these costs.
- Comprehensive Services Act (CSA) programs costs are also increasing by significant amounts. Like incarceration costs, CSA costs have a big impact on the tax rate.
- The number of families in poverty in the City has been increasing. It is likely that changing City demographics are related to increases to incarceration, CSA and other social service costs. We need to take a big picture approach to dealing with poverty instead of the current piecemeal approach.
- Surprisingly, Education has received less of an increase in City spending then nearly every other City department over the past seven years. We may want to consider whether our level of funding to the schools is consistent with our needs and priorities.
- We need to balance the City's revenue stream so that it does not depend so heavily on residential real estate tax.

Based on the above conclusions, I have made a number of long terms proposals to lower City costs, which are contained in the following pages. I have also made two proposals for this year:

1. The City should change its tax relief program for the elderly so that it is a tax deferral program, rather than a tax rate reduction program. This would allow the City to provide relief to more people at the same or reduced cost.
2. The City should assess automobiles by using the average trade in value instead the average loan value. Average trade in value is a more accurate measure of a car's worth. The increase in revenue from automobile should be used to further reduce the real estate tax – either by further decreasing the rate, or expanding tax relief for the elderly. We also may want to consider putting some portion of this revenue into educational programs – particularly those that are shown to be effective in reducing the high school drop out rate.

Other proposals are sure to come forward in the next five weeks as we complete the budget. I believe that if we work together to identify our priorities, we can find ways to adequately fund our current needs and improve our community so that our needs in the future become less expensive.

An analysis of Charlottesville 2005 budget issues – by Kevin Lynch

To those citizens who have contacted City Council concerning the tax burden caused by rising assessments, I want to assure you that my fellow councilors and I hear you. This is something that impacts all of us - some more heavily than others. The taxes on my own home have gone from 150 dollars a month when I bought it 13 years ago to over 400 dollars a month now. I don't mind working a few extra hours to pay for this increase. I have seen many improvements in the City over the past 13 years and I appreciate the increase in value of my house. At the same time this situation can create hardship for those on fixed incomes. For someone on Social Security, an increase of 100 dollars a month (or more) for City tax could be a real financial burden.

Those citizens who have been following this year's budget discussions know that I have been advocating reducing the real estate tax rate by 4 cents, to 1.05. Assessments have increased an average of 12 percent and the rate cut will bring the effective tax increase to 8 percent. This is the target that I advocated for in November of last year. It will result in an overall budget increase of about 5 _ percent. I appreciate Councilor Caravati's support in asking that City Manager and staff build a budget around a 4 cent rate reduction. I also appreciate the hours that the City Manager and staff put in making tough decisions and balancing the numbers into this year's budget.

An eight percent real estate tax increase is a large increase, but it is much smaller than previous years of double digit increases. Some of this represents new construction so the increase for existing properties will average 7.3 percent. The challenge we face as a City is that all other sources of revenue for the City grew at an average rate of only about four percent this past year. These are expensive times to be an employer and to meet an overall budget increase of 5 _ percent we will have to cut some open positions and ask our employees to help the City become more productive with what we already have. Ultimately I believe we need to continue to reduce real estate tax increases so that they are in line with the overall budget increase, which is 5 _ percent this year. This requires that we reduce services, diversify our tax base or both.

Analyzing Expenditures

Most of the City's costs are for personnel - teachers, police, fire, public works, social services, parks & recreation, etc. When their health care and retirement costs go up, the City cannot simply "outsource" jobs overseas as many businesses do. Do you really want to speak to someone at a call center in Kazakhstan to get access to City services? We must look for operating efficiencies or else pass the cost to the tax payer. I believe that the City is run as well or better than most municipal governments or private sector diversified services companies with 100M/year gross receipts, but there is always room to do better and in this climate it is absolutely necessary.

The City has had a AAA bond rating for so long that some take it for granted. I would like to see the City get new recognition for being not only fiscally sound, but also giving the community good value for the tax dollar. This isn't to say that we should be the cheapest municipality, but we should deliver the best services and quality of life possible, in an equitable manner and at a cost that the community agrees is reasonable. In moving towards this goal, I believe it is helpful to first consider our priorities and then look at historical spending in various categories to see where the largest increases have occurred, to see if they are in line with our priorities. Shown on the next page is a comparison of spending levels for those departments and programs which have had the largest percentage and total dollar increases from 1997 to 2004.

| Department / Program | 1997 (appropriated) | 2004 (budgeted) | \$ Increase | % increase |
|--|---------------------|--------------------|-------------------|----------------|
| Regional Jail | 387,997 | 3,437,057 | 3,049,060 | 785.85% |
| Juvenile Detention | 229,976 | 1,050,690 | 820,714 | 356.87% |
| Incarceration Expense Drivers | 617,973 | 4,487,747 | 3,869,774 | 626.20% |
| Fire Dept | 4,372,778 | 6,410,138 | 2,037,360 | 46.59% |
| Police Dept | 6,725,848 | 9,704,954 | 2,979,106 | 44.29% |
| 911/Emergency Center | 543,188 | 1,182,709 | 639,521 | 117.73% |
| Courts | 613,811 | 935,527 | 321,716 | 52.41% |
| Sheriff | 495,623 | 778,903 | 283,280 | 57.16% |
| Commonwealth Attorney | 505,401 | 650,426 | 145,025 | 28.70% |
| Public Safety Expense Drivers | 13,256,649 | 19,662,657 | 6,406,008 | 48.32% |
| Social Services (city share) | 1,334,265 | 2,414,956 | 1,080,691 | 81.00% |
| Children, Youth, Family Services | 1,715,700 | 2,639,539 | 923,839 | 53.85% |
| Comprehensive Services Act | 380,010 | 1,631,161 | 1,251,151 | 329.24% |
| Housing programs | 257,952 | 880,667 | 622,715 | 241.41% |
| Healthy Community Expense Drivers | 3,687,927 | 7,566,323 | 3,878,396 | 105.16% |
| City contribution to public Schools | 22,149,966 | 30,620,025 | 8,470,059 | 38.24% |
| Education and Arts (mostly library) | 987,875 | 1,236,445 | 248,570 | 25.16% |
| Education Expense Drivers | 23,137,841 | 31,856,470 | 8,718,629 | 37.68% |
| Neighborhood Development Services | 452,724 | 1,901,737 | 1,449,013 | 320.07% |
| Economic Development and Tourism | 334,575 | 997,600 | 663,025 | 198.17% |
| Parks and Recreation | 3,215,311 | 5,004,658 | 1,789,347 | 55.65% |
| Public Works / Public Service | 6,039,159 | 7,946,976 | 1,907,817 | 31.59% |
| Public Works / Facilities | 1,567,692 | 4,126,644 | 2,558,952 | 163.23% |
| Public Works / Transportation | 847,540 | 2,996,066 | 2,148,526 | 253.50% |
| City Services Expense Drivers | 12,457,001 | 22,973,681 | 10,516,680 | 84.42% |
| City Manager's Office | 558,608 | 763,851 | 205,243 | 36.74% |
| Communications | - | 263,473 | 263,473 | |
| Human Resources | 461,736 | 800,703 | 338,967 | 73.41% |
| City Council | 119,046 | 163,997 | 44,951 | 37.76% |
| City Attorney | 340,525 | 512,654 | 172,129 | 50.55% |
| Registrar | 134,799 | 237,700 | 102,901 | 76.34% |
| Commisioner of Revenue | 528,242 | 771,686 | 243,444 | 46.09% |
| Finance and Real Estate | 1,048,309 | 1,558,223 | 509,914 | 48.64% |
| Treasurer | 619,136 | 886,090 | 266,954 | 43.12% |
| Operational Expense Drivers | 3,810,401 | 5,958,377 | 2,147,976 | 56.37% |
| Debt Service | 4,059,128 | 5,350,000 | 1,290,872 | 31.80% |
| General Fund contribution to CIP | 2,280,343 | 3,634,000 | 1,353,657 | 59.36% |
| Meals tax contribution for school CIP | - | 1,450,000 | 1,450,000 | |
| Infrastructure Expense Drivers | 6,339,471 | 10,434,000 | 4,094,529 | 64.59% |
| Total Expense Drivers | 63,307,263 | 102,939,255 | 39,631,992 | 62.60% |

The Costs of doing business as an employer

Critical observers of the budget have noted that for the past 7 years, the City budget has been growing faster than inflation, as measured by the Consumer Price Index (CPI). From 1997 to 2004, the CPI increased by 20 percent, while the City Budget has grown by over 60 percent – about seven percent a year. The CPI comparison is interesting but not very helpful as a measurement of government efficiency. CPI measures the increasing costs of living to *Consumers*. If one looks at the individual categories which make up this index, it is obvious that average costs to *Employers* in the past seven years have much higher. For example, it may be good for *Consumers* that the cost of clothing has fallen 9 percent in the past seven years, thanks to textile jobs that went from Virginia to Mexico and China, but the City doesn't have much use for the cheap clothing and household goods which consumers can find at Wal-Mart.

The City's increasing costs, like those of other governments and many private businesses are largely attributed to the increasing costs of personnel who deliver services. The costs of providing health insurance to City workers and retirees have increased by over 80 percent in the past 7 years, which is comparable to the private sector. Medical claims have risen sharply from 1997 to 2004 so it is likely that this trend will continue. The Dow Jones average is lower now than it was six years ago in 1999, which has hurt public and private pension and insurance funds, especially as baby boomer workers are starting to retire. The majority of the City's retirement fund is invested in the stock market. For the past 6 years, the City has had to increase the amount of general fund revenues which go into the retirement fund to offset poor performance of the stock market. This is something that almost all employers have had to face. Energy costs have been tough on consumers but have been tougher on the City, which must keep fleets of police cars, school busses, public works vehicles and transit in near constant motion. The price of oil has doubled since 2002, causing big increases in prices for steel, cement, asphalt and other building materials which the City needs to keep its infrastructure in good repair. Environmental stewardship also has a cost. State mandated cleanup costs for the Ivy Landfill are expected to cost the City more than 10 million dollars over the next 30 years, even though the landfill is no longer being used by City residents.

However, not all of the increase in City spending can be attributed to increased costs of doing business. The City has increased the number of employees by about 11 percent since 1997. And we should expect that our employees are becoming more efficient and are matching the productivity gains of the private sector. So it is important that we ask: Are City facilities and services noticeably better now than they were in 1997? Do the results match our priorities and spending expectations? As we move forward into the future can we provide the same or better services with the same or fewer people and if not should we reduce some services? To answer these questions, a helpful starting place is to look at the largest expense drivers and see how our expenses have matched our priorities.

The Increasing Costs of Incarceration

The largest percentage increase by far is the cost of incarceration, which rose by over 600 percent. I don't think that incarcerating people is the highest priority for this community, but it is unfortunately where we are putting a lot of taxpayer money. There are a number of factors driving this: State support for correctional facilities is decreasing and the number of inmates has increased. Increased costs of incarceration since 1997 are equivalent to nearly 10 cents on the tax rate. In addition, there is a "hidden" incarceration cost – the cost for new court facilities, which shows up in our growing Capital Improvement Program (CIP) fund. In the past four years, the City has committed in excess of 7 million

dollars for our share of the Juvenile and Domestic Relations court renovation and the purchase of the Levy Opera House and other properties for courts' use. When you add in the increased costs of police, sheriff and the social service costs for families of incarcerated individuals, it is clear that the cost of incarceration is a very large portion of the budget.

Reducing Incarceration Costs

Incarceration costs are something that we need to work aggressively to control during the upcoming budget and over the next several years. First, we must continue to insist that the State pay its full share for incarceration. Many of the prisoners at the regional jail are State prisoners, for which we do not receive adequate reimbursement. Second, we must continue to look for ways to divert young people from the criminal justice system. It is a waste of human potential and it is expensive. Third, we need to look at health care costs at the jail which are rising rapidly. We can't allow our jails to become the health care provider of last resort for individuals with chronic substance abuse and related problems.

To begin reducing incarceration costs, we can start by identifying where jail inmates reside, not just where they were arrested. It would also be helpful to know where jail inmates went to high school and whether or not they graduated. If a significant percentage jail inmates reside outside of our City, this should help us argue the case to other localities for more funding. If a significant percentage are from outside the region, we should press the Governor, General Assembly and our local Congressman for more funding from the State and Federal government. If we find that most of our inmates reside in Charlottesville then we should consider that we have a serious social problem and focus our community resources around this problem, starting with programs to help keep our middle school and high school kids out of trouble with the law.

We must seek to expand programs like the drug court which rehabilitate offenders without incarcerating them. I believe that we should also expand education and rehabilitation programs within the jail – especially those with a proven track record of reducing recidivism. We also should find a better alternative punishment for child support delinquency than to put the offender in jail during hours when the offender could otherwise be working. While I do believe that failure to pay child support is reprehensible, I fail to see how removing an individual from the workforce and putting him into the regional jail solves the problem.

I would like to take a closer look at how the Juvenile Detention center is used. There is currently spare capacity at this facility, which I would like to see used by something other than housing more juvenile offenders, preferably some deterrent based program or a Comprehensive Services Act (CSA) facility of some sort. We also need to take a look at the space needs of the City's alternative school. I would also be willing to consider a new program for children of the City and County who are at risk of falling into the criminal justice systems. Many of these children currently receive CSA services which are very expensive. An innovative new program within our school system which emphasizes discipline, structure, counseling and life skills for at-risk children may turn out to be more effective and less expensive than courts, foster homes, therapy and jails.

If we could reduce the number of individuals in the City who become involved in criminal activity and the justice system by 25 percent over the next 5 years, the savings from jail costs alone would be enough to lower the tax rate by another 3 cents. Decreased costs in policing, courts, sheriff and attorneys could make the total rate reduction 10 cents or more. Unfortunately, the trend has not been going in the right direction. In order to turn it around, the community needs to be proactive.

Healthy Community programs

The second largest budget increase is in healthy community programs, led by the 329.24% increase in costs mandated by the Virginia Comprehensive Services Act. The Virginia general assembly passed the CSA in 1993, in order to shift the responsibility for juvenile mental health, court placements, special education and other services to local governments. Local CSA services are mandated by the State, but are only partially funded by the State. The unfunded portion of CSA services cost the City over 3 million dollars a year, or about 8 cents on the tax rate. Last year, the Commission on Children and Families implemented a CSA cost containment program, which should result in a leveling of expenses for this year. We need to continue to work on this so that these numbers drop in future years.

Most of the 241.41% increase in housing programs is due to the increase in tax relief for the elderly, which now accounts for the majority of the housing program funds. This program is a rapidly growing expense, but it is not keeping up with the number of residents who need tax relief. I believe that we may need to restructure this program, and I will address this later in more detail. The increase in Social Services and Children, Youth and Family Services are mostly due to changing City demographics, which I will also address later. Overall, increases in Healthy community programs over the past seven years account for nearly 10 cents on the real estate tax rate.

Education spending is not consistent with our stated priorities

Surprisingly, Education has received the smallest percentage increase over the past seven years, even though polls consistently show that this is residents' highest priority. This is partly because City spending on education was already relatively high in 1997, and to give credit where it is due, Mark Warner and the State legislature did step up the plate and provide about 1.2M in additional funding for the schools last year, taking some pressure off the City's general fund. While this does not make up for many years of under funding by the State, it was helpful. Also capital projects like school building renovations are funded separately by the City. Despite the relatively modest level of new support from the City's general fund, school teacher salaries have been raised to competitive levels, currently starting at \$35,000 per year. At the same time the school system has reduced 21 positions.

I believe that the City has an excellent school system, especially for high achieving children of all races. Our advanced placement, college prep and arts programs are among the best in the Country. I do think that we must do a better job of providing a good education for disadvantaged children, many of whom lack the financial resources and support at home that middle class children typically enjoy. It is essential that we reduce our high school drop out rate. A young adult with a high school diploma makes on average 200K more over their lifetime than someone who does not complete high school. An associate degree adds another 500K of lifelong earnings on average and a four year college degree adds even more. High school graduates are less likely to become involved in the criminal justice system and to perpetuate poverty. I believe it is much better and usually less expensive to invest in educating our children, rather than pay the costs of dysfunctional adults.

The School Board and Superintendent are going to have a tough time balancing community priorities and state mandates within the funding parameters of this year's school budget. We also must deal with increasing numbers of English as Second Language (ESL) students. There were 44 such students in 1997. Now there are 230. The City has traditionally committed 40 percent of new real estate and personal property taxes to the City schools. This year the school's portion of new revenue is expected

to be 1,480,000 dollars. If there is any part of the budget that I would look to increase beyond the baseline this year, it would be education, provided that we can do so without raising our overall budget.

General City Services – some money is getting counted twice and reorganizations make year-to-year comparisons difficult

City services appear to have gone up by a total of 84.42%. However, a direct comparison of the 1997 and 2004 budgets is a bit misleading. The City school system contracts with various City departments to provide a number of services, including facility repair and maintenance and pupil transportation and security. These services are getting counted twice in the budget – first when the City allocates money to the schools, and second when the schools use their City general fund money to then contract back to other departments in the City which are outside of the school system. The City only takes the money from the taxpayer once. But it is counted as revenue twice. This should be fixed when we move to the new City Link computer system.

Reorganizations with the various departments that make up City Services make comparisons within each department difficult. For example, a number of engineering functions have been moved from Public Works to Neighborhood Development Services. And as previously noted, a significant percentage of the increase in Parks and Public Works budgets has come from work that is contracted by the City school system.

Facilities and Maintenance

Facility repair and maintenance and pupil transportation account for nearly 4 million dollars a year in additional educational infrastructure expenses that show up in public works. If one subtracts out these duplicated costs, the increase in “City Services” expenses drop from to 84 percent to 52 percent. This is still a significant increase. Facilities maintenance costs are becoming a rapidly growing share of City expenses. This is something that I believe we need to consider carefully. How can the City reduce long term maintenance costs for school buildings, firehouses, libraries, parks and recreation, courts and office buildings? Concern for the costs of keeping our aging facilities in good condition was one reason that I agreed to put plans for improving McIntire Park on hold until we finish a cost containment strategy for existing Parks and Recreation facilities. An improved and more accessible McIntire Park is one of my personal top priorities, however I believe that it is important that we first get a handle on costs for existing facilities before we take on this project.

New Capital projects

The capital improvement budget went up over 4 million dollars or 64.59% over the past 7 years. This is equivalent to 10 cents on the tax rate. I believe that this is an area where residents have generally received good value for their money. Most of this money goes into facility costs which exceed normal maintenance budget, such as new roofs, boilers, etc. In the past 7 years major renovations have occurred at Washington Park, Belmont Park, the Downtown Rec center, Venable school and Clark school. The High School renovation is nearly complete. 3M has been set aside for the renovation of Jefferson School, which I would like to see become the new site for our Central Library. The water street parking garage has been expanded. We are also about to go “live” with a new 800Mhz radio system which will greatly improve communication for our public safety workers.

I do believe that as we move forward, we need to hold the line on any new facilities and make sure that our existing facilities are in good condition. We may even need to consider selling existing facilities if it is not cost effective to maintain them. For example, if we are able to move the Central Library to a new home at Jefferson school, I would be in favor of finding a new owner for the current building, rather than keeping it as a City property. I believe that there may be some potential for consolidation of our recreation facilities. And as I mentioned previously, I am very concerned about the increase in the amount of capital improvement dollars that are used to support our criminal justice system.

Neighborhood Services

For those City Services which directly impact residents, the increase in costs has generally been accompanied by services that are much better than they were in 1997. For example the increase in general fund support to CTS has increased by 449K to support the new trolley service and more frequent service on most routes. Funding for neighborhood sidewalk and drainage projects increased from 505K per year to 848K per year and while not everyone is satisfied with the pace of projects, most residents can see the difference. New housing and code inspectors have resulted in less blighted property. Court Square has been recently renovated, the Greenbelt trail has been extended, and construction of a new downtown transit center is in progress, thanks to Federal TEA-21 grants which were managed by the City. The City is now managing more of our transportation projects, such as the renovation of the Park and Locust Ave bridges and the extension of Hillsdale drive. Our traffic lights on Rt 29 are now synchronized.

Tourism funding is an area where I have been skeptical in the past. I still would like to see more promotion of downtown by the Charlottesville Albemarle Convention and Tourist Bureau, especially now that the Court Square renovation is complete and the Paramount is open. Tourism funding is tied to 25 percent of lodging taxes collected by the City, and the marketing done by CACVB does seem to have a very positive impact on hotel occupancy rates in the City. The City's economic development efforts have resulted in increases in new construction and sales tax within the City (although the increases in tax revenue from new activity have not kept pace with rising assessments on existing properties). I continue to believe that a larger percentage of our economic development efforts should be directed workforce development and small business development.

Arts Funding

Funding for the arts, other than for the library costs, has actually decreased slightly over the past seven years, from \$181,924 to \$168,335. This does not include the costs of providing below market rents to arts programs such as McGuffey and tax exemption for the Paramount. If these costs are added to the arts budget, as I have advocated for several years, the total is about half a million dollars, but the real costs to the City are still declining. I am disappointed that so much civic energy has been spent debating the merits of funding the "Art in Place" program, which costs the City less than \$5,000 per year, or about 0.005 percent of the City's budget. At the same time incarceration costs have exploded by millions of dollars with hardly a peep from the "budget critics". I do agree with citizens who have pointed out that some of locations for the highway installations are distracting. It might be better if this program could be more consolidated in one place, perhaps around the new East End Mall improvements or along West Main Street, so that the art can relate more to pedestrians than motorists.

Public Safety

Excluding incarceration costs, I believe that City residents have received good value for the increases in public safety spending. During the past seven years we have increased the number of police by 18, including 9 community policing positions. Crime has decreased significantly and neighborhoods are generally much safer than they were seven years ago. The addition of 17 firefighters and a new safety inspector has resulted in the City's fire department receiving the highest Insurance Service Office rating in the State of Virginia, resulting in lower costs for residents to insure their houses and substantial decreases in loss of life and property. The one area of public safety that I believe warrants further scrutiny is the 911 / Emergency dispatch center, which is escalating rapidly in cost. The City fire department does its own dispatch so the main benefit to the City for the center is for EMS and police dispatch. If the costs for 911 dispatch were added to the police department, the increased costs of police would rise to 49.7 percent

City Operational Overhead

Operational expenses such as management, payroll, finance, treasurer, etc. have gone up an average of 56.37% in the past seven years. For the most part, these are internal functions that the average citizen does not "see" and therefore, I would expect these areas to experience less of an increase than say police, fire, transit, etc, where the public can point to increased levels of service over the past seven years. The one exception to this is the communication department. I believe that the City's website and public access channel have improved greatly over the past seven years, although this has occurred at some cost. It is important to note however that while communications appears to be a new department, its functions are not new. They were previously spread across other departments. Public access support used to be provided by Adelphia Cable. Adelphia still completely funds this program, but now it is a City program. The City webmaster was formerly in the IT department.

As the new City Link computer system becomes operational, I will expect to see our operational costs decrease. I do not expect any layoffs although we may see some reductions in force as some employees retire and others become more efficient.

Changing Demographics, a long term strategic response to the costs of poverty,

Rising costs for healthy community programs and incarceration are partially the result of decreases in State funding and services (for example, the State has nearly eliminated its mental health facilities for juveniles). It is likely that changing demographics in the City also plays a large part. The number of families in poverty in the City is increasing, even as the majority of families are doing better. This is something that I believe we must address. Reducing the amount of poverty in the Charlottesville area is not just a moral issue, but is increasingly becoming an economic one as well.

The most reliable numbers we have on poverty are from the US Census Bureau, which collects demographic data on the City every 10 years. Because of the student population, the Census count for individuals poverty is somewhat inflated. The number of families in poverty is a more accurate measure and in 1990, there were 843 families living in poverty (at the time \$12,700 for a family of four). Of these 843 families, 657 had related children under the age of 18. In the year 2000, the number of families in poverty (at the time \$17,050 for a family of four) increased to 925, of which 773 had related children under the age of 18.

If we look just outside the poverty range, at “working poor” families making less than \$25,000 per year, we see that in 1990 there were 2946 such families and in 2000 there were 2082 such families, a decrease of about a third. Some got better off, others moved away and a significant number of families slipped into poverty.

A family living at poverty wages in Charlottesville is not just poor, but is near destitute. In 2004 the guideline for poverty was \$9,310 for an individual, \$12,490 for a two-person household, and \$18,850 for a four-person household. Of course, not every family that is poor results in increased costs to the City. There are plenty of success stories. However, on average, families in extreme poverty put an increased strain on social services and are at greater risk to end up in the criminal justice system. The costs of poverty also put a strain on schools and public safety.

A plan for poverty reduction

I believe that it is an economic imperative that we come up with a realistic plan to reduce poverty in the City. To create such a plan, we must first get a better understanding of the underlying dynamics that have caused poverty numbers in the City to increase.

Poverty in the City can generally be divided into three categories: Generational poverty, in-migration of poverty and situational poverty. Each type of poverty is addressed with a different set of strategies. The first step towards solving our poverty problem is to figure out how many of our 935 families are in each of these categories. This will help us decide where to put the resources that we use to combat poverty.

Generational poverty refers to families who have lived in the City at a poverty level for at least two generations. My guess is that this accounts for about half the families in poverty, but the truth is that no one nearly knows for certain – not even our service providers. In some ways, solving generation poverty should be the most straightforward: We need to insure that the next generation escapes poverty. Of course, this is easier said than done, but it is not impossible with the resources that we have in this community. The school system is already taking steps to better address the educational needs of low income children. Better workforce training and vocational track development in high school will also help. We need to continue to reduce teen pregnancy rates and help families become self sufficient. Ultimately, I would like to see us set a goal of reducing the number of families in generational poverty by half over the next 15 years.

In-migration refers to families in poverty who come to Charlottesville from other localities, often because of the services that Charlottesville provides. Some come from surrounding counties, others come from across the world. Poverty in the City is strongly related to poverty in the surrounding region and to the availability of affordable housing in the region, as significant number of low income families move every year. In the metropolitan area (Charlottesville, Albemarle, Fluvanna, and Green), Charlottesville provides two thirds of the affordable rental housing, despite a total population that is only a quarter of the metropolitan population.

I believe that as the urban center of the region, Charlottesville has some obligation to provide for the in-migration of poverty. However, I don't think that we should be paying for in-migration of poverty with local taxpayer funds. One advantage of being able to quantify the in-migration is that we will be better position to ask the State and Federal government for more assistance if we can document where families needing services are coming from. For example, this year there are over 50 new international

refuge children in our City school system. Even at an average cost of \$12,566 a year to educate a child, these new children will cost the school system in excess of \$750,000 per year, and these kids have needs which are much higher than average. I am very supportive of our refugee families who come to Charlottesville. Still, it is impossible to ignore that this State Department program adds about 2 cents on the real estate tax rate because of the City Schools costs in the last year alone. Since 1997, the number of ESL children in the schools has increased from 44 to 230. We need to insist that the Federal Government pay a fair share for these children. We also may be able to evaluate if any of our other programs that are designed to alleviate poverty are in fact attracting poverty from elsewhere and decide what to do about this.

Situational poverty refers to families who were previously not in poverty but who find themselves temporarily in poverty for a variety of reasons. Some causes such as loss of income from layoff or plant closing can be addressed with workforce training. Other causes, such as substance abuse or domestic violence are more difficult and expensive to solve.

Is State and Federal Funding really decreasing?

Jim Gilmore was elected Governor in 1997 on a single issue “No Car Tax” campaign. Not coincidentally, this is the same year that City budgets began to increase sharply. The car tax was an unpopular tax, particularly for owners of expensive cars in Northern Virginia and elsewhere. Gilmore’s Big Idea was that the State was receiving a good bit of new income tax revenue from the internet bubble so why not require local governments to give car owners a discount on the automobile portion of their personally property taxes? This idea has great appeal if you own an expensive car and even if you don’t it feels vaguely good to get a few bucks back from somewhere. Not so good if you are a local government trying to figure out how to make up the lost revenues. Gilmore figured if the Internet bubble continued 4 years, then the State could reimburse the localities for the loss in revenues using record levels of new State income tax as stock options were exercised. And if the scheme didn’t work out, it would be his successor’s problem. Which is pretty much where we are today. The car tax rebate now costs the state 950 million dollars a year and rising!

During the Gilmore years, from 1997 to 2001, the State general fund budget grew from 8.1 billion a year to 12.28 billion. The last of these years were riddled with accounting tricks, leading to multi billion dollar deficits. During the 3 years under Warner the general fund budget has only grown to 12.37 billion in 2004. Holding the line on spending nearly constant for 3 years during a recession is an impressive feat. However this was done more out of necessity than by choice as income tax and sales revenues were mostly flat while costs of the car tax reimbursement increased significantly. In addition, rising Medicaid health care costs meant that to meet the bottom line, the State had to cut other programs such as funding for transportation, education, police and jails, leaving local governments to pick up the slack. Overall, Virginia ranks 35th in State spending per capita which is in the bottom third. Virginia ranks 44th in State tax receipts as a percentage of personal income. Some see this as a positive attribute, although in government as in most things, you generally get what you pay for.

Responding to rising assessments

Over the past 7 years, the City has made a conscientious effort to invest in neighborhoods and keep property values up. This investment, combined with low interest rates and many attractive things about our region, have caused property values to shoot through the roof. Our assessments are rising and while the personal capital wealth of homeowners is going up, the increase in wealth can only be

realized by selling. I don't intend or want to sell my house and I presumed that most residents don't either. The people that are selling are making a windfall, but unlike a stock portfolio, residents can't sell off a few shares of their house to cover the capital gains taxes - it's an all or nothing deal. Real estate taxes due to rising assessments are not entirely a bad thing. Commercial property owners and student housing providers enjoy increasing incomes from rents on their properties and can afford to pay the taxes on their increased wealth. However for private homeowners, rising assessments is a form of wealth with no associated income stream and taxing this wealth at a high rate can lead to an individual being forced to sell involuntarily in order to keep up with expenses. This is a subtle form of injustice.

Most residents are aware that we already have real estate tax relief for the elderly. Not everybody qualifies, but it does keep senior citizens from becoming destitute over real estate taxes. It doesn't do much for the retired working class, who are feeling a real strain. At the same time, the cost of providing this program is increasing for the City. In 2004 the program cost 500K and this year it is expected to increase to over 750K. That is equivalent to 2 cents on the tax rate.

Consider allowing residents to escrow a portion of real estate tax increases

One possible change that might help this situation is to allow seniors on fixed income to defer some portion of any tax increases into an escrow account that is payable upon sale or transfer of the house. This would allow a larger pool of citizens to benefit from property tax deferral, without causing the City to permanently forgo revenues.

The tax on real estate property is a little over 1 percent a year (\$1.05 per hundred if the 4 cent rate reduction is approved). Assessments have been rising 10 to 12 percent, although I expect them to level off within a few years to 4 or 5 percent. If, for qualifying individuals, a portion of the increase in taxes due to rising assessments was deferred until that person eventually sold or transferred their house, the deferred tax would add up to a substantial sum, but in the meantime, the value of that house would have grown much more, so that in the long run, the individual benefits economically.

As an example, consider a house that is worth \$100,000 today and owned by an individual who is 65 years old and of limited means. The yearly tax on the house would currently be \$1090 a year (\$1050 a year if we decrease the tax rate as proposed). Suppose the real estate market cools off to a modest 3 percent a year in the long term and in 30 years the house is worth \$200,000. If the City allowed the owner to defer all tax increases over \$1050 for 30 years, and then at age 95, the owner sold the house then he or she would owe the City \$15,750 in back taxes, which is a substantial sum. However the house would have increased \$100,000 in value, so overall the owner would net about 84K without having the burden of paying additional taxes for the past 30 years. The City would have to modify the way that we do long term budgeting and financing of our capital projects, but would not lose income in the long term. As long as real estate values rise by more than 1 percent a year on average, residents will come out ahead in the end.

I can't promise that this will happen this year, but it is something that I have been exploring with City staff. I would be interested in citizen's opinion on this - particularly those who are on a fixed income but currently just outside the eligibility requirements for tax relief.

Diversifying the Tax Base

Another solution for relying less on residential real estate tax is to increase other sources of taxes, such as sales tax and Business/Professional/Occupational Licenses (BPOL) taxes. The City has been working to increase its commercial tax base. Last year, new commercial and residential construction added over 54 million of new property to the tax roles, which generated almost 600K of new revenue – equivalent to 1.5 cents on the tax rate. Sales tax revenues from the new Best Buy alone are equivalent to about 1 cent on the property tax rate. New development is not enough to completely fund the increased costs in City services, but it helps. One of the reasons that the City is planning to extend Hillsdale drive from Greenbrier to Hydraulic is that it will aid in the further economic development of this part of the City, resulting in increase sales and commercial property taxes.

I am also in favor of changing the way that the City assesses automobiles for its personal property tax calculation. Currently automobiles are assessed at average loan value, which greatly underestimates how much an automobile is really worth. Assessing cars at the average trade in value would still be quite fair to the owners and would generate another 500K in revenue for the City.

I have taken some heat for saying this, but I will say it again: Automobiles are under taxed in the State of Virginia. Thanks to Gilmore, automobile taxes have decreased by 70 percent since 1997. However, no new revenue stream has magically appeared to make up the revenue shortfall. The result is that real estate taxes have increased 69 percent over the same period. In the past seven years, we have seen a significant portion of the tax burden shifted from car owners to real estate property owners. There has never been a fiscally sound argument for shifting the tax burden in this way. It was simply an election gimmick which legislators are now afraid to change. It is bad fiscal policy and we should not be afraid to change it.

If we change the automobile assessment, there is a number of ways in which the new revenue could be used, some of which are revenue neutral and others are not. Revenue neutral possibilities include reducing the real estate tax rate by another cent to 1.04. Alternatively we may want to put more money into real estate tax relief for working class retirees on fixed incomes. We also may want to consider making an increased investment in our school system (which would not be revenue neutral). Or we could some combination of the above. I will withhold any judgement on what would be the best course of action until I have had more time to look at the details of the City Managers proposed budget, but I do believe that an adjustment to automobile assessments is prudent.

Long Term Budget goals and expectations

Of course it is impossible to see the future. What I see as a likely scenario is that over the next few years property values will cool of a bit but will still be in the 8-10 percent increase per year range. Given a reasonably stable economy we should be able to further reduce the tax rate at least another 5 cents over the next two or three years, so that total property taxes only go up by 5 or 6 percent each year. We will adjust our budget so that a greater percentage of it is going towards the schools. If we can start to solve some of the underlying problems that are adding to our criminal justice system then in a few years we might start to see some additional budget relief in the form of less individuals in the criminal justice system and in CSA programs.

We need to continue to focus on diversification of the tax base. Looking at examples of urban successful areas in the State, Arlington and Alexandria are a good model of how transit oriented mixed

use development can help the tax base. Arlington has the second lowest real estate tax rate of any urban area in the State at \$0.958 per hundred dollars of assessed value. Alexandria and Charlottesville both started in 2000 with a tax rate of \$1.11. Largely because of new development around the train station metro, Alexandria's rate is under a dollar and is likely to go down another 8 cents this year. In both Alexandria and Arlington, it took a prolonged focus on attracting new transit based, mixed use development to achieve these low tax rates. Alexandria and Arlington are the two most dense locality in the State. Charlottesville is the 4th. Most urban areas in the state have a higher tax rate. Norfolk is at \$1.40, Richmond at \$1.38, Hampton is at \$1.25, Roanoke at \$1.21

Looking forward at future State and Federal impacts

Looking forward, there are two possible scenarios for the State which the City must plan for: If Tim Kaine is elected governor in 2005, we are likely to see some modest improvement in State funding support with most State tax rates held constant as the economy recovers and revenues improve. Mark Warner has already done most of the heavy lifting of getting the budget balanced within existing tax revenues and Kaine is likely to continue this "pay as you go" philosophy. Kaine's experience as mayor of Richmond will give him an appreciation of the issues that urban areas like Charlottesville face, which could be helpful. We may be able to advocate successfully for a fairer share of State transportation and education dollars. If Jerry Kilgore is elected, we will more likely see a return of the Gilmore pattern, in which case we can expect State tax cuts and heavy borrowing by the State, likely accompanied by big increases in spending for the criminal justice system and shifting of most other services to local governments. Overall, State spending will probably be about the same or greater and we may be able to advocate for more State funding for City jails and police while we brace for the budgetary hangover that Kilgore will likely leave to his successor.

At the Federal level, we must consider the possibility of decreases in Federal support for a number of important social programs, including support for low income housing and community development, as the long term Federal Budget costs of the Bush administration's geopolitical ambitions become more apparent. This is another reason why it is essential for us to tackle poverty – we are likely to get less help from the Federal government to pay for it in the future. I doubt that Bush will be successful in privatizing Social Security, but if for some reason he is, this will likely create a big potential future liability for local governments, including the City. As our pension fund experience over the last 6 years shows, not everyone who invests in the market makes money. Unless we become willing to see a large number of senior citizens panhandling, local governments will be under a lot of pressure to provide some safety net. If the price of oil ever returns to its pre Iraq war level of \$25 a barrel, this would offer the City and its residents some relief, although this is not likely to happen for some time. It is just as likely that oil prices will continue to increase, in which case improving our transit system will become more important.

In Conclusion

I appreciate the input of those citizens who have taken an active interest in this year's budget. I hope that these few pages have given you some indication that I have listened and have some realistic proposals to improve our budgeting process now and in the future. City Councilors, the City Manager and Staff have been working hard to produce a preliminary budget for the coming year that reflects the priorities and capabilities of this community. Over the next five weeks, we will continue to work, with input from the public, to finalize this budget. I look forward to hearing from you as we begin this important public process.