



Long-Range Financial Planning Working Group Memorandum

To: Mayor Nader Baroukh, Councilwoman Johannah Barry Councilwoman Robin Gardner, Councilman Ira Kaylin, Councilman Ron Peppe, Councilman Dave Snyder, Councilman Lawrence Webb

CC: Wyatt Shields, City Manager, Melissa Ryman, Assistant Finance Director, John Foster, City Attorney

From: Richard Sommerfeld-Chairman, Chad Fulgham, Kathy Dempsey, Michael Ankuma

Date: December 10, 2010

Re: Balanced Budget Requirement

There has been continuing confusion among the public, and some members of the City Council, regarding whether or not the City Manager's FY11 budget was in fact approved as a "balanced budget" in compliance with *The Code of Virginia*, *The Code of the City of Falls Church* and the City's financial policies. Adding to the confusion was mention in the City Manager's report to the Council at its September 24-26 retreat noting that the City, only 3 months into the current fiscal year, already had a \$1.4M shortfall (i.e., operating deficit) and mention in a PowerPoint presentation dated November 1, 2010 of a \$920K shortfall without any change to the current tax rate. Moreover, at the Council work session on October 18, 2010, Councilman Lawrence Webb said, "We were doing a push off. We told the public that there would be an increase [in real estate taxes]. We didn't want such a high increase in June, to give folks time to prepare for an additional increase."

Summary Findings

Prior to distributing this memo, its subject matter was discussed with the City Attorney on December 3. At that time he was also provided a draft copy of the memo for review and comment.

It is the opinion of the Working Group that the City Manager may not have submitted a balanced budget to the City Council and that the City Council may not have approved a balanced budget for the fiscal year 2011, which commenced on July 1, 2010. The City essentially rolled its FY10 budget deficit into FY11, as evidenced by the alarmingly early operating deficit and fund balance of just 6.4% reported by the City Manager only three months into the current fiscal year. The City gave the appearance of balancing the budget through the June real estate tax collection that was intended to finance the FY11 budget.

The current FY11 budget deficit of \$1.1M would appear to be in the process of being rolled into FY12. Also, the City remains out of compliance with its minimum fund balance target of 8%, as the fund balance is currently projected to be 6.2%. Mathematically, this empirically



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confirms that the City has been rolling its budget deficits forward into the next fiscal year and not balancing its budget as mandated by law. This could have been avoided through (1) a real estate tax increase of \$0.0386 in the December 5 billing, (2) cutting expenses by \$1.1M, or (3) a combination of options 1 and 2.

Under the Dillon Rule, the City had no express authority from the General Assembly to roll its budget deficits forward and it had no apparent authority to pass an unbalanced budget.

We recognize that the City Manager's original budget proposal recommended a \$1.27 tax rate, which the City Council did not accept and requested instead a \$1.24 rate. As has been mentioned previously, the "dependent variable" of the budget equation became the City Manager's assumption that revenues would increase by 3% in FY11 in order for the Council to report a lower than recommended real estate tax increase and still claim that the budget had been balanced when, in fact, it had not.

Questions: Was the Council informed that the action would in substance, if not in form, be a violation the *The Code of Virginia*, *The Code of the City of Falls Church* and the financial policies adopted by the City Council? If the intention was, as asserted by Mr. Webb, "to do a push off" [of the full tax increase], why did the City Manager not propose to the Council in Ordinance 1843 a further \$0.04 increase in the real estate tax in the second billing due December 5, 2010 to balance the budget for the current fiscal year? That rolling deficits may have been done in the past or that other jurisdictions use a similar practice is insufficient rationale. What actions is the City Manager taking to ensure that this deficit rolling practice to the next fiscal year is never used again?

☛ We urge the City Manager and City Council to cease this practice of rolling budget deficits into the next fiscal year and immediately comply with *The Code of Virginia*, *The Code of the City of Falls Church* and the financial policies adopted by the City Council.

☛ It is also recommended that the City move to change the effective date of real estate tax assessments to coincide with the fiscal year. This simple solution would remove a major element of revenue uncertainty from forecasting revenues that account for more than 63% of gross receipts.

Background

In April 2010, the Working Group input the City Manager's budget into the financial forecasting model we prepared for the City. The model was constructed so as to take into consideration the cash flow timing differences between real estate tax receipts and expenses for the fiscal year. At that time, despite evidence from the City Assessor that real estate values were on the decline, the City Manager assumed a 3% increase in real estate tax receipts. The model indicated that the proposed budget did not balance without a \$0.04 tax increase in the second billing or else the City would have a \$1.1M deficit. In fact, the only way one could logically assume a 3% increase in real estate tax receipts in the face of declining real estate



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values would be to increase the tax rate. We brought this to the attention of the City Manager at that time. The existence of the deficit has been mathematically confirmed in subsequent financial reports from the Acting Director of Finance.

Article 10, §7 of the 1971 Constitution of the Commonwealth of Virginia requires the state to approve a balanced budget and *The Code of Virginia* requires all local governments, including the City of Falls Church, to adopt a balanced budget (i.e., expenditures may not exceed revenues). *The Code of Virginia*, §15.2-1100, specifies the powers held by cities and towns and it does not allow for unbalanced budgets.

We believe that, under the Dillon Rule, the City had no express authority from the General Assembly to roll its budget deficits forward into the next fiscal year. According to the League of Women Voters for the Fairfax Area Education Fund, Dillon's Rule arose in response to local corruption and fiscal irresponsibility.

"This doctrine of limited authority for local governments is commonly called the Dillon Rule, a name that is derived from the writings of John Forest Dillon, who served as a judge, a law professor and an author of legal textbooks in the latter part of the nineteenth century. The Dillon Rule is used in interpreting law when there is a question of whether or not a local government has a certain power. The Dillon Rule narrowly defines the power of local governments. It also states that if there is any reasonable doubt whether a power has been conferred on a local government, then the power has NOT been conferred."¹

Dillon's Rule has been part of the law of Virginia since 1896 and is a fundamental rule for construing the scope of governmental powers.

"It is a general and undisputed proposition of law [concluded by Virginia courts] that a municipal corporation possesses, and can exercise, the following powers, and no other: first, those granted in express words; second, those necessarily or fairly implied in, or incident to, the powers expressly granted; third, those essential to the declared objects and purposes of the corporation not simply convenient, but indispensable. Any fair, reasonable doubt concerning the existence of power is resolved by the courts against the corporation, and the power is denied."²

According to *The Charter of the City of Falls Church*, §6.05:

"In no event shall the expenditures recommended by the city manager in the general fund budget exceed the receipts estimated, taking into account the estimated cash surplus or deficit at the end of the current fiscal year, as provided in the preceding section, unless the city manager shall recommend an increase in the rate of *ad valorem* taxes on real

¹ <http://www.fairfaxcounty.gov/government/about/dillon-rule.htm>

² U.S. Advisory Commission on Intergovernmental Relations (ACIR), "Unshackling Local Government," 24th Report, 1968



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estate and tangible personal property or other new or increased taxes or licenses within the power of the city to levy and collect in the ensuing fiscal year the receipts from which, estimated on the basis of the average experience with the same or similar taxes during the three tax years last past, will make up the difference.”

Finally, Council Resolution 2009-01 is unequivocal in mandating a balanced budget. Mathematically, it does not appear that the City has been in compliance with its own financial policies.

“WHEREAS, the City Council of the City of Falls Church is charged with the ultimate oversight of the fiscal activity of the City government; and

WHEREAS, City Council is resolved to adopt best practices in the prudent exercise of their oversight responsibilities;

The City of Falls Church will adopt an annual General Fund budget in which the budgeted revenues and expenditures are equal (a balanced budget). The budget shall clearly delineate the sources of funding for each year’s expenditures.”

Summary

It is the opinion of the Working Group that the City Manager may not have submitted a balanced budget to the City Council and that the City Council may not have approved a balanced budget for the fiscal year 2011, which commenced on July 1, 2010. The City essentially rolled its FY10 budget deficit into FY11 and is on track to do the same again vis-à-vis the FY12 budget unless corrective action is taken. The problem becomes even more acute because of the difficult economic environment in which the City and its residents find themselves and pressing issues such as underfunded pension programs and the intentional failure to defund essential CIP items. In short, the financial predicament of the Little City is not being forthrightly addressed for the benefit of the residents of Falls Church.

Real estate tax receipts are due no later than June 5 and December 5. The City Manager has the option to (1) request of the Council another real estate tax increase in the second tax billing, (2) cut expenses, or (3) adopt a combination of options 1 and 2 above.

If the City Council wishes to abide by “best practices in the prudent exercise of their oversight responsibilities,” then we urge the Council to pass fully funded and balanced budgets.