

BUDGET MESSAGE

FY 2012 OPERATING BUDGET

Submitted September 28; Introduced October 10, 2011

Introduction:

The Draft FY 2012 Operating Budget was delivered to the City Council on September 28, 2011. The draft budget was a result of many hours of hard work, number crunching, and program review by the department heads and their staff. I would like to especially thank Regina Mauras, the Finance Director, for her immeasurable contribution to this effort. I believe the budget document contains more information and is easier to read than ever before. This draft budget is often referred to as the "Manager's Budget" and it is scheduled to be introduced via a budget ordinance at the regular meeting on October 10, 2011. After the budget is introduced by ordinance, it becomes the Council's budget and it can be amended as Council sees appropriate at anytime right up to final adoption.

The draft budget contains new graphics and data regarding personnel costs that I think the Council and the public will find to be helpful. The budget incorporates a recalibration of how some expenditures on the Spit related to the visitor industry (garbage collection, restroom maintenance and custodial) are shared between the General Fund and the Port and Harbor Enterprise Fund. The budget also fully incorporates the transfer of the port maintenance function from the Public Works Department to the Port and Harbor Department.

In developing this budget, I did my best to adhere to the budget priorities identified by the Council and balance them against fiscal reality and what is needed to maintain core municipal services. For example, my priorities as City Manager were workforce morale, productivity, building reserves, filling some vacant positions, and maintaining a high level of service delivery. This budget achieves those objectives for the most part with the notable exceptions of COLA's and filling vacant positions. The budget addresses Council priorities including no new or increased taxes or fees, at least in the initial draft, a conservative budget that acknowledges continued economic and revenue uncertainty, and increased transfers to depreciation and fleet reserve accounts. One Council priority that the budget does not address at this time is refilling vacant positions in core programs.

A budget summary follows which provides a quick overview of the draft budget. This summary covers all three operating funds and highlights the "flashpoints" that many people zero in on and want to know first about the budget. A more detailed description of the contents of each fund follows in subsequent sections and we will go through the budget with you line item by line item at the Committee of the Whole on Monday.

Budget Summary:

- There are no new or increased taxes or fees
- All funds are balanced, meaning that revenues meet or exceed expenditures
- Transfers to depreciation and fleet reserves are included for the General Fund this year but they have been reduced slightly for the Port and Harbor Enterprise Fund and the Water and Sewer Utility Fund.
- Increases in real expenditures are limited to fixed costs, training, and basic operating supplies.
- Non-profits are funded at last year's level. That includes The Chamber of Commerce, the Homer Foundation, the Pratt Museum, and Haven House.
- There are no new positions or vacant positions that have been filled with the exception of a part time seasonal position with Parks.
- There are no changes to employee compensation from last year.

- The budget does not include a COLA.

The General Fund

The General Fund is balanced in the sense that revenues meet or exceed expenses. The total General Fund Budget is \$10,782,862. Total Revenues and Transfers are projected to increase by \$668,004. This is due largely to the fact that PERS relief payments are shown as revenue. Property tax is projected to remain essentially level and sales tax is projected to increase by almost \$200,000 over what was budgeted last year. Expenditures increase by \$622,756 over 2011 however, most of that is accounted for by transfers to depreciation and reserve accounts and PERS relief payments which also are included on the expenditures side. Projected revenues exceed projected expenditures by \$ 443,246 before transfers. Virtually all of those excess funds were transferred into reserve accounts. Of that amount, \$329,894 was transferred into depreciation and fleet reserve accounts.

Following are some budget highlights that I would call your attention to:

- The lobbying contract is included at the same level as last year, pending Council action. \$22,000 from the General Fund and \$22,000 from P&H Fund (page 55).
- The Attorney Contract and budget is included at last year's level, consistent with Council action. (page 55).
- The Animal Shelter contract is included at last year's level, pending Council action. (page 97).
- Non-Profits are included at last year's level (Pages 66, 92, and 114.)
- Fishing Hole Contribution included at last year's level (page 66).
- Contributions to depreciation and fleet reserves included for first time in two years, restored to 2009 levels but still far short of 2008 (page 47).
- Almost no major capital expenditures from reserve accounts proposed (page 201)
- No new positions or vacant positions filled with exception of restoration of vacant summer temporary Parks position. (page 228.)
- Funding restored for Council stipends (back to previous level) and for Council travel (for AML and Juneau) (page 55).
- Funding restored on limited basis for training (Clerk, Finance, Personnel, Police, Fire) and for basic operating supplies.
- Funding included for two elections (to provide for possible runoff or special elections) (page 60).
- Estimated "warm status" costs for HERC Building (Old School) (page 70)
- Estimated energy costs for expanded but more efficient City Hall (page 78)

Analysis / Comment

Overall, the general fund is in much better shape than it has been the previous couple of years. We can be thankful that at least this year, we are not talking about layoffs, eliminating entire programs, reducing the level of services, and deleting funding for services that might be considered "nice" but not essential. I am very pleased that we were able to include transfers to depreciation and fleet reserves for the first time since FY 2009.

However, we should not allow our collective relief over the fact that we can manage to produce what is essentially a status quo budget cloud our vision. There are still a number of concerns that must be addressed. Although the General Fund reserve is now close to the level recommended by the auditors, this budget does not "grow" the reserve at all. Second, although we are happy to be able to do something about depreciation this year, the amount transferred is far below what was transferred in the past and that recommended by the auditors and Council resolution. The economy and tax revenues continue to be very uncertain as we move forward. That is why I chose

to place all of the excess revenues this year into savings accounts rather than fill vacant positions. I was not confident that the positions we would fill would be sustainable. Finally, the number of vacant positions continues to be a problem. The most critical positions right now, in my opinion are the project manager, maintenance and custodial, dispatch, and the jail. I would be happy to talk with the Council about this in detail.

Port and Harbor Enterprise Fund:

The Port and Harbor Enterprise Fund is balanced in that projected total revenues (\$3,431,243) exceed projected total expenditures (\$3,174,725). The fund is operating in the black in terms of operating expenses however, when the recommended depreciation expenses are included as though they represented a real expenditure this year, it appears that the fund is operating in the red, and by a large margin. Projected revenues are down slightly from 2011. The budget includes expenditures that are up approximately \$100,000; a fact that can be attributed largely to PERS Relief, increases in operating supplies, and increased garbage collection costs. This budget transfers \$470,000 into depreciation and fleet reserves which is \$30,000 less than 2011. Budget highlights for the Port and Harbor Enterprise Fund Include:

- No new fees or fee increases pending Council action (see below)
- Incorporation of the port and harbor maintenance function
- Moderate expenditures from reserves (page 201)
- No new personnel
- An essentially status quo operating budget

Analysis / Comment:

The Port and Harbor Enterprise Fund is solvent but it is essentially treading water. This is basically a maintenance budget. It covers day to day operating costs and that is about it. The City has deferred maintenance, repair, upgrades, and investment in this vital infrastructure for too long. There is room to generate more revenue that can be reinvested in the port and harbor however, deciding how to increase revenues and what to spend them on can be difficult. Political pressure to keep fees low has trumped good management. As a result, fees have not kept up with inflation and they do not generate enough revenue to address basic depreciation. Because the City has not raised fees as it should and has not kept up with maintenance, repair and investment, the decisions get harder and the necessary fee increases more drastic.

The Enterprise Fund does not have as much in its depreciation reserve account as it should given its assets and the value of its infrastructure. Instead of transferring \$500,000 a year, the City should be transferring three times that much. The Fund is also developing a problem with retained earnings and cash on hand. This is getting dangerously low and it means that the Fund does not have much margin for error if a large unforeseen expense occurs or revenues suddenly decline.

As noted above, there are legitimate opportunities to raise fees and the City should probably do so simply to grow the depreciation reserves and improve the Fund's retained earnings position. But, given the current state of the economy, care should be taken to not raise fees to the point of diminishing returns. As you know, the Special Port Revenue Bond Committee is looking at the possibility of selling revenue bonds to leverage other funds and finance improvements in the harbor. This would also require raising fees. This is where the decisions get tough. But, the City has a wonderful asset and economic engine here. We have exciting opportunities before us to improve and maintain the asset if we manage it carefully with an eye toward the future.

Water and Sewer Utility Fund

The Water and Sewer Utility Fund is balanced but the margin between revenues and expenditures is tight. Water revenue is projected to increase by about \$150,000 over the 2011 Budget to \$1,717,101 but sewer revenues are anticipated to decrease by \$300,000 to \$1,572,089. Total revenues are projected to decrease by \$129,852 to \$3,289,190. Expenditures are budgeted to increase by \$115,284 to \$3,107,571. This can be accounted for by PERS relief showing as an expense, and by increases in fixed costs and essential operating supplies. Only the minimum amount authorized by resolution, \$200,000, was placed in the depreciation reserves. That was necessary to balance the budget.

Highlights for the Water and Sewer Revenue Fund Include:

- No increases in fees consistent with the fee schedule adopted in July
- No new staff positions
- Expense increases limited to inflation and purchase of basic supplies
- Moderate capital expenses from reserves for basic infrastructure upgrades and repair (page 201)

Analysis / Comment:

The Water and Sewer Utility Fund remains vulnerable because of the basic structural flaws we have discussed in the past. We have a production and distribution infrastructure that is very expensive to operate and maintain and relatively few customers to pay for it. We have a reliable source of funds to build things and expand the infrastructure (dedicated sales tax) but inadequate funds to maintain it all (user fees). There is intense political pressure to keep fees down even though doing so may not always be in the best interest of the Fund. Our bonded indebtedness is significant and will limit opportunities to finance new projects or expansion of the distribution system for the next few years at a minimum. That is a problem if the Council's goal is to increase the number of customers. This year we have further uncertainty on the revenue side until we fully understand how the new "meter" ordinance will work in practice. We have already discovered some unanticipated flaws and will soon be discussing amendments with the Council.