

2014 BUDGET MESSAGE

Fiscal Year 2014

Introduction

Homer City Code Section 3.05.010 requires that the City Manager provide the City Council with a budget proposal for the next fiscal year by the third Friday in October. HCC 3.05.011 states that the budget proposal should be accompanied by a budget message which summarizes the proposal, highlights significant changes from the previous year's budget, and addresses other important fiscal policy considerations.

The budget proposal for Fiscal Year 2014 is attached for your consideration. The Committee of the Whole meeting on October 14th is dedicated entirely to going over the draft budget. The Finance Director will be there to talk about revenue projections and to make sure everyone understands the budget layout and where to find the information they need. The Acting City Manager and Department heads will be available to discuss expenditures and overall fiscal policy. It is my goal to make sure the Council understands the budget and the assumptions that went into putting it together. This is a draft budget and is commonly referred to as the "Manager's Budget." Once the budget ordinance is introduced by Council, (scheduled for October 28), it becomes the Council's budget and amendments can be made as Council deems appropriate.

General Fund

The draft budget contains revenue projections that we consider to be realistic and conservative. The projections are based upon audited numbers from Fiscal Year 2012 and revenue received so far for Fiscal Year 2013 through the end of September. This data is supplemented with tax and economic projections provided by the Borough and the State. Finally, we take into consideration information about economic trends provided by local sources such as the Chamber of Commerce and the Marine Trades Association. Based upon anecdotal information, we expect that the third quarter sales receipts will be significantly higher than last year. We have projected, based upon what we know, that revenues will increase by at least \$400,000 over last year. Once again, we are preparing a budget with limited information regarding revenues. New property tax information and additional sales tax information will become available in November. Therefore, it is possible that the Council will be able make budget amendments based upon this new information prior to final adoption of the budget in December.

On the expenditure side, this can basically be described as a "status quo" or "treading water" budget. The budget is "balanced" in the sense that expenditures do not exceed revenues. The budget is basically flat with the exception of the new items added which include funding for depreciation, Phase I of the IT upgrades, and a 2% COLA. Noteworthy expenditure reductions occurred in fuel costs and insurance premiums. The conservation and risk management measures we have implemented are paying off.

Unfortunately, revenue limitations prevent us from proposing that important programmatic and staffing issues be addressed at this time. In addition to that, proposed contributions to depreciation accounts are less than desirable and cannot be increased unless revenue projections improve or significant program cuts are made. Hopefully, it will be possible to address depreciation further either before the budget is adopted in December or at mid-year. Once again, the Department Heads have been very frugal with respect to operating expenditures and keeping costs down. There are very few increases in line items that are discretionary. The Budget contains very lean departmental operating budgets.

On the capital and equipment side, this budget contains proposed expenditures that begin to address the priority needs backlog. A description of these expenditures and a justification for them is included in the budget. These expenditures can be explained more fully at the Committee of the Whole meeting. They include repainting the 1995 backhoe, removing an underground fuel tank at the airport, and a new vehicle for the project manager at Public Works, a new phone system, air conditioner for the radio room and new squad car for the Police Department, a new gas detector and external fire escape for the Fire Department, new technology equipment at the Library, and Phase One / virtual server and storage arrays for IT. Unfortunately, I was not able to approve other worthy projects. These projects are included at the back of the budget and I hope to have those added soon.

Highlights / What is and is not Included

This section contains a list of highlighted items in the operating budget that are of great interest and importance to the City Administration, City employees, the Council, and the general public. These are issues that the Council is likely to hear much more about as the budget approval process moves forward.

- COLAs: The budget includes a 2% COLA for all employees. The employees have not received a COLA for the past five years. Adding a COLA is consistent with the Council's request that we look at the entire compensation package and not just focus on health insurance. The COLA helps employees keep up with inflation and helps to partially compensate for the pay cut contained in the health insurance plan amendments. The cost of living continues to rise and the value of City compensation continues to erode. This issue is beginning to affect the City's ability to recruit and retain quality employees. I hope Council will increase the COLA if it has the opportunity.
- Personnel: This budget does not include any new personnel, including positions requested and filling currently vacant positions. From a management perspective, I can tell you that we have very urgent needs in some departments, especially Police Dispatch, building maintenance, parks, and the library.
- Depreciation: This budget contains a minimal amount of money for depreciation. The good news is that we were at least able to transfer some money into depreciation accounts this year. That was not the case last year. The fleet reserves are funded at last year's levels.
- Nonprofits: This budget contains funding for all nonprofits at last year's levels. The Chamber of Commerce has formally requested an increase in its budget allocation. Other requests may be coming. None of these requests are included in this draft budget. The Council may amend this part of the budget as it sees fit and appropriate.
- Money for a Parks and Recreation Needs Assessment is not included due to budget limitations.

- Money requested by the Public Arts Committee for Baycrest gateway is not included due to budget limitations.

Budget Priorities

This section contains the City Manager's budget priorities for items that are presently not included in the budget. If revenue projections improve before December or by mid-year 2013, I would recommend that the following be added to the budget.

- Personnel: We have very serious needs in some departments, especially Police Dispatch, Public Works and the Library. Staffing requests from Fire Department are well supported and would improve public safety and public services. Parks could really use another seasonal employee. The top, critical priorities from my perspective are filling the vacant police dispatch position, upgrading the Children's Librarian position, and getting help for building maintenance.
- Depreciation: It is the Council's adopted policy to provide significant funds for depreciation and I could not agree more. This should be addressed if more revenues become available.
- COLA: This issue is very important for competitiveness and for the morale of City employees. Unfortunately, I could only find enough money for 2%. That does not keep up with inflation over the past five years.

Policy Considerations

There are several important General Fund policy consideration that I believe the Council should take into consideration as it moves ahead with budget discussions.

- Health Care Costs: Rapidly escalating health insurance costs continue to consume more and more of the available revenues despite recent steps that were taken to restrain or reduce costs. This puts significant constraints on the City's ability to address program and service delivery needs. We believe the amendments proposed for the health insurance plan which accompany this budget will address the problem in a very significant and meaningful way. We look forward to your response.
- Core Programs: There has been a good deal of discussion lately about new programs and services that the public wants but the City cannot afford. The public has been asked to identify where the money would come from or to show that they were willing to pay for it. I think at this point, it would be useful to note that the City needs some of that additional revenue to take care of its most basic services and functions. The fact that we are continually talking about the lack of funds for depreciation, maintenance and repair, replacement of aging equipment, vacant positions and competitive compensation should be an indicator.
- The Disconnect: There continues to be a huge public disconnect between what we want and what we are willing to pay for and maintain. We all love our capital projects. There is no shortage of ideas about new programs, new services, and new infrastructure. There are so many examples and the pressure continues to grow. We continue to build new stuff and make requests for more. Unfortunately, all of that new stuff requires money and increased staffing for maintenance and operations. The City's maintenance and operations responsibilities continue to grow while the

budget and staffing levels continue to stagnate and in many cases, decrease. The City staff have done an excellent job of increasing efficiency and “doing more with less.” However, we are getting very close to our limits and the point of diminishing returns. This needs further public discussion.

Port and Harbor Enterprise Fund

The Draft FY 2014 Budget projects that revenues will increase by approximately \$200,000. We believe that number is very conservative and it ultimately could be significantly more than that. Most of the increase is related to increased activity at the Deep Water Dock which we expect to continue. This projection does not assume that the drilling Rig Endeavor will dock there again this year. It also does not include any increases in fees. An increase across the board to cover inflation is recommended and fee increases are also recommended by Northern Economic in their new rate study. Fees will be discussed in detail by the Port and Harbor Commission and it may make recommendations by the time the Budget is formally introduced on October 28. Revenue projections are based on actual revenue receipts in 2012 and receipts to date in 2013. We also take into consideration current revenue trends and business cycles. The projected revenues are sufficient to cover basic maintenance and operations. The Enterprise Fund is balanced in the sense that expenditures do not exceed revenues. This Budget contains revenues of \$4,544,817 and expenditures of \$4,534,344.

Expenditures have changed very little from last year if you look solely at maintenance and operations. The Port and Harbor staff has been very frugal and efficient when it comes to costs that are within their control. The increase in overall expenses is attributable largely to a substantially larger transfer to depreciation reserves and to new bond payments. This budget funds depreciation at \$705,217 which is about \$200,000 more than last year. It also transfers \$300,000 into the Bond Reserves Account. In short, the fee increases instituted in 2012 and 2013 are doing exactly what they were intended to do; cover the cost of bond repayment and provide additional revenue for depreciation. Overall, the Enterprise Fund is in pretty good shape. There are operational needs that cannot be funded at this time but should be identified and prioritized. Chief among them is the need to increase staffing levels and contributions to depreciation accounts.

This budget contains several relatively small capital expenditures which total \$62,000. They are all explained and justified in the budget document and can be discussed more fully at the Committee of the Whole meeting. Capital improvements include maintenance cameras at the Fish Dock, a float sweeper, a new door on the Fish Dock cold storage unit, a used two wheel drive vehicle, and a new waste oil heater for the maintenance shop.

Budget Priorities

If the revenue picture were to change in a positive way, there are several priority items that I would recommend be added to the budget or receive increased funding.

- Depreciation: The depreciation account fund balance is insufficient for the amount of assets the Port and Harbor owns and maintains and transfers to this account are far below what is recommended by the auditors.

- Funding for a Port Operations Specialist.

Budget Policy Considerations

- Depreciation: The depreciation fund balance remains insufficient given the assets of the Port and Harbor. This fund took a big hit when approximately \$800,000 was transferred recently to the Port Bond Reserves Account. According to the Bond Bank, we should transfer that money back into the depreciation account. The Bond Reserve account only needs to have a balance of 1:25 times the annual bond payment. The City should find ways to increase contributions to the depreciation fund.
- Revenues for Operations: Fees were increased recently to cover anticipated bond payments and depreciation. However, this left little room for additional fee adjustments to cover increasing maintenance and operations costs. The City recently received the rate study it commissioned from Northern Economics. The study addresses maintenance and operations and the level of revenues that are needed to make the enterprise fund sustainable.
- Staffing levels: Staffing levels have not changed for many years but duties and responsibilities have increased dramatically. Most evenings there is only one harbor officer on duty which is a bit risky considering the total value of not only the port and harbor assets, but the value of assets mooring in or otherwise using the facilities.
- Revenues Generally: Significant structural changes are occurring in both the commercial and sport fishing industries. It will be important to monitor these changes and their potential impacts upon the revenues and business model of the port and harbor.

Water and Sewer Special Revenue Fund

There is good news overall about the Water and Sewer Special Revenue Fund. This proposed budget is balanced and there is no need to dip into the reserves, raise fees, or make unsustainable cuts to an already lean budget. The Fund is expected to be operating in the black in 2014 which is good news for all. The projected revenues are conservative. We felt that a conservative approach was necessary because revenues under the new rate structure are much more dependent on consumption than the prior fee schedule which brings with it a greater level of uncertainty. In addition we don't know what effect the new schedule might have on consumer behavior. Consumption was definitely trending upward this year and that provides a measure of confidence in our projections. The projected revenues are sufficient to cover budgeted expenditures. The budget is balanced in the sense that expenditures do not exceed revenues. At the time this report was written, revenues were projected at \$3,621,500 and expenditures were \$3,616,062. Some last minute adjustments are anticipated before the Council receives the final draft.

Expenditures for basic maintenance and operations have changed very little from last year. In fact, the sewer budget has actually decreased slightly. The Water and Sewer Superintendent and his staff should be commended for providing a very lean and efficient operating budget and for holding expenses down. The slight increase in expenditures is mostly attributable to increases in fixed costs. This budget transfers the minimal amount (\$200,000) into the depreciation account. More would be desirable.

The draft budget contains a number of capital expenditures which will come out of depreciation and fleet reserve accounts. The capital budget includes a total of about \$75,000 in expenditures for sewage lagoon improvements, a water storage tank diffuser, a snow plow and flatbed for an existing truck, mixed oxidant disinfectant at the water treatment plant, and a new mid-size 4by4. If more revenues become available, it is recommended that they be placed into the depreciation account.

Policy Considerations

- Increasing Customers: This has been discussed many times before. One of the fundamental flaws that needs to be addressed is that we have an expensive and expansive treatment, collection and distribution infrastructure and very few customers to pay for maintenance and operations. There are many ideas for increasing the customer base from in-filling, to expanding the system to the rest of the city, to identifying new buyers for bulk water. All of these ideas should be explored further.
- Rate Model: 2014 will be the first year for the new rate structure and it should provide us with experience and good information as we head into 2015. We would recommend that the Council consider spending some funds to commission a rate study similar to the one it received for the Port and Harbor.