

2016 BUDGET MESSAGE

Fiscal Year 2016

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 City of Homer has been impacted by the down turn in the price of oil and the ensuing State revenue shortfall. After years of belt tightening from the elimination of sales tax on non-prepared food and not funding reserves, the City is in an untenable fiscal situation without drastic cuts to services. The State has reduced the City's contract for providing community jail services by 40%. Other state assistance, Revenue Sharing, is scheduled to shrink and disappear altogether, prompting Council to remove Revenue Sharing from the operating budget via Ordinance 15-16. Add a decline in sales tax revenue and the City of Homer faces a projected decline in revenue of \$884,984. Coupled with the increasing cost of doing business, the City faces a \$1,192,596 million gap between 2015 adopted budget and 2016 projections.

Since July of 2015 the Mayor and Council have engaged the community in a conversation about core services, cuts and potential revenue. To that end, I am presenting two budgets to the City Council. Budget A - "the assumes revenue budget" - assumes \$1 million in revenue to the General Fund will be approved by Council and the voters. Budget A is by no means a lavish budget; it contains \$725,000 in cuts to personnel and non-personnel expenditures and approves no new capital projects. Budget B is a bare bones budget and absorbs the shortfall with reductions in services. Budget B is austere and will have many consequences for the community; reduced responsiveness for first responders, reduced hours at the library, reduced public meetings, reduced recreation opportunities, and an overall reduction in our ability to respond quickly and efficiently to the public.

Budget A and Budget B proposals for Fiscal Year 2016 are outlined below. The Draft Budget will be presented in its entirety on October 12. An amendment representing the changes needed to balance the budget with cuts to services (Budget B) will be incorporated into the enacting Ordinance presented on October 26. The proposed reductions in Budget B are also detailed in this budget message below. Budget A will be conditional upon the approval of revenue. Without revenue, Budget B will automatically become effective. The Worksession and Committee of the Whole meeting on October 12th is dedicated to a presentation of the draft budget. The Finance Director will be there to talk about revenue projections, proposed expenditures, and to make sure everyone understands the budget layout and where to find the information they need. The 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

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budget, the assumptions that went into putting it together and differences between the two proposed budgets. These are drafts budget, commonly referred to as the “Manager’s Budget.” Once the budget ordinance is introduced by Council, (scheduled for October 26), they become the Council’s budgets 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 on audited numbers from Fiscal Year 2014 and revenue received so far for Fiscal Year 2015 through the end of September. This data is supplemented with tax, property valuation, and economic projections provided by the Borough and the State. Finally, we take into consideration information about economic trends provided by local and state sources. We have projected, based upon the information available to us, that revenues will decrease over last year. The impact of the state’s fiscal situation and the declining price of oil is affecting all Alaskan organizations. In FY2015 the City received a \$330,000 cut to our community jail contract. Revenue sharing, representing \$341,000 in FY 2015, was removed from the operating budget based on the knowledge that the state is tapering off this program. These declines in revenue combined with anticipated lower sales tax returns project a significant gap for 2016. We project that without a new revenue source to the General Fund, total General Fund Revenues in 2016 (\$10,609,675) will decrease by \$933,984 or 8.1% over the 2015 Adopted Budget. We project that sales tax (\$4,950,746) will decrease by \$100,381 or 2.0 % over the 2015 budget and that Real Property Tax (\$3,152,711) will increase by \$34,075 or 1.1%. In order to present a balanced budget without significant cuts to services the community values, Budget A assumes \$1 million in new revenue to the General Fund which would bring General Fund revenue to \$11,658,093.

As always, we are preparing a budget with limited information regarding revenues. New property tax information and additional third quarter 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.

Increased Expenses

- Health Insurance: As anticipated, health insurance costs are predicted to increase by a minimum of 10% this year. We should have a better handle on the exact increase by the November meeting. In 2015 the City experienced substantial savings from changes to the employee benefit package and switching from self-funding to private insurance. This savings was used to balance the 2015 operating budget instead of put into the health insurance fund to cushion against future increases.
- Utilities are predicted to increase. The savings from City facilities converting to natural gas has been realized in the 2015 budget. The cost of electric has increased sharply from year to year and sewer is scheduled to increase by 6.5%.
- Personnel: The City’s biggest expense, and largest asset, is the employees that provide City services. The 2016 budget does not include a cost of living increase for employees. However, there are, as always, personnel increases. In early 2015 patrol officers were refactored to come

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closer within range of the salaries of neighboring communities. A modest increase based on merit is budgeted for eligible employees, but not always awarded.

HCC 3.05.045 requires that the City Budget must be balanced. The 2016 draft Budget A and Budget B are “balanced” in the sense that expenditures do not exceed revenues. However, budget A is conditional upon adoption of a new revenue source for General Fund. The enacting budget ordinance is written so that if voters do not approve new revenue, budget B will become effective.

BUDGET A – ASSUMES REVENUE

Budget A total General Fund Revenues are projected to be \$11,658,093 and proposed expenditures are \$11,658,093. Budget A assumes \$1,000,000 in revenue to the General Fund will be approved by voters. Budget A is a minimalist budget. Personnel cuts were made to Planning, Administration, Finance, Police Department and Public Works and all the departments were squeezed in their non-personnel operating budgets. No new general fund capital projects were approved despite the dire need for maintenance projects such as a new roof for City Hall and vehicles for Public Works and the Police Department. The departments have been incredibly lean with their budgets this year have been very frugal and conservative in their budget requests and fiscal management. Budget A does include an approximate \$600,000 transfer to reserve accounts. It is no longer tenable to not fund our reserves; we are forced into making emergency purchases out of general fund fund-balance and/or run the reserves into a negative balance when critical equipment breaks. Under the advice of the auditor, \$114,428 of the transfer to reserves wipes out negative balances that have accumulated in many reserve accounts. Another \$97,000 is a mandatory transfer to the Public Works Fleet Reserve to fund lease payments on a street sweeper and dump truck that were approved in 2014 and 2015, respectively. That leaves just over \$390,000 distributed among the remaining reserve accounts, including fleet reserves.

Many of the capital requests departments made for 2016 cannot be ignored. If budget A is approved, it is my intention to reassess the most critical capital needs at midyear and present an adjustment to Council once there is a clear picture of our revenue situation and the impact of any potential further cuts from the state. Below are several noteworthy changes in the General Fund that should be highlighted.

Decreased Expenses

This budget contains the reduction of 6.5 positions. This will impact City staff’s ability to be responsive to the public and efficiently and effectively perform our duties as public servants. Budget A also includes over \$150,000 in non-personnel cuts. These cuts represent everything from being squeezed on tools, equipment and office supplies to reducing the line item for professional services. These reductions give departments less flexibility to respond to emergency situations and will require vigilance to administer. I expect they will need to be tweaked and increased in the coming years as we gain experience living within such tight margins.

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Proposed Cuts to City of Homer Operating Budget: Budget A

Department/ Division	Reduction	Amount	Impact
Homer Police Department	2 positions - dispatch and jail officer	\$ 155,000	Less coverage in dispatch & jail. Increased liability
Planning	1 position - code enforcement	\$ 78,000	Less code enforcement
Library	Books and supplies	\$ 29,000	Slashes books budget - Older circulation
City Manager's Office	.4 position - admin assistant	\$ 28,000	Less responsiveness to public. Less capacity in admin.
Finance	1 position	\$ 127,000	Short term impact in ability to produce timely and accurate reports
Public Works	2.5 positions – 1 project manager, .5 admin assistant and .5 equipment operator	154,000	Less ability to take on new projects. Less administrative capacity. Less capacity for large snow events. Temp building maintenance goes to part time.
Senior Center		\$10,000	2015 one time request
Homer Hockey Association		\$14,000	2015 one time request
Total personnel		\$ 571,000	
Non-personnel		\$ 154,000	
Total		\$ 725,000	

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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 2015, I would recommend that the following be added to the budget.

- Personnel: Budget A proposed 6.5 full time equivalent cuts to personnel. These cuts will have an effect on the ability to provide services and should be reinstated when the revenue picture allows. Priority staffing will be a jail officer at the police department, a temporary equipment operator in public works, and additional help for the fire department.
- Capital projects. There are a number of well documented capital project needs. Chief among the priorities is a patrol vehicle for the Police Department, a small sander and trailer for Public Works, a light tower for the Fire Department and roof replacement for City Hall. These projects are justified and needed and I hope to be able to address them at midyear.

Other Changes of Note:

Unfortunately, revenue limitations required cuts that will impact our efficiency and responsiveness. In addition to the personnel priorities listed above, administrative support positions have been cut or reduced across the City that will need to be replaced so staff can do their important work and be responsive to the public. Long standing needs for a new patrol officer, a full time building maintenance position and a half time position at the Community Recreation Program continue to be badly needed and justified. Though the proposed budget contains \$600,000 in transfers to General Fund depreciation accounts or fleet reserves, far more would be necessary to catch up after 3 consecutive years of not funding reserves. To put things in perspective, in 2006 Council set a goal of accumulating 40% of depreciable assets (combined value of \$72) in General Fund and Water Sewer reserves. The City would need to put \$2.9 million each year to reach that goal over the next 10 years. Water sewer and General Fund transfer to reserves in Budget A total just over \$1 million.

On the capital and equipment side, this budget contains no new General Fund capital projects. The budget contains a description of all capital and equipment requests submitted by department heads so Council can understand the full need out there and the impact of not funding these important priorities.

BUDGET B – BARE BONES

The bare bones budget, Budget B, is balanced without a revenue stream to General Fund. Budget B total General Fund Revenues are projected to be \$10,609,675 and proposed expenditures are \$10,609,675. This is truly a bare bones budget and makes severe cuts to important services such as parks and recreation, hours the library is open, marketing the City of Homer and services provided by area non-profits. Budget B replicates Budget A with the exception of the items below that represent a direct cut to services. This includes a total of 3 additional positions (full time equivalent) and 3 temporary positions. Not only does Budget B not fund reserves, it cripples our ability to provide services to the public. Everything from responsiveness when an emergency call is placed to indoor recreational space has been reduced in Budget B.

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Proposed Cuts to City of Homer Operating Budget: Budget B

(Reductions are in addition to cuts proposed in Budget A)

Department/ Division	Budget B - Bare Bones	Addition to A	Impact
Homer Police Department	1 position - patrol officer	\$90,700	Less officer time on streets. Increased liability
Homer Volunteer Fire Department	2 temporary seasonal positions	\$33,900	Potential impact to response during busy summer month. Overworked employees
Library	1.2 (FTEs) positions	\$82,800	Close library for a minimum of 12 additional hours, bringing us under the minimum required to be in compliance with state.
Clerks	.4 position	\$34,600	Less ability to support public meetings. Longer time for minutes to turn around. Need to reduce committees/ Commissions
Community Recreation	.4 position and less temporary hours	\$49,000	Only drop-in activities. No educational programing, special classes or activities. \$15,000 less in revenue.
HERC	Mothball HERC 1	\$31,000	No activities at HERC
Lobbyist	Do not renew contract	\$22,000	No presence in Juneau. 1/2 paid for by Enterprise
Economic Development	No non-visitor advertising	\$8,000	Eliminates City directed non- visitor industry promotion
Public Works	1/2 of overtime winter equipment operator hours and temporary park maintenance	\$20,000	Less responsive snow removal. Less park maintenance (cleaning restrooms, beautification projects)
Homer Foundation	70% Cut	\$13,300	Less grants to non-profits through HF.
Homer Chamber of Commerce	70% Cut	\$35,700	Severely reduced marketing of Homer
Pratt	70% Cut	\$46,600	Reduced educational programing at Pratt
Total		\$467,600	

*BB Funds payment of street sweeper and dump truck from reserves (\$97,000).

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Fiscal Policy Considerations

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

- Continued Revenue Cuts from the State. The FY2016 revenue shortfall can be directly related to cuts from the state as they face their own revenue shortfall and go through the exercise of trimming their budget. The state has a long ways to go before revenue meets expenditures. I anticipate continued impact to municipalities from the state's fiscal situation. This could take the form of decreased PERS relief, further cuts to contracts such as community jails and road maintenance or defunding maintenance of Alaska Land Mobile Radio on behalf of municipalities. 2016 will be a year of playing defense in Juneau for Alaskan municipalities.
- Core Programs: In the face of looming revenue shortfalls, the Council and the public has engaged in a productive and thoughtful discussion about what the public values and core services. At the July 20 Town Hall meeting around 100 participants engaged in an exercise prioritizing the importance of the service and the level of the service provided for all City services. Results showed that for the most part the public who participated felt like all services the City provided were critical and delivered at the right level. This was backed up by participants supporting a cadre of revenue options. An online survey where participants were forced to prioritize core services listed Fire and EMS, Police and Public Safety and Winter Road Maintenance as the top three priorities. The City needs additional revenue just to take care of its most basic services and functions. The public has been asked to identify where the money would come from or to show that they were willing to pay for it. Suspending the Homer Accelerated Roads and Trails program and a seasonal sales tax increase have both been put forward as viable options to maintain services and will prompt lively debate as the Council and public debate the budget.
- The Disconnect: There continues to be a huge disconnect between what the public wants and what we can afford. Everyone loves capital projects. There is no shortage of ideas about new programs, new services, and new infrastructure. City staff has done an excellent job of increasing efficiency and "doing more with less." However, we are at the limit of our ability to maintain current infrastructure. Every new road, trail, and facility comes with an increased operating and maintenance cost that needs to be considered.
- Depreciation: This budget contains \$600,000 in transfers to reserves. This is not sufficient to make up for three consecutive years of not funding depreciation, but it is a great start. In 2006 Council adopted Resolution 06-100 with a goal of funding reserves at 40% of depreciable capital assets (excluding land) by 2016. Year-to-date, reserves are funded at 8% of depreciable assets.

Port and Harbor Enterprise Fund

The Draft FY 2016 Budget projects revenues of (\$4,688,729), which is about \$48,000 less than 2015 budgeted and approximately \$120,000 less than the 2014 actual.

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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 \$4,688,729 and expenditures of \$ 4,688,729. The budget contains a transfer to depreciation accounts of approximately \$599,668 and a transfer to the Bond Payment Reserve of \$300,000 and \$57,648 loan payment to general fund. Due to cuts to the General Fund budget that the Overhead Administration Cost Allocation is based on, it comes in about \$573,691, which is \$32,235 less than last year (\$605,925).

We believe these numbers to be fairly conservative. After much study by the Port and Harbor Commission and support from Council, Harbor moorage rates were increased by 4.3%. Unlike in years past, we do not project an increase in activity at the Deep Water Dock and Pioneer Dock due to a slowdown in oil and gas exploration in the Inlet related to the low price of oil. Transfers to the reserves for fiscal year 2016 reflect the effort to keep customer costs as low as possible but still build a reserve that will meet our long term goals.

Expenditures have changed very little from last year. Total expenditures (\$4,688,729) represent a 1% decrease. The Port and Harbor staff has been very frugal and efficient when it comes to costs that are within their control. 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. The chief operational need is to increase Harbor operations staff to maintain to provide needed coverage. The 2016 draft budget includes one new position, harbor officer. **Harbor** operations have not increased staffing levels in 25 years - even with millions of dollars in expansion projects that have taken place. The Port and Harbor customer base continues to expand and so does the need for trained personnel to ensure all the diverse needs are met.

This year's Port and Harbor draft budget is largely a status quo budget with the exception of one additional position and the necessary increases to the moorage fees in the harbor to help fund the reserves. We believe that the other port related rates are competitive at the current levels and don't recommend any increases. The Port and Harbor would benefit from taking time this winter to review and reevaluate the rate structure for the Fish Dock. After a careful review we may find it necessary to make changes to encourage sales. This draft budget contains a few capital expenditures that will improve safety, operations, and service delivery to Port and Harbor customers: consulting services for a tariff upgrade, new billing software, and refurbishment of a fish dock crane and fire cart. Capital requests are all explained and justified in the budget document and can be discussed more fully at the Committee of the Whole.

Budget Priorities

If the revenue picture were to change in a positive way, I would recommend increasing funding of depreciation. The depreciation account fund balance is insufficient for the amount of assets the Port and Harbor owns and maintains. Transfers to this account are far below what is recommended by the auditors.

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Budget Policy Considerations

- Depreciation: The depreciation fund balance remains insufficient given the assets of the Port and Harbor. Recommendations contained in the rate study, as amended by the Port and Harbor Commission, as soon as FY 2016.
- Revenues for Operations: Fees were increased recently to cover anticipated bond payments. However, this left little room for additional fee adjustments to cover increasing maintenance and operations costs and the need to grow the depreciation reserves. 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. An automatic fee increase tied to the inflation index has been adopted by Council and will become effective January 1, 2016.
- Revenues in General: Significant structural changes are occurring in the commercial and sport fishing industries, as well as oil and gas exploration and development in Cook Inlet. 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

The rate restructuring implemented in 2015 and reorganization of labor costs has had the intended positive effect on the water and sewer special revenue fund; 2016 anticipates a \$439,745 transfer to reserves in the water sewer budget. This includes the minimum required contribution of \$100,000 from each of water and sewer funds to depreciation; \$305,928 for water and \$133,807 for sewer. This draft budget projects that combined water and sewer revenues will be \$3,745,746 in 2016. This represents a slight decrease (by \$48,338) in revenues from the FY 2015 budget. The water and sewer fund continues to benefit from the rate restructuring implemented in 2015 and Public Works and water and sewer reorganization (personnel reallocation). The Water and Sewer Fund is balanced in the sense that expenditures do not exceed revenues. It is always hard to project water and sewer revenue. Based on 2015 experience, water surplus exceeds sewer. This could be due to 2015 being a second unseasonable warm summer. The 6.5% sewer rate increase adopted by Council should help with 2016 sewer revenue.

The draft budget contains a number of capital expenditures which will come out of depreciation and fleet reserve accounts. These expenditures include non-routine maintenance of the fire hydrants (painting), replacing the influent pump station mixer and raw water pump and a computer systems upgrade.

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.

Respectfully Submitted,

Katie Koester
City Manager