



City of Homer

www.cityofhomer-ak.gov

Finance Department

491 East Pioneer Avenue
Homer, Alaska 99603

finance@cityofhomer-ak.gov

(p) 907-235-8121

(f) 907-235-3140

Memorandum 20-206

TO: Mayor Castner and Homer City Council
THROUGH: Rob Dumouchel, City Manager
FROM: Elizabeth Walton, Finance Director
DATE: December 10, 2020
SUBJECT: FY21 Truncated Budget Walkthrough

The purpose of this memo is to walkthrough the condensed budget process related to the Amended FY21 budget.

Background

Council passed Resolution 20-112 giving City administration the official directive to perform the necessary work to transition the City of Homer from a calendar year budget to a fiscal year budget running from July 1 to June 30 of the succeeding year. Per Resolution 20-112, the effective date of this transition is July 1, 2021. In order to accommodate that effective date, the FY21 Adopted Budget needs to be amended to reflect the January 1 to June 30, 2021 time period. Resolution 20-119 is before Council acknowledging that FY21 will be truncated in order to transition from a calendar year to a fiscal year.

Per the timeline presented to Council, City Administration is to provide Council with an Amended Budget at the December 14th meeting. Ordinance 20-93 on the December 14th agenda provides Council with the necessary appropriations for the truncated FY21. Accompanying this Ordinance is a budget document that illustrates how those appropriations were determined. Also before Council at the December 14th meeting is Ordinance 20-89, which amends City Code to properly reflect a fiscal year of July 1 – June 30.

Budget Process

Resolution 20-112 passed on October 26th and since then the Finance Department has been working to present Council with a balanced budget for the truncated FY21. The budget process typically takes City leadership four months to develop a proposed budget for Council. This amended budget required the same level of work on the Finance Department and the leadership team.

The budget development schedule was fast tracked for the truncated FY21, with departments required to submit amended budgets to Finance within two weeks' time (typically they have a month to dissect department spending and propose budgeted expenditures). After that,

Finance and City Administration had a couple weeks to pull the budgets together and present Council with a balanced budget for each of the Operating funds.

Per HCC 3.05.045, projected expenditures shall not exceed projected revenues in the operating budget. As you will see in the amended budget before you (and detailed below), each of the operating funds has total projected expenditures exceeding projected revenues. Therefore, utilization of fund balance/reserves is necessary to meet code and to maintain a balanced operating budget.

Budget Methodology - Revenues

Most of the budget methodology remains consistent with the truncated version. Typically sales and property tax revenues are determined utilizing a regression model. The model was not statistically appropriate and, therefore, we switched to utilizing a three year average for these values. The three year average is based on the January 1 – June 30 time period for the preceding three years (FY18, FY19, and FY20). The rest of revenues generally follow the utilization of a three year average (this is consistent across each of the funds). The main exception is Water/Sewer metered sales, which is based on 2019 usage and applying the rates recently adopted.

Budget Methodology – Expenditures

Most of the Maintenance & Operations (M&O) expenses were reduced by half to account for half a year's worth of spending. Departments also took into account the three year average spending and modified expenditure estimates accordingly.

There are three line items that remained at the same adopted FY21 level: Audit Services, Finance Overtime, and Finance Professional Services.

- **Audit Services** costs are expected to meet a full year's cost, as the Finance Department is working to wrap up the FY20 audit in a timely manner. Also, it has been the general practice for the subsequent fiscal year to pay the audit costs associated with the previous fiscal year. So, even if work isn't completed prior to June 30 most of the audit expenses associated with FY20 will be back posted to FY21.
- **Finance Overtime** has been kept consistent with those costs presented in the adopted FY21 budget, as staff will be highly engaged to complete the FY20 audit, CARES reporting wrap up, and assisting with the transition of fiscal years.
- **Finance Professional Services** has been kept consistent with those costs presented in the adopted FY21 budget, as we are reserving funding to potentially utilize outside resources to assist with CARES reporting and fiscal year conversion.

One other major change is that none of the operating budgets include a transfer to reserves, as each of the funds did not have "excess" budgeted revenue to transfer to reserves. Each of the funds have a handful of mandatory transfers (bond payments, seawall reserves, hydrants, GF admin, revolving energy, debt payments, etc.), but anything outside of mandatory is not taking place during the truncated fiscal year.

General Fund

Similarly with the other two funds, the General Fund will require a draw on fund balance/reserves to balance the truncated FY21 Operating Budget. The budgeted draw presented in the budget before Council is \$2,971,020. Without factoring in this draw to balance the budget, revenues are budgeted to be down roughly 73%.

The draw is significant for the General Fund because the majority of sales tax and property tax revenues are received in the second half of each calendar year. Therefore, this truncated fiscal year is lacking the majority of these revenues (property tax budgeted revenue is down 97% and sales tax is down 67%). Looking at budgeted revenue for FY20, property tax represented roughly 28% and sales tax accounted for roughly 44%.

Department heads have worked to decrease total expenditures for this truncated fiscal year, with total Maintenance & Operations expenses being down just shy of 44%.

HCC 3.05.049 (effective FY20), states that emergency fund balance for the General Fund is equal to four months operating revenue for the current fiscal year. Exhibit B-1 (page 21) of the financial statements provides an unassigned general fund balance of \$9,522,558. Based on the FY20 budget, the emergency fund balance should be approximately \$4,153,169. This leaves an estimated unassigned fund balance of \$5,369,389.

There is sufficient balance in the unassigned fund balance for the General Fund to absorb the budgeted draw to balance the truncated FY21 Operating budget. The budgeted draw will utilize approximately 45% of the unassigned balance.

Water/Sewer Fund

Consistent with the other two funds, the Water and Sewer Fund will require a draw on fund balance/reserves to balance the truncated FY21 Operating Budget. The budgeted draw presented in the budget before Council is \$53,439 (\$25,372 Water and \$28,067 deficit). Without factoring in this draw to balance the budget, revenues are budgeted to be down just shy of 50%.

The draw is not as severe for the Utility fund as the revenue is relatively stable through the calendar year. If spending is monitored closely or if revenue is above budget expectations, there is potential for this fund to break even without the need of relying on fund balance or reserves.

Utility Administration decreased total expenditures for this truncated fiscal year, with total Water Maintenance & Operations (M&O) expenses down 46% and total Sewer M&O expenses down 36%. The biggest reason why Sewer M&O expenses aren't down closer to 50% is due to the tri-annual Kachemak septic pumping contract. This contract is expected to be completed during the truncated FY21.

If you reference Exhibit H-3 (page 90) of the financials, the fund balance of Utility Operations (Fund 200) is \$673,608. This fund should have sufficient fund balance at the end of fiscal year 2021 to absorb the budgeted draw. If not, there should be sufficient balance in Utility reserves to fund the deficit. As of 11/30/20, the balance of the Utility Reserves is \$4,582,260 (\$2,609,724 Water Reserves and \$1,972,536 Sewer Reserves).

Port and Harbor Fund

As with the other two funds, the Port and Harbor Fund will require a draw on fund balance/reserves in order to balance the truncated FY21 Operating Budget. The budgeted draw presented in the Amended Budget before Council is \$660,176. Without factoring in this draw to balance the budget, revenues are budgeted to be down roughly 65%.

The draw is significant for the Harbor because berth stall revenues are received in October of each year. Therefore, this truncated fiscal year is lacking those revenues. These stall revenues represented roughly 27% of total budgeted revenue for FY20.

Harbor Administration has worked diligently to decrease total expenditures for this truncated fiscal year, with total Maintenance & Operations expenses being down just shy of 53%.

If you reference Exhibit I-4 (page 97-98) of the 2019 Basic Financial Statements, you are able to extract information that makes it is apparent that the Operations component (Fund 400) does not have sufficient balance to cover this deficit. A quick formula for fund balance is current assets minus current liabilities. If we perform this quick math on Harbor Operations (Fund 400) it comes to a deficit of \$1,375,697.

Also detailed in Exhibit I-4 is the cash balance available for each of the “units” within the Enterprise Fund. As of 12/31/19, the total cash balance available to the Port and Harbor fund is \$1,942,518 (negative cash balance of \$553,116 for operations). The cash balance represents the Harbor’s share of the central treasury and in a simple sense is what the Harbor could write a check for.

If you reference Exhibit I-5 (page 99) of the financials, the net position of Harbor reserves is \$1,829,802 (\$2,160,222 less \$330,420 for bond reserves). As of 11/30/20, the balance of the reserves is \$2,097,153 (not including bond reserves).

Financial Implications

It is important to understand that the loss to fund balance will not simply be reimbursed in subsequent fiscal years. Management will need to be actively planning in future years to work on reimbursing the fund balance. Otherwise, the fund balance will remain at the lower levels.

The revenue that the City receives in the second half of calendar year 2021 will not be available to replenish the fund balance, as this revenue will need to be utilized to fund the expenditures for the first six months of calendar 2022 (FY22 will run July 1, 2021 – June 30, 2022).

Still to Consider – Capital Budget

The Amended Budget before Council is only representative of the FY21 Operating Budget. What still needs to be discussed is how to handle the FY21 Capital Budget. The Adopted FY21 Operating Budget includes various transfers to fund reserves. However, the Amended (truncated) FY21 Operating Budget does not include transfers to fund reserves. Initial questions to answer: Are the already approved FY21 capital projects allowable? Is new capital spending allowable?