



# City of Homer

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## Memorandum 21-013

TO: Mayor Castner and Homer City Council  
THROUGH: Rob Dumouchel, City Manager  
FROM: Elizabeth Walton, Finance Director  
DATE: January 7, 2021  
SUBJECT: FY21 Truncated Budget – Supplemental Information

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The purpose of this memo is to provide supplemental information to Memorandum 20-206, which was presented to Council at the December 14<sup>th</sup> meeting.

### Key Terminology

**Fund Balance:** Simply speaking, it is the difference between assets and liabilities in a governmental fund. Fund balance is intended to serve as a measure of the financial resources available in a governmental fund. It is important to remember that the fund balance is a snapshot in time and is constantly fluctuating.

**Unassigned Fund Balance:** This fund balance is the residual classification for the General Fund. It is also used to report negative fund balances.

**Reserves:** Fund that accounts for monies set aside to be used for the purchase and maintenance of City buildings and equipment. Each of the City components (General Fund, Utility Fund and Enterprise Fund) have a respective reserve fund. The General Fund has the CARMA (156) and Fleet CARMA (152) funds. The Utility Fund has the Utility CARMA (256) fund that is further broken down to Water CARMA (256-0378) and Sewer CARMA (256-0379). The Enterprise Fund has the Port Reserves (456) fund and it includes a reserve component for each of the following: Port and Harbor, Load and Launch Ramp, and Revenue Bond reserves.

### FY21 Truncated Budget Reminders

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, 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.

One major change for FY21 is that none of the operating budgets include a transfer to reserves, as each of the funds is not expected to have “excess” budgeted revenue to transfer

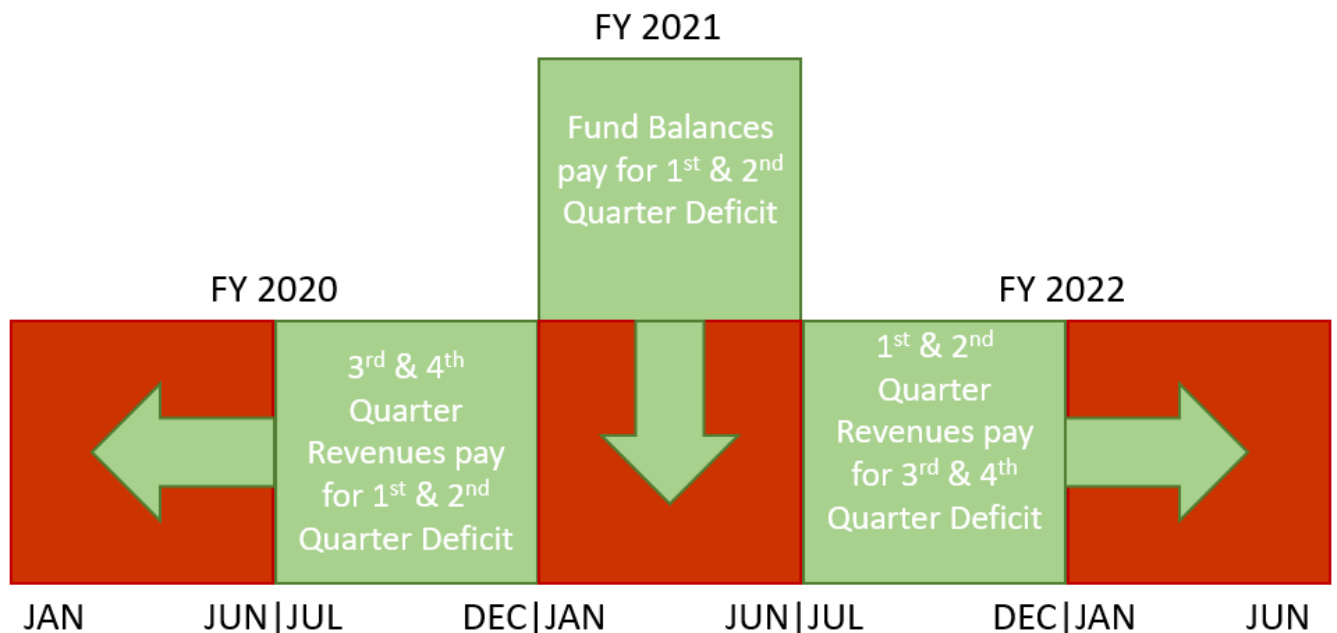
to reserves. Each of the funds have a handful of mandatory transfers (bond payments, seawall reserves, hydrants, GF admin, revolving energy, debt payments, etc.), but anything outside of mandatory is not taking place during the truncated fiscal year.

**Balancing the Budget**

Each of the operating funds (General Fund, Utility Fund, and Enterprise Fund) require a draw on fund balance/reserves to balance the truncated FY21 Operating Budget. The size of the draw varies significantly between the operating funds, but a basic cash flow problem exists for them all. That is, the majority of the City’s revenue is received in the last six months of the calendar year (July – December).

Switching fiscal years effective July 1, 2021 puts the City in a position in which the deficit that is naturally born in the first six months of the calendar year will not be reimbursed by revenues received in the last six months of the calendar year. It will instead be paid by fund balance/reserves. The size of the deficit for FY21 (January 1 to June 30, 2021) is no greater than deficits in prior years for the same period. This is the natural cash flow pattern for the City of Homer.

The figure below shows a simplified view of the change in cash flow pattern. The current pattern (FY 1987 through FY 2020) has us spending and then reimbursing. The new pattern (FY 2022 and onwards) earns money and then spends it. The transition year (FY 2021) is cut off from a revenue source and will use fund balance/reserves to balance the equation.



**Funding the Deficit**

Any deficits/surpluses that are accrued by the end of a fiscal year naturally remain in the specific fund in which they are derived, unless other financial direction is provided on how to handle the deficit/surplus. Due to this natural process, the FY21 Amended Budget is balanced by drawing on each fund’s respective fund balance.

If Council would like to utilize reserves (or any other funding source), then a budget amendment needs to be proposed prior to the passage of the FY21 Amended Budget – or – Council can pass a subsequent Ordinance at a later date that amends the budget to reflect the updated funding source.

There are some options associated with the timing of the transfer (if utilizing reserves). The budget can be balanced with a transfer from reserves up front and the transfer can be done matching the budgeted deficit. The other option is waiting until the fiscal year concludes and amending the budgeted transfer from reserves to match the actual deficit.

City Administration recommends that the fund balance is utilized to balance the budget for each of the operating funds.

## **Financial Implications**

### **Citywide**

It is important to understand that the loss to each 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 balances, assuming Council wants to build up similar balances. Otherwise, the fund balances 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 balances, 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).

### **General Fund**

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**

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.

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 CARMA to fund the deficit. As of 12/31/20, the balance of the Utility Reserves is \$4,582,260 (\$2,555,102 Water CARMA and \$1,932,218 Sewer CARMA). This balance represents the actual spending and revenue recorded to the CARMA funds in FY20.

### **Port and Harbor Fund**

If you reference Exhibit I-4 (page 97-98) of the 2019 Basic Financial Statements, you are able to extract information that makes it 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 12/31/20, the balance of the reserves is \$1,824,493 (not including bond reserves). This balance represents the actual spending and revenue recorded to the reserve fund in FY20.

**City Administration strongly recommends Council provide support to the Enterprise Fund to balance out the impacts of the fiscal year change.** The Finance Department is actively researching the options that are available for the General Fund to support the Enterprise Fund through this transitional year.

### **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.

Council passed Resolution 20-050 stating that all non-critical capital projects were to be delayed. As such, City Departments took that direction and postponed those non-critical projects. Administration will be bringing additional information associated with the Capital Budget to Council at the meeting on January 25<sup>th</sup>.