

2013 BUDGET MESSAGE

Fiscal Year 2013

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 2013 is attached for your consideration. The Committee of the Whole meeting on October 8th 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 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 22), it becomes the Council's budget and amendments can be made as Council deems appropriate.

General Fund

The draft budget contains revenue projects that we consider to be realistic and conservative. The projections are based upon audited numbers from Fiscal Year 2011 and revenue received so far for Fiscal Year 2012. 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. 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. Unfortunately, revenue limitations and increases in fixed costs 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 either before the budget is adopted in December or at mid-year, like Council did this year. By status quo, I mean that with the exception of transfers to depreciation accounts, if it was in the budget last year, it is in the

budget this year. Once again, the Department Heads have been very frugal with respect to operating expenditures. There are very few increases in line items that are discretionary.

On the capital and equipment side, this budget does contain significant proposed expenditures that 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 one new police vehicle, a new utility vehicle and SCBA (airpack) equipment maintenance and upgrade for the Fire Department, a vacuum excavator, an 8 cubic yard sander unit, a rubber tire excavator, painting for a backhoe, replacement of a V plow, replacement of a service body unit, and a 2 ton 4by 4 truck at Public Works, Jack Gist parking and drainage improvements, trail improvements at Karen Hornaday Park, Greatland and Fairview, and engineering and design work at Hickerson Cemetery for Parks and Recreation, codification and electronic publishing service for the Clerk's office, and park signage for Public Arts and Parks. Unfortunately, I was not able to approve other worthy projects including new IT server storage arrays and a virtual server hypervisor. I hope to have those added soon.

What is not Included?

This section contains a list of items that are not included 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:** For the fourth year in a row, the City employees will not receive a COLA under this budget. I was not able to find a way to include that without significant budget reductions to programs and services. 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.
- **Personnel:** This budget does not include any new personnel, including filling any of the current vacant positions. From a management perspective, I can tell you that we have very urgent needs in some departments, especially IT and Police Dispatch.
- **Depreciation:** As noted above, this budget contains almost no money for depreciation with the exception of items we must fund like the leave cash out bank, transfers to the revolving energy fund, and the seawall maintenance fund. Fortunately, the fleet reserves are funded.
- **Community Recreation Program:** The Parks and Recreation Commission has recommended a new Parks and Recreation Department and that the Community Recreation Program be relocated to the HERC Building. Given current fiscal constraints and the uncertainty about the future of the HERC building, none of this is included in this budget. It could be added later if fiscal conditions improve and the Council makes a decision about the future of the building.
- **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 and I believe the Pratt Museum may have as well. The Senior Center has requested a line item in the budget and an allocation of \$50,000. Other requests may be coming. None of these requests are included in this draft budget.

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, IT, and Public Works. There are also staffing problems at the Clerk's office and the Finance Department. Staffing requests at the Fire Department and the Library 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, moving a part time IT position to full time, and partial funding for the project manager position at PW.
- **Depreciation:** It is the Council's adopted policy to provide 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 not find the money again this year. A 1% COLA would cost approximately \$120,000 for all employees.

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. This budget increases the contribution to the Health Insurance Fund by about \$200,000. This is less than the amount initially recommended by the Finance Director, the Personnel Director and the City's Insurance broker. I would recommend that Council schedule another workshop with the City's insurance broker, possibly early next year to discuss options for containing costs. The broker has provided us with a preliminary list of ideas that would modify the benefit package somewhat, closer to industry standards, and save \$150,000. This proposal has not been shared with the Employee Committee. The Finance Director recommends that we take another look at putting health insurance out to bid.
- **Debt:** The General Fund does not have much in the way of outstanding debt with the exception of a relatively small construction loan for the library. This is a good position to be in. However, the Council is presently considering borrowing about \$12,000,000 to finance the construction of a natural gas distribution system. Although that debt will be repaid through assessments, it is still larger than the entire General Fund Annual Budget. In addition, the City will not begin to receive assessment payments until after the project is completed; in about 2 years. At least one and probably two principle and interest payments will be due in the interim. An independent financial analysis of the City's ability to obtain financing for this amount and its ability to accomodate that amount of debt might be warranted. The Bond Bank would do that for us if we go that route.

- 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. 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

In terms of revenue, FY 2013 is the year that the approved fee increases are implemented fully. So you will notice about a \$450,000 increase in projected revenues. Some of that increase is also attributable to PERS Relief and increased activity at the docks, ramps, and tidelands. We consider these revenue projections to be conservative. They are based on actual revenue receipts in 2011 and receipts to date in 2012. We also take into consideration current revenue trends and business cycles. In short, 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

Expenditures have changed very little from last year if you look solely at maintenance and operations. The Port and Harbor staff have been very frugal and efficient when it comes to costs that are within their control. The increases in overall expenses are attributable largely to PERS Relief, an increase to the administration fee, and increases in fixed costs. This budget funds depreciation at slightly more than last year's level. It also creates and transfers money to a new Bond Reserves Account as directed by Council. 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 increasing staffing levels and contributions to depreciation accounts.

This budget contains several important capital expenditures. 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 refurbishment of one crane on the Fish Dock, drilling a new saltwater well for the fish grinder, refurbishment of the fire carts, a new outboard motor for the harbor skiff, and a patrol truck.

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 refurbishment of another crane.

- Funding for a Port Operations Specialist.

Budget Policy Considerations

- Depreciation: The depreciation account remains insufficient given the assets of the Port and Harbor. This account took a big hit when \$500,000 was transferred recently to the Port Bond Reserves Account. We need to find ways to increase contributions to this fund.
- 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. We recommend that the Council commission an independent port and harbor rate study to determine if fees are adequate and what level of revenue is necessary for sustainability.
- 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 2013 which is good news for all. The fee adjustments adopted by the Council this past summer appear to be having the desired effect.

Revenues for water and sewer services are projected to increase in 2013 due in part to fee adjustments. The revenue numbers are a little skewed by the PERS Relief adjustment which occurs in all of the budgets. But in short, the projected revenues are sufficient to cover budgeted expenditures. The budget is balanced in the sense that expenditures do not exceed revenues.

Expenditures for basic maintenance and operations have changed very little from last year. The water and sewer Superintendent and his staff should be commended for providing a very lean and efficient operating budget. The increases in expenditures shown are mostly attributable to PERS relief, a small increase in the administration fee, and increases in the cost of things like fuel and electricity. 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. In addition to the cost of new equipment that is shared with Public Works, the capital budget also contains funding for new lift station equipment, sewer treatment plant odor control and bar screen equipment, and sewer pipeline inspection equipment. 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:** The rate model and fee structure that was approved last summer appears to be working. It looks like it will generate the revenue that is needed. The number of complaints we have received has subsided greatly as people get familiar with the new structure. Perhaps the complaints are on hold because folks recognize that a task force is looking at this issue. At any rate, we would suggest that the Council look long and hard before it makes any new and substantial changes to the rate model. Any change to the model, regardless of how fair it may seem on the surface, will create a new set of winners and losers. The current model is a good one and it has been reviewed several times by independent analysts from the state and a university.