



City and Borough of Sitka

100 Lincoln Street • Sitka, Alaska 99835

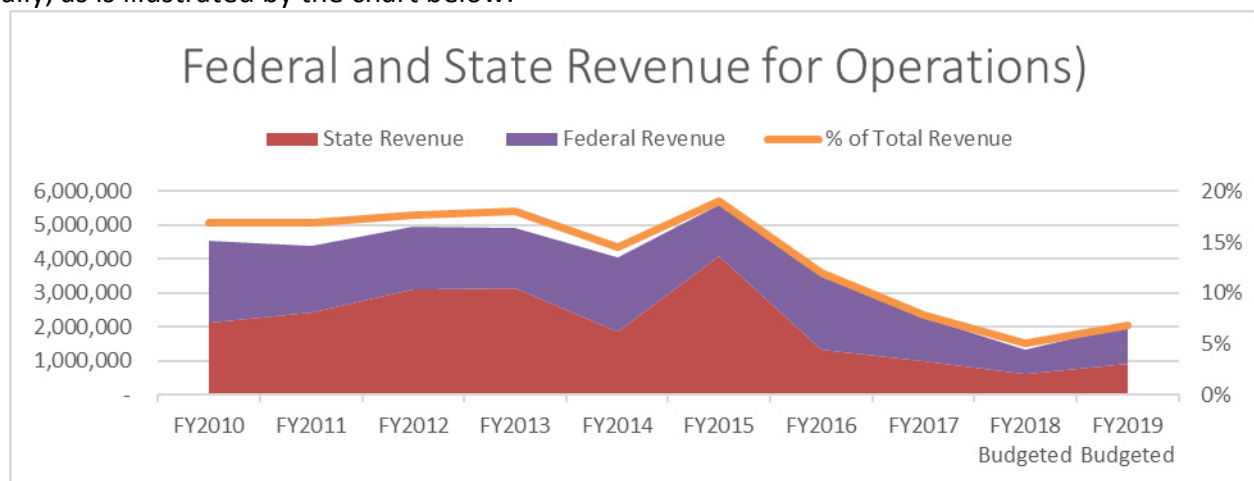
May 4, 2018

Mayor, Assembly Members, and Fellow Citizens of the City and Borough of Sitka

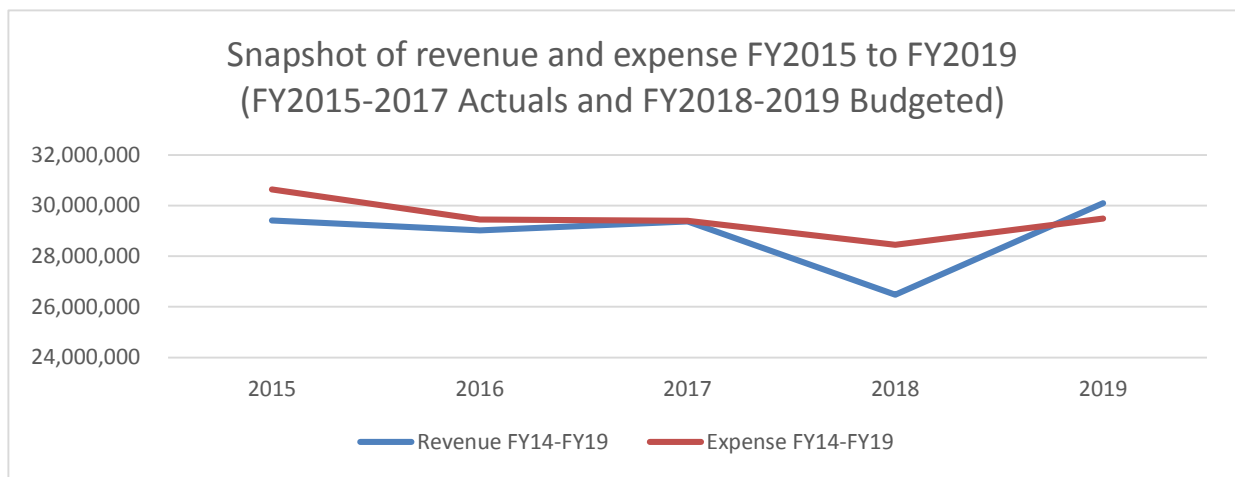
Dear Mayor and Assembly Members,

In accordance with the provisions of Article XI, Section 11.02 of the Home Rule Charter of the City and Borough of Sitka, the Fiscal Year 2019 Consolidated Operating Budget of the City and Borough of Sitka and Sitka Community Hospital are hereby presented for your approval.

Despite a very challenging budget process, we are pleased to submit a FY2019 budget to you that largely maintains current operations, increases local funding to the school district, and also provides a small surplus at the end of the fiscal year, which can be used to address the growing amount of deferred maintenance across the City and Borough of Sitka. As we have discussed in-depth throughout this process, the City and Borough of Sitka now must rely much more heavily on revenue generated locally, as is illustrated by the chart below:



This chart shows both that federal and state funding are decreasing, and also that our revenue is extremely fixed (as the orange line demonstrates). As federal and state funding levels decrease we have very limited ways to replace that funding. Expenditures for FY2019 are projected to be below 2015 levels, both through reduction in staff and cuts to other expenses. Many of our fixed costs (such as health insurance and staff covered under collective bargaining agreements) have increased during this time, where total revenue has either dropped (in some years) or seen very limited growth. After 5 years of improving efficiencies and cutting costs, including personnel, we are at a point where any further reductions will result in reduced services to the community. In addition, current staffing is lean enough that it is becoming difficult to dedicate time to seek additional efficiencies that could benefit the community.



While no new taxes have been approved, the assembly passed an ordinance eliminating the senior citizen tax exemption and replacing it with a need-based rebate program, to ensure that only those who most need it, will receive it. This is the sole source of new, renewable revenue in the FY2019 budget.

The FY2019 budget contains no significant increased expenditure other than programmatic spending increases due to collective bargaining agreements and significant infrastructure repairs as allowed by the prior year surplus that was transferred into the Public Infrastructure Sinking Fund. While we have budgeted for Secure Rural Schools Act funding by the Federal Government for Federal fiscal year 2019, we are uncertain as to the sustainability of this funding beyond 2019. The budget for Payment in Lieu of Taxes (PILT) from the Federal Government remains at the same level as in 2018. While we hope that the CBS will receive this funding, it is not guaranteed.

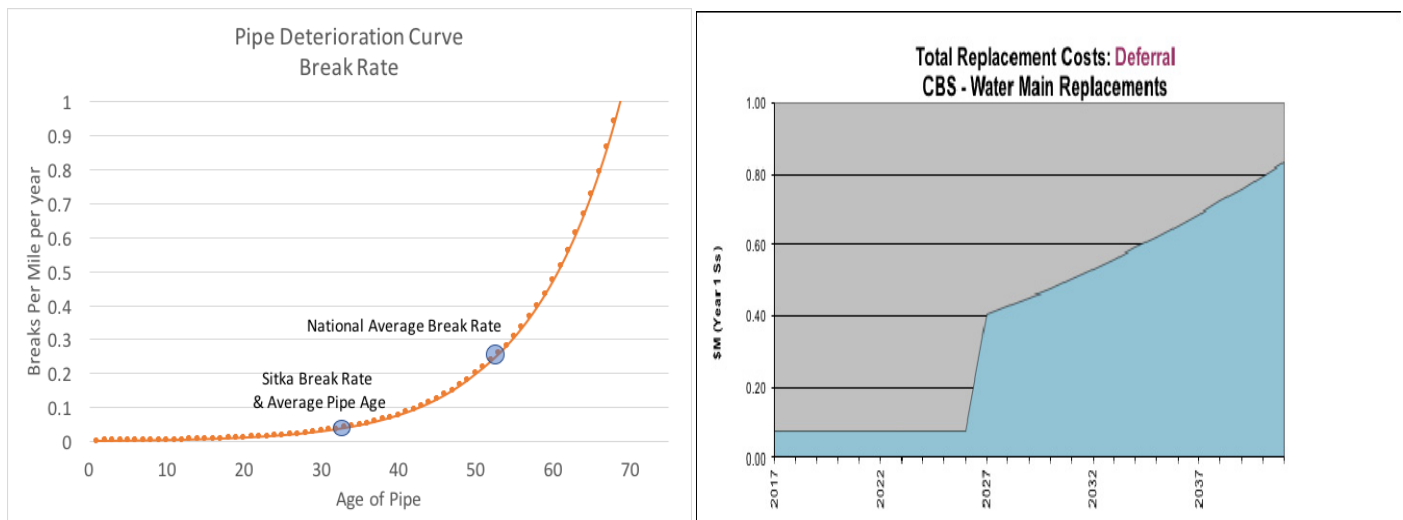
Our budget proposes user fee increases in our solid waste, water, and wastewater utilities, as well as in our moorage rates for the harbors, however there is no proposed increase to electricity rates this fiscal year. Current projections show that we will be able to maintain the debt service coverage in the Electric Fund that is required by our bond agreements without an increase this year, though we will be very closely monitoring this as if consumption falls, it will become necessary to make an increase. We do not project significant increases in future fiscal years, however regular adjustments for inflation will be necessary to ensure the fiscal health of the fund and to ensure future capital is available to maintain the utility's infrastructure. We have adopted a policy of considering annual user fee increases that are in line with long range fiscal plans. Our fiscal plans span a decade, at a minimum, and model the necessary increases in user fees required to finance needed infrastructure renovation while maintaining minimum levels of liquidity and financial stability. The fiscal plans are constantly evolving and are collaboratively updated at least annually.

Other than no increase for electric rates, we will see the following increases:

- Water: 22% estimated \$8.92/residential account/month (the large increase is driven by the need to finance through debt a secondary water supply/ filtration system)
- Wastewater: 5.5% estimated \$3.08/residential account/month
- Solid waste: 6.5% estimated \$3.38/residential account/month
- Moorage: 6.3% estimated \$8.31/40ft vessel/month

The financial pressures faced by the Sitka School District (SSD) are severe and will have a direct impact on the municipality. Much as with the municipality, SSD has expenditure increases which are linked to collective bargaining agreements. While the SSD was able to balance their FY2019 budget using reserves from FY2018, this is not sustainable. In addition, with declining enrollment and increased expenses, combined with the state legislature's reluctance to increase school funding, the municipality may soon be in a situation in which even funding to the maximum allowable level will not be sufficient. Local funding levels this year excluding the amounts spent by the SSD on non-instructions (student travel, the Blatchley pool, and community schools), are at 94% of the maximum allowable, and if all funding was spent on instructional purposes, our funding level would exceed the maximum allowable. The amount approved for the SSD should not be seen as sustainable beyond this year, as revenues and spending priorities change from year to year.

Maintenance of critical municipal infrastructure continues to be underfunded in the FY2019 budget. We will, once again, not be able to afford all street and building repairs which are scheduled and necessary for fiscal year 2019. Furthermore, much of our under street water and sewer infrastructure is very poor condition. Each year the work we defer on our municipal infrastructure sets us up for increased likelihood of catastrophic failures, as demonstrated this year by the failure of the Thompsen harbor lift station. These unplanned failures are costly and potentially very disruptive to households and businesses, yet without additional revenue to fund preemptive maintenance and renovation, their likelihood increases.



Municipal employees' wages will increase in accordance with collective bargaining agreements, and, non-represented employees will receive a 1.5% wage increase. As in recent years, we continue to see an increase in our health insurance rates that is much more significant than inflation. In future years we will seek, along with the Sitka Community Hospital and SSD to self-fund, which should result in some savings and more control over the health plan in general.

In summary, our municipal budget continues to allow us to substantially maintain the services we provide to our residents and visitors, but does not adequately address the preventative infrastructure needs we face. Each year that we defer maintenance on our infrastructure, we risk losing some of the infrastructure that is critical to providing these core services to our residents and visitors.

Capital Improvement Program

The 2019-2020 Capital Improvement Program has been developed to address the pressing infrastructure and service needs of our community. Wherever possible, we have identified Federal and State sources of revenue to finance these projects. Individual capital improvement projects have already been described in detail in many of the previous discussions of individual Departments/Funds. Detailed information concerning the Capital Improvements Program is contained within a separate section of this Consolidated Operating Budget.

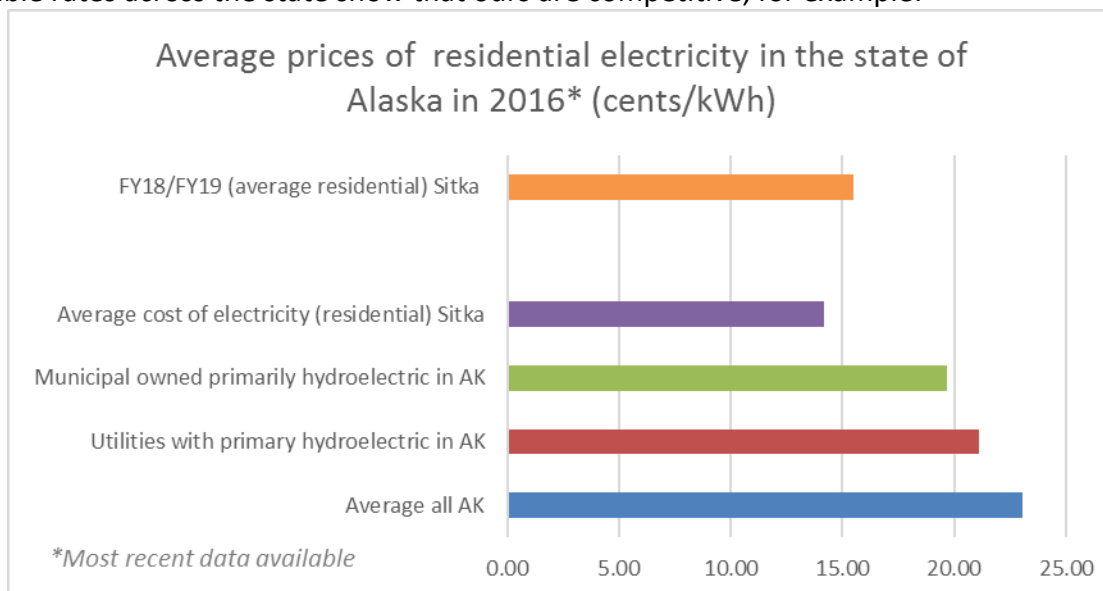
This year we have again constructed a separate budget for each individual capital improvement project. These budgets clearly show the amount, and source, of all of the working capital to be expended in each project including grant revenue, loan proceeds, transfers from the General Fund or Proprietary Funds, or expenditures of reserve working capital in each fund (from previous years grant advances or transfers from other funds).

The 2019-2020 Capital Improvement Program is shown in its entirety at the Capital Improvements Tab (pages 33-45), and, individual projects for each fund are shown in the respective capital sections for that fund.

Future Outlook

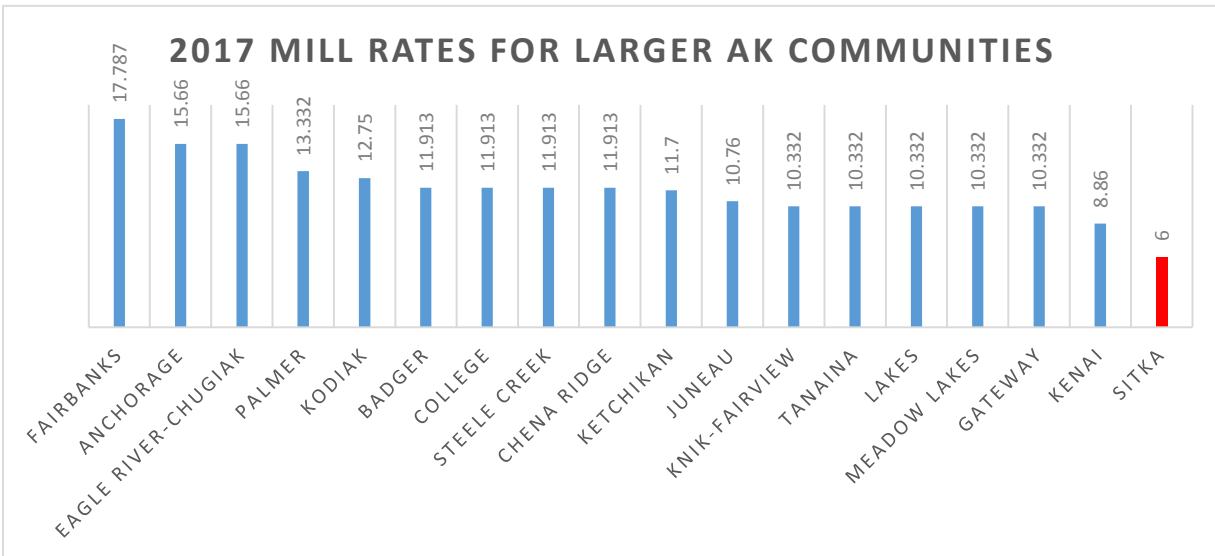
The key challenge facing the CBS continues to be the alignment of governmental services provided by municipality to its citizens with sustainable revenue streams to not only pay for such services, but also, to provide for the repair, maintenance, and eventual replacement of the infrastructure associated with such services.

For our utilities, years of making no rate increase (even at times of high inflation) have left us in a situation in which we must rely heavily on debt and rate increases to fund that debt must be made every year. This has led to a perception among citizens that our rates are very high, even when comparable rates across the state show that ours are competitive, for example:



The current level of municipal services (CBS, Hospital, and Sitka School District), continue to be unsustainable, given current levels of revenue. Insufficient funding exists on an ongoing basis to repair

and maintain aging infrastructure, especially roads. Traditional sources of revenue from Federal and State of Alaska sources are drying up while programmatic expenses, such as wages and benefits, continue to increase. Without seeking additional revenue, additional and more visible cuts to municipal services will become necessary. While the cost of living on our island may be high, it is not accurate to lay blame solely on the taxes and charges levied by the municipality. Sales tax rates are comparable with many other municipalities and the Sitka's property tax remains one of the lowest in the state:



Despite the challenges, there are bright spots in Sitka's outlook. Tourism continues to rebound, and a plan for increased Coast Guard presence in Sitka is encouraging. We are encouraged that the Assembly is considering the sale of public land for development of the economy of Sitka for jobs and to support affordable housing. This direction will help the city continue to be more sustainable in the future, leading us down a path in which the future has a private sector which is larger than public sector, as is the status quo.

Summary

Despite the challenges, municipal staff and assembly have worked to both decrease costs and increase revenue throughout this budget process, leading to an FY2019 budget that anticipates a year-end surplus. While not necessarily sustainable in future years, we are moving in a positive direction. In addition, careful management of our finances ensures that, while we can always use more, what we have is being used well.

Respectfully Submitted,

P. Keith Brady
Municipal Administrator

Melissa Haley
Controller/Acting Chief Financial and
Administrative Officer