

**IV. "FISCAL GAP" --
PROBLEM AND SOLUTIONS**

IV. "FISCAL GAP" - PROBLEM AND SOLUTIONS

This section is a new addition to the Fiscal Trends Report. It was developed over the course of 1990 with the intent of identifying and providing corrective action to the Fiscal Gap facing the Municipality. The term Fiscal Gap is derived from the shortfall that exists when desired expenditures are greater than available revenues. In order to alleviate this budgetary shortfall, corrective solutions were identified. The Administration's recommendation to resolve the Gap is contained later in this section.

PROCESS

The Municipality has undertaken an extensive long range planning process in the development, analysis and presentation of the data contained in this section. The process is defined in Section II of this report, along with the flow chart diagram utilized by the Administration in developing solutions to the Fiscal Gap.

"FISCAL GAP"

Over the past few months, the Administration has briefed the Assembly, Community Councils, Budget Advisory Commission and interested citizen groups on the "Fiscal Gap" facing the Municipality. Table 4-1 depicts the assumptions utilized for revenues and expenditures, resulting in the Fiscal Gap of \$11.2 million in 1991. Additive to the \$11.2 million are the new requirements of \$10.8 million, bringing the total Fiscal Gap for 1991 to \$22 million. Keep in mind that three cases with different Fiscal Gaps were developed during the planning process. We have presented the "Most Likely Case" for purposes of evaluating solutions to the Fiscal Gap in this document.

The new requirements have been developed by each of the departments in General Government. The direction given to these departments centered on providing realistic new requirements that would impact the operating budget during the 1991 to 1996 time frame. All cost information reflects expenditures over the 1990 approved budget level, adjusted for first quarter revisions and one-time expenditures.

The majority of the new requirements is derived from safety, federal mandates, and prudent policy directives of the Municipality. They do not reflect a "wish list" of new programs for the departments, yet concentrate on maintaining public services and safety requirements.

It is anticipated that the Municipality will receive \$4.9 million in State Program Assistance to offset the following three components of the new requirements:

• Underground storage tanks	\$1.9 M
• Building maintenance (deferred and ongoing)	2.0 M
• Street maintenance and repair	<u>1.0 M</u>
	\$4.9 M

The largest component of the New Requirements is the \$4.8 million for Police/Fire retiree medical benefits. This number is fairly conservative since recent estimates by Mercer Inc., health care consultants for the Municipality, indicate that the actuarial evaluation of the potential unfunded liability is just over \$146 million.

Table 4-1 on the following page outlines the Fiscal Gap if nothing is done to correct our current situation. All assumptions for revenues have been delineated within parentheses next to the revenue source. Wages, benefits, and other components of the expenditures are shown increasing at a conservative rate of 4% during the future years. With recent projections on health care benefits indicating potential increases of 16%, the expenditure portion is conservative.

Table 4-1

**"Fiscal Gap"
Before Implementation of Solutions**

REVENUES	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
Federal Revenues (0%)	\$ 1.2	\$ 1.2	\$ 1.2	\$ 1.2	\$ 1.2	\$ 1.2
State Revenues (-2% after 1991)	35.4	34.7	34.0	33.3	32.7	32.0
Local Revenues (2%)	34.2	34.9	35.6	36.3	37.0	37.8
Utility Revenue Distribution	2.5	2.5	2.5	2.5	2.5	2.5
Property Taxes - General Government	92.1	92.5	93.0	93.5	94.0	94.0
Fund Balance Applied (2% of Expend.)	4.4	3.7	3.8	4.0	4.1	4.3
Intragovernmental Charges	<u>18.4</u>	<u>18.4</u>	<u>18.4</u>	<u>18.4</u>	<u>18.4</u>	<u>18.4</u>
TOTAL REVENUES (Nominal \$'s)	188.2	187.8	188.5	189.2	189.9	190.1
EXPENDITURES						
Personnel - Wages/Benefits	115.3	119.9	124.7	129.7	134.9	140.3
Debt Service	23.1	23.1	23.1	23.1	23.1	23.1
Other	<u>61.0</u>	<u>63.4</u>	<u>66.0</u>	<u>68.6</u>	<u>71.4</u>	<u>74.2</u>
TOTAL EXPENDITURES (Nominal \$'s)	199.4	206.5	213.8	221.4	229.3	237.6

FISCAL GAP (Nominal \$'s)	\$ 11.2	\$ 18.6	\$ 25.3	\$ 32.2	\$ 39.5	\$ 47.4
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NEW REQUIREMENTS - INCREASES TO THE GAP

Police/Fire Retiree Medical Benefits	4.8	5.0	5.2	5.4	5.6	5.8
Underground Storage Tanks	1.9	0.8	0.5	0.1	0.1	0.1
Building Maintenance (Deferred & Ongoing)	2.0	2.1	2.2	2.5	2.6	2.6
Street Maintenance and Repair	1.0	2.1	3.1	4.2	5.2	5.2
Inebriate Program	0.0	0.0	0.0	0.0	0.0	0.0
Health and Human Services	0.0	0.3	0.3	0.3	0.3	0.3
Social Services Block Grant (90 day supplm)	0.6	0.0	0.0	0.0	0.0	0.0
Public Works	0.1	0.5	0.6	0.8	0.9	0.9
Economic Development & Planning	0.2	0.1	0.1	0.1	0.1	0.1
Cultural & Recreational Services	0.2	0.2	0.3	0.3	0.4	0.4
Police	0.0	0.4	0.4	0.4	0.5	0.5
Fire	0.0	1.3	1.4	2.7	2.9	2.9
Employee Relations	0.0	0.3	0.4	0.3	0.1	0.0
Transit	0.0	0.1	0.1	0.0	0.0	0.0
Utility Increases	<u>0.0</u>	<u>0.0</u>	<u>0.3</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>
TOTAL NEW REQUIREMENTS (Nominal \$'s)	10.8	13.3	14.9	17.4	19.0	19.1

TOTAL FISCAL GAP with increases (Nominal \$'s)	\$ 22.0	\$ 31.9	\$ 40.2	\$ 49.7	\$ 58.4	\$ 66.6
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Property Taxes held at 1991 level plus New Construction.

Figure 4-1

**TOTAL FISCAL GAP
"MOST LIKELY CASE"**

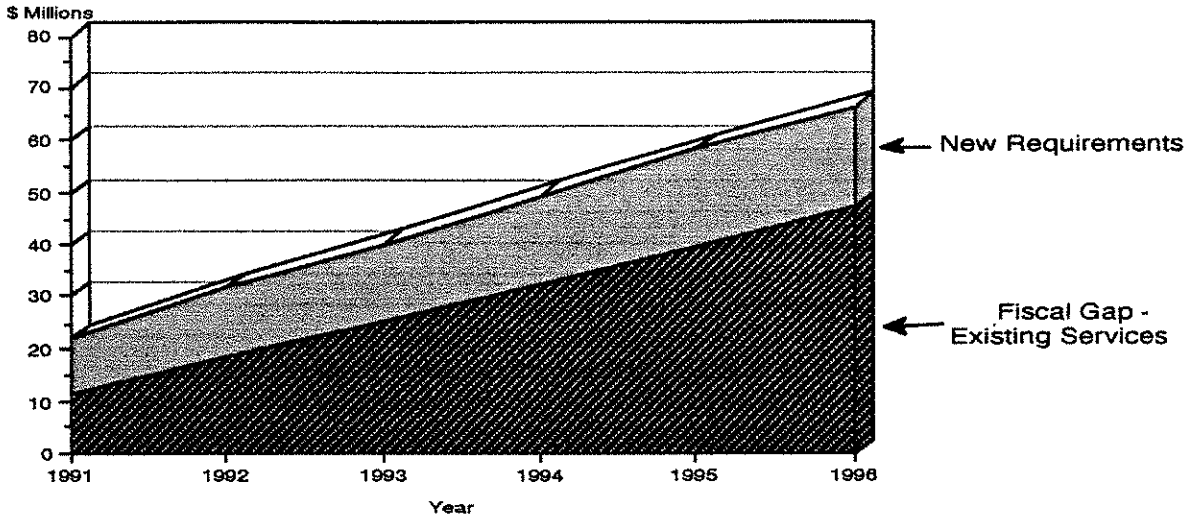
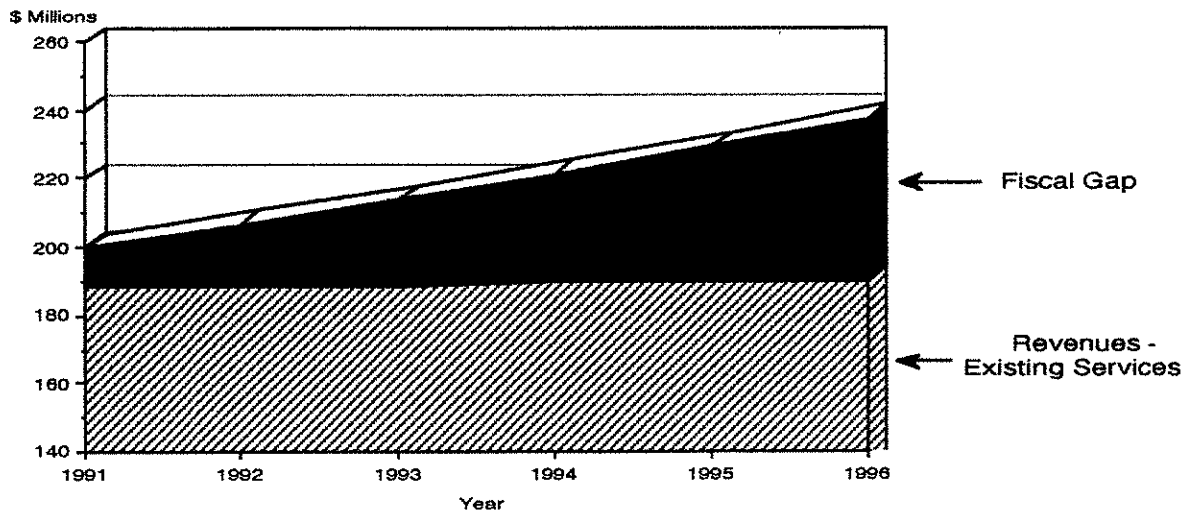


Figure 4-2

**CURRENT LEVEL EXPENDITURES
MINUS EXPECTED REVENUES**



Based on First Quarter Budget Revisions - One-time expenditures

Property Taxes held at 1990 level plus New Construction

FISCAL POLICY ANALYSIS

This portion of the Fiscal Trends document explains the policy analysis that took place when solutions to the Fiscal Gap were being evaluated.

In order to develop a comprehensive plan to solve the Fiscal Gap, it was necessary to agree on the solution option that would resolve the projected gap. The feasibility of the most desirable public policy solution options was assessed as the final step in the process.

The Fiscal Gap is a projection prior to implementing any solutions to solve the problem. The fiscal model forces the identification and prioritization of solutions to ensure the Municipality's long-term fiscal integrity.

Once the Gap was identified, the next logical step was the establishment of solutions necessary to remedy the problem. Policy options were defined in the following four categories:

- Compensation Concessions
- Utility Policy
- Service and Program Adjustments
- New Revenues

Compensation Concessions

Cost of Living Adjustments (Salaries) - These reductions from the projected Fiscal Gap eliminate any inflationary increases reflected in the Consumer Price Index (CPI). The approximate 1991 impact for salaries equates to \$4.2 million.

Cost of Living Adjustments (Benefits) - These reductions from the projected Fiscal Gap eliminate increased medical and dental benefits. These adjustments are substantial and for our purposes we will be assuming 16% in the "Most Likely" case. The approximate 1991 dollar impact equates to \$2.3 million.

Police and Fire Retiree Medical Benefits - Currently, post-retirement medical benefits are paid for as they occur. Under this approach, current taxpayers fund benefits earned from prior years. In order to bring the retirement costs and benefits closer in line, the Projected Unit Credit (PUC) method should be adopted. The PUC method would cost the city approximately \$4.8 million per year above the current \$600,000 level based on a \$48 million unfunded liability. Since the original evaluation was developed, the problem has increased from \$48 million to over \$146 million. Corrected amounts will be utilized when we have developed a specific solution to dealing with this substantial potential unfunded liability.

Under the solutions developed for consideration, the Municipal contribution would be about \$2.4 million. This partial contribution is an attempt to address the liability facing

the Municipality. The amount could be much higher based on the new projections developed by our health consultants, Mercer Inc.

Currently, these benefits are provided within the labor agreements with APDEA and IAFF. This is a major issue in the current negotiations with APDEA.

Compensation Concessions - This solution would center on direct salary and benefit reductions. It is important to keep in mind that compensation concessions will be implemented after COLA adjustments have been factored out of the projected Fiscal Gap. The following reductions are approximate savings realized from compensation concessions at varying levels:

2.5% = \$2.8 million
5.0% = \$5.7 million
10.0% = \$11.3 million

Utility Policy

Sale of ATU - Under this solution, the Municipality could sell ATU and use some of the revenues to assist in closing the Fiscal Gap. This solution could not be utilized for 1991, but may be helpful in future fiscal plans.

- Outstanding debt at ATU. Approximate dollar value of \$170 million.
- Invest \$100 million for retiring debt, which has a \$12 million impact on taxes.
- Establish a permanent fund for approximately \$130 million. The interest earnings before inflation-proofing are approximately \$12 million, which should be used to close the Fiscal Gap.

In addition, this solution would provide a source of funds for critical fiscal priorities after approval of the voters.

Sale of Other Utilities - Solid Waste Collections and ML&P are the only other feasible candidates. These two would not be expected to generate near the revenues predicted from the sale of ATU.

Increased Utility Revenue Distribution - These amounts are directly dependant on the Municipality's dividend policy and the Utilities' ability to pay. Projected utility rates will be affected by the anticipated URD's. As revenues increase, so would the MUSA surcharge percentage of the calculation.

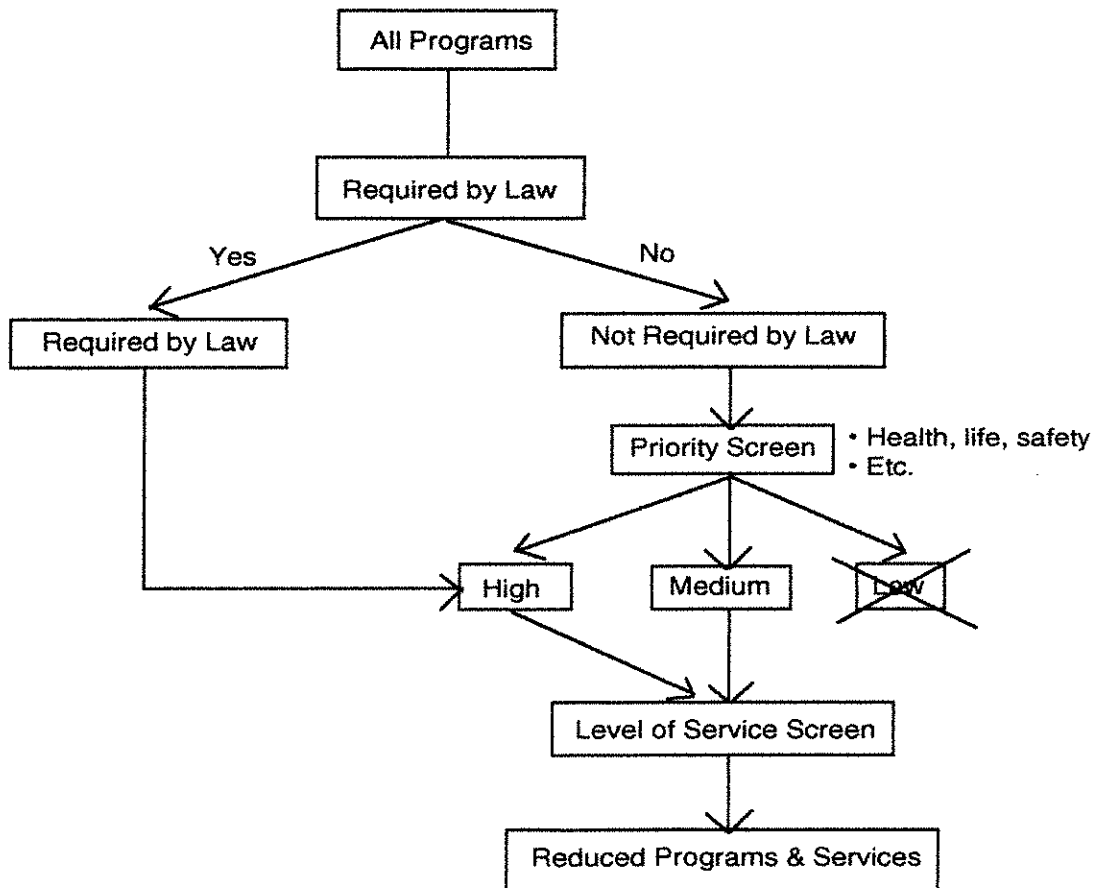
Service and Program Adjustments

Consolidation and Efficiency Savings - Many of these reductions have already been implemented. The identification of additional savings in this category will likely require a comprehensive analysis. Any substantial savings will require time to implement.

Service and Program Reductions - This category will encompass a wide range of dollar savings, which will vary with the assumptions utilized in determining service/program priorities and desired levels of service.

- **Services** - The Mayor's Committee on Fiscal Policy (Sept. 1988) determined that the citizens of Anchorage receive a broad range of services, more than provided in many other cities. Many of these services were expanded and made more sophisticated when revenues were plentiful. The past level of State assistance has not continued, but some of the expanded services continue to be offered. Under this solution, some of the programs developed during the high revenue days might be reduced.
- **Contributions** - Organizations such as the Alaska Center for the Performing Arts, Anchorage Convention and Visitors Bureau and Anchorage Economic Development corporation currently receive operating assistance from the Municipality. Under this solution, the contribution might be reduced.

The following model of a decision tree can be referenced for an overview of prioritization of service and program adjustment:



New Revenues

State Assistance for Major Repairs - The historical premise of the Municipality's Capital Budget has centered on projects that were new roads, facilities and recreational areas. The philosophy that would be more consistent with the economic conditions facing Anchorage would put more emphasis on major repair and maintenance of the existing infrastructure. Under this component of our solution set, the Municipality would request approximately \$4.9 million from the State for the 1991 budget, which would further reduce the Fiscal Gap.

Exemption Program Senior Citizens and Disabled Veterans - The Municipality could reduce taxes to existing taxpayers if the Legislature would fully fund the exemption program for senior citizens and disabled veterans, as set forth in Alaska Statute 29.45.030. Fully funded, this program would generate an additional \$4 million, which would be available for reallocation. In 1990 we expect to be below the tax cap. Conceptually, it would have an effect similar to new construction.

User Fees - This category would entail an increase to the fee structure imposed by the Municipality on its users. Although we may be able to increase fees, this is a category that should be considered long-term in nature.

Property Tax Allocation between the Municipality and the School District - This solution provides for a transfer of the tax resource base within the single tax limitation between the Municipality and the School District. Under this solution, \$9.3 million is available for 1991.

Additional Taxes - This solution has various possibilities for generating a range of revenues. Recent surveys indicate that the public is opposed to any new form of general taxation. Examples are as follows:

- Alcohol Tax - Average package store retail prices from local sources (\$10 for a bottle of liquor, \$7 for a bottle of wine and \$12 for a case of beer) were used to estimate package store sales. Sales volumes for the remaining 18% of alcohol volume from restaurants and bars were calculated on a per drink basis. Both of the aforementioned sales were then multiplied by a 6% tax to arrive at estimated revenues of \$6.57 million per year after administrative costs.
- Sales Tax - \$10 million annually. Current estimates indicate that a broadly based tax at a 1% rate would raise approximately \$10 million after administrative costs.
- Sales Tax with a Sunset Clause - Same as above, but it would be for a fixed term.
- Seasonal Sales Tax with effective dates during the summer season (mainly May through September). The revenue from this tax varies with the level imposed. For purposes of this model, we can assume that \$3 million would be the net yield on a 1% sales tax, after administrative costs.

- Fuel Tax - By taxing the individuals benefitting from the fund's reserves, an equitable basis for taxation has been established. (There are several indirect benefits that individuals will receive in addition to the improved roads, such as cleaner air, increased usage of the transit system and possibly a reduction in traffic congestion.) It is difficult to determine at what point the indirect benefits will come into play, but for the purposes of this paper it can be assumed that with increasing levels of taxation the indirect benefits will also increase due to the increased burden on the taxpayer. The yield on a 4 cents per gallon fuel tax would be approximately \$3.6 million.
- Automobile Registration Tax - This solution would include a revision to the State statute which sets the fee schedule for automobile registration taxes. Currently, the fee schedule for automobile registration taxes is below the equivalent personal property tax, which might be levied as an alternative. This solution would be a redistribution of the taxes, rather than additive money, unless it was taken to the voters for specific approval.
- Property Tax - This solution would incorporate almost \$2 million for inflation and population adjustments allowed in the tax calculation.
- Tobacco Tax - The 1990 Operating Budget contained \$2.6 million of estimated revenues from this tax. After the court decision on the legality of such a tax, collections were halted mid-year. Given the court's ruling, any 1991 projections containing the tobacco tax as a source of local revenue would be included within the 1991 tax limitation.

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Once the fiscal policy analysis was completed, the solutions to the Fiscal Gap were identified and presented to the Assembly. The remainder of this section of the report outlines the various solutions and presents the Administration's recommendation.

PROPOSED SOLUTION TO THE FISCAL GAP

Since March, the development of the Fiscal Gap solution matrix has been an evolutionary process. The final three options have been identified in Table 4-2 for a consolidated view of the solutions. Option 1 is the recommendation of the Administration and focuses on compensation concessions to bring salaries and benefits in line with the Pacific Northwest adjusted for cost of living differentials. The following bullets identify the development process of the Solution Matrix:

- Solutions or "Fills to the Gap" were outlined in a matrix form to identify the various combinations that would be available to solve the shortfall.
- Solutions were added or updated to conform with the evolving goals.
- The Budget Advisory Commission prioritized the solutions.
- A solution matrix was developed to address the Gap for 1991 -- \$22 million. The dollar impact range of each solution was also established at this time.
- The Assembly prioritized the solutions and established their objectives to solve the Gap.
- The Budget Advisory Commission submitted their input on the solution to the 1991 Fiscal Gap.
- The Administration submitted AM 582-90 and AR 90-153 recommending three options to solve the Gap. The Assembly provided the Administration with some guidance, although no formal action was taken by the Assembly.

The "Most Likely" projection represents the Fiscal Gap if no solutions are implemented to solve the problem and the assumptions regarding revenues and expenditures actually occur. The reason for displaying the case in this manner is to present the full magnitude of the Fiscal Gap, which could materialize unless we take appropriate action.

Prevention of inflationary increases to labor and benefits and the reduction of salaries and benefits to reach parity with the private sector, or the Pacific Northwest adjusted for cost of living where such comparisons don't exist, continue to be a high priority of the Administration.

Table 4-2

**"FISCAL GAP" SOLUTION OPTIONS
1991**

	<u>Option 1</u>	<u>Option 2</u>	<u>Option 3</u>
Local Tax Transfer	\$ 8.5 M	\$ 8.5 M	\$ 8.5 M
State Capital Program Assistance	4.9	4.9	4.9
Police/Fire Retiree Medical	2.4	-0-	-0-
Compensation Concessions	5.0	-0-	-0-
Productivity Savings	0.8	-0-	-0-
Service/Program Reductions	0.4	-0-	6.0
New/Increased Taxes:			
Fuel	-0-	3.6	-0-
Tobacco	-0-	2.6	2.6
Special Sales	-0-	-0-	-0-
Populaton & Inflation Increase	<u>-0-</u>	<u>-0-</u>	<u>6.0</u>
Subtotal Taxes	-0-	9.5	2.6
Increased Utility Revenue Distribution	-0-	2.4	-0-
Increased User Fees	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
TOTAL	\$22.0 M	\$22.0 M	\$22.0 M

Each option focuses on significantly different approaches to closing the Gap:

- Option 1 emphasizes compensation concessions.
- Option 2 emphasizes the implementation of new taxes and increased utility rates.
- Option 3 emphasizes service/program reductions as an alternative to compensation concessions or new taxes.

The Administration recommends Option 1 as the optimal solution to closing the \$22 million shortfall in the 1991 budget.

Impact of Corrective Action

The prior pages in this section gave an indication of the three options that would realistically fill the Gap for 1991. Table 4-3 on the following page portrays the long-term impact of implementing Option 1.

If Option 1 were implemented in 1991, the Fiscal Gap in years 1992 through 1996 would automatically be reduced because of revised starting bases. The Fiscal Gap originally defined as \$22 million in 1991 and increasing to almost \$67 million in 1996 only exists if **NO SOLUTIONS ARE IMPLEMENTED** to correct the shortfall.

Table 4-3 best depicts the effect on future years if Option 1 is implemented. All wage and benefit reductions achieved in 1991 would carry over to the outyears, reducing the base and commensurate impact on the Gap. The full impact of wage and benefit reductions would be realized in 1992 and would also contribute in a carryover fashion to reducing the Gap in future years. For example, the almost \$50 million Gap in 1994 would be reduced to \$6.1 million through the carryover effects of Option 1 being implemented in 1991.

The full impact of productivity savings, mainly in the areas of leave, holiday and contracting out would be realized in 1993 through 1996, because of the lag between implementation and reduction of pre-established leave banks.

Table 4-3

**"Fiscal Gap"
Impact of Corrective Action
1991 - 1996**

Prior to Implementation of Solutions:

<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
\$22.0	\$31.9	\$40.2	\$49.7	\$58.4	\$66.6

After Implementation of Annual Solutions:

1991	\$ -0-	\$ 7.6	\$10.3	\$13.8	\$16.2	\$19.0
1992	-0-	-0-	5.2	8.7	11.1	13.9
1993	-0-	-0-	-0-	6.1	8.5	11.3
1994	-0-	-0-	-0-	-0-	5.1	7.9
1995	-0-	-0-	-0-	-0-	-0-	5.6
1996	-0-	-0-	-0-	-0-	-0-	-0-

Corrective Strategy Matrix:

Local Tax Transfer	\$ 8.5	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-
State Capital Program Assistance	4.9	-0-	-0-	-0-	-0-	-0-
Police/Fire Retiree Medical	2.4	2.5	2.6	2.7	2.8	2.9
Compensation Concessions	5.0	3.5	0.4	-0-	-0-	-0-
Productivity Savings	0.8	0.5	1.5	1.5	0.1	0.9
Service/Program Reductions	0.4	1.1	0.7	1.9	2.2	1.8
Taxes	-0-	-0-	-0-	-0-	-0-	-0-
Utility Revenue Distribution	-0-	-0-	-0-	-0-	-0-	-0-
User Fees	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
TOTAL SAVINGS REQUIRED	\$22.0	\$ 7.6	\$ 5.2	\$ 6.1	\$ 5.1	\$ 5.6