IV. FISCAL GAP - PROBLEM AND SOLUTIONS

The Fiscal Gap section is intended to identify corrective actions to resolve potential Fiscal Gaps facing the Municipality. The term Fiscal Gap is derived from the shortfall that exists when planned expenditures are greater than available revenues. The Administration's recommendations to resolve potential Fiscal Gaps is contained later in this section.

PROCESS

Many of the factors directly impacting the model have been reviewed and analyzed by the Administration, department directors, and the Fiscal and Economic Trends Committee. Input from these various groups provided a strong base for the planning process involved in the fiscal gap model.

FISCAL GAP

Per Figure 4-1, the primary Fiscal Gap estimate is that amount which includes Mandated New Requirements. In addition to the primary Fiscal Gap amount, other potential increases to the Gap have been shown, such as potential personnel cost increases, potential future revenue decreases, High Priority New or Increased Discretionary Programs/Services and the potential Police/Fire retiree medical liability.

The New Requirements have been developed by each of the departments in General Government. The direction given to these departments centered on providing <u>realistic</u> new requirements that would impact the operating budget during the 1995 to 2000 time frame. All cost information reflects expenditures over the 1994 approved budget level, adjusted for first quarter revisions and one-time expenditures.

The New Requirements section of the Fiscal Gap Report is divided into several sections, which are outlined below:

1. Legally Mandated Services -- This category encompasses services or programs mandated by Federal, State, or Municipal law, statute, ordinance, code, or regulation. The components of this category should receive priority funding because of the implications of non-compliance.

2. Additional costs of existing programs/services -- This category centers on the additional cost of current contracts or programs, other than inflationary increases, needed to provide the same level of service.

3. High Priority New or Increased Programs/Services -- This category entails the increased discretionary programs/services that would be beneficial to the Municipality to increase. This is not a wish list, but a well developed management plan for the effective functioning of the various Municipal departments.

In order to cover the costs of certain mandated new requirements, it is anticipated that the city will receive State grant assistance or voter approved bonds in the following areas:

- Americans with Disabilities Act (ADA)
- Asbestos Removal

Additionally, certain High Priority new or increased programs/services will be included in the 1995 Legislative Program for the Municipality. Some of these key projects include:

- Building Maintenance (deferred and ongoing)
- Road Rehabilitation
- Park and Trail Compliance with ADA

By far the largest component of the New Requirements would be the potential unfunded medical liability for Police and Fire retirees. Serious efforts are currently under way to alter the retiree medical program for current active employees, and to the extent permissable by law, the program for current retirees. Should those efforts be successful, the amount of the Municipality's potential liabilities should be reduced.

All assumptions for revenues and expenditures at Figure 4-1 have been delineated either by line item parentheses or by footnote.

Figure 4-1

Potential Fiscal Gap Projections
1995 - 2000
(In $ Millions)

	1995	1996	1997	1998	1999	2000
REVENUES						
Federal Revenues (0%)	$ 1.09	$ 1.09	$ 1.09	$ 1.09	$ 1.09	$ 1.09
State Revenues (See below for effect of potential future reductions)	26.09	26.09	26.09	26.09	26.09	26.09
Local Revenues (+2%)	46.97	47.90	48.86	49.84	50.84	51.85
Property Tax ($3.5M under cap, adj for pop/inflation)	122.32	124.32	126.42	128.61	130.90	133.29
Fund Balance Applied (+2% Prior Yr. Expend.)	6.32	4.35	4.45	4.55	4.65	4.75
IGC's (+4.7%)	14.85	15.55	16.28	17.05	17.85	18.69
TOTAL REVENUES	**$217.64**	**$219.31**	**$223.19**	**$227.22**	**$231.41**	**$235.76**
EXPENDITURES						
Personal Services *	$126.46	$128.86	$131.31	$133.80	$136.35	$138.94
Debt Service	23.31	23.31	23.31	23.31	23.31	23.31
Other (+3.5% after 1995)	67.88	70.25	72.71	75.26	77.89	80.62
TOTAL EXPENDITURES	**$217.64**	**$222.42**	**$227.33**	**$232.37**	**$237.54**	**$242.86**
Subtotal	**$ 0.00**	**$ 3.11**	**$ 4.14**	**$ 5.15**	**$ 6.14**	**$ 7.10**
NEW REQUIREMENTS - INCREASES TO THE GAP						
Legally Mandated Services:						
Employee Relations -- ADA/Other Compliance	$ 0.00	$ 0.08	$ 0.08	$ 0.08	$ 0.08	$ 0.08
Employee Relations -- New Labor Contracts	0.00	0.20	0.60	0.20	0.20	0.60
H&HS - ADA (Supplemental Trans. Vans)	0.00	0.14	0.17	0.17	0.17	0.17
Asbestos Removal -- P&FM	0.00**	0.60	0.60	0.60	0.60	0.60
Handicapped Access (ADA) -- P&FM	0.00**	0.35	0.35	0.35	0.35	0.35
Cultural & Rec Svcs -- Required ADA	0.00**	0.50	0.50	0.50	0.50	0.50
Subtotal	**$ 0.00**	**$ 1.86**	**$ 2.30**	**$ 1.90**	**$ 1.90**	**$ 2.30**
Additional Cost of Existing Programs/Services:						
Increased Utility Charges to General Govt.	$ 0.00	$ 0.19	$ 0.19	$ 0.19	$ 0.19	$ 0.19
Police/Fire Retiree Medical Pay-As-You-Go Costs	0.00	0.62	0.63	0.72	0.82	0.89
Subtotal	**$ 0.00**	**$ 0.81**	**$ 0.82**	**$ 0.91**	**$ 1.01**	**$ 1.07**
FISCAL GAP Before Addition of Discretionary New Requirements and Before Other Potential Increases	**$ 0.00**	**$ 5.78**	**$ 7.25**	**$ 7.95**	**$ 9.04**	**$ 10.47**

* Applicable step and longevity increases only. See potential Fiscal Gap increases shown later in Figure 4-1 under the section titled Personnel Costs.

** Funding will be pursued through 1995 State Legislative Capital grants, April 1995 bonds, or Heritage Land Bank funds, as applicable. Should these alternate sources not be available, the 1995 deferred costs may need to be funded from the 1996 Operating Budget.

NOTE: Due to rounding, amounts shown in Figure 4-1 may not total exactly.

	1995	1996	1997	1998	1999	2000
FISCAL GAP Before Addition of Discretionary New Requirements and Before Other Potential Increases (balance forward)	**$ 0.00**	**$ 5.78**	**$ 7.25**	**$ 7.95**	**$ 9.04**	**$ 10.47**
Personnel Costs						
Potential Increase in Personnel Cost (+3.5% annually beyond 1995)	$ 5.90	$ 10.62	$ 15.58	$ 20.81	$ 26.31	$ 32.10
Subtotal	**$ 5.90**	**$ 10.62**	**$ 15.58**	**$ 20.81**	**$ 26.31**	**$ 32.10**
Revenues						
STATE -- Potential Decrease in Future State Revenues (-5% per year beyond 1995)	$ 2.00	$ 3.20	$ 4.35	$ 5.44	$ 6.47	$ 7.45
ATU -- Potential non-receipt of Additional Utility Revenue Distribution from the Anchorage Telephone Utility	1.50	1.50	1.50	1.50	1.50	1.50
Subtotal	**$ 3.50**	**$ 4.70**	**$ 5.85**	**$ 6.94**	**$ 7.97**	**$ 8.95**
High Priority New or Increased Discretionary Programs/Services:						
P&FM -- Deferred/Ongoing Building Maint.	$ 0.00	$ 0.20	$ 0.40	$ 0.50	$ 0.50	$ 0.50
P&FM -- Replacement of Heavy Equipment	1.00	0.75	0.50	0.50	0.50	0.50
Pub. Works -- Deferred/Ongoing Maintenance	13.10	13.10	13.10	13.10	13.10	13.10
Finance	0.59	0.59	0.59	0.59	0.59	0.59
Transit -- Operating Costs -- 3 New Vehicles	0.49	0.49	0.49	0.49	0.49	0.49
Cultural & Recreation	0.33	0.33	0.39	0.39	0.39	0.39
Fire -- Replace/Expand Equipment Inventory	2.18	2.30	2.42	2.55	2.69	2.83
Subtotal	**$ 17.69**	**$ 17.75**	**$ 17.89**	**$ 18.12**	**$ 18.25**	**$ 18.40**
TOTAL MANDATED AND DISCRETIONARY NEW REQUIREMENTS	**$ 27.09**	**$ 35.75**	**$ 42.44**	**$ 48.67**	**$ 55.44**	**$ 62.81**
Police/Fire Retiree Medical Liability						
Police/Fire Retiree Medical Benefits * (Based on 40-Year Partial Advance Funding)	$ 21.60	$ 21.60	$ 21.60	$ 21.60	$ 21.60	$ 21.60
Less: Pay-As-You-Go Costs	(2.32)	(2.94)	(3.57)	(4.29)	(5.11)	(6.00)
Subtotal	**$ 19.28**	**$ 18.66**	**$ 18.03**	**$ 17.31**	**$ 16.49**	**$ 15.60**
TOTAL POTENTIAL FISCAL GAP	**$ 46.37**	**$ 60.19**	**$ 67.72**	**$ 73.93**	**$ 80.97**	**$ 88.89**

* This funding represents the potential estimated annual pre-funding level should the present system of Police/Fire retiree medical benefits continue. The potential liability under the current situation should be reduced if a recent proposal to change to a defined contribution plan is formally accepted by the Administration, the Police and Fire Unions, and the Assembly.

NOTE: The Total Potential Fiscal Gap projection shown above represents the fiscal gap if the conditions described above were to occur and if no solutions were implemented. Appropriate actions are needed to address fiscal gaps that face the Municipality. See Page 4-11 regarding the solutions that have been proposed to address the Fiscal Gap in 1995.

Figure 4-2

Total Potential Fiscal Gap

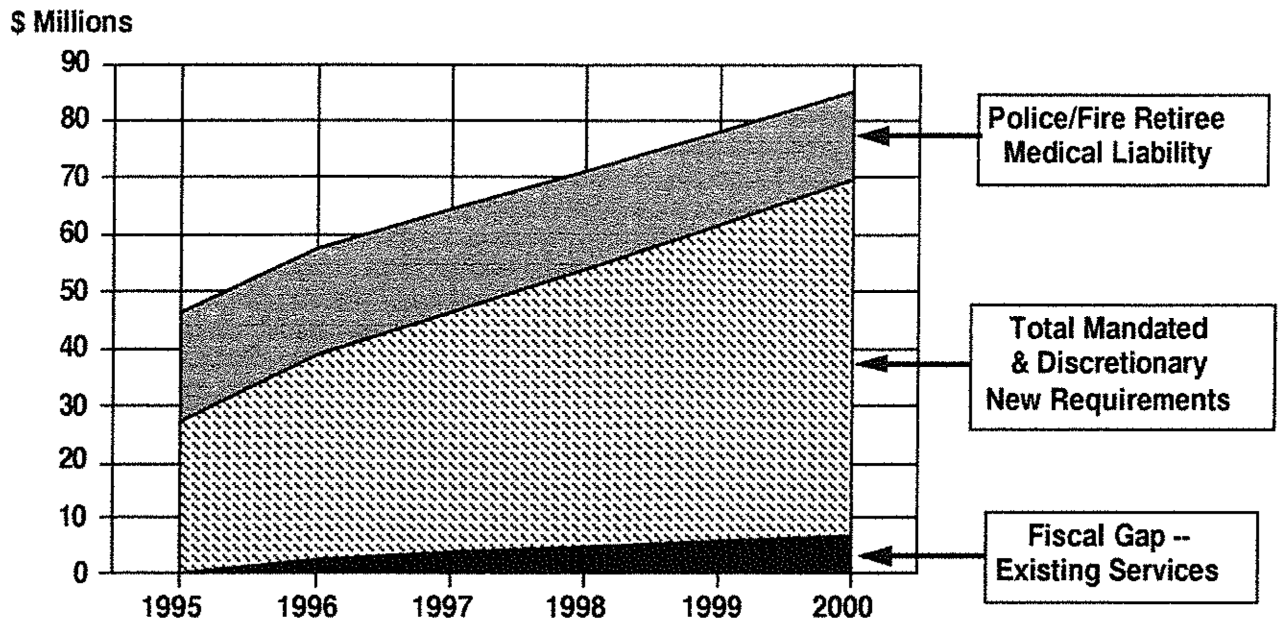
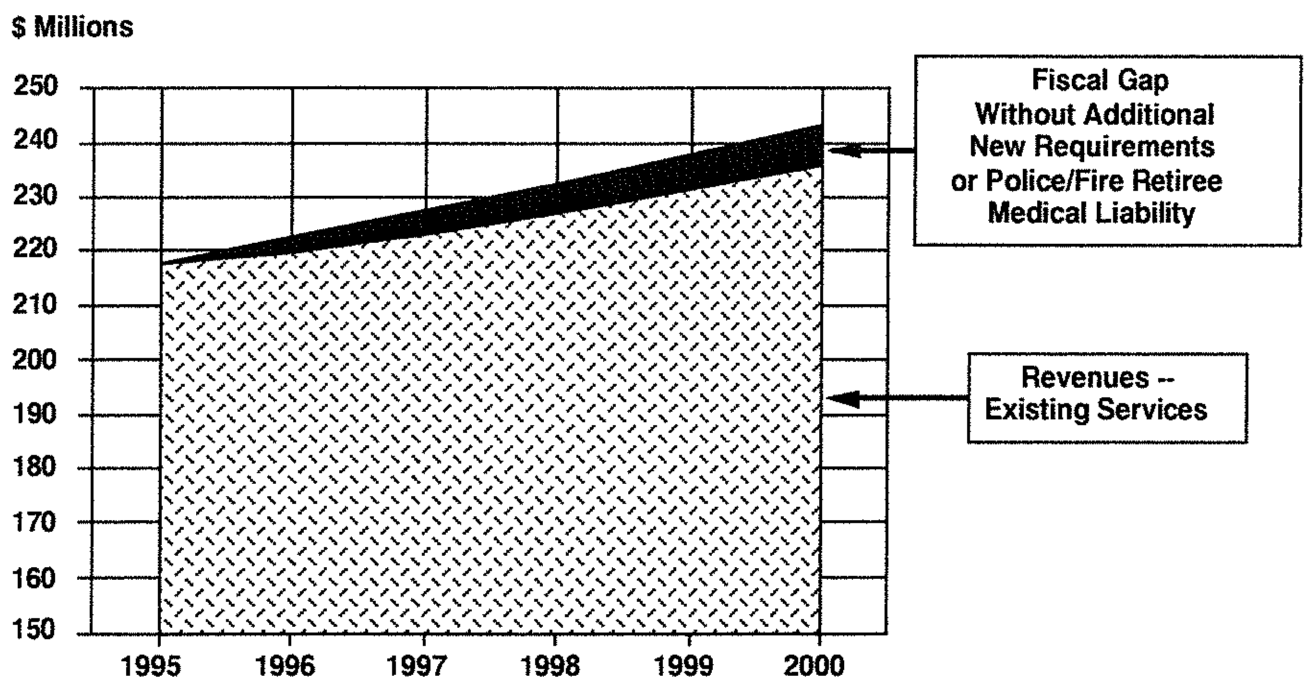


Figure 4-3

Current Level Expenditures Minus Expected Revenues



FISCAL POLICY ANALYSIS

This portion of the Fiscal Trends document explains the preliminary policy analysis related to the evaluation of potential Fiscal Gap solutions.

In order to develop a comprehensive plan options to solve potential Fiscal Gaps, it is necessary to reach consensus on various solutions. The feasibility of the most desirable public policy solution options is then assessed as the final step in the process.

Policy solution options include such categories as:

- Personnel Cost Issues
- Utility Policy
- Service and Program Adjustments
- New Revenues

These policy options are presented for analytical purposes. The Administration is not currently proposing any significant revenue enhancements in the 1995 Operating Budgets for General Government and Utilities, except for small increases in Utility Revenue Distributions from the Port and Anchorage Telephone Utility.

Personnel Cost Issues

Salaries - Labor contracts for all Municipal labor groups are scheduled for renegotiation during 1994/95. Depending upon the outcome of these negotiations, personnel costs could significantly affect the need for departmental reductions. Labor unions and the Administration will need to work together to develop labor agreements that balance the proper level of public service with no overall compensation increases in 1994 and 1995.

Inflationary Adjustments (Benefits) - Inflationary increases and projected experience factors related to health benefits have not been included in the Fiscal Gap model beyond 1995. Should unfavorable changes occur, they would increase the Fiscal Gap.

Efficiency Measures/Consolidation - Provide government services using fewer resources, through revised work methods and scheduling and through consolidation efforts.

Privitization of Services and Functions - Evaluate areas where private sector may be able to more efficiently provide government services. Contracting out services would be implemented to the extent appropriate.

Police and Fire Retiree Medical Benefits - As a result of intense scrutiny of the retiree medical issue, serious efforts are being made to negotiate a less costly Police and Fire Retiree medical program for current active employees, and to the extent permissable by law, the program for current retirees. To the extent that these efforts are successful, the potential liabilities should be significantly reduced. If they are not, the potential liability is described below.

An actuarial valuation as of January 1, 1991 of the potential future benefit payments under the Anchorage Police and Fire retiree health plan was estimated at $1.3 billion. A December 1993 update of the actuarial valuation estimated the present value of potential benefits related to the Municipality's Police and Fire retiree health plan at $167.2 million. In other words, if $167.2 million were currently set aside, earning interest at an annual rate of 8%, that amount would cover the potential future payments needed to fund such a plan ($1.3 billion). If we were to continue operating under past assumptions related to the Police/Fire retirement program, the potential annual cost of partial advance funding based on a 40-year amortization period amounts to $21.6 million. FASB 106 currently applies to the private sector and a similar pronouncement has not yet been adopted for local governments to follow. Standards for recording and/or funding the full actuarial liability may be set by the Governmental Accounting Standards Board (GASB) as early as 1997 with implementation to follow during the succeeding several years. The 1995 solution to the Gap does not provide any additional funding of the potential liability.

Utility Policy

Increased Utility Revenue Distribution - The Administration feels strongly that Utilities should begin to provide its owners (i.e., the general public) with an appropriate rate of return, guided by industry standards, limited of course to each Utility's ability to pay. Projected utility rates could be affected by anticipated Utility Revenue Distributions (URD's); however, all viable alternatives to rate increases will be evaluated first.

Sale of Utilities - One of the options available for reducing a fiscal gap is for the Municipality to sell ATU and use some of the revenues to assist in offsetting a Fiscal Gap. If the terms of sale were similar to those proposed during the previous sale attempt, the Municipality would benefit as follows:

- $150 million of outstanding debt at ATU would be eliminated.
- $100 million could be used to retire general obligation debt, which would have a positive corresponding impact on the taxpayer.
- $150 - $200 million could remain to establish a permanent fund. The interest earnings after inflation-proofing would be approximately $6.7 - $8.9 million annually, which could be used to close the Fiscal Gap. One possible use of the fund or earnings could be to fund needed public projects, in lieu of bonds.
- Under the last sales proposal there was a guarantee of a multi-year utility rate freeze. This same condition could be placed on future bidders if a sale were once again proposed to the voters.

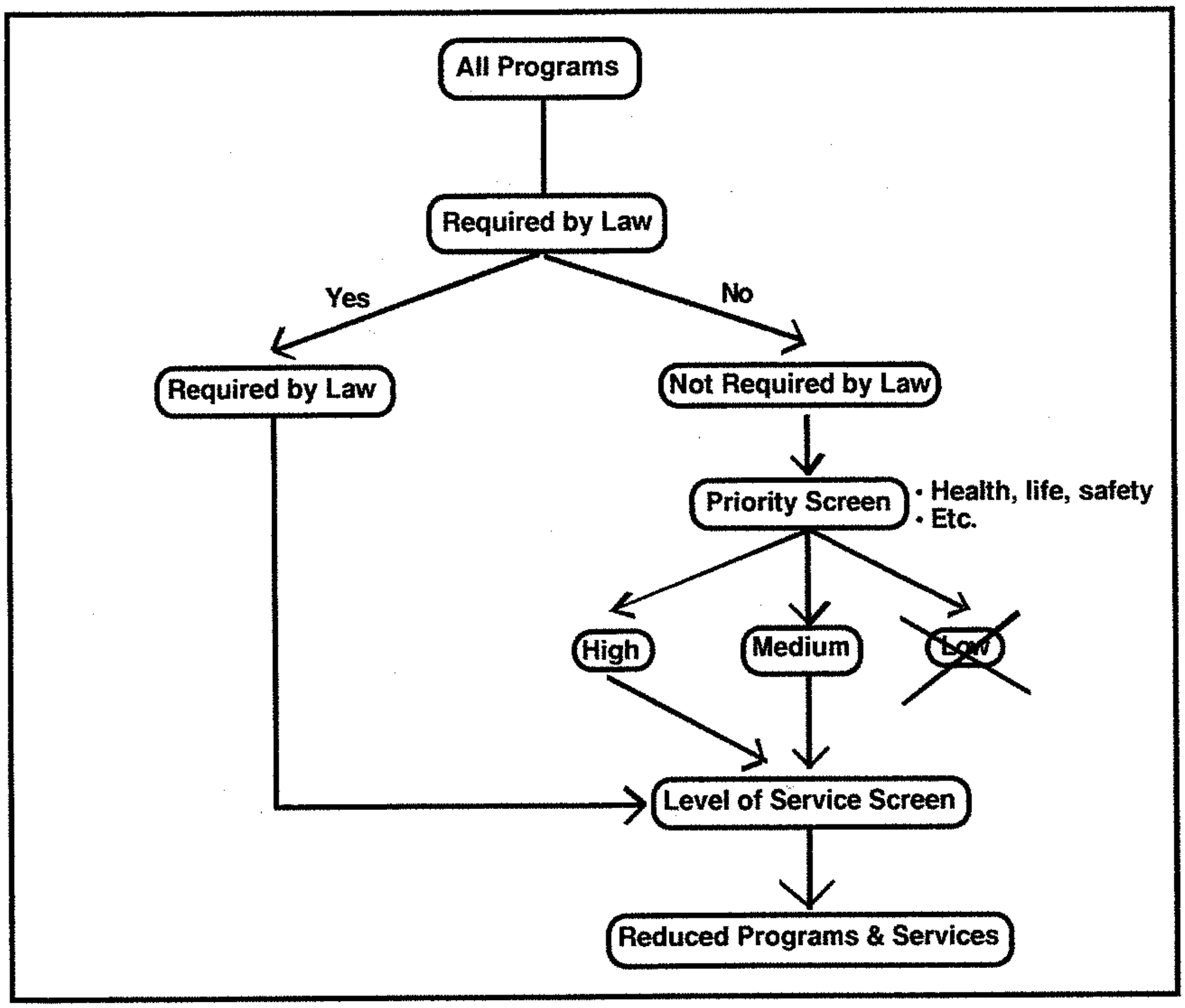
Service and Program Adjustments

Service and Program Reductions - This category will encompass dollar savings which will vary with the assumptions utilized in determining service/program priorities and desired levels of service. The model shown below was utilized in establishing priorities for services and programs.

Internal Management Review - An internal management review program has been initiated to find ways to save money (efficiency) and to make operational improvements (effectiveness). Consultants specialized in certain fields may eventually be hired to assist in specific reviews. Recommended actions resulting from an internal/external review may include deletions, reductions, consolidation, reorganization, elimination of duplication, privatization, operational improvements, new or additional cost saving technology, and other alternate, less costly ways of performing services.

Figure 4-4

Process for Determining Service/Program Priorities



New Revenues

State/Federal Assistance for Mandated Programs - More emphasis should be put on assistance with State or federal mandated requirements.

Major Repairs and New Requirements - Additional State grants and bond funds should be sought to provide more funding for rehabilitation and maintenance of the **existing** infrastructure and for new, mandated requirements.

Exemption Program for Senior Citizens and Disabled Veterans - The Municipality could reduce taxes to existing taxpayers if we were given a local option for the property tax exemption program and if we amend the Municipal Code to provide a needs-based or smaller exemption. The Municipality is anticipating State funding at less than 8% for 1995. This option would be a redistribution of taxes rather than additional money.

User Fees - This category would entail an increase to the fee structure imposed by the Municipality on its users. Generally, the Administration does not recommend this as a new revenues solution.

Property Tax - This solution would incorporate taxing the maximum allowed under the cap. Generally, the Administration does not recommend this as a new revenues solution, since the tax cap should be treated as a ceiling rather than a target.

Heritage Land Bank - Revenues from the sale of land parcels which are best suited for commercial development can be used to reduce operation, repair and maintenance costs at public facilities through a continued maintenance program. Note that as land is sold, the Municipality will subsequently add to its property tax revenues which helps support existing government services.

Additional Taxes - This solution has various possibilities for generating a range of revenues. It is presented here for analytical purposes. In June of 1994, Dittman Research conducted a random survey of Anchorage residents regarding their support of various new or increased taxes. At the bottom of the list was increased property taxes which was opposed by 75% of the respondents. Below are all the other potential tax revenues that respondents were asked if they support; these taxes are shown in relative order, with the most supported taxes per the survey shown first:

- <u>Tobacco Tax</u> - Estimated revenues resulting from tripling the current excise tax on cigarettes to 18 mills per cigarette and on non-cigarette tobacco to 30%, assuming no exemption for distributors from outside Anchorage, would be approximately $5 million per year of additional revenue.

- Alcohol Tax - Estimated revenues from a retail alcohol sales tax are $1 million annually per 1 percent of tax.

- Rental Car Tax - This tax would primarily affect visitors to Anchorage, similar to the hotel/motel tax. Estimated revenues from an assumed 8% tax on car rentals would generate approximately $1.0 - $1.5 million annually.

- Hotel/Motel Tax - Currently the tax of 8% is estimated to generate $7.1 million. Therefore, an increase from 8% to 10% could be expected to generate an additional $1.8 million in revenues without any real increase in administration costs. These increased revenues could be used to support Municipal agencies whose functions beautify the city and directly promote tourism (e.g., downtown flowers, parks, trails, etc.).

- Sales Tax - $10 million annually per 1 percent of sales tax. These estimated revenues assume retail sales only as well as certain exemptions (i.e., food, prescriptions, professional services, etc.).

- Fuel Tax - Past estimates of a tax on gasoline and diesel ranged from $1 million to $2.8 million per $.01 per gallon tax, depending on exemptions and use conversions and whether the tax would be seasonal.

Note that in addition to the taxes described, there are additional variations and factors that are also possible. For example, a wholesale alcohol tax might be considered instead of a retail tax, or a seasonal sales tax might be considered instead of a year-round sales tax.

PROPOSED SOLUTIONS TO THE 1995 FISCAL GAP

The 1995 Budget has been submitted to the Assembly as a balanced budget, $3.7 million under the tax cap; therefore, no 1995 fiscal gap is currently projected. The 1995 budget, however, assumes three critical assumptions which we are working to achieve:

- Personnel cost freeze for all non-union employees and bargaining units through December 31, 1995 ($5.9 million in personnel cost savings)
- An appropriate return from the Anchorage Telephone Utility to its owners, the taxpayers of Anchorage (an additional $1.5 million of dividend revenue)
- No decrease in State Revenue Sharing from the 1994 level (approximately $2 million)

A balanced budget is heavily dependent upon the three assumptions shown above. A significant fiscal gap may result if:

- The labor unions do not meet the challenge to help us to develop agreements that ensure the proper level of public service with no overall personnel cost increases.
- The Anchorage Telephone Utility does not increase its Utility Revenue Distribution to its owners at an appropriate level.
- The Anchorage State Legislative delegation does not work with the Municipality to stop the trend of the State balancing its budget on the backs of local government.

Immediate measures will have to be taken should budgetary problems develop. In general, options that would need to be pursued include increasing revenues or decreasing expenditures.

Funding for certain mandated new requirements for 1995 will be pursued through 1995 State Legislative Capital grants and/or bond propositions. To the extent this is not successful, the 1995 deferred costs may need to be funded as part of the 1996 General Operating Budget and would consequently increase the 1996 fiscal gap.

The Administration's Proposed 1995 General Government Operating Budget does not provide additional funding for the potential Police/Fire retiree medical liability at this time; we are currently working toward developing a defined contribution plan which should reduce the overall potential liability.

FISCAL GAP BEYOND 1995

Fiscal Gap projections beyond 1995 are not expected to diminish as long as declines in State Revenues continue. Without substantial increases in local revenues and/or major cost saving measures, future fiscal gaps driven by any additional declines in State Revenues and by personnel cost increases, will become significantly less manageable. For that reason, long-range planning is needed to develop a variety of fiscal strategies. Significant public policy decisions need to be made in resolving future fiscal gaps. Fiscal gaps previously faced by the City have managed to be resolved; however, future budget deficits will require even more difficult solutions. In addition to baseline fiscal gap projections, other significant factors such as significantly reduced State Capital grant subsidies, the potential Police/Fire Retiree Medical liability, increased State/Federal mandates, cost of living adjustments, and increased repair costs related to deferred maintenance will only increase the magnitude of future fiscal gaps.

Examples of long-term solutions to the Fiscal Gap which could help to reduce fiscal gap projections beyond 1995 include:

- Future additional personnel cost savings beyond any obtained during 1994 Labor Contract negotiations.

- Joint ventures between private citizen groups and local government to minimize costs of operating, maintaining or constructing public facilities.

- Sale of ATU to create a permanent fund of possibly $150-$200 million, to eliminate ATU's outstanding debt of approximately $150 million, to provide funds to assist with G.O. bond debt retirement, and to assist in funding public services and public projects.

- New or increased annual utility dividend contributions from Utilities.

- Privatization of certain functions.

- Consolidation measures.

- Efficiency measures.

- Heritage Land Bank sales of land, thereby increasing the fund balance available to the Department of Property and Facility Management for needed facility repairs.

- Reduced or stabilized operation and maintenance costs, through rehabilitation and major repair of existing roads and buildings using funds such as Heritage Land Bank fund balance, ISTEA funds, increased bonding, etc.

- Elimination of duplication, consolidation and transfer of programs/services between State and local government.
- Lowest priority program/service reductions and eliminations.
- New or increased local taxes or user fees.