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## MEMORANDUM TO COUNCIL

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To: Mayor and City Council Members  
From: Jim Sharpe, Interim Finance Director  
Through: Erin Reinders, City Manager  
Date: September 14, 2021  
Re: Fiscal Sustainability

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**SUMMARY:** This discussion is a continuation of the City's Fiscal Sustainability initiative by providing additional information regarding the City's operations for FY 2021 (unaudited) and the previous 10 fiscal years (audited). It provides further guidance on how the City can better manage its treasury function as well as introducing the concept of a Permanent Fund to provide additional revenue to offset future General Fund revenue shortfalls or assist in the funding of future capital projects. Finally, it provides some additional context and a continuation of the September 13, 2021 Council meeting.

**PREVIOUS COUNCIL ACTION:**

On March 22, 2011, City Council passed Resolution 2011-19 reclassifying \$13,000,000 of General Fund unassigned fund balance to General Fund committed fund balance for emergency operations.

On January 26, 2021, City Council passed Resolution 2021-06 reclassifying \$12,000,000 of General Fund unassigned fund balance to General Fund committed fund balance for emergency operations.

**BACKGROUND:**

In December 2019, the current Council was introduced to the concept of fiscal sustainability. This introduction included a work session PowerPoint presentation followed up with a copy of the Government Finance Officers Association publication *Long-term Financial Planning for Local Government* for Council members to read.

This discussion was revisited at the January 13, 2021 City Council meeting, where more specific topics were presented, including the need to increase the amount set aside for emergency operations. As a result of this discussion, Council passed Resolution 2021-06 reclassifying \$12,000,000 unassigned fund balance to General Fund committed fund balance for emergency operations.

**DISCUSSION:**

Since January, Council has made additional inquiries of the City Manager regarding the administration of the funds set aside for emergency operations. These inquiries prompted a broader discussion with staff and Alaska Permanent Capital Management (APCM) about the City's treasury function, investment policy statement and potential for the City to establish a Permanent Fund. The ultimate goal of those discussions is to develop an approach to prudently manage City funds into the future.

As of June 30, 2021, the City had cash and investment balances as follows:

Key Bank Operating account	\$1,800,807
AMLIP short-term investment account	47,238,275
APCM long-term investment account	<u>112,299,325</u>
Total	\$161,338,407

The City utilizes a centralized treasury concept; therefore, all cash and investments held by the City are recorded in the General Fund and each of the other non-General Fund departments' cash balance is recorded and reported in the City's accounting system as Due from General Fund. As of June 30, 2021, \$85,150,453 of the City's combined cash and investment balances were allocated to the General Fund, with the remaining \$76,197,954 allocated to various governmental funds (i.e., 1% Sales Tax Fund, Bed Tax Fund) and proprietary funds.

Prior to meeting with APCM, staff expected the discussion to include how the City could maximize its treasury function while addressing its operational and long-term needs. Included in that discussion was how best to invest the \$25,000,000 set aside for Emergency Operations in order to meet any short-term acute needs (local disaster, unexpected loss in revenue) as well as provide a supplemental revenue stream to be available for any potential revenue shortfalls in future years.

As staff discussed options with APCM, the idea of separating those needs began to emerge. Conceptually, monies set aside for short-term acute needs must be invested in lower risk, short-term investment vehicles, while monies set aside to assist with future revenue shortfalls should have a longer-term investment horizon and can tolerate more risk.

Based on that concept, APCM recommended that the best way to achieve each of those needs was to create separate investment accounts, with an investment mix better suited for each purpose.

In summary, three main topics were discussed with APCM:

- What is the appropriate amount to maintain in operational accounts (Key Bank and AMLIP); response was approximately 6-months General Fund operating expenditures or \$15,000,000
- How to invest monies set aside by Council for Emergency Operations (Rainy Day Fund); response was to maintain these funds in the General Fund; related amount (\$25,000,000) be allocated to liquid investments to preserve capital, minimizing risk
- How the establishment of a Permanent Fund can benefit the City in future years with the expectation that investment earnings would help fund future City needs

### **Operational Accounts**

Based on their knowledge of other Alaska governments (municipalities and boroughs) APCM recommended that the City maintain sufficient monies in their AMLIP account to meet approximately 6 months of General Fund operating expenditures, about \$15,000,000. This is in addition to the amounts maintained in the City's Key Bank checking account.

## **Rainy Day Fund**

APCM recommended that monies set aside for this purpose be invested in short to medium-term debt instruments to minimize market risk, preserving the investment so it is available at any time.

In order to accomplish this task:

- The City's Investment Policy Statement will need revisions that allow for these types of investments
- A separate custodial account will need be established specifically for these monies
- Council shall establish criteria for which monies transferred to or from the Rainy Day Fund

## **Permanent Fund**

The purpose of a Permanent Fund would be to provide supplement revenue to offset revenue shortfalls or contribute to capital projects. With respect to revenue, staff has reviewed the fiscal impact of City-provided services (General Fund) FY 2021 operations as well as the previous 10 fiscal years of audited financial information. Based on this review, it is apparent that the City budgets revenue and expenditures conservatively. Essentially, the General Fund has consistently exceeded budgeted revenue amounts while consistently not expending their full budgeted amounts. One significant area of concern is the reduction in revenue in FY2021, from prior years, and the potential for continued revenue reductions in the future. The table below details the City's revenue since FY 2011 (all years, except FY 2021 are audited):

Year	Budget	Actual	Difference
FY 2021	29,142,071	29,376,596	234,525
FY 2020	29,594,258	36,478,643	6,884,385
FY 2019	30,164,158	36,419,248	6,255,090
FY 2018	31,781,160	30,300,957	(1,480,203)
FY 2017	31,357,134	34,371,441	3,014,307
FY 2016	30,937,803	30,723,626	(214,177)
FY 2015	36,153,188	34,525,170	(1,628,018)
FY 2014	32,101,456	34,376,971	2,275,515
FY 2013	31,555,103	32,609,892	1,054,789
FY 2012	30,003,700	31,634,417	1,630,717
FY 2011	29,896,607	29,152,912	(743,695)

As the table demonstrates, while incomplete, General Fund revenue in FY 2021 was the lowest since FY 2011. Should this trend continue, the City will further struggle to approve a balanced General Fund operating budget in future years.

As previously mentioned, the City maintains all of their cash and investments in the General Fund without considering investments as a potential revenue source. APCM introduced this concept during our discussions stating that, given the amount of cash and investments held by the City, the establishment of a permanent fund could provide ongoing long-term cash flow to the City.

In addition to operating needs, a permanent fund could potentially provide cash flow to service debt obligations, should the City determine that is the best option for certain capital projects, such as Captain's Bay Road or the Public Safety Building. Currently, the General Fund has no

outstanding debt obligations; however, the proprietary funds have approximately \$68,000,000 in outstanding debt, which is serviced through Charges for Services.

In order to establish a permanent fund, the following would be required:

- City Council establish a Permanent Fund through Ordinance
- City Council establish parameters to which the Permanent Fund must adhere:
  - Necessity of an annual evaluation of the City operations and determination if a contribution to the Permanent Fund shall be made
  - Establish criteria by which monies will be transferred to or from the Permanent Fund
  - Whether or not the corpus be maintained in full or if annual deductions can include portions of the corpus
  - Usage of earnings derived by the underlying portfolio (i.e., supplement budget due to revenue shortfalls or supplement capital project budgets)

As of June 30, 2020, the General Fund had approximately \$86,000,000 in fund balance. Of that amount \$29,619,902 was or has since been earmarked for other items, including the Rainy Day Fund (\$25,000,000), leaving \$56,381,807 unrestricted and unassigned; therefore available for City needs with no strings attached. It seems reasonable that approximately half of the unrestricted and unassigned fund balance would be suitable to establish a permanent fund. Based on this methodology, an initial amount of \$25,000,000 appears to be reasonable to establish a permanent fund.

#### **ALTERNATIVES:**

Based on the information contained above, Council has several options available including the following:

- Establish a Rainy Day investment account
- Establish a Permanent Fund
- Take no action

#### **FINANCIAL IMPLICATIONS:**

The goal is to establish a perpetual revenue source to best meet the fiscal needs of the City in future years while also having sufficient funds available for Emergency Operations, when necessary.

#### **LEGAL:**

City attorneys will be consulted as we move forward with the development of the Permanent Fund.

#### **STAFF RECOMMENDATION:**

Staff recommends moving forward with establishing a Permanent Fund. Staff also recommends setting up a separate investment account for Emergency Operations monies and for the Permanent Fund. While the examples above include \$25,000,000 for each (\$50,000,000 total), it may be in the best financial interest of the City to allocate a greater portion of those funds to a Permanent Fund in order to maximize sustainable annual distributions.