City of South Lake Tahoe

"making a positive difference now"

October 1, 2014

Honorable Mayor and Members of the City Council:

I am pleased to present the Fiscal Year 2014-2015 (FY 2015) Municipal Budget for the City of South Lake Tahoe. For the second straight year, the general fund budget has been balanced between conservatively anticipated revenues and projected expenses.

A year ago, it was projected that *"although the City is not out of the woods, there is daylight"* at the end of the long tunnel created by the Great Recession. One year later, that forecast remains true. However, as a result of some of the employee agreements reached just as the 2015 budget was being finalized[1], we are now able to state with confidence the City's long-term financial health is on the road to sustained recovery.

"A Rendezvous with Destiny"

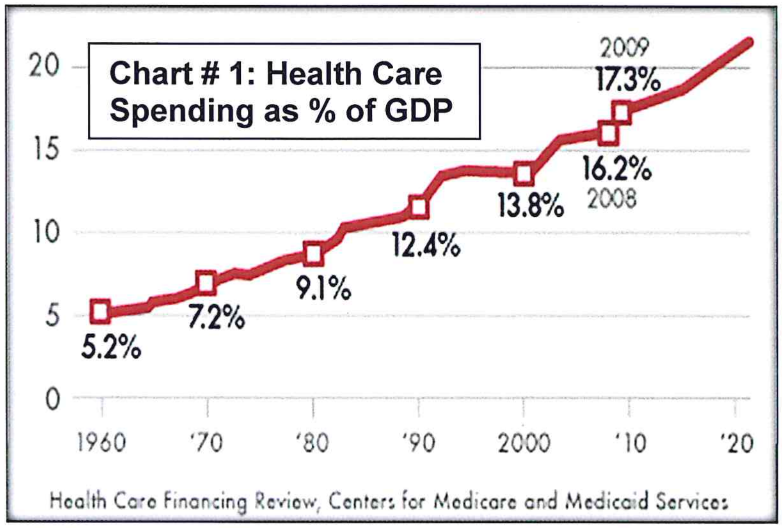
In 1936, Franklin Delano Roosevelt gave a passionate speech, entitled "A Rendezvous with Destiny," during which he said, *"There is a mysterious cycle in human events: To some generations much is given. Of other generations much is expected. This generation of Americans has a rendezvous with destiny."*

78 years later, in the same vein as the country faced in 1936, our small town community is at a critical tipping point. Our local resident population residing in approximately 9,500 homes is saddled with a looming invoice, a debt in the amount of $75 million dollars in unfunded pension and retiree health care liability. That $75 million dollars, if unchecked, would be collected by the City from our local residents and in turn sent to retirees, most of whom live outside the City. Adding to the community's debt are the unfunded liabilities of other local government agencies, including utility companies and other local and state regulatory agencies. Hundreds of millions in unfunded liabilities that our local residents, who earn about 50% of the average government salary, simply cannot afford. Our heavily regulated built environment is necessary to protect the lake, but that same regulatory environment further constrains the City's ability to generate additional revenues or realize gains in property values. Without substantial reductions in annual expenses and unfunded liabilities, our community will be financially crippled for generations to come.

In the mid-1980s, the City began to offer employees who retired the option to remain covered by the City's self-insured health plan for medical benefits. At the time, the cost of covering a couple of retiring employees was minimal because health insurance and health benefits were reasonable and covering a few employees was not a costly expense. Over the years, more employees negotiated to retain coverage and agreed to receive the same medical plan as the employees. As more and more employees retired, obviously the costs grew significantly. At the same time, medical costs have been skyrocketing.

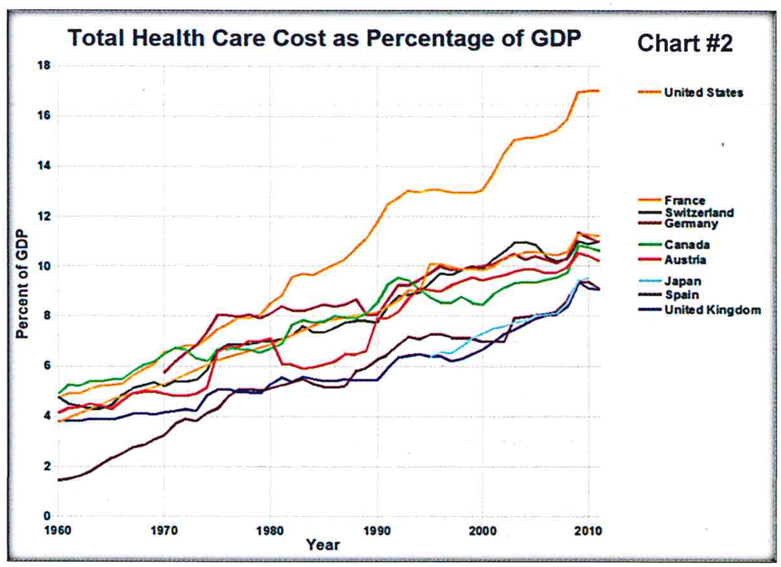
[1] At the time of this writing in preparation of the October 1, 2014 City Council meeting, the City has reached agreement with unrepresented employees and employees represented by Local 39 and Local 1 and Tentative Agreements with (some) other bargaining units.

The high cost of health care is ***not*** unique to South Lake Tahoe. Nationally, health care costs have risen **four times faster** than the consumer price index (CPI), **twice as fast** as wages and health insurance premiums have increased **80% over the last decade**.



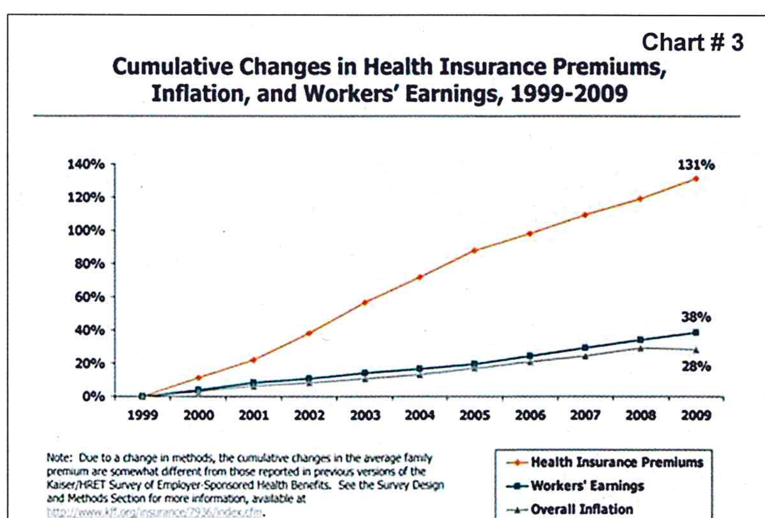
Health care spending as a percent of the Gross Domestic Product (Chart #1) have tripled since 1960 and as compared to other countries, the United States spends more on health care than most other developed countries (Chart #2).

Of particular interest is Chart #2, which demonstrates the U.S. spent relatively the same on health care as a percent of GDP in 1960 as other countries yet, by 2010 we outpaced those countries by double digits and still failed to provide adequate health coverage to the uninsured.



Reviewing "Cumulative Changes in Health Insurance Premiums" as compared to inflation, and worker's earnings (Chart #3), between 1999-2009, the cost of health insurance premiums rose 131% (nationally) as compared to workers earning (38%) and overall inflation (28%).

The health care industry has a cost-containment problem and the result is employers and employees (private and public sector) are negotiating for changes to health care benefits more so in the past ten years than in years previously. The difference between private and public sector employment benefits have characteristically been the difference between "defined" and "undefined." Private sector employees typically have defined financial contributions for pension and health, which enables defined budgeting. Prior to the Great Recession, government sector benefits were more typically "undefined" resulting in taxpayers bearing the burden of the rising costs, which also created substantial unfunded liabilities nationally, state and at local levels (both pension and health care).



City's Cost Containment Strategies

As the cost of health care (and pensions) rose exponentially over the years, the City's cost-containment strategies included the following:

- Increasing deductibles
- Increasing out-of-pocket expenses
- Eliminating or reducing coverages
- Eliminating participants
- Changing benefit plan designs (eg: from 100% covered to shared cost plans)
- Eliminating coverages for expensive prescription and other expensive office visits
- Implementing pension plan "tiers"

In other words, the only solutions available were to reduce or eliminate benefits. In 2001, the City eliminated retiree healthcare coverage for spouses of employees hired after June 30, 2001 and in 2007, the City eliminated employees hired after January 1, 2008 from receiving healthcare plan benefits upon retirement. Although these were "cost containment strategies," costs have continued to rise because those changes would not positively impact the City's annual expenses for 20 to 30 years. In the meantime, costs would rise considerably (as employees retired and new employees hired) before expenses would begin to recede.

These 2001 and 2007 decisions created significant design flaws in the City's Healthcare Plan and created a substantial imbalance in the organization. Healthcare plan benefits for employees should not be as imbalanced as one group having 100% benefit and another group having zero (0%) benefit both performing similar jobs. The imbalance is further complicated by the costs of health care, which have not slowed and in spite of the many cost containment strategies, health care costs continue to strain the City's financial resources.

A New Strategy: A Rendezvous with the Community

For many years, the City and its employees have implemented strategies in an effort to control pension and health care costs, and yet, the financial strain on the City's budget persists. That is true for most government agencies in America, primarily state and local governments that do not possess the power of taxation without a vote of its constituents, which is a good restriction on government powers. The City of South Lake Tahoe is a unique local agency in that it is the only entity with jurisdictional boundaries entirely within the Tahoe Basin. As a result, the City relies heavily on tourism and property values for its general fund revenues. The City is constrained in its efforts to attract and retain businesses by local development regulations, which is necessary for the protection of Lake Tahoe. Tourism is weather dependent, and property values are constrained by the lack of employment opportunities. Further, the City is burdened by more than $75 million dollars of unfunded liabilities, clearly an unsustainable number.

The City Council has held multiple public meetings to address these concerns. The City Council adopted its 2014 Five Year Financial Forecast, which indicated the rising cost of employee benefits will continue to negatively impact the City's General Fund for the foreseeable future. At the same time, the City's employees have been evaluating the City's Healthcare Plan to correct the flaws and imbalances in the plan, while providing options for employees and a mechanism to fund changes in wages and benefits.

In 2013/2014, it was clear the City of South Lake Tahoe could not continue on the same course it has in years past, that is, to postpone implementation of solutions to resolving health care costs. As noted earlier, the cause of the problem is the medical industry itself, not employees nor their employer who attempted to offer benefits which, at first, were inexpensive. As the costs in the medical industry outpaced inflation cost-containment strategies were implemented, but they haven't resolved the issue.

*"It is common sense to take a method and try it.
If it fails, admit it frankly and try another.
But above all, try something."*

Franklin D. Roosevelt, Address at Oglethorpe University (May 22, 1932)

Comparing the "Great Recession" of 2007-2009, of which we are still recovering, to the Great Depression, there are similarities from which we can learn. In the 1930s, U.S. unemployment was at 25%, food was as scarce as jobs. In some cases, people lost their life-savings, their homes, retirement benefits, lost faith and trust in the government and yet demanded the government do something – anything – to help. FDR implemented a variety of strategies, some worked and some did not. The government was used as the economic driver for the economy and did so by investing in communities, in business and in its people. The policies strengthened trust in the government and brought about change for the benefit of many.

Somewhat similarly, during our recent Great Recession, overnight people lost their jobs, retirement savings, U.S. unemployment climbed to over 10% and the high number of foreclosures pushed many communities into bankruptcy. Locally, unemployment rose to 17%, foreclosures and falling home values reduced the City's revenues creating a forecasted annual structural deficit of $3M to $5M and simultaneously pension and health care costs continued to rise. In response, the City reduced its workforce by 30% and employees agreed to concessions in salary and benefits, which reduced the deficit and helped the City get its financial footing.

Rather than wait for the storm to pass, the City of South Lake Tahoe utilized its governmental resources to heavily invest in the community over the past several years. The City invested in local road improvements, environmental improvements, developed partnerships with local business and property owners to improve the Harrison Avenue business district, invested in a Recreation Master Plan to plot the road map for investing in our recreation economy, and adopted a Capital Improvement Program as a Community Investment Plan to continue to provide additional investment in the community.

In August of 2014, the City Council adopted a Financial Strategy to restructure its debt and redirect those same funds back to the community through capital improvement projects focused primarily on recreation and with the greatest return on investment. In addition, the City Council gave direction to develop a similar strategy to resolve the health care issues. Employees also offered creative suggestions to implement a mixture of defined contributions and benefit options which will result in a more trusted, secure and valued benefit to employees.

At the time of this writing, more than half of the City's employees have agreed to a wage and benefit structure that will strengthen the City's partnership with its employees. These agreements will provide employees greater assurance and more reliable benefits in the future. The City is continuing to negotiate in good faith with the remaining employees and anticipates completion of the negotiations process.

In years to come, the agreements reached with employees this year may likely be viewed as a time in which a "rendezvous with destiny" was made. As FDR said in 1936, *"to some generations much is given. Of other generations much is expected."* For government employees who retired in the last five to ten years with generous pension benefits, who avoided the impacts of the recession and were not required to contribute to pension and benefit costs, it could be said that to them, *"much was given."* Comparatively, it should be realized of today's public employees, *"much has been expected."* They have made wage and salary concessions, they are paying a far greater share toward their benefits, and in the case of our City employees, because of the new FY 2014-2017 employee agreements[2] and because of their willingness to put the community above their self-interests, it will be said that <u>from</u> them, *"much has been given"* in service to their community. As FDR said, it is the *"mysterious cycle of human events,"* that some give, from some are expected and some have a date with destiny to make significant change with lasting results.

As a result of the employee agreements being reached today, the residents of South Lake Tahoe will have the opportunity for a future in which community investment becomes routine, practiced and successful. The employees of the City of South Lake Tahoe by their leadership, their example and their sacrifice have helped to ensure a more fiscally sound future for their community. These employees recognized the errors of the past and although not a fault of their own, they realized they could help correct those mistakes and in so doing provide a more secure future for the residents of South Lake Tahoe and themselves. In working as a partner with the City to resolve these issues, never more true indeed have these employees heeded the call of the late John F. Kennedy, who said, *"Ask not what your country can do for you; ask what you can do for your country,"* or in this case, their City. **They have exemplified the spirit of public service and should be commended**.

The FY 2014/2017 employee agreements[2] will model the way for governments to shift away from undefined, unreliable and unaffordable benefit structures lacking specific costs for which the government can properly budget and plan, to a mixture of basic and optional benefits as well as defined compensation options giving employees greater control over their benefits, compensation and retirement resources. At the same time, the agreements with employees will reduce the financial burden on residents for the City of South Lake Tahoe.

"Never doubt that a small group of thoughtful committed citizens can change the world; indeed, It is the only thing that ever has."

- Margaret Mead, American Cultural Anthropologist

---

[2] At the time of this writing in preparation of the October 1, 2014 City Council meeting, the City has reached agreement with unrepresented employees and employees represented by Local 39 and Local 1and Tentative Agreements with (some) other bargaining units.

Fiscal Year 2014-2015 Budget

The City's projected revenue for all funds is $76.2M. All funds are listed below and include the City's General Fund (general operating fund), Special Revenue, Enterprise, Internal Service, City's Debt Service, Capital Improvement and Trust and Agency. All revenues and expenses are accounted for in these seven fund types as shown in the table below. Each fund type is comprised of several individual funds for a total of 66 funds. Within each of the fund types, there are individual cash balances, assets and liabilities, debt (if applicable), revenue and expenses, and reserves.

The General Fund is the largest fund and includes the resources necessary to provide most of the City's core services and day-to-day activities. Transfer of resources between the General Fund and the other six fund types occurs frequently. These transactions are shown in the General Fund as ***"Transfers In or Out**.*" This transfer to and from other funds occurs to ensure that the legal and operational requirements of all of the funds are met on a daily basis. It should be noted that "transfers in or out" between other funds were also utilized during the previous five years to offset budget deficits. Transfers in to the general fund can mistakenly be interpreted as an increase in revenue and impact revenue trends; where that is applicable, it will be noted.

City of South Lake Tahoe Fund Types

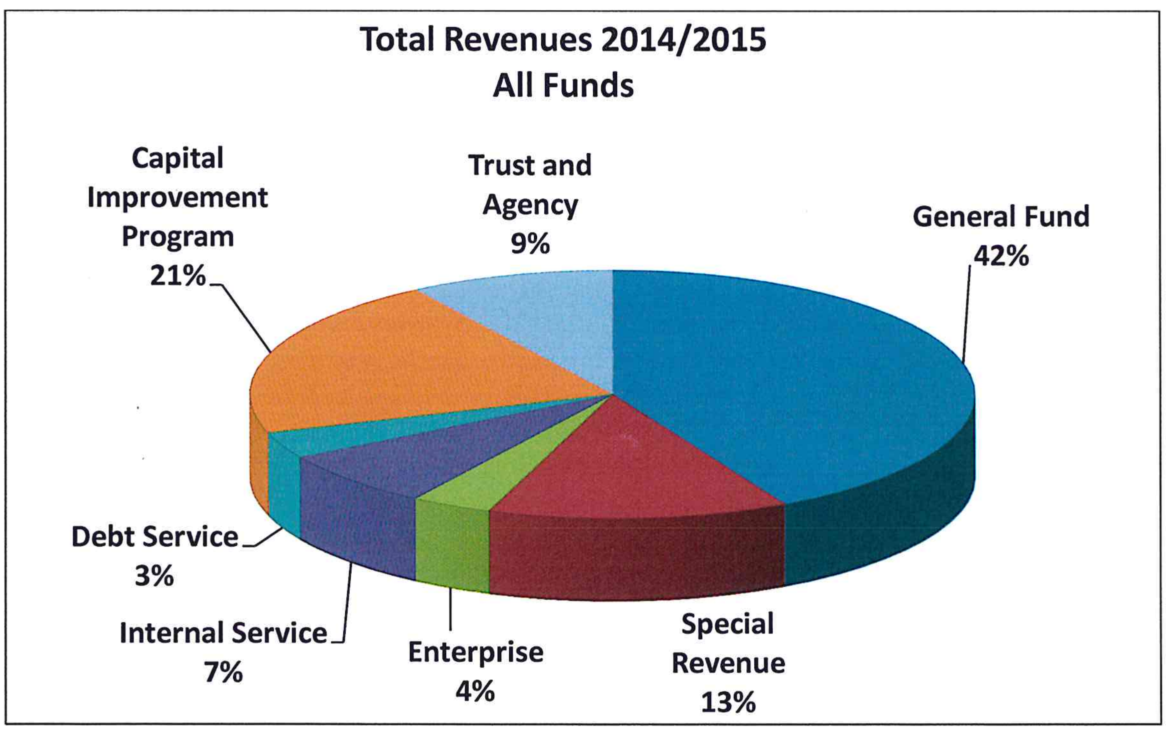
Fund Type	Examples	Number of Funds
General Fund	General Fund	1
Special Revenue Funds	Snow Removal, Vehicle Replacement, Solid Waste JPA, TOT revenue fund, gas tax, storm water management program, Tourism Improvement District fire safety sales tax, nuisance abatement and vacation home rental program	38
Enterprise Funds	Airport, Parking Garage, Transit, Code Enforcement and Parking Management	6
Internal Service Funds	Health, Workers Comp	3
Debt Service	City Debt Service	1
Capital Improvement	City CIP (Construction in Progress)	7
Trust & Agency	Community Facilities District, RD Successor Agency	10
		66

Projected Revenues and Expenses for FY 2014-2015 totals $76.2M in revenue and $84.6M in expenses. As noted in the table, the General Fund is balanced. The General Fund would have had a projected positive net fund balance of $600,000; however, City Council directed those funds into the Capital Improvement Program. Special Revenue Funds will utilize existing fund balances maintained within those funds, which occurs routinely as a manner of operations. The Capital Improvement Program will expend funds received in the prior year before CIP project expenses occur. Trust and Agency (primarily Former Redevelopment Agency debt obligations) is balanced.

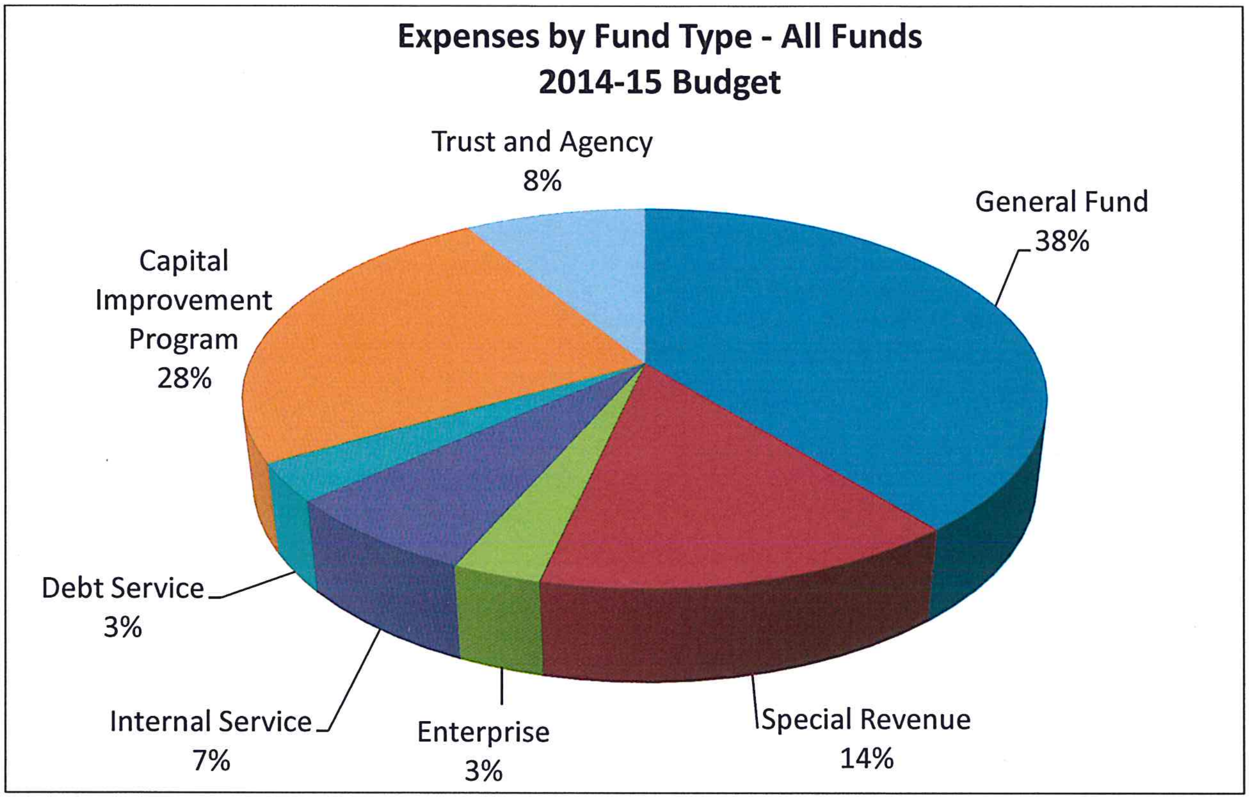
Revenue / Expense, by Fund Type

Fund Type ($ mil)	Revenue	Expense	Fund Bal. (Use)/Incr.
General Fund	$ 32.1	$ 32.1	$ 0.0
Special Revenue	10.2	11.6	(1.3)
Enterprise	2.8	2.4	0.3
Internal Service	5.6	5.6	0.0
Debt Service	2.6	2.6	0.0
Capital Improvement Program	16.0	23.3	(7.4)
Trust & Agency	7.0	7.0	(0.0)
Total	$ 76.2	$ 84.6	$ (8.4)

TOTAL REVENUES (as shown in the chart below), the General Fund is the largest percentage of revenues for the City this year (42%), followed by the Capital Improvement Program (21%) and Special Revenues (13%), which include snow removal, safety sales tax and vehicle license fees. Trust and Agency (9%) revenues includes primarily funds to pay debt service of the Former Redevelopment Agency. Together these funds account for 85 % of the City's total revenues.



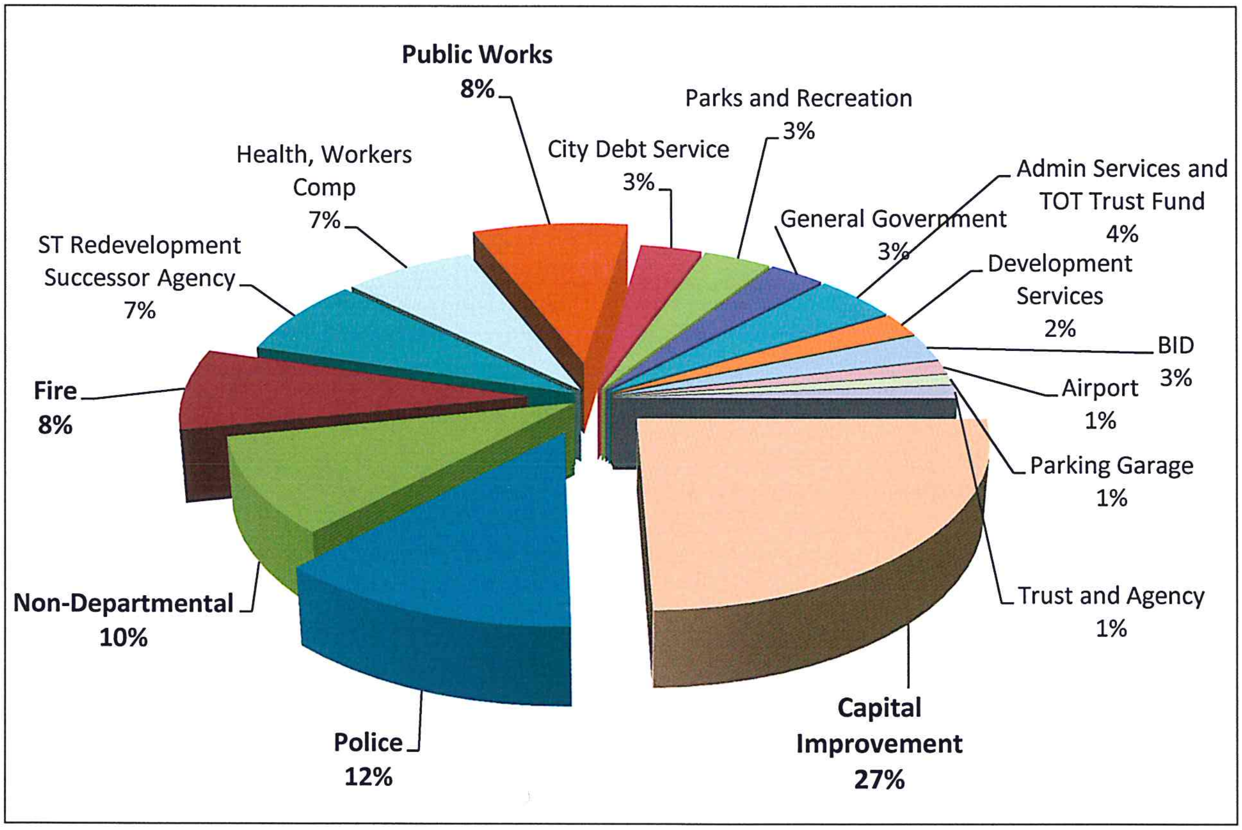
TOTAL EXPENSES (as shown in the chart below) closely mirror total revenues (previous page). The City's General Fund is the largest expense fund at (38%), followed by the Capital Improvement Program at (28%), Special Revenue at (14%), Trust and Agency (8%) and Internal Services (7%).



Total Expenses, All Funds, by Categories

Further break out of expenses by categories including departments, programs and services for all funds is illustrated in the chart below. The largest share of expenses is in the Capital Improvement Project Category (27%), which contributes to the City's Strategic Priority to Improve the Built Environment.

Other significant categories include Police, (12%), Fire (8%), Public Works (8%), Non-Departmental (10%), Health and Workers' Comp (7%), and South Tahoe Redevelopment Successor Agency (7%), followed by categories at four percent (4%) or less of total budget expenses.

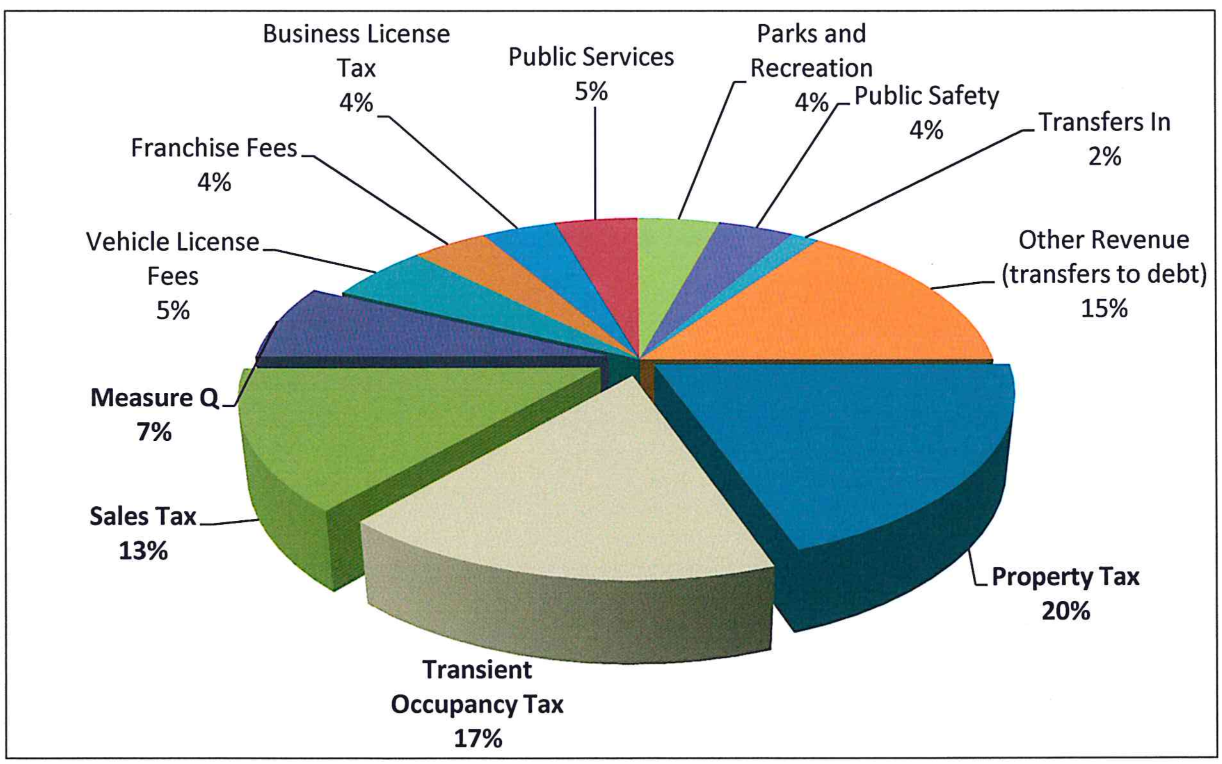


General Fund

General Fund revenues for FY 2014-2015 are $32.1M, which is approximately $640,000 above FY 2014 amended budget. The 2014 Five Year Forecast projected this positive cash flow indicating projections are on target. The FY 2015 budget philosophy was continued from FY 2014's successful strategy to eliminate one-time expenses from the budget where feasible, and include anticipated revenues using in-depth economic forecasts and analysis. FY 2014-2015 included the elimination of paid-parking program revenues. FY 2014-2015 expenses were conservatively budgeted. Employee Agreements with labor groups were not finalized in time for the preparation of the FY 2014-2015 budget; although some agreements were reached prior to this writing and presentation of the FY 2014-2015 Budget to the City Council. Those agreements will restructure wages and benefits in a manner cost-neutral to the City's General Fund budget in the first year, although a budget adjustment to properly reflect the changes will be brought to the City Council in February along with mid-year adjustments.

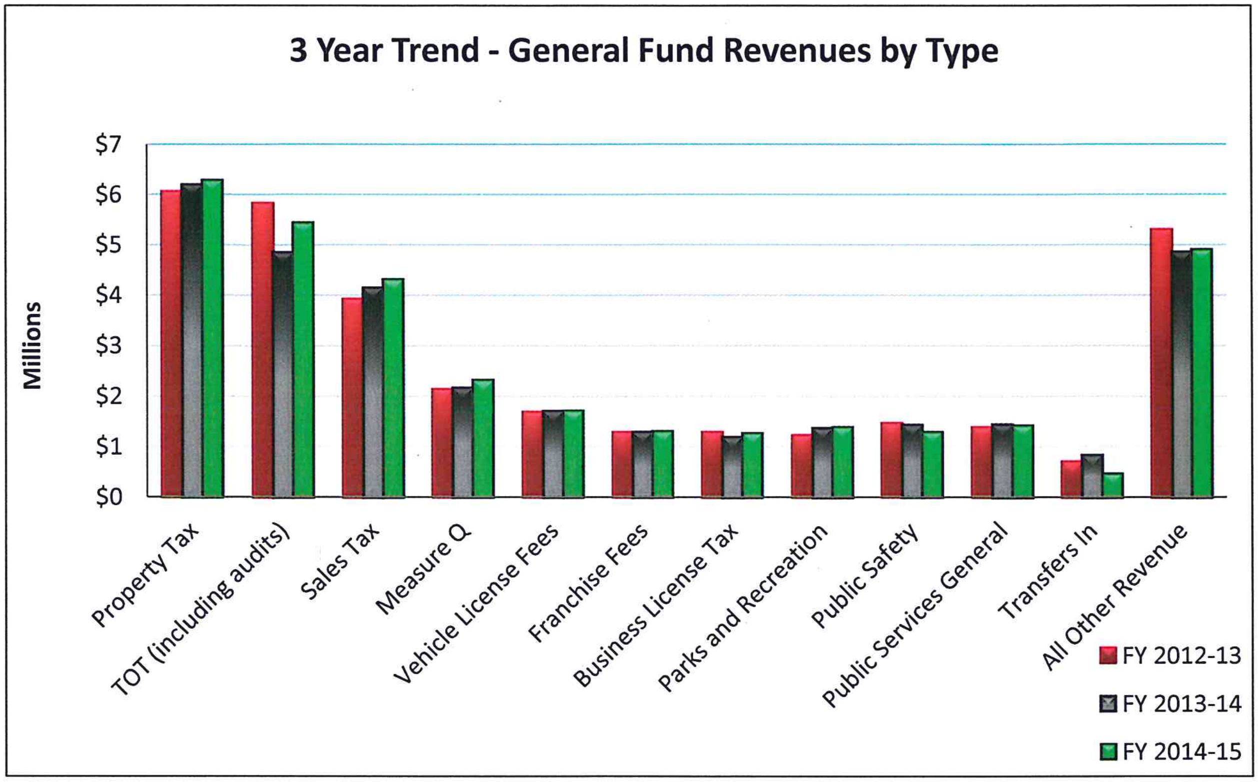
General Fund Revenues

As shown in the chart below, the primary sources of revenue comprising 57% of all general fund revenues are Property Tax (20%), Transient Occupancy Tax (TOT) (17%), and Sales Tax (General Sales Tax (13%) and Measure Q (7%)). "Other revenue" (15%) primarily reflects revenues collected in the tourist core area, which is primarily utilized to cover debt service. The FY 2015 General Fund revenues reflect very modest changes from FY 2014.



General Fund Revenue Trends

General Fund revenue trends portray a local economy reflecting the return of tourists to the community. As shown on the Three-Year General Fund Revenues chart below, Transient Occupancy Tax has increased, which has been boosted by auditing of hotels and Vacation Home Rental properties. Property taxes and sales taxes (including Measure Q) are slightly above last year. The continuing decline in "transfers in" over the past three years reflects the declining need to transfer in revenue reserves from other funds to balance the budget. As noted previously, "all other revenue" is primarily Former Redevelopment Agency revenue.



Top Three General Fund Revenue Sources

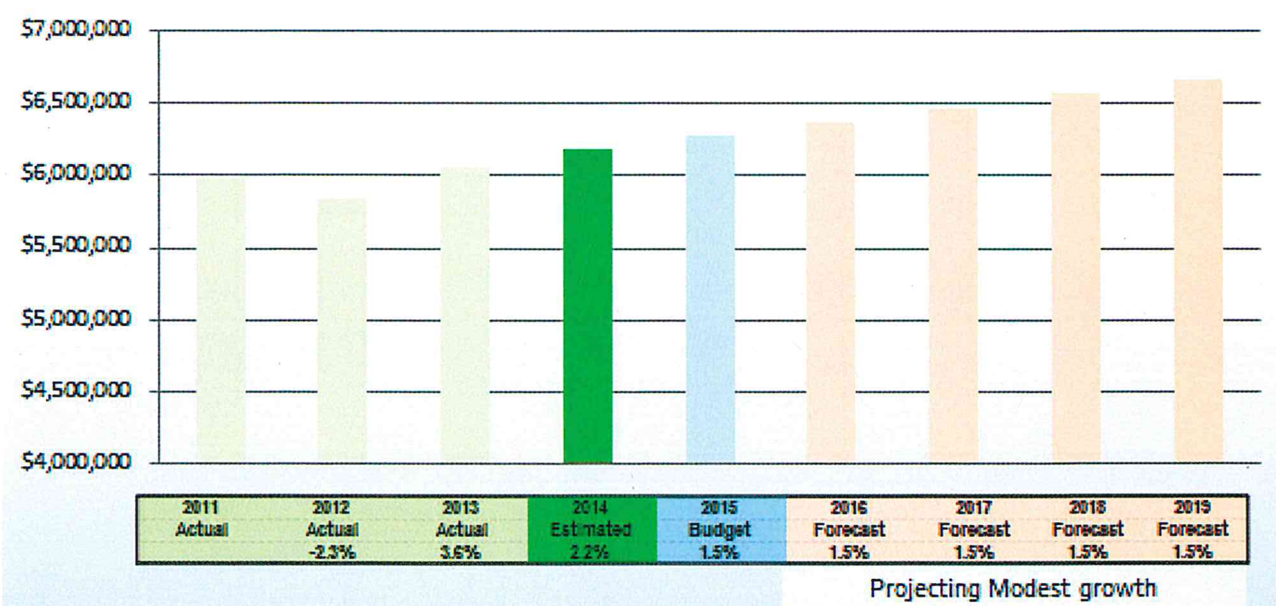
Property Tax, Transient Occupancy Tax (TOT) and Sales Tax (including Measure Q) revenues represent 57% of total general fund revenue for the City. Following adoption of the FY 2013 and FY 2014 budgets, revenues in TOT and Sales Tax were higher than budgeted resulting in a positive cash flow at the year-end.

Property Tax Revenue

Property tax is the largest revenue source representing 20% of General Fund revenues. The City receives approximately 20% of the 1% levy on assessed taxable value of all real property within the City limits. As shown on the graph below, property tax revenue continued to decline long after the Great Recession was officially "over" and the country was in recovery. The City is projecting modest, but steady increases (1.5%) through 2019. However, historical trends indicate an economic slowdown should be expected between 2017 and 2020.

Between 2012 and 2013, median home prices steadily increased; however, for the past twelve months, the median home price has remained steady, but does not indicate increases above one or two percent for the next few years. As of August, 2014, the median price of a Single Family Residence sold was $342,000, which is the same as it was in June of 2004 and September 2009, but **44% below** what it was in March 2006. A review of the historical data is indicative of the rise and fall of housing prices in South Lake Tahoe. Given that property tax revenues are the largest percentage of General Fund revenues, **it is critical** the City keep an eye on historical trends and if property values increase significantly again, as they did in 2005-2006, the City should not expect increases to continue indefinitely, but rather budget those revenues for one-time expenses or set aside those revenues for future expenses in times when home prices decline.

Property Tax Revenue 2011-2019

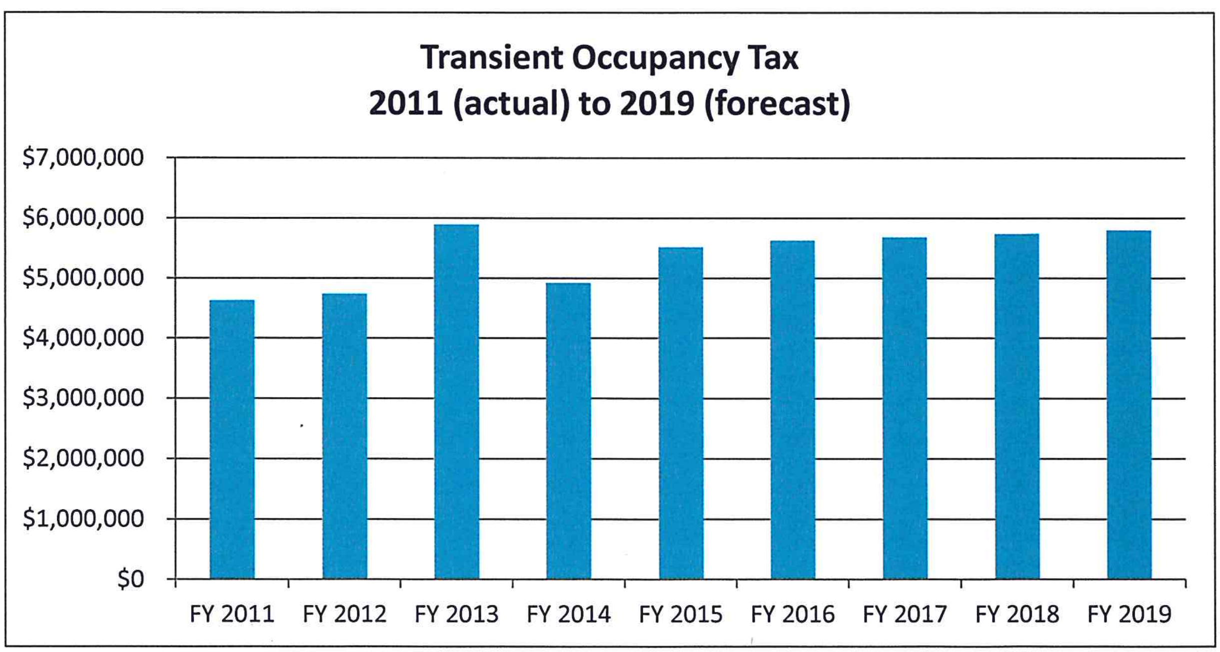


Transient Occupancy Tax

Transient Occupancy Tax (TOT) is the City's second largest revenue source representing 17% of the projected total General Fund revenue for FY 2015. The TOT is levied at 10% per dollar of daily room prices in hotels, motels and vacation homes used by visitors staying in South Lake Tahoe for less than 30 days. For lodging located within the South Tahoe Redevelopment Agency's (now the Successor Agency) Project Area #1, the TOT rate is 12%. The 12% TOT funds are held in Trust until such time as they might be needed to support the repayment of redevelopment debt for construction of the Heavenly Village project.

TOT is a volatile revenue source for the City as noted by data as shown below. In FY 2012, TOT increased by just 2%, yet the following year it increased by 24%, followed by a significant decline in FY 2014 (-16%) and there is a projected increase in FY 2015. These dramatic swings in revenue are due to weather and the general economy. Visitors come to South Lake Tahoe when there is lots of snow (FY 2013), but they drop off significantly when there is a lack of snow as there was in FY 2014. These considerable shifts in revenue impede the City's ability to adequately project TOT and, similar to property tax revenue shifts, the City must be cautious in budgeting. The City has taken a conservative approach to these revenues; when revenue increases are <u>*realized*</u>, they have been used for one-time expenses such as capital projects, community investment and in January 2014, a portion was provided to employees through a one-time 2% compensation benefit.

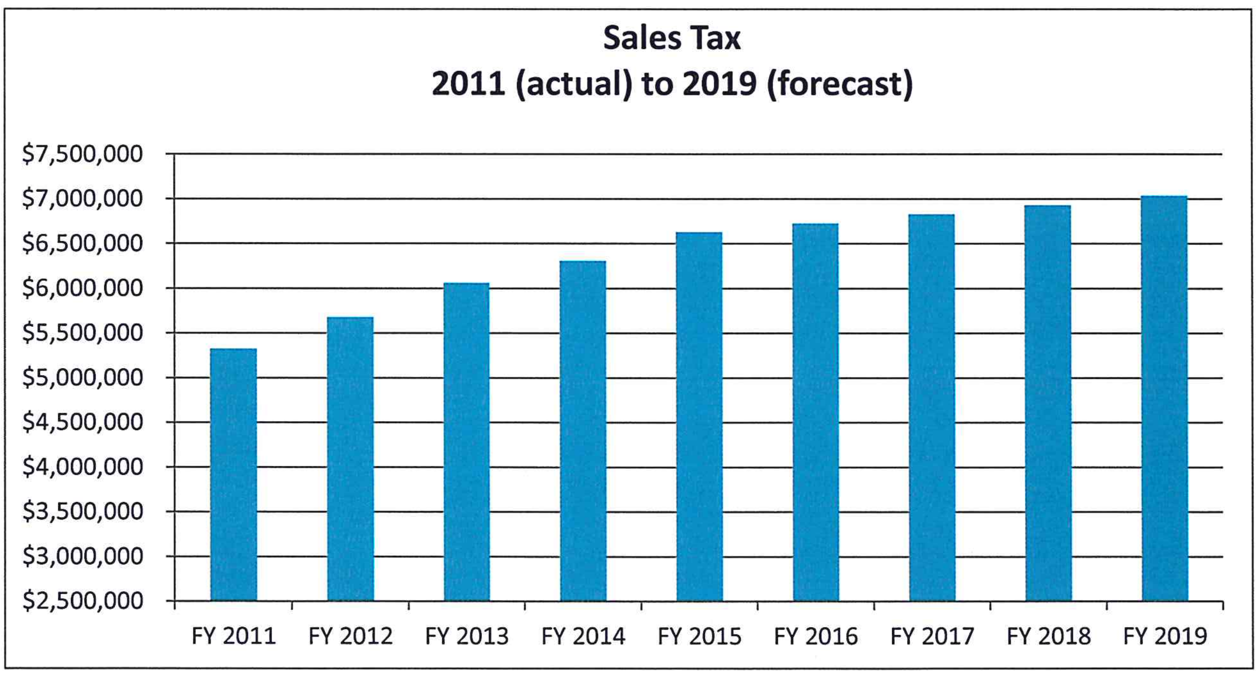
Transient Occupancy Tax							
Actual	Actual	Budget	Budget	Forecast	Forecast	Forecast	Forecast
FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
$4,736,202	$5,895,328	$4,925,000	$5,515,850	$5,626,167	$5,682,429	$5,739,253	$5,796,646
+2%	24%	-16%	12%	2.0%	1%	1%	1%



Sales Tax Revenue

Sales tax is the City's third single largest revenue source and represents 13% of the total projected General Fund revenue for FY 2015, which is identical to FY 2014. Measure Q provides another 7% in sales tax revenues. Sales tax revenues have been less volatile than TOT and property taxes. In FY 2011 and FY 2012, sales tax revenue was 7% higher than the previous year, 4% in FY 2014 and a projected 5% increase in FY 2015. Revenues will be closely monitored as in years' past and adjustment to expected increases will be made during mid-year budget review.

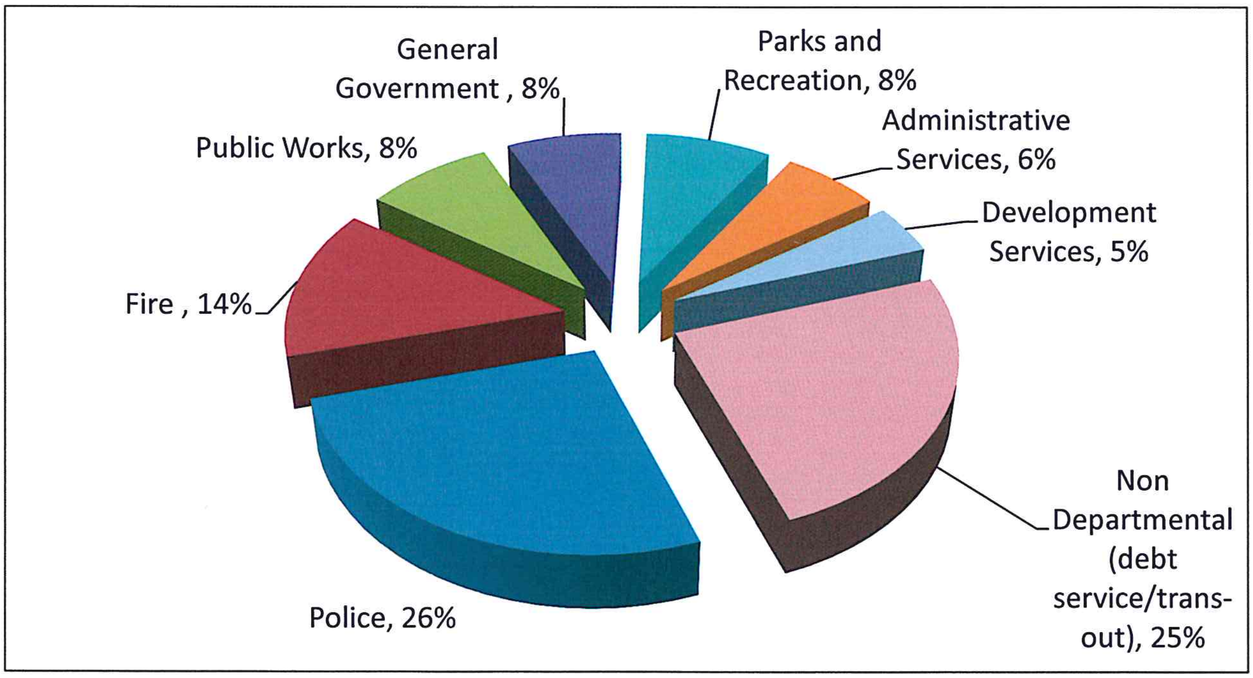
Sales Tax Revenue, 2012 - 2019							
Actual	Actual	Budget	Budget	Forecast	Forecast	Forecast	Forecast
FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
$5,681,785	$6,063,716	$6,310,000	$6,629,067	$6,728,503	$6,829,431	$6,931,872	$7,035,850
7%	7%	4%	5%	1.5%	1.5%	1.5%	1.5%



General Fund Expenses

General Fund expenditures are programmed at $31.5M, after the transfer of $600,000 to the Capital Improvement Program. Over the past few years, expenditures are budgeted for the City's core services. Evaluating expenses by department demonstrate the City's commitment to public safety (fire and police) and public works, the primary services on which the City was founded. Those services comprise 48% of the City's General Fund expenditures. Police services comprise the largest share of general fund expenditures (26%), followed by Fire (14%). Public Works Department, General Government and Parks and Recreation each comprise 8% of expenses. The remaining departments Administrative Services (Finance and Human Resources) and Development Services utilize 6% and 5% respectivley. "Non-Departmental" expenses primarily include debt service.

General Fund Expenses, by Department



Personnel – The Primary Cost of Public Services

The primary product of municipal government is to provide services for the community (police, fire, parks & recreation, capital improvements, public works and development services) and the services that support those functions (human resources, legal, finance and communications). Therefore, as it will always be, the largest expense of the City is personnel; salaries, pension, health care and other benefit costs. In the FY 2015 General Fund budget, these expenses represent **62%** of total General Fund expenses.

As noted in the table below, when evaluating General Fund salaries and benefits by Department, Police, Fire, and Public Works continue to comprise the majority of expenditures at **70%** of salaries and benefits.

Salaries and Benefits by Department			
Police	$	7,869,376	39%
Fire		4,056,472	20%
Public Works		2,156,822	11%
General Government		1,758,179	9%
Parks and Recreation		1,630,846	8%
Administrative Services		1,491,258	7%
Development Services		1,375,374	7%
Vacancy Factor		(300,000)	-1%
Total		20,038,327	100%

Last year, a comparison of salaries and benefits by collective bargaining group posed a concern regarding overtime, primarily in public safety departments. However, as shown below, between FY 2014 and FY 2015 overtime has remained flat compared to previous years (not shown). Overtime in public safety units is primarily due to staffing shortages, injuries, minimum staffing requirements and service demands.

Salaries and Benefits, by Collective Bargaining Group						
Salaries & Benefits		*FY 2014*		*FY 2015*	*%Difference 2014-2015*	*% of total 2015*
Safety Police	$	5,841,152	$	5,881,063	0.7%	29%
Safety Fire		4,148,229		3,812,905	-8.1%	19%
Misc.		8,346,963		9,184,222	10.0%	46%
Total Salaries & Benefits	$	18,336,344	$	18,878,190	3.0%	94%
Temp Employees		830,104		856,264	3.2%	4%
Overtime		613,274		603,873	-1.5%	3%
Vacancy Factor		(200,000)		(300,000)	50.0%	-1%
TOTAL	$	19,579,722	$	20,038,327	2.3%	100%

CalPERs Pension Cost

Member agencies of California Public Employees Retirement Services (CalPERs), of which the City is a member, were once again assessed with unexpected rate hikes in the employer's contribution rates. CalPERs rates comprise two portions – the employee rate and the employer rate. The CalPERs employee rates were intended to mirror Social Security payroll contributions (7%) paid by private sector employees. Prior to the Great Recession and the enactment of Governor Brown's 2013 Public Employee Pension Reform Act (PEPRA), many public sector employees did not contribute to either the employee or the employer rate. The City of South Lake Tahoe employees didn't need PEPRA to make the change, by 2012 all employee groups were paying their full employee share (7% to 9% of salary). PEPRA requires public sector employees contribute 50% of the "normal" cost of CalPERs rates by 2018. For most of the City's public safety employees that may require an additional three percent (3%) contribution by 2018 and one percent (1%) from most miscellaneous employees.

Following on the heels of PEPRA changes, in 2014, CalPERs adopted changes to its actuarial assumptions prompting immediate increases in contribution rates for all member agency employers. The City is expected to see annual increases of at least $300,000 *each year* over the next five years.

Similar to the City's issue involving the rising costs of health care, changes to the benefit plan design would provide greater reductions in the unfunded pension liabilities than these constant adjustments to benefits and increase in rates by both employees and employers. The state legislature needs to grant CalPERs member agencies the authority to negotiate contracts. It's nonsensical that a CalPERs member agency can negotiate with employees to improve the benefit that they can earn, but cannot negotiate with employees to reduce the benefit.

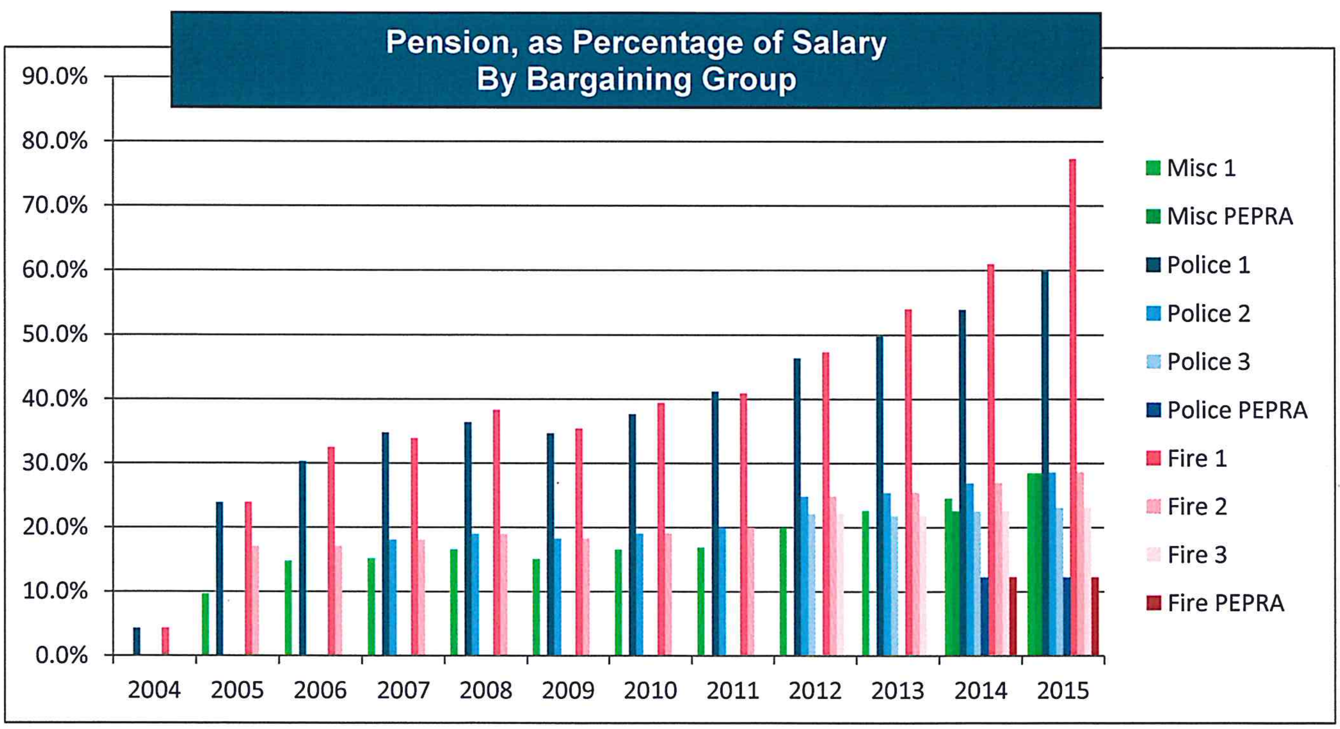
The total amount budgeted in FY 2015 for the City's pension costs is $4.1M, a **13% increase** from last year (FY 2014). The year prior (between FY 2013 and FY 2014), the increase was only 4%. The pension costs represent **13%** of total general fund expenses and **20%** of all payroll costs (salaries and wages).

FY 2015 Employer Pension Costs By Bargaining Unit	
Safety Police	1,419,899
Safety Fire	1,035,844
General & PW	590,096
Other Misc	1,052,541
TOTAL	**4,098,380**

Pension by Tiered Groups

As shown on the chart below, pension costs have increased from **zero percent (0%)** as a percentage of salary, to a high in FY 2015 of 77.3% (Fire, Tier 1) and 59.9% (Police "Tier 1"). Plainly speaking, for every dollar in salary for these employees, the City must set aside $0.77 and $0.60 for the City's share of pension costs; as compared to miscellaneous employees the cost is 28.5% (or $0.285 for every dollar in salary). This issue is equally frustrating to employees when negotiating for wage and benefit changes. For example, if the City had $1,000 in revenue to offer salary increases to a Tier 1 Police officer, the City must instead only offer $401 because $599 would be needed to cover the pension (which also doesn't take into account other 'roll up' costs). "Tier 1" employees in the Fire and Police departments have a greater pension benefit than those of "Tier 2", "Tier 3", and PEPRA.

When pension costs were **zero percent** (0%) for miscellaneous employees (2002 - 2004) and relatively minimal for public safety employees (less than 5%) as a percentage of salary, that is the time when CalPERs member agencies agreed to increase benefits, which, as shown below, had an **immediate and significant increase** in cost the following years (2005). The cost for miscellaneous employees has almost tripled from 10% in 2005 to 28% in 2015; for fire and police (Tier 1) costs have more than tripled (from 24% in 2005 to 77% in 2015) due to early retirements (age 50) and enhanced benefit plans (single highest year salary and 3% of salary for each year worked). With these cost increases, it's understandable that the City's cost-containment strategies have simply been consumed by the unrelenting pension increases.



City's Self-Insured Health Care Benefit Plan

As described in the introduction of this budget message, the rising cost of health care is understood as a serious problem throughout the United States. In 2010 the federal government adopted the Patient Protection and Affordable Care Act ("ACA") with the majority of provisions phased in by January 2014. Because the City is self-insured, we must adopt a Healthcare Plan that meets the Affordable Care Act requirement. Further adding to the City's unfunded health care liability is the number of lives for which the City is providing medical coverage. Although the City only employs about 175 permanent employees, the City is covering the medical expenses for approximately four times that many people. The City covers the medical expenses for approximately 800 lives, about half of which are retirees and their dependents.

As has been explained in many public meetings, workshops and for many years in the City's budget messages and presentations, the City's Healthcare benefit plan is full of design flaws contributing significantly to the high cost of salary and benefits. The City has implemented many cost-containment strategies over the years. Employees (and retirees because they receive the same plan as employees) have been subjected to frequent changes in the benefit plan. Over the years, the Healthcare Plan included increased deductibles, reduced and eliminated coverages, and eliminated participants. The Healthcare plan benefit has remained undefined, unreliable and therefore unsustainable.

However, as also explained in the introduction of this message, the City has been negotiating with employees, both represented and unrepresented, for the last several years to develop a plan to reduce costs while providing a plan that can be relied upon and sustainable for the future.

A Healthcare Plan, with Options

The City has had one medical/health benefit plan for all employees for many years. Medical coverage and health benefits are not suitable to a one-plan-fits-all approach.

The City has been negotiating in good faith with represented and unrepresented employees. For those employees who have completed negotiations and have entered into agreements with the City, the agreements include a new Healthcare Plan, which includes a basic plan and for the first time – ever – employees will have the option to purchase additional health benefits to choose the plan best suited for them and their family (retirees receive the same plan as employees ("Plan A") and will also be offered the option to purchase optional plans).

For the employees who have entered into new employment contracts and agreements with the City, the Healthcare Plan will be the "Plan A" of the Keenan (the City's Broker) proposed schedule. Plan A will be the City's designated Healthcare Plan and it meets the regulations of the Affordable Care Act. Plan participants will have the option to purchase an improved benefit plan with reduced out of pocket expenses and deductibles. Because "Plan A" meets the new federal regulations, the City's Healthcare Plan will finally be a plan that employees and retirees can rely on. Plan A provides 100% of many important 'well-care' visits and $50 co-pay for office visits.

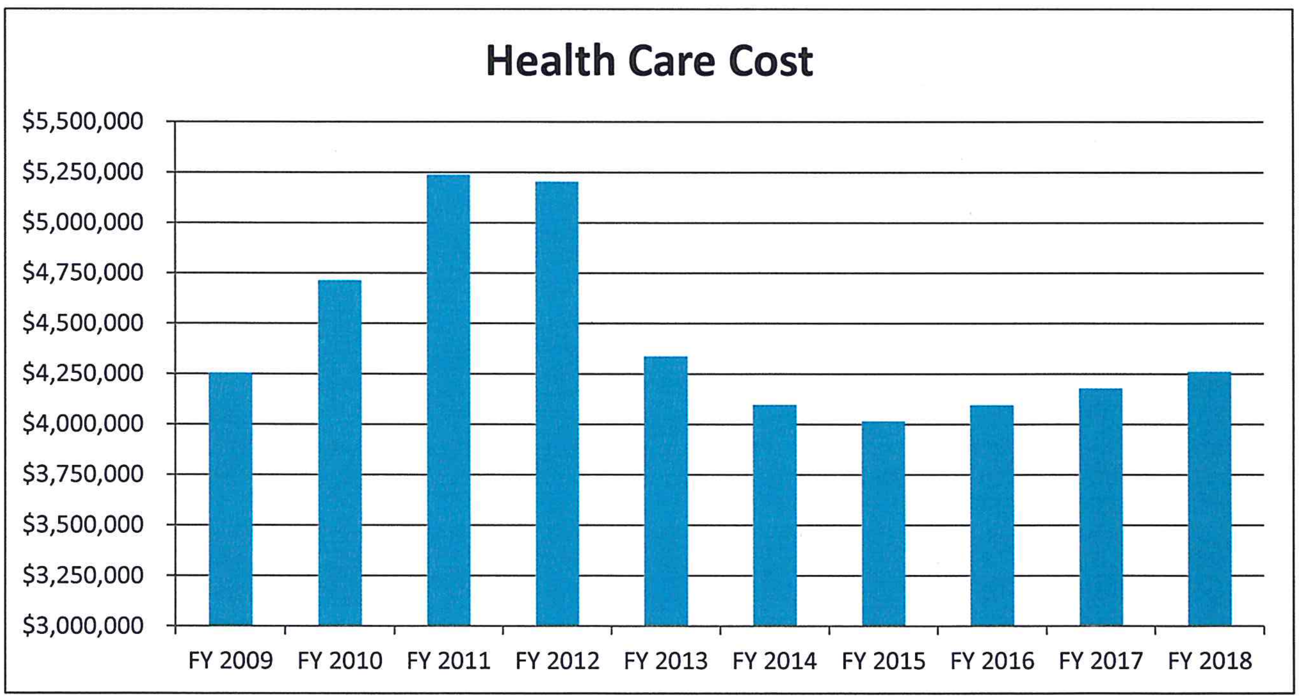
FY 2014-2015 Health Care Budgeted Expenses – Before New Changes

The following budgeted figures are included in the City's FY 2014-2015 budget. Negotiated changes to wages and benefits were concluded ***after*** completion of the budget. Further, negotiations are continuing in good faith between the City and labor groups, which may further amend the FY 2014-2015 budget.

Until such time as the FY 2015 budget is amended, the following costs are budgeted for health care and include $4M in expenses in this fiscal year. 35% of this year's costs are budgeted for retiree health care. Between 2009 and 2018, the City has budgeted over $44 million dollars in health care expenses.

Health Care Cost 2011-2018

	Budget	Budget	Budget	Budget	Budget	Forecast	Forecast	Forecast
	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
EE	$3,403,646	$3,215,411	$2,477,850	$2,641,291	$2,588,465	$2,640,234	$2,693,039	$2,746,900
Ret	$1,834,329	$1,989,712	$1,859,107	$1,456,092	$1,426,970	$1,455,509	$1,484,619	$1,514,311
Tot	**$5,237,975**	**$5,205,123**	**$4,336,957**	**$4,097,383**	**$4,015,435**	**$4,095,743**	**$4,177,658**	**$4,261,211**



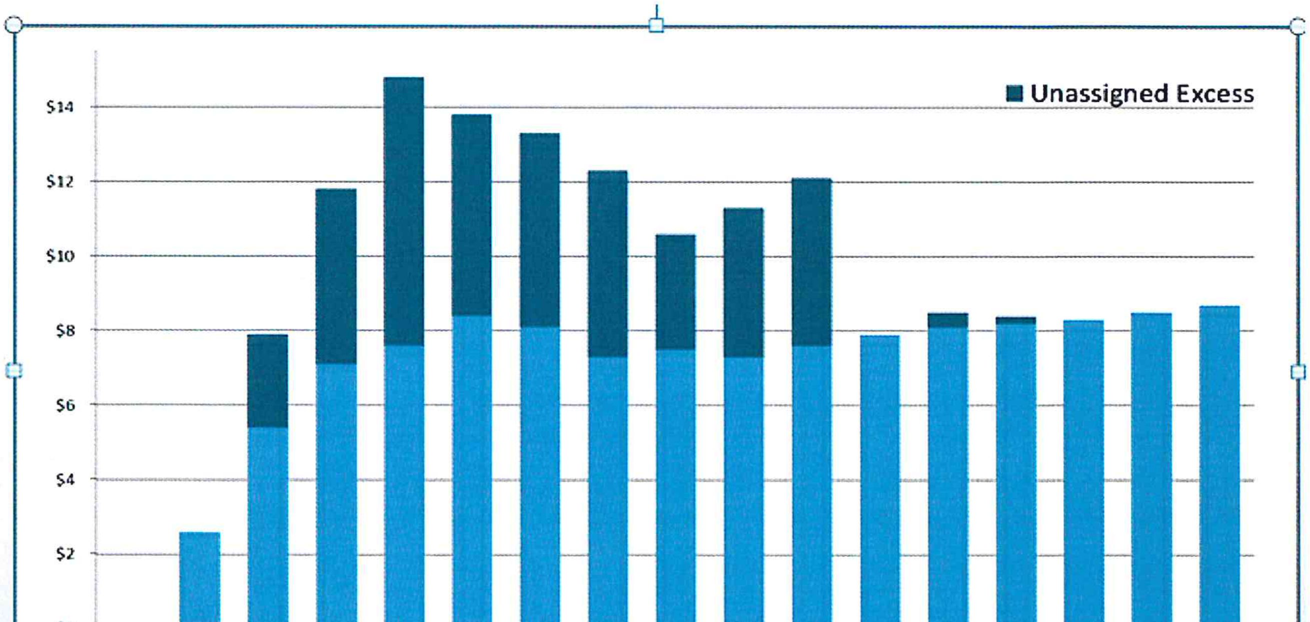
General Fund Reserves

25 % General Fund Reserve Policy

As shown on the chart below, in 2003, the City's General Fund Reserves were **zero**. Consider that at the same time, pension costs were also **zero.** As pension costs rose, the City adopted and implemented a General Fund Revenue Reserve policy (2005) requiring 25% of general fund revenue to be set aside in reserves. As a result, by 2007, reserves had grown to $14M providing a much-needed safety net to draw from as the recession began and as it worsened. Between 2008 and 2012, to balance the budget, the City utilized <u>excess</u> reserve funds to help offset the impacts of the recession. However, the City's reserves did not go below its adopted 25% reserve policy, which has been maintained even as excess reserves were utilized to fill the budget gaps. Looking back, had the City not adopted the 25% reserve policy and maintained it throughout the recession, the City would likely not have been able to maintain basic services.

At the conclusion of FY 2014, the General Fund Reserve Fund Balance is projected to be $8M, meeting the City Council's 25% reserve requirement. In 2013, (FY 2013-2014) the City utilized excess reserves ($1.9M) to purchase property in the Industrial Zone, which will be used to relocate the Public Works Yard from its undesirable location (adjacent to Campground by the Lake). FY 2014-2015 net fund balances are expected to be retained in the City's General Fund Reserves.

General Fund Reserves 2004-2019



	Actual 2003	Actual 2004	Actual 2005	Actual 2006	Actual 2007	Actual 2008	Actual 2009	Actual 2010	Actual 2011	Actual 2012	Actual 2013	Budget 2014	Forecast 2015	Forecast 2016	Forecast 2017	Forecast 2018	Forecast 2019
25% Reserve Policy	$0	$2.6	$5.4	$7.1	$7.6	$8.4	$8.1	$7.3	$7.5	$7.3	$7.6	$7.9	$8.1	$8.2	$8.3	$8.5	$8.7
Unassigned Excess	$0	$0	$2.5	$4.7	$7.2	$5.4	$5.2	$5.0	$3.1	$4.0	$4.5	$0.0	$0.4	$0.2	($0.2)	($0.8)	($1.5)
Year-End Balance	$0	$2.6	$7.9	$11.8	$14.8	$13.8	$13.3	$12.3	$10.6	$11.3	$12.1	$7.9	$8.5	$8.4	$8.1	$7.7	$7.2

Community Investment Program

The City's Strategic Priority to Improve the Built Environment continues to drive investment. FY 2015 Capital Improvement Program or more appropriately referred to as the **Community Investment Program** continues to demonstrate the City Council's focus on capital investment with a specific focus on Recreational opportunities that will generate a return on the their investment. In addition to the City's investment, private capital investment over the past three years is estimated at $110M in property valuation. The long awaited Chateau project, highway frontage portion, was completed in Summer 2014, which infused $15M in private capital into the local economy. New and current businesses are investing in the South Shore. The Lake Tahoe Unified School District completed it's $100M investment into our local school system, attracting new students to the South Shore. The Recreation Joint Powers Authority has invested in the revitalization of bike paths. CalTrans has invested $50M in new sidewalks, curb, lighting, landscaping and environmental improvements. The California Tahoe Conservancy has acquired several old buildings in stream environment zones for demolition and restoration. Several local business and property owners have invested in their properties in partnership with the City's Harrison Avenue Project. The City launched an Economic Development Task Force aimed to attract another $100M in investment to the South Shore in the next few years. Community investment is the key to sustained economic development.

On August 5, 2014, the City Council adopted a Financial Investment Strategy to restructure debt generating the opportunity for additional community investment.

The following are projects included in the FY 2014-2015 (and beyond) CIP:

- Completion of Bijou Area Erosion Control Project. This project is an innovative "pump and treat" storm water control project.
- Completion of Harrison Avenue Project.
- Bike Paths: El Dorado Beach to Ski Run
- Bike Park at Bijou Park (a public/private partnership).
- Relocation of the Public Works Yard.
- Community play field turf replacement (field will be tested in Spring 2015).
- Sierra Boulevard Intersection Improvements: Widening Sierra Boulevard at the US 50 intersection, turn lanes, new signals, curb and gutter, crosswalks, and ADA upgrades. This is a City/Caltrans cost-sharing project. City's funding is through RSTP, and TRPA AQ.
- Sierra Tract Erosion Control Project Phase 3 and 4 is a Water quality control project within the Sierra Tract neighborhood of the City to provide water quality improvements at the Truckee River outfall. This project is in design phase with a 2015 scheduled construction, pending identification of funding sources.
- 2014/2015 Regan Beach improvements will include community input, finalization of plans, construction drawings and environmental review; construction 2016.

Summary

The FY 2015 budget demonstrates a commitment to community investment and implementation of the City Council's strategic priorities to Improve the Built Environment and Fiscal Sustainability. Given that labor negotiations are on-going as the FY 2014-2015 budget is being adopted, amendments to the budget are expected within a few months or during mid-year budget review. The amendments are expected to be cost-neutral to the City.

As we look back, it was only a few short years ago, the City was forced to reduce its workforce by 30%; the magnitude of the loss of hard working public employees is still felt today. At the same time, the loss of revenues across the board in all categories could have been disastrous coupled with the decline in housing prices, the increase in foreclosures, the loss of many businesses in town and the empty streets left vacant by tourists who were not visiting.

Today, more than $200M in recent public and private capital investment is evident. Public agencies and private property owners are investing in the South Shore. Similarly, the City has faced very difficult decisions head on and is continuing to address its unfunded pension and health care liabilities. The City and its employees have shown courage in confronting the challenges and designing a more stable wage and benefit package for all employees.

Are the next few years going to be viewed as the City's "Rendezvous with Destiny" as we make significant investment progress while reducing and restructuring long-term debts of the City? While we don't know the answer to that question just yet, the path to achieve these measureable outcomes is before us. We must continue to be diligent in our efforts, conservative in our approach to revenues and expenditures with an eye on the lessons history can provide.

The community is well served by the City's hardworking team of public employees. They are to be commended for their collaborative efforts delivering what the City Council has requested in all categories. I appreciate the City Council's clear direction throughout this past year regarding the City's fiscal resources and investment strategies with a focus on results and return on investment.

During FY 2014-2015, the City will continue to deliver by demonstrating our commitment to providing the necessary resources to ensure the community is well protected, well served and understands our commitment to excellent public service.

Fiscal Year 2015 budget is Respectfully Submitted,

Nancy Kerry

Nancy Kerry, City Manager