



September 17, 2013

Honorable Mayor and Members of the City Council:

I am proud to present the Fiscal Year 2013-2014 (FY 2014) Municipal Budget for the City of South Lake Tahoe. For the first time in five years, balancing the budget did not require the use of general fund reserves, other excess reserves, staffing reductions or service reductions. Balancing the FY 2014 budget is possible because during the last several years the City confronted its long-term structural deficit realities by making the difficult, but necessary decisions.

While balancing the budget within expected revenues might create the impression we're out of the woods, it's important to note, *we are not*. The unrelenting rise in the cost of employee pensions is expected to easily devour conservative gains in revenue in the coming years. In addition, when the City's pension costs are coupled with our self-insured health care program provided to its employees, retirees and their dependants (for life), at a cost of over \$4 *million* dollars *annually* and rising, gains in revenue may not cover the escalating cost of these benefits. In fact, had the City not been able to implement the first step in our three step approach to solving our fiscally unsustainable health care program in this year's budget, the *budget would not have been balanced*. However, we did balance the budget because the City of South Lake Tahoe employees accepted responsibility and are beginning to understand the major budget issues. In previous years, employees have agreed to furloughs and reductions in pay to contribute the entire employee share of pension costs (ranging from 7% to 9%), and taken on much higher levels of work due to the loss of 30% of the workforce. This year, the employee Health Care Cost Containment Committee and all labor groups worked with the City Manager and the new health insurance broker to implement the first step toward solving our unsustainable health care benefit plan. These contributions by employees helped achieve a balanced budget. Many cities today are facing similar conditions, but are forced into bankruptcy because employees and labor groups have chosen to fight rather than collaborate on solutions. I appreciate our City team and recognize the sacrifices they have made in the last several years.

While we are not out of the woods, there is daylight at the end of this long tunnel. However, as we begin to make the turn toward brighter days, we must be diligent and conscientious; we must learn from the practices of the City's past and not repeat the decisions that have resulted in a bust and boom cyclical style of budgeting. In reviewing thirty years of City's budgets, a pattern becomes clear. During recessions, the City enforced substantial layoffs and cut backs (services, salaries and staff); then, as revenues grew during periods of recovery, hiring was brought back to pre-recession levels. This practice *should not be repeated*.

We must take a different approach than in previous years by implementing a more sustainable approach that best serves the entire community. This new strategy would recognize our most important mission, which is to invest in the community. We must rebuild, restore, revitalize and reinvest in our **primary industry: recreation** and use the return on those

investments to strengthen core services (public safety and public works). During this long protracted global recession, communities that survived the recession best developed an agreed upon *shared vision of the future*. Joining forces on an agreed course of action with public and private sector partners can leverage resources and potentially develop lasting revenue streams to rebuild the community. The return on those investments, if prudently expended, could revitalize public safety services, public facilities, and city streets.

FY 2014 Budget Philosophy

The FY 2014 balanced budget maintains core services through the adoption of a new budget philosophy: prudent, conservative and *realistic*. The budget was built for *expected* rather than *projected* revenues and expenses. Although revenue projections for FY 2013 are better than anticipated, FY 2014 budget relies on stable, rather than anticipated, revenues. The new budget philosophy recognizes the City is on the right track which began several years ago. If revenues exceed expectations, the City Council will have the opportunity at mid-year, for the first time in several years, to determine the best *investment strategy* to rebuild, restore and revitalize the community. We must stay focused on the vision that the future of the City of South Lake Tahoe and in fact all of the South Shore is contingent upon where we invest our revenue increases, which should be in our community's infrastructure and our prime industry, recreation.

Strategic Priorities

Fiscal Sustainability is the single most important Strategic Priority of the City's Strategic Plan adopted by the City Council on March 2011, and reaffirmed in May of 2013. Focusing on Fiscal Sustainability ensures that the City considers all options, addresses issues without delay and nothing is off the table when it comes to ensuring the long term fiscal health of the City.

The Strategic Priorities include the following:

- Fiscal Sustainability
- Economic Development
- Improve the Built Environment
- Public Trust and Accountability
- Partnership Development
- Quality Core Services (added in 2013)

FY Budget 2014: Fiscal Sustainability

The goal of fiscal sustainability is to ensure the City is a wise steward of the public's resources and maintains long-term financial viability. There is no better evidence we're on the right track toward fiscal sustainability, than producing a balanced budget without the use of fund balances. However, equally important is looking ahead. Are there headwinds to fiscal sustainability? Are there concerns on the horizon that may impede a balanced budget in the future? The answer is a resounding and unequivocally, **yes**. As noted above and described in detail later in this budget message, without long-term *transformative change* to public employee pensions and our employee and retiree health care benefit plan, fiscal sustainability *is at risk*. The good news is

that we're heading in the right direction. The FY 2013 budget (and FY 2014 and forward) include employee contributions to pension for the first time in many years. FY 2014 budget includes the first step of a three step approach to reducing the cost of the City's health care benefit plan. These are important and transformative changes to tackle rising benefit expenses. The key to lasting fiscal sustainability is to work with state legislators and the City's employees to recognize the importance of reducing these benefit costs which in turn will provide financial stability.

Focusing on the Future – Recreation

In addition to managing expenses, we must continue our efforts toward transformative revenue generation that can be achieved by investing in the South Lake Tahoe industry: **Recreation**. In the past year, public and private partners and community members came together in a series of workshops and meetings to develop a shared vision for the future of South Shore. Without question, our shared vision is the recreation industry. Each partner and community member must identify their role in meeting the demands of the recreation tourist. The City recognizes its role in providing recreation facilities and programming, investing in our infrastructure to improve the built environment to more appropriately align with the natural environment, and maintaining quality core services including public safety and public works.

Many studies have been conducted by a variety of experts regarding the Tahoe basin's tourism industry. One study after another confirms that tourists now come to Tahoe to recreate and enjoy our unique and awe inspiring natural environment. During the global recession, the Tahoe basin was hit hard and fast. Business closings and massive layoffs across all industries were evident through unemployment numbers (17% at the peak); empty stores and restaurants, and even the empty streets told the story. However, the recession also provided an opportunity for local partnerships to be strengthened. Public and private partners in all sectors came together and focused on solutions. We sought each other's expertise and advice, leveraged resources, joined forces, hired experts to evaluate where resources would be best invested, and we developed our shared vision: recreation is our industry and we should be targeted, focused and aligned.

There is no doubt that investing in recreation has a direct return on investment for the City and will strengthen the City's fiscal sustainability. Tourists pay Transient Occupancy Taxes (TOT) when staying in hotels and vacation home rentals. The FY 2014 budget includes \$4,850,000 in TOT. Any increase in TOT is a direct financial benefit to South Lake Tahoe. If the City develops better recreation facilities, offers quality programming and attracts organized sports to the City, the investment would have an immediate financial impact to the City with increased TOT, sales tax and direct recreation revenue. Those investment returns could be reinvested by improving City streets (which currently do not have an ongoing revenue stream), facility and asset management and replacement (which also does not have an ongoing revenue source) and bolstering public safety services.

As part of our role in recreation, the City partnered with El Dorado County and is currently in the process of developing a comprehensive Parks, Trails and Recreation Master Plan that will produce a capital investment plan prioritized by community interest, available capital and return on investment. In addition to the City and El Dorado County, our Nevada neighbor, Douglas County has also partnered in the master planning process, which will result in the ***first ever***

comprehensive recreation plan developed for the *entire south shore*. The Master Plan is expected to provide a road map for private and public sector partners to invest in recreation, improve current recreation user experiences and attract new recreation tourists to South Lake Tahoe. The future of the South Shore looks bright as we move out of the global recession and into a period of recovery provided we learn from the practices of the past and begin investing in the community and recreation first, and leverage those returns to rebuild the public's infrastructure.

Fiscal Year 2013-2014 Budget

The City's projected revenue for all funds is \$90M. 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 64 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 funds 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.

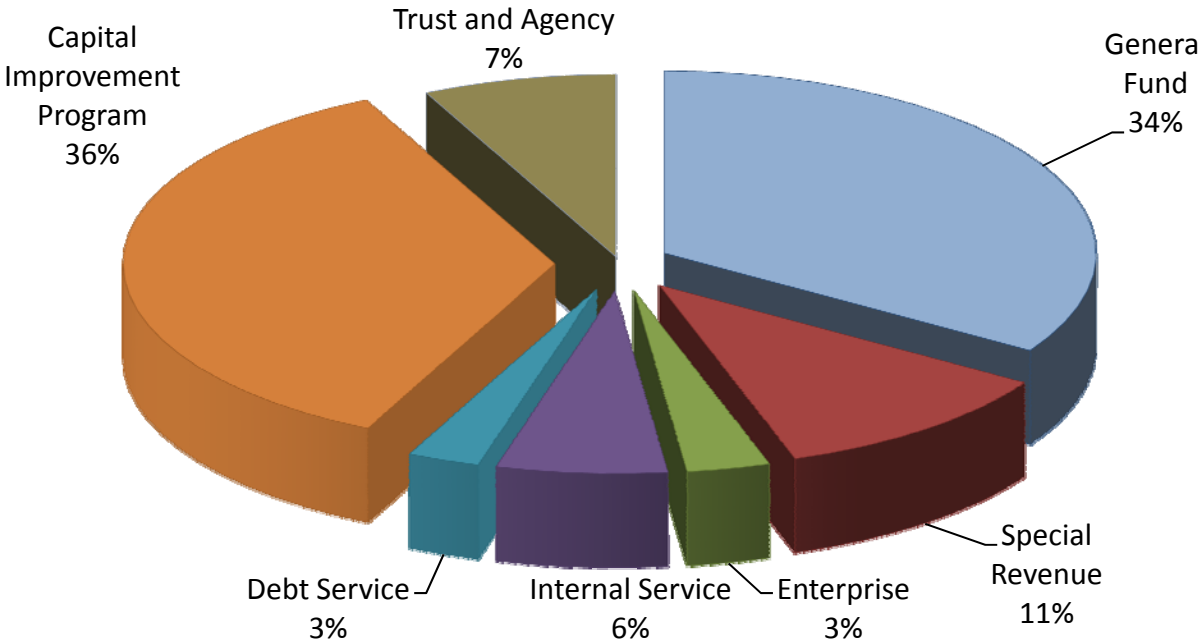
City of South Lake Tahoe Fund Types

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	37
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)	6
Trust & Agency	Community Facilities District, RD Successor Agency	10
		<u>64</u>

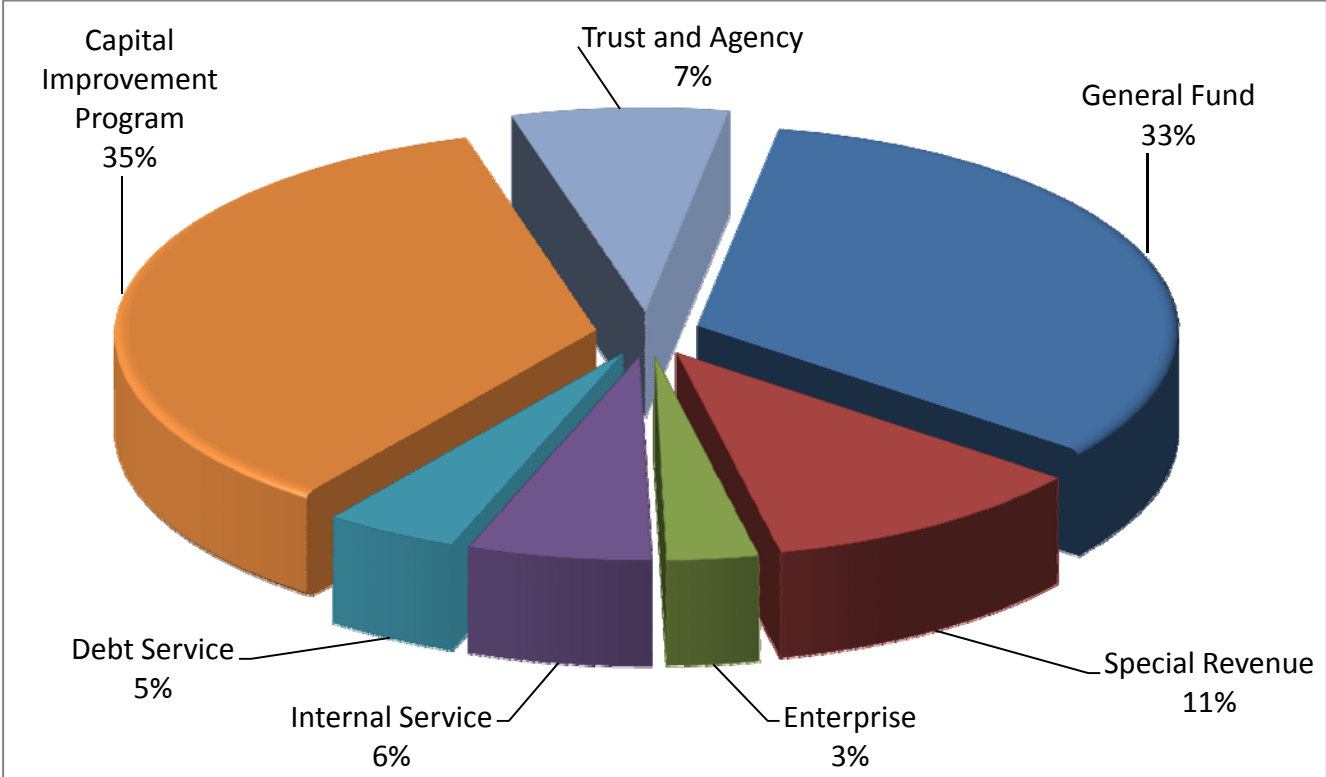
Projected Revenues and Expenses for FY2014 totals \$90M in revenue and \$93.3M in expenses. As noted in the table, the General Fund is balanced and will not utilize fund balances or other sources of revenue to achieve its balance. Special Revenue and Enterprise Funds will utilize existing fund balances maintained within those funds, which occurs routinely as a manner of operations. Debt Service will utilize \$1.8M of fund balance that will be transferred out to the Harrison Avenue and Linear Park Projects for expenses expected to occur in FY 2014. The CIP fund will utilize \$.9M of fund balance received in a prior year before CIP project expenses occur. Trust and Agency will utilize \$300k in fund balance for expenses related to redevelopment debts and obligations.

Revenue / Expense, by Fund Type			
Fund Type (\$ mil)	Revenue	Expense	Fund Bal. (Use)/Incr.
General Fund	\$ 30.57	\$ 30.5	\$ 0.0
Special Revenue	9.9	10.3	(0.4)
Enterprise	2.8	2.9	(0.1)
Internal Service	5.8	5.8	0.0
Debt Service	2.4	4.2	(1.8)
Capital Improvement Program	32.1	33.0	(0.9)
Trust & Agency	6.5	6.8	(0.3)
Total	\$ 90.0	\$ 93.4	\$ (3.4)

TOTAL REVENUES (as shown in the chart below) indicate that the City's Capital Improvement Program generates (36%) of total revenue, followed by the City's General Fund (34%) and Special Revenue (11%), which together accounts for 81% of total revenue. Examples of Special Revenue include Snow Removal, Safety Sales Tax, Vehicle License Fees etc.

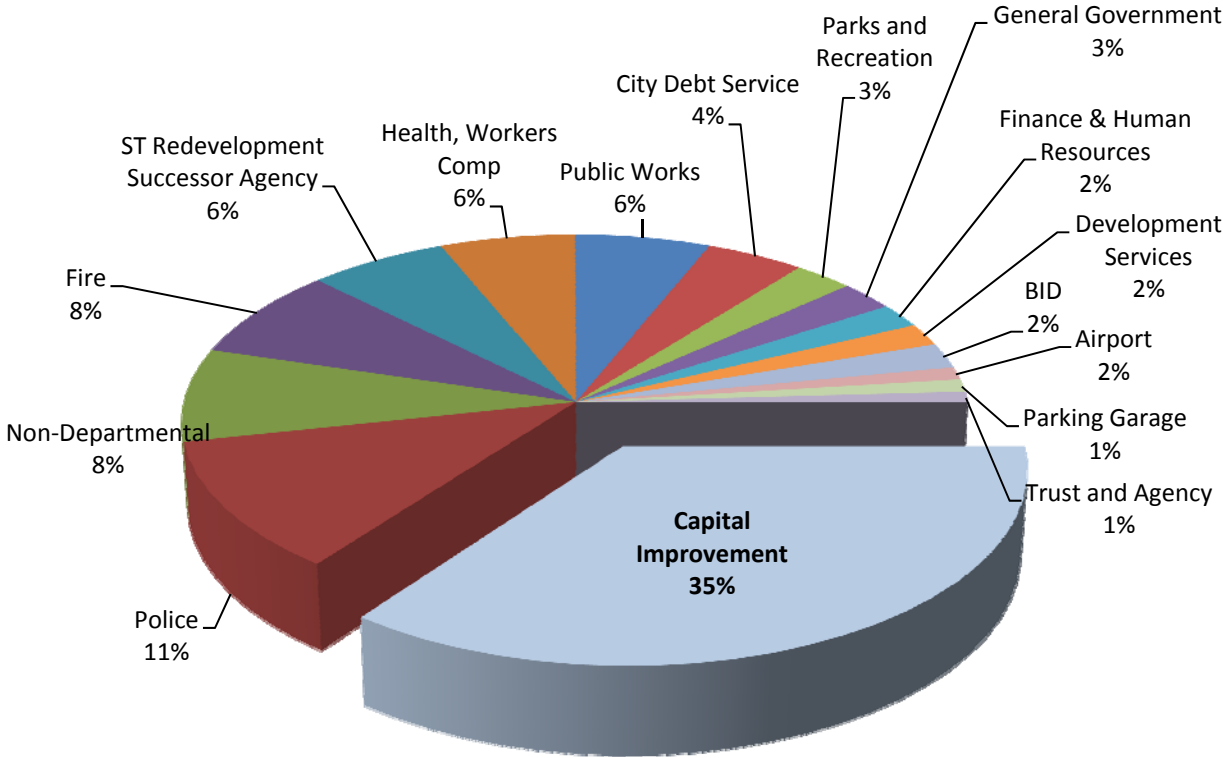


TOTAL EXPENSES (as shown in the chart below) indicate the City's Capital Improvement Program is 35% of all expenses, followed by General Fund at 33% and Special Revenue at 11% totaling 79% of all expenses.



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 (35%), which contributes to the City's Strategic Priority to Improve the Built Environment. Other significant categories include Police, (11%), Fire and Non-Departmental (8%), Health and Workers' Comp (6%), Public Works (6%) and South Tahoe Redevelopment Successor Agency (6%), followed by categories at five percent or less of total budget expenses.

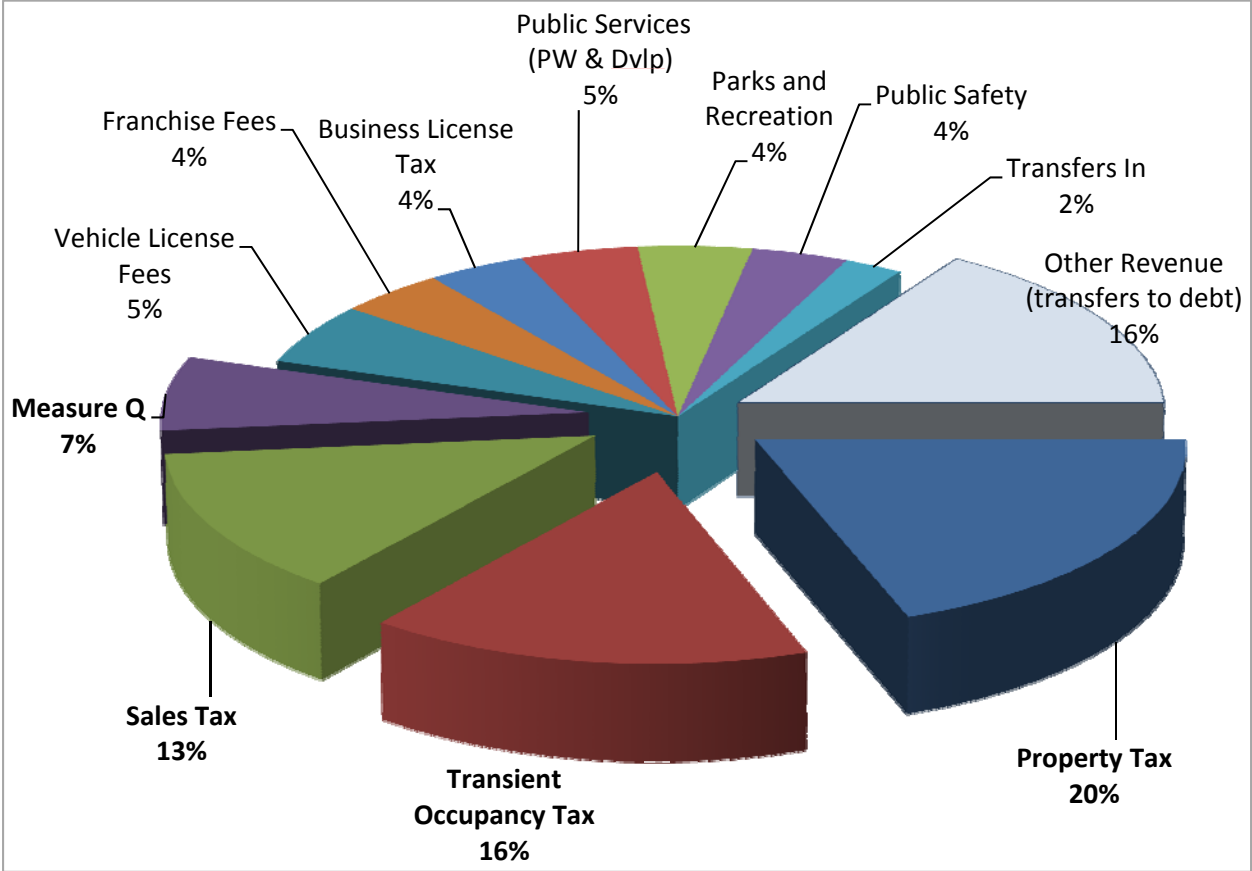


General Fund

General Fund revenues for FY2014 are \$30.5M, which mirrors projected expenses. The FY 2014 budget when first evaluated exposed a potential \$1.6M deficit. The budget was balanced by adopting a budget philosophy of eliminating one-time expenses from the budget where feasible, conservative revenue and expense budgeting, capturing revenue from the new paid parking management program, elimination of a potential transfer to cover redevelopment debt service deficit, and implementation of the first step of a three step health care benefit plan cost containment strategy.

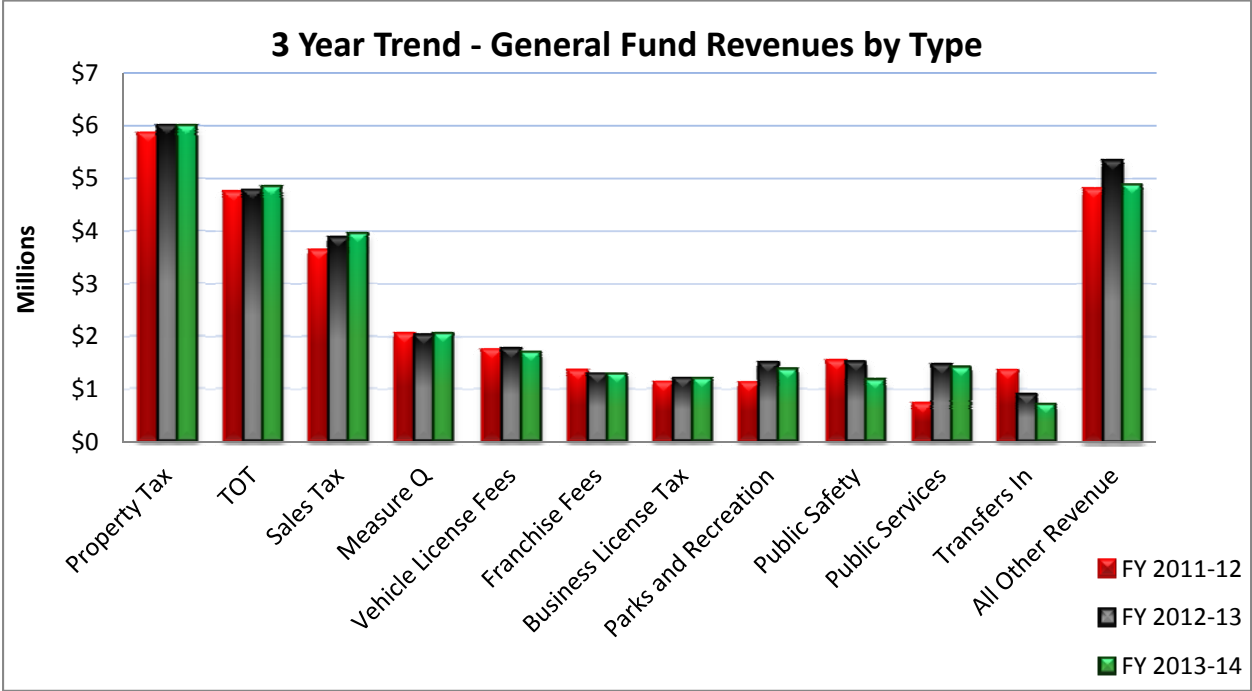
General Fund Revenues

As shown in the chart below, the primary sources of revenue that comprise 56% of all general fund revenues are Property Tax (20%), Transient Occupancy Tax (TOT) (16%), and Sales Tax (General Sales Tax (13%) and Measure Q (7%)). "Other revenue" (16%) primarily reflects collected in the tourist core area, which is primarily utilized to cover debt service.



General Fund Revenue Trends

General Fund revenue trends reflect an economy in slow recovery. As shown on the chart below, the budget reflects stable property tax revenue, a small increase in transient occupancy tax (TOT) revenues and a slightly greater increase in sales and Measure Q taxes. Note the 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. On the following pages, the top three revenue sources and trends will be discussed. As noted previously, “All other revenue” is primarily comprised of TOT revenue collected in the tourist core area, a majority of which is utilized to cover debt service.



Top Three General Fund Revenue Sources

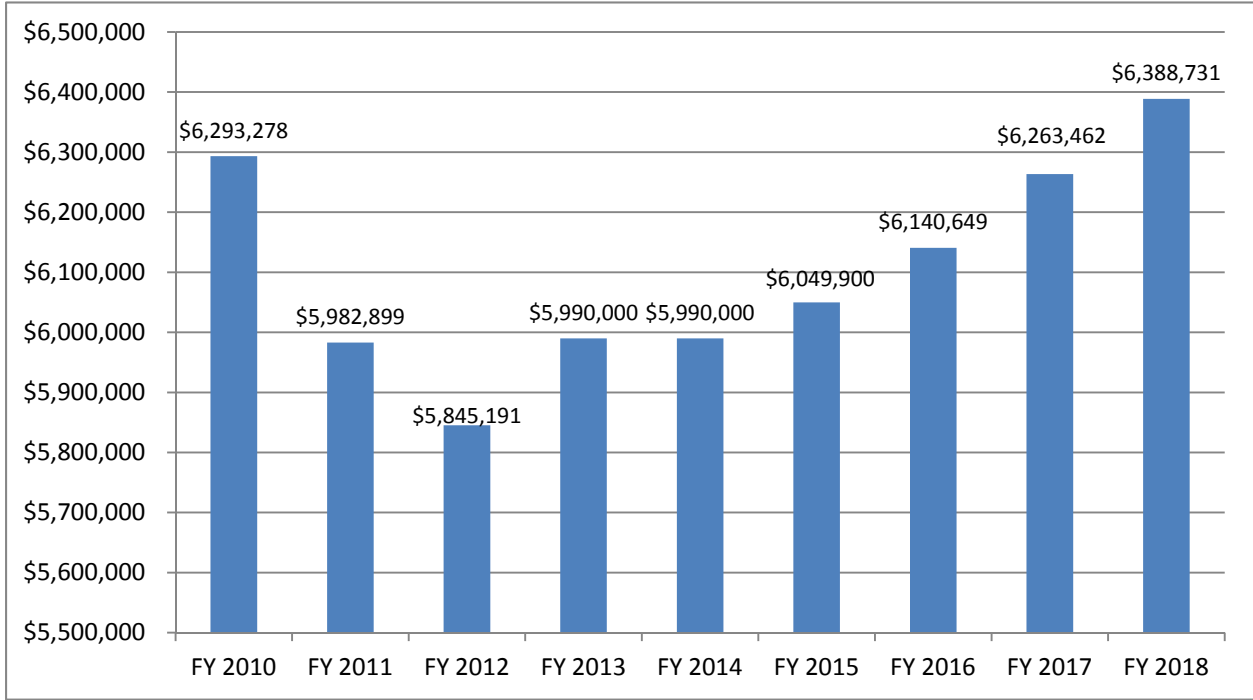
Property Tax, Transient Occupancy Tax (TOT) and Sales Tax revenues represent 56% of total general fund revenue for the City. In the past few years, all three revenue sources were projected to decline although property taxes experienced the sharpest declines through the recession. However, following adoption of the FY 2012 and FY 2013 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 declined sharply from 2010 to 2012. Property tax revenue has been negatively impacted by the decline in property values and the number of foreclosed properties. Currently, the South Lake Tahoe real estate market has fewer homes available for sale than demand requires resulting in a significant increase in the number of homes sold and a steady rise in the median price of a single family residence (July 2013 SFR Median value \$292,000, up 23% from July 2012). If the trend in real estate continues, it will have a positive impact on the City’s property tax revenues.

The FY 2014 budget expects property tax to remain flat over FY 2013. Five-year forecast shown below includes modest increases ranging between 1% and 2% from FY 2015 and FY 2018.

Property Tax Revenue 2010-2018

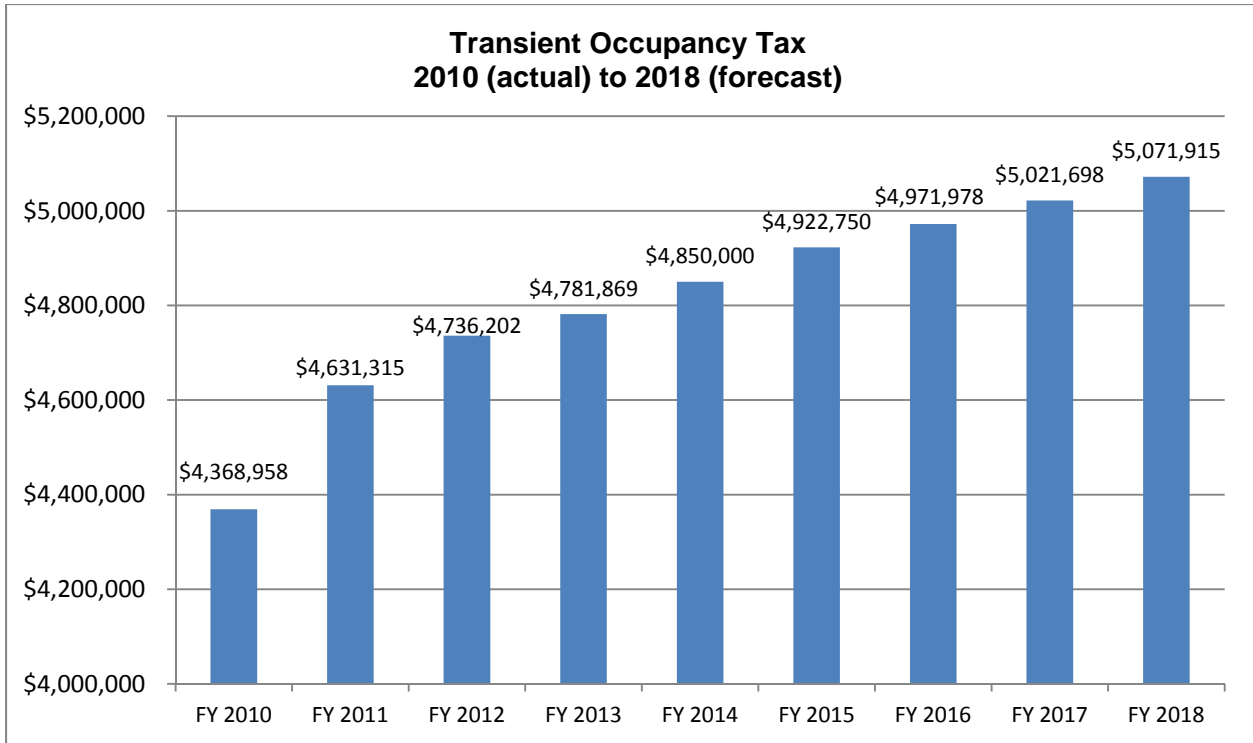


Transient Occupancy Tax

Transient Occupancy Tax (TOT) is the City's second largest revenue source representing 16% of the projected total General Fund revenue for FY 2014. 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.

The FY 2014 budget includes a 1% increase in City TOT based on improved occupancy, which is acknowledged as conservative. The FY 2014 budget philosophy of projecting revenues conservatively may provide the City Council an opportunity during mid-year budget review to determine an appropriate investment strategy, if receipts exceed projections. Current national economic trends demonstrate a slow recovery and thus, revenue projections reflect the same.

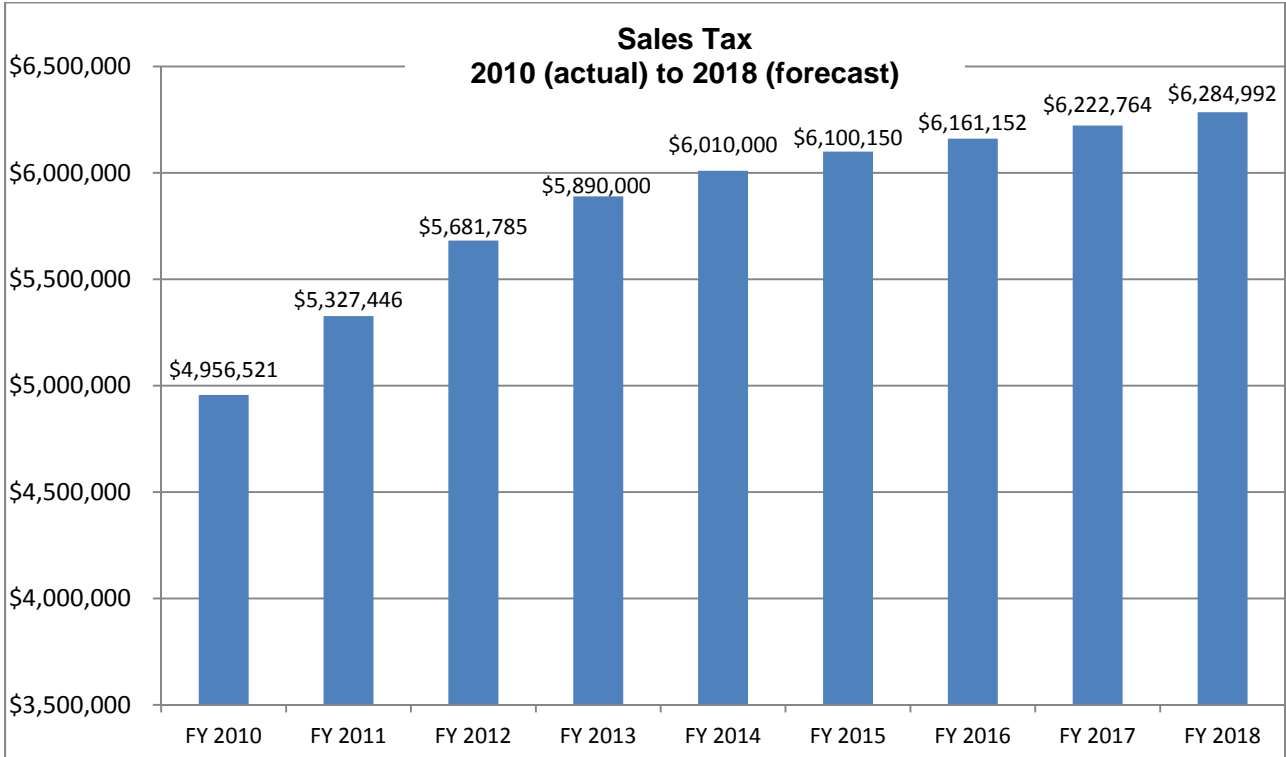
Transient Occupancy Tax							
Actual	Actual	Budget	Budget	Forecast	Forecast	Forecast	Forecast
FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
\$4,631,315	\$4,736,202	\$4,781,869	\$4,850,000	\$4,922,750	\$4,971,978	\$5,021,698	\$5,071,915
% Change:	2%	1%	1%	1.5%	1%	1%	1%



Sales Tax Revenue

General sales tax is the City’s third largest revenue source and represents 13% of the total projected General Fund revenue for FY 2014. In addition, the City receives sales tax from the passage of Measure Q, which contributes additional 7% to the City’s General Fund. In FY 2011 and FY 2012, sales tax revenue was 7% higher than the previous year. Despite the recent increases, for the forecast period FY 2015 through FY 2018, the increase is conservatively assumed to be nominal. If receipts exceed projections, the City Council may have an opportunity during mid-year budget review to determine an appropriate investment strategy.

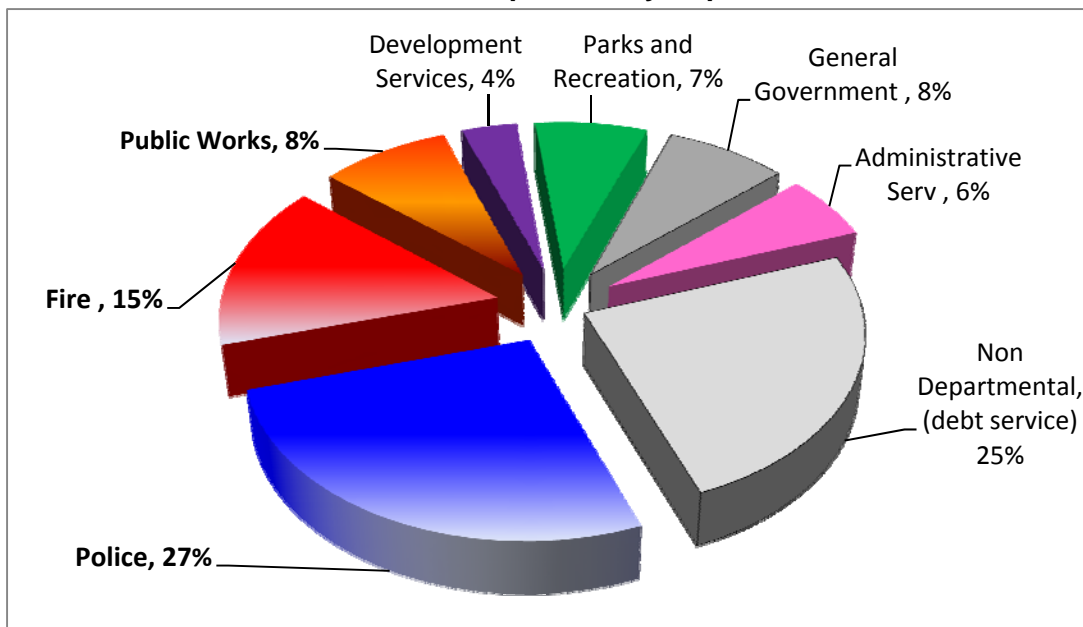
Sales Tax Revenue, 2011-2018							
Actual	Actual	Budget	Budget	Forecast	Forecast	Forecast	Forecast
FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
\$5,327,446	\$5,681,785	\$5,890,000	\$6,010,000	\$6,100,150	\$6,161,152	\$6,222,764	\$6,284,992
7%	7%	4%	2%	1.5%	1%	1%	1%



General Fund Expenses

General Fund expenditures are programmed at \$30.5M, balanced to the revenues budgeted at the same amount. Expenditures, by department, demonstrate the City's commitment to public safety and public works, the primary services on which the City was founded. Those services comprise 50% of the City's General Fund expenditures. Police services comprise the largest share of general fund expenditures (27%), followed by Fire (15%) and Public Works and General Government (8%). The remaining departments range between Parks and Recreation (7%) and Development Services (4%). Non-Departmental primarily includes 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). It is therefore not surprising that the largest expense of the City is personnel; salaries, pension, health care and other benefit costs. In the FY 2014 General Fund budget, these expenses represent **64%** of total General Fund expenses.

In reviewing the City's budgets over the last 30 years, the City's practice has been to reduce the workforce during recessionary periods and rebuild the workforce during recovery periods. This boom-bust cycle of budgeting repeated itself many times. It would serve employees and the public better if a fourth revenue source was created: **Recreation**. Investment in South Lake Tahoe's industry, recreation, can provide returns that could be utilized to rebuild the City's infrastructure, streets and facilities and bolster public safety services. Investing first in the community and our agreed upon industry, will create jobs for the local economy, promote private investment, and simultaneously bolster the City's general fund.

Additionally, it is recommended that the City adopt a financial policy directing additional reserves be set aside during the “boom” cycle while acknowledging those funds would be used during the “bust” cycles particularly to offset the expected upsurge in pension costs as a result of new CalPERS policies (see Pension discussion later in this message). Recognizing that the City will likely face recessionary periods and escalating pension costs in the future, a policy directing the set aside reserves would help to stabilize public service levels during economic down turns. **Most importantly**, the City must not repeat the patterns of the past when economic recovery happens. Instead, the City should use periods of growth to strongly invest in infrastructure, tourist amenities (with demonstrated return on investment) and vigorously supplement the general fund reserve account.

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 **73%** of salaries and benefits.

Salaries and Benefits by Department		
Police	\$ 7,668,908	39%
Fire	4,476,506	23%
Public Works	2,115,462	11%
General Government	1,706,698	9%
Parks and Recreation	1,379,399	7%
Administrative Services	1,397,136	7%
Development Services	1,035,612	5%
Total	19,579,721	100%

One area of concern, as shown on the table below, is demonstrated when evaluating salaries and benefits by collective bargaining group. Overtime, primarily in public safety departments continues to be difficult to control. As shown, overtime increased by nearly 18% in FY 2014 and had already been increased from FY 2012 to FY 2013 by nearly 40% (from \$370k to \$520k) (those figures are not shown). Overtime costs are primarily due to staffing shortages, injuries, minimum staffing requirements and service demands.

Salaries and Benefits, by Collective Bargaining Group				
<u>Salaries & Benefits</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>% Difference 2013-2014</u>	<u>% of total 2014</u>
Safety Police	5,826,174	5,841,152	0.3%	30%
Safety Fire	4,227,851	4,148,229	-1.9%	21%
Misc.	8,152,682	8,346,963	2.4%	43%
Subtotal	18,206,707	18,336,344	0.7%	94%
Temp Employees	884,684	830,104	-6.2%	4%
Overtime	520,701	613,274	17.8%	3%
Payouts	49,161			
TOTAL	19,661,253	19,579,721	-0.4%	100%

Pension Cost

The unrelenting rise in pension cost is impeding local and state government's ability to stabilize their budget during a slow economic recovery. The cost of public pension benefits are increasing faster than the reduction in expenses, resulting in benefits being provided to former employees at the expense of providing public services. That outcome is untenable and not supported by the public. The City's current unfunded pension liability is **\$53.6 million**.

How did we get here? Although it has been said before, in 2002 and 2003, CalPERS offered incredibly generous retirement packages to partner agencies at "zero" cost to the employer because funds were "super funded." It didn't take long for most employees and member agencies to adopt the new benefit packages jumping in to what is now a retirement benefit *money pit*. Elected officials today are now in the unenviable position of having to account to the public for past decisions to provide these costly benefits. Councilmembers and City administrators must respond to the strong public sentiment that recognize these retirement costs and other post-retirement benefits (retiree health insurance) are indefensible. In years past, public sentiment supported public employees, pensions and benefits due to the recognition that services provided tend to be dangerous and demanding, especially those in the public safety fields. However, today, the public pressure is equally loud as the demand to reduce these costs outweighs public support.

The City of South Lake Tahoe employees are to be commended for accepting the realities of the recessionary impacts on the General Fund. They have stepped up and contributed to the solution by paying their employee share of the cost of retirement benefits. By October 1, 2012, all employee groups were paying their full employee share (7% to 9% of salary).

PEPRA (Public Employee Pension Reform Act)

The Public Employees Pension Reform Act (PEPRA) signed into law in 2012 became effective January 1, 2013. PEPRA will provide some relief to cities in the long run, but the Act does little to help offset rising costs in the near term. The League of California Cities and City Managers throughout California support additional amendments to the legislation that would allow public employers to renegotiate current retirement packages. It's a simple strategy: The costs of retirement benefits will be reduced when the amount of the benefits provided are reduced, which requires negotiating lower benefits for *current* employees.

However, CalPERS does not allow cities to renegotiate current benefit packages. Instead, cities must adopt a new retirement benefit package that applies only to *new hires*. Those benefit plans become 'tiered benefits,' meaning employees hired after enactment of the lower benefits are on a lower benefit plan than current employees. However, a drawback to that process is that the tiers become closed loops and as employees in those tiers retire, fewer and fewer active employees pay into the system, thus increasing the cost of that plan, exponentially. In addition, providing different benefits to employees working for the same organization, doing similar work, can negatively impact organizational culture. CalPERS will not change this regulation unless sufficient public pressure is placed on legislators who can enact the change.

City's Unsustainable Health Care Benefit Plan

One year ago, during the FY 2013 budget workshop and subsequent budget presentation, the City's Health Care Benefit Plan design was identified as a **significant** financial burden to the City. Further, the plan as designed, is destined to fail and is unsustainable. For the past year, the City Manager, Human Resources Manager and Health Care Cost Containment Committee discussed this issue. We sought and obtained a new health insurance broker, Keenan and Associates. We sought and developed solutions to solving the health care plan design flaws.

Currently, the City employs approximately 170 permanent employees. However, there are nearly 800 lives in the health care program. Back in the late 1970s, health care benefits were offered to one or more employees who retired and needed health care. Agreements with labor groups soon allowed all retirees to stay on the City's health care plan. Similarly, when one employee or retiree was offered to stay on the plan at no cost, others soon followed and then dependents were added and when a retiree passed away, their spouse was allowed to stay on the plan, and then other spouses were allowed on the plan. Currently, the number of retirees and their dependents comprise about half of the lives in the program.

Plan Design Changes Over the Years

Active employees determine the plan design through agreement. By the late 1990s, in order to reduce costs plan design changes were implemented and in 2000, plan design changes offered different benefits for employees compared to retirees. In the late 1990s various benefits were eliminated or offered to people retiring in 1997, 1998 and 2000. In 2000, as a retiree, spouses and dependents were eliminated from coverage for anyone hired after 2001. In 2007, all those hired after January 1, 2008 were no longer be eligible for the program. In 2012, drastic plan design changes were implemented to reduce costs, which included increasing the deductible (\$750 per person) and raising the out of pocket maximum contribution to \$4,000 per year, per participant (for a family of three, that's \$12,000 they may likely result in paying).

Those plan design changes have created three groups of benefit participants: (1) employees hired and retired before 2000, (2) employees hired between 2001 and 2007 and (3) employees hired after 2008. The consequence of these plan design changes have resulted in a group of active employees (all those hired after 2001 and in particularly after 2008) who are not willing to reduce their wages and other retirement benefits, to fund a benefit plan that they will not even be entitled to receive.

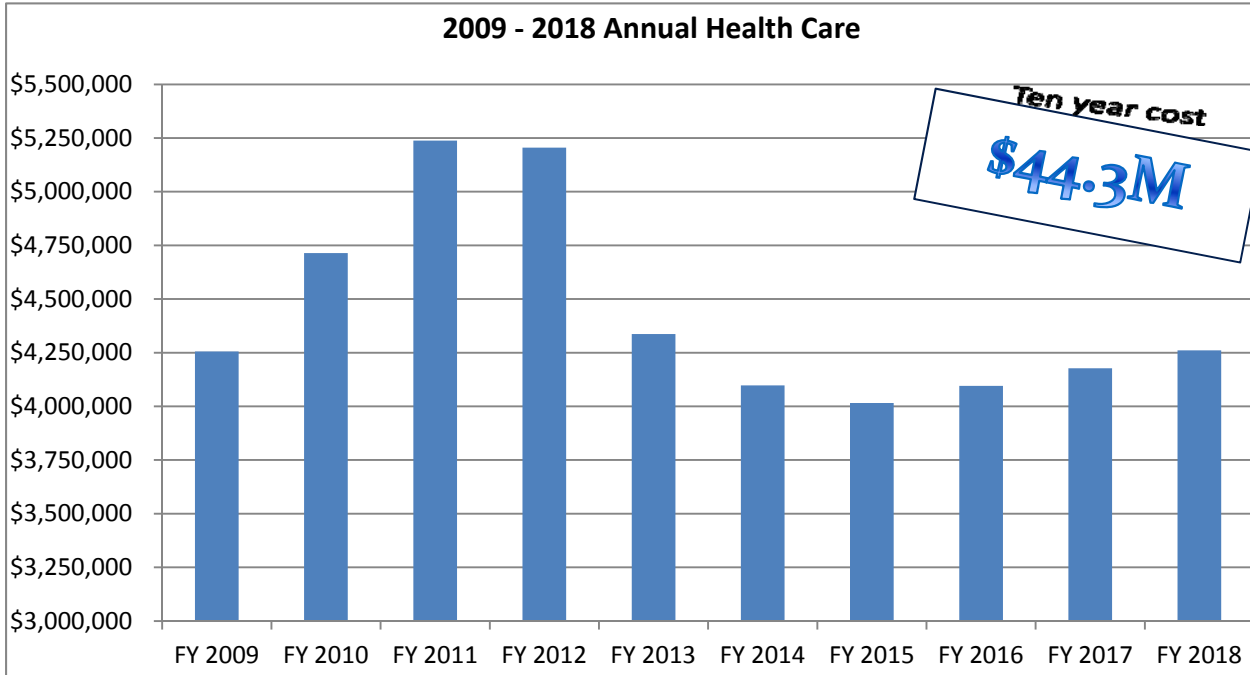
During the recession with massive layoffs and cutbacks, suggestions for health care plan design suggestions included eliminating the coverage all together or reducing it to catastrophic only, in order to save jobs or offset rising benefit expenses. These are reasonable suggestions given the circumstances. Employees, City Management and the Health Care Cost Containment Committee investigated alternatives including utilizing CalPERs Health Plan as the benefit provider because CalPERs reduces (and caps) the amount of contribution for retirees to approximately \$115 per month, compared to the City's cost of \$1,500 (family rate). However, continually reacting to the rising costs by implementing drastic cuts to the health care plan design doesn't produce a very good health plan, but does result in costs savings.

The City of South Lake Tahoe is one of few cities in the state that offers retiree medical insurance to the *wives and dependants* of retired employees at *no-cost-to-employee/retiree*. Employees who retire after 25 years of service are provided these benefits *at no cost – for life* - except for deductibles and out-of-pocket expenses. It may be reasonable to provide such a benefit to an *employee* who gave long years of service to the City, in this example 25 years. Where it becomes irresponsible, is when the benefit is also given, to their spouse and dependants and then continues *even after the death of the retiree*. If an employee retires after less than 25 years of service, the benefit is still offered, but the retiree contributes to a portion of the cost.

As shown below, the City is now paying nearly as much for retirees as it does for active employees. The FY 2014 budget includes \$4.1 million for health care, which represents **13%** of total general fund expenses. Costs decreased in FY 2013 due to the reductions in workforce, implementation of drastic changes to the plan design and the implementation of the first step of a three step solution to the health care plan design.

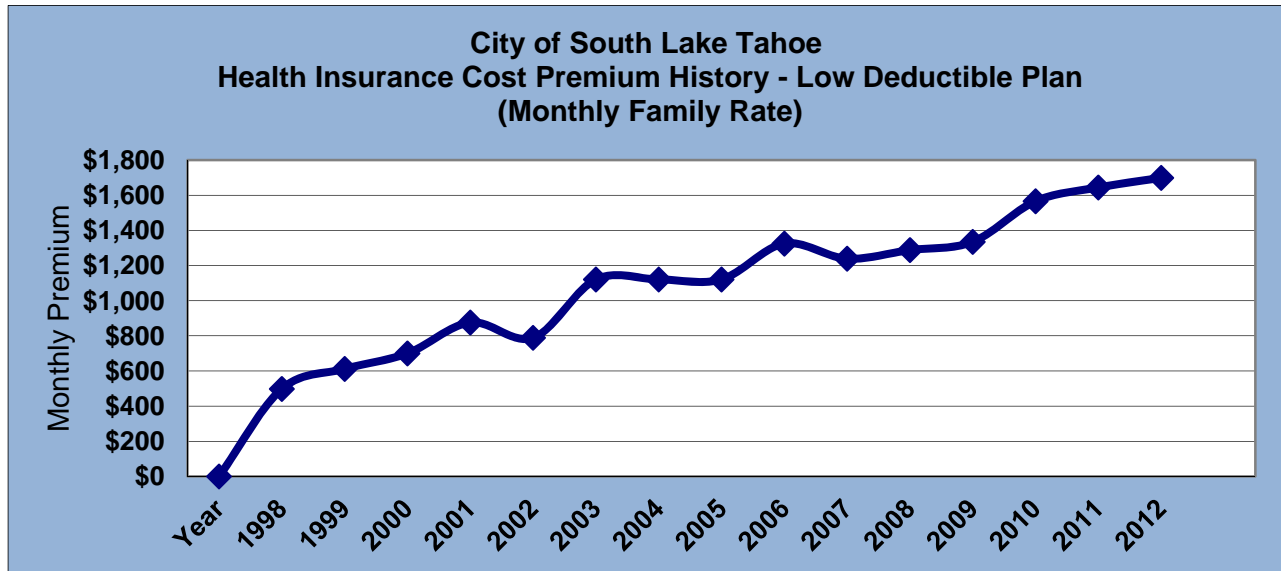
Health Care Cost 2011-2018								
	Budget	Budget	Budget	Budget	Forecast	Forecast	Forecast	Forecast
	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
EE	\$3,403,646	\$3,215,411	\$2,477,850	\$2,641,291	\$2,588,465	\$2,640,234	\$2,693,039	\$2,746,900
Ret	\$1,834,329	\$1,989,712	\$1,859,107	\$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

Reviewing ten years of financial impact to the City’s General Fund as shown below, the City has expended **\$44.3 million** covering the cost of health care for employees, former employees and their dependents.



Health Insurance Premium Rates

Although substantial Plan Design changes have been implemented over the past 10 years with a goal of reducing costs, the chart below demonstrates that the plan design is the fatal flaw. Since 1998, **costs have risen by 240%**, regardless of how many cuts and reductions in benefit coverage the City has implemented. In the past ten years, premium costs have risen by \$113%. The reason costs continually rise, is similar to the pension benefit cost issue. As employees retire, there are fewer active employees in the system, as a percentage of those retired. These costs are a burden upon active employee salaries and thus, the premium rates rise.



Three Step Solution

We took a proactive approach to solving this problem rather than continually reacting to rising costs. Following thorough investigation, a three-step solution was developed:

1. **Medicare-eligible retirees.** Retirees age 65 and over will continue to join Medicare as their primary insurance provider. However, Medicare supplemental plans will be their secondary insurance rather than the City's current provider. It is correct that Medicare eligible retirees were provided *both* Medicare and the City's plan as secondary. All labor groups have agreed to implementation of this plan design change for 2014. Meetings were held with retirees and individual assistance has been and will continue to be provided during the transition.
2. **Early Retirees** (under age 65). It is projected that Early Retirees may have similar opportunities through health plans offered through the Affordable Health Care Act. Labor groups, and the health care committee are watching implementation.
3. With Step 1 and 2 in place, **Active Employees** will solicit health benefit plan insurance providers, or join a large network at an expected lower cost with more plan options.

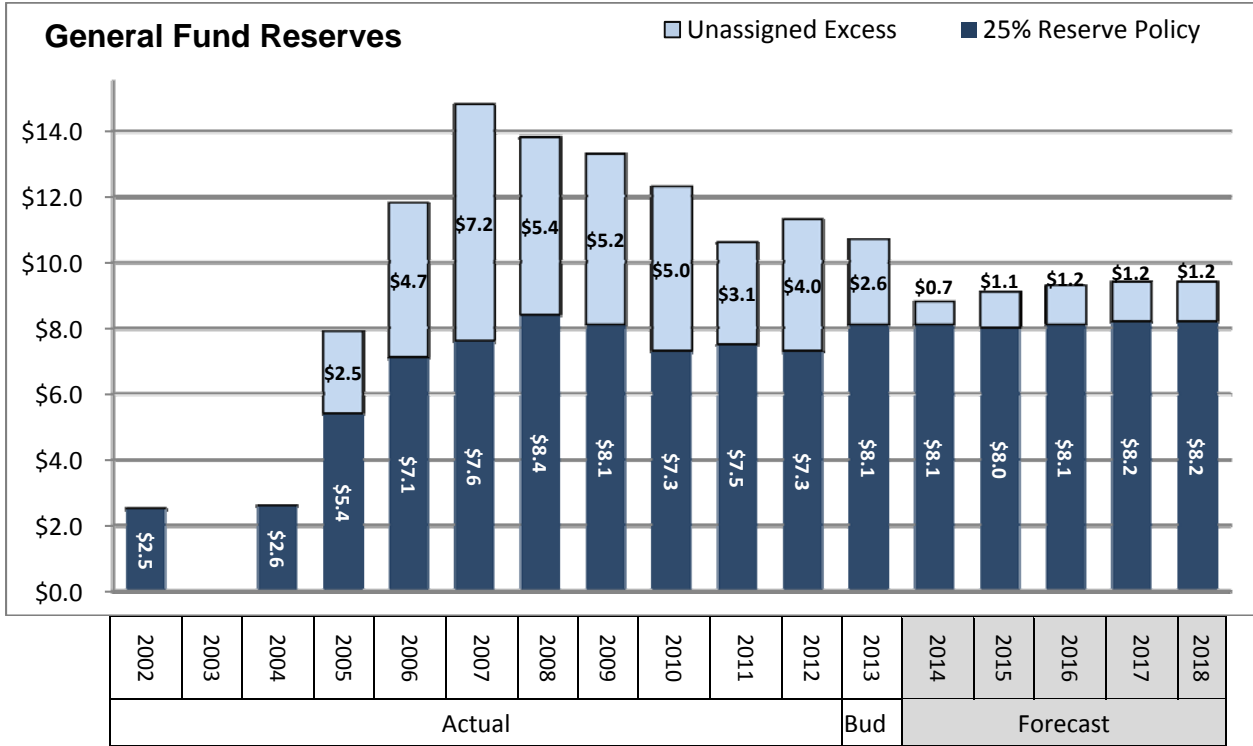
Without these changes, the City will have to implement catastrophic only health care and seek legal protection for unfunded liability. By implementing these solutions, the City moves toward reducing this significant financial burden.

General Fund Reserves

25 % General Fund Reserve Policy

As shown on the chart below, in 2003, the City’s General Fund Reserves were **zero**. In 2005, the City adopted and implemented General Fund Revenue Reserve policy 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 excess funds from the Health Care Fund, Workers’ Compensation Fund, and General Fund Excess Reserves along with significant staffing reorganization and reductions, broad expense reductions, and employee concessions and contributions. Throughout the recession, the City’s adopted 25% reserve policy has been maintained even as excess reserves were utilized to fill the budget gaps. In fact, 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 2013, the General Fund Reserve Fund Balance is projected to be \$10.7M, which is \$2.6M (or 8%) above the 25% minimum reserve requirement. During FY 2014, the City anticipates borrowing approximately \$1.9M for capital investment expenditures, leaving a balance in excess reserves of \$700,000. The \$1.9M in capital investment expenditures are not included in the FY 2014 General Fund budget; they will be budgeted at the time of the expense and repaid over ten years.



Improve the Built Environment – *We’re Still Delivering!*

Another key feature of the FY 2014 budget includes a continued focus on the Strategic Priority to Improve the Built Environment. Improving the Built Environment will produce lasting change in South Lake Tahoe. The summer of 2013 brought nearly \$30 million dollars of capital investment into the community, some of which will continue into the summer 2014. Private capital investment also arrived in 2013, bringing with it jobs, new businesses and environmental improvements. The long awaited reigniting of the Chateau project got underway in August, 2013 with an expected completion date on the retail frontage of June 2014.

The following are projects begun in 2013, to be completed in 2014 and 2015:

- Linear Park Rehabilitation, construction begun summer 2013.
- Bijou Area Erosion Control Project Phase 1 is underway and with an expected completion date of 2015. This project is an innovative “pump and treat” storm water control project.
- Pioneer Trail Pedestrian Sidewalks Project is underway and will provide sidewalks and lighting on both sides of Pioneer Trail between Echo Road and Larch Avenue, with an effort to extend to Ski Run Boulevard by 2015.
- Acquisition has begun for El Dorado Beach to Ski Run Bike Trail Project, which is intended to fill critical gaps in class 1 bike trails adjacent US highway 50 between El Dorado Beach and Ski Run Boulevard.
- The Class 1 Bicycle Trail Rehabilitation and Replacement Project got underway in the fall of 2013.
- 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 2014 scheduled construction, pending identification of funding sources.

FY 2014 budget includes funding for construction of the following capital projects:

- Harrison Avenue Streetscape Project has an expected May 2014 ground breaking. This project will provide significant street and frontage improvements in the Harrison Avenue business district.
- Citywide ADA Facility Improvements Project will provide ADA improvements at various City Facilities based on a developed priority schedule. Phase 1 scheduled and budgeted for summer 2014.
- Improvements to Fire Station #2 are scheduled for construction October, 2013.
- Improvements to parking on Lakeshore Drive are scheduled for design and bidding, winter 2013/2014 with a projected construction date of Summer 2014. Funding is projected from General Fund Balance, excess reserves.

An Opportunity for Further Investment?

While the budget is balanced, and includes significant capital investment, the City Council may have an opportunity to further invest in the community and infrastructure during mid-year budget review (March 2014). Current national economic trends indicate we are in a slow economic recovery thus, revenue projections were budgeted conservatively. If revenues exceed projections, the City Council will have funds available to further invest in strategic priorities, including Improving the Built Environment and Economic Development. These options have not been available to the City Council for many years and thus, there are many needs.

If investments are considered, they should be prioritized based on City Council priorities, return on investment and community impact. The following recommendations and suggestions have been offered by the City's senior management team:

- **Community investment**

Business Plan: Fixin' 50 Initiative. The City's business plan included a comprehensive initiative to improve Highway 50 frontage. Investing in this initiative could incentive business owners to improve their façade, improve sidewalks and storefronts and improve landscaping and lighting.

Parks, Trails and Recreation Master Plan Capital Plan. When the Master Plan is complete, funding will be needed to invest in recreation programming and facility upgrades.

- **Facility and Asset Management investment**

A Maintenance and Asset Replacement Plan will be developed in FY 2014; it will identify and prioritize asset and facility management and replacement needs. A comprehensive plan has not been previously conducted. Once the needs are identified, investing in the plan will need to become a priority.

- **Organizational investment**

Public Safety: A recommendation by the Fire Chief to develop a Fire Department Apprenticeship program has been submitted. The apprenticeship program is expected to provide the next generation of recruits for full time positions and offset the impacts of the current management structure. 911-Dispatch call center staffing requirements are not currently being met; additional part time staff is needed.

Recreation: providing excellent recreation requires additional programming and staff to meet demands and create enhanced services.

Special Events: The strategic priority and business plan initiative to attract and assist with new special events would require additional staffing.

Summary

The FY 2014 budget continues our march toward fiscal sustainability with a continued focus on delivering **Quality Core Services** to the community. The City is beginning to reap the benefits of having faced the hard decisions, head on during the past few years. Employees have provided concessions including salary reductions, contributions to retirement, have supported solutions to the health care costs and continue to take ownership of the organization.

As stated in the beginning of this message, there is daylight at the end of this long tunnel, but we must stay diligent and fervent in our approach to revenues and expenditures and not repeat the practices of the past 30 years. We must be ever diligent and conscientious in preparing the budget and planning for the upcoming period of recovery. The City's reorganization several years ago set us on the right path to fiscal sustainability and we must stay the course.

With the adoption of the FY 2014 budget as presented, the City is adopting a balanced budget that for the first time in five years does not include layoffs, furloughs, salary reductions or service reductions. We're moving forward on significant capital investment to Improve the Built Environment and there may be opportunity during mid-year budget adjustments for the City Council to invest further. The long awaited Harrison Avenue Project will get underway in 2014. 2014 will also see the completion of our signature capital project, the Bijou Area Erosion Control Project. The Linear Park project was started in 2013 and will be completed in 2014. This past year, we have aggressively worked with our local private and public partners to agree upon a course of action for the community to encourage capital investment in recreation as a catalyst for local economic recovery. We have dealt with the loss of redevelopment and tackled the dissolution process with a commitment to City's fiscal preservation by working with the State Department of Finance in order to utilize our fund balances for debt service, saving the City's general fund reserves from having to meet the shortfall.

The City's organization has developed a noticeable sense of team, and pride in their organization which is expected to continue and increase. I am proud to be a member of this team and leading this organization toward brighter days. I appreciate the City Council's efforts over the past few years; having faced difficult financial challenges with courage and professionalism by enacting the necessary changes to set a course towards fiscal sustainability.

This year we will continue to deliver what the community expects 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 2014 budget is Respectfully Submitted,

Nancy Kerry, City Manager