

**BEFORE THE LOCAL BOUNDARY COMMISSION
ALASKA DEPARTMENT OF COMMUNITY AND
ECONOMIC DEVELOPMENT**

In the matter of the Petition for)
Consolidation of the Ketchikan)
Gateway Borough and the City of)
Ketchikan into the Municipality of)
Ketchikan, a Home Rule Borough)

**KETCHIKAN CHARTER COMMISSION'S
REPLY BRIEF**

The Ketchikan Charter Commission (KCC) reviewed the brief and comments submitted to the Local Boundary Commission by the City of Ketchikan, the Ketchikan Gateway Borough and City Mayor Bob Weinstein. We met with representatives of both the City and the Borough extensively to address the concerns expressed in their submittals. We agreed to modify our petition for clarity, to address errors and omissions and to find compromises.

RESPONSE TO THE CITY OF KETCHIKAN BRIEF

The City's brief was very specific and we will address it first in our reply. This reply is by no means comprehensive, but will attempt to follow the format utilized by the City:

The City identified four areas of significant deviation from their petition in 2000:

- a) The introduction of a tight property tax cap;
- b) A super-majority vote for fee increases;
- c) A re-allocation of financial resources from the City to the areawide municipality;
and
- d) A reduction in sales tax revenues available for services within the City.

The KCC modified our petition documents as follows:

- a) Repealed the tax cap in favor of a super-majority to increase the tax rate for both property and sales tax;
- b) Deleted the supermajority requirement for fees;
- c) Addressed the re-allocation of financial resources under consolidation;
- d) Restored the 0.25% Public Works sales tax to the Gateway Service Area; and
- e) Modified our Budget Projection (see Attachment A for a detailed description of changes to the budget).

Plausible Operating Budget Issues

The City commented, “The actual budgets of the new government and the taxes necessary to fund those budgets will not resemble the figures projected in the Petition.” The KCC agrees with this statement: Due to the nature of the consolidation process that requires approximately two years to complete, there is little chance that anyone can predict a budget that far into the future with any accuracy. The KCC “zeal” was to provide a demonstration that a consolidated Assembly would have sufficient resources to create and manage the combined entity based on information (current budgets) the KCC possessed when the Petition was filed. The KCC intended that the new Assembly would have wide latitude to address issues arising in the interim period, as well as equity issues.

Government’s Operating Costs

The City claimed that the Petition seriously understated personnel and general operating costs. Specifically, that personnel costs would increase at an annual rate of 2-% and that this assumption does not account for the rising cost of PERS, Worker’s Compensation and health insurance.

The KCC used an overall inflation rate of 2% per year across the board, including personnel costs. While some existing costs may increase more than 2%, others may not increase at all or may even be eliminated. This is a standard *budgeting* technique to account for overall inflation. The KCC did not ignore the PERS/TRS issue. We discussed it at length in our narrative. The problem arises between an advisory/feasibility document and actual practice. It is a political question left to elected officials regarding how to fund these extraordinary expenses: one can increase taxes, decrease services or, for a while, use reserves. Since neither elected government had determined the method they planned to address the PERS/TRS issue, it would be rather arrogant of the KCC to decide for them in a feasibility document. Certainly, we could have simply shown a tax increase, however, we would not then be comparing apples with apples since neither existing budget (which was the basis for our budget) included a provision for a PERS/TRS tax increase. It is possible that the State of Alaska may use some of its windfall oil revenue to bail out the local governments. It is likely this will remain an issue until the local elected governments decide how they are going to deal with it.

The problem with including these costs in our budget is that they can be misinterpreted by unsophisticated observers that consolidation in and of itself will cause an increase in taxes, a reduction in services, or a draw-down in reserves which is not necessarily the case. These *extraordinary* costs may be inevitable, but to include them in the consolidation budget skews the comparison between “now” and “then”.

The KCC determined that we would revise our budget documents to include a reasonable estimate of these cost increases and “let the chips fall where they may”. The increase in costs created a deficit of approximately \$2.1 million per year. This

deficit is approximately equivalent to an areawide increase of 1% in the sales tax or about 2 mills in property taxes or some combination of the two. Additionally, some cost savings may be found in later years (or State assistance) to help offset this, but these are not projected in the revised budget. These costs are fairly evenly distributed between the existing Borough, City and Ketchikan Public Utilities and highlight the challenges these entities face in the very near future.

The City asserted “A budget that ignores increases in these costs is useless as a plan or a projection”. The KCC would concur with this statement to a degree. The Petition’s budget was never intended to be adopted by the new consolidated Assembly as a rubber stamp. It was not an operating plan or projection. It would be foolish to assume we could look that far ahead. Rather it was an attempt to show that there are sufficient financial resources to consolidate. The budget the KCC adopted is *feasible* based on the then *current* known and measurable data.

Given that these large costs are out there, the City was further alarmed because of the property tax cap of 10 mills. The property tax cap eliminated easy access to a revenue source and thus limited the new government’s options to address the problem. The KCC eliminated the property tax cap from its Petition and Charter.

Increases in Property Values

The City stated that the KCC assumption of a 1% increase in property values was unlikely. KCC confirmed with the local Assessment Department that 1% is a conservative figure. In 2005, assessed property values were \$1,024,185,000, an increase of 3.8% over 2004 values.

Staffing Plan

The KCC did not attempt to cut combined staffing beyond obvious duplication at the executive level and the obvious duplication of Assembly/Council. This is definitely an area where some savings could be found. For example, the combined finance department would have a total of 23 employees that may be excessive for an organization this size on an ongoing basis. There are other departments where savings could be made as well, but the KCC felt that those decisions were best left to the new Manager and Assembly. It was assumed there should be ample funds in KPU’s budget to cover the cost of its management functions, regardless of the individuals, and that KPU would have to reorganize its staff under the new regime since those specific employees, like the City Manager, who serve in a dual capacity and whose employee costs are currently split between the City and KPU will more than likely take on just one position, ending the dual responsibilities.

Subsidizing the General Fund

The City correctly asserts that the consolidated budget continues the current practice of subsidizing the General Fund with earnings from specially designated accounts. This is

the current practice of the City regarding its Public Works and Hospital Sales Tax funds and the Transient Occupancy Tax fund, as well as the Borough's Land Trust Fund.

The City stated that after the third year of consolidated government, the \$1,862,316 transferred into the General Fund will be spent and a property tax increase would be necessary. This is simply *not true*. None of the principal of these funds was to be transferred, only the earnings (interest). Furthermore, the programs are funded in the KCC budget *before* any funds are transferred. KCC acknowledges that this subsidy is intended to reduce the need for tax increases and it is about 2 mills. We note, however, that not only is this the current practice but all the funds so used are available for that purpose.

The City's comment that the Hospital Sales Tax Fund subsidy will not be available due to the City's decision to use those funds for roof repairs that may be covered by a warranty claim against a contractor is spurious. The use of those earnings represents a transient *financing* choice by City management. The funds for those repairs could have been pulled from other sources such as bonds, inter-fund loans, or reserves and those expended funds are expected to be recovered from the contractor. The revenues from this fund are generated by an ongoing sales tax and will be available to the consolidated Municipality as a revenue source in subsequent years.

Similarly, the comment regarding the Borough's Land Trust Fund is not true. The Borough budget used in the KCC budget allocated funds for debt service and Ward Cove *before* transfers to the General Fund. Ward Cove is in the process of being sold and the ongoing operational costs at that facility may be eliminated prior to a vote on consolidation.

City's Economic Development and Parking Fund

The City objected to the combination of their Economic Development Fund with the Borough's Economic Development fund on the basis that it is already committed to the port expansion project. This objection was noted previously and the funds have been segregated in our revised budget.

The KCC budget included all of the costs in the underlying Borough Budget for Ward Cove operations. As noted above, the Borough is selling its interest in Ward Cove and, to date, has received over \$3 million, with a final \$9 million deal pending to sell the remainder. This illustrates the "moving target" nature of the budget process.

Risks and Costs to City Residents

The City stated in part "City residents need greater protection from increased costs and taxes." KCC would agree whole-heartedly. In every case, the KCC attempted to allow the new Assembly the greatest latitude in determining fair and equitable government while placing reasonable restraints on a "tax and spend" mentality that so many governments adopt over time.

Payments in Lieu of Taxes

The City complained that the Gateway Service Area would need a Payment in Lieu of Taxes (PILT) from the Port of Ketchikan and Ketchikan Public Utilities to balance its budget. Currently, the City receives \$650,000 from KPU and \$102,000 from the Port. The KCC agreed that services provided by the Gateway Service Area to the Port and KPU need to be compensated.

The KCC budget has been modified to incorporate the above PILT. The PILT funds paid to the Municipal General Fund have been maintained at their current levels to support general government in lieu of property taxes.

Sales Tax Revenue

The KCC budget had moved 0.25% of City Public Works sales tax to the areawide General Fund. The City objected to this transfer since it removed approximately \$560,000 from the Public Works fund that is required for ongoing capital investment and infrastructure. In our revised budget KCC restored that tax to its original level in the Gateway Service Area..

Asset Allocation

The City objected to the transfer of 20% of the net assets of the City's general fund and 100% of the Economic Development & Parking Fund to the new borough's corresponding funds. The Economic Development Fund issue has been discussed previously.

The 20% figure was an amount that had been previously agreed to by City staff and the KCC. The City states, "the net assets of the City's General Fund were derived from programs that generated surplus revenues" but they then assert that those entities to be transferred to an areawide basis did not generate surpluses and therefore did not contribute to the net balance. This is a shortsighted position considering the complexity and cross-subsidy nature of the City's budget and the various revenue sources (including the approximate 33% of City locally paid sales tax revenues paid by residents from outside the city limits). The KCC took the view that the surplus balance was insurance against future disasters, unforeseen events or extraordinary costs (like the hospital roof). Thus some portion of the general fund surplus should be "attached" to the assets being transferred: the Museum, Library, and Civic Center. The City itself states, "Large reserves are necessary to fund these services and the inevitable emergencies arising when facilities fail."

Although the City has spent only \$80,000 annually since 1998 on these assets, perhaps it is because there is a planned replacement of the Library (latest budget \$13 million) and the Civic Center is fairly new. It would also be interesting to determine what

percentage that \$80,000 is to the overall maintenance and capital improvements of those facilities.

While not a major issue from an operating budget standpoint, the KCC prefers that the new Assembly should delegate the decision as to what is a fair and equitable split between the remaining service area and the areawide general fund. Our revised budget exhibit F-2 reverses this allocation of fund balances and starts out with the projected fund balances from the City and Borough.

Annexation

The KCC agrees with the City's comment: "It was, of course, impossible for the consolidation Petition to anticipate this potential annexation." It still is a moving target. We have not adjusted our budget to reflect annexation estimates.

Cap on Fees

As stated previously, the super majority vote on fees was redacted by the KCC.

Refunding of Revenue Bonds

The entire bonding section of the Charter was reviewed and re-written in concert with Mr. David Thompson, bond attorney for both the City and Borough. We believe all substantive matters regarding bonds have been addressed adequately.

KPU Water Division

Both the KPU Water Division and Electric Division are subsidized by the Telephone utility. Telephone rates are paid on an areawide basis, thus folks outside the city limits are paying, in part, for City water. The KCC did not intend to rip KPU apart, but did intend that the Assembly have the discretion to address equity issues sometime down the road. The Charter merely requires a full accounting of the water subsidy.

Naming

The KCC spent several agonizing sessions struggling with naming conventions. The names selected were after an exhaustive public process. KCC remains open to suggestions for better names, but until and unless someone comes forward, we stand by our names. Furthermore, we would like someone to explain the legal difference between a geographic name and a municipal name; it is our understanding that the naming conventions we used are legal and proper.

Solid Waste

Solid waste disposal is slated to be an areawide function under the new General fund, thus it was separated from the Gateway Service Area's solid waste collection fund for

accounting purposes. There is no reason that the current operational synergies cannot continue under this scenario: the costs will still need to be identified by function.

New Bond Issues

The KCC determined that it is counterproductive to continually update the budget document for changing circumstances. The entire process could take years and finances change daily. Again, it is the problem of the moving target and feasibility.

Miscellaneous

These miscellaneous corrections were incorporated into Exhibit F & J.

RESPONSE TO THE KETCHIKAN GATEWAY BOROUGH 9/21/04 RESPONSIVE LETTER

Part of initial paragraph of the Ketchikan Gateway Borough's responsive letter dated September 21, 2004 reads as follows:

“The consolidation petition, Charter, transition plan, and three-year budget provide an adequate basis for creation of a new consolidated municipality. There are likely innumerable specific policy issues or choices made in the petition which could be debated but never fully resolved to the satisfaction of all because not everyone shares the same opinions. However, we do not believe that any of these points present legal defects with the petition or the organization proposed.”

The KGB letter then goes on to say that the choices made in the petition may be subject to LBC scrutiny and possible recommended changes by the LBC, while further detailing these choices and pointing out errors and omissions that should be corrected.

The Ketchikan Charter Commission fully appreciates the remarks tendered by the KGB and, while some of the policy issues discussed by the KGB were affirmed, all of the noted items of a clerical or “housekeeping” nature were corrected. The following represents a short discussion on the points raised by the KGB in their letter.

Policy Recommendations – Exhibit J-1

The KCC firmly believes that it is not the role of the Commission to be legislators, but to suggest a form and path that the newly elected Assembly can refer to as they begin the huge task of merging the two governmental bodies. With that said, the suggestions included in Exhibit J-1 are mostly policy decisions that **should** be made by those legislators chosen by the electorate.

Clerical (Housekeeping) Changes Made

The following items (with their numerical reference from the KGB's letter) were corrected in the Petition documents:

#2 - removal of footnote, #7 - correction in written & numerical reference, #9 – reference to Land Trust Fund, #10 – service area powers, #11 – budget labels, #'s 12 & 18 – water service reference

Charter Section 3.02(b)

This section was amended by changing the word “substantively” to the phrase “which materially change the subject of the ordinance”, however, the amendment did not address the comments regarding what would occur if an amendment is made on the second reading of the ordinance that materially changes the subject of the ordinance. This omission can easily be rectified by ordinance of the new Assembly.

Appointing Authority

The KGB mentioned that in Section 7.01(a) of the Charter, the Assembly is listed as the appointing authority for planning commission members, however, there is no indication of where a list of candidates would originate. The KCC felt that this was a legislative matter and should be determined by the new Assembly in an ordinance specifying those procedures.

Property Tax Cap

As indicated in the discussion of the City's brief, the tax cap was removed from the Charter.

Raising Taxes and Fees

Section 10.08 of the Charter was amended to remove the super-majority requirement for raising fees and also stipulated that any rate of sales tax levy or property tax levy would be done “above the rate levied in the prior fiscal year”. The KCC further put a super-majority requirement on raising these taxes. The KGB's main concern in its remarks seemed to be the lack of specific language addressing the tax levels from one year to the next and we believe our modifications have satisfied those concerns.

Charter Article XI, Borrowing

The KGB commented on non-recourse bonding and avoidance of voter ratification. After extensive discussion and in-put from both the City Attorney, the Borough Attorney and both the City & Borough's bond counsel, Article XI was amended extensively, addressing the KGB's concerns.

Conflicting Statements in Charter Article XII, Section 12.03 (a)

This section was amended to remove the conflicting statements regarding the exercise of areawide powers.

De Minimus Changes to Service Areas

The KGB pointed out that Article XII, Section 12.04 (b) calls for votes for adding or subtracting property from a service area, but made no provision for a waiver of a public vote for a de minimus change in the service area. After very extensive discussion of the merits of setting a de minimus percentage in the Charter, the section was amended so that the Borough Assembly could, by ordinance, establish a process to provide for de minimus exemptions to boundary amendment that need not be approved by voters.

Public Works Facilities and Maintenance Expenses

The KGB pointed out that in Exhibit J of the Petition, the public works facility and vehicle maintenance for the GSA were discussed, but there was no discussion of those entities that are currently exercised by the Borough. Another item discussed was there was no mention in the Petition as to how to public facilities and vehicles will be allocated within the new Municipality; geographically or identified to the exercise of the power for which those facilities or vehicles are used.

Both of those points were noted as being worthy of further discussion in Exhibit J and that section of the Petition was re-written to clearly reflect the intent of the commission regarding these facilities, vehicles and maintenance expenses.

Procedures and Procurement

A plan as suggested by the KGB has been incorporated into Exhibit J regarding selection of procedures for the new Assembly and procurement policy until a Municipal procurement policy is issued.

Employees

The KGB pointed out that there may be a dichotomy between wages of IBEW-represented employees from the City and the Borough and these differences would need to be addressed. The KGB noted that Exhibit J-1 acknowledges this as an issue and while the wage differential will exist, the KCC did not feel that, at this juncture, it was material to the budgeted expenses for wages, as we are sure during an interim period, that all personnel will continue at their present rate of pay until new contracts can be negotiated and new wage scales set for positions.

Moving Targets

There were numerous “moving targets” listed in both the KGB and City comments. These included updating to current levels the bonded indebtedness, the maps for the various service areas whose changes occurred after the original Petition was submitted,

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specially designated account fund availability, and the possible Borough annexation of land.

While the KCC does agree that these numbers have (or will) change, by continuously updating the information in the Petition, we will create a conundrum that will require the necessity of updating the document without ever completing the process as we were elected to do.

Conclusion

Based on the changes made to the Charter and Petition, we believe we have substantially answered all of the objections and comments raised by the City and the Borough. Some of the issues raised, however, rise to the level of political choice. It is the considered opinion of the KCC that we are establishing a framework within which an elected political body can make those choices. The framework should provide the authority as well as appropriate checks and balances on political power. We believe it does so.

We further believe that we have sufficiently addressed the issues regarding the budget and financial plan such that an ordinary person can understand the issues and make an informed choice at the polls.

The consolidation process is not meant to simply “wring out costs savings and make efficiencies.” Those will hopefully come given time. Rather, it brings together all the people in a local geopolitical and economic area with one voice and one government for the betterment of all.

The City’s 2000 petition failed because while transferring the burden of areawide functions and cost to all taxpayers, it failed to consider existing support by non-city residents in the form of water subsidies and sales taxes. Thus, non-city residents rejected the tax burden. The KCC, on the other hand, started with the premise to keep the status quo in goods and services and *tax structure* to minimize the initial “shock of change”. However, financial circumstances unrelated to consolidation, forced a projected increase in taxes. This projected increase in taxes may, or may not materialize as discussed previously.

Hopefully the changes to the Petition in this brief will change the City staff’s opinion that “the Petition unreasonably harms City taxpayers”. That was certainly never the intent and we do not believe that to be the case.

Dated this _____ day of _____, 2005

Glen Thompson
Chair
Ketchikan Charter Commission

Attachment A

Budget Modifications

- In the original budget, we reallocated 0.25% of the City's existing Public Works Sales Tax to an areawide basis. This adjustment had the effect of transferring approximately \$560,000 of sales tax revenue from the GSA to the general fund of the new borough. The effect on the taxpayers was only about \$55,000, since most sales within the borough are subject to the tax currently. The City objected that this transfer would be detrimental and KCC agreed to reverse it.
- The City noted that the costs for 911 services should have been allocated on an 80/20 split between police and fire operations. The KCC made this adjustment in the budget document.
- The City commented that the elimination of a City Manager position had effectively cut ½ of a manager from KPU. It was never the intention to disrupt the operation of KPU by cutting staff so \$50,000 has been added to the KPU budget line to offset this inadvertent cut.
- At the request of the City, we have split the Economic Development and Parking Fund of the City and the Borough's Economic Development Fund and allocated the City's fund to the GSA.
- For purposes of clarity, the KCC reversed the entries made to balance the general fund of the new borough using Hospital Sales Tax Fund earnings, Land Trust Fund Earnings, and Transient Occupancy Tax Fund earnings. These monies remain available for that purpose should the new Assembly desire to allocate them.
- On September 2, 2005, the City of Ketchikan provided the KCC specific financial information regarding PERS and insurance costs.(See Attachment B) The KCC incorporated the City's information into our budget documents.
 - a) In Exhibit A, the City produced a strategy to pay for PERS and insurance costs by increasing transfer subsidies from the Public Works Sales Tax fund to the General Fund to avoid raising the mil levy. The KCC agrees that this is a method that both the City and Borough have used in the past to fund general government but offers two comments:
 - The use of these funds for general government purposes is in discord with the intended purpose of the tax and thus some elements of the Public Works maintenance and capital improvements might suffer or be postponed.

- The residents living outside city limits would effectively be paying a portion of the costs while deriving little benefit. Such inequities create friction in our small community.
 - b) The City's Exhibit B presented a proforma labor and employee benefit cost analysis. The KCC calculated the annual increase in overall personnel costs to be 4.58%. An analysis of the City's department overall costs (Exhibit A) indicated that 80% of departmental costs were personnel related. The KCC had been using a 2% annual inflation rate for departmental costs. The KCC therefore adjusted its inflation rate to a composite rate of 4.1% for general government and 3.2% for KPU in accordance with the City's data. This adjustment incorporated the estimated increase in PERS and medical insurance into the KCC budget and created a deficit of approximately \$2 million per year.
 - c) Exhibit C provided a proforma debt service estimate for the City's 2005 General Government Wastewater GO Bonds and the 2006 KPU Municipal Utility Revenue Bonds. The KCC determined that we would not incorporate this information into our budget documents unless directed by the LBC since these bonds were issued subsequent to the petition and are to be paid through user fees and subscriptions.
 - d) Exhibit D provided a narrative regarding Payment in Lieu of Taxes (PILT or PILOT). The KCC concurred that an additional PILT from the Ketchikan Port Fund and KPU to the GSA was appropriate and adjusted our budget accordingly. We further determined that the existing PILT in both the KPU budget and the Port budget would remain in place of "borough" property tax PILT.
 - e) In Exhibit E the City provided a rationale to discourage allocating net assets of the City's general fund to the new consolidated General Fund. The KCC believes that the new Assembly could determine an allocation, if appropriate. We therefore adjusted our beginning balances for the new General Fund and the GSA to eliminate any allocation. Please note that the Borough's balances were updated to reconcile to the 2005/2006 budget's fund balances for accuracy.
- The annual earnings of the Borough's Land Trust Fund appeared overstated. There was an adjusting entry on the originally submitted budget that did not appear to be related to the LTF in the amount of \$650,000. That entry has been deleted and the earnings of the fund now appear to reflect market returns.
 - In conclusion, in order to balance the budget subsequent to the inclusion of increased PERS and insurance cost estimates, the KCC increased areawide property tax revenues by 2 mils and re-instituted the fund transfers as a subsidy to the General Fund. (Both of these adjustments are incorporated in the revised

budget documents.) This 2-mil adjustment can be modified by the new Assembly as they finalize their working budget, possibly by fund transfers, modification to sales taxes, decreasing operating costs or a direct assistance from the State, or any combination thereof.

