



May 18, 2015

Honorable Mayor and Commissioners:

I am very pleased to present the City of Covington's FY 2015-2016 Annual Budget recommendation. As you know, KRS 83A.150(7)(c) requires the City Manager to recommend an annual budget no less than 30 days prior to the end of the fiscal year, which this year is June 30, 2015.

The City of Covington is required to operate and expend funds under an annual budget that must be adopted by Ordinance (KRS.91A.030(1)). Further, the Kentucky Constitution, Section 157, and KRS 91A.030(8)(b) require that the budget proposal be structurally balanced, meaning that estimated revenues meet or exceed estimated expenditures for the year. The process for preparing and approving a City budget is outlined by state statute and further explained by the City Solicitor.

Estimated Revenues for the 2015-2016 General Fund Budget are \$47,010,405, a decrease of .57% over FY 2014-2015. Estimated Expenditures for the 2015-2016 General Fund Budget are \$46,976,369, a decrease of .60% over FY 2014-2015, leaving a very small carryover amount of \$34,036 in unappropriated funds. Estimated Revenues for the All City Funds FY 2015-2016 budget are \$61,811,715, a decrease of 19% over FY 2014-2015. Estimated Expenditures for the All City Funds FY 2015-2016 budget are \$71,843,839, a decrease of 5.8% over FY 2014-2015.

Of course, a budget is not only about numbers. Rather, it demonstrates the City's values and priorities. A City's annual budget is based on more than just revenue and expenditures. It is based on a vision, a plan, and a direction of where a community wants to go. Although this budget recommendation contains difficult choices, I believe it must represent the City's commitment to sound financial practices and to establishing priorities for growth and improvement. That is the only way to grow the revenue we need and improve the quality of life for all who experience Covington.

Brief Overview of FY 2014-2015

Before embarking on a presentation of the FY 2015-2016 budget, it is worth recounting the detail of the progress and accomplishments of our City Departments and Staff in FY 2014-2015, and their new goals for FY 2015-2016 reflected in this budget recommendation. Much has been accomplished in FY 2014-2015 as you can see and read in the “Department Narratives: FY 2014-2015 Accomplishments: FY 2015-2016 Goals and Objectives”.

It cannot be denied that the City’s renewed focus and effort on growth and improvement is producing results, which leads to the primary theme of the City Manager’s FY 2015-2016 Budget Recommendation, to “Stay the Course!” **The City must be as patient as it is determined. The City’s vision and plans for success require constant vigilance, support, and patience.**

On to Our Third Century and Our Future

RESPONSIBILITY

First, and foremost, the City must be responsible as to our legal and financial obligations.

Our annual budget must be structurally balanced. That is a simple matter of law. Current expenditures cannot exceed current revenues.

We must meet the City’s legal obligations to repay our long term debt and the Tax Anticipation Note and to fund the City Employees and Police and Fire Retirement Funds.

When the City’s revenues begin to grow, these legal and financial obligations must receive primary consideration for funding to a reasonable level to be determined by the City Commission and established by City Ordinance.

SUSTAINABILITY

The City must maintain certain “reserve” funds in order to meet our ongoing needs. The City cannot “raid” these reserve funds to balance the budget in a given year when current expenditures exceed current revenues. If we do, the consequences can be disastrous for our residents and the long term fiscal health of our City.

We must establish and maintain a minimum amount of cash reserve in order to meet the demand of bi-weekly payroll and benefit expenditures, and ongoing operational costs, that are constant, unlike our cash flow that is dependent on seasonal receipts of property tax, waste fees, payroll and net profits tax receipts.

We must establish and maintain a minimum amount of cash reserves for our Self-Insured Medical Plan. The City provides an outstanding health and dental plan to its employees and families. The City pays for all claims directly. The City budgets a fixed amount per employee in each budget year, at \$14,000 in FY 2015-2016. That is an estimate of course as no one can accurately predict the health needs of employees or their families. In some years the \$14,000 is enough to cover the claims. In some years it is not enough. In years when it is enough to cover the claims, the City must “reserve” any unexpended amounts that were budgeted for the claims, in the event that the following year the \$14,000 per employee is not enough. The City cannot use the “savings” in the “good” years, because when the “bad” years occur, then something else has to be cut from the budget, and the consequences can be severe.

We must establish and maintain a minimum amount of cash reserves for our Self-Insured Liability. The City does not purchase a liability policy to cover claims for damage to City property or property of others. The City pays for these claims directly. In some years, enough is budgeted to cover those legal claims. In some years, claims exceed what was budgeted. In those years when claims do not exceed what is budgeted, the City must “reserve” any unexpended amounts in the event that the following year what was budgeted does not cover the claims. The City cannot use the “savings” in the “good” years, because when the “bad” years occur, then something else has to be cut from the budget, and the consequences can be severe.

We must provide for the ongoing business needs of the City such as police cars, fire trucks, ambulances, snow plows, dump trucks, lawn mowers, computers, etc. We cannot rely on grants to provide regular funding for these items. Grants help and extend our efforts, but they are not reliable, and when equipment wears out, it needs to be replaced, grant or no grant. We must provide the tools necessary to our employees so they can deliver quality services to our residents, businesses and visitors. We must provide regular funding for our infrastructure needs. Grants help and extend our efforts, but they are not reliable and not sustainable.

When the City’s revenues begin to grow, our sustainability needs must receive consideration, second only to consideration for our legal and financial obligations, for funding to a reasonable level to be determined by the City Commission and established by City Ordinance.

INVESTMENT

With limited funds for investment in the City from bonded indebtedness, grants, federal and state sources, and our private partners such as the Catalytic Development Funding Corporation and others, where do we invest and what tangible and intangible returns on investment do we seek?

OUR NEIGHBORHOODS

As we set our goals each year, the City must remain steadfast in its efforts to improve property values, retain and attract residents, businesses, investment and jobs, and in a financially responsible and sustainable manner, despite pressures on our General Fund. The City’s strategy to improve property values and encourage other investment; improve our appearance and public realm and appeal, and retain and attract new jobs, is the long term strategy to grow and improve our economic base and to increase our General Fund revenues. Improving property values is accomplished by encouraging and supporting private and public investment; elimination of blight and depressing factors that decrease property value in our neighborhoods through demolition of unsafe and dilapidated buildings; rehabilitation of properties where structurally and economically feasible; and unified, aggressive enforcement of all City codes and laws by our Legal, Police, Fire, Finance, and Development Departments using every tool at our disposal to ensure that buildings and occupants are safe and orderly and not a hazard, nuisance or detriment to the neighborhood. We will move from blight to bright, clean and nice.

INVESTMENT IN OUR INFRASTRUCTURE, FLEET, AND EQUIPMENT

The City must invest in its own infrastructure to improve property values and quality of life, if we want others to invest here. Better property values, more jobs, more residents, more private and public investment, more revitalization in our neighborhoods and business districts, means more revenue in our General Fund, the funding source of our services and programs. It also means more fiscal stability so the City can reduce its reliance on short term debt instruments such as the Tax Anticipation Note that the City has historically used to cover seasonal fluctuations in revenue; grow its financial reserves and; continue to reinvest in itself.

The City Commission in 2015 has acted boldly to transform our five-year Community Investment Plan that was adopted in 2013, into a continuous five-year plan, “Fiscal Stability: Meeting the City’s Business Needs”, by adopting a dedicated revenue source for sustainability. This action demonstrated its commitment to good equipment and continued investment in infrastructure with adoption of an increase in the City’s insurance premium license fee, restricted to such capital expenditures only. This Plan will improve funding for City equipment, facilities, and infrastructure, and ensure that our workforce has the equipment and tools they need to provide a high level of public services.

INVESTMENT IN OUR GREATEST PHYSICAL ASSET - LOCATION

Covington has not one, but two, natural bodies of water, the mighty Ohio River, and the more serene Licking River. The City must continue to pursue development of our Ohio riverfront taking advantage of our greatest physical asset, our location in a thriving and successful metropolitan region. One only needs to look at the Cincinnati, Ohio and Newport, Kentucky riverfronts to envision what Covington can accomplish. The ongoing Licking River Greenway is

providing an immense quality of life improvement for residents and visitors and connecting neighborhoods and commercial areas.

SUMMARY

The FY 2015-2016 Annual Budget recommendation is based on a vision, a plan for the future of Covington. This plan, rooted in the tenets of investment in our neighborhoods, our infrastructure, fleet and equipment, and our greatest physical assets, our riverfronts, is our way forward with patience, constant vigilance, and your support.

FY 2015-2016 Annual Budget

City Manager Budget Goals

- 1) A Structurally Balanced Budget per Kentucky Revised Statute and State Constitution
- 2) Financial Responsibility and Sustainability

Establish Reserve Funds to Meet City's Legal Obligations

- **Fund for Repayment of Tax Anticipation Note**
Source of Funds: General Fund
Use of Funds: Annual Repayment of Tax Anticipation Note

- **Fund for Continued Commitment to City's Pension Funds: City Employees, and Police and Fire**
Source of Funds: General Fund and Bonded Indebtedness
Use of Funds: City Employees and Police and Fire Pensions

Establish Reserve Funds to Meet City's Risk Mitigation Needs

- **Fund for Self-Insured Medical**
Source of Funds: General Fund
Use of Funds: City Employee Medical Claims

- **Fund for Self-Insured Liability**
Source of Funds: General Fund
Use of Funds: City Liability Claims

Establish Reserve Fund for City's Business Needs

- Fund for Minimum Cash Flow
 - Source of Funds: One Time Sale of Assets and 80% of Delinquent Taxes and Fees Collected
 - Use of Funds: Cash Flow to Meet City's Need for Payroll and Benefits and Ongoing Operating Expenses during Seasonal Fluctuations of Revenue and Expenditures

- Fund for Restricted Capital Improvement
 - Source of Funds: Increase in Insurance Premium License Fee Rate
 - Use of Funds: Capital Projects, as Approved by City Commission in annual Capital Budget

3) Budget Transparency

New to the FY 2015-2016 Annual budget is a complete summary page of all City funds with fiscal year beginning and ending balances, revenues and expenditures, and sources and uses of funding.

The purpose and use of all City funds explained in "Description of All City Funds"

Last year's accomplishments and next year's goals and objectives are outlined in "Department Narratives: FY 2014-2015 Accomplishments: FY 2015-2016 Goals and Objectives".

4) Investment

FY 2015-2016 Capital Fund

"Fiscal Stability: Meeting the City's Business Needs – March 19, 2015", a Continuous Five Year Capital Plan

Economic Development Project Funding (TIF; HUD 108; Loan Program Income)

5) Grow General Fund Revenues with Emphasis on Property Tax and Payroll Tax

6) Reduce General Fund Expenditures through Operational Efficiencies and other Cost Reductions

Other Budgetary Guidance

It must be noted that the following legislative enactments of 2013 guided the FY 2014-2015 Annual Budget, and continue to guide the development of the FY 2015-2016 Annual Budget:

- 1) Order Resolution O/R 43-13 approved in February of 2013, established “A Vision for Our Third Century (2015)
- 2) Order Resolution O/R 166-13, approved in June of 2013, established a Five Year Community Investment Plan
- 3) Order Resolution O/R -173-13, approved in June of 2013, adopted the Covington Center City Action Plan

Transparency

In April of 2014 the City Commission unanimously approved a Transparency Policy by City Ordinance (Commissioners Ordinance No. 06-14) committing itself to several aspects of transparency, including budgetary and financial. City staff has attempted to make the FY 2015-2016 Annual Budget even more transparent than FY 2014-2015, by introducing an All City Funds Budget Summary that shows all funds, beginning and ending fund balances, revenues and expenses by department, and sources and uses of funding. The budget format includes details of every fund, department and line item of the total City budget all of which is available for the public to view on the City’s website as well as copies available at no charge at our Finance Department every day that City Hall is open.

The All City Funds Budget Summary also illustrates the reserve funds that have been established, the sources of revenue for each, and any expenditures from them. It shows where, for example, the proceeds of the one-time sale of some City assets are placed.

The City’s annual budget and annual CAFR (Comprehensive Annual Financial Report) are posted on our website, www.covingtonky.gov.

The City Finance Director updates the City Commission and public each quarter on the status of the City’s budget, revenues and expenditures.

The City’s Finance Director meets regularly with Department Directors to review departmental budgets and expenditures.

The Budget Process

City staff has worked to make the budget process transparent as well. Operating from an internal budget calendar, City staff began working as a team on the FY 2015-2016 Annual budget in December of 2014, seven months in advance of the new budget year that begins July 1, 2015. Directives and forms were provided to each Department on how to submit their respective annual operating budget requests for FY 2015-2016. For the annual operating budget, with FY 2015-2016 revenues forecasted to be steady, meaning no increases or decreases, Departments were instructed to submit a “status quo” budget request, meaning that they should use their FY 15 budgeted amounts, inclusive of any built-in changes in expenditures such as the 3% wage increases for labor union employees that went into effect on January 1, 2015; employer pension contribution changes, etc. This process caused each Department to analyze each and every line item in their budgets to justify each dollar of each expenditure, much the same as is done on a continuous basis in private businesses. It also allowed each Department the flexibility in establishing their own priorities in spending as long as the total department “bottom line” met the operating budget directive.

No requests above and beyond the “status quo” budget were made through a Supplemental Budget Request process as was the practice in FY 2014-2015. Last year Supplemental Requests exceeded \$4 million and with no increases in revenue forecast for FY 2015-2016, this process was not used.

Department Directors and other key staff met several times from December to May to brainstorm how to increase revenue and reduce expenditures and balance the budget with the least negative impact to public services. Many good ideas were listed. Many were considered and many were incorporated in the FY 16 budget proposal. Further detail on these items is provided later in this Memorandum.

City Administration also met with individual members of the City Commission for several hours on at least two occasions and provided a binder of information for reference and review, asking for feedback continually, as the FY 2015-2016 budget was developed.

FY 2015-2016 Budget Basic Assumptions

- 1) **REVENUE.** General Fund Revenue is expected to remain steady, with a slight increase of .57% from last year.
- 2) **PROPERTY TAXES.** The FY 2014-2015 Recommended Budget does not include an increased property tax rate intended to produce additional revenue. The City adopted a compensating tax rate of .3045 per \$100 of assessed valuation in 2014. It is anticipated that the City will adopt a rate in 2015 that yields at least the same amount of revenue, the compensating rate. When the tax roll is certified by the state in August of 2015, further discussion will occur concerning the adoption of the actual tax rate for 2015
- 3) **PROPERTY TAX ASSESSMENT.** It is anticipated that the City's total property tax assessment for 2015 will increase by .01 perhaps requiring a change in the current compensating rate of .3045.
- 4) **SALARIES AND WAGES:** The FY 2015-2016 Annual Budget includes a full year of wage increases for union employees and no wage increases for any non-union employees. On January 1, 2015, each of the City's collective bargaining units, the FOP, Local 38, and AFSCME, received 3% wage increases, the last wage increase of a four year labor contract that expires on December 31, 2015. Non-union employees received no such across the board wage increase in 2015. During that four year labor contract, wage increases totaling 9% were given to employees represented by our three collective bargaining units, FOP, Local 38, and AFSCME. It is recommended that we revisit wage increases for non-union employees if revenues increase beyond what is budgeted.
- 5) **KENTUCKY RETIREMENT – Hazardous Duty Employees:** The City's current employer contribution rate of 34.31% will decrease to 32.95% for FY 16 effective July 1, 2016, for all salaries and wages for Police Officers and Fire/EMS personnel.
- 6) **KENTUCKY RETIREMENT – Non-Hazardous Duty Employees:** The City's current employer contribution rate of 17.67% will decrease to 17.06% for FY 16 effective July 1, 2016 of administrative, managerial, and supervisory personnel.
- 7) **HEALTH AND DENTAL INSURANCE.** No Changes. The City funds the City employees' health and dental plans from the General Fund.

Key Recommendations

1) Establish Reserve Funds to Meet City's Legal Obligations

- **Fund for Repayment of Tax Anticipation Note**
Source of Funds: General Fund
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Establish Reserve Fund for City's Business Needs

- **Fund for Minimum Cash Flow**
Source of Funds: One Time Sale of Assets and 80% of Delinquent Taxes and Fees Collected
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- **Fund for Restricted Capital Improvement**
Source of Funds: Increase in Insurance Premium License Fee Rate
Use of Funds: Capital Projects, as Approved by City Commission in annual Capital Budget

- 2) Continue the plan initiated in FY 2014-2015 to pay down the City's \$3.5 million Tax Anticipation Note (TAN) over a period of time. The City's banking institution and Moody's Investor ratings have stated the City must do this. The FY 15 budget recommendation included an initial payment of \$350,000 on the TAN that will put the City on a trajectory to pay it off in ten years. The FY 16 budget includes the second annual payment. These actions will demonstrate the City's commitment and self-discipline enabling the confidence the City needs from its lenders and world renowned investment analysts.
- 3) Investment. Complete the development of the "Fiscal Stability: Meeting the City's Business Needs – March 19, 2015" recommendation with its new dedicated revenue source, based on the Community Investment Plan adopted in 2013. It is imperative that the City continue the reinvestment into our community's Infrastructure, Economic Development and Neighborhood Revitalization, Facilities and Recreation, and Fleet and Equipment that was begun in FY 2013-2014.
- 4) Grow and direct funding where possible toward the City's Economic Development Investment Fund (21). Using the City's lease proceeds from the Kentucky Career Center; TIF district funds; pursuit of non-performing loan repayment, and other private and public sources, ensure that the City has adequate funding to continue to see high quality economic development projects that leverage private investment in the City, increase property values, and produce jobs, all of which will grow the City's General Fund revenues.
- 5) General Fund. Maintain a lean and strategically focused General Fund budget. Reduce all costs possible in order to maximize the City's ability to reinvest strategically. Pension and health care costs continue to burden the City's overall personnel costs
- 6) Continue to pursue a long term physical and financing plan for replacement of aging and deteriorating City facilities including a permanent City Hall, Public Improvements facility, fire and police stations, and assess the benefit of partnerships with other public and private entities to share space, improve upon our collaborative working practices and save on costs.

The General Fund

Revenue

Key Changes

Conservative Projections Based on Prior Years' History

Increase in Revenue at Midtown Parking Garage and other Parking Assets - \$226,850

Special Event Permits' Increase in Charges - \$30,000

Increase in Ambulance Billing for Emergency Medical Services - \$20,000

Decrease in State Municipal Road Aid - \$320,326

Expenditures

Key Changes

- Full Year of 3% Wage Increase for Union Employees
- Zero Percent (0%) Wage Increase for Non-Union Employees
- Staffing

Fire Department

Hiring 6 New Firefighters

Reducing Average Daily Staffing from 27 to 26

Police Department

New Organizational Structure with 2 Assistant Chiefs of Police

Realignment of Some Duties

1 Police Department Position Not Filled

Development Department

Changing 1 Full Time Administrative Assistant to Part Time

Realignment of Code Enforcement Duties, 2 Full Time Positions
Converted to 4 Part Time Positions

Finance Department

1 Full Time Position Eliminated

Department of Public Improvements

Not Filling 1 Seasonal Position

The Capital Fund

The proposed Capital Fund includes approximately \$39 million in projects, utilizing \$15 million in bond proceeds and \$24 million in other funds including non-City sources such as federal Community Development Block Grant (CDBG), Devou Properties, Inc., state and federal grants and programs, and direct budget allocations for projects for Infrastructure, Economic Development and Neighborhood Revitalization, Facilities and Recreation, and Fleet and Equipment.

Next Steps in the FY 2015-2016 Annual Budget Process

May 18	First Reading of Budget Ordinance
May 19 – May 28	Commission and Community Feedback
May 19	Public Meeting at City Hall, 6:00 P.M.
May 21	Covington Neighborhood Collaborative, at Center for Great Neighborhoods on Russell Street, at 6:00 P.M.
May 28	Scheduled Second Reading of Budget Ordinance
May 28-June 30	Staff Implementation of Budget Changes
July 1	FY 2015-2016 Budget Begins

Thank you for your time, attention and consideration to the Recommended Budget for FY 2015-2016.

Respectfully Submitted,

A handwritten signature in black ink that reads "Larry Klein". The signature is written in a cursive, flowing style.

Larry Klein
City Manager
City of Covington, Kentucky