

July 28, 2011

Citizens of Grants Pass
Mayor Mike Murphy and City Council Members
Budget Committee Members
City Personnel



Budget Message for Fiscal Year 2011-12

BUDGET OVERVIEW

I am pleased to present to you the balanced budget for the Fiscal Year 2011-12 (FY'12). This budget represents the combined efforts of the City Council, the Budget Committee, staff, advisory boards, and the citizens of Grants Pass.

Similar service without increasing tax levy

Citizens showed overwhelming support for the Public Safety Local Option levy in the November 2010 vote which will allow the City to continue to provide similar service levels without increasing its tax levy in the adopted FY'12 budget. We owe this responsible budget and proactive financial planning in part to previous Councils and staff who have prepared for the future. A few examples of the actions taken include: 1) creation of the intern program which provides college interns to assist firefighters; 2) the layoff of eight employees at the beginning of the construction industry downturn; 3) use of Community Service Officers to relieve police officers of more routine duties; 4) staff participation in health insurance planning and cost sharing; 5) no cost of living increases for three straight years for all managers, supervisors, and Grants Pass Employee Association employees; 5) no cost of living increases in January 2010 for the local Fire union and the local Teamster employees. Many cost saving measures taken in recent years were detailed throughout this message and in budget meetings this year.

Voter approved levy

This budget document includes the resources that the voters authorized through passage of the new Three-Year Public Safety Levy in November of 2010. The approved levy provides an estimated \$4,253,996 in FY'12 for City Public Safety operations. While all property taxes are dedicated to Public Safety, the temporary local option levy in place last year expired June 30, 2011. The overwhelming support for the Public Safety Levy in 2010 demonstrates the community's desire for quality services. The adopted budget for FY'12 continues the high level of Public Safety services and other government services our citizens expect and have received over the period covered by the current levy. The three-year levy starting

in FY'12 is set at the same rate as the previous two-year levy. While conservative projections through FY'14 show that significant General Fund savings will have to be used towards the end of the levy period, the resources provided by the levy should be sufficient to maintain current services through this next three year levy time period.

Residents appreciate City services

The empirical and statistical data gathered from the citizens of Grants Pass indicate that the residents appreciate the services provided by the City. Both the recent vote for General Fund Public Safety Funding and the annual survey continue to demonstrate the community's desire to have City services maintained at the current service level. This budget has been prepared with an eye toward continuing to provide the high quality services the City has delivered over the years while acknowledging the more fiscally conservative stance that the local economy demands. However, inflationary pressures on operations will not always match up with revenue growth. The difference between revenue growth and actual operational inflation is expected to be unusually heightened in coming years causing budgets for various City operations to be under significantly more pressure in the future. The continuation of longer-term financial planning will be key to maintaining the services our Citizens expect today.

Budget based on Council goals

Grants Pass is a strategically motivated municipality, whose direction is annually defined and affirmed by the Governing Body through a series of goal statements that reflect the values of the community. These goals are used to formulate a work plan with corresponding performance measurements, serving as the foundation upon which the budget is developed. The normal day to day duties and budgets required to maintain operations do not change a great deal from year to year. However, the City Council recently completed the 2011-2012 Strategic Goals and Work Plan and identified a number of projects that are to be considered both in the short-term and longer-term. This budget, through its allocation of resources, communicates and defines priorities we believe will serve the community for the ensuing year while simultaneously insuring sufficient reserves for future needs of local government operations.

The City of Grants Pass enhances the "quality of life" in our community through sound service delivery systems. The City generally offers high quality and well maintained streets, parks, water and wastewater systems. The City's nationally accredited Police and Communications operations are among the best in the country and many of the City's other activities have received national recognition for their performance.

Impact of population growth

Grants Pass, along with every city in the nation, is coping with the lingering effects of a world-wide economic downturn, particularly in the housing market. However,

while the community's growth rate has slowed from the rapid pace of just a few years ago, the City's population continues to grow as estimated by Portland State University's (PSU) Population Research Center and the recently completed national census data. Higher volume of demands for service, particularly in the City's Public Safety services, has accompanied the City's population growth in recent years. In recent years the City's population growth has been significantly higher than the County's growth and the State's growth rates. The 2010 census shows a City population of 34,533 versus last year's population (estimated by Portland State University) of 33,225. Grants Pass continues to rank as the 15th largest city in Oregon. We believe we have met the challenge to maintain the "livability" of our community while facing the broad economic realities head on.

Budget guidelines

The executive team and staff were given some specific guidelines for preparing the FY'12 budget. With limited growth in resources and expected cost inflation pressures in many of the most routine operational expenditures, general directions included the need to hold the line where possible on personnel and other expenditures. While there are some cost increases such as the cost of chemicals or electricity that cannot be avoided, staff has been instructed to continue to look for any operating efficiencies available. With the exception of the highest priority needs in Public Safety, staffing levels were not to be increased in operational budgets this year. Also, outside of Public Safety Divisions, the number of unfunded positions has also increased slightly from last year meaning funding has been withdrawn from positions that were existing in previous years.

After numerous cuts in certain division expenditure budgets in recent years and a focus on cuts in non-personnel expenditures in order to maintain services, any further budget cuts are expected to result in a cut in services offered to the public. However, decision packages were presented to the Council and the Budget Committee to show the service effect if funding is cut or reallocated among the various operational divisions. While there is not a present need to make further cuts based on short-term revenue forecasts, the presentation of the service level effect for funding reallocations assisted the financial planning process now and in the future.

Budget changes overview

The FY'12 Adopted Operating Budget, excluding contingencies, debt service, and transfers out to capital projects, totals \$30,419,773. This is up approximately \$1.5 million from last year's Operating Budget total of \$28,884,851 due mostly to the recommendation of three additional Police Officer positions, increases in health insurance rates, increases to mandated PERS retirement payment rates, new pass-through revenues to the 911 Agency, and increases in energy rates and chemical costs. Public Safety accounts for a little more than half of the total operating costs for the City, and its budget increased approximately 5.5% due largely to the need for new positions to fill existing service gaps, contractual or mandated increases to insurance and retirement rates, and supplies necessary to

equip the new officers. Absent the new officer recommendation, the Public Safety budget increase would have been closer to 4% for the FY'12 budget year.

There is also a new revenue and expenditure line in the General Fund, General Program Operations (Policy & Legislation) that is merely recording a pass-through revenue and expenditure of approximately \$166,000 that has no net effect on the budget. The other operational departments of the City increased operating expenses by approximately \$480,000 in total compared to last year due mostly to contractual or mandated increases to insurance, PERS retirement rates, and higher energy or chemicals rates. A significant electric rate increase by Pacific Power of nearly 20% in 2011 is also adding to inflationary pressures, the biggest of which are felt by the City's Water and Wastewater utilities. The City's total annual budget for electricity across utilities and all other operations is in excess of \$1 million and recent changes to electricity rates is having a significant impact on the FY'12 adopted budget. As with any major expenditure, the City will continue to look for energy and other cost efficiencies.

Capital allocation recommendation

Annual transfers from the General Fund to capital projects of nearly \$1 million per year to transportation and other high priority projects were eliminated two years ago. This elimination helped to ensure the City could continue to provide services at levels similar to prior years. While this certainly didn't reduce the City's need to maintain or upgrade equipment and infrastructure, there is a new recommendation this year for determining dollars allocated to capital projects from the General Fund. What follows is a brief description of this recommendation.

In Fiscal 2010, the General Fund achieved the targeted budgetary fund balance policy of 30% to 40% of annual expenditures by ending the year near the middle of that target range. This range was set to avoid having the borrow funds between July and November each fiscal year before the bulk of property taxes are received by the General Fund. This also gives the General Fund the proper contingency and reserves to respond to potential emergencies or other unanticipated financial needs throughout City governmental and utility operations. By continuing to target the middle end of that range at 35%, any one time savings whether through revenue or expenditure differences to budget could then be allocated to the highest priority capital projects. This leaves the General Fund with a 5% contingency and the necessary 30% minimum carryover balance from year to year.

Once those savings are identified and in the bank, they could then be appropriated for high priority capital purposes. The Council, Budget Committee, and Citizens can continue to help prioritize these capital expenditures and after the fiscal year is closed the actual savings amounts (if any) are known. Fiscal 2010 was an exceptional year for the net of both expenditure and revenue savings. The General Fund ended the FY'10 year with a fund balance approximately \$630,000 higher than budgeted due to a variety of one time savings amounts. Therefore, the bulk of the amount approved to be transferred to high priority capital projects in the FY'12 budget relates to this identified savings from the last fiscal year.

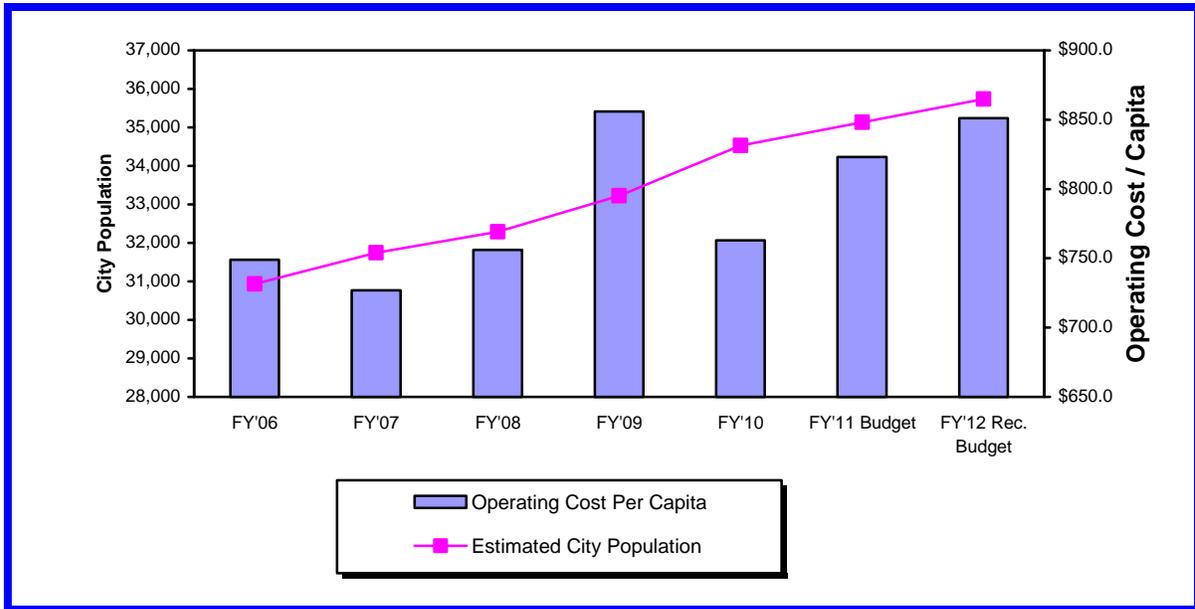
The decision to eliminate regularly scheduled capital transfers from the General Fund may have long-term implications as the City defers capital investments. The executive team and I will strongly advise the City Council to restore funding for Capital Investments once the recession subsides to avoid the inefficiencies and exponential costs of deferred maintenance. Delaying needed purchases and improvements will not save money, but will only postpone those expenses to a later date and perhaps increase those future costs. This short-term response will have to be revisited in coming years to make sure that additional real costs are not incurred.

However, there are certain capital requirements, particularly in Public Safety and information technology, that cannot be deferred much longer. Under proper financial and budgeting policies of matching one-time resources with one-time expenditures to maintain a sustainable budget, the adopted budget allocates capital to certain Public Safety and City wide information technology related projects. For example, the remainder of the necessary funding for projects such as the City's share of the Computer Aided Dispatch (CAD) system upgrade in the 9-1-1 call center and Mobile Data Terminals for Public Safety vehicles is being provided through the FY'12 budget.

Real efficiencies and effectiveness measures will be impacted by replacing the City's very old phone system and by replacing or integrating various software systems. One-time savings have been recommended to be used for overdue projects such as the phone system, connectivity among City operating locations, the financial software system, and other overdue software upgrades. In addition to having more efficient operating systems, projects such as connectivity and replacing the phone system will save money on telecom expenses each and every year in the future once they are completed. It has been estimated that telephone line expenses will be reduced by at least \$40,000 per year once the City replaces the 20-year old phone system with a modern VoIP phone system. The use of technology across various operations to increase efficiencies was a big theme in last year's budget and continues to be a prominent consideration in the FY'12 budget.

Operating costs per capita less than inflation

Despite modest growth in the total adopted operational budget this year, City stakeholders should be aware that the City continues to grow, and the total dollar amount to serve a larger community will also grow over time as long as the City keeps the current level of services. The recession being experienced in the region has not slowed the City's estimated population growth as measured by Portland State University's Population Research Center and the recent census.



Over a longer time period, it is important to manage expenses and ensure the cost per capita of operations, for a full service City such as Grants Pass, do not increase more than the rate of inflation. This ensures growth is being managed appropriately and within reasonable resources. Using Fiscal 2006 as the base year, the total cost per citizen of providing all the critical services (Police, Fire, Water, Wastewater, Transportation, Legislation, Parks, Development, and Other Services) has not exceeded inflation as measured by the national CPI index 10-year average through the FY'12 adopted budget. Using the average inflation rate of 2.35% in the last decade and using FY'06 as the base year, the adopted FY'12 budget estimated operating costs per capita are under the compounded effect of inflation since 2006. While budgets will never be fully spent unless there are unanticipated events, the budgeted expenditures are still projected to be under nationally reported inflation averages.

	<u>FY'06</u>	<u>FY'07</u>	<u>FY'08</u>	<u>FY'09</u>	<u>FY'10</u>	<u>FY'11 Budget</u>	<u>FY'12 Budget</u>
Estimated City Population	30,930	31,740	32,290	33,225	34,533	35,133	35,733
Operating Cost	\$23,172,859	\$23,070,007	\$24,401,413	\$28,446,551	\$26,344,157	\$28,884,851	\$30,419,773
Actual Op. Cost / Capita	\$749	\$727	\$756	\$856	\$763	\$822	\$851
Cost / Capita If Matched Avg. Inflation (CPI)		\$767	\$785	\$803	\$822	\$841	\$861

However, there is a growing strain on the City's operational budgets as actual inflation for operations is starting to significantly outpace nationally reported inflation figures. Growth in revenues and expenditures per capita will never exactly match the national or regional consumer price index, however there is a significantly growing gap between actual operating inflation and the CPI. Increased

mandated and contractual obligations for personnel costs and items such as energy costs are having an extreme effect on budgets throughout City governmental and utility operations. While nationally reported CPI changes remain relatively muted, the cost of electricity has increased nearly 50% in the last five years. Other types of energy costs are also rising significantly, the state mandated costs of the PERS system are increasing, and health insurance rates are rising significantly each year. Each year the budget pressures are growing more acute and while the City of Grants Pass is not unique in this regard the further we look at our budget forecast in coming years the more limited our financial flexibility becomes.

Revenues relatively stagnant

A large part of increasing limitations on the City's budgetary flexibility also relates to the revenue side of the equation. Growth for most of the major revenue sources for City operations are directly tied to the performance of the housing market. Growth in property taxes (the primary resource for Public Safety and the General Fund) is limited to either 3% per year on existing properties or market value changes, whichever is less. Annual changes to City utility user rates are directly tied to the national CPI-U changes, and the largest component of determining CPI is housing costs. The City's main transportation funding sources are not even tied to a CPI index and until the last year have remained relatively stagnant. The State's gas tax (shared with the City) has increased in the last year which will contribute more funding to Transportation projects, but other major Transportation funding sources have not kept up with inflation. Staff will continue to work with the Council and community on ways to diversify revenue sources and prepare for increased budgetary limitations in the near future. Having many major revenues so directly tied to growth or declines in the housing market is a significant financial risk for the City especially during times of extended downturns in the housing market such as the one we are experiencing today. Cost increases, many of which are largely out of our control without service level changes, are becoming more detached from changes to revenues and resources required to maintain those operations.

All property taxes recorded as revenue for the General Fund are dedicated to Public Safety each year. In the FY'11 budget nearly 90% of the resources dedicated to Public Safety came from property taxes and Public Safety is by far the largest operating division of the City. Due to the decline in the housing market and significantly lower property tax growth rates, Public Safety will have to use more General Fund support from non-dedicated resources as compared to recent years. Limited growth in revenues coupled with cost increases largely out of our control will cause significant pressure on the General Fund in coming years. A conservative three year revenue and expenditure forecast for Public Safety has been provided to the Council and Budget Committee in this annual budget season so we can all be aware of the General Fund's financial limitations during the fixed three year Public Safety local option property tax levy from FY'12 to FY'14.

The total adopted budget, including Capital and unappropriated (or carryover) amounts, is \$91,525,481. This is slightly higher than last year's total budget of \$89,408,798 due to a number of capital projects that have not yet begun the expenditure phase and modest operational budgetary increases. The total balanced budget figure includes internal service funds, debt funds, and all auxiliary funds that have unique or restricted resources. Total operational budgets previously mentioned includes costs for many of these stand alone internal service funds and total changes to the operational budget may be a more meaningful representation of changes to the City's annual expenditure budget (rather than the change to the total budget figures). Budgeted resources available to capital projects this year are shown by the four major capital programs: Lands and Buildings, Transportation, Water, and Wastewater in those respective program sections in the budget book.

PREPARING FOR TODAY AND THE FUTURE

Public Safety

The construction of new fire and police facilities has been executed with foresight and efficiency and finally completed during early FY'11. The voters approved the bond levy that paid for these facilities, a training tower, and three new fire trucks. These resources will help provide more effective and efficient Public Safety services to our community for decades to come. The City now has the critical tools necessary to achieve emergency response times that meet national standards, particularly in the southern sectors of our community. This project, along with the historic approval of Public Safety Local Option Levies, demonstrates the value that the community continues to place on Public Safety services. Including the property tax levy for the bonded debt, the total FY'11 property tax rate for City residents was relatively unchanged and will remain flat for the next three years with the renewal of the existing levy for the same rate of \$1.79 per \$1,000 of assessed value for the next three fiscal years. Included in the Council approved work plan this year is a study of funding alternatives for the Public Safety levy to see if there is any way to avoid the disadvantages of the current supplementary funding structure for Public Safety. The permanent property tax rate of \$4.1335 cannot be changed by law and will still be the largest single funding source for Public Safety services even if a suitable supplemental funding alternative is found.

Public Safety programs have been supported in the past entirely by property taxes, dedicated revenues, and through the use of resources set aside in reserve. There are two noteworthy impacts of this financing practice. First, historically, Public Safety has not drawn significantly on other General Fund resources that have been used for other public services and second, all property taxes will continue to be dedicated to Public Safety services. This year, similar to FY'11, Other General Fund resources are being directed to Public Safety programs. Without redirecting approximately \$800,000 of General Fund resources to Public Safety functions, there would have been cuts roughly equivalent to at least four to five police officer equivalent positions from the FY'12 adopted staffing levels. These positions would

not use the whole \$800,000 General Fund resource allocation, but rather reflect approximately how many positions would have to be eliminated to avoid drawing down the General Fund ending balance in a typical year. Budgets are never fully spent unless unplanned needs surface throughout the year. City officers are already so busy that this budget approved three additional officers, two of which will eventually be dedicated to a traffic team. Looking out to FY'13 and FY'14, Public Safety's draw on other General Fund resources and reserves increases significantly each year due to relatively minimal growth in property tax revenues.

Community Development responds to development downturn

Grants Pass, like other regions throughout Oregon, has experienced a severe decline in building activity. Community Development departments such as Building Services and Planning Services continue to budget for extremely low levels of activity and low levels of staffing compared to previous years. While there has been a very small uptick in commercial building activity, residential building activity remains at the lowest level in the last 10 years. On the plus side for new construction, Home Depot is set to break ground on a new store in Grants Pass and has recently turned in building permit paperwork.

The Building and Safety Division wisely maintained restricted reserves from prior years and is thus able to manage the temporary decline in revenues from permit activity. The layoffs of 8 employees throughout the Community Development activities two years ago (4 of which were in Building), though unpleasant, were necessary to ensure extended benefits of these reserves. Similarly, the City has acted proactively in choosing to leave positions "unfilled" when we see either a decline in service demand and/or revenues. There are currently 17 positions that are authorized but not funded due to both declining service demand and revenues in the four programs managed by the Community Development Department (Building, Planning, Engineering, and CD Management). These prompt actions will help ensure that restricted reserves last as long as possible during this period of the building cycle and will allow management to respond quickly when service demands return closer to historical levels.

However, at current run rates without supplementary funding the Building department would deplete its restricted reserves held in the General Fund in nearly two years. This budget continues a \$50,000 annual General Fund transfer per year into the Building department in case activity does not pick up in coming years. This annual transfer began in FY'11 and the goal is to make sure there is nearly three years of operating reserves available to the Building department for maintaining services during low levels of permit activity. Shutting down the Building and Safety department and turning this required program over to the State would be a decision that by law could not be reversed in short order if activity picked up. It will be important for many efficiency reasons throughout the other Community Development departments to keep this activity operated by the City if possible.

System Development Charge (SDC) revenues generated through growth have declined along with residential building activity. Transportation SDCs appear likely

to fall well short of projections this year due to fee reductions and low levels of building activity. Revenue projections for FY'12 have been estimated at even lower levels to reflect the reduction in development activity and the Council's desire to study other transportation project funding allocations. These conservative estimates will help ensure that spending does not exceed revenues for transportation projects. Other SDC forecasts for systems such as Water and Wastewater also remain relatively low in this year's budget and capital project resources across the board will have to be heavily focused on maintaining or upgrading existing infrastructure in the near-term.

Financial policies incorporated into the Budget

The adopted FY'12 budget has General Fund contingency of \$1,000,000 excluding Building's restricted resources / requirements, which is slightly less than 5% of the City's General Fund operational budget (Policy and Legislation, Public Safety, Parks, and Development). This contingency is nearly in the range of a typical 5% to 10% contingency and should provide Council with the resources to deal with emergencies in combination with contingencies available in other funds.

While in FY'10 Council adopted a new financial policy target for the proper range of beginning fund balances for the General Fund, addressing financial policies regarding ending fund balances in other funds and the use of contingencies will be one of the topics the City Council should consider prior to the next budget cycle. It will be my recommendation that the City consider a more formal policy for carryover balances and contingencies in the City's utility funds. A higher or different level of contingencies does not mean a higher level of spending, it merely means a higher level of financial flexibility for Council in dealing with unexpected events. Contingencies can only be appropriated for use by the City upon approval by the City Council, and are one-time reserves that cannot be repeatedly used without building them up again. Currently the utilities are not setting aside enough funds from operations to cover the cost of infrastructure depreciation over time (with the potential exception of the Street Utility now that the State's gas tax has increased), which may result in higher unexpected infrastructure projects in the future.

STAFFING CHANGES

There were 3 additional funded positions by Full Time Equivalent (FTE) approved for the FY'12 budget, all of which are officers in Public Safety's Police division. There is also one additional grant funded position for a Firewise Coordinator that will be a temporary employee until that grant funded project is completed. This is partially offset by the elimination of funding for 2.3 FTE positions in other City departments. Many of the positions previously authorized by the City Council continue to be unfunded this year. The number of total approved but unfunded positions has increased from 19.75 in FY'11 to 22.05 in FY'12. This approved change in staffing addresses the perceived highest operational risks and matches the service needs with the staffing needs.



As a result of reductions in revenue, reduction in service needs, or efficiencies found through regular operational reviews, positions that do not have funding included in the adopted Budget are shown below.

Summary of FY'12 Unfunded Personnel Positions			
Activity	Program	Title	# of Positions
Finance	Administrative Services	Accounting Tech Assistant Finance Director Financial Analyst	2.50
Management	Administrative Services	Office Assistant I	0.25
Community Development	Support	Office Assistant	1.00
Planning	Development	Planner III Department Support Tech Associate Planner (3) Assistant Planner (3)	8.00
Building	Development	Residential Building Insp Plans Examiner II (2) Office Assistant I Building Inspector I	5.00
Engineering	Support	Utility Engineer Project Specialist (2)	3.00
Parks & Community Services	Fleet, Parks & Recreation, Property Management, Information Technology	Parks Mun. Svc. Work. (1.0) Urban Forester (0.5) Office Assistant II (0.1) Admin Support Spec (0.1) Dept Support Tech (0.1)	1.80
Streets	Transportation	Urban Forester	0.50
		Total	22.05

New positions that are unfunded starting in FY'12 include 1.0 FTE in Finance, 1.0 FTE in Planning, and 0.3 FTE in Parks & Community Services. Should activity significantly increase during the fiscal year in any of the City's departments, a supplemental budget could be brought before the Council that would recognize the staffing needs for the unanticipated increase in service demand and/or revenues.

CHALLENGES AHEAD

Public Safety faces staffing challenges

One of the most significant challenges facing Grants Pass is the need for a secure financial funding resource for Public Safety services. While a local option tax can provide secure funding after it is approved; the time, effort, and the uncertainty of it passing all have costs to the City and impacts on retention, recruitment, and stability within a department that is already significantly understaffed compared to the service needs and calls for service. For example, it takes nearly 5 years for a new officer to become trained and sufficiently experienced on the job. The need for Fire and Police services is constant and it is a far better practice to ensure that funding of the services is more secure as well.

These challenges have been presented in much more detail in Council workshops or budget meetings in previous years and in the next year the Council will have to decide whether to begin to take public input on funding alternatives. Even if a suitable alternative to the Public Safety Levy is found, Council will always maintain the right to make changes to fees, taxes, or service levels in the future. While using the voter-approved temporary Public Safety local option levy, Council's flexibility to change service levels and fees or taxes is limited.

The City is falling further behind in addressing the staffing need of the Police and Fire Divisions. We are unable to fund positions recommended by a staffing study completed in 2000, as well as the Strategic Plan adopted by Council in 2008. A number of external reports have now all shown similar results – the Grants Pass Police department is one of the most understaffed agencies in Oregon compared to the service need. In order to respond to the urgent calls for service, some of the proactive work cannot be addressed. In addition, as work load continues to increase, our officers find themselves in the precarious position of balancing officer safety with the need to respond to a high risk call with inadequate resources. This issue cannot wait much longer to be addressed and that is why the adopted budget takes a small step towards this higher risk staffing need.

A new multi-agency report on crime rates in Oregon cities is also available for our citizen's consideration. The 2009 Report - Oregon Anti-Crime Alliance (Of 107 Small Oregon Cities) calls Grants Pass, "the most understaffed small city in Oregon" and shows Grants Pass as the highest per capita for Property Crime, Motor Vehicle Theft, Larceny/Theft, Burglary, and Robbery. While these crimes are not the most serious types of crimes that can be committed, this is a problem and is exactly what has been keeping our officers so busy in the last year. This speaks to both the population surge that Grants Pass experiences during a typical day and the need to boost staffing to be able to handle the relatively high calls for service. While many citizens may not be aware of how busy our Police force actually is today because they may not have been personally affected yet, we look forward to working with the Council and community on addressing these challenges before they get too far out of control. While Grants Pass still feels safe

and is safe, it's not prudent to breeze over this risk to our residential and business community.

Public Safety concerns are also affected by the County. The loss of Federal funding to Josephine County and the failure of their last levy request resulted in decisions to use the full diminishing three year federal allocation over two years and make an effort to replace those funds sooner rather than later. Future resources for County Public Safety remain in doubt. For the very short-term, it appears that the County intends to keep jail space available and the District Attorney has recommended to continue operating at similar service levels in the next year. The County's federal funding continues to decline and will be completely used up by the County within the next year unless lobbying efforts renew the funding are successful. Versions of the next Federal budget show significantly less funding to Oregon counties in future periods. The County's contingency plans for funding after FY'12 have not been revealed to date and this could have another significant impact on City Public Safety services as the City relies on the County for services such as the Adult Jail and the District Attorney.

Staffing for an expanding Park System

Over the last 5-10 years, park acreage and developed park sites have increased substantially to match a larger City. While park and trail maintenance responsibilities are increasing, the Parks Division eliminated one full-time position in 2010 due to the economic climate and has not had significant changes to staffing levels in the last 10 years. The 2011 budget slightly increased funding for additional contractual labor to maintain the expanded park system but employees have not been added in recent years or in the adopted FY'12 budget.

Addressing PERS funding

As anticipated, employee benefit costs continue to be a factor in operating expenses. Like other Oregon governmental entities, the City of Grants Pass faces an increase in rates paid to the Public Employees Retirement System (PERS) effective July 1, 2011. The PERS Board made a policy decision to spread unfunded liabilities, largely the result of retirement benefits for Tier 1/Tier 2 employees, to all groups. As the membership in Tier 1/Tier 2 has declined due to retirements, the financial impact of liabilities and financial market losses in 2008 produced staggering rate projections for all classes of employees. Government agencies have found these impacts more manageable by allocating a portion of the liabilities across all groups of employees, however since 2003 new public employees do not have the same defined benefits.

PERS rate changes are largely and directly correlated to the broad performance of financial markets, and rate changes tend to lag the actual performance of financial markets by nearly two years. The FY'10 and FY'11 rates billed by PERS were reduced because of financial market performance that was healthy prior to 2008. However, knowing that 2008 was one of the worst financial market performances in many years, the City billed all departments at the same PERS rates as the

previous two-year cycle and set a small amount of reserves aside in the Benefits Administration program (Insurance Fund) in preparation for rates that will be higher in the next two-year cycle and probably a number of biennial cycles after 2011.

Due to the historic losses in financial markets in 2008, it is currently expected that at least 3% increases will be implemented by the state PERS program every two years until the losses are recovered and the retirement assets equal the actuarial liabilities. Over the next two years, the City will bill all departments at slightly higher rates each year and actuarial liabilities compared to growth in assets for the state system will have to be monitored to predict the impact of future rate setting cycles. Ultimately the move to create a small amount of City PERS reserves will lessen the future impact of PERS rate hikes towards the end of the rate increase cycle and will help smooth the potential volatility of City personnel and related benefit costs. While the City cannot control these rates, the City has taken steps to prepare for future PERS cost increases.

Managing health care costs

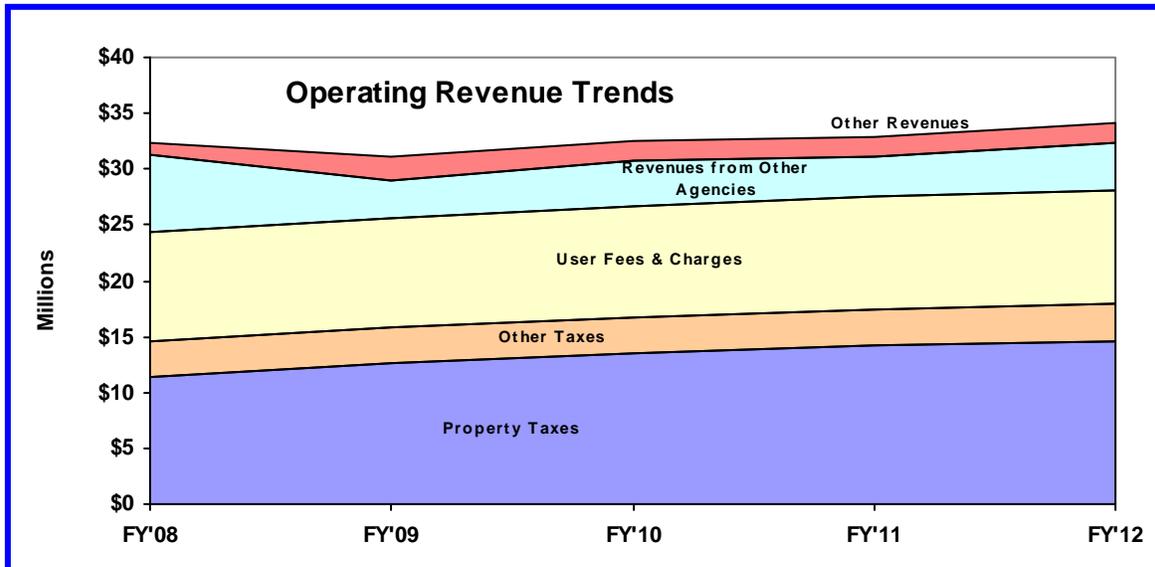
The City has a choice of two health care packages effective January 2007. Employees can select either a standard existing plan or a lower premium plan in association with an HRA/VEBA account funded by the City. There was a significant increase in the number of participants in the HRA/VEBA plan in the last few years, with approximately 80% of eligible employees taking advantage of the opportunity to have monies placed in a tax-deferred account for future out-of-pocket costs, assuming a greater share of co-pays and expenses. This move, approved by the Council, saves the City money compared to traditional taxable benefits and strengthens management's goal of achieving greater employee ownership in managing health care costs. The annual increase to health insurance premiums in calendar year 2011 was lower than budgeted due to lower actual claims costs as compared to recent years.

Negotiating with labor organizations

The City is currently negotiating with two of the four unions/bargaining groups, and the Grants Pass Employees Association (GPEA) is now considered an official bargaining unit within the City effective in 2010. GPEA makes up most non-supervisory employees that are not part of another union and is in the process of writing their first proposed contract. All four unions/bargaining units are set for negotiations in the next year for at least wages. The Police contract term is up at the end of calendar 2011, Fire and Teamsters can open for wages only for the 2012 calendar year, and GPEA is expected to begin negotiations within FY'11 for the initial contract. Supervisors, Directors, Classified, and GPEA employees have not received or requested a COLA salary schedule adjustment for three straight years beginning in 2009.

OPERATING REVENUE TRENDS

Financial Overview for FY'11



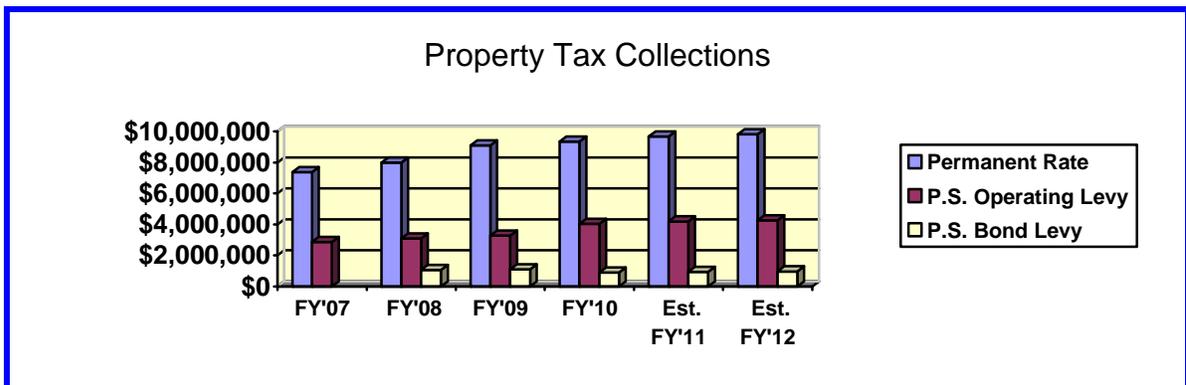
The compilation of this one-year operating budget reflects key revenue sources and adopted fee changes outlined below:

Property Taxes – Permanent Rate and Public Safety Local Option Levy

FY'12 will be the first year of the three-year Public Safety Local Option Levy which will end June 30, 2014. The levy was renewed at the same rate of \$1.79 per \$1,000 of assessed valuation and is estimated to be a total levy of approximately \$4.5 million for FY'12. The levy renewal for FY'12 is anticipated to provide approximately \$85,000 in additional resources in FY'12 as compared to FY'11 due to growth in assessed values and small amounts of new construction. In time, slightly more than 97% of property tax levies are collected due to discounts available for paying the tax in a timely manner. The FY'12 levy will provide about \$4.25 million in revenue next year and approximately \$4.4 million in total revenue in coming years. That resource, along with our permanent property tax rate, is anticipated to fund the majority of the City's Public Safety program with an additional reliance on the General Fund estimated at \$800,000 this year.

This budget reflects what we perceive to be the Council's direction in finding resources other than property taxes to support Public Safety for the short-term. The estimated combined tax rate for the permanent levy, the Public Safety Levy, and the Public Safety Bonded Debt will be approximately the same as FY'11 at close to \$6.33/\$1,000 assessed valuation. It is noteworthy that the tax rate for the Public Safety Bond declined by approximately \$.10 per \$1,000 assessed valuation from the 2009 rate of approximately \$.50 to approximately \$.40/\$1,000 during FY'10. The bond levy rate in the last year of the Public Safety Bond payment

(2019) will also be less than originally estimated due to money left over at the end of the construction that was used to pay off a small portion of the 2019 bond maturity.



Grants Pass' total taxable values continue to increase as a result of relatively small amounts of new construction. Assessed values will also increase in FY'12 as a result of both a small amount of new construction in 2010 and a small amount of increases of assessed value on existing properties. Increases in assessed valuation on existing properties is generally capped at 3% per year. This restriction has resulted in assessed valuations being significantly lower than true market value. With market values currently declining and the assessed value increasing by 3% or less, more and more properties have an assessed value that has reached the market value. Annual property tax revenue increases in the next couple years on existing properties will be extremely limited compared to the last 10 years.

Total assessed values rose 2.86% in FY'11 and are estimated to increase 2.0% in FY'12. In FY'11 about 1% of the 2.86% increase was due to new construction and in FY'12 about 0.90% of the 2.0% projected increase is due to new construction in calendar 2010. Historical trends together with updated data furnished by the Josephine County Assessor's office are used to project assessed values. The number of building permits and respective valuations along with local housing market conditions are factored into the equation.

The absence of new annexations, which could have had a positive impact on the property tax base in recent years, will also impact FY'12 and perhaps FY'13. Bringing in the additional valuation from these properties that the City already serves would increase tax dollars thereby sharing the burden of funding public services. The impact of not annexing properties served by the City is expected to continue to affect resources in future years. The questions surrounding annexations will require staff to seek more firm input and direction from the City Council about whether the City should provide services outside the corporate limits within the Urban Growth Boundary. These questions become even more critical to address over the next year as the City is currently in the process of redefining and finalizing the new UGB borders in the next fiscal year.

Property Taxes – Public Safety Bonded Debt

In November, 2006, Grants Pass voters approved a bond measure to fund construction of two new public safety facilities and purchase equipment for each through the sale of bonds prior to the close of FY'07. The approved debt of \$9,875,000 is a twelve-year bond issue funded by a property tax levy which began at approximately \$.51/\$1,000 of assessed value for the first two years and dropped to approximately \$.40/\$1,000 of assessed value in 2010. The current year bond levy, near \$.40, will remain at approximately the same rate until the final year of the Public Safety Bond Levy.

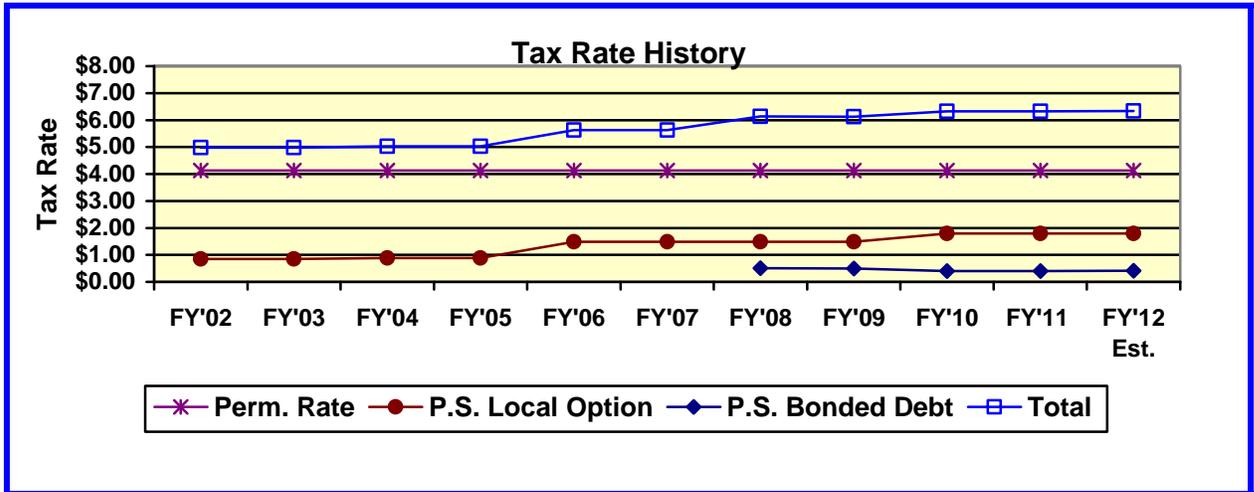
Property Taxes – Future Public Safety Local Option Levy

In November of 2010, the voters overwhelmingly supported the three-year renewal of the Public Safety Local Option Levy. The levy will provide funding for the Public Safety Department for FY'12 through FY'14. Having completed the Public Safety Strategic Plan early in 2008, there are important recommendations that the City must consider. The future funding available to Public Safety will have the most significant impact on our ability to execute the plan.

This budget has been prepared with the assumption that the Council intends to strive toward eventual implementation of the Public Safety Strategic Plan adopted by Council in FY'08. However even under this adopted budget Public Safety still has significant hurdles to meet the plan's targets. Historically, prior Public Safety levies have increased over previous levies to address inflationary impacts and to meet the additional needs of the community. For example, the current Public Safety operations levy is \$1.79 per \$1,000 of assessed value while the preceding levy was \$1.49. Property values (assessed valuation) have not kept up with the demands of growth and inflation. The tax rate must increase to provide sufficient resource to keep up with the combined impact of growth and inflation. The more people that visit our community, the better it is for business but the more it places a burden on existing City property owners as Public Safety relies almost exclusively on property taxes to cover program costs. Grants Pass is an exceptional hub for both business and travel.

The Budget Committee met once in January of 2011 to hear an overview of the budget process and met two other times during early 2011 in smaller "two by two" sessions to hear updated operating information from each program. In recent years Council has also asked the Budget Committee to act in an advisory capacity for the Public Safety levy and for Public Safety funding options in general. While recognizing that the levy must increase if most aspects of the Public Safety Strategic Plan are implemented, Public Safety staff and management have worked diligently to develop a budget that targets the highest operational risk areas with the same continuing local option levy rate of \$1.79 per \$1,000 of assessed valuation. Implementing the Public Safety Strategic Plan on the schedule recommended by our consultants would have required a levy in the amount of nearly \$2.25/\$1,000. The \$1.79 levy proposal was achieved by delaying certain elements of the Strategic Plan implementation to future years after FY'14, and by

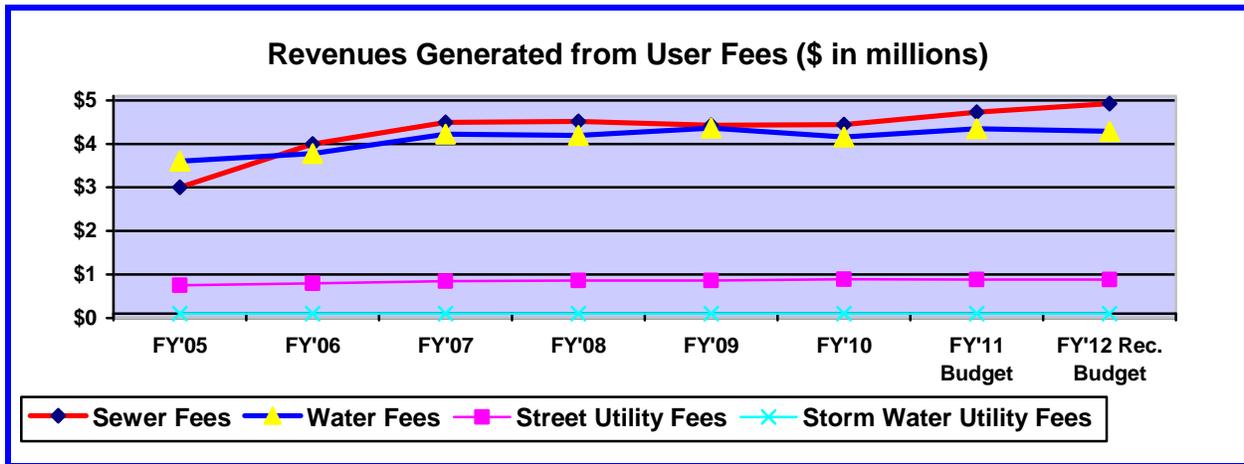
making significant cuts to proposed non-personnel expenditures within the Public Safety Department and throughout the General Fund. A variety of external reports suggest that Grants Pass needs at least 7 more officers if not more, and we are only able to fill 3 of those in the near-term. Understaffing is also becoming more apparent when looking at the number of traffic crashes or crime rates in our City.



Taxes Other than Property

Franchise fees received from each of the private utilities providing service to municipal residents are estimated to total \$2.573 million in FY'12 and this is the second largest revenue source for the General Fund. This amount is relatively stable from year to year, but due to the recession and less use of traditional utilities such as land-based phone lines, the revenue projection is built around flat local economic growth to be conservative. If the City were to annex properties, there would be new revenues from telephone, electric, gas, garbage, and cable television services as well as increases from state gas tax revenues and other state revenue sharing amounts. Diminished growth in land based telephones compared to cell phones has resulted in an adverse impact on telecommunications franchise fees, but most other franchise revenue sources are relatively stable. Historical trends, proposed rate increases or decreases by utility firms, and additional consumers, are taken into consideration when estimating franchise fee revenues. Fee changes such as the large rate increase recently implemented by Pacific Power is the primary reason franchise revenues are projected to be nearly 9% higher than in the FY'11 budget estimate.

User Fees and Charges



Revenue estimates for Utility user fees:

	Wastewater	Water	Street	Storm Water
Actual FY'10	\$4,342,921	\$4,059,740	\$790,921	\$0
Budget FY'11	\$4,629,530	\$4,244,708	\$781,800	\$0
Projected FY'12	\$4,820,600	\$4,189,400	\$781,500	\$0

The foregoing chart reflects revenue estimates for wastewater, water, street, and storm water funds. Water revenues have been negatively impacted by the March 2009 Council repeal of the annual cost of living adjustments (COLA). However, the Wastewater COLA was reinstated in February 2010 after the financial performance of the Wastewater Utility was reviewed by Council in more detail. The Street Utility fee has remained unchanged at \$3 per month since its adoption and its value continues to diminish due to inflation. Current residential growth is largely confined to the southwest sector where wastewater services are provided by the Redwood Sanitary Sewer Service District (RSSSD). Thus, the growth rate estimated for City wastewater accounts is slightly less than the growth rate anticipated for City water service accounts. City wastewater does, however, charge fees to RSSSD for certain services, and over the next few years management will be evaluating the process of consolidating the District into City operations. The City's utility billing department already processes and collects RSSSD utility bills and the District is also managed by the City.

Significant decreases in growth and development have resulted in either flat or slightly lower projected revenues in Water, Wastewater, and Transportation funds. Water usage is highly vulnerable to weather patterns, especially during the warmer irrigation months. Water estimates in the budget are generally conservative to make sure the City does not plan on unpredictable weather patterns. Wastewater on the other hand should see a slight increase in revenue in the next year due to a slightly higher winter average usage rate that increased last winter and is used to calculate wastewater volume charges for residential properties for the remainder of the year. The average winter usage rate had dropped to nearly the lowest average rate in history one year ago but bounced back to historical norms this winter.

Extremely low levels of housing and commercial development were considered in developing the Street Utility revenue estimates. No revenues are anticipated in the yet to be adopted Storm Water Utility.

Revenues from Other Agencies

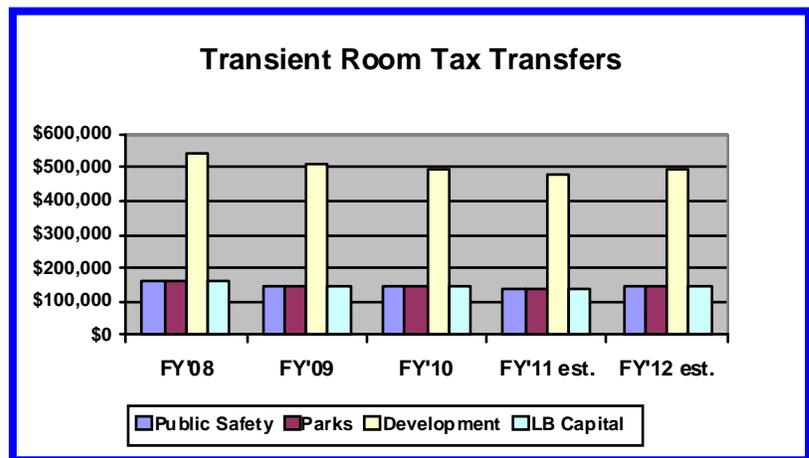
Revenues from other agencies are on track with estimates for FY'11 and an increase is projected for FY'12 due almost entirely to a large increase for State Gas Tax revenue. Revenues from the State of Oregon for Liquor Tax, Cigarette Tax, and Revenue Sharing, which make up the largest share of revenue from other agencies in the General Fund, are projected to be nearly flat from FY'11 to FY'12.

State Gas Tax is projected to provide intergovernmental revenue of \$1.948 million in FY'12 as compared to approximately \$1.663 million in FY'11 due to a state gas tax increase of \$.06 per gallon that was implemented halfway through FY'11 on January 1, 2011. This increase is projected to provide slightly less than \$600,000 per year once fully implemented (assuming statewide gasoline sales do not decrease due to improving fuel consumption in new vehicle and reduced driving). Per capita estimates are provided by the state through the League of Oregon Cities and are the basis for projections of Revenue Sharing amounts and Gas Tax projections. The increase in gas tax revenues is recommended to be dedicated to transportation capital projects.

Revenues from the 911 Agency for dispatching services are set for a very small increase by contract and will be similar to last year. Wastewater treatment services provided to the Redwood Sanitary Sewer Service District will generate \$255,000, an estimate based upon historical flows and the actual treatment costs realized by the City.

Transfers In

Transient Room Tax revenues are distributed among Development (which includes Tourism), Public Safety, and Parks as well as the Lands and Building program. Percentage distributions from the Transient Room Tax Fund are projected at approximately \$935,000, of which approximately \$790,000 will be directed to operations and \$145,000 will be directed to Capital. The combined total is nearly 3% higher than last year's forecast but still below the total actual revenues transferred in FY'09 two years ago. There are many factors, including weather, the cost of travel, forest fires, etc. that affect tourism in our region. We believe that



Grants Pass tourism will continue to hold its own compared to peers in spite of current economic conditions and projections of limited growth in tourism nationwide. Our tourism is supported by growing out-of-town participation in community events like “Boatnik,” “Back to the 50s,” “Art along the Rogue,” and perhaps by our proximity to California tourists, many of which elect to visit our region instead of more distant destinations.

Transfers also include \$5,000 allocated to the Code Enforcement division from Planning, in recognition of services it provides; and, \$24,000 from the Solid Waste Fund for Code Enforcement. Beginning in FY’11, Code Enforcement was integrated into Public Safety’s Field Services for its administration and budget.

Other Resources

In the General Fund, license and permit revenues generated from building activity are anticipated to produce \$196,000, nearly flat from this year’s conservative estimate of \$191,000. Percentages of court fines from traffic violations are estimated to produce revenues of approximately \$218,000 which is up just slightly from the current year budget and in line with historical averages in recent years. Public Safety will also have dedicated revenue of slightly more than \$200,000 each year from current service and annexation agreement fees until such time as the next annexation occurs and replaces these agreements with City property tax levies in the same amounts. Unspent contingencies are combined with the estimated beginning fund balances to show total beginning resources available for the upcoming budget year.

OPERATING COST TRENDS

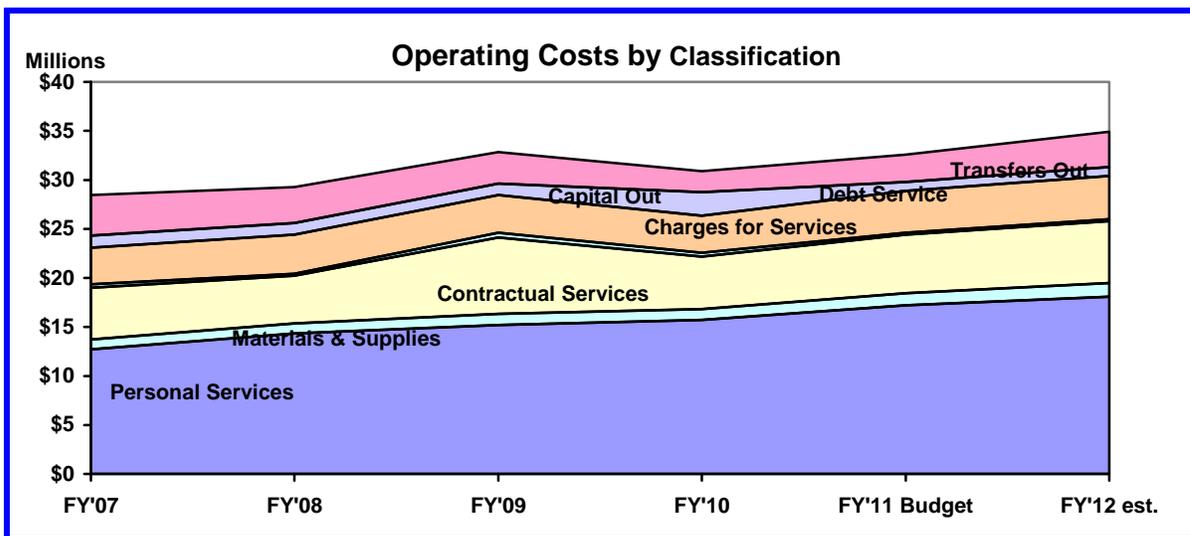
By Classification Category

The following graph illustrates increased operating costs over time to meet service delivery expectations of our community. Personal services is showing an increase of approximately \$901,000. This increase is due to 3 additional funded positions in Public Safety, one temporary grant funded position in Public Safety, contractual cost of living adjustments, step increases, and increases in the cost of benefits such as PERS billings by the State and health insurance premium increases. The impact of every 3% increase to PERS rates equates to between \$350,000 and \$400,000 per year in benefit costs for the City, and PERS rates are expected to increase 3% every two years until the PERS system is fully funded again. PERS rates billed out to departments are increased each year to approximately match the expected actual PERS rate change every two years. A small City PERS reserve has been created in recent years by a slight difference between department charges and actual payments into the PERS system and this reserve will be drawn down starting a few years from now when actual PERS rates are expected to be even higher than they will be in FY’12. Almost all non supervisory employees are now either part of a union or an officially recognized bargaining unit. Little can be changed about these mandated or contractual amounts without the legal

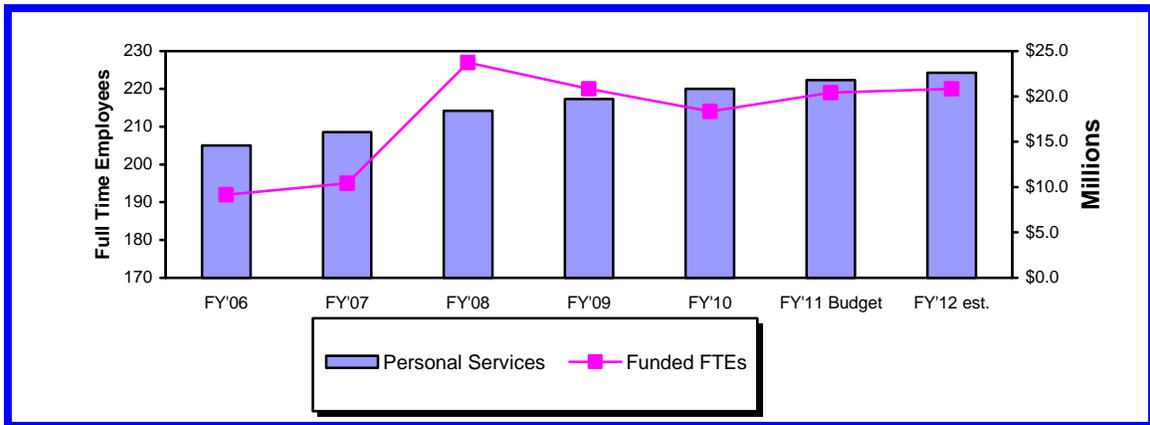
bargaining process and Council will continue to direct the negotiation process as they have always done over the years.

Materials & supplies are budgeted to increase by \$132,000 due mostly to increases in chemical budgets. Contractual services are budgeted to increase \$401,000 due mostly to increased rates for electricity and natural gas. The capital outlay classification within operating budgets is slightly less than last year at \$185,000. One minor change that affected these amounts this year is that any capital item less than the City's capitalization threshold of \$5,000 is considered a supplies expenditure starting in FY'12. Therefore, smaller items such as computers have been moved from capital to supplies. There are minor budget changes anticipated in the categories of direct charges for services and indirect charges for services which both come mainly from Internal Service Funds that provide services and pay for certain costs that apply to many (if not all) operational programs.

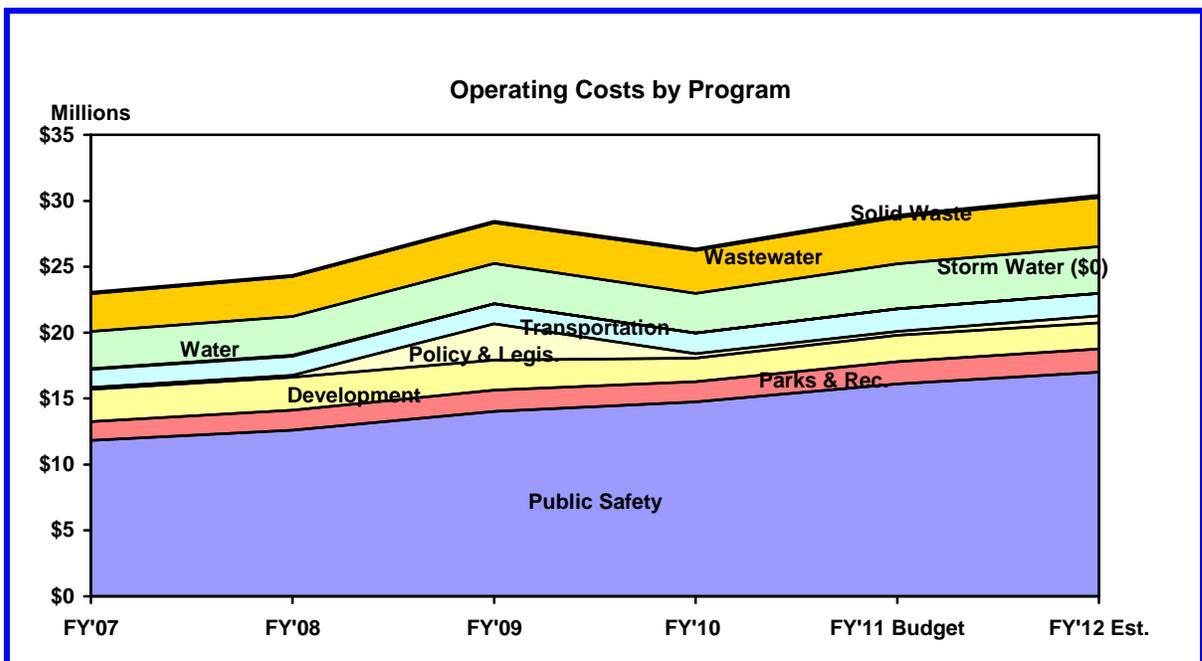
Transfers out of the General Fund to Capital funds are increasing slightly for FY'12 only due to the allocation of one-time General Fund resources to one-time Capital projects. As discussed previously, it is recommended that savings in the previously closed fiscal year be allocated to one time high priority capital project needs in the next budget year. Wastewater transfers to Capital projects have increased due to higher expected revenues and finally reaching a safe fund balance (contingency) in the Wastewater operations fund. Water transfers to Capital are significantly lower than previous years due to rolling back of the COLA in 2009, flat revenues, and increasing costs such as power costs. Water and Wastewater are not able to transfer an annual amount to capital projects in a sufficient dollar amount to cover annual depreciation costs, which means that these funds are not setting aside enough money to maintain infrastructure over time. Transportation capital transfers are increasing due to expected increases in gas tax distributions to the City. The financial tables and charts at the beginning of the budget book provide an excellent reference for operational activity should you desire more detail.



The following chart illustrates the cost of “Personal Services”, a state classification designated for employee and employee benefit related costs, and the number of approved and funded full time equivalent positions in Grants Pass by year.



The City utilizes internal service funds for: Property Management, Vehicle Maintenance, Vehicle Replacement, Engineering, Community Development Management, Administrative Services (including Management, Legal, General Accounting, Accounts Payable and Receivables, Utilities Billing, Payroll, Human Resources, and General Programs), Insurance, Benefits, and Information Technology. Use of these funds helps in identifying the true cost of program operations and can centralize specific operations to help reduce expenses and increase efficiencies.



Public Safety

Public Safety has been the focus of this year’s budget preparation. The significant impact the local option levy has on the City cannot be over stated. The adopted

budget includes the resources provided by the levy of \$1.79 per \$1,000 of assessed valuation. With these resources, Public Safety services will continue at levels similar to prior years. While there were discussions about possibly expanding some of the services provided by the Public Safety Department, there are not sufficient new resources to do that in a significant way and won't be unless alternative or supplemental revenue sources are studied. The Council may want to seek additional revenues if the City wants to improve traffic safety operations to address unusually high crash rates and traffic related complaints within the community or high crime rates. Two of the three new approved officer positions in this year's budget will be dedicated to starting a traffic team as recommended by the strategic plan.

Parks

The "River Vista" addition at Reinhart Volunteer Park is finally complete and will provide new opportunities for parks users. Further development of Redwood Park has resulted in incremental increases for operating supplies, grounds repair and maintenance items, and utilities. The City will continue contracting with the local YMCA to operate Caveman Pool and again with Recreation Northwest to administer the City's year-round recreation and downtown programs. Preliminary and potential development options for the River Road Reserve property are in process and will continue to be discussed in the next year.

Development

While issued permits still remain near 10 year lows, there remains a significant work load in the Planning and Building Divisions. Planning has been working on tasks for the evaluation and expansion of the Urban Growth Boundary (UGB). This project is continuing and may take slightly longer than forecasted last year as there were several issues Council wanted to review and many steps required to be taken before adoption. The Division has also been working on text amendments and other long-term projects that require staff time. These projects are ongoing in addition to completing daily tasks of reviewing plans and providing high quality service to our customers. The division will renew its focus on long-range planning and preparing for the next development cycle to help the City manage the effects of growth while maintaining our quality of life. All Community Development related activities are working on streamlining processes to make the customer service aspects as convenient as possible.

Revenues from construction permits are below expenses for the fourth year in a row for the Building division, the result of reduced construction activity in single family homes and related development. Therefore, the Building and Safety Division will draw upon reserves to support operating costs for another year. The draw will be slightly less than originally projected for FY'12 but the new General Fund contribution of \$50,000 to Building that started last year will have to remain in place this year.

This budget also allows the City to continue updating and maintaining the Geographic Information System. This system is used extensively throughout almost all departments in the City. The City is currently using a version of the software that is no longer supported by the manufacturer. However, the City does not have the expertise on staff to make the transition to the current version of software. This budget provides for a contractor to continue working with the City staff to make the upgrade and provide the support needed for the upgraded software. The funding for this new contract has been shared by departments throughout the organization, reflecting the integral part it plays in the operations.

Tourism / Downtown / Economic Development

Tourism and Downtown activities have been managed by the Parks and Community Services Director since a minor reorganization four years ago. This has resulted in improved communication and relationships with the downtown business community. Transient Room Tax revenues, the primary source of resources for these programs, are expected to be relatively flat in FY'11 before slightly increasing in FY'12. In addition to room tax revenues, downtown derives a small amount of income from parking programs. Improvement plans include encouraging facade renovations and completing historic lighting installations throughout areas of downtown.

We hope to continue marketing support to attract new business opportunities for economic development through the City's partnership with SOREDI (Southern Oregon Regional Economic Development Incorporated). SOREDI has been a successful partnership for Grants Pass and other regional agencies.

Transportation

State Gas Tax provides the primary revenue source for street maintenance and capital projects and is apportioned by the state based upon population. Gas Tax revenues are expected to generate \$500,000 to \$600,000 more per year now that the new \$.06 per gallon increase has recently taken effect. The decision to forgo planned annexations also negatively impacts revenues from State Gas Tax receipts. While refusing to annex does not slow growth, it does impede the City's ability to pay for increased service demands and our ability to manage growth impacts. Street Utility Fees provide the majority of the balance of transportation revenues and are dedicated specifically for roadway maintenance and safety enhancements such as sidewalks, traffic signals, traffic signage and markings and clearing hazardous sight obstructions within the right of way.

The costs for transportation improvements and related services continue to climb; however, the Street Utility fee has not been adjusted since implementation in 2001. Review of this fee is included in the current work plan and at a minimum Council wants to have a discussion of indexing this fee to inflation over time. The Transportation SDC Task Force has also recommended a number of ways to help fund local Transportation projects in conjunction with an extensive report about SDC and other Transportation funding.

Storm Water and Open Space

The City's storm water program, designed for collection system maintenance, storm water retention, and treatment of storm water run-off in the community, has not yet been adopted. The funding mechanisms are ready for deliberation if Council desires to consider this issue in the next year. Internal loans of approximately \$146,000 in total will need to be addressed to cover the startup costs that have already been incurred. Payment for interest on the loans has been budgeted in the Street fund. If the program is not implemented soon, the costs incurred will most likely fall to the Street fund causing a one-time expense of approximately \$146,000 to repay the loans.

Water

The Water Plant will operate on a 24/7 schedule again this summer to manage water production at a more consistent pace, thereby reducing stresses on plant equipment and processes. Federal and state mandates requiring additional testing of both water and waste water continue to be a growing cost and concern for the City. A portion of the net margin between resources and requirements, totaling nearly \$368,000 for FY'12 is anticipated to be available to be transferred for investment in capital projects. Water revenues were affected by the Council's decision to roll-back the annual COLA (cost of living adjustment) step increase in water rates effective in March, 2009. After a significant electric power rate increase in January 2010 and an even larger power rate increase in 2011, the Water Department has been sending declining amounts of resources to capital projects. Therefore the Water fund is having a harder and harder time keeping up with necessary infrastructure replacement and maintenance and will be in need of a rate increase in the future. Current annual depreciation costs are nearly \$1 million per year and this year the Water fund can only set aside \$368,000 for infrastructure upgrades and capital projects. On the plus side, the Water fund will be debt free at the end of FY'12 after making the final annual bond payment and this will provide some financial flexibility for high priority capital projects.

Wastewater

Wastewater collection, wastewater treatment, and the JO-GRO™ activities are designed to protect the public's health and the environment. In FY'12, while nearly \$850,000 is budgeted to be transferred to capital projects, this amount is still well short of the nearly \$1.1 million in annual depreciation costs. The cost of providing service continues to climb as wastewater treatment is impacted by the increasing power rates just as the water system is impacted. Additionally, federal and state regulations continue to dictate additional monitoring and testing for contaminants being introduced into the system beyond the control of the City. The Wastewater Collection Division will maintain its program of cleaning sanitary wastewater lines and inspecting for system failures and blockages.

An additional rate increase will need to be considered to keep up with the increasing cost of power, new and expensive monitoring, infrastructure

depreciation over time, and infrastructure expansion needs. The Wastewater system also has the largest dollar amount of high priority capital projects over the next five years, as compared to Transportation and Water utility needs. Wastewater has yet to identify funding for most of these high priority projects which are necessary just to replace old infrastructure and prepare for small amounts of growth. The effect of many years of not setting aside enough money for infrastructure maintenance is most apparent in the Wastewater utility today and deferring the collection of resources for these projects may result in higher costs in the future.

Solid Waste

The City continues maintenance activities and monitoring of greenhouse gas emissions, ground water, surface water, and the landfill cap at the Merlin Landfill site. The primary issues in the Solid Waste fund will be: continuation of the required remediation and monitoring actions at the Merlin Landfill pursuant to the final Record of Decision, reforestation and fuels reduction on the landfill property.

Internal Service Funds

Independent funds have been established to provide an array of specialized services to the operational programs of the City and ensure that the program costs accurately reflect the resources needed to provide the program services. These funds are designed to be financially self-sufficient and the services they provide cover everything from office space to vehicle rental. The basis of billing for these funds vary, depending upon the nature of the service provided. For example, space is based on square footage; vehicle rents are a combination of actual costs incurred for repairs and depreciation costs; engineering is based upon time consumed; direct overhead is allocated based on personnel, time and materials, direct reimbursement; and, general overhead for management, legal, finance, personnel services and other general government administrative costs are funded on a fixed percentage of 8% of operating costs. Information technology services are also funded on a fixed percentage established at 2%.

For some Internal Service funds, retaining adequate reserves is critical to the purpose of the fund itself. Examples of these include Equipment Replacement, Workers' Compensation, General Liability Insurance, and Benefits. Other funds such as Community Development Management, Engineering, and Property Management need to assess fees more closely with annual operating costs so that they can provide the best possible service without accumulating significant fund balances.

Engineering Rates

Historically, billable rates for engineering services have not been reflective of actual costs; hence an average rate increase was approved effective July 1, 2007 and was intended to be annually indexed with inflation. City Council rolled back the rate increase for 2009 in reaction to the recession. Engineering is funded through

an Internal Service fund generating revenues necessary to cover operating expenses. The anticipated resources may fall below the requirements in 2-3 years if it is not supported from other sources. A \$30,000 General Fund retainer has been charged in order to maintain the Engineering fund operations. The Division, under the management of Community Development, assists with orderly development of our community by ensuring compliance with adopted facility plans and development standards. Customers include: internal customers such as streets, water, and wastewater fund capital projects as well as day-to-day operations and external customers such as private developers. A recent performance audit of the Engineering division resulted in a firm recommendation to change from a time and materials billing to a fixed rate fee structure. This will be studied and brought to Council early in FY'12 for consideration.

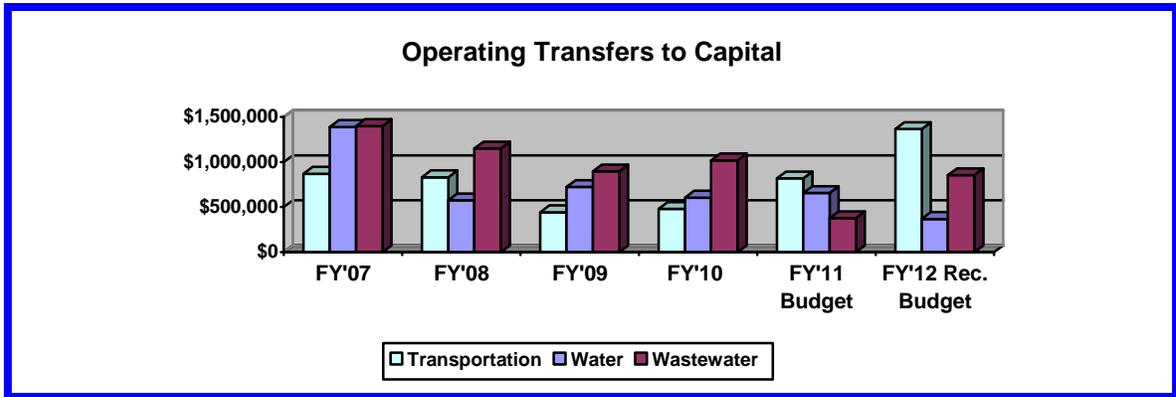
Other Rates

No change has been made to the fixed rate of 8% applied to all operating costs for Administration since the mid-eighties. It is important to recognize that the fund balance for Administrative Services is slowly being consumed and that the 8% charge is no longer sustainable to provide services that have necessarily expanded in scope and complexity over the last twenty years. These new services include active management of property acquisition, disposition and recordkeeping, grant procurement and management, active investment management, increased union negotiation activity, and others. However, the 8% of costs recorded as revenue for the Administrative Services Fund has matched up fairly closely with the cost to provide these services as cost changes over time are similar across the organization.

Worker's Compensation rates are determined by the state based upon job classification and the City is self insured for Workers Compensation Insurance. The rates billed out to departments have not changed in the last couple years due to sufficient reserves in the fund and low loss rates. In fact, beginning this year Workers Comp Fund may provide a credit back to departments in return for having low loss rates.

Property Management's billable rate has been changed from \$1.43 per square foot to \$1.44 per square foot in FY'12 to keep up with increases to items such as energy and electricity expenditures.

For the utilities, the difference between operating resources and operating requirements, which is annually transferred to capital projects, serves as a key element in determining revenue available for improvements. The water and wastewater capital improvement programs, adopted by Council in May 2005, identified plant upgrades and capacity expansion requirements for both utility systems. Water system improvement needs through 2024 were estimated to cost \$33.5M while the upgrades, expansion and structural repairs to the wastewater system, will require \$33.7M.



Operating Transfers to Capital Projects

	FY'07	FY'08	FY'09	FY'10	FY'11 Budget	FY'12 Rec. Budget
Transportation	869,606	831,096	443,387	478,808	818,584	1,366,158
Water	1,390,000	576,000	723,725	605,166	655,531	367,801
Wastewater	1,400,000	1,150,000	896,664	1,017,834	378,206	855,046

A major source of funding for capital improvements in the past has been a transfer from the General fund. That transfer, usually in the range of \$300,000 to \$400,000 annually to Transportation projects, is not included in this adopted budget after it was eliminated in FY'10. Each of these three utility systems has annual depreciation costs of nearly \$1 million or more per year, and in the near term only the Transportation Fund is able to transfer enough money to capital projects annually. A rate increase has been recommended in Wastewater to begin preparing for a larger increase necessary in the future, and user rates on both Water and Wastewater will be studied in depth after the UGB and new master plans are completed or revised in the coming two years.

Impact of Capital Projects on Operations

Expenditures for capital improvements can have an impact on future operations. Some capital projects will require additional resources to maintain and operate. Others may reduce repairs and maintenance or reduce costs through improved efficiencies. Many capital expenditures will not have significant impacts or the impacts may be offset by increasing resources. The two new Public Safety facilities have operational impacts that are addressed through the budget process.

Beginning in FY'07 additional personnel were planned and budgeted to staff two new public safety stations which recently came on line. In FY'08 there were additional hires, and though not directly related, there were other Public Safety positions approved in the FY'09 budget. Salary and benefits together with the associated costs of equipment, uniforms, and operating supplies have been incorporated into the operating budget for Public Safety each year. The City

weighs the total cost (the capital cost and the on-going operational cost) against the anticipated benefits when evaluating capital projects.

Operating and maintaining all of the City's Public Safety facilities throughout this next fiscal year were among the key purposes of the levy election. The resources historically provided by voter approved levy funds are so significant that the face of Public Safety and of the City as a whole would be dramatically different if those resources are not renewed in full in the future.

Each of the foregoing capital expenditures will have an impact on future budgets and service requirements. This budget has been developed following thorough analysis and discussion among staff and management in an effort to ensure that the City can adapt to changing economic conditions, that the services and policies of the City are sustainable, and that careful planning and execution permit the City to operate more effectively than ever before.

The following table identifies the major capital improvements planned for this year and in summary form identifies anticipated future savings and costs.

Project	Description	Future Costs Estimate	Future Savings
Public Safety Computer Aided Dispatch	The CAD System, the central computer system that integrates with most operations and other IT systems of Public Safety and the 911 Agency, is past due for an upgrade after being in use for nearly 20 years.	<ul style="list-style-type: none"> • City's share of multi-agency cost is estimated to be \$800,000 to \$1,000,000 • Equipment Depreciation • Newer system will create significant staffing efficiencies through avoiding duplicated work on entering call or case information 	<ul style="list-style-type: none"> • Response times may be improved • Improved Public Safety staff efficiencies • Potentially less maintenance costs
HTE (Financial Software) replacement	Upgrade or replace financial software used throughout City departments (current system is 15 years old)	<ul style="list-style-type: none"> • Installation & initial licensing cost estimate \$140,000 • Future annual maintenance cost similar to annual cost today on old system of approximately \$50,000 per year 	<ul style="list-style-type: none"> • More staff efficiencies through a better integrated financial system • Less training time required from a more modern web based financial software system
Hillcrest Fire Station Seismic Rehab	Awarded a Grant to upgrade the Hillcrest Fire Station building according to modern seismic standards	<ul style="list-style-type: none"> • Limited additional future costs beyond maintenance of the new generator 	<ul style="list-style-type: none"> • The building will last longer and upgrades could result in less maintenance costs over time
Phone System and Data Connectivity	Upgrading data capacity throughout operating locations and installing VoIP phone system (two separate capital projects that will be implemented at nearly the same time)	<ul style="list-style-type: none"> • Minimal annual licensing fee for phone system of \$12,000 or less 	<ul style="list-style-type: none"> • Increased productivity with various technology and software uses • Will decrease hard costs for traditional phone lines by nearly \$40,000 per year

Redwood Avenue - Dowell to Hubbard	Widen Redwood Avenue from Dowell Road to Hubbard Lane to a three lane road	<ul style="list-style-type: none"> • This road serves most of the Redwood area residents • No significant anticipated change from current maintenance costs. • Any added sweeping, patrol, or other related costs will be minimal. 	<ul style="list-style-type: none"> • Issues of a narrow and old road will be eliminated. • Long-term maintenance costs will be reduced.
Other Road Improvements	There are a number of other road improvements in the Capital Budget	<ul style="list-style-type: none"> • No significant anticipated change from current maintenance costs. • Any sweeping, utility, patrol, or other related costs will be minimal. 	<ul style="list-style-type: none"> • Most are on the Transportation Master Plan and are designed to provide for current and future demands. • Long-term maintenance costs will be reduced.
Water Reservoir #3 upgrades	After structural assessment, it was determined reservoir #3 would require in-place replacement. Next steps will be design and construction of a new reservoir.	<ul style="list-style-type: none"> • Limited additional maintenance costs beyond today's requirements. 	<ul style="list-style-type: none"> • Avoids potential costly repairs and maintenance to existing infrastructure and avoids having a failure for critical water capacity and infrastructure needs.
Sewer Main Structural Repairs (Multiple Phases)	Replaces very old structurally deficient sewer pipe in 5th Street, the alleys fronting 5th Street between 'M' and 'A' Streets and the alleys fronting Pine Street between Bridge and 'G' Streets.	<ul style="list-style-type: none"> • No known increases in cost. 	<ul style="list-style-type: none"> • Safety is increased • Potential environmental problem decreased • Long-term maintenance cost will be reduced for this area • Structural defects fixed
Wastewater Phase 2 Expansion	Expands capacity and meets new regulatory requirements	<ul style="list-style-type: none"> • Additional utility/energy consumption expected. 	<ul style="list-style-type: none"> • Prepares to meet future regulatory costs.

Planning for the future is one of the most important responsibilities the City has. It is important to analyze all of the expected costs along with the benefits related to capital expenditures. We believe in preparing for the future.

CONCLUSION

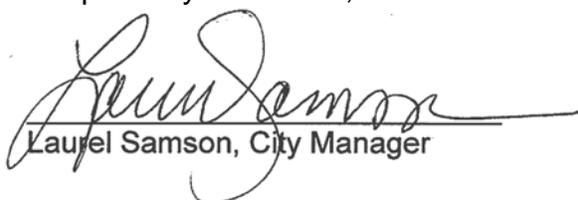
The City of Grants Pass is an innovative organization that is focused on value. Our elected officials and employees demonstrate a willingness to seek and create alternative solutions to problems. The knowledge and years of experience of our employees will help Grants Pass succeed. Through this budget we are recognizing the needs of today and the needs of the future by planning strategically and implementing measurable objectives. With adopted Council goals and work plan, staff will be able to direct their energies, skills, and talents, in applying the financial resources which have been approved through the budget process to make measurable progress toward achieving those goals.

This budget recognizes the economic reality of today and enhances the efficiency of City operations. Because of careful financial planning in the past, the City is not in a position like so many other agencies of having to cut critical services to the public. While decision packages have been presented to the Council and Budget Committee for the impacts of changes to services, we can rest relatively easy in that any cuts we may choose to do in services today or even next year would just be to enhance our financial condition and not because we are in a position of forced cuts today.

I also feel compelled to provide a cautionary note. The level of service that can be provided through the adopted budget is not sustainable for more than a couple years without starting to draw on necessary financial reserves. Throughout the organization the pressure is growing as demand for services is outstripping our ability to safely respond. The next three years of relatively flat funding will provide the time to explore alternatives to stabilize funding and evaluate whether to reduce service levels or increase funding. We will also have to explore potential changes to employee benefit structures through the bargaining process to make sure we're all on the same page of providing fair wages in combination with a reasonable sharing of benefit costs. We will need to work together to evaluate certain benefits that are more under our control at the local level such as health insurance costs.

In closing, I would like to acknowledge the teamwork, commitment, and assistance of all of our elected officials and Budget Committee members, City staff, and participating members of our community in the preparation of this budget document. I am particularly grateful to Jay Meredith, our Finance Director and the Finance staff for their continuing commitment to excellence in municipal finance and budgeting for the benefit of our community. Creating and maintaining a sustainable, balanced budget helps the community provide its critical and quality services for many years to come.

Respectfully submitted,



Laurel Samson, City Manager