EXECUTIVE SUMMARY

Financial Forecasting Overview

At the February 20, 2018, City Council meeting, Council requested staff prepare preliminary budgetary projections from 2019 through 2021 to provide initial analysis and projected trends surrounding financial issues of interest, including projected property tax outcomes.

Financial forecasting includes numerous assumptions and components that can fluctuate based on a variety of actions. The budgetary projections for 2019 through 2021 presented by staff in this agenda item utilize numerous assumptions (included as Attachment #1). These assumptions are based on current policy decisions, current economic conditions, known expense and revenue variables, and projected actions; however, it is critical to understand that changes to any of these documented assumptions (or others) will have an impact on future annual budgets presented to the City Council.

Changes to assumptions can take many forms, including policy decisions or policy changes by the City Council; unanticipated economic fluctuations at the national, state, and local level; or other decision points. Often when one assumption changes or does not come to fruition, this impacts numerous other assumptions due to the interconnectivity of budgetary components. This ultimately leads to different budgetary outcomes than originally forecast.

The City's budget cycle formally starts in August; however, staff continually reviews expenditures, revenues and service delivery methods year-round to capitalize on efficiencies and identify factors which may be influencing assumptions. The City's mission statement, ends policies and financial principles are all high-level guiding influences in the annual budget process.

The following attachments include high-level and detailed projections for the 2019 through 2021 operating budgets. As noted above, these projections are based upon a series of assumptions that are outlined in detail in Attachment #1. A high-level overview of previous assumptions and impacts, current major assumptions and policy decisions is included in this executive summary along with projected property tax outcomes through 2021.

Assumptions Overview

Financial Principles

In 2015, the City implemented three financial principles that guide financial decisions. These principles were developed to promote the long-term financial success of the community. The following principles were adopted:

- *Principle #1* - The City will pass a structurally balanced operating budget annually;
- *Principle #2* - The City commits to continuous improvement in the delivery of necessary and cost-effective services; and
- *Principle #3* - The City will actively seek to increase its reserves to 25% and reduce its debt by 25% in the next eight years.

Financial Principle Assumptions/Impacts to Current Budget

When the City instituted its financial principles, they were based on several assumptions about the City's future financial picture and how the City would manage its finances. Of the 12 major assumptions used by staff in creating the principles, nine were attained as anticipated, with the remaining three not coming to fruition. Below is the impact on the 2018 budget of those assumptions not being realized.

- *Pension Growth*
  - Since FY07, the City has experienced a 144% ($8.13 million) increase in required pension payments. The City saw a 16% ($2.25 million) increase alone from 2017 to 2018, placing significant pressure on the City's budget for the current year. The recent increases were caused by several factors that included, but are not limited to, changes in mortality tables, payroll growth and fluctuations in the market returns on the pension investments. The City's current pension funding methodology requires 100% funding by 2033.
- *State Pressures*
  - As part of the State of Illinois' budget compromise in 2017, several items were introduced that impact Naperville's financial picture in 2018 and beyond. Specifically, two items reduce the overall revenue received by the City from the state. These include a 2% home rule sales tax (HRST) administrative fee, which reduces revenue by $175,000 annually to the City on a 0.50% HRST rate. The second change was a 10% reduction in the state income tax allocated through the Local Government Distributive Fund (LGDF). This reduced the City's budgeted revenues in 2018 by $750,000. As part of the Governor's budget proposal, the reduction of LGDF is being extended. This will reduce the 2018 budget by an additional $650,000, for a total reduction of $1.4 million.
- *Property Tax Policy Decision*
  - The City's property tax levy includes several components, including City operations, public safety pensions, debt service, Naper Settlement and the Naperville Public Library. The policy decision by City Council to maintain a flat property tax levy versus a flat property tax rate has reduced the overall amount of property tax received by the City since 2016. Maintaining the property tax rate at the same level would have allowed the City to take advantage of incremental EAV growth, including new development. If the City had maintained a flat property tax rate versus a flat levy, an estimated additional $9.15 million of property tax revenues would have been received from 2016 to 2018.

2019-2021 Expenditure and Revenue Projection Assumptions

In developing the 2019-2021 projections, staff utilized short-term averages to account for changes in expenditures. In addition, expenditures were aligned with existing contracts, including collective bargaining agreements and procurement contracts. Assumptions utilized are consistent with current operational practices and service provision levels.

Both long-term and short-term trends were considered when creating revenue projections, which allowed staff to flatten out the impact of economic conditions. Using these considerations, staff made the following assumptions in revenues and expenditures:

- *Expenditures* - Average annual spending increase of 0.3% across all funds and expense categories
- *Revenues* - Average annual revenue decrease of 2.0% across all funds and revenue categories

Policy Decisions and Potential Impacts to Financial Forecasts

Understanding that changes to assumptions take numerous forms, it is important to consider how current and future policy decisions will impact the financial forecasts presented in this document as well as annual budgets brought before the City Council. The five policy decisions below may not necessarily have the greatest financial impact on annual budgets; however, they are budgetary factors that the City Council can exert the most control over. Any changes to current policies utilized in staff's financial forecasting through 2021 will directly impact and change those forecasts.

- *Service Levels*
  - Setting citywide service levels ultimately controls the revenue and expenditures of the City. The estimates included in these projections are based upon the current service levels provided by the City. Any increase in service levels would require additional resources, and any decreases in service levels would result in fewer resource requirements.
- *Food and Beverage Tax Rate*
  - Changes to the Food and Beverage tax rate have a cascading impact on other revenues. For example, if the Food and Beverage Tax was reduced from 1.00% to 0.75%, then the dollars available for debt service and pension contributions would be reduced. These expenses would have to be offset through potential property tax or other revenue source increases.
- *Property Taxes*
  - The policy option to maintain a flat property tax levy versus a flat property tax rate impacts the amount of annual revenue generated. Maintaining a flat property tax rate allows the City to take advantage of incremental EAV growth throughout the City, including new development, whereas maintaining a flat property tax levy reduces the property tax rate and therefore the annual property tax burden.
- *Home Rule Sales Tax*
  - At what rate the HRST is set and how the funds are allocated will impact other revenue sources, borrowing, and service levels. Each 0.25% increment of HRST is valued at $4.4 million. The revenues can be used to wholly decrease borrowing requirements or property tax requirements, or any combination of those two.
- *Debt Reduction Goal and Borrowing*
  - Financial Principle #3 currently sets the parameters required to reduce debt by 25% by the end of 2022. This parameter means that borrowing is restricted to $7.25 million on an annual basis. If this parameter is adjusted,

it would impact the workload and revenues associated with capital investment. For example, if the principle and associated goal was amended to decrease debt by 20% by the end of 2022, the City would have the ability to borrow an additional $1.25 million on an annual basis.

Property Tax Outcomes

Based on the assumptions discussed in this document and the attached materials, staff projects the budgetary requirements between 2019 and 2021 will have the following impact on the City's property tax levy and property tax rates. The table below shows annual projections for each component of the property tax bill (in millions).

	2018 Budget	2019 Estimate	2020 Estimate	2021 Estimate
Debt Service	11.08	12.09	12.04	11.82
Fire Pension	8.38	8.39	8.51	8.39
General Corp	0.79	3.32	4.92	6.94
IMRF	2.54	2.53	2.51	2.50
Library	14.58	15.13	15.49	15.85
Police Pension	6.61	6.62	6.81	6.66
Settlement	2.90	3.15	3.28	3.41
Grand Total	**$46.89**	**$51.22**	**$53.56**	**$55.57**

The below chart shows the impact of the above property tax values on the projected rates in future years compared to prior years. The rate assumes a 4% annual growth in EAV. The upper and lower bounds are set by the probability of attaining the projections based upon assumptions and policy decisions.