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**CITY COUNCIL AGENDA ITEM**

**ACTION REQUESTED:**

Receive the 2019 2nd Quarter Financial Report

**DEPARTMENT:** Finance Department

**SUBMITTED BY:** Rachel Mayer, Finance Director

**BOARD/COMMISSION REVIEW:**

The Financial Advisory Board (FAB) reviewed the financial report at the July 29 meeting.

**BACKGROUND:**

Attached is the 2019 2nd quarter financial report. Staff will present the information in this report during the August 20, 2019, City Council meeting to provide Council with an opportunity for discussion and questions.

This memo provides an overview of the City's financial status and highlights through the first six months of 2019 and a preview of the forthcoming budgetary discussions. More detailed financial information can be found in the attached documents.

**DISCUSSION:**

**2019 Financial Performance to Date**

Overall, the City performed close to expectations through the second quarter for both revenues and expenses. Items that significantly differ from expectations are explained below. Other differences are attributable to timing issues for both revenues and expenses.

- Citywide revenues came in at \$208.99 million, which is 46.0% of budget. This is a 1.9% deviation from 2018 revenues and 6.6% lower than budget projections.

- Citywide expenses came in at \$182.48 million, which is 40.4% of budget. Expenses were 0.8% higher than 2018 and 6.1% lower than budget projections.

The below chart displays revenues and expenditures among the City’s major fund categories. It indicates where the City is in comparison to the total budget and a comparison to the City’s six-month actuals from the prior year.

Fund		2019 Budget	2019 Q2 Actuals	% Spent	2018 Q2 Actuals	Q2 Actuals Variance
<b>Maintenance &amp; Ops</b>	<i>Revenue</i>	373.9	175.5	46.9%	178.1	98.6%
	<i>Expense</i>	370.8	159.6	43.0%	159.8	99.9%
<b>Capital &amp; Debt Service</b>	<i>Revenue</i>	48.5	17.5	36.0%	17.9	97.2%
	<i>Expense</i>	48.1	8.8	18.3%	8.7	101.1%
<b>Special Funds</b> <i>*In Millions</i>	<i>Revenue</i>	31.7	15.9	50.4%	16.9	94.6%
	<i>Expense</i>	32.6	14.1	43.3%	12.6	112.0%

## Overall Highlights

### State Shared Tax Revenues

Revenues from state taxes are currently outpacing projections. The City is benefiting from an overall increase in statewide tax receipts, with the state seeing an increase of 15% in income tax and 17% in local use tax. The increase in income tax is associated with better collection of withheld taxes and positive growth in the labor market, according to the Illinois Municipal League (IML). IML also has seen an increase in local use tax due to an estimated 7% growth in online sales and changes arising from the Wayfair decision.

The City initially projected a significant increase in state shared revenues due to the 2018 Special Census, which added 5,596 people to the City’s certified population, now totaling 147,449. The additional population increases the per capita distributions for three primary revenues: state income tax, local use tax and motor fuel tax. The Special Census was completed in 2018 at a total cost of \$210,469. To date, the census generated an additional \$558,000 in revenues.

For the first six months of the year, Motor Fuel Tax (MFT) revenues have been stagnant even with the increase in population. The City received \$1.8 million, a 0.6% increase over 2018 six-month totals; however, this was in line with staff estimates. The City is likely to see an increase in MFT revenues starting in October as part of Governor Pritzker’s Rebuild Illinois plan, which doubled the MFT rate to \$0.38 per gallon on July 1. Per IML projections, the City is estimated to earn \$12.80 per capita of incremental revenue from the MFT fund annually, which equates to \$1.89 million annually.

### Salaries and Benefits

Salary and benefits combined is the largest budgeted expense component and accounts for 31% of the expenditure budget. Year-to-date total spending is \$69.9 million, or 49.8% of the projected year-to-date budget. This figure is trending at 99.9% of 2018 totals.

- Regular pay totals \$44.8 million, which is 1.2% higher than 2018. However, this is trending lower than the 2.2% increase that was projected in the 2019 budget.

- Overtime is trending 11.2% higher than 2018 at \$4.2 million. This is primarily due to back-filling open positions and winter events.

Combined, the expenditure difference between regular pay and overtime pay balances out and the City is maintaining its projected personnel costs.

### **Healthcare**

Healthcare costs are another significant component of the City's annual budget. The City is self-insured, meaning that the City funds all types of insurance required, including medical, dental, general liability, worker's compensation, auto liability, life and unemployment. The City has actively managed its benefit plans to implement cost-saving opportunities, such as the elimination of the Consumer Driven Health Plan (CDHP), generic preventative drug programs, virtual visit offerings, and dental plan changes.

Through the first six months of 2019, healthcare costs totaled \$10.4 million, which is a 33.5% increase from 2018 and 60.1% of the \$17.3 million budget. For context, the prior four-year average of annual costs for plan administration, claims and prescription drugs has been \$16.8 million, meaning the City has far exceeded the claim trends of prior years.

Because healthcare costs are ultimately claim based, the City is projecting significant increases in 2020. Staff is working with the City's insurance broker to finalize 2020 costs increases within the next month.

### **Pension Benefits and Actuarial Valuations**

*Public Safety Pension* - The City recently received the 2019 public safety pension actuarial valuations calculated by the City's actuarial consultant, Foster and Foster. The City's overall contribution level projections for 2020 are seeing an increase of \$1.66 million, or 10.4%. The Firefighter pension increased by \$1.12 million, or 12.5%, and the Police pension increased by \$544,000, or 7.7%. These increases are primarily driven by poor investment returns but also include changes to City pension assumptions.

*Illinois Municipal Retirement Fund (IMRF)* - The City received preliminary figures from IMRF for 2020 contributions. The City's contribution rate is estimated at 11.05%, which is a 18.3% increase from the 2019 rate of 9.34%. The City's overall IMRF contribution is approximately \$5.24 million in 2019; combined with salary increases, the City is projecting a \$990,000 increase across all funds for 2020.

### **Maintenance and Operating Funds**

#### **General Fund**

##### *Revenues*

General Fund revenues of \$63.5 million are 6.2% higher than the 2018 performance of \$59.8 million. Overall revenues are aligning with projections.

- **Property Taxes** - The City levied a property tax of \$49.08 million to fund debt service, pensions, Naper Settlement, the Library, and a small component of general operations. The City has received approximately 50% of disbursements and will receive the next major installment in September.
- **Sales Tax** - \$16.6 million of receipts were received in retail sales tax, finishing only behind the City of Chicago for the second quarter. This was a 0.5% increase over 2018 year-to-date collections and is in line with projections.

- **Utility Tax** - \$8.42 million was collected in utility taxes for the first half of the year, which is a 3% increase over last year. The most significant increase is related to the state telephone tax, which is up more than 15% and totaled \$2.3 million, a \$300,000 increase over last year.
- **Fees** - The City experienced a decline in residential and commercial permits compared to 2018; however, this trend was projected and is in line with expectations as a community that has reached build out. Residential permits were down 9% from last year, while commercial permit revenue dipped 1%. Through June, the City issued 3,412 total permits compared to 4,049 in 2018.

### *Expenses*

General Fund expenditures of \$60.3 million are 1.1% higher than the 2018 performance of \$59.7 million. Overall expenditures are aligning with projections.

- **Refuse and Recycling** - The City entered into a new contract with Groot Industries that started on May 1, 2019. The City has expended \$2.8 million of the \$6.8 million budget. The per household price is now \$12.95 per month, which is a direct service charge to residents.
- **Winter Operations** - The City saw an increase in expenses related to winter operations. The City spent \$224,000 on roadway plowing by third-party contractors and \$640,000 on roadway salt and calcium chloride. The City saw spikes in overtime spending in March and April related to winter events.
- **Leaf Collection** - In July, City Council passed a budget amendment to increase the General Fund budget by \$274,000 for contractor services, disposal costs, and rental costs for the fall 2019 leaf collection program.

### ***Electric Utility Fund***

#### *Revenues*

Revenues from the Electric Utility totaled \$72.55 million, an 8.5% decline from 2018. Staff anticipated a slight reduction in revenues due to a 2% rate reduction approved during the 2019 budget process.

The primary component of revenues is tied to charges for electricity, which totaled \$70.65 million through June. The decline in revenues matches the decline in purchased electricity, which is down from last year. Additionally, rates paid to IMEA per megawatt hour are down from the budget amount of \$0.082 to an average of \$0.078 through June.

#### *Expenses*

Electric Utility expenditures for the first half of the year total \$63.3 million. Purchased power, which represents 79% of total expenditures, is less than prior year spending by \$4.4 million. Consumption for the first half of the year is down due to the mild spring and the first hot days of 2019 arriving in late June at the end of the second quarter. Consumption figures are down 5.7% from 677.3 million kWh in 2018 to 638.8 million kWh in 2019.

The utility continues to proactively re-invest in its infrastructure and assets to provide continued reliable service and attempt to avoid excessive cost spikes for repairs in the future. One example of this work is its cable injection program, which is a cost-efficient way to extend the life of electric cables. The department has completed 18,000 linear feet, with an additional 110,000 linear feet planned for the remainder of the year. The anticipated cost will be \$1.3 million.

### ***Water Utilities Fund***

#### *Revenues*

Revenues for the Water Fund are up nearly 2% and totaled \$28.05 million. However, this is less than the projected 3.5% increase with the gap being attributable to water loss. Water loss is tracking in excess of what was projected in the rate study. Most revenues are related to charges for water, which totaled \$17.8 million, or nearly identical to the 2018 output. Wholesale revenues were at \$9.77 million and increased following a rate increase by DuPage Water Commission in May. This change adjusted the charge from \$3.70 to \$3.72 per hundred cubic feet.

Wastewater revenues totaled \$10.52 million and were up nearly 9%. Revenues from the phosphorous surcharge totaled \$545,000, nearly double the 2018 revenues. Residential customers currently pay \$1.80 per month, which will remain in effect until the City generates half the funds needed for state-mandated facility upgrades.

### *Expenses*

Water Utility spending to date is consistent with the projected budget. Purchased water accounts for 41% of the Utility's budget. Spending on water to date is consistent with the budget at \$11.3 million. The amount of purchased water decreased approximately 10% from 2018, at 264 million gallons, due to the wet spring weather.

In 2019, the utility has increased its focus on replacing older water meters throughout the community. The budget doubled from 2018 to 2019 from \$925,000 to \$2.3 million, with \$1.2 million spent to date.

## **Special Funds**

### **Revenues**

The primary revenue source for three of the major special funds - Library Fund, Naper Settlement Fund and SSA #26: Downtown Maintenance Fund - is property taxes. The first disbursement of property taxes was recorded in June and the revenues received align with budgetary projections for 2019.

Food and beverage tax receipts continue to overperform relative to prior year actuals in the second quarter. The City has received \$2.3 million, a 3.6% increase from 2018.

### **Expenses**

All expenditures through the Special Funds are aligning with prior year actuals and the 2019 projected budget, excluding the ETSB Fund. The fund is a pass-through from the State of Illinois on behalf of the City of Aurora's Public Safety Answering Point. The City took the responsibility of disbursements in November 2018. Collections have been significantly less than anticipated in recent months; staff is reviewing these decreases with the City of Aurora.

## **Capital and Debt Service Funds**

### **Revenues**

One of the City's leading indicators for economic health is the performance of the Home Rule Sales Tax (HRST). In 2019, the HRST is being utilized for capital project funding and debt reduction. On July 1, 2018, the City increased the HRST to 0.75%, with anticipated revenue collection estimated at \$13.98 million in 2019. The tax has generated \$6.70 million through June and is tracking on pace with staff projections.

One of the revenues to watch from 2018 was the local gasoline tax. Through six months, revenues from the local gasoline tax have held steady, generating \$1.29 million and matching the 2018 output.

As the City moves into the last half of 2019, staff will begin preparation for the 2019 bond issuance. The City budgeted \$5.98 million in bond proceeds for the capital improvement program. Staff's review will look at current spending and available cash to determine if there can be a reduction in 2019 borrowing.

**Expenses**

Capital outlay is progressing close to budget. The Capital Projects Fund and the Bond Fund are the primary funds for capital spending with a budget of \$25.3 million. Through six months the City has expended \$5.1 million, a 17% reduction from 2018. The spending is reasonably consistent with annual trends, with the majority of expenses for capital coming in the third and fourth quarters as projects are completed.

**Financial Principles**

The 2019 budget adheres to the City's established three financial principles and meets the service needs of the community's citizens while simultaneously advancing Naperville's goals and ends policies.

<b>Principle #1</b> The City will pass a structurally balanced operating budget annually	<b>Principle #2</b> The City commits to continuous improvement in the delivery of necessary and cost-effective services	<b>Principle #3</b> The City will actively seek to increase its reserves to 25% and reduce its debt by 25% in the next eight years.
<b>2019 Approved Budget - Achieved</b>	<b>2019 Approved Budget - On Target</b>	<b>2019 Approved Budget - On Target</b>

Specifically related to Principle #3, the City has reduced debt from \$121.3 million at the end of 2014 to \$95.9 million at the end of 2018, a 20.9% reduction. Additionally, the City's cash reserves continue to progress towards the 25% goal.

As staff moves towards creation of the 2020 budget, any budgetary recommendations will align with the three financial principles.

**Upcoming Budget Discussions**

The 2020 budget cycle officially started at the beginning of August. Departmental operating and capital budget requests are due to Finance at the end of August. At that point, staff will begin internal review stages before presenting a more refined budget recommendation to City Council in October at the first of a series of budget workshops.

Leading up to these workshops, staff will present Council with context around the philosophy guiding preparation of the 2020 budget. These discussions at the Sept. 3, 17, and Oct. 1 City Council meetings are meant to enhance understanding of the driving forces behind the numbers presented as part of the budget and more closely align the City's budget requests with the ends policies, mission and values of the City. Topics include:

- Sept. 3: Staff will present a high-level overview of the status of 2019 budget items, including additional personnel that were approved last year, and how 2019 budget requests granted by Council have both impacted and positioned the organization.
- Sept. 17: Staff will formally introduce the concept and basis of the 2020 budget, "Refocus

2020.” This effort seeks to plan and position the City for the future through reviewing past efforts, resetting priorities based on lessons learned and research and development, and planning future needs.

- Oct. 1: Staff will present information about how 2019 actions coupled with refocusing priorities is setting the stage for the 2020 budget. This includes an update and review of capital investment needs, including the assessment of City infrastructure and technology initiatives.

## **SUMMARY**

Throughout the remainder of 2019, staff will continue to monitor any trends in revenues and expenses and provide City Council updates on the overall financial status of the City

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