Legislation Details (With Text)

File #:	18-766 **Version:** 1		
Type:	Report	**Status:**	Filed
File created:	9/12/2018	**In control:**	City Council
On agenda:	9/18/2018	**Final action:**	9/18/2018
Title:	Receive the report on property taxes, debt reduction, and cash reserves as part of the 2019 financial priorities guidance discussions and direct staff accordingly		
Sponsors:			
Indexes:			
Code sections:			
Attachments:	1. 2019 Budget Calendar		

Date	Ver.	Action By	Action	Result
9/18/2018	1	City Council	received	

CITY COUNCIL AGENDA ITEM

ACTION REQUESTED:
Receive the report on property taxes, debt reduction, and cash reserves as part of the 2019 financial priorities guidance discussions and direct staff accordingly

DEPARTMENT: Finance Department

SUBMITTED BY: Rachel Mayer, Finance Director

BOARD/COMMISSION REVIEW:
N/A

BACKGROUND:
City Council's proactive approach to fiscal management including the ends policies, City goals, and the financial principles have put Naperville on solid financial ground. Council initiatives have led to pension stabilization, debt reduction, rebuilding of cash reserves, and property tax reductions.

At the August 21, 2018 City Council meeting, Finance presented the six-month 2018 financial update as well as updated assumptions for the 2019 budget. These projections and assumptions have provided early indicators that not all City financial goals and principles can be achieved in 2019 without some modification. Additionally, as we continue to drive towards the City's mission with new initiatives, it is necessary to provide resources to attain those goals. For staff to present a budget that reflects the priorities of the Council, there needs to be further understanding of Council's flexibility toward financial policies.

With the goal of bringing forward a 2019 budget that meets Council's priorities, staff has engaged Council in a policy discussion over the last two meetings. Specifically, the four interconnected budgetary policies and service levels, property taxes, debt issuance, and cash reserves.

At the September 4, 2018 City Council meeting, Finance presented an overview of current and anticipated City service levels. Staff continually evaluates performance levels and how they interact with the mission statement, ends policies, and City goals. The service level assessment included a review of the 2018 budget cuts and changes to overall service levels. Additionally, staff provided solutions to solve current service level concerns and resource requirements that would be required to implement those solutions.

DISCUSSION:

Update to 2019 Financial Projections

Compared to the original financial projections developed in February, the updated budget projections reduced estimated 2019 borrowing and reduced projected property tax increases. However, there is still an estimated increase in borrowing of $9.79 million and an estimated increase in property taxes of $2.04 million for 2019. These increases are based upon projections that would maintain the City's current service levels.

The three remaining budgetary policies - property taxes, debt reduction, and cash reserve levels - are now being discussed as financial "levers" that, should Council choose to exercise flexibility, could provide funding for service level resource requirements. In these discussions, staff is seeking direction from Council as to which financial policies they are not willing to adjust or deviate from. This information will be used to guide staff during the budget preparation process.

Property Taxes

Property taxes primarily fund long-term obligations of the City such as public safety pensions, IMRF pensions, and debt service payments. Property taxes are also the predominate funding source for the Library and Naper Settlement operations. Historically, only 2% to 5% of property tax revenues are used to fund City operations.

The 2018 property tax extension totaled $47.38 million, with a property tax rate of 0.6815. The 2019 levy projection currently totals $49.42 million. Staff is using a 4% EAV growth factor, which puts the City valuation at $7.23 billion and increases the average home value to $409,000.

Guidance around property tax levels impacts the amount of annual revenue generated to support current City operations. Maintaining a flat property tax ***rate*** allows the City to take advantage of incremental EAV growth throughout Naperville, including new development. This equates to approximately $1.9 million for 2019. Maintaining a flat property tax ***levy*** reduces the property tax rate, and therefore the annual property tax burden on residents. City Council has utilized the flat levy approach to property taxes, which, from 2015 through 2018 reduced property tax bills from $995 to $818. If the City had used the flat rate approach, $20.3 million more in incremental property tax receipts would have been received by the City since 2015.

By utilizing a flat rate approach, the City would also take advantage of natural appreciation that occurs due to inflation. Other revenue streams, including the home rule sales tax (HRST), build in inflationary impacts. Through maintaining a flat rate, the City would no longer lose tax dollars to inflation and more closely align property tax budgeting with other tax revenue streams.

25% Debt Reduction Goal

This principle currently sets the parameters required to reduce debt by 25% by the end of 2022. This long-term financial goal is expected to reap positive impacts starting in 2024, when debt payments significantly decrease and eventually stabilize around 2030, resulting in $9 to $10 million in annual payments compared to the 2018 payment of $13 million. This parameter means that borrowing is restricted to $29 million through 2022, or $7.25 million annually.

Adjusting this parameter would impact revenues and workload associated with capital investment. Based on current projections, there remains a $9.79 million disparity between 2019 project requests and alignment with the City's 25% debt reduction goal. Adjusting this goal impacts the amount of annual revenue generated to support capital reinvestment. Options include maintaining the debt reduction goal or altering the percentage goal or timeframe for debt reduction. Maintaining the debt goal would require deferment of 2019 capital projects or borrowing above the $7.25 million cap, which would reduce borrowing capacity in a future year through 2022. Providing flexibility around the goal would extend the timeframe necessary to reach the 25% goal or reduce the debt goal percentage. Each percentage decrease equals $250,000 annually, or $1 million of total incremental borrowing capacity through 2022.

25% Reserve Level Goal

The City's current Emergency Reserve Policy was adopted by the City Council in 2011 and stipulates that the City maintain a minimum 20% cash reserve. In 2015, City Council approved Financial Principle #3 which states that the City will actively seek to increase its reserves to 25% over eight years. The intent of this long-term goal includes protection against a potential downgrade of the City's AAA bond rating and security in the event of financial hardship.

The City ended 2017 with $28.41 million, or approximately 23.7% of the 2017 actual general fund expenditures of $119.66 million. This fund balance figure is $4.48 million more than the City's 20% reserve requirement and $1.5 million short of the 25% reserve level goal. Adjusting this goal impacts the amount of revenue available to support capital reinvestment. Options include maintaining the 25% reserve level goal or altering it. Preserving the current cash reserve level would have no impact on 2019 property taxes or borrowing levels and would keep the City above the 20% requirement but below the 25% goal. Staff would continue to work towards the 25% reserve level over the next four years; this could be accomplished through increasing revenue sources such as property taxes or reducing service levels. Providing flexibility around the goal would allow a one-time cash infusion to offset capital. Based upon current 2019 budget projections, the City could utilize up to $3.56 million of reserves to offset projected borrowing.

Next Steps

Staff is seeking direction from Council regarding which of the financial policies - property taxes, debt reduction, and cash reserves - it is not willing to adjust or deviate from. This input, combined with guidance from the service level discussion, will be used to bring forth a 2019 budget that reflects Council's priorities. Attached is the detailed schedule for presentation and discussion of the 2019 budget.

FISCAL IMPACT:

Based upon these discussions, staff will develop and present a budget that reflects the financial and service level priorities of City Council