



Legislation Details (With Text)

File #: 18-678 **Version:** 2

Type: Report **Status:** Filed

File created: 8/13/2018 **In control:** City Council

On agenda: 8/21/2018 **Final action:** 8/21/2018

Title: Receive the report on the City's 2019 Financial Priorities and Budget Development

Sponsors:

Indexes:

Code sections:

Attachments:

Date	Ver.	Action By	Action	Result
8/21/2018	2	City Council	received	Pass

CITY COUNCIL AGENDA ITEM

ACTION REQUESTED:

Receive the report on the City's 2019 Financial Priorities and Budget Development

DEPARTMENT: Finance Department

SUBMITTED BY: Rachel Mayer, Finance Director

BOARD/COMMISSION REVIEW:

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BACKGROUND:

Financial Priorities Overview

The City's budget process is guided by the City's mission statement, ends policies, goals and financial principles. To assist in initial creation of the 2019 budget, staff seeks City Council's guidance on financial priorities, including citywide service levels, long-term financial goals, and short-term financial impacts.

This review of policies and the City's financial principles is necessary due to competing initiatives in the City's budget and the recognition that not all goals and principles can be met under current budgetary conditions. The feedback provided by Council will guide staff in the development and presentation of a budget that highlights the financial and service level priorities of Council.

To assist Council, below is background on the City's 2018 financial performance to date, updated financial projections and an overview of financial priorities.

DISCUSSION:

2018 Financial Performance to Date

Overall, the City performed close to expectations in the second quarter for both revenues and

expenses. Major items highlighted in the Q2 financial report attachment account for the difference between projections and actuals; other differences are attributable to timing issues.

- Citywide revenues came in at \$212.9 million, which is 47.2% of budget. This is a 4.6% deviation from 2017 revenues and less than a 1.0% difference from projections.
- Citywide expenses came in at \$180.7 million, which is 40.9% of budget. Expenses were 0.9% higher than 2017 and 6.6% lower than budget projections.

The below chart displays the 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 budget estimates.

Fund		2018 Budget	2018 Q2 Actuals	% Spent	2018 Q2 Budget	Q2 Budget Variance
Maintenance & Ops	Revenue	378.5	178.4	47.1%	180.3	98.9%
	Expense	368.9	159.7	43.3%	165.4	96.6%
Capital & Debt Service	Revenue	41.1	17.7	43.0%	18.5	95.4%
	Expense	40.3	8.5	21.2%	12.8	66.4%
Special Funds	Revenue	31.6	16.9	53.5%	15.8	107.3%
	Expense	33.2	12.6	37.9%	15.2	82.6%

The City’s past budgetary performance and relative alignment with projections is indicative of staff’s abilities to soundly develop future budgetary requirements. Based upon the City’s current performance compared to projections, staff has confidence in year-end projection figures. Throughout the budgetary process, staff will continue to monitor any trends in revenue and expenses and provide City Council with updates on the overall financial status of the City.

Updated 2019 Financial Projections

Staff prepared and presented preliminary budgetary projections from 2019 through 2021 to City Council in March. The original forecast showed a 2019 budget that totaled \$481.15 million in expenditures and \$482.31 million in revenues. Since the original forecast, there have been numerous assumption changes that have altered the projected expenditure and revenue outcomes. (Please see the Budget Projections memo for assumption change details.) The updated forecast shows a 2019 budget that totals \$479.99 million in expenditures and \$484.43 million in revenues.

2019 Outcomes	Original Projection	Updated Projection	Change
Revenues	\$ 482.31 M	\$ 484.43 M	\$ 2.12 M
Expenditures	\$ 481.15 M	\$ 479.99 M	(\$ 1.16 M)

The intent of the financial projections is to provide analysis and projected trends surrounding financial issues of interest, including projected property tax outcomes and projected debt issuances. Property taxes and debt issuance are the two areas that City Council has direct control over by setting amounts rather than rates. Based upon the financial principles and prior City Council actions, staff understands that property tax increases and debt issuances are revenue-generating actions to be undertaken only if other financial avenues have been exhausted.

The 2019 budget cycle officially started on August 1, and final operating and capital budget requests

are due 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. Based on preliminary information heading into the 2019 budget preparation, staff is confident in the current assumptions and outcomes presented.

Financial Priorities Guidance

Previous, current and future policy decisions all play a role in shaping the City's operational and capital budgets. These policy decisions, while seemingly mutually exclusive at the time, interconnect with each other over the short- and long-term. Over time, these policies have resulted in a budget with competing priorities. This priority disconnect is due to direct and indirect assumption changes over the last three years that include pension growth, property tax decisions and state actions.

Moving into 2019, and based on staff's projections and assumptions, the City is at a point where priority guidance is necessary as not all goals and principles can be achieved under current conditions. Although some financial factors are outside of local control, City Council exerts primary control over four major areas of the budget. Staff will bring these priorities forward, along with options, over the next month for Council guidance because of their significant impact on the budget.

Service Levels

The City needs to generate revenues through taxes and fees to support the many services our residents have come to expect. The setting of community service levels by City Council ultimately dictates the revenue and expenditures requirements of the City.

Current budget projections are based upon maintaining the current service levels provided to the community. Any increase in service levels would require additional resources and any decreases in service levels would result in fewer resource requirements.

At the September 4 City Council meeting, staff will present a high-level overview of service level options for Council's guidance moving forward.

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.

Guidance around property tax levels impacts the amount of annual revenue generated to support current City operations. Options include maintaining a flat property tax rate or maintaining a flat property tax levy.

25% Debt Reduction Goal

Financial Principle #3 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. This parameter means that borrowing is restricted to \$29 million through 2022, which is \$7.25 million annually.

Guidance around the City's 25% debt reduction 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.

25% Reserve Level Goal

Financial Principle #3 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, approximately 23.7% of the 2017 actual general fund expenditures of \$119.66 million.

Guidance around the 25% cash reserve level goal impacts the amount of revenue available to support capital reinvestment. Options include maintaining the cash reserve target or altering the reserve goal by utilizing existing cash reserves.

Upcoming Discussions

To best gauge Council's priorities, staff will be presenting policy options for Council's consideration at upcoming City Council meetings. At the September 4 City Council meeting, staff will present a high-level overview of service level options for Council's consideration. At the September 18 City Council meeting, staff will provide a more in-depth analysis of policy options for property taxes, debt reduction, and cash services.

FISCAL IMPACT:

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