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CITY COUNCIL AGENDA ITEM

ACTION REQUESTED:

Receive the 2019 Financial Projection Report

DEPARTMENT: Finance Department

SUBMITTED BY: Rachel Mayer, Finance Director

BOARD/COMMISSION REVIEW:

N/A

BACKGROUND:

Financial Forecast Update

At the March 6, 2018, City Council meeting, staff prepared and presented to City Council preliminary budgetary projections from 2019 through 2021 to provide analysis and projected trends surrounding financial issues of interest, including projected property tax outcomes and projected debt issuances. The original forecast showed a 2019 budget that totaled \$481.15 million in expenditures and \$482.31 million in revenues.

These financial forecasts include numerous assumptions and components that can fluctuate based on a variety of actions. The budgetary projections for 2019 through 2021 utilized assumptions that are based on current policy decisions, current economic conditions, known expense and revenue variables and projected actions. When an assumption changes, this often impacts numerous other assumptions due to the interconnectivity of budgetary components. Changes to any of the documented assumptions (or others) may lead to different budgetary outcomes than originally forecast.

Since the original forecast in March, there have been numerous assumption changes through the second quarter that have altered the projected expenditure and revenue outcomes. These assumption changes are highlighted below. Currently, the updated forecast shows a 2019 budget that

totals \$479.99 million in expenditures and \$484.43 million in revenues.

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 below. The updated 2019 forecasts are a complete view across all 29 City's funds and include building cash reserves in city utility and capital project funds.

DISCUSSION:

Assumptions Overview

From a high-level perspective, the City's budget process is guided by the City's mission statement, ends policies, goals and financial principles. Specifically, City staff develops the annual budget based upon the following:

Financial Stability Ends Policies

- Naperville will be financially stable and maintain a AAA bond rating.

Financial Principles

- *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.

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:

- *Expenditure*
 - Average annual increase of 0.3% across funds and expense categories
- *Revenues*
 - Average annual decrease of 2.0% across funds and revenue categories
- *Capital Expenditures and Revenues*
 - Capital expenditures have high variability. Based upon 2018 submittals there is a spike in 2019 and 2020 due to several major unfunded projects, including the potential Moser Tower Rehabilitation, North Aurora Road Underpass, Downtown Washington Street Bridge Rehabilitation, North Aurora Road Construction, and Ogden Avenue Corridor Enhancements.

Assumption Updates

Staff reviews expenditures, revenues and service delivery methods year-round to capitalize on efficiencies and identify factors which may be influencing assumptions. There have been numerous

assumption changes since the initial financial forecast presented to Council this spring which have had an overall positive impact on the City's budgetary projections.

1. *State Actions*

- *Administrative Fee on Home Rule Sales Tax* - The state reduced its administrative fee from 2.0% to 1.5%. This is \$70,000 of incremental revenues for 2019.
- *Income Tax* - In 2018, the state reduced disbursements by 10% and in 2019 changed that reduction to 5%. Staff projected a 10% reduction for six months of 2019; therefore, a 5% reduction for the full year has no fiscal impact.

2. *United States Supreme Court Decision*

- In June, the Supreme Court issued an opinion in the South Dakota v. Wayfair case, therefore allowing states to collect sales tax from businesses with no physical presence in the state. Based upon current disbursements from the state, the City estimates a \$350,000 increase in 2019.

3. *Pension Benefits*

- *Public Safety Pensions* - The pension reports for both Police and Fire saw overall contribution levels decrease by \$41,508, or 0.26%.
- *IMRF* - The City's preliminary contribution rate of 9.34% is a 16% decrease from 2018 and staff is projecting a \$990,000 decrease in expenditures.

4. *Special Census*

- The recently conducted special census increased Naperville's population by 5,988 residents. This census will increase projected revenues in local use tax, motor fuel tax and income tax; an incremental \$880,000 of revenues is expected in 2019.

5. *Property Sale*

- The City sold 8.2 acres of property on Frontenac Road for \$2.2 million. Staff is currently recommending using these funds for capital in 2019.

6. *Water Street Tax Increment Financing (TIF)*

- As part of the annual budget, staff transfers funds received from the prior year in a TIF fund to offset debt service payments. In 2018, the City saw a significant increase in TIF disbursements due to valuation increases and is projecting to transfer \$250,000 from the TIF in 2019 for debt repayment.

Risks and Opportunities

The City recognizes a variety of risks and opportunities that will continue to be reviewed as part of the 2019 budget process and beyond. These include:

- Household Hazardous Waste Facility
- Ogden Ave. Corridor Enhancements
- Administrative Hearing Process
- Service Fee Reviews
- Downtown Streetscape Project
- Fire Station Consolidation
- Legal Settlements
- 5th Avenue Project
- Downtown Parking Decks
- Refuse/Recycling Contract

Property Tax Levy and Capital Projection Updates

Based upon the financial principles and prior City Council actions, staff understands that property tax increases and debt issuances are revenue actions to be undertaken only if other financial avenues have been exhausted. Should expenditure savings be realized or other revenue streams come in more favorably than expected, staff immediately looks at how those actions can then offset the property tax request or planned borrowing.

Due to the overall positive budgetary impacts realized through the second quarter, staff now projects the budgetary requirements in 2019 will have the following impacts on the City's property tax levy and capital requirements.

2019 Outcomes	Original Projection	Updated Projection	Change
Capital Deferrals/ Additional Borrowing	\$ 12.58 M	\$ 9.79 M	(\$ 2.79 M)
Property Tax Increase/ Service Level Reduction	\$ 4.33 M	\$ 2.04 M	(\$ 2.29 M)

To provide further detail on the three-year projections, staff has attached to this document are several different views of the City's future year projections. They include the following:

- Annual change in revenue and expenditures by fund in 2019
- Annual change in line item categories in 2019
- A fund-by-fund comparison of expenses and revenues in 2019

FISCAL IMPACT:

Based upon the financial performance of the City in 2018 and the assumptions utilized for the 2019 through 2021 projections, staff is confident in these projections and their utilization for upcoming budget prioritization discussions.