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**CITY COUNCIL AGENDA ITEM****ACTION REQUESTED:**

Receive the report on alternate revenue options for the 2019 Annual Operating Budget

**DEPARTMENT:** Finance Department**SUBMITTED BY:** Rachel Mayer, Finance Director**BOARD/COMMISSION REVIEW:**

N/A

**BACKGROUND:**

The \$451.4 million 2019 annual operating budget was approved at the December 4, 2018 City Council meeting. This 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.

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

To support the 2019 budget, the City Council approved a \$49.1 million property tax levy at its December 18, 2018 meeting. This value, combined with the projected equalized assessed valuation (EAV) increases, will allow the City to leverage community growth and maintain a flat property tax rate, estimated at 0.6815. Property taxes are the primary funding source for long-term obligations of

the City, such as public safety pensions, IMRF pensions and debt service payments. Property taxes are also the major funding source for the Library and Naper Settlement operations.

As part of the budget and property tax levy approval process, City Council asked staff about funding alternatives that could negate the need for an increased property tax levy, specifically in the areas of the food and beverage tax and commuter parking fees. Staff was directed to provide a revenue report in January 2019 that includes alternatives.

Staff has researched both revenue enhancement and expenditure reduction options to evaluate the potential of abating a component of the City's property taxes. The City has until March 2019 to finalize any property tax abatements.

### ***Revenue Guidelines and Recommendations***

During the annual budget process, staff conducts an in-depth review and analysis of potential taxes and fees to determine if they fit within the City's organizational goals and legal parameters before making appropriate recommendations to City Council. Concurrently, as part of the City's ongoing financial planning efforts, staff identifies and reviews funding mechanisms routinely based upon these four criteria.

1. **Consistent:** The City wants to make sure that a revenue is going to provide consistent dollars over a period of time. For instance, as the telecommunications tax continues to decline, staff recognizes that will not be a stable funding source over time.
2. **Competitive Advantage:** The City wants to make sure that a revenue is not going to negatively impact local businesses' competitive advantage compared to similar communities. For instance, the City's hotel and motel tax is set at the average of Naperville's comparable communities, and any increase could negate that advantage.
3. **Service Alignment:** Revenues should be aligned with services and draw from the people or businesses that derive value from the service. For instance, utility rates are based upon the cost of providing that service. Similarly, the City only charges refuse costs to residents who receive that service.
4. **Diversification:** Staff believes the City's revenue sources should be balanced and that no one revenue source should be overly burdensome to either businesses or residents. By keeping the City's revenues diversified, it helps to reduce Naperville's risk of exposure to any particular source during economic downturns.

To address Council's question about funding alternatives, staff reviewed numerous existing taxing options in preparing this memo and associated options for discussion. Various taxes, such as telecommunication, utility, and hotel/motel were determined not to be viable options for several reasons, including inconsistent revenue generation, current alignment with comparable communities, and the City already charging the maximum rate allowed.

Staff also reviewed fee options, such as increasing development-related fees and administrative tow fees. As part of the 2019 budget, development-related fees were recommended and approved for a 10% increase. In reviewing administrative tow fees, it was determined, due to legal parameters, that these fees could not be set in excess of the cost of service.

The revenues that are included in the discussion section below are for City Council's consideration and are based upon staff's research. The information includes background on the revenue, including structure, timing, financial impact, and criteria alignment. The first item, property taxes, maintains the status quo approved during the budget process. The next two items, citywide food and beverage and commuter parking fees, are included based upon City Council input and to directly address Council's question in this area. The final two items, home rule sales tax and the solid waste fund, are revenue opportunities identified by staff.

## **DISCUSSION:**

### ***Discussion Point 1: Property Taxes***

The City continues to have the lowest property tax rate of comparable communities. While the City component makes up only 10% of a resident's tax bill, staff attempts each year to minimize the impact the City has on a resident's overall property tax bill.

The approved property tax levy is \$49.1 million. This value, combined with the projected equalized assessed valuation (EAV) increases, will allow the City to leverage community growth and maintain a flat property tax rate, estimated at 0.6815.

Since implementation of the financial principles in 2015, the incremental increase in value due to appreciation and new growth was used to reduce the property tax rate from 0.8081 to the 2018 levy estimate of 0.6815. During the timeframe, the City portion of an average homeowner's property tax bill decreased from \$995 to a projected \$848.

This option meets all four of the City's criteria for revenue generation:

<b>Consistent</b>	<b>Competitive Advantage</b>	<b>Service Alignment</b>	<b>Diversification</b>
Provides a stable funding mechanism as the amount generated by property taxes is based upon the amount necessary to fund City operations.	Despite the increase in property tax levy, the City continues to maintain the lowest property tax rate of comparable communities.	Property taxes primarily fund long-term obligations of the community and the direct operations of the Library and Naper Settlement.	Property taxes allow the City to maintain balance among its four major revenue sources and provides flexibility for the usage of other revenue sources in the future.
<b><i>Meets criteria</i></b>	<b><i>Meets criteria</i></b>	<b><i>Meets criteria</i></b>	<b><i>Meets criteria</i></b>

### ***Discussion Point 2: Food and Beverage Tax Increase***

One revenue option for consideration is increasing the citywide Food & Beverage Tax from the current rate of 1.00% to 1.25%. The 2019 budget includes \$4.36 million in projected revenues. A 0.25% increase in the tax rate would generate an estimated additional \$1.09 million for a full year of receipts.

The food and beverage tax is locally administered by the City. To properly implement and administer

the tax increase, staff would recommend implementing the tax on July 1, 2019. This would allow 60 days' notice to the business community and would align on a quarterly basis. With a July 1, 2019 implementation, the City would begin receiving receipts in August and therefore receive 5 months of revenues.

Funds generated through the Food and Beverage tax have specific restrictions on their usage based upon the current ordinance. Receipts are first used to cover administration costs, which are budgeted at \$93,027 for 2019. The remaining funds are split two ways:

- 25% of all receipts are used to fund public safety pensions.
  - Public safety pensions are budgeted at \$1.066 million for 2019
- Of the other 75% of receipts, funds are first disbursed to SECA, second to Social Service grants, and the remainder to debt service.
  - SECA disbursements are capped at \$1.938 million for 2019
  - Social Service disbursements are capped at \$500,000 for 2019
  - Debt Service disbursements are budgeted at \$759,980

By increasing the food and beverage tax by 0.25%, it would increase the disbursements to the Police and Fire pensions by \$270,000 and to debt service by \$815,000. In a full-year of collections, this could reduce the property tax levy request by \$1.09 million. However, due to the implementation timeframe described above, the City would only project to collect \$454,000 in 2019.

This option meets one of four of the City's criteria for revenue generation:

<b>Consistent</b>	<b>Competitive Advantage</b>	<b>Service Alignment</b>	<b>Diversification</b>
The food and beverage tax has proven to be consistent. Since its implementation in 2004 the revenue has never declined and the only year it did not grow was between 2010 and 2011. The revenue is projecting a 4% growth for 2019.	An increase of 0.25% would move the City above the average rate of 1.00% for 15 comparable communities. Additionally, this tax only impacts 350 businesses compared to the 2,000 businesses that pay home rule sales tax.	As the City has received incremental revenues through the food and beverage tax, the disbursement methodology has moved further away from the original intent of funding special events and cultural amenities.	Even with its consistency, increasing the food and beverage tax shifts more of the City's revenues to market driven. This does not provide future flexibility in the event of an economic downturn.
<b>Meets criteria</b>	<b>Does not meet criteria</b>	<b>Does not meet criteria</b>	<b>Does not meet criteria</b>

### **Discussion Point 3: Commuter Parking Fees**

The current commuter parking permit rates were established in 2008 following a detailed study of known and projected costs associated with delivering and maintaining commuter services, including parking and multi-modal access. In 2019 City staff will review the cost study and prepare updated expense projections to determine if the current revenues are adequate. The study will include consideration of potential enhancements to commuter parking as well as cost obligations associated

with the City of Naperville's agreement with the City of Aurora for maintenance of the Route 59 station. Staff's recommendation is that any fee updates for commuter parking fees be based upon the 2019 rate study.

#### **Discussion Point 4: Home Rule Sales Tax Increase/Food & Beverage Tax Decrease**

Another revenue option for consideration is increasing the City's Home Rule Sales Tax (HRST) from the current rate of 0.75% to 1.00%. HRST is a revenue source assessed by the City on retail transactions with specified exclusions, including automotive sales and grocery sales. The 2019 budget includes \$13.3 million in net HRST revenues. Therefore a 0.25% increase in the tax rate would generate approximately \$4.43 million of net revenues for a full year.

The HRST is collected by the State of Illinois along with state and other local sales taxes. The State remits the tax to the City on a monthly basis. The state charges a 1.50% administration fee for the service of collection and remittance. Due to state filing requirements, the earliest the tax could be implemented is July 1, 2019, with the first disbursements being received in October. Therefore, the incremental net revenues for 2019 are projected at \$1.11 million.

Based on the current rate and historical receipts, the estimated gross tax to be collected and remitted to the City in 2019 is \$13.98 million. However, there is a state administrative fee assessed on HRST collection and the City provides an offset to the Downtown Food & Beverage Fund based upon the ordinance. The below chart shows the net impact of each 0.25% increment of HRST.

Net Home Rule Sales Tax			
Rate Increase from 0.75% to 1.00% (effective July 2019)			
	Current Budget/Projection	Projection w/ 0.25% Increase	Increase
2019 Budget	\$13.30 M	\$14.41 M	\$1.11 M
2020 Projection	\$13.30 M	\$17.73 M	\$4.43 M

In conjunction with this increase, staff would recommend the reduction of the citywide Food & Beverage Tax from the current rate of 1.00% to 0.50% in 2020. There are several objectives of this decrease:

- It spreads the tax burden across a broader spectrum of businesses. Of the estimated 2,000 businesses that pay home rule sales tax, 17.5% (350 businesses) pay the incremental food and beverage tax.
- The total rate for businesses that pay the food and beverage tax goes down. Currently, they pay 1.75% in local taxes (1.00% Food & Beverage plus 0.75% HRST). This modification to the taxing structure would have those businesses paying 1.50% in local taxes (0.50% Food & Beverage plus 1.00% HRST).
- The Food & Beverage tax could be re-aligned to its original intent of funding special events and cultural amenities with the projected \$2.18 million in revenues for 2020.
- The City would have a net positive revenue outcome in 2019 and beyond.

	Current	2019	2020
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HRST	\$13.30 M	\$14.41 M	\$17.73 M
Food & Beverage	\$4.36 M	\$4.36 M	\$ 2.18 M
Total	\$17.66 M	\$18.77 M	\$19.91 M
<b>Net Increase</b>	-	<b>\$1.11 M</b>	<b>\$2.25 M</b>

This option meets two of four of the City's criteria for revenue generation:

<b>Consistent</b>	<b>Competitive Advantage</b>	<b>Service Alignment</b>	<b>Diversification</b>
The food and beverage tax has proven to be consistent with no declines in revenues since its implementation in 2004. The HRST has only been in place for several years; however, linking it to trends from the City's sales tax show that there is exposure to downturns in the financial markets.	An increase of 0.25% in the HRST would make the City equal to comparable communities; combined with the 0.50% decrease in food and beverage for 2020, the City would significantly drop below comparable communities. Additionally, there would be greater equity amongst businesses in the community.	The dollars received through HRST are utilized for debt reduction and capital investment; shifting the cost to non-residents through this tax helps to align costs of capital spending provided to this group. Additionally, reducing food and beverage tax re-aligns with the original intent of funding special events and cultural amenities.	The changes in the HRST and the food and beverage tax does shift more of the City's revenues to market driven. This does not provide future flexibility in the event of an economic downturn.
<b>Does not meet criteria</b>	<b>Meets criteria</b>	<b>Meets criteria</b>	<b>Does not meet criteria</b>

### **Discussion Point 5: Solid Waste Fund**

An additional revenue option is implementing an enterprise fund to account for all activities related to refuse, recycling, yard waste, and other solid waste collection and disposal. This fund would provide dollars for solid waste activities including, but not limited to, contractor costs, equipment, personnel, administration, operations, and supplies. As an enterprise fund, the Solid Waste Fund is expected to be have revenues that equal the cost of operations. As a result, revenues and rates should be scheduled to increase annually to meet costs of solid waste operations.

Staff is recommending the creation of a solid waste fund for 2019 and will develop a budget amendment based upon Council's feedback. The baseline recommendation is to only move refuse and recycling costs to their own enterprise fund. The refuse collection contract that begins in May 2019 is a take-all flat rate program for refuse, recycling, and the City's six-week bagged leaf collection. This fund would be a direct pass-through of the monthly \$12.95 paid per household to Groot and the \$12.95 received per household per month on the utility bill.

In addition to the baseline recommendation, City Council has the option to increase the monthly per household charge for solid waste services not covered by the contract. These services include the curbside bulk leaf collection program, the curbside brush collection program, household hazardous waste (HHW) collection, electronic recycling, and other refuse collection costs. The monthly household costs are based on 2019 budget figures and 42,000 households.

*Curbside Bulk Leaf Collection*

The City provides a six-week bulk curbside leaf collection program that complements the City's bagged collection program. The 2019 budget includes \$836,576 for leaf collection costs including personnel (regular pay, overtime, temporary, and benefits), contractor costs, disposal fees, equipment, and supplies. The current curbside leaf collection program is being reviewed by the Department of Public Works and any program modifications will impact the overall cost of the program. Converting the current program and its associated costs would equate to a monthly household cost of \$1.66.

*Curbside Brush Collection*

The City provides an annual curbside brush collection program. The 2019 budget includes \$180,000 for brush collection costs including personnel costs, contractor costs, disposal fees, equipment, and supplies. Converting that cost to a monthly household cost would equate to a \$0.36 charge.

*Household Hazardous Waste*

The City operates a household hazardous waste drop-off site at its Fort Hill location. The 2019 budget includes \$199,000 for this site, including personnel, supplies, and equipment. Additionally, the City receives \$155,000 in grant revenues from DuPage County, Will County, Kane County, and the City of Aurora. The net program cost is \$44,000, which equates to a \$0.09 monthly per household charge.

*Other Refuse Collection Program Costs*

These program costs include the City's refuse and recycling cart program as well as administrative costs such as billing, customer support, and contract management. The 2019 budget includes \$164,624 for these costs, including personnel and supplies. In addition, there are \$155,100 in estimated revenues for cart sales and deliveries. The net program cost is \$9,524, which equates to a \$0.02 monthly per household charge.

Program	Incremental Household Cost/Month	Total Household Cost/Month
Base Program (refuse, recycling, & bagged leaves)		\$12.95
Leaf Collection Program	\$1.66	\$14.61
Brush Collection Program	\$0.36	\$14.97
Household Hazardous Waste	\$0.09	\$15.06
Other Solid Waste Program Costs	\$0.02	\$15.08
<b>TOTAL</b>	<b>\$2.13</b>	<b>\$15.08</b>

If the City were to increase the monthly household price for solid waste services, the projected increase would be \$2.13 for a total monthly charge of \$15.08. This would generate an estimated \$1.07 million in revenues to fund city operations.

This option meets all four of the City's criteria for revenue generation:

<b>Consistent</b>	<b>Competitive Advantage</b>	<b>Service Alignment</b>	<b>Diversification</b>
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Provides a stable funding mechanism as the fee is determined based upon the cost of service and is charged directly to residents.	Despite the increase in the fee, the \$15.08 monthly household price continues to be one of the lowest refuse collection costs compared to other communities.	The services that are included in the charge are primarily available to the recipients of the service.	Since this is a user fee; it does not expose the City to the variability of market-driven revenue sources and provides more diversity in revenue streams.
<b><i>Meets criteria</i></b>	<b><i>Meets criteria</i></b>	<b><i>Meets criteria</i></b>	<b><i>Meets criteria</i></b>

### **RECCOMENDATION:**

Based upon the review and analysis of alternate revenue options in alignment with the four revenue criteria, it is staff's recommendation that Council maintain the existing property tax levy to support the 2019 budget.

Additionally, staff recommends the establishment of an enterprise fund for solid waste services that will provide a direct pass-through of the monthly household collection cost in accordance with the refuse and recycling contract.