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Title: Receive the August 2020 Financial Report and approve actions providing financial flexibility in the 2020 and 2021 budgets (Item 1 of 2)

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CITY COUNCIL AGENDA ITEM

ACTION REQUESTED:

Receive the August 2020 Financial Report and approve actions providing financial flexibility in the 2020 and 2021 budgets (Item 1 of 2)

DEPARTMENT: Finance Department

SUBMITTED BY: Rachel Mayer, Finance Director

BOARD/COMMISSION REVIEW:

The Financial Advisory Board (FAB) has reviewed monthly financial reports through July and expressed support to utilize available options that will increase financial flexibility in response to the COVID-19 pandemic.

BACKGROUND:

The other item on the City Council agenda related to this item is:

- 20-928

The City, region, and nation continue to experience the ongoing economic effects of the COVID-19 pandemic that began in mid-March. To provide Council with current data to make strategic financial decisions at the appropriate time, staff is bringing a financial report to the Council at its second meeting of each month.

In July, Council provided staff with direction to develop the actions necessary to increase the City's financial flexibility through 2020 and 2021. Those items included removing restrictions on certain revenues and increasing borrowing with the goal of maintaining core services at their current levels.

DISCUSSION:

New Information

Ongoing developments continue to shape the pandemic's financial impact on the City. Since the July 21 Council meeting, the following new events occurred:

- **COVID-19 Cases Rising:** The City is divided by county among two of the state's 11 public health regions. Both regions have seen increases in the COVID-19 positive test rate in recent weeks. The Region 7 (Will) positivity rate has risen from 5.2% on July 20 to 6.7% on August 8. The Region 8 (DuPage) positivity rate has risen from 4.2% to 4.6% during that same period. Per state guidelines, if a region meets certain criteria such as a positivity rate of 8% or higher for three consecutive days, new mitigation strategies can be mandated. New mitigation strategies may bring additional economic impact; however, none have been implemented at this time.
- **Return to School Plans:** Districts 203 and 204 have delayed the start of the 2020-21 school year and will begin the year using an e-learning format. High school athletic programs are being rescheduled throughout the state, with many fall sports being delayed to winter or spring seasons. North Central College is planning for the return of students to their campus; however, fall sports, including football, have been postponed. These events may have some economic impact as parents may delay typical back-to-school purchases of clothing and supplies and the postponement of athletic events may decrease visitors traveling to the City, which could have some impact on the local hospitality industry.
- **Will County Cares Act:** The City received official notice that Will County will allocate \$33 million of CARES Act funds to local governments. Naperville's allocation is \$2.02 million, which will be distributed upon submission of eligible expenditures. Applications for reimbursement are due September 8. The Will County program does not require an intergovernmental agreement as was the case with DuPage County.
- **2021 Budget Process Underway:** On August 3, the City officially began the 2021 budget development process. Departments are currently developing operational and capital budgets for next year, which will be refined through an internal review process before discussions with the Council beginning in October. Just as flexibility has been a key theme throughout the monthly financial discussions with Council, flexibility is critical throughout the budget process. Departments have been asked to plan for multiple scenarios and find opportunities to control spending, understanding that this will allow for the greatest level of flexibility based on the realities of COVID as we enter 2021.

Revenues Update

The City continues to closely monitor state and local revenues to gain a clearer understanding of the fiscal impact of the pandemic. While local revenues are recorded month-by-month, some state revenues are delayed by up to three months. Sales tax is delayed a full three months, so August revenues represented sales in May.

State revenues

Sales tax revenues improved in August but remained well below original budget projections. State sales tax came in 24% below projections, while home rule sales tax was 29% below projections. These numbers provide some validating data around the theory of sales taxes bottoming in April and rebounding in subsequent months.

State income tax payments spiked in August due to the arrival of the delayed income tax filing deadline on July 15. August revenue came in 82%, or more than \$900,000, higher than budget projections for the month. This may indicate that prior month declines were attributable to delayed

payments as much as they were unemployment.

Local use tax tied to online sales continues to outperform, with August revenues being 51% higher than projections.

State motor fuel tax revenues continue to be impacted by decreased travel across the state. July receipts declined approximately 7% from budget projections. Original budget projections did not include motor fuel tax allocated under the state’s new transportation renewal fund, so this decline is not representative of the overall decline in fuel sales.

August State Shared Taxes

Revenue	Projection	Actual	Diff (\$)	Change (%)
Sales Tax	3,210,942	2,429,791	(781,149)	-24.3
State Income Tax	1,094,191	1,999,149	904,953	82.7
Home Rule Sales Tax	1,282,066	901,233	(467,134)	-29.0
Motor Fuel Tax	467,134	435,951	(31,183)	-6.7
Local Use Tax	362,969	548,933	185,964	51.2
Totals	6,417,306	6,324,058	(93,242)	-1.5

Year-to-date, actual revenues for the five major state collected revenue categories are now 7% below budget projections through August.

Revenue	Projection (through Aug)	Actual (through Aug)	Diff (\$)
Sales Tax	23,094,179	21,158,087	(1,936,092)
State Income Tax	10,778,077	9,161,266	(1,616,811)
Home Rule Sales Tax	8,449,904	8,232,868	(217,036)
Motor Fuel Tax	3,559,281	3,169,141	(390,140)
Local Use Tax	3,058,434	3,823,904	765,470
Totals	48,939,875	45,545,265	(3,394,610)

Local revenues

Staff continues tracking overall taxable sales reported in several local revenue categories. Sales numbers for prior months are adjusted as delayed tax receipts are received. In June, food and beverage sales continued to show strong recovery, up 37% from May and up 69% from the low in April. June’s food and beverage sales remain 18% below pre-pandemic sales in February. As predicted, hotel/motel tax receipts for the second quarter came in well below first-quarter numbers. Receipts received as of August 10 indicate a 63% decline. Local gasoline taxes improved 39% in June but remain 17% below February sales. Real estate sales in July, which are tracked through transfer taxes paid, increased 11% from June.

Month	Food & Beverage	Hotel/Motel	Local Gas	Real Estate
January	34.63	0.85	5.38	66.11
February	32.69	0.93	5.27	67.11

March	22.27	0.48	4.26	89.48
April	15.76	7.38	2.39	71.07
May	19.42	0.06	3.39	107.41
June	26.69	0.12	4.40	135.77
July	-	2.71	-	150.50
Totals	151.46	12.53	25.08	687.46
\$ in millions				

The next major distribution of property tax is due in September. Staff will monitor closely for any deviation from the trend seen through the first half of the year, which was in line with collections in previous years.

Updated Projections and Risk Assessments

Staff continues to review and update risk assessments for the various revenue categories identified as being at-risk at the outset of the pandemic. Staff has removed ambulance fees and property tax from the risk assessment as revenue data for these categories does not present any significant concerns at this time. Staff will continue to monitor for changing trends.

Revenue Source	Level of Risk	Reasoning
Hotel/Motel Taxes	High	Business and leisure travel continue to be limited by the pandemic.
Food and Beverage Taxes	Medium	Business limited by consumer demand and Phase 4 mandates.
State & Home Rule Sales Taxes	Medium	Consumer spending lower as part of the broader economic slowdown.
Income Taxes	Medium	Statewide unemployment in June remained high at 14.6%.
State & Local Motor Fuel Taxes	Medium	Work-from-home economy and reduced leisure travel impact miles driven.
Commuter Parking Fees	Medium	Reduced rail commuter traffic due to telework impacting parking fees.

Six-Month Budget Review

Overall, the City is tracking toward a balanced budget through the first half of the year. Revenues and expenses are both down between 3 and 5% compared to projections, indicating lost revenues early in the pandemic were offset by reduced expenses through June. Expenses were up 8% over 2019; however, the increase was expected in the 2020 budget.

- Citywide revenues came in at \$210.79 million, which is 43.6% of budget. This is a 0.9% deviation from 2019 revenues and 3.1% lower than budget projections.
- Citywide expenses came in at \$186.83 million, which is 40.1% of budget. Expenses were 7.7% higher than in 2019 and 5.4% 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		2020 Budget	2020 Q2 YTD Actuals	% Spent	2019 Q2 YTD Actuals	% Change from 2019
Maintenance & Ops	Revenue	390.83	174.22	44.6	175.25	(0.6)
	Expense	387.96	164.04	42.3	150.50	9.0
Capital & Debt Service	Revenue	59.55	18.63	31.3	17.72	5.1
	Expense	43.63	6.77	15.5	8.81	(23.2)
Special Funds	Revenue	32.85	17.95	54.6	15.90	12.8
	Expense	34.43	16.02	46.5	14.11	13.5
\$ in millions						

Revenue highlights include state shared taxes, property taxes, and home rule sales tax, which all exceeded budget projections by more than 10% and outpaced 2019 actuals. Notable revenues tracking 30% below projections include food and beverage tax, real estate transfers, fines, licenses, and permits. Several state shared taxes are delayed by several months; therefore, revenue impacts from April through June will be reflected in the third quarter financials while impacts to local revenues are less delayed.

Expenses are tracking close to expectations. The City is seeing significant savings in capital expenses. After factoring the \$24.9 budget amendment reduction from May, the capital program is still 35.8% below projections and 14.3% lower than 2019. The City is also seeing declines in purchased services and insurance benefits, which are both down 5% from 2019 and 15% below projections. The lone expenses outpacing projections are benefits and grants and contributions. Benefits are tracking 11.8% higher due to retirement-related payouts, while grants and contributions are due to ETSB withdrawals owed to the City of Aurora.

Financial Flexibility

At the July 21 Council meeting, staff sought specific direction on various financial tools that could be used to ease the burdens created by pandemic-related revenue shortfalls that are known for 2020 and projected for 2021.

Council expressed consensus that the City should use these various tools, when needed, to create flexibility and maintain service delivery. Staff brought this discussion before the Financial Advisory Board (FAB) on July 27. FAB reached the same consensus and stressed the need to utilize available tools to ensure financial flexibility through 2021. The following actions address two components that, if approved, will assist staff in developing a budget for 2021 that reduces the potential for negative impacts to service levels and continues investing in the City's future, both immediately and long-term.

Amending Home Rule Sales Tax (HRST)

The City's HRST, as established in 2015 and amended in 2018, is collected at a rate of 0.75%. Per City code, these taxes are used for funding capital projects, reducing debt obligations, and replenishing cash reserves. The 2020 budget included \$14 million in HRST revenue that is allocated among three funds: Capital Projects (\$11.7M), Debt Service (\$1.6M), and Downtown Parking (\$700K). The HRST is an economically sensitive revenue stream that has been impacted by COVID-

19; current projections suggest the City may only collect \$12 million in 2020.

Most of the HRST is dedicated to capital projects, many of which qualify to be financed through long-term borrowing. The 2020 budget contemplated borrowing \$13.5 million for funding capital projects. Given the very favorable interest rates currently available, staff recommends that the City borrow at an amount higher than what was included in the budget. Preliminary estimates indicate that the City is likely to incur \$18-20 million in capital project costs eligible for borrowing. Staff is working to refine that estimate before an October debt issuance. Borrowing at a higher amount would allow for the use of HRST revenues for other purposes and provide greater flexibility through 2021.

Temporarily suspending the HRST use restrictions requires an amendment to City code. Staff recommends an amendment allowing for the unrestricted use of HRST through 2021 subject to Council approval through the budgetary process. The proposed amendment also reflects Council's prior decision during the 2020 budget process to continue the HRST.

Amending Food & Beverage Tax

Like the HRST, the food and beverage tax is restricted to certain uses as defined by City code. The primary uses of food and beverage tax are funding the Special Events and Cultural Amenities (SECA) program, public safety pensions, social services, and debt service. The 2020 Budget included \$5.3 million in anticipated food and beverage tax revenue. This revenue stream has proven to be one of the most sensitive to the pandemic as restaurant and bar traffic has slowed considerably and was especially hard hit during the stay-at-home period. Revenues have rebounded in recent months but may remain constrained into 2021.

As discussed on July 21, increasing the level of flexibility in allowable uses of the City's revenues will make it considerably easier to develop a budget that provides necessary funding for services. The allocation of food and beverage taxes are strictly specified in City code both by percentage allocation and the order in which dollars are dedicated to the specified purposes. By removing these restrictions, taxes could be dedicated to other uses or reprioritized within the currently allowable uses. For example, funding of social services currently occurs only after SECA and pensions are funded.

Staff recommends an amendment to City code allowing for the unrestricted use of food and beverage taxes through December 31, 2021. As with the HRST, the use of funds would be approved by Council through the budgetary process.

Next Steps

Staff continues to closely monitor City finances to identify trends as we progress through the various stages of the pandemic. These trends, along with Council direction provided during monthly reports, are informing the 2021 budget development process that is now underway. Staff will continue providing monthly reports and closely examine the 2021 budget with Council during workshops scheduled for October and November. Staff is also working to determine the amount eligible for borrowing in 2020 with plans to bring a bond issuance ordinance before Council in early October.

In addition, staff is finalizing the online financial dashboard and will be rolling it out to the Council and public within the next few weeks.

FISCAL IMPACT:

N/A

