



## Legislation Text

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**File #:** 17-676, **Version:** 2

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### **CITY COUNCIL AGENDA ITEM**

#### **ACTION REQUESTED:**

Pass the Home Rule Sales Tax and Downtown Food and Beverage Tax Ordinances Amending Section 11 of Chapter 1, Title 3, and Amending Section 9 of Chapter 1, Title 3 of the Naperville Municipal Code.

**DEPARTMENT:** Finance Department

**SUBMITTED BY:** Rachel Mayer, Director of Finance

#### **BOARD/COMMISSION REVIEW:**

The Financial Advisory Board recommended a 1.00% Home Rule Sales Tax and the elimination of the current property tax abatement.

#### **BACKGROUND:**

##### ***Home Rule Sales Tax***

The City of Naperville is a home rule unit of local government. The 1970 Illinois Constitution granted home rule authority to qualifying municipalities providing those municipalities with the ability to exercise any power and perform any function pertaining to its government and affairs including, but not limited to, the power to regulate for the protection of the public health, safety, morals and welfare which includes the broad general power to tax.

Illinois law authorizes the imposition of Home Rule Sales Taxes (HRST) by a home rule municipality upon all persons engaged in the business of selling certain tangible personal property at retail in the municipality of the gross receipts from such sales; and upon all persons engaged in the municipality of certain tangible personal property transferred by said servicemen either in the form of tangible personal property or in the form of real estate as an incident to a sale of service. The sale of certain items such as vehicles registered or titled with the State of Illinois, groceries other than alcoholic beverages, soft drinks and food prepared for immediate consumption and prescription and nonprescription medicines, drugs and certain medical appliances are statutorily exempt from the Home Rule Sales Tax.

Home Rule Sales Taxes are administered, collected and enforced by the Illinois Department of Revenue (IDOR). Two annual deadlines are imposed for the implementation of a Home Rule Sales Tax. If an ordinance is adopted and filed on or before by October 1, IDOR will begin administering and enforcing the Home Rule Sales Tax as of January 1 the next year. The second filing deadline is April 1 for a July 1 implementation.

On September 1, 2015, the City approved an ordinance (15-160) establishing a Home Rule Sales Tax at the rate of 0.50%, specifying proceeds of the tax would be restricted for use in increasing the

City's cash reserves and reducing the City's debt. The ordinance included a sunset provision which requires the City to review the ordinance for continued appropriateness in two years.

### **Food and Beverage Tax**

The City's Downtown Food and Beverage Tax, pursuant to Section 3-1-9 of Naperville Municipal Code, requires an adjustment of said tax in the event of enactment of a Citywide "Home Rule Sales Tax" that is imposed for the purpose of financing parking facilities, and it is foreseeable that the Home Rule Sales Tax would be used to reduce debt for any potential parking facilities. If the Home Rule Sales Tax ordinance is sunset or the rate is amended, the City would need to adjust the Downtown Food and Beverage Tax appropriately.

### **DISCUSSION:**

Due to the sunset clause in the original ordinance, the City is required to re-assess the Home Rule Sales Tax rate prior to the end of September 2017. Any changes to the tax, including the sunset or amendment of the rate, require paperwork to be filed with the State of Illinois prior to October 1 for the ordinance to go into effect on January 1, 2018.

Staff is therefore bringing the Home Rule Sales Tax before City Council for review and re-authorization. Additionally, staff is recommending the increase of the Home Rule Sales Tax from 0.50% to 1.00% for 2018. Based on budgetary cost pressures already identified, this increase is a critical component to ensuring the City stays on track with its financial principles and the City Council's budgetary priorities while maintaining service levels.

### **Citywide Financial Principles**

In 2015, the City implemented three financial principles that guide financial decisions. These principles were developed to promote the long-term financial success of the community.

- *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.

When the City instituted the three financial principles they were predicated on several assumptions about the future financial picture of the City and how the City would manage finances in the future. These assumptions included:

- Limiting the increase in the operating budget to no more than 3% annually
- Planning moderate pension growth
- Expecting \$16-\$17 million of capital projects with undedicated revenue sources
- Projecting conservatively for future revenues
- Holding operating expenses in line with planned revenues
- Aligning the fees and charges appropriately with the total cost of service
- Maintaining a flat property tax rate
- Utilizing HRST for debt reduction and reduction in future borrowing
- Continuation of status quo from Springfield
- Utilizing revenue from sale of assets to offset capital or reduce debt
- Evaluating future revenue against four criteria: equity, consistency, competitive advantage,

- and service alignment
- Minimizing risk for our bond rating

Over the last two years, several of these assumptions have changed due to external factors or a change in budgetary policy priorities. The largest assumption changes have been related to pension growth, the flat property tax rate and changes from the State.

The City is continually testing its finances against the three Financial Principles, and while developing the CY2018 budget, staff identified several pressures that could cause the City to no longer meet its financial principles without significant service level changes. These pressures include public safety pensions, state pressures, the roadway maintenance improvement program (MIP) and the property tax abatement.

### **Public Safety Pensions**

Since the implementation of the Home Rule Sales Tax, the City has seen a significant increase in pension obligations related to public safety. The below chart shows the year over year increase from 2016 to 2018. Overall, the City's required contribution increased by \$4.32 million, approximately 37%, over two years. In 2017, the City was able to offset around \$1 million of the increase through food and beverage tax receipts; however, the incremental \$2.25 million increase in 2018 places significant pressure on the City's overall budget.

	<b>CY2016</b>	<b>CY2017</b>	<b>CY2018</b>
Police Pension	\$5.83 M	\$6.54 M	\$7.13 M
Firefighter Pension	\$5.87 M	\$7.24 M	\$8.89M
<b>Total</b>	<b>\$11.70 M</b>	<b>\$13.78 M</b>	<b>\$16.02 M</b>

### **State Pressures**

As part of the State of Illinois' budget compromise in 2017, several items were enacted that will impact Naperville's financial picture in 2018. Two items in particular reduce the overall revenue received by the City from the State.

1. *Sales Tax Administrative Fee* - The state implemented a 2% administrative fee on the collection of the City's Home Rule Sales Tax. Based upon current Home Rule Sales Tax receipts, this administrative fee is projected to reduce revenue by \$175,000 for a 0.50% Home Rule Sales Tax rate.
2. *State Income Tax* - The state also reduced the municipal allotment of state income tax through the Local Government Distributive Fund (LGDF) by 10% through June of 2018. Although the state is accelerating payments on revenues already received in 2017, the 10% reduction will reduce City receipts by an estimated \$750,000 in 2018. Any extension of the reduction will continue to negatively impact the City.

The City will continue to monitor actions at the State level that could have a negative impact, including any extension of the LGDF reduction or a local property tax freeze.

### **Maintenance Improvement Program (MIP)**

Naperville maintains 458 centerline miles of roadway through a variety of treatments, including

resurfacing, micro-surfacing, reconstruction and other methods. Roadways are of vital importance to the City to help ensure economic viability and community livability; this was evident through the responses from the recent Citizen Survey, where residents continued to identify streets as a top priority. To properly invest in our road network, the City hired an outside consultant in 2017 to validate the City’s roadway maintenance program (MIP). The last study was completed in 2010 and recommended a \$11.6 million annual investment. The 2017 validation study recommended that to effectively maintain City streets in their current condition, that the City should invest \$12 million on an annual basis. The City does receive revenue from the State Motor Fuel Tax and the Local Gas Tax; however, those funding sources have historically been supplemented with a transfer from the General Fund, which equated to \$2.8 million in 2017. The recommended \$12 million investment is an increase of approximately \$2 million over the 2017 program of \$10.2 million.

**Property Tax Abatement**

The City’s property tax levy has several components, including the Naperville Library, public safety pensions, debt service, the Settlement and City operations.

A property tax abatement was implemented as part of the approval for the Home Rule Sales Tax in 2015. Set at \$2 million, the abatement reduced the City’s property tax extension from \$48.4 million in 2015 to \$46.4 million in 2016. Combined with that year’s equalized assessed valuation (EAV) growth, the property tax rate decreased from 0.8081 to 0.7392. This reduced the average taxpayers bill by approximately \$125.

Per the assumptions utilized when setting the City’s three financial principles, this abatement was anticipated to expire in 2017 and the property tax rate was estimated to be commensurate with the original 2015 rate of 0.8081. As part of the CY2017 budget process, City Council made the policy decision to keep the property tax levy flat at \$46.8 million, requiring the continuation of the abatement at \$2 million. Combined with that year’s EAV growth, the property tax rate again decreased from 0.7392 to 0.7004. This reduced the average taxpayer bill by an incremental \$61, thus bringing the reduction in property tax bill for the two-year period to \$186.

The below chart displays the impact of the original abatement and the continuation of the flat property tax extension versus what would have happened if the City had maintained a flat property tax rate for the same period. Maintaining the property tax rate at a level amount would have allowed the City to take advantage of the incremental EAV growth throughout the City, including new development. For comparative purposes the City has projected a 4% EAV increase into 2018.

	<b>EAV Valuation</b>	<b>Actual Rate</b>	<b>Extension</b>	<b>Flat Rate</b>	<b>Extension</b>	<b>Difference</b>
CY15	5,993	0.8081	48.43	0.8081	48.43	-
CY16	6,279	0.7392	46.41	0.8081	50.74	4.32
CY17	6,668	0.7004	46.70	0.8081	53.88	7.18
CY18 (Projected)*	6,934	0.6735	46.70	0.8081	56.04	9.34

*\*4% EAV Growth and Holding Extension Flat*

*\*\*in Millions*

The policy decision to maintain a flat property tax extension versus a flat property tax rate has reduced the overall property tax receipts received by the City over the past two years. If the City maintains a flat property tax levy versus flat tax rate, there is an estimated \$9.3 million decrease in projected revenues from 2018 from 2016.

This difference is equivalent to the amount of Home Rule Sales Tax receipts projected for 2018, meaning that the implementation of the Home Rule Sales Tax has only equalized the decreases in property taxes, and not provided the additional financial capacity that was anticipated as part of the financial principles projections to increase reserves and reduce debt.

### ***Focusing on Principle #2 - Continuous Improvement and Cost Savings***

City staff re-evaluates costs and services throughout the year, seeking efficiencies and innovating ways to provide high quality services while maintaining our fiscal responsibility to the community. Staff does not wait until budget time to look for savings or service efficiencies, but rather does so throughout the general course of daily business. Below are several examples of cost savings realized throughout CY16 and CY17.

Personnel costs make up 61% of the budget, therefore staff continually evaluates every position to maximize savings and efficiencies in operations. Over the past two years, seven City departments were able to reduce costs by \$1.55 million by reducing a total of 5.02 FTEs, changing positions to better align with current business needs and reducing overtime. During the same two-year period, \$1.65 million was saved in healthcare costs through plan modifications, reduced prescription drug costs and the elimination of City Council benefits.

In the area of technology, the City has seen significant cost savings in the Electric Department of \$4.4 million related to the conservation voltage reduction (CVR) program and the cable injection program. The City also realized \$320,000 in additional savings by eliminating unnecessary software and renegotiating technology-related contracts.

The City continues to focus on providing cost-effective services, which has resulted in numerous savings and efficiencies over the past two years. With the implementation of LED streetlights and changes to leaf and tree trimming programs, the City saved close to \$200,000 to date and expects to hit \$450,000 in savings for these programs by the end of this year. The use of Alternative Response Vehicles in place of ladder trucks by Fire has seen costs go from \$29 per mile to \$.51 per mile due to reductions in staff used, gasoline and maintenance. In addition, the Water Utility saved \$643,000 in FY16 through the Leak Reduction Program.

One of the City's four ends policies deals specifically with high-performing government. Staff believes that a robust, high-functioning local government should be consistently seeking cost efficiencies not just at budget time, but year-round, and staff has done so in alignment with this ends policy. Keeping in mind service levels and citizen expectations as noted in the recent Citizen Survey, staff is presenting the HRST recommendation within the framework of implementing ongoing cost efficiencies.

### ***Conclusion***

In conjunction with the budget pressures identified above, there are several projected pressures that the City is monitoring around capital improvements and operating costs. Attached is a more detailed list of expense reductions implemented in 2016 and 2017, as well as a detailed comparison of six major financial indicators for the City in FY07, FY11, and the current CY17 budget.

Staff's recommendation to increase the HRST rate from 0.50% to 1.00% with an elimination of the property tax abatement will provide adequate funding to continue the progress made towards the financial principles and support the City Council's budgetary priorities. Additionally, at the 1.00% level, funding will be available in 2019 to address East Ogden Avenue improvements as well as other capital improvements that do not yet have an identified funding source.

**FISCAL IMPACT:**

Each 0.25% of Home Rule Sales Tax has a net value of \$4.25 million.