Legislation Text

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CITY COUNCIL AGENDA ITEM

ACTION REQUESTED:
Receive the July 2020 Financial Report and provide direction on financial philosophies for the remainder of 2020 and 2021

DEPARTMENT: Finance Department

SUBMITTED BY: Rachel Mayer, Finance Director

BOARD/COMMISSION REVIEW:
N/A

BACKGROUND:
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.

DISCUSSION:
New Information
Ongoing developments from various levels of government continue to shape the pandemic's financial impact on the City. Since the June 16 Council meeting, the following new events occurred:

- **Transition to Phase 4 of Restore Illinois Plan**: On June 26, Governor Pritzker announced that all regions of the state had entered Phase 4 of the Restore Illinois plan. Phase 4 allows gatherings of up to 50 people and further relaxes some of the restrictions that remained in place. Restaurants and bars are now allowed to provide indoor service with appropriate safety measures in place. Indoor and outdoor recreational activities, including movie theaters, bowling alleys, and health clubs, may also resume.
- **New COVID-19 Regions Announced:** On July 15, Gov. Pritzker announced that the state is being split from four to 11 public health regions to detect and respond to localized COVID-19 outbreaks. DuPage County is in the West Suburban region, and Will is in the South Suburban region; prior to this change, both counties were included in a region with Chicago and Cook County. Various mitigations from the Illinois Department of Public Health could be applied to business settings in specific regions should a surge in cases occur.

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 revenues received in June represented sales in March, the first month of restricted business activity. July revenues represent April sales, which are

anticipated to be the most impacted as the stay-at-home order was in effect for the full month.

A rebound in economic activity in Naperville can be seen in the seven-day average of night and weekend downtown parking garage occupancy. Usage year-over-year hit a low in early April with a 90% reduction from that same time in 2019. Since that time, usage has rebounded to a 35% reduction from mid-July last year.

State revenues

As anticipated, the stay-at-home order had a significant impact on July state disbursements that reflect activity for the month of April. Sales tax revenues declined 38% from projections, while home rule sales tax revenues were 42% below projections. State income tax payments declined 22%, and state-shared motor fuel tax revenues continue to be impacted by a statewide reduction in travel. July receipts declined 5% from projections. It is worth noting that original budget projections did not include motor fuel tax allocated under the state's new transportation renewal fund, so the decline is not representative of the overall decline in fuel sales. Local use tax collected on out-of-state purchases continues to outperform projections, with July receipts being 40% above projections, as consumers make more purchases online during the pandemic.

July State Shared Taxes

Revenue	**Projection**	**Actual**	**Diff ($)**	**Change (%)**
Sales Tax	2,895,62	1,793,477	(1,102,150)	-38.1
State Income Tax	1,883,63	1,462,205	(421,428)	-22.4
Home Rule Sales Tax	1,142,71	658,406	(484,310)	-42.4
Motor Fuel Tax	375,856	356,250	(19,606)	-5.2
Local Use Tax	351,370	493,588	142,218	40.5
Totals	**6,649,20**	**4,763,926**	**(1,885,277)**	**-28.4**

While the pandemic's impact on June and July state revenues is significant, its effect on full-year projections for 2020 continues to be mitigated by the overperformance seen in the first quarter of the year. Year-to-date, actual revenues for the five major state collected revenue categories are only 2% below budget projections.

Revenue	**Projection (through July)**	**Actual (through July)**	**Diff ($)**
Sales Tax	19,883,238	18,728,295	(1,154,943)
State Income Tax	9,683,881	9,161,266	(522,615)
Home Rule Sales Tax	7,167,844	7,322,635	154,791
Motor Fuel Tax	3,092,147	3,169,141	76,994
Local Use Tax	2,695,465	3,274,971	579,506
Totals	**42,522,575**	**41,656,307**	**(866,268)**

Local revenues

Staff is tracking overall taxable sales reported in several local revenue categories as collections may be delayed. Food and beverage sales in May increased 43% after falling 40% in April. However, May food and beverage sales were 42% lower than pre-pandemic sales in February. Local gasoline taxes improved 36% in May but remain 39% below February sales. The real estate market continues to show some strength with a 26% gain in June, which follows a 51% increase in May. Hotel/motel tax receipts are remitted quarterly, with April, May, and June receipts due to the City in late July.

Month	Food & Beverage	Hotel/Motel	Local Gas	Real Estate
January	34.62	0.85	5.38	66.11
February	32.56	0.93	5.27	67.11
March	22.00	0.48	4.26	89.48
April	13.10	6.88	2.34	71.07
May	18.71	0.06	3.19	107.41
June	-	-	-	135.77
Totals	**120.99**	**9.2**	**20.44**	**536.95**
$ in millions				

Property tax collections do not appear to be significantly impacted through the first six months of the year. As of July 1, 2020, the City had recorded 51% of dollars levied. This trend is consistent with previous economic downturns, including the Great Recession of 2008, in which collection rates held steady above 98.5%.

Updated Projections and Risk Assessments

In the early stages of the pandemic, staff projected an $18 million revenue shortfall in the General Fund. Staff developed that highly conservative projection having no historical basis for comparison. Now that several months of revenue data is available, staff has revised that projection. Barring any significant impediments to economic recovery throughout the remainder of 2020, staff projects a $12 million revenue shortfall in the General Fund, with sales tax accounting for approximately $5 million of the total. This projection assumes that July represents the fiscal “bottom” and that impacts lessen as the state continues in Phase 4 of the Restore Illinois plan. This projection uses conservative estimates for recovery in certain categories given some states are seeing a resurgence in COVID cases and the duration of the economic recovery is still unknown. The revised projection is based on assumptions for the remainder of 2020, which include: sales tax declines of 30%; income tax declines of 15%; and declines in most other revenue categories ranging from 5% to 10%. Property tax collections are assumed to decline by only 2%.

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 lowered the level of risk associated with several categories, including food and beverage taxes, ambulance fees, and property taxes.

Revenue Source	Level of Risk	Reasoning
Hotel/Motel Taxes	High	Travel and leisure activity continue to be limited by Phase 4 of Restore Illinois plan and rising number of COVID cases in various states.

Food and Beverage Taxes	Medium (reduced)	Restaurants/bars allowed to operate with fewer restrictions in Phase 4. Revenues increased last month.
State & Home Rule Sales Taxes	Medium	Steep decline in July receipts. Transition to Phase 4 should improve sales; however, consumer spending may lag for some time.
Income Taxes	Medium	Although improving, May statewide unemployment remained high at 14.7%.
State & Local Motor Fuel Taxes	Medium	Work-from-home economy and reduced leisure travel impact miles driven.
Commuter Parking Fees	Medium (new)	Reduced rail commuter traffic impacting parking fees. While dollars are not significant, this trend may linger as commuters continue to telework or avoid public transit.
Ambulance Fees	Low (reduced)	Calls for service returning to normal.
Property Taxes	Low	YTD collections total 51% of total levy, in line with previous years.

Grant Opportunities
Staff continues efforts to mitigate the pandemic’s fiscal impact through the pursuit of grant funding opportunities. The most significant opportunity comes through the federal CARES Act, which allocated $161 million to DuPage County. Through discussions with the DuPage Mayor’s and Manager’s Conference (DMMC), and per a recent County Board vote, DuPage County agreed to make funds available to municipalities up to $51.84, per capita, for certain reimbursable expenses incurred between March 1 and December 30, 2020. Under the agreement, the City is eligible to be reimbursed up to $5,011,217. Naperville anticipates submitting for dollars related to public safety and other payroll costs, purchased services, and purchased equipment resulting from the pandemic by the end of July. Staff is confident that the City will incur reimbursable expenses up to the full amount allocated before the year-end.

Will County also received CARES Act funding, and it is anticipated that a portion will be shared with municipalities like DuPage; however, no agreement has been reached.

Expenditures Update
Expenses continued to trend below projections throughout the City. In the non-utility funds, expenses were $4.03 million under projection. The biggest source of savings continues to be capital expenses, which are down $3.80 million compared to projections. The City is also seeing positive trends in overtime, medical and dental claims, purchased services, and purchased items. Overtime expenses are $586,000 under projection, with Public Works ($344,000) and Police ($246,000) generating most of the savings. Purchased items are down $1.55 million, in large part due to savings in equipment parts ($465,000) and fuel ($494,000). Medical and dental claims have normalized but remain down $1.44 million for the year. Purchased services are down $826,000, including $305,000 in savings from education and training.

Financial Philosophies
The May report to City Council included a brief discussion of fiscal response options. As the 2021 budget planning cycle approaches, staff is seeking Council direction to establish fiscal strategies for

the remainder of 2020 and into 2021 that will provide flexibility that will allow the City to maintain existing service levels in a fiscally responsible manner.

Currently staff is seeking Council consensus to bring back specific action plans related to the following philosophies, which are detailed below:

- Reevaluating the financial principles concerning cash reserves and debt
- Easing restrictions on certain revenues
- Implementation of local relief programs

Reevaluation of financial principles

Over the past five years, the City has strengthened its financial position by adhering to the financial principles put in place by Council in 2015. Over that period, the City has increased cash reserves and reduced debt while focusing on its high level of service delivery. The 2020 budget continued to build financial strength; however, the unanticipated impacts of the pandemic are cause for a reevaluation of the City's financial principles.

- **Cash reserves:** The City maintains cash reserves for funding operations when unforeseen circumstances present fiscal challenges. Although the current year's operating budget was balanced to start the year, it is now clear that revenue constraints will make it a challenge to end the year in that same position. The use of cash reserves in this scenario would be an appropriate alternative to expense reductions that would require adjustments to service levels across the City. Similarly, developing a balanced budget for 2021 that provides for the same level of services will be challenging as the duration of the pandemic and its related fiscal impacts remain unknown. The use of cash reserves would delay progress toward the goal of 25% cash reserves by 2023; however, it would allow the City to maintain current service levels during the period of economic recovery.

- **Debt issuance:** The 2020 budget contemplated borrowing $13.5 million for capital projects. Other sources for capital funding include the home rule sales tax, which will fall short of projections. Given interest rates remain low, the City may consider borrowing an amount closer to $20 million to fund capital projects in 2020, which would support projects that otherwise would have been funded by home rule sales tax. Borrowing at this higher amount would delay progress toward the City's goal of reducing debt; however, it would allow home rule sales tax revenue to be dedicated to operational expenses, temporarily, should the Council desire to loosen those restrictions.

Easing revenue restrictions

Certain revenues, such as home rule sales tax, are restricted for specified purposes as established by City code. For example, the use of home rule sales tax is currently restricted to capital projects and debt service. The Council could loosen these restrictions on revenues to support other expense categories and ease the burden of revenue losses in the interest of maintaining service levels. Options include using home rule sales tax for operational expenses and using food and beverage taxes to establish a local business assistance program. This temporary action could include a sunset provision.

The Financial Advisory Board (FAB) reviewed the June financial report during its June meeting and expressed general support for temporary adjustments to the City's financial philosophies in the areas of using cash reserves, increasing borrowing, and loosening revenue restrictions. FAB emphasized the City's need to remain flexible in how it manages finances if the goal is to maintain current service levels. Staff will present additional information and seek specific recommendations from FAB at its July meeting.

Local Economic Relief Programs
Council has previously expressed a desire to assist local small businesses that have been significantly impacted by the pandemic. Many local businesses have already taken advantage of federal and state programs underway and received varying levels of assistance; more locally, the City could offer additional assistance.

In establishing a program, the City would need to balance the ability to offer meaningful assistance against the overall cost and administrative oversight required. Understanding that economic impacts will likely linger into next year, options could be developed as part of the 2021 budget process. Food and beverage tax dollars are one source of revenue that could be utilized in funding a program, possibly through a rebate arrangement.

Under executive order, the City placed a moratorium on utility disconnections and suspended the application of late fees to customer accounts in March. The number of delinquent accounts has grown steadily over that time. As of July 7, there were 3,995 delinquent accounts with balances totaling $2.1 million. As account balances continue to grow, staff is exploring ways to ease the burden for customers experiencing financial hardship. In addition to offering payment plans, the City could offer a utility assistance program through a third-party capable of evaluating a customer's financial need. Ideally, the City would determine a funding amount and those funds would be administered and granted to customers by the third-party. The goal is to offer assistance with minimal administrative oversight. If supported by Council, staff would work to further develop this idea and return with a refined program for approval.

Next Steps
Staff continues to refine projections monthly. These projections, along with Council's direction on financial philosophies and strategies, will play an important role in the development of the 2021 budget beginning in August. Should Council support adjustments to the financial philosophies, staff would return with specific action items for consideration next month.

FISCAL IMPACT:
N/A