May 8, 2020

TO: Mayor Julie Moore Wolfe & Members of the City Council

FROM: Scot Wrighton, City Manager

RE: May 11, 2020 Council Study Session

The COVID-19 Pandemic disrupts many financial planning assumptions upon which the city of Decatur's FY 2020 budget was founded. Sales taxes, income taxes, food & beverage taxes, video gaming revenues, motor fuel tax receipts, parking fines, hotel/motel taxes and many other revenue categories are directly impacted by the Stay-at-Home order. Other revenue categories will likely be indirectly impacted or delayed: property taxes, utility revenues, some intergovernmental transfers, and others.

Quantifying the extent of financial impact on Decatur city budgets is problematic for several reasons:

1) **We do not know when the emergency will end and how long it will take for the local economy to rebound**. *The renewed Stay-at-Home order runs through May 30 but could be extended. The rate at which Decatur and Macon County move through gradual re-opening phases of the "Restore Illinois" plan is hard to predict. We do not know how many businesses will be able to reopen even when they are given the clearance to do so; nor do we know how quickly people idled by the pandemic will be able to return to their jobs or obtain alternative employment*.

2) **Relief funding is in flux, and there are normal delays in reporting**. *Actual Macon County-specific data from the period following the initial March 20 Stay-at-Home order is still largely unavailable due to normal reporting and processing delays. The CARES Act includes several special categories of relief funding (first responders' equipment, transit systems, etc.) which we are in the midst of seeking. There is no general relief funding for the revenue shortfalls municipal governments will face as there has been for small businesses—but it has been proposed in some of the latest relief bills now circulating in Congress*.

3) **There is wide variation in local circumstances making city-to-city comparisons unreliable**. *Most other Downstate Illinois home rule cities have a regional shopping mall in their jurisdictions, but Decatur does not. A large state university whose students have all gone home is not a primary anchor of the local Macon County economy. As of now, most of Decatur's industrial and manufacturing employers are still in operation (the local unemployment rate for March was actually below the same March rate last year)*.

Some analysts follow a "V" shaped, "U" shaped or "W" shaped model to predict funding gaps and recovery rates. Our analysis follows a "L" or "checkmark" model (also called the Nike Swoosh; see graphic illustrations in power point). The "checkmark" model assumes a steep decline followed by a slow and gradual return to economic normalcy (but not full restoration of pre-pandemic economic activity), with below pre-pandemic performance extending into 2021. Despite the uncertainty shrouding any statistical analysis of impending financial impacts on the Decatur budget, staff has proceeded with its research using inputs from other cities and the Illinois Municipal League (see attached), and a category by category analysis of revenue source changes (see attached). Using this approach, we predict a revenue shortfall in the General Fund exceeding $5.4 million in 2020, with additional shortfalls in 2021.

After reviewing the forecasting documents provided, it is recommended that the City Council move next to develop a roadmap for moving forward consisting of a timetable and budget revision scenarios.

TIMETABLE

It is recommended that the City Council provide direction and guidance to staff in the May 11 Study Session, or as soon as possible thereafter, about initial actions to be undertaken to alter the budget and financial planning decisions for both 2020 and 2021. It is further recommended that the City Council convene another financial planning study session in July when more Decatur-specific data is available. Additional actions to keep the city on a sound financial footing will likely be required at that time. Based on updates to our financial planning model and the effect of changes made as a result of the May and July council study sessions, it is recommended that the City Council begin work in September to assemble a proposed FY 2021 budget (final adoption in December 2020) that assumes the economic impacts of COVID-19 will have a profound influence on the 2021 budget as well.

BUDGET REVISION SCENARIOS

The brunt of the COVID-19 impact will be felt by the General Fund. The General Fund supports most of the city's staffing costs. It is also recommended that the City Council prepare for three levels of funding gap severity. Level #1 navigates the crisis using spending reductions, transfers and other strategies to adjust the budget, but without the need for involuntary staff cuts. It is recommended that we proceed first with Level #1 strategies before enacting more severe measures. The details of this Level #1 approach are listed below. Level #2 would be required if Level #1 measures are insufficient to meet the new budget targets and would include involuntary staff reductions, service terminations or cutbacks, and intra- or inter-agency mergers of services, departments and divisions. If more draconian measures are required in the future, Level #3 could include debt issuance to fund operating expenses and interfund transfers from enterprise and special purpose funds. While both Level #2 and Level #3 measures are harsh (and hopefully avoidable), I consider Level #2 measures less draconian than Level #3 because they deal with the funding shortfall in the present, whereas Level #3 measures defer the financial impacts of the shortfall to the future (when the city would face additional debt service, utility rate increases, deferred maintenance capital backlogs, etc.).

To fund a gap of $5.4 million in the General Fund without involuntary staff reductions requires aggregating numerous financial strategies, and these Level #1 measures may not be sufficient if the assumptions on which they are based prove to be too optimistic. But the City Council could proceed with these measures and then re-assess whether they will be sufficient at the next financial crisis study session in July. Notes regarding each of the nine measures below follow the summary.

Level #1: Multi-Faceted Strategies for Bridging the COVID-19-created funding gaps in 2020 & 2021:

1. Refinance and restructure the city's long-term debt
   General Fund 2020: $ -0- Non-General Fund 2020: N/A
   General Fund 2021: $ 140,000 Non-General Fund 2021: N/A

2. Anticipated relief funding from the State and Federal governments
   General Fund 2020: $ 250,000 Non-General Fund 2020: N/A
   General Fund 2021: $ 150,000 Non-General Fund 2021: N/A

3. Establish an Employees' Clinic (& other measures) to reduce group health care costs
   General Fund 2020: $ 125,000 Non-General Fund 2020: N/A
   General Fund 2021: $ 350,000 Non-General Fund 2021: N/A

4. Eliminate/Restrict "non-essential" expenditures
   General Fund 2020: $1,850,000 Non-General Fund 2020: N/A
   General Fund 2021: $ 600,000 Non-General Fund 2021: N/A

5. Temporarily reduce funding to police & fire pension funds
   General Fund 2020: $ 150,000 Non-General Fund 2020: N/A
   General Fund 2021: $ 525,000 Non-General Fund 2021: N/A

6. Delay some planned capital expenses based on new decision matrix
   General Fund 2020: $ -0- Non-General Fund 2020: N/A
   General Fund 2021: $ 150,000 Non-General Fund 2021: N/A

7. Modest Revenue Enhancements
   General Fund 2020: $ 100,000 Non-General Fund 2020: N/A
   General Fund 2021: $ 250,000 Non-General Fund 2021: N/A

8. Use of Non-General Fund Internal Service Funds supported by the General Fund
   General Fund 2020: $1,000,000 Non-General Fund 2020: N/A
   General Fund 2021: $ 150,000 Non-General Fund 2021: N/A

9. Use of the General Fund Restricted Reserve
   General Fund 2020: $2,000,000 Non-General Fund 2020: N/A
   General Fund 2021: $2,500,000 Non-General Fund 2021: N/A

TOTAL GENERAL FUND 2020: $5,435,000
TOTAL GENERAL FUND 2021: $4,855,000

NOTES to Level #1:

1. Refinance and restructure the city's long-term debt: The City Council recently hired a new bond underwriter that has started the process of refinancing certain debt instruments. We have calculated that these efforts will principally benefit Non-General Fund debt costs. There will be a benefit to the General Fund to the extent that it will not have to backstop as much of the downtown improvement debt, but even this benefit will not occur until FY 2021.
2. Anticipated relief funding from the State and Federal governments: The city has already received approval to obtain some program and project specific funding from emergency funding bills, and these types of revenues are anticipated here. This calculation assumes no funding from yet-to-be approved federal funding that promises to address our General Fund gaps.
3. Establish an Employees' Clinic (& other measures) to reduce group health care costs: Group health care costs will see some decrease due to employee attrition and delays in non-emergency medical procedures due to COVID-19. But most of this savings comes from net projected savings that will accrue from the creation of a new employee clinic.
4. Eliminate/Restrict "non-essential" expenditures: The aggregate projected savings from cancelling planned vehicle purchases, delayed software upgrades, training and travel cancellations, net savings from not replacing 3 fire inspectors, and other miscellaneous expenses. This total DOES NOT include (but could include) deferring a new fire ladder truck and postponing work on fire stations #3 and #7 (although grant funds are restricted to this use).
5. Temporarily reduce funding to police & fire pension funds: The city has historically funded its fire and police pensions at or above the 100% level, but the law requires that we fund no less than 90%. With the current year tax levy already set, these savings would mostly occur in 2021.
6. Delay some planned capital expenses based on new decision matrix: The packet material includes a matrix for deciding what capital projects can be considered for delay, and project list. But this analysis does nothing for the General Fund in 2020.
7. Modest Revenue Enhancements: When the economy is strained is not generally the best time for revenue enhancements, unless they are user-fee based or paid primarily by those benefitting from city services that they are not paying for now: targeted user fees, fees assessed against non-residents, special benefit fees, vacant and foreclosure fees, etc.
8. & 9. Restricted reserves are for use in unplanned emergencies—such as the one we find ourselves in now. However, it is recommended that the council not exhaust more than half of the restricted General Fund reserve over the next two years. Reserves in the insurance and risk management funds can make substantial contributions, but only in 2020, without significantly deferring costs to the future.

Level #2: More Severe Cost Reduction Measures:

In addition to involuntary staffing reductions, service terminations or cutbacks, and intra- or inter-agency mergers of services, departments and divisions—Level #2 reductions would also have to include an examination of subsidies the city supplies to Macon County Animal Control, the Civic Center, the Convention and Visitors Bureau and other direct city-to-agency external subsidies. Labor contracts require that any layoffs be in inverse order of seniority (although management will meet with employee groups in advance to discuss alternative approaches to reducing salary costs if going to Level #2 cutbacks is required). A list of potential service terminations, service cutbacks, and intra- or inter-agency mergers or services will be provided at the July study session if is determined that they must be considered. The aggregate cost of external subsidies exceeds $1.5 million per year.

Closing Comments:

The nine components that make up the Level #1 proposed gap eliminations is not meant to be an exhaustive list. Council members may wish to delete some items or suggest others that are not listed here. That is the council prerogative. Alternative ideas for all three levels should be brought to the table at the study session. In general, however, I recommend a set of strategies (Levels 1, 2 and 3) that get progressively more severe—to be implemented as actual conditions and the City Council determine—to serve as the framework for managing budget impacts as we move forward.

Although city-to-city comparisons are problematic, as noted above, our projected losses are in range of those projected elsewhere. The city of Peoria projects a financial hit to their General Fund of more than $8 million per year, and the city of Bloomington projects a $5 million deficit to their General Fund for the fiscal year beginning May 1, 2020.

Although the city's financial planning policies are the principal topic of the May 11 study session, Decatur's ability to return to a "new normal" will also depend on how quickly we can move from Phase 2 to Phase 3, and then from Phase 3 to Phase 4, in the Governor's "Restore Illinois" plan. This progress directly impacts our financial planning model. A copy of the plan is attached. The Crisis Communication Team, and other health care and governmental entities in Macon County, are discussing the best ways to accelerate our progress through the phases, and they will likely make recommendations in the near future. But if time during the study session permits, the City Council could also discuss their ideas for implementing the recovery plan.

Attachments:

1. Power Point Slides
2. "The Recovery may be Shaped Like the Nike Swoosh," CNN, May 6, 2020.
3. "New CBO Projections Suggest Even Bigger State Shortfalls," Center on Budget & Policy Priorities, April 29, 2020.
4. IPRIME Market Update, PMA Asset Management, LLC, May 2020.
5. IML memo dated May 4 on Preliminary Revenue Forecasts for Illinois municipalities.
6. General Fund revenue analysis and shortfall projections.
7. Decision Matrix for possible delay of capital infrastructure projects in pandemic
8. Community Survey Results
9. Governor Pritzker's May 5 "Restore Illinois" plan