City of Arts & Innovation

Budget Engagement Commission

TO: HONORABLE COMMISSIONERS **DATE: AUGUST 12, 2021**

FROM: FINANCE DEPARTMENT **WARDS: ALL**

SUBJECT: MANAGING CITY'S FINANCIAL HEALTH THROUGH USE OF FINANCIAL HEALTH INDICATORS TO MAINTAIN FISCAL RESPONSIBILITY

ISSUE:

Receive and provide input on the use of Financial Health Indicators to report on and manage the overall fiscal health of the City and maintain fiscal responsibility.

RECOMMENDATIONS:

That the Budget Engagement Commission receive and provide input on the Financial Health Indicators discussed herein.

BACKGROUND:

To maintain the City's goal of fiscal responsibility, Financial Health Indicators (FHI) have been produced to measure the City's overall financial health compared to similar and surrounding cities.

There are many ways to evaluate a city's financial health. The City prepares numerous financial and budgetary reports every year. In addition, there are rating agency analyses, as well as several different proposed measures of financial condition.

Financial Health Indicators are a proactive approach to monitoring or assisting local governments that show early signs of fiscal stress. The City can use FHIs to recognize early signs of fiscal stress and take a proactive approach while monitoring the fiscal health of the City.

This report explores one perspective on how to measure the City's financial condition. It does not give a grade to the City's financial condition, but rather looks at 10 different aspects of the City's finances to see how the City was doing as of the end of the 2019-20 fiscal year. This includes the City's trend over the previous five (5) years and how the City compared to other similar California jurisdictions. Since the data used for this analysis is only produced on an annual basis, an annual update will be presented each year. Cities are required to complete and issue the Annual Comprehensive Financial Report (ACFR) by December 31 of each year. The Finance Department will return each year following the publication of the ACFR with updated FHIs.

The cities selected for comparative purposes were selected due to their similar size and characteristics to that of the City of Riverside. The cities compared were updated according to the Market Basket recommendations by Human Resources presented to City Council on October 1, 2019. The comparison data from the other cities is derived from each respective City's ACFR. This is audited information and is used for comparative purposes against the City's financial results as presented in the ACFR for the fiscal year ended June 30, 2020. Trend information is provided to show the City's performance over the last five (5) fiscal years (Attachment 1).

This report is meant for the City's government leaders, decision makers, residents, businesses, and taxpayers. It provides financial context for the impacts on services and maintenance that the City has seen over the last five years. It simplifies the detailed information contained in the City's Annual Comprehensive Financial Report (ACFR) and gives residents a sense of how the City is faring compared to its peers.

DISCUSSION:

Sound fiscal health is imperative to ensuring the effective operation of the City. It is critical that the City continuously assesses its financial condition and fiscal health. Staff reports quarterly the financial condition analysis with valuable information on the current and future state of City finances. Regular analysis can highlight potential fiscal problems and provide information necessary for timely corrective action. By taking action to address weaknesses and strengthen fiscal health, the City can better ensure that resources are available to fund the level and quality of services expected by our citizens.

The FHIs discussed below correlate to the City's ability to meet its financial commitments now and into the future and have been identified as useful in determining signs of fiscal stress. The FHIs are based on information derived from the City's Annual Comprehensive Financial Report (ACFR).

These financial health indicators are designed to open a dialogue and provide clear and useful information. Staff has centered the discussion of financial condition on three (3) basic questions and 10 measures to evaluate financial condition. At the core of each question is an evaluation of the City's ability to provide services to the residents of Riverside.

FINANCIAL POSITION - Can the City Pay its bills now?

The City's financial position is strong if it has plenty of cash and other liquid resources available. Without those resources, it will have to borrow money, delay payments, or liquidate some of its other assets, all of which carry significant financial costs. Some bills might be unexpected, such as legal settlements or emergency infrastructure repairs. A strong financial position means the City is prepared for these and other contingencies.

FHI #1 General Fund Reserve Ratio

What it means: This indicator identifies changes (increases or decreases) in unassigned fund balance in the General Fund from the prior year to the current year and is useful in identifying if the City's unassigned fund balance is deteriorating.

Why it is important: A declining unassigned fund balance can be a sign of fiscal stress. This indicator is important in identifying a trend of a deteriorating unassigned fund balance as well as how rapidly it is deteriorating. A **higher ratio** suggests larger reserves for dealing with unexpected resource needs in the long run.

FHI #2 General Fund Liquidity Ratio

What it means: This indicator identifies changes (increases or decreases) in available cash and is useful in identifying the City's ability to pay bills on time by measuring readily available cash.

Why it is important: A declining ratio indicates that the City does not have sufficient cash available to meet its current obligations as they come due. This indicator is important in identifying a trend of deteriorating cash as well as how rapidly it is deteriorating. For this measure, a **higher ratio** suggests a greater capacity for paying off short-term obligations.

FINANCIAL PERFORMANCE - Can the City's revenues cover its expenses?

The City does not only need to pay bills now, it needs to make sure that the money it brings in regularly is enough to cover its annual expenses. If this does not happen, service levels will not be sustainable in the long-term.

FHI #3 General Government Growth in Net Position Ratio

What it means: A growth in net position indicates that the City can pay its expenses with its revenue and is able to make a little extra.

Why it is important: Revenues from the City's programs ideally should cover the expenses that the City incurs for those programs, otherwise the City will have to make ends meet by dipping into reserves, and it won't be able to save money for projects. A **higher ratio** indicates that annual costs are adequately financed, and the financial health is improving.

FHI #4 General Government Operating Margin Ratio

What it means: The City funds certain programs via grants and intergovernmental aid from other government agencies (e.g. Federal and State) and also charges for services that are offered to its residents. This measurement indicates the degree to which the City relies on grants and fees for services rather than taxes to fund the City's operations.

Why it is important: The City collects revenues from charges, fees, and grants to support some of its programs. Some programs however, such as public safety, are funded by general tax dollars. For this measure, a **lower ratio** suggests basic government services are more self-sufficient through charges, fees, and grants rather than general tax dollars to fund programs.

FHI #5 General Government Own Source Revenue Ratio

What it means: The City receives grants and intergovernmental aid from other government agencies, such as the state and federal governments. While the City welcomes grants and aid to support City services, the less reliant the City is on money from those sources, the more independent the City's financial condition is.

Why it is important: A lower ratio shows that the City had a larger portion of its revenues coming from its own sources, namely fees, charges, and taxes. For this measure, a **lower ratio** indicates more independent financial condition.

LONG TERM SOLVENCY – Can the City pay its bills in the future?

The City will have bills in the future, and its current financial condition will influence its ability to pay them. For the long-term future, the City needs to make sure that its revenue sources are enough to cover long-term spending needs and provide services to a growing, changing population.

FHI #6 General Government Near-Term Solvency Ratio

What it means: The City has both short-term and long-term obligations that must be paid in the future, such as accounts payable and notes payable. The fewer number of years of annual revenue needed to pay the City's obligations, the better the City's financial condition.

Why it is important: A lower ratio shows that the City is able to pay a larger portion of its debts with annual revenues. For this measure, a **lower ratio** indicates better financial condition.

FHI #7 General Government Debt Burden per Resident Ratio

What it means: The City issues debt for a variety of reasons. Having a low amount borrowed per resident would put the City in a better position, and potentially make it easier to borrow more money should the need arise.

Why it is important: Lower debts per capita result in a smaller debt burden on taxpayers and a greater capacity for the City to borrow money if it needs it. For this measure, a **lower ratio** indicates better financial condition.

FHI #8 Governmental Funds Coverage Ratio

What it means: If a large portion of the City's expenses go towards paying debt principal and interest, it shows that the City is less able to spend money on services and capital improvements.

Why it is important: A city has principal and interest payments on debt. The lower the amount of these payments compared to all the other expenses it has, the better its financial condition. For this measure, a **lower ratio** indicates better financial condition.

FHI #9 Enterprise Funds Coverage Ratio

What it means: This measure compares the interest expense owed on debts annually to the ongoing, typical operating revenues from which that expense will be paid. This is similar to a small business owner making sure that the interest payments on the mortgage for her office aren't too large compared to the revenues she brings in each year.

Why it is important: Just like the City's governmental services need to pay their debts (e.g., bonds) in the long-term, the City's Enterprise Funds need to do so as well. The City's Enterprise Funds include Electric, Water, Sewer, Airport, Refuse, Transportation, Public Parking, Convention Center, and Entertainment Funds. For this measure, a **higher ratio** indicates better financial condition.

FHI #10 General Government Capital Asset Value Ratio

What it means: Capital assets include buildings, land, vehicles, and public infrastructure. Most of the City's capital assets decrease in value over time because of depreciation. If the City doesn't replace or renovate its capital assets, the value over time decreases.

Why it is important: A negative ratio indicates that the City's assets decreased in value—that is, the value at the end of the year was less than the value at the beginning of the year. This indicates that the depreciation of capital assets was greater than the value of capital assets added, and that some capital assets may need to be renovated or replaced. The City needs to make sure that as capital assets age, it is renovating or replacing them. For this measure, a **higher ratio** indicates better financial condition.

Financial health is more than a grade; it is about whether a local government has sufficient resources to deliver the services its residents expect. The FHIs described herein are designed to provide explanations for some measures of financial condition and are part of an ongoing conversation about financial health and service delivery in the City. The Finance Department will present this report to the Financial Performance and Budget Committee on August 13, 2021 and to the City Council on August 17, 2021.

STRATEGIC PLAN ALIGNMENT:

This item contributes to Strategic Priority No. 5 High Performing Government and the following four Goals:

- 5.2 – Utilize technology, data, and process improvement strategies to increase efficiencies, guide decision making, and improve access to and delivery of financially sustainable city services.
- 5.3 – Enhance communication and collaboration with community members to improve transparency, build public trust, and encourage shared decision making.
- 5.4 – Achieve and maintain financial health by addressing gaps between revenues and expenditures and aligning resources with strategic priorities to yield the greatest impact.
- 5.5 – Foster a culture of safety, well-being, resilience, and sustainability across the city organization.

The Report utilizes City and comparative data to present informative measures of the City's financial health that can help guide decision making related to providing City services in alignment with strategic priorities. The information is provided publicly to enhance transparency surrounding City finances and encourage community input.

This item aligns with EACH of the five Cross-Cutting Threads as follows:

1. **Community Trust** – The Financial Health Indicators Report enhances transparency regarding City finances and shares important information about the City's fiscal health with the public in relation to comparative cities.

2. **Equity** – The Financial Health Indicators Report is available to all members of the public and provides data that can help guide financial decision making regarding the equitable distribution and fiscal sustainability of city services.

3. **Fiscal Responsibility** – The Financial Health Indicators Report demonstrates fiscal responsibility through the monitoring of the City's financial health. The Report is designed to facilitate open dialogue and provide clear and useful information using 10 fiscal health measures to evaluate financial condition of the City.

4. **Innovation** – The Financial Health Indicators Report utilizes the most currently available data alongside that of comparative cities to help guide decision making for the delivery of financially sustainable city services.

5. **Sustainability & Resiliency** – The Financial Health Indicators Report uses 10 fiscal health measures to evaluate the City's fiscal sustainability and resiliency and provide useful information for decision making related to the provision of city services and funding of long-term needs.

FISCAL IMPACT:

There is no direct fiscal impact associated with this report.

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Attachments:
1. Financial Health Indicators 5-Year Trend and Comparable Cities
2. Presentation