CITY OF RIVERSIDE

City of Arts & Innovation

City Council Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL **DATE: OCTOBER 1, 2019**

FROM: FINANCE DEPARTMENT **WARDS: ALL**

SUBJECT: MANAGING CITY'S FINANCIAL HEALTH THROUGH USE OF FINANCIAL HEALTH INDICATORS AS PART OF CITY'S LONG-TERM FISCAL MANAGEMENT OF CALIFORNIA PUBLIC EMPLOYEE RETIREMENT SYSTEM LIABILITY

ISSUE:

Receive and provide input on the use of Financial Health Indicators to report on and manage the overall financial fiscal health as part of the City's Long-Term Fiscal Management of the California Public Employees Retirement System liability.

RECOMMENDATIONS:

That the City Council:

1. Receive and provide input on the Financial Health Indicators discussed herein; and

2. Direct staff as to recommended strategies and next steps.

COMMITTEE RECOMMENDATION:

On August 14, 2019, the Finance Committee, with Chair Adams, Vice Chair Conder, and Member Soubirous present, considered a report on the use of financial health indicators to report on an manage the overall financial fiscal health as part of the City's long-term fiscal management of the California Public Employee's Retirement System liability. Following discussion, the Committee unanimously and without formal motion received and ordered filed the report. Additionally, on August 15, 2019, the Budget Engagement Commission received this same report. Following discussion, the Committee, via a motion by Commissioner Mayes, unanimously received and ordered the report filed.

BACKGROUND:

Faced with significant budgetary constraints primarily driven by increasing CalPERS costs, the City is expected to be confronted with key challenges to meet service commitments and obligations to the citizens of Riverside.

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 a number of different proposed measures of financial condition.

Financial Health Indicators (FHI) 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 to monitoring the fiscal health of the City.

This report explores one (1) 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 2017-18 fiscal year. This includes the City's trend over the previous five (5) years and how the City compared to other similar California jurisdictions.

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 decade. It simplifies the detailed information contained in the City's Comprehensive Annual Financial Report (CAFR) 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 periodically assesses its financial condition and fiscal health. Staff are proposing to do this by performing a regular, timely 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 Comprehensive Annual Financial Report (CAFR).

The cities selected for comparative purposes were selected due to their similar size and characteristics to that of the City of Riverside. The comparison data from the other cities is derived from the respective city's CAFR. This is audited information and is used for comparative purposes against the City's financial results as presented in the CAFR for the fiscal year ended June 30, 2018. Trend information is provided to show the City's performance over the last five (5) fiscal years (Attachment 1).

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 a CAFR by December 31 of each year. The Finance Department will return in February of each year with updated information. Since this is only one aspect of financial health, other performance indicators will be incorporated into a comprehensive report with more frequent updates as the timing of data permits.

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 Short-run Financial Position – Building Up Reserves

What it means: This indicator identifies changes (increases or decreases) in unassigned fund balance 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 Liquidity – Ability to Pay Expenses

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. Ideally, 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 just 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 Net Asset Growth – Change in Net Assets

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 Operating Margin – Reliance on General Tax Dollars

What it means: The City charges for some services that it offers to its residents with the expectation that some or all of its costs will be recovered by the fees charged. Other services are covered by the taxes received by the City. This operating margin indicates the degree to which the City relies on taxes rather than fees for services or other revenues.

Why it is important: The City collects revenues from fees, charges, fines, and grants to support some of its programs. Some programs however, such as public safety, are funded by general tax dollars. This measure shows the extent to which basic government services were supported by general tax dollars. A lower ratio indicates that the City's services were supported through service fees and required less general taxpayer support. For this measure, a **lower ratio** indicates more independent financial condition.

FHI #5 Own Source Revenues – Reliance on Grants and Aid

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 Near-Term Solvency – Ability to Pay Obligations with Annual Revenues

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 Debt Burden – Amount Borrowed per Resident

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 Coverage 1 – Ability of Governmental Funds to Make Bond Payments

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 debts and interest on debts to pay as well, and 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 Coverage 2 – Availability of Resources for Business-Type Activities to Make Bond Payments

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 (i.e., bonds) in the long term, the City's *business-type activities* need to do so as well. The City's business-type activities include the Public Utilities and Wastewater Treatment System, and the Parking System. For this measure, a **higher ratio** indicates better financial condition.

FHI #10 Capital Asset Condition – Change in Value of Capital Assets

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: The 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 these *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 FHI's described herein are designed to provide explanations of some measures of financial condition and are part of an ongoing conversation about financial health and service delivery in the City. This report will be updated on an annual basis and the Finance Department will return to this governing body by the Spring of each year with the results.

FISCAL IMPACT:

There is no direct fiscal impact associated with this report.

Prepared by: Edward Enriquez, Chief Financial Officer / City Treasurer
Certified as to
availability of funds: Marie Ricci, Assistant Chief Financial Officer
Approved by: Carlie Myers, Deputy City Manager
Approved as to form: Gary G. Geuss, City Attorney

Concurs with:

Steve Adams, Chair
Finance Committee

Attachments:
1. Governing Guide to Financial Literacy
2. Financial Health Indicators Comparatives and Trend
3. Presentation