

To: Honorable President and Board of Trustees
From: William T. Lichter, Village Manager
Date: September 6, 2005
Subject: **Report on Lombard's Financial Condition and the Need for a Source of Long-Term Additional Revenue**

During the budget workshop process for the FY 2005-2006 Annual Operating Budget, the Board of Trustees requested that a report be prepared regarding longer-term revenue options to address on-going economic issues and the impact of the property tax cap on Lombard's ability to maintain essential public services. The following report is in response to that request.

Unlike the private sector, residents and businesses expect local government to provide high quality services regardless of revenue constraints imposed by the economy or by costly mandates from higher levels of government. Lombard recognizes that reality, and has thus far been able to provide services at a level expected by the public through conservative management of municipal finances. However, staff has significant concerns that, despite the Village Board's decision to institute budget cuts beginning in June 2000, a relatively stagnant economy and the growing negative impact of the property tax cap will soon make it impossible to maintain current service levels without an additional long-term source of revenue. Therefore, it is imperative that steps be taken to inform the public of the impact of the Village's revenue situation on service levels, and to begin a public dialogue on ways to fund services in the future.

BUDGET CUTS

Currently, over 84% of Lombard's operating budget goes toward funding public safety services provided by the Police, Fire, and Public Works Departments. The Village has made substantial cuts and changes to its budget over the past four years in order to maintain those and other essential services. At the same time, it has been necessary to impose higher tax, permit, and licensing fees. What follows are several examples of the steps taken thus far in order to maintain balanced operating budgets.

- \$20,990,830 in reductions were made in capital project expenditures programmed for the next ten years;

- \$960,000 in Motor Fuel Tax revenue normally used for capital improvements is now being used to cover Public Works Department operating expenses instead;
- \$328,340 in property tax revenue previously used to pay a portion of special assessment costs is now used for operating purposes;
- Reductions in routine services have been implemented;
- Training budgets were sharply reduced;
- Hiring freezes have been imposed across all departments, including public safety. Currently, ten (10) vacant full-time positions are frozen including two Firefighters, Deputy Fire Chief, three Civil Engineering positions, Fleet Services Superintendent, Human Resources Manager, Assistant to the Village Manager, and Forestry Technician. Additional positions are carefully evaluated as vacancies occur;
- Reservation of funding for replacement of obsolete computer technology was either cut significantly or eliminated;
- There was a reduction from 10 to 9 hours per day in operation of the Fire Department's 3rd paramedic ambulance;
- Annual revenue for emergency preparedness is now 107% (\$138,500) lower than it otherwise would have been under the Village's previous funding policies;
- A 1% Places of Eating Tax was approved;
- A 5% Amusement Tax was approved.

IMPACT OF THE PROPERTY TAX CAP

The negative impact on service levels of the Property Tax Extension Limitation Act (Tax Cap) was first predicted by the Finance Department in the 1990's and is now coming to pass. That impact has been compounded by actions of the General Assembly, particularly in terms of mandating pension benefit increases for police and fire personnel without new revenue to fund the increased cost of those benefits.

The Village Board is well aware of the negative impact that the property tax cap has had on the current year's budget, and will have on budgets into the future. However, the

detrimental impact of the tax cap on the ability of the Village to continue providing a high quality level of service bears repeating.

The impact of the tax cap is reflected in the following ways.

- The Corporate property tax levy will be eliminated in its entirety within the next three years resulting in a transfer of costs to the General Fund of an estimated \$1.172 million;
- The Public Benefit levy will be eliminated four years from now. As a result, there will be a loss of \$5.6 million over the ten year period of the current Capital Improvement Program that otherwise would have been utilized to fund capital projects;
- The property tax levy for Social Security will be eliminated five years from now, resulting in a transfer of costs to the General Fund of an estimated \$740,000;
- The property tax levy for the Illinois Municipal Retirement Fund (IMRF) will be sharply reduced five years from now and completely eliminated in six years. This will result in a transfer to the General Fund of \$710,000;
- Police and fire pension costs, which are largely funded through the property tax, have increased by \$1,429,012 (121.7%) since 1995 due, in part, to benefit enhancements mandated, but not paid for, by the Illinois General Assembly.
- Within ten years, property tax revenues will no longer be sufficient to fund the Police and Firefighter pensions in their entirety. Therefore, a portion of those costs will need to be funded with general revenue or the pension funds will slip below their actuarially required funding levels.

In six years, an estimated \$2.8 million annually in expenditures for health insurance, social security, and IMRF that are currently supported from property tax revenue will be competing for funding with the same revenue sources that are currently being used to support on-going Village services.

LONG-TERM REVENUE OPTIONS

Three long-term revenue options were discussed during the budget process – instituting a non-home rule sales tax, increasing the Village’s property tax extension limitation, and a return to home rule status. What follows is a summary of the options, all of which require referendum approval.

Non-Home Rule Sales Tax

Home rule communities have no restriction on their ability to impose a retail sales tax over and above the one percent (1.0%) municipal sales tax provided by state law. Many home rule communities have exercised that authority. In January 2000, non-home rule communities received authorization through Public Act 91-0649 to institute a non-home rule retail sales tax if approved by referendum. Attachment A indicates the sales tax rate for home rule and non-home rule municipalities in the Chicago metropolitan area.

PA 91-0649 initially provided for an additional one-half percent (0.5%) retail sales tax to be collected on most merchandise sold within a municipality’s corporate limits beginning in January 2002. It required that the additional 0.5% sales tax be authorized by a voter referendum, and that the additional funds generated by the sales tax be utilized for public infrastructure improvements. One nuance of the legislation required that a municipality seeking implementation of the sales tax simultaneously seek referendum approval for both a retail occupation and service occupation tax. As such, communities are also required to impose the sales tax on any merchandise that accompanies the provision or sale of a service occupation.

Generally speaking, PA 91-0649 was drafted to exclude most groceries, prescriptions, medical supplies, and large titled items such as motor vehicles, trucks, RVs, and boats. Alcoholic beverages, soft drinks, and food which is prepared for immediate consumption are not excluded.

In 2003, the law was modified to permit the option for municipalities to impose the additional retail sales tax in one-quarter percent (0.25%) increments up to the original maximum of 0.50%, while expanding the use of the additional revenue to also include property tax relief. In the recently concluded session of the General Assembly, SB 172 was approved and sent to the Governor for his signature. SB 172 would have increased the amount that a municipality could collect under the non-home rule sales tax to an amount not to exceed one percent (1.0%), if approved by referendum. However, on August 12, 2005, the Governor vetoed SB 172.

Increase in Property Tax Extension Limitation

A provision of state statute provides for the ability of a municipality to increase its property tax levy extension limitation (tax rate) by referendum. ILCS 200/18-205 provides that “A taxing district may increase its extension limitation for a current levy year if that taxing district holds a referendum before the levy date...”

The statute goes on to state that the question shall be presented in substantially the following manner: “Shall the extension limitation under the Property Tax Extension Limitation Law for... (tax district name)...be increased from... (the lesser of 5% or the increase in the Consumer Price Index over the prior levy year)...% to... (percentage of proposed increase)...% for the ... (levy year)...levy year?”

Looking back at the 2004 levy passed in December 2004 as an example, the Village had to use the CPI increase of 1.9% because it was less than 5.0%. If Lombard had been looking at a 20% increase over the 1.9% that was allowed, the referendum question the Village would have needed to ask before the adoption of the levy would have read as follows: “Shall the extension limitation under the Property Tax Extension Limitation Law for the Village of Lombard be increased from 1.9% to 21.9% for the 2004 levy year?”

Approval of this question would have increased Lombard’s limiting property tax rate from .5045 to .6035. Therefore, the Village would have been able to levy an additional \$1.3 million. That amount would have thereafter been rolled into Lombard’s levy request and would have become part of our “base” property tax extension for the following year. In future years, the Village’s increases would go back to being limited by the lesser of the CPI or 5.0%.

Home Rule

When the new Illinois Constitution was adopted in 1970, it provided for Illinois counties and municipalities to have home rule powers. Municipalities with populations over 25,000 were automatically granted home rule authority. Communities with populations of 25,000 or less were given the ability to become home rule by referendum. A referendum to become home rule is provided for either by resolution of the governing body or by petition of the electors. The petition of the electors must be signed by a number at least equal to 10% of the number who voted in the last general election. The governing body may schedule the referendum to be held at a general, regular election. The same provisions apply to a referendum to eliminate home rule. However, that issue may not be voted on more than once in four years.

As of one year ago, there were 159 home rule municipalities in Illinois, and one home rule county (Cook County). Approximately 58% of the people living in Illinois reside in a home rule community. Among nearby communities, Addison, Bloomingdale, Carol Stream, Downers Grove, Elmhurst, Glen Ellyn, Glendale Heights, Wheaton, and Woodridge have home rule status. Lombard was originally granted home rule authority. However, that authority was eliminated by referendum in 1981. Lombard is only one of four local governments in Illinois that has lost its home rule powers in that manner. The others are Rockford, Villa Park, and Lisle. No community has voted to eliminate home rule since Rockford did so in 1983.

Broad home rule powers are granted by the Illinois Constitution. Under home rule, local governments can exercise any local powers not denied them by the State. Without home rule, they can exercise only those powers explicitly given to them by the State. A study conducted by Northern Illinois University in 2002 found that home rule is most frequently used to promote economic development and to levy taxes. Other uses of home rule powers most often deal with regulatory matters, reducing the cost of borrowed money, the purchase, sale, and lease of property, regulatory licensing, and intergovernmental agreements.

In regard to taxation, the study concluded that home rule leads to lower property taxes by allowing home rule cities and villages to diversify their tax base and rely more heavily on less onerous sources of tax revenue. In 1992, the Illinois General Assembly voted to prohibit home rule jurisdictions from enacting their own retail sales tax. Instead, the state gave those communities authority to increase the local option component of the state retail sales tax from the one percent authorized for all cities and counties to as much as 2.5 percent. Because this new arrangement gave home rule governments the freedom to levy higher sales taxes without having to incur any collection costs, the use of home rule sales taxes has increased significantly since that time. Municipalities responding to the survey on which the study was based reported no significant local opposition to use of other means of taxation in lieu of the property tax.

RECOMMENDATION ON LONG-TERM REVENUE OPTION

Given the public opposition to increased property taxes, and based upon the statements in opposition to home rule made by members of the Village Board during the recently concluded budgetary process, staff has chosen to exclude both an increase in the property tax extension and a return to home rule from further consideration. Instead, the balance of this report will focus on the non-home rule retail sales tax option.

Staff recommends that a one-half of one percent (0.50%) retail sales tax rate increase be considered, and that the referendum question be placed on the ballot for the March 21, 2006 election date. As indicated in Attachment B, that date could be utilized assuming that the referendum is not the only issue on the ballot. Since March 21st is the date for the primary election, it is virtually certain that there will be candidates on the ballot, therefore making it a suitable date for a referendum. If the referendum were to be approved, the ordinance imposing the tax would be considered by the Village Board following canvass of the votes, with the effective date of the tax being January 1, 2007.

The overall tax rate would rise to 7.25 percent (7.25%) from the current 6.75 percent (6.75%). As noted in a previous section of this report, prescription drugs, groceries, and other items such as automobiles, would not be affected by the sales tax increase. Given the presence of Yorktown Center, it is anticipated that non-residents would pay a significant portion of the sales tax increase. The additional money would be used solely to fund Village infrastructure needs. Directing the money to pay for infrastructure improvements would allow the Village to apply other revenue currently used for capital improvements to help support and maintain the high quality of Village services over time, including police and fire protection.

Attachment C is a multi-year financial forecast based upon current revenue projections. The Attachment (1) assumes the same inflationary increases for most expenditures as were used in previous financial forecasts, (2) includes filling the ten frozen position vacancies in FY 2006-2007, (3) provides for the annual allocation of \$860,000 in Motor Fuel Tax monies for operating purposes, and (4) accounts for the use of general revenue in lieu of property tax beginning in the years noted in an earlier section of this report.

As indicated in Attachment C, without reduced expenditures or a substantial increase in revenue, the Village would accumulate General Fund deficits of as much as \$18.42 million by FY 2010-2011. Since that is not a viable option, substantial budget cuts would need to be made on an annual basis.

Attachment D is the same multi-year forecast, but includes additional revenue from a 0.50% increase in the retail sales tax paid by shoppers in Lombard. As indicated in Attachment D, it is projected that \$17,326,780 in additional retail sales tax would be generated through FY 2010-2011 if the referendum were to be approved. However, even with the additional sales tax, there would still be little financial flexibility to add new programs or services. Nevertheless, the additional funds would help to ensure that, with continuing attention to careful financial planning that has been the Village's practice to date, effective public services would continue to be provided.

Prior to the Village Board making a final decision, it is recommended that this matter be referred to the Finance Committee for discussion and consideration at its September meeting.

Please feel free to contact me should you have any questions regarding this report. The report has been scheduled for discussion and direction at the September 1st meeting of the Board of Trustees.

Cc: Department Heads
Finance Committee