

Principles of Public Finance

Assessing Financial Conditions

Illinois Municipal Treasurers Association

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INVESTED
IN you



Michael W. Frerichs
ILLINOIS STATE TREASURER





“

By failing to plan, you
are preparing to fail.”



Benjamin Franklin

“

Plans are useless, but
planning is
indispensable.”



Dwight D. Eisenhower

“

Forecasts may tell you a
great deal about the
forecaster; they tell you
nothing about the
future.”



Warren Buffett

Why Does Financial Health Matter?



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- Without knowing your current health, how can you provide services now?
- Without knowing your long-term health, how can you plan for the services you you will need to provide in future?

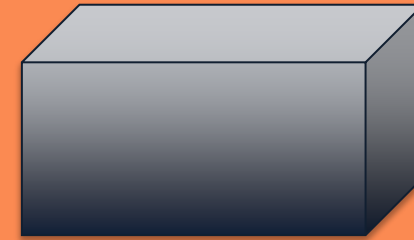




ASSETS



LIABILITIES



FUND BALANCE



- **Something *owned* by government that has value**
 - Cash & Investments
 - Equipment & Buildings
- **Money *owed to* the government**

- **Liability = Money gov't owes to someone else**
 - Unpaid Invoices
 - Pension Liability
- **Fund (Net) Balance = Surplus funds from previous Fiscal Year**



■ FINANCIAL POSITION

- *Measures government's ability to pay its bills as they come due (60-90 days)*

■ FINANCIAL PERFORMANCE

- *Measures government's ability of its revenues to cover its expenses (6 months – 2 years)*

■ FINANCIAL SOLVENCY

- *Measures government's ability to pay bills in the future*



Financial
Position



Financial
Performance



Financial
Solvency

▪ Fiscal Policy Space

- *“What is your budgetary flexibility?”*
- There are external constraints that limit flexibility to maneuver and adjust to changing circumstances.
 - Property tax limitations
 - Contractual obligations
- *“Shrinking” policy space limits current and future choices*



Position

- Short-Run Financial Position
- Liquidity

Performance

- Own-Source Revenues
- Operating Margin
- Net Asset Growth

Solvency (cash)

- Debt Burden
- Near-Term Solvency
- Coverage 1
- Coverage 2

Solvency (structural)

- Unfunded Liability Indicator

Important Note: The scoring methodology is meant to be comparative (i.e. if the ratio is better than 75% of all other governments, etc.). The ratios, by themselves, tell little.



Short-Run Financial Position

$$\frac{\textit{Unassigned General Fund Balance}}{\textit{Total General Fund Revenues}}$$

- MORE IS BETTER
- A higher ratio suggests larger reserves for dealing with unexpected resource needs in the long run

Liquidity

$$\frac{\textit{Total General Fund Cash \& Investments}}{\textit{(General Fund Liabilities - General Fund Deferred Revenues)}}$$

- MORE IS BETTER
- A high ratio suggests a greater capacity for paying off short-term obligations



Operating Margin

$$\left(\frac{\text{Revenue for Gov't Activities}}{\text{Total Gov't Activities Expenses}} \right) * -1$$

- Low ratio suggests basic government services are more self-sufficient through charges, fees, and grants

Own-Source Revenues

$$\frac{\text{Primary Gov't Revenues} + \text{Gov't Operating Grants}}{\text{Total Primary Government Revenues}}$$

- Low ratio suggests government is not heavily reliant on intergovernmental aid.

Net Asset Growth

$$\frac{\text{Change in Gov't Activities Net Assets}}{\text{Total Gov't Activities Net Assets}}$$

- High ratio suggests annual costs are being adequately financed and financial condition is improving

- **Not all ratios are better if they are smaller.**

- Net Asset Growth (sometimes referred to as “Financial Performance”) shows adequate financing of current activities



Debt Burden

$$\frac{\text{Total Outstanding Debt}}{\text{Total Population}}$$

- **LESS IS BETTER**
- Low ratio suggests less burden on taxpayers
- Also suggests greater capacity for additional borrowing

Near-Term Solvency

$$\frac{(\text{Primary Government Liabilities} - \text{Deferred Revenues})}{\text{Primary Government Revenues}}$$

- **LESS IS BETTER**
- Low ratio suggests outstanding obligations can be more easily met with annual revenues



Coverage 1

Debt Service

Non – Capital Gov't Funds Expenditures

- **LESS IS BETTER**
- Low ratio suggests general governmental long-term debt can be more easily repaid when it comes due

Coverage 2

(Enterprise Funds Operating Funds + Interest Expense)

Enterprise Funds Interest Expense

- **MORE IS BETTER**
- High ratio suggests greater resource availability for repaying debts from enterprise activities (water, sewer, etc.)



$$\frac{\textit{OPEB Assets}}{\textit{OPEB Liabilities}}$$

Funded Ratio

- Unfunded liability indicator
- Shows level of funding for pension and other post-employment benefits (OPEB) by government, as a ratio of those benefits that have already been earned by employees



Naperville Data Item	FY16
Primary Government Liabilities	355,856,605
Primary Government Deferred/Unearned Revenue	51,062,313
Beginning Governmental Activities Net Assets	342,525,054
Ending Governmental Activities Net Assets	346,369,859
Charges for Services - Public Safety	8,081,170
Expenses - Public Safety	78,038,293
Primary Government Total Expenses	362,108,379
Primary Government Charges for Service	232,533,276
Primary Government Operating Grants and Contributions	3,166,070
Primary Government Capital Grants and Contributions	8,671,170
Primary Government Unrestricted Aid	0
Net Expense/Revenue for Governmental Activities	-117,737,863
Primary Government General Revenues	127,230,430
General Fund Cash and Investments	15,519,760
General Fund Liabilities	31,967,322
General Fund Deferred Revenue	20,742,437
Unassigned General Fund Balance	26,825,874
General Fund Revenues	118,144,674
Governmental Funds Capital Outlays	21,847,927
Governmental Funds Debt Service	10,779,155
Governmental Funds Total Expenditures	159,781,901
Proprietary Funds Operating Revenue	210,481,239
Proprietary Funds Interest Expense	2,389,497
Beginning Net Value of Primary Government Capital Assets	1,000,211,064
Ending Net Value of Primary Government Capital Assets	997,380,657
Outstanding Debt for the Primary Government	154,500,000
Population	145,058



Ratio	FY16	Formula	What it tells you?	Rule of Thumb
Short-Run Financial Position	22.7%	$\frac{\text{Unreserved GF Balance}}{\text{Total GF Revenues}}$	How much in unrestricted resources do we have as a percent of our revenues?	>5%
Cash Ratio (Liquidity)	138%	$\frac{\text{General Fund Cash + Investments}}{\text{(General Fund Liabilities - General Fund Deferred Revenue)}}$	Will cash and investments cover near-term obligations?	>100%
Net Asset Growth	1.12%	$\frac{\text{Change in Governmental Activities Net Assets}}{\text{Total Governmental Activities Net Assets}}$	What is the return on taxpayer investments?	Positive
Near-Term Solvency	240%	$\frac{\text{(Primary Govt Liabilities - Deferred Revenues)}}{\text{Primary Government Revenues}}$	How well can this government meet its near-term obligations with annual revenues?	<150%
Own-Source Revenues	0.85%	$\frac{\text{(Operating Grants + Contributions + Unrestricted Aid)}}{\text{Total Primary Government Revenues}}$	How much does this organization depend on other govts?	<10%
Operating Margin	100%	$\frac{ \text{Net expense/revenue for govt activities} }{ \text{Total governmental activities expenses} }$	Do operating revenues cover operating expenses?	Positive
Debt Burden	\$ 1,065.09	Total Outstanding Debt/population	How much debt is the community currently carrying?	Depends
Coverage 1	7%	$\frac{\text{Debt Service}}{\text{Noncapital governmental funds expenditures}}$	How easily can this government repay its debts as they come due?	< 25%
Coverage 2	8809%	$\frac{\text{Proprietary Funds Operating Revenue}}{\text{Proprietary Funds Interest Expense}}$	How easily can this government's business-type activities repay their long-term debt obligations as they come due?	> 50%
Capital Assets	-0.28%	$\frac{\text{(Ending NV of Pri Govt capital assets - Beginning NV)}}{\text{Beginning net value}}$	Is this government investing in its capital assets?	Positive



Metric	2016	Points	2017	Points
Short-Run Financial Position	22.71%	1	23.00%	1
Liquidity	138.26%	1	-296.85%	-1
Net Asset Growth	1.12%	0	-0.20%	-1
Near-Term Solvency	239.56%	0	175.31%	1
Own-Source Revenues	0.85%	2	0.67%	2
Operating Margin	99.66%	-1	94.59%	-1
Debt Burden	\$ 1,065.09	1	\$ 1,003.20	2
Coverage 1	6.75%	0	8.65%	0
Coverage 2	8808.60%	2	10480.91%	2
Capital Asset Condition	-0.28%	-1	-2.21%	-1
Total		5		4
Naperville's Financial Position is:		Better Than Most		Average

QUARTILE	First	Second	Third	Fourth
POINTS	-1	0	1	2
Short-Run Financial Position	8%	15%	25%	>25%
Liquidity	28%	62%	193%	>193%
Net Asset Growth	0.27%	2.38%	5.39%	>5.39%
Near-Term Solvency	273%	199%	140%	<140%
Own-Source Revenues	11%	8%	4%	<4%
Operating Margin	54%	45%	37%	<37%
Debt Burden	\$ 2,641	\$ 1,613	\$ 1,065	<\$ 1065
Coverage 1	10.11%	6.13%	3.63%	<3.63%
Coverage 2	4.11%	6.73%	11.61%	>11.61%
Capital Asset Condition	0.32%	2.24%	4.86%	>4.86%
	Worse Than Most	Average	Better Than Most	Among The Best
	0	5	10	

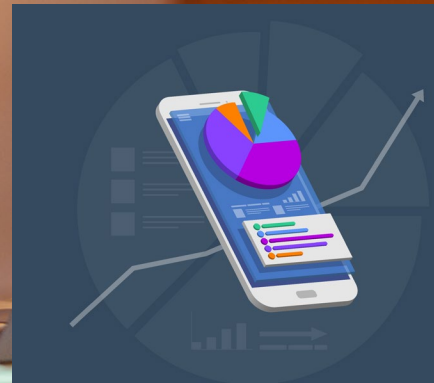
Monitor Your Progress



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- **Dashboards and ten-point tests don't replace plans and actions**
- Financial teams should conduct annual benchmarking, regular reviews
- Ensure reports go out to management team, up to Board, for active discussions and feedback
- Establish timeframes for major reviews
- Reach out to colleagues for coaching, accountability
- **Communicate, communicate, communicate!**





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Questions?