



September 8, 2021

**TO:** Mayor and Members of City Council

**FROM:** Paula Boggs Muething, City Manager

*PM*

202102726

**SUBJECT:** FY 2021 Carryover to FY 2022 Report

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This is an overview of the City of Cincinnati’s General Fund FY 2021 year-end balance and application of the Stabilization Funds Policy adopted by the City Council.

**General Fund 2021 Fiscal Year-End Balance and One-Time Uses**

As set forth in the table below, the City’s General Fund ended FY 2021 with a carryover amount of \$71.2 million, including \$6.4 million net FY 2020 carryover. That carryover amount is reduced by approximately \$50.0 million to establish an Income Tax Reserve for Refunds. Utilizing the City’s established Stabilization Funds Policy, this results in \$3.16 million for one-time uses.

The State of Ohio’s temporary municipal income tax withholding rule, in place pursuant to the Governor’s COVID-19 pandemic emergency declaration, allows employers to continue through December 31, 2021, to remit employee withholding taxes based on an employee’s “principal place of work” established prior to the COVID-19 pandemic restrictions. The underlying municipal income tax obligation in state and local law is distinct from the withholding rules; therefore, this arrangement has created a situation where employers may be withholding and remitting income tax proceeds to the City, but the City may not legally be able to tax all or a portion of that individual’s income under existing law if the individual is working remotely outside of the City. In addition, the state legislature has taken steps in an attempt to extend the City’s liability for refunds. Accordingly, the carryover amount for FY 2021 must be reduced proportionately to this unprecedented potential liability for income tax refunds.

Under applicable law, the City properly taxes the income of city residents, regardless of their work location. However, the City’s ability to tax the income of non-residents is more limited and the location where services are performed can impact the portion of income the City is able to tax. Approximately 70% of all income tax revenues arising from employer withholdings is generated from non-residents; changes in work locations of non-residents may have a considerable financial impact on the City.

Due to the COVID-19 pandemic, many employers located within the City of Cincinnati have utilized remote work or hybrid remote work and in-office models during calendar year (CY) 2021. Further, as the pandemic has shifted throughout the year, these models have also shifted-creating continuing uncertainty. For non-residents, these shifts may lead to direct impacts on the amount of income that is taxable by the City. As stated above, Ohio law has permitted employers located within the City to continue to withhold city income tax during CY 2021. Individual non-residents may file for a refund from the City, to the extent they are entitled to do so, when they file their

2021 taxes. Due to the administrative burden, complexity, and cascading tax consequences, it is unlikely that 100% of individuals who may be entitled to a refund will seek one.

In order to estimate the portion of the carryover amount of \$71.2 million that will be required to be refunded to non-residents once 2021 individual tax filings are made in the spring of 2022, the City Administration worked with the University of Cincinnati (UC) Economics Center. The internal City team and UC benchmarked against the estimate of refund liabilities by other Ohio municipalities and gathered information from our largest employers on their remote work practices. In brief, the UC Economics Center estimated earlier this year that 40% to 50% of subject income tax revenues could be required to be refunded; however, these estimates were made in early 2021 prior to many large employers implementing return to office policies. Cleveland is estimating 20% of subject income tax revenues will have to be refunded and the Regional Income Tax Agency (RITA), which provides income tax collection services for many Ohio municipalities, is estimating 10% to 30%. Based on a survey of our largest income tax withholding employers, the City Administration estimates that among this sample, which represents approximately a third of all withholdings, 35% of the subject income tax revenues may be subject to refund.

Based on this research and analysis, the Administration is recommending an approximately \$50.0 million income tax reserve for refunds, which represents 30% of the income tax revenue collected through withholdings and from individuals during the first half of calendar year 2021. The City Administration will ensure that the City retains all income taxes to which it is legally entitled to under state and local law.

The following table includes a breakdown of how the carryover was applied to reserves and the Administration's recommended one-time uses.

### Application of FY 2021 Carryover Balance

<b>Cash Basis Carryover Balance FY 2021</b>	\$	71,239,421
<b>Uses of Carryover Balance</b>		
Less Transfer to Reserve for 30% Income Tax Reserve for Refunds	\$	50,015,389
<b>Application of Stabilization Funds Policy:</b>		
Less General Fund Carryover Balance (1.5% of operating revenue )	\$	7,242,543
<b>Less Transfers to Reserve Accounts:</b>		
General Fund Contingency Account (2.00% of operating revenue)	\$	4,397,435
Economic Downturn Reserve (5.00% of operating revenue)	\$	3,258,579
Working Capital Reserve (8.2% of operating revenue)	\$	<u>3,162,738</u>
<b>Total Reserve Transfer from Stabilization Funds Policy</b>	<b>\$</b>	<b><u>10,818,752</u></b>
<b>Carryover Balance Less Total Applied to Stabilization Funds Policy</b>	<b>\$</b>	<b>3,162,737</b>
<b>Less One-Time Uses:</b>		
Human Resources Sworn Testing	\$	45,237
Parks Mower and Other Maintenance Equipment	\$	22,000
Police and Law: Records Management Software	\$	85,000
Assorted Capital Projects Shifted to the Operating Budget (OES/DOTE/Planning)	\$	251,600
DCED Capital Projects Shifted to the Operating Budget	\$	273,400
Chamber of Commerce - Immigration Center Partnership (COMPASS)	\$	50,000
Central Parkway Streetscape	\$	1,000,000
Safe and Clean Neighborhood Fund	\$	250,000
Manager's Advisory Group (MAG) Youth Violence Reduction Initiative	\$	200,000
Human Resources HR Centralization Initiative	\$	102,500
Cincinnati Contemporary Arts Center (CAC) Creativity Center Renovations	\$	100,000
King Records	\$	475,000
Equitas Health Mobile Outreach Vehicle (MOVE) Initiative	\$	100,000
Cincinnati Citizens Respect Our Witnesses (CCROW)	\$	<u>208,000</u>
<b>Balance Available</b>	<b>\$</b>	<b>-</b>
<b>Capital Budget Resources Available Due to Swaps</b>		
Assorted Capital Projects Shifted to the Operating Budget (OES/DOTE/Planning)	\$	251,600
DCED Capital Projects Shifted to the Operating Budget	\$	<u>273,400</u>
<b>Balance Available</b>	<b>\$</b>	<b>525,000</b>
<b>Less One-Time Uses:</b>		
King Records	\$	<u>525,000</u>
<b>Balance Available</b>	<b>\$</b>	<b>-</b>

## Uses of Carryover Balances

### **Application of Stabilization Funds Policy**

The Government Finance Officers Association (GFOA) recommends that local governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the General Fund. The City's Stabilization Funds Policy, approved by the City Council in Ordinance No. 0253-2015 and subsequently amended in Ordinance No. 0213-2019, incorporates the GFOA's recommended two months of general fund operating revenues, or 16.7% of annual general fund operating revenues, and has put the City on a responsible multi-year path to achieving that benchmark.

Per the Stabilization Funds Policy and after setting aside funds to cover the approximately \$50.0 million reserve for income tax refunds, the following transfers will be requested via ordinance: \$3.2 million to the Working Capital Reserve, \$4.4 million to the General Fund Contingency Account, and \$3.3 million to the Economic Downturn Reserve Account. Based on the policy, \$7.2 million will remain in the General Fund balance.

#### FY 2020 Balances After Close-out Adjustments

Annual Revenue	\$424,214,473	
Working Capital Reserve	\$35,447,902	8.36%
General Fund Contingency Account	\$8,484,289	2.00%
Economic Downturn Reserve	\$6,051,949	1.43%
General Fund Carryover Balance (After Uses)	<u>\$6,363,217</u>	<u>1.50%</u>
Total Combined Reserves	\$56,347,357	13.28%

#### Balances June 30, 2021 After Proposed Transfers

Actual FY 2021 Revenue	\$482,836,175	
Working Capital Reserve	\$38,993,000	8.08%
General Fund Contingency Account	\$9,656,724	2.00%
Economic Downturn Reserve	\$9,310,527	1.93%
General Fund Carryover Balance (After Uses)	<u>\$7,242,543</u>	<u>1.50%</u>
Total Stabilization Policy Reserves	\$65,202,793	13.50%
30% Income Tax Reserve for Refunds	<u>\$50,015,389</u>	
Total Combined Reserves	\$115,218,182	

Overall combined reserves will increase by \$8.9 million, from 13.28% in FY 2020 to 13.50% in FY 2021, excluding funds set aside for income tax refunds. To ensure fiscal stability, the Administration will continue to prudently manage City operations through adherence to responsible funding policies, including the Stabilization Funds Policy. The City must plan for and be prepared to mitigate fluctuations in demand for services as well as changes in revenues influenced by the economy and budgetary decisions made by the State of Ohio and the federal government. Particularly with respect to the evolving COVID-19 pandemic and its impacts, the City must be prepared for unforeseen events that could result in additional expenditure requirements or loss of revenues by maintaining prudent levels of fund balance and reserves as set forth in the Stabilization Funds Policy. The City must continue on the path toward meeting the GFOA's recommendation of 16.7% of annual general fund operating revenue in reserves.

The rating agencies have emphasized the importance of maintaining appropriate reserves to ensure financial stability and to retain the current bond ratings. The Administration has committed to the rating agencies' plan to build the reserve balances each year until reaching the goal of 16.7%.

### **Carryover Uses**

As part of the Stabilization Funds Policy, \$3,162,737 is available for one-time uses for FY 2022. Below are the Administration's recommendations on use of these funds.

- Department of Human Resources Sworn Testing (\$45,237) – Additional funds are needed for Police and Fire promotional exams for sworn personnel. With high rates of attrition in the promoted sworn ranks in both departments, additional funds are needed to maintain active promotional lists for each rank in compliance with labor management agreements.
- Department of Parks Mower and Other Maintenance Equipment (\$22,000) – These funds were not able to be spent before the close of FY 2021, and the funds fell to the balance of the General Fund. The funds will purchase necessary lawn mowing and landscape maintenance equipment to be used at various City parks facilities.
- Cincinnati Police Department / Law Department Records Management Software (\$85,000) – This would allow for the acquisition of records management software that will assist both Police and Law with tracking and managing public records requests.
- Assorted Capital Projects Shifted to the Operating Budget (\$251,600) – The Department of Finance determined that the actual expenditures sought within the various scopes of work associated with certain projects would be better aligned with operating budget resources as opposed to capital resources. As such, these needs will be shifted to the General Fund operating budget. Affected departments and projects include the following: Office of Environment and Sustainability (OES) Regulatory Compliance & Energy Conservation, Center Hill Gas & Leachate, and Emergency Environmental Cleanup/UST (Underground Storage Tank); City Planning and Engagement Neighborhood Studies; and the Department of Transportation and Engineering (DOTE) Information Systems Acquisition.
- Department of Community and Economic Development Capital Projects Shifted to the Operating Budget (\$273,400) – The Department of Finance determined that the actual expenditures within the various scopes of work associated with certain projects in the Department of Community and Economic Development Tax Incentive/Enterprise Zone and Retail/Commercial Opportunities program would be better aligned with operating budget

resources as opposed to capital resources. As such, these needs will be shifted to the General Fund operating budget.

- Chamber of Commerce – Immigration Center Partnership (COMPASS) (\$50,000) – Leveraged support funding for this organization was budgeted but not expensed before the end of FY 2021, and the funds fell to the balance of the General Fund. The funds will now be made available to COMPASS from the FY 2021 Carryover balance.
- Central Parkway Streetscape (\$1,000,000) – This would provide funds for the Central Parkway streetscape improvements project to improve the streetscape and increase pedestrian safety along the portion of Central Parkway proximate to the FC Cincinnati stadium.
- Safe and Clean Neighborhood Fund (\$250,000) – This would provide funds to establish a Safe and Clean Neighborhood Fund from which neighborhood groups and organizations could apply for funding for projects aimed at improving the safety and cleanliness of neighborhoods.
- Manager’s Advisory Group (MAG) Youth Violence Reduction Initiative (\$200,000) – This would provide funds to support the efforts of the Manager’s Advisory Group in funding programming to support a reduction in youth violence.
- Human Resources (HR) Centralization (\$102,500) – This would provide funds to support the HR Centralization initiative that will streamline human resource operations for departments by bringing human resource staff currently imbedded within departments under the Human Resources Department.
- Cincinnati Contemporary Arts Center (CAC) (\$100,000) – This would provide funds for the Cincinnati Contemporary Arts Center to renovate the 6th floor Creativity Center.
- King Records Renovation (\$475,000) – This would provide funds to support the renovation of the City-owned King Records studio building, located in the Evanston neighborhood. The City was able to acquire this historic site in 2018 but has lacked funding to renovate the site into the intended museum and community and arts center. These public funds will be leveraged to raise additional private funding to support the renovation and preservation of this iconic landmark that is a cornerstone of Cincinnati music history.
- Equitas Health Mobile Outreach Vehicle (MOVE) Initiative (\$100,000) – This would provide funds to support the Equitas health initiative to address health care needs for those who are living with HIV or are at risk of HIV transmission. Funds would enable Equitas Health to purchase a custom upfitted cargo van to deliver health screenings, outreach, and health care.
- Cincinnati Citizens Respect Our Witnesses (CCROW) (\$208,000) – Funds will be provided to support the CCROW program which provides court-related services, social services, and referrals to counseling services designed to meet the needs of witnesses and their loved ones.

With the aforementioned swap of existing capital budget resources in various departments to the General Fund operating budget, a total of \$525,000 in capital budget resources are now available. The Administration recommends the following use for those funds:

- King Records Renovation (\$525,000) – As described above, this would provide funds to renovate the King Records studio site and increases the total amount allocated to this project to \$1,000,000.

## **2022 Pending Matters**

There are several budget concerns for FY 2022 and beyond that are noteworthy. These include the following:

- COVID-19 Budget Impact – Due to the impact to income taxes and other sources of revenues related to the COVID-19 pandemic, the Approved FY 2022 General Fund Budget was balanced but not structurally balanced due to the reliance on \$67.5 million in one-time ARP recovery funds. The Administration will monitor the budget closely and use any surplus in revenue from other sources prior to the use of these one-time funds during FY 2022. Based on guidance from the Department of the Treasury, the calculation of revenue replacement is done on a calendar year basis so the City’s next calculation will not occur until January 2022.
- FY 2023 Projected Deficit – Despite the reliance on \$66.0 million of ARP recovery funds for FY 2023, the Approved FY 2022-2023 General Fund Biennial Budget document includes a General Fund preliminary deficit of \$17.8 million for FY 2023. This assumes a 4.0% wage increase for sworn personnel, a 2.0% wage increase for non-sworn personnel and a 5.0% increase for healthcare. If contract negotiations result in higher increases, the projected deficit will increase. Depending on how quickly revenues rebound in a post-pandemic environment, deficits may be projected for future fiscal years which may necessitate the use of ARP recovery funds in FY 2024 and FY 2025.
- Stabilization Funds – The Stabilization Funds Policy, described above, directs specific amounts of funds to various reserves until the total of the City’s Combined Reserves is equal to 16.7% of prior year general fund revenues. Specifically, the policy directive addresses four components: Working Capital Reserve, General Fund Contingency Account, Economic Downturn Reserve Account, and the General Fund Carryover Balance. Overall, the Combined Reserves will be increased from 13.28% to 13.50% following the FY 2021 carryover process.
- Ratings Agencies – Moody’s Investors Services’ current assigned rating is Aa2 for the City’s outstanding general obligation unlimited tax (GOULT) debt, and the rating is Aa3 on the City’s outstanding non-tax revenue debt. The outlook is stable. Standard & Poor’s Ratings Services’ current assigned rating is AA for the City’s long-term unlimited-tax general obligation (GO) bonds and an AA long-term rating on the City’s non-tax revenue bonds. The outlook is stable.
- Income Tax – The FY 2022 Income Tax estimate reflects a decrease from FY 2021 to account for the shift in the number of non-resident employees working from home either full-time or maintaining a hybrid work environment. In addition, during the second half of CY 2021 the City continues to receive withholding taxes from non-residents working from home which may be subject to refund in April 2022. A reserve for income tax refunds is funded as part of the FY 2021 carryover to provide funding for the refunds arising from collections in the first half of CY 2021, but the City will likely have to set aside additional funding that will be collected in the second half of CY 2021 to account for this liability. Since the FY 2022 budget was revised to account for a reduction in income tax revenue resulting from remote

work, so long as current withholding practices continue, the Administration expects collected revenues to continue to trend above estimates during the remainder of CY 2021. This expected positive variance is intended to be utilized to address any remaining refund liability for CY 2021 once individual tax filings have occurred in 2022. It should be stressed that the City remains over reliant on income tax revenue, which make it susceptible to long-term changes in work trends.

**Recommendation**

The Administration requests this report be approved and filed and will present an Ordinance reflecting these recommendations for approval.

c: William "Billy" Weber, Assistant City Manager  
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