



THE HEART OF CUYAHOGA COUNTY

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MEMORANDUM

To: Mayor Gregory P. Kurtz
Members of Council

From: Finance Director Vernon Blaze

Date: Friday, March 29, 2024

Re: Finance Office and Related Topic Updates

Financial Woes for Some – Importance of Prudent Financial Management

It was reported that a number of smaller, liberal arts colleges across the country have recently announced their closings. Included in that list was the local, South Euclid-based Notre Dame College.

The *Wall Street Journal* article indicated that some of these schools' financial woes were “masked in recent years by federal Covid relief funding, but that money has since dried up.”

There's **Lesson #1** for any organization, including Independence – Financial woes can be masked for a bit, but at some point, they need to be properly and adequately addressed, as “*the chickens eventually come home to roost.*”

One college mentioned, Birmingham-Southern College in Alabama, had been in “financial distress” for years. The article cited at least two reasons for that financial distress:

1. Overly optimistic revenue forecasts

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2. A board that provided little financial oversight

Lesson #2 this week: It's more conservative to underestimate revenue than be "overly optimistic" when it comes to revenue forecasting and budgeting.

Lesson #3: The Independence Finance Office is consistent in noting the important financial oversight role that Council Members here fulfill.

All spending goes through Council at least once a year via the Annual Appropriations Ordinance – Oftentimes more with periodic amendments.

Council gets a second financial oversight opportunity with most expenditures that exceed \$15,000. These are the Ordinances that dominate most months' Legislative Agendas.

And for Capital/Infrastructure purchases and projects, the Five-Year Capital Improvement Plan (CIP) provides a third opportunity for Council's financial oversight.

Because of these possible multiple financial oversight opportunities, it would be hard for someone to legitimately levy the charge that Independence City Council Members "*provide little financial oversight.*"

Office Rents Hold Firm Despite the Market's Turmoil

Although the City derives revenue from a number of sources, it's no secret that Municipal Income Tax is the "Big Kahuna" that is the dominant revenue source by far for Independence.

For the majority of that Municipal Income Tax, Independence has traditionally relied on "in-bound," office-type commuters driving into Independence to work who then drove home at the end of the workday.

Related to one of the above points about "*overly optimistic revenue forecasts,*" the *Wall Street Journal* reports about the above headline that due to varying

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circumstances, office rents have generally held steady since the whole office work dynamic changed starting in 2020.

But the “light” that is seen at the end of the tunnel is still thought to be more of an “oncoming train” than the “light of day.”

Following are some quotes from this article that the Independence Finance Office and Council take seriously when forecasting and budgeting future income tax revenue that is so office-employee dominant:

- “U.S. office markets are suffering from soaring vacancy rates, a record amount of sublease space and rising defaults.”
- “Office rents are expected eventually to tumble, probably after owners and lenders are forced to restructure mortgages or sell distressed properties.”
- “Office vacancy is at record levels and continuing to rise because companies that adopted flexible workplace strategies during the pandemic are leasing less space.”
- “Businesses occupy 200 million square feet less than they did before the recession of 2020. Another 150 million square feet of this so-called “negative absorption” is expected to be added over the next two years.”
- “More than 70% of current office leases were signed before the pandemic. As they come up for renewals, those tenants will benefit from the market softness. Many businesses have committed to new hybrid workplace strategies that require less space.”
- “When companies with hybrid strategies renew leases, they tend to take less space. *“You’re going to have this continued exertion of downward pressure from lease renewals.”*”

As always, prudence and fiscal conservatism is the best course of action given these potential headwinds. Independence will continue to advance forward as long as it recognizes market realities and strategically adapts accordingly.