

March 4, 2016

Mayor & Council,

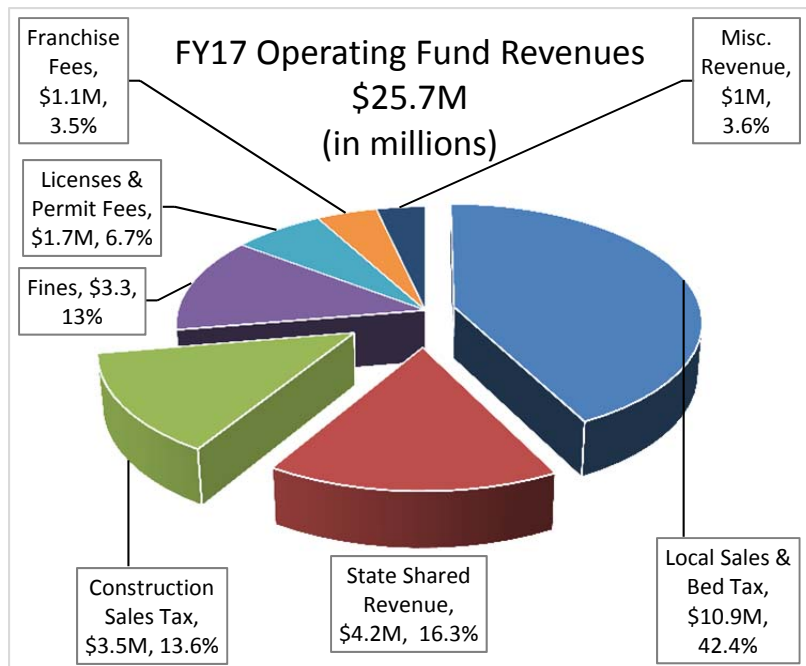
How we spend the public's money is our most important business. With this letter, I transmit the FY17 (July 1, 2016-June 30, 2017) Town Manager's Recommended Budget. I am proud to present a balanced budget that advances the Town's Goals, maintains its important infrastructure, and improves Town services to its residents.

We continue to be challenged by the state-imposed Expenditure Limitation Rule (ELR) to provide the services demanded by our residents; however, due to the carry forward of unused ELR capacity from previous years and eligible exclusions, this Budget accomplishes its goals within those restrictions.

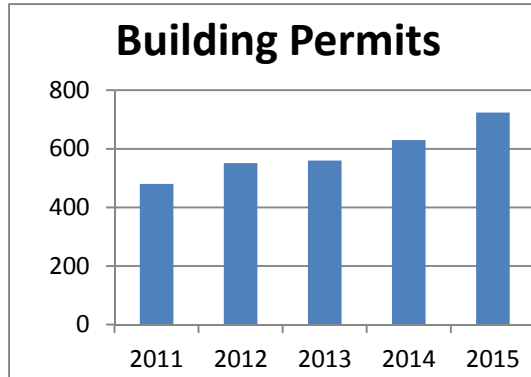
Economic Backdrop/Revenues

As we complete FY16 and prepare for FY17, there is good reason to be optimistic about the Paradise Valley economic condition. Renovations of Mountain Shadows, Hermosa Inn and Cottonwoods are well underway and will make a real, positive, financial impact to the Town's budget this coming year. All resorts in Paradise Valley reinvested in their properties in some capacity this year improving the financial health of the Town now and for years to come. This reinvestment is captured in increased construction sales tax. Overall, however, revenue from the lodging industry is flat. This is consistent with flat occupancy rates and only slightly higher Average Daily Rates.

Perhaps the largest, but as of yet unrealized, financial impact will be attributed to the Ritz-Carlton. While much of FY16 was spent reviewing the plans, any financial benefit is only realized once they start construction and eventually start operations. Therefore, forecasts for related revenue in this FY17 Budget are quite conservative while personally I remain optimistic that construction commencement is very near. As a reminder, sales tax and bed tax from resorts contribute over 40% of our General Fund revenues.



Outside of resort redevelopment, overall construction in the Town is experiencing robust growth. Building permits in calendar year 2015 were up 15% over calendar year 2014. And values were up by more than 36%. Construction generates revenues for the Town in two ways, first with permits (which covers part of the labor expense to review and inspect the development) whose revenue is up 18%; and second, through construction sales tax. This is important as construction sales tax over \$500,000 goes towards funding the Town's Capital Improvement Program (CIP). The CIP is about taking care of existing



assets and developing new assets critical to meeting service expectations. Construction sales tax is up 29% or \$800,000 to \$3 million in FY17.

As noted in the graph above, State Shared Revenue is 16% of our General Fund revenue. Therefore, PV's economy is very dependent upon the State's economy. And the State's economy is doing better. Our revenue forecasts are very conservative but still show an increase in State Shared Income Tax and State Shared Sales Tax of slightly less than 2%. Our own sales tax is expected to grow at a

similar rate of 2% (excluding construction sales tax). We must be cautious about committing construction revenue to on-going expenses because it tends to peak and fall; however, much of this construction will result in new rooms at the resorts. That produces an on-going bed tax and sales tax revenue source for future fiscal years.

The last large revenue category in the General Fund is fines. These are principally associated with court fines due to speeding or red light violations. This also seems to be sensitive to economic conditions as traffic counts tend to swell and shrink with the economy. Moreover, the Town sought to extend its slower, quieter speeds from not just the center of Town (Lincoln and Tatum) but to the perimeter of Town. Studies were showing a high volume of speeders coming into the Town at our northern border on Tatum and our western border on Lincoln. The purpose of enforcement is to change behavior not to generate revenue. However, that learning curve does not appear to be fully achieved by motorists and the Town's gross fine revenue has increased \$800,000. On the flip side, with increased revenues come increased expenses in our courts and for the infrastructure. This is likely a temporary increase in revenues and expenses as speeders who receive tickets often change their driving habits or patterns and citations even out. However, for FY17 there is anticipated to be some associated one-time revenue & expense increases.

Overall, these economic conditions set the stage for a projected revenue growth of 10% in the General Fund and 4.3% across All Funds. Total revenues for the General Fund and then All Funds (excluding reserves) is \$25.7M and \$44.2M respectively.

Expenditure Limitation

The next logical step in budgeting once the revenue is known, is allocating that revenue against competing resource requests. However, in Arizona, expenditures are further governed by a constitutional amendment known as the Expenditure Limitation Rule (ELR). The ELR caps expenditures regardless of the amount of revenue the municipality takes in. This cap is based upon expenditures during the 1979-1980 budget year adjusted for inflation and population.

This seems like a reasonable formula, however, growth in Town resorts does not affect population. As resorts add more rooms it increases Town revenues and associated expenses, but the ELR only accounts for population or inflationary increases and therefore does not adjust. Likewise, residential construction would appear to increase population and therefore the ELR cap; however, many home owners do not count Paradise Valley as their primary residence for Census purposes. Moreover, the Town provides many more fee-for-service deliverables such as sewer, fire, and alarm monitoring that were not in place in 1979. These factors drive expenditures above the ELR cap.

For FY17 the ELR cap is approximately \$25 million for All Funds. As noted above, the Town anticipates \$44.2 million in revenues in FY17 plus has another \$30.5 million in reserves. Fortunately, the Town had some unused ELR capacity from previous years. Adding this capacity to the cap takes the Town to a total limit of \$37 million in expenditures.

In addition, there is approximately \$12 million dollars in expenditures that are excludable from the ELR calculation (such as transfers, debt payments, grant expenditures, and gas tax related expenditures). This reduces the \$44 million in expenditures down to the \$37 million limit. The Recommended Budget stays within that limit including contingency dollars.

In summary, the Town has \$75.1 million in revenue available; it will continue to reserve \$20 million and expends \$37 million in FY17 under the Manager's Recommended Budget.

Key Expenditures

Given the large use of carry forward ELR capacity, the Budget continues to look at many of its expenses as "one-time" expenses. These are expenditures that if not funded in subsequent years, can be ceased without any contractual obligations or legal consequences. Operationally, discontinuing one-time expenditures will have impact, but that impact will vary. The following are some notable one-time expenditures in the FY17 Recommended Budget:

- \$1,000,000 in additional payments to reduce the unfunded Police Pension liability;
- \$250,000 in new photo enforcement expenditures to the vendor due to increased citations;
- \$128,000 for LPR Maintenance fee;
- \$105,000 for an additional building inspector/plans examiner. Expecting a two year bubble in terms of increased building permits and the associated plan reviews and inspections;
- \$98,000 for Regional Wireless Cooperative (RWC) fees;
- \$90,000 for an Evidence Technician to process the backlog of work in the Police Evidence room;
- \$50,000 for COPLINK Software Maintenance Fee;
- \$50,000 toward hosting the NCAA Final Four;
- \$50,000 for a temporary procurement officer;
- \$42,500 for more temporary court staff to process increased citations;
- \$30,000 for a firearms simulator (MILO);
- \$25,000 for firearm replacement program;
- \$25,000 for a newly required ADEQ Stormwater Permit;
- \$23,360 for the 2016 elections;
- \$20,000 to replace half the Taser's in PD;

The Capital Improvement Program represents another significant investment of public funds in the community. The FY17 program includes:

- \$4,000,000 to construct the public safety radio tower;
- \$640,000 for Lincoln Drive Sidewalk project;
- \$429,366 burying of the overhead power lines in APS District 30 (the last district);
- \$384,200 to conduct the first of 5 assessment phases of the sewer pipes and decommission the telemetry system;
- \$300,000 to implement 52nd Street improvements;
- \$150,000 to implement a GIS program.

A full listing of the CIP is found later in the Budget Book and totals approximately \$8.4 million in FY17 and then budgets for the subsequent four years.

On the compensation and benefits front, the Manager's Recommended Budget accounts for a 5% increase in health insurance (\$38,000) to the employer over FY16, a slight decrease in Police Pension (72% to 71% contribution rate), and a 3.5% merit pool. A study of compensation in our peer cities reflects a 3.6% increase in salaries. The Recommended Budget takes a slightly different approach to merit distribution this year versus previous years. This budget plans on 15% of the employees receiving a 2.5% increase or lower; 55% receiving a 3.5% increase, and 30% of employees receiving a 4.5% increase. This distribution incurs an on-going expense of \$375,000.

Enterprise Funds

The Town of Paradise Valley maintains three enterprise funds: Alarm Monitoring, Fire Service, and Wastewater. The Alarm Monitoring Fund is poised for a major overhaul in its service. Therefore a large portion (\$300,000) of its reserves (a.k.a. fund balance) is allocated for expenditure in FY17. Mayor & Council direction in October 2015 was to pursue a hybrid system where PV Dispatchers still answer alarms on its system, but the technology associated with those alarms is managed by a third party. This budget prepares for that transition.

The Fire Service Fund is principally a status quo budget. Revenues are flat while budgeted expenditures drop slightly. The drop is associated with a budgeted line item in FY16 for Fire participation in the public safety radio tower. Fire participation in that tower is no longer anticipated.

The Wastewater Fund (a.k.a. the Sewer Fund) continues to be the Town's most financially challenged fund. As noted in FY16, Fund Balance was depleted to repay a General Fund loan to purchase capacity in the Scottsdale sewer plant. Unfortunately, the Wastewater Fund had been and continues to operate with a structural deficit (meaning ongoing expenditures are outpacing ongoing revenues). The Fund generates enough revenue to cover its required operating expenditures but not to pay its debt payments. Therefore, the General Fund will continue to loan the Wastewater Fund money to meet these obligations. In FY17 this is anticipated to require a \$345,000 transfer.

Over the course of FY16, staff undertook various financial planning efforts to remedy this situation in the Wastewater Fund. First, a new IGA was negotiated with the City of Scottsdale. This IGA more clearly spells out operation and maintenance responsibilities, capacity forecasts, and costs. While the IGA is not yet approved by both parties, it is expected to be approved before July 1, 2016. Further, the Town has not conducted video surveillance of its pipes and manholes in many years. The Town will participate in an assessment program with the City of Scottsdale over the next five years. This increases the costs of operations but is an absolute necessity to avoid unanticipated and costly unbudgeted reactions to breaks and failures of the collection system. With these new long range costs known, the staff further initiated a rate study. The results of that study will be brought before the Mayor & Council in the fourth quarter of FY16. The Budget anticipates a rate increase to begin tackling the challenges of this fund.

Acknowledgements

The creation of the Manager's Recommended Budget takes the effort of a lot of people. On point in this effort is Christine Covell-Granberg, Director of Administration and Government Affairs, Dawn Marie Buckland, provided a great deal of time, leadership and expertise on the Budget Development. The

Department Directors spend countless hours working with their staff to draft the core of the budget. I want to thank them all for their work in developing this document. I look forward to reviewing this with the Mayor & Council.

Respectfully Submitted

Kevin Burke
Town Manager