WHY BOND IN GOOD ECONOMIC TIMES

PARADISE VALLEY, AZ - The Arizona Constitution prescribes an Annual Expenditure Limitation ("AEL") for each city and town. The limitations stated purpose is to control expenditures of local revenue and limit increases in spending to adjustments for inflation and population growth. The Constitution provides cities and towns several voter-approved options to alter their expenditure limitations. Paradise Valley voters approved a permeant increase to the expenditure limitation effective July 1, 2017 that assists in paying a significant liability in the Public Safety Personnel Retirement System ("PSPRS").

The majority of the Town's expenditures are "subject to" the AEL, but some spending of certain revenues are "exempt from" the AEL. Expenditures that are "exempt from" include spending federal grants, investment earnings, contributions and donations from private organizations, the use of bond proceeds and the repayment of bonded debt.

The 2020 Budget and 2019 draft financial statements identify that there is enough revenue and cash for the Town to pay the entire PSPRS Unfunded Liability, all the Capital Improvement Plan ("CIP") and continuing status quo Town operations, while maintaining sufficient reserves in the event of a sudden stress on the Town's economy. But there is not adequate Annual Expenditure Limitation capacity to do so.

The Town's total CIP is over $17 million; $6 million from the Town's general fund and $1 million from the wastewater fund with over $10 million to be reimbursed from private organizations and developers. The Town's CIP is "subject to the AEL" with certain reimbursed projects qualifying as "exempt from" the AEL.

The Town entered into contractual agreements where the Town fronts the cash on major projects and developer reimburses. Timing of the reimbursements could put the Town at risk of exceeding its expenditure limitation.

In 2016, the Town Council declared paying the PSPRS unfunded liability as a top priority. Since then, the Town has paid above the required contributions in the amounts of $5,000,000 in FY2017; $1,000,000 in FY2018; $9,000,000 in FY2019; and $3,000,000 in July, the first week of FY2020 for a total of $18,000,000.

Based on the most recent PSPRS actuarial (2018) the Town's current estimated Unfunded Liability is at least $5,800,000. This amount is expected to increase as the PSPRS plans to realign pension expectations such as the expected return rate and mortality tables.

The current expected rate of return ("ROI") for investments with PSPRS is 7.3%. This suggests for every $1,000,000 the Town has invested in PSPRS will yield $73,000 in 12 months; and for every $1,000,000 of the Town's Unfunded Liability the Town is falling behind. $5,800,000 at 7.3% is $423,400. Actual PSPRS investment earnings have ranged from 13% to 0.4% with a smoothing average of 5.9% the last 7 years. The Town's current fixed income investment pools yield 2%.

Town Council's approved budget appropriations for 2020 were designed to give the Town flexibility to navigate anticipated and unknown challenges related to increasing construction costs and balancing the Town's priority of paying the PSPRS Unfunded Liability by including contingencies for various financing options.

Town policies restrict the government from issuing long-term debt that exceeds the Town's resources for repaying the debt or setting debt payment schedules that exceed the useful life of a project; and allow bond issuances that are limited to capital improvement projects too large to be financed from current revenues, or too large to be included in the Annual Expenditure Limitation.

By issuing excise tax obligations to pay for CIP, the CIP projects move from being "subject to the AEL" to being "Exempt from the AEL". This opens Annual Expenditure capacity that is available to cover increases in construction costs, honor contractual obligations, secure the PSPRS pension and trades the PSPRS unfunded liability 7.3% rate for a bonded debt rate of 2% (estimated).

The Town does not anticipate this AEL challenge to continue once the driving factors of paying the PSPRS unfunded liability is completed and the 5-star related road and drainage improvement projects are completed and reimbursed by the developer.