

# MEMORANDUM



TO: Mayor and Council

FROM: Tom Duensing, Chief Deputy City Manager  
Lisette Camacho, Financial Services Director

DATE: November 2, 2023

SUBJECT: Long-Range Financial Forecast Update

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## PURPOSE:

To provide an update to the City's long-range financial forecast for the City's major operating funds.

## RECOMMENDATION OR DIRECTION REQUESTED:

The City Council is invited to provide comments and suggestions regarding the City's long-range financial strategies.

## CITY COUNCIL STRATEGIC PRIORITY:

Maintaining a long-range financial forecast and eliciting City Council feedback on financial policies relate directly to City Council priority #5 – *Financial Stability and Vitality* and are critical strategies to achieving the following performance measures:

- 5.04 – Maintain highest general obligation bond (credit) rating
- 5.05 – Maintain a General Fund unassigned fund balance at a minimum of 20% and maximum of 30% of General Fund revenue.

## BACKGROUND INFORMATION:

The last long-range financial forecast was presented to the City Council on February 23, 2023.

## FISCAL IMPACT or IMPACT TO CURRENT RESOURCES:

No financial commitments will be made during this presentation to the City Council; only direction for budget development and long-term financial planning will be elicited.

## ATTACHMENTS:

PowerPoint Presentation

## Introduction

This is the initial update to the long-range forecast for the City's major operating funds, beginning the process for developing the Fiscal Year (FY) 2024/25 operating and capital improvement program (CIP) budgets. We will refine the projections contained in this forecast as part of the final financial forecast update in February 2024 to finalize parameters for current budget decisions and to plan for future operating and capital needs. Although projections of future revenues and service costs can never be exact, the models utilized by the Municipal Budget Office have proven to be good indicators of potential resources and costs.

## General Economic Conditions and Projections

For FY 2022/23, the City's overall financial condition continues to be strong and stable. Our 5-year forecast for revenues includes the loss of residential sales tax revenue, which impacts local taxes. All remaining local tax categories, over the forecast period, remain stable. The forecast also includes declines in intergovernmental revenues driven primarily by declines in state-shared income tax collections. These revenue reductions are offset somewhat by increases in interest income. The forecast for other revenue remains stable, consistent with the February 2023 forecast.

On August 1, 2023, Senate Bill 1131 was signed into law. Effective January 1, 2025, Arizona cities and towns are prohibited from taxing *residential rental* activities. Early estimates indicate recurring sales tax revenue reductions of approximately 9% in the City's General Fund, Transit Fund, and Arts and Culture Fund, or approximately \$21 million across all funds. To address the residential rental sales tax loss, budget reduction measures will be necessary in both the General Fund and the Transit Fund.

The overall economy remains relatively stable with low unemployment and stable household disposable income. Retail sales tax revenue, other than the residential rental tax loss, has experienced some moderation from the strong recovery from the COVID-19 pandemic but is forecasted to continue with modest growth throughout the forecast period.

Commercial and residential development activity has bolstered both construction sales tax revenues and building and trades/planning and zoning revenues in recent years and is projected to continue with a positive trend during the forecast period. Additionally, the recent Federal Reserve interest rate increases have resulted in increased interest income from the City's cash and investments.

The forecast does not include a projection for a recession or other major economic slowdown. This is consistent with information from our forecast partners, including the Eller College of Management Forecasting Project, and Municipal Budget Office regression modeling.

Although inflationary pressures have eased over the past twelve months, worker shortages and supply chain issues continue to put pressure on the overall economy. We anticipate lower but moderate growth in the City's overall revenues over the forecast period; however, we continue to monitor economic events.

Current, long-term memoranda of understanding (MOUs) with our four employee groups have stabilized forecasted personnel cost increases, with fair and steady salary increases projected over the forecast period. Although current MOUs will expire during the forecast period, we have assumed continuation of the salary increases and market studies in the out-years of the forecast period consistent with the current agreements.

The forecast assumes no additional legislation will be enacted that could negatively affect the City's major revenues, such as the taxability of food for home consumption. Additionally, the forecast assumes future State-shared revenue and Highway User Revenue Funds (HURF) revenue will continue to be distributed per current statute. Any legislative changes could impact the amount of funding received in future years.

### **Preparing for Potential Budget Challenges**

As indicated earlier, budget reduction measures will be necessary in the City's General Fund and Transit Fund due primarily to the loss of residential rental tax revenue beginning in FY 2024/25. Additionally, an economic downturn is inevitable at some point in our cyclical economy, and we will continue to watch economic trends for indications of any economic slowdown and monitor legislative activities closely.

We have not programmed a recession into our forecast models and have not assumed additional legislative changes, each of which could negatively impact the City's finances. However, it is important to understand the impact of a recession and legislative changes on revenues and steps that could be taken to enable the city to navigate these issues.

A mild recession, like the City experienced from 2001 to 2003, or future legislative changes could impact local sales tax revenues. As such, these would have the greatest impact on those City funds that derive the majority of their revenue from local taxes: the General Fund, Transit Fund and the Arts and Culture Fund. While we project healthy fund balances at the end of FY 2023/24 in these funds, reliance on fund balance reserves alone would not be sufficient to make up the shortfall in local tax revenue. Continuing operations at status-quo would eventually result in a depletion of fund balance reserves.

During the great recession from 2007 to 2010, drastic measures were required to reduce expenses and increase revenues in order to maintain the stability of the City's funds, primarily the General Fund. However, during a mild recession, most city services as well as employee salary and benefits could be maintained while steps are taken to reduce expenses and minimize reliance on fund balance draw downs. Policy steps resulting in moderate revenue reductions could include:

- 1) Continued salary steps and market increases as outlined in the MOUs. Employees would still be performing their duties and responsibilities regardless of the economic climate.
- 2) Freeze vacant positions to reduce personnel expenses. A process could be implemented to allow hiring of crucial positions (e.g., first responders, etc.).
- 3) Reduce or suspend supplemental funding requests for one or more years.
- 4) Reduce service levels to reduce costs and mitigate the impact of unfilled (vacant) positions.
- 5) Shift resources to the highest priority services and programs.

- 6) Suspend cash funding of CIP programs.
- 7) Continue to identify economic opportunities to increase the tax base.

As noted above, even though we do not forecast a recession or additional legislative changes, budget reduction measures will be necessary to absorb the impact of the residential rental tax loss. We will also continue to monitor economic trends for signs of an economic slowdown and future legislative changes. If either of these occur during the 5-year forecast period, staff will update the City Council and seek specific direction on steps to be taken to reduce expenses during the recessionary period.

#### Recent Issues Impacting the Forecast

- 1) The prohibition of cities and towns collecting residential rental sale taxes impacts the General Fund, Transit Fund, and Arts and Culture Fund beginning January 1, 2025, mid-way through FY 2024/25. Retail sales outlook on other taxable activities continues to be stable with modest growth anticipated. **The forecasts indicate budget reduction measures will be necessary in both the General Fund and Transit Fund to eliminate structural deficits due to the elimination of residential rental sales tax collections.**
- 2) Hotel and restaurant revenues were impacted more than any other categories during the COVID-related downturn. These two sectors have stabilized after the strong recovery from the COVID-19 pandemic.
- 3) Intergovernmental revenues driven primarily by declines in state-shared income tax collections are projected to decrease. This is offset by increased interest income projections due to Federal Reserve actions to address inflation.
- 4) Building and trades/planning and zoning revenues are projected to remain strong throughout the forecast period.
- 5) Revenue from recreational and cultural activities are projected to grow during the forecast period as normal group and structured recreational and cultural activities resume post COVID-pandemic.
- 6) Current fiscal year (FY 2023/24) expenditures in the forecast include \$14.8 million in General Fund supplementals (\$11.2 million recurring and \$3.6 million one-time) and \$2.9 million on supplementals in the city's other major funds (\$2.4 million recurring and \$0.5 million one-time) approved during the FY 2023/24 budget development process.
- 7) Inflationary increases have eased but are assumed throughout the forecast.
- 8) Payments from the General Fund to the Tempe Coalition for Affordable Housing (known as The Affiliate) have been included throughout the forecast period.
- 9) CIP-Cash funding is consistent with the currently adopted 5-Year CIP plan.
- 10) As a best practice, any revenues from planned developments are not included in long-range forecasts until the development projects are completed.
- 11) The issuance of \$343 million in taxable certificates of participation in August 2021 at a favorable rate has enabled the pay-down of the City's unfunded accrued liability with the Public Safety Personnel Retirement System (PSPRS) for the Fire and Police plans. Repayment of this debt obligation and establishment of a \$25 million reserve has been included in the General Fund forecast.

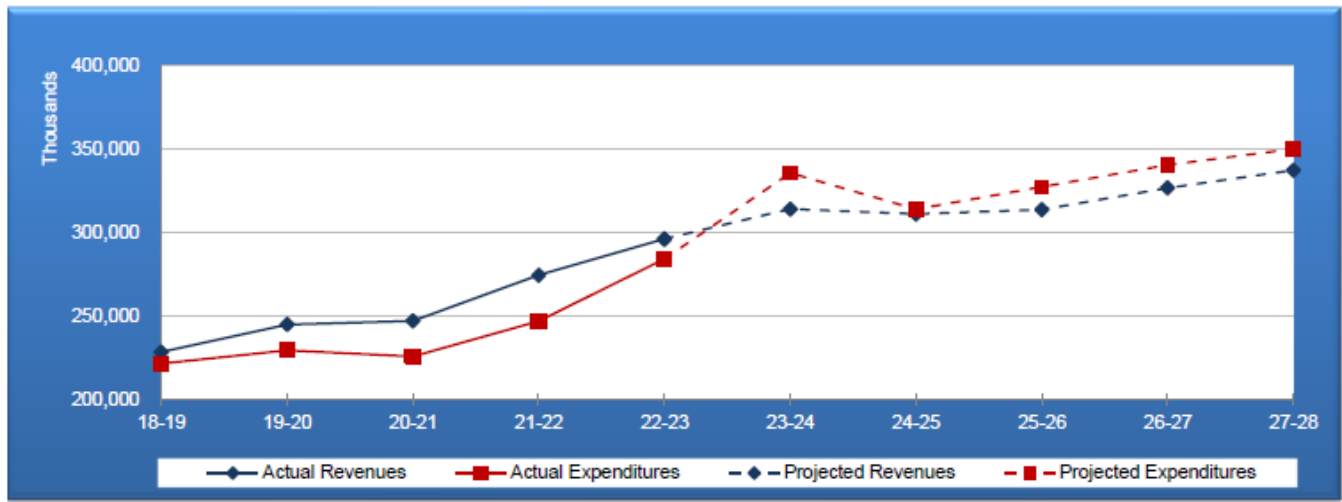
- 12) Pension contribution rates for the Arizona State Retirement System (ASRS) and the Public Safety Personnel Retirement System (PSPRS) are based on a) recently released mandatory employer contribution rates for FY 2023/24 and b) slightly better than expected pension investment performance.
- 13) The City's unaudited, unreserved General fund balance at the end of last year (FY 2022/23) is projected to be \$125.4 million. In addition to better than anticipated tax revenues, the fund balance has been bolstered by one-time payments and higher than normal vacancy savings from unfilled positions.
- 14) Prior to FY 2023/24, activities for the Ken McDonald and Rolling Hills golf courses were accounted for in a separate, Golf Enterprise Fund. Starting this fiscal year, both golf courses have been entered into long-term leases with management companies. The City will now receive rent payments beginning in FY 2023/24, with annual increases, and certain revenue sharing payments. This revenue will be deposited into the General Fund, which will eliminate the need for the Golf Fund.

# Long-Range Financial Forecast Update

## Forecast Model for the General Fund

Following is the 5-year forecast model for the General Fund.

General Fund: Projected Revenues and Expenditures: November 2, 2023



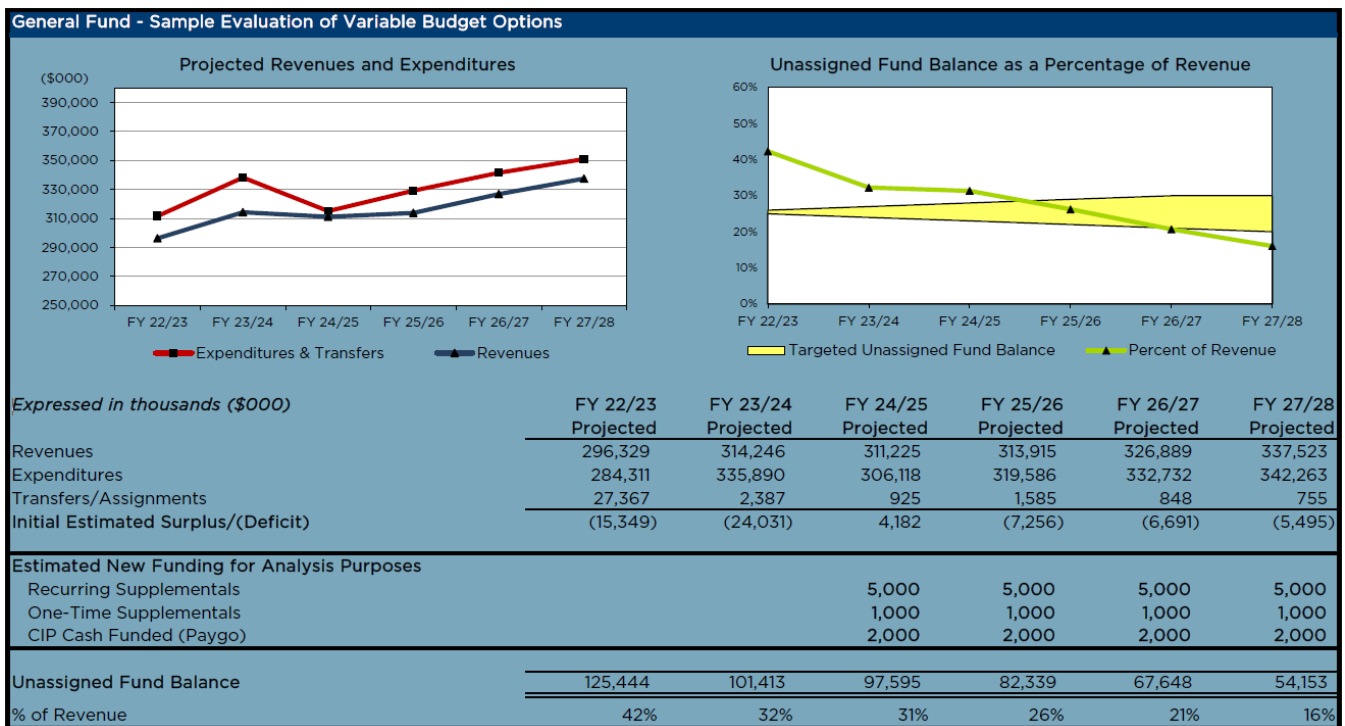
	18/19	19/20	20/21	21/22	22/23	23/24	24/25	25/26	26/27	27/28
	Actual	Actual	Actual	Actual	Projected	Projected	Projected	Projected	Projected	Projected
<b>Revenues (\$000)</b>										
Local Taxes	129,881	132,284	138,368	162,445	173,383	179,387	181,148	182,379	190,475	198,686
Intergovernmental	48,024	52,940	60,503	58,955	71,277	85,914	78,009	78,944	82,636	86,578
Bldg & Trades/Planning & Zoning	11,581	14,048	10,098	12,796	15,346	11,722	11,903	12,189	12,481	12,756
Cultural and Recreation	6,409	4,944	3,141	4,579	6,507	6,038	6,262	6,483	6,711	6,933
Fines, Fees and Forfeitures	6,434	5,613	4,418	4,943	4,147	3,392	3,456	3,519	3,583	3,647
Business Licenses	2,159	1,848	2,230	2,338	2,368	2,590	2,657	2,721	2,786	2,847
Interest Income	3,228	4,283	2,187	1,942	5,376	6,435	7,850	7,124	7,115	4,540
Franchise Fees	3,401	3,247	3,213	3,393	3,078	2,910	2,986	3,057	3,131	3,200
Other Revenue Sources	17,377	25,743	23,006	23,213	14,847	15,858	16,956	17,501	17,971	18,336
<b>Total Revenues</b>	<b>228,495</b>	<b>244,951</b>	<b>247,164</b>	<b>274,604</b>	<b>296,329</b>	<b>314,246</b>	<b>311,225</b>	<b>313,915</b>	<b>326,889</b>	<b>337,523</b>
<b>Expenditures (\$000)</b>										
Personnel Costs	177,009	183,556	188,628	188,005	199,283	231,843	240,567	248,250	255,064	261,363
Materials and Supplies	9,035	9,581	8,575	10,644	13,096	11,558	11,832	12,116	12,407	12,680
Fees and Services	34,840	35,003	32,681	37,838	48,296	50,781	47,019	48,431	49,893	51,327
Travel and Training	904	542	357	732	1,250	1,109	1,138	1,166	1,194	1,220
Non-Dept/Loan Repayment	1,846	2,001	2,646	2,502	2,965	4,370	4,094	4,192	4,293	4,387
Capital Outlay	4,236	3,420	2,459	3,822	6,137	10,035	4,886	4,965	4,889	4,426
CIP-Cash/Muni Arts Funding	2,472	2,689	260	11,597	17,846	34,806	4,678	3,988	3,687	708
Community Facilities District	(379)	(405)	72	(356)	(586)	(556)	(449)	(490)	(532)	(575)
Special Assessments	1,031	1,032	1,031	1,033	1,027	1,028	997	997	997	997
HURF & Solid Waste CIP Funding	-	1,500	-	1,500	2,440	3,380	3,380	3,380	3,380	3,380
Tourism and Convention Bureau	2,845	2,774	2,843	2,911	2,911	3,080	3,121	3,183	3,247	3,312
Internal Services/Adjustments	(12,120)	(12,217)	(14,924)	(13,904)	(13,001)	(17,759)	(18,154)	(18,509)	(18,759)	(18,989)
Contribution to Housing Affiliate	-	-	1,200	625	2,647	2,235	2,321	2,377	2,434	2,487
Preapproved Supplementals & CIP PAYGO							600	540	540	540
Additional CIP PAYGO							2,000	2,000	2,000	2,000
Recurring Operating Supplementals							5,000	10,000	15,000	20,000
Non-Recurring Operating Supplementals							1,000	1,000	1,000	1,000
<b>Total Expenditures</b>	<b>221,519</b>	<b>229,475</b>	<b>225,829</b>	<b>246,949</b>	<b>284,311</b>	<b>335,890</b>	<b>314,118</b>	<b>327,586</b>	<b>340,732</b>	<b>350,263</b>
<b>Net Operating Surplus/(Deficit)</b>	<b>6,975</b>	<b>15,476</b>	<b>21,335</b>	<b>27,655</b>	<b>12,018</b>	<b>(21,645)</b>	<b>(2,893)</b>	<b>(13,671)</b>	<b>(13,843)</b>	<b>(12,740)</b>
<b>Interfund Transfers</b>	-	-	-	-	-	-	-	-	-	-
<b>Change to Assigned Funds</b>	<b>(1,383)</b>	<b>(507)</b>	<b>1,594</b>	<b>(25,717)</b>	<b>(27,367)</b>	<b>(2,387)</b>	<b>(925)</b>	<b>(1,585)</b>	<b>(848)</b>	<b>(755)</b>
<b>Unassigned Fund Balance</b>	<b>100,958</b>	<b>115,926</b>	<b>138,855</b>	<b>140,793</b>	<b>125,444</b>	<b>101,413</b>	<b>97,595</b>	<b>82,339</b>	<b>67,648</b>	<b>54,153</b>
<b>Unassigned Fund Balance as a % of Revenue</b>	<b>44%</b>	<b>47%</b>	<b>56%</b>	<b>51%</b>	<b>42%</b>	<b>32%</b>	<b>31%</b>	<b>26%</b>	<b>21%</b>	<b>16%</b>

The figure above provides detail for budgeted accounts within the General Fund, with “sample” budget decisions incorporated from the interactive model appearing below:

- 1) Projected growth in annual compensation represents the projected contributions to retirement systems, salary step increases included in current MOUs, projected market adjustments to the salary ranges and increases to health/dental/life insurance plans as provided in the detailed assumptions on the last page of this report.
- 2) Recurring and non-recurring supplemental budget increases have been included in each year of the General Fund model, but actual uses of the additional funding have not been determined. Adjustments in these estimates could be used as budget strategies to mitigate revenue loss impacts.
- 3) Pay-as-you go (cash) funding for capital improvement program (CIP) have been included to provide additional funding for CIP projects. Like supplemental budget requests above, these can also be adjusted to mitigate revenue loss impacts.

The forecast includes a structural deficit that, if unaddressed through budgetary measures, will jeopardize the stability of the fund. Staff will bring forward options to ensure stability of the FY 2024/25 budget and beyond during the upcoming budget development process.

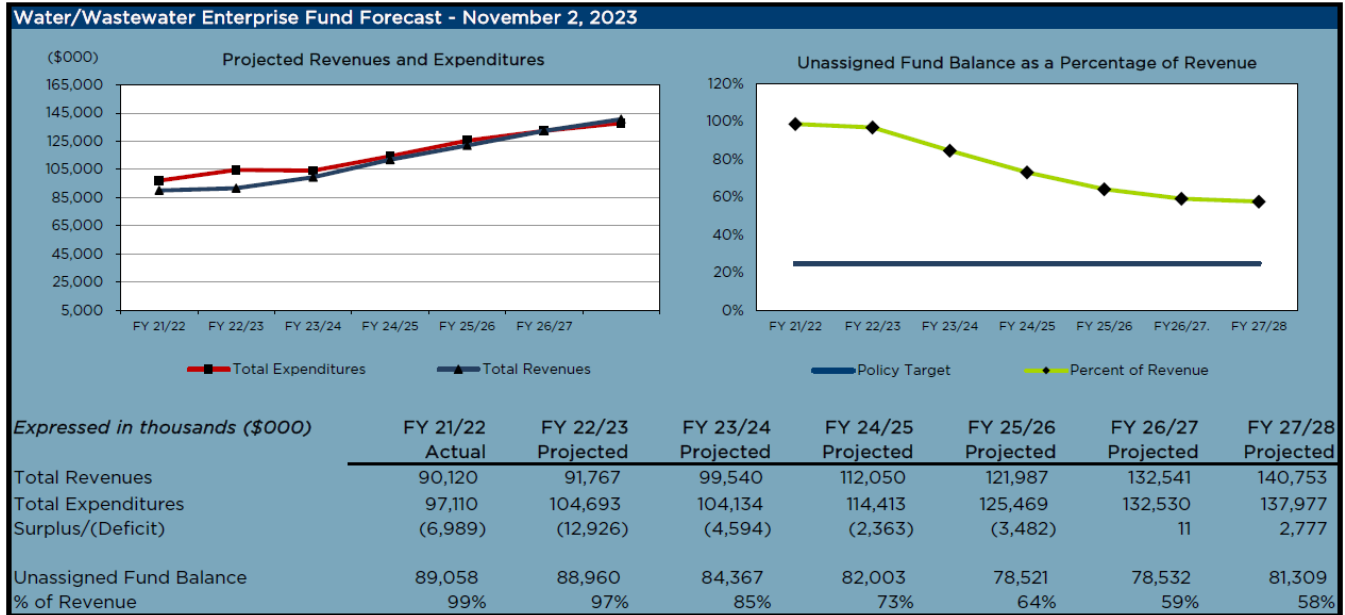
The projections and associated growth variables displayed in the model are not recommendations by management. Rather, the estimated new funding are examples to demonstrate how supplemental requests and CIP Cash Funded amounts could be allocated in future years and impact the fund balance policy. The graph on the right side of the figure shows how the unassigned fund balance declines and falls below the 20% minimum fund balance policy in FY 2027/28. Maintaining the fund balance near the top of the fund balance policy range of 20% to 30% helps to address uncertain economic conditions.



**Forecast Models for Individual Operating Funds (other than General Fund)**

Listed below are summary comments regarding the status of the City’s other major operating funds.

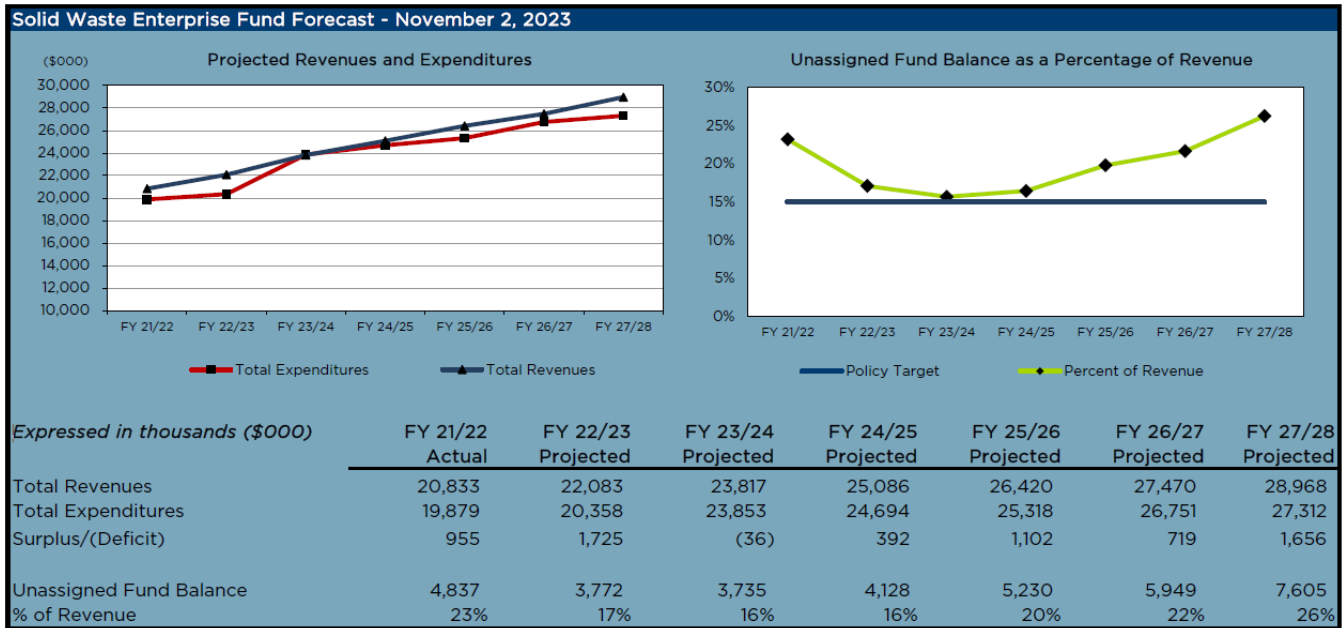
*Water/Wastewater Enterprise Fund*



Consistent with the February 2023 forecast, the Water and Wastewater Fund remains stable, with the unassigned fund balance to remaining within policy throughout the forecast period. Revenue amounts reflect the recommended water, wastewater, stormwater, and flood irrigation rate adjustments scheduled to become effective January 2024 as well as anticipated future rate adjustments. Consistent with the most recent rate study, the forecast assumes a planned draw down of the unassigned fund balance in a sustainable manner, including increased pay-as-you go (cash) funding of CIP projects.



Solid Waste Enterprise Fund

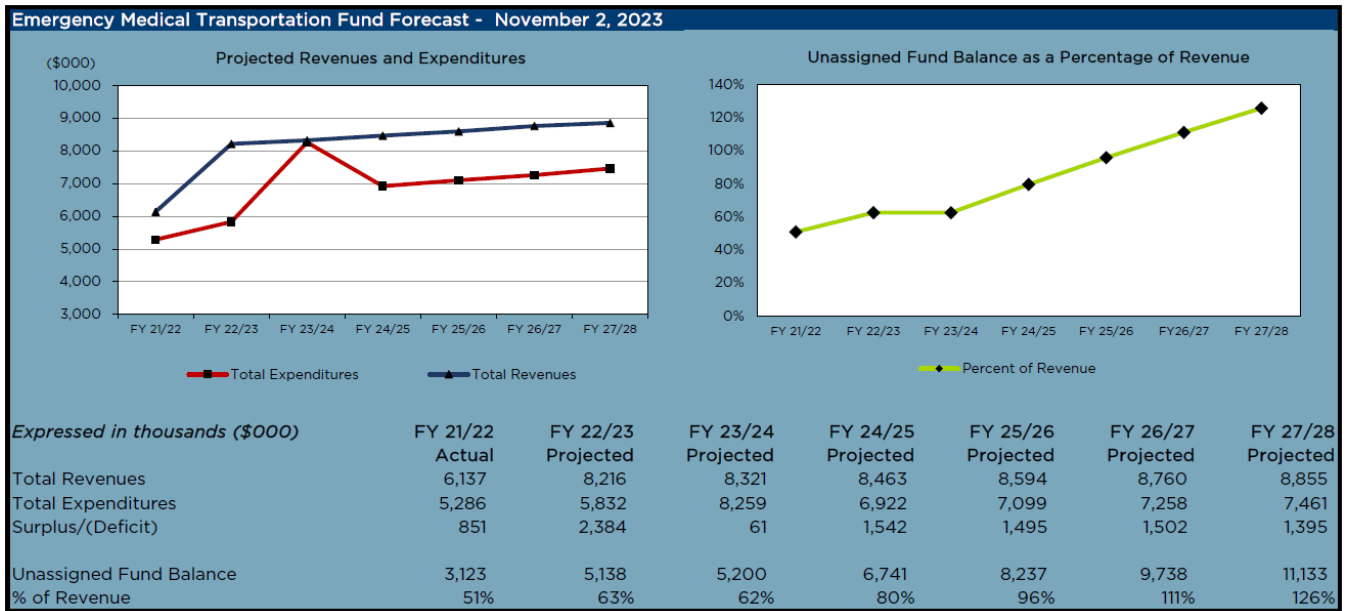


The Solid Waste Fund is stable with future planned rate increases reflected in the revenue projections. Operating revenue and expense projections are in-line with the February 2023 forecast with increases in interest earnings. The planned rate increases will help to ensure the stability of the fund through full recovery of operating and capital improvements costs for both residential and commercial solid waste services.

The unassigned fund balance is projected to be maintained within the fund balance policy of 15 percent of revenue during the forecast period.

The forecast includes an annual transfer from the General Fund to offset costs of the alley maintenance program. The FY 2022/23 approved recurring transfer was \$939 thousand with the amount increasing to \$1.9 million annually starting in FY 2023/24. A request to relocate a portion of alley maintenance operations from the Solid Waste Fund to the General Fund will be requested starting in FY 2024/25. If approved, the recurring transfer to the Solid Waste Fund will be reduced, offset by a reduction in Solid Waste personnel costs.

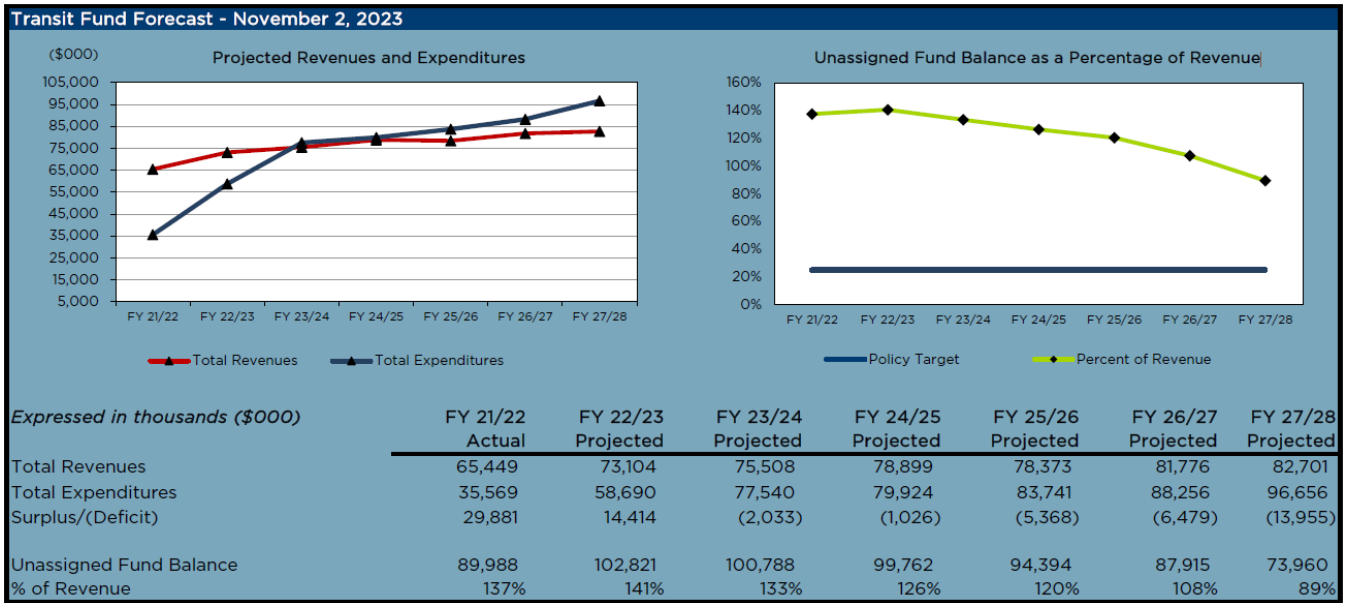
Emergency Medical Transportation Enterprise Fund



The Emergency Medical Transportation Fund captures all the revenue and expenditures for the Emergency Medical Transportation program which was started in October 2017 and is operating at full capacity with 6 ambulance companies in service.

Revenues for the forecast period are significantly higher than the February forecast resulting in annual surpluses each year throughout the forecast period. Staff from the Fire Medical Rescue Department will work with the Municipal Budget Office to refine a capital reserve policy and fund balance policy to ensure adequate future funds are set aside for the operation while maintaining fund stability.

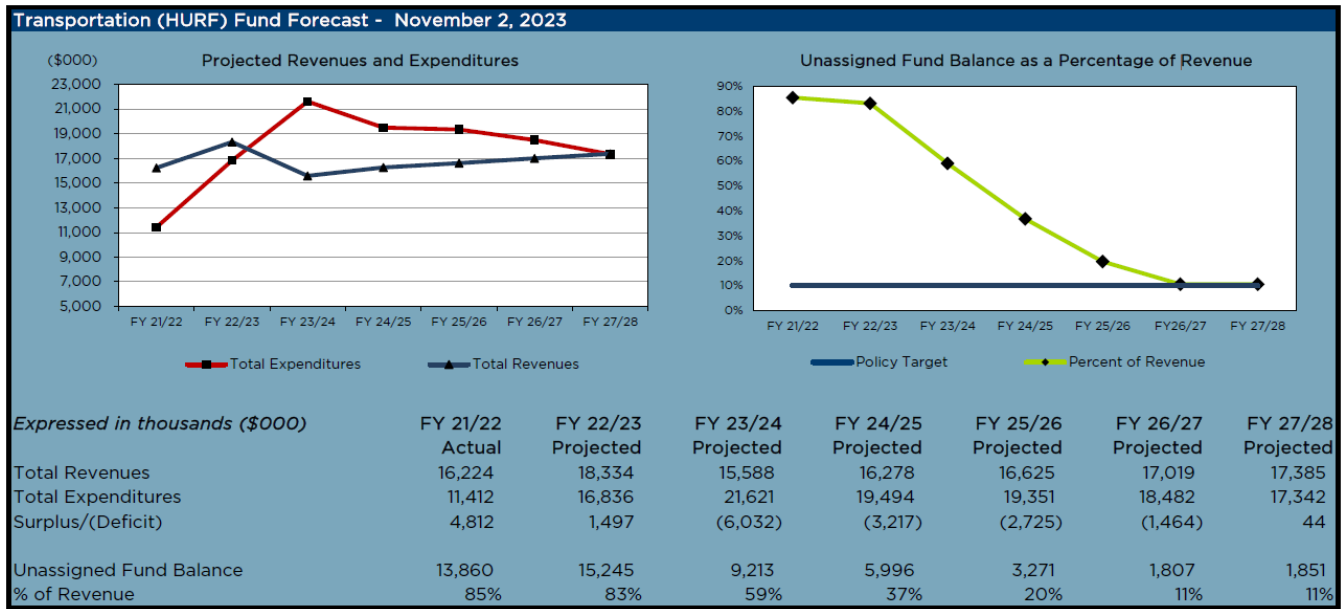
Transit Special Revenue Fund



Although the unassigned fund balance remains above policy throughout the forecast period, the annual losses, beginning in FY 2025/26, indicates a structural deficit due to the elimination of residential rental sales tax. Upon completion of FY 2027/28, the fund remains above the fund balance policy level; however, the structural deficit will require Transit Fund budget reduction measures in the near future. Currently, there are no additional planned changes in transit services. Staff will continue to explore long-term balancing strategies to ensure that the fund remains stable.

The expenditure amounts in the forecast include operating expenses for the streetcar operations that started in May 2022. The largest operating expenses for the Transit program are the bus, rail and streetcar operations that are provided through contracts with Valley Metro. The forecasted expenditures assume controlled growth in these contract amounts. Staff is currently exploring the most cost-effective method to provide local bus services in the future as well as working with Valley Metro to control costs for bus, rail, and streetcar operations.

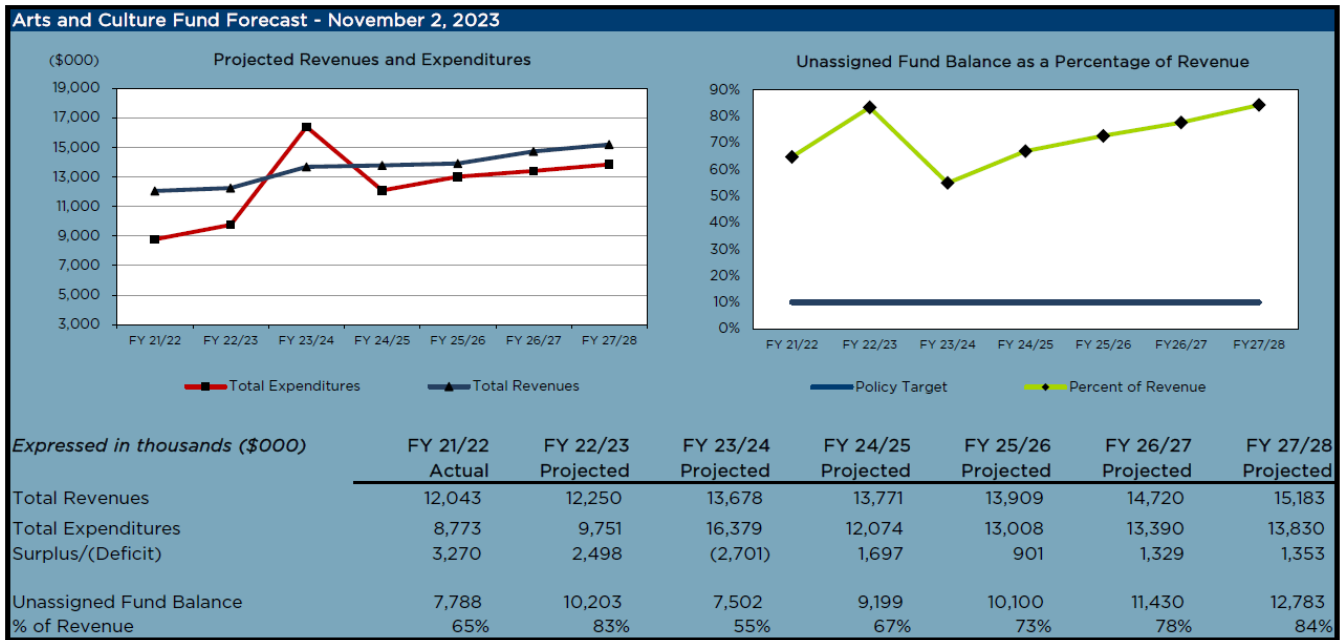
Transportation (HURF) Special Revenue Fund



The Transportation Fund receives a majority of its funding from the distribution of state-shared Highway User Revenue Funds (HURF). Revenue projections over the forecast period are approximately 3.7% (\$2.8 million) lower than the February 2023 forecast based on the latest forecast projections from the Arizona Department of Transportation (ADOT) and projections from year-to-date activity. To offset the projected revenue reduction, the forecast assumes a reduction in cash funded CIP projects of \$3 million throughout the five-year forecast period. Despite declining fund balances, the fund remains stable with unassigned fund balances projected to remain within fund balance policy (10% of revenues) through-out the forecast period; however, staff will monitor economic trends to ensure the fund balances remain within policy.

Future HURF monies are subject to pending legislation that may increase or decrease the amount of HURF funds the City receives. The forecast does assume an annual transfer from the General Fund of \$1.5 million per year for street repair and maintenance projects. However, the actual amount of the transfer each year will be based on the General Fund’s financial capacity and Council direction.

Arts and Culture Special Revenue Fund



Despite the loss of residential rental sales tax revenues beginning in January 2025, the Arts and Culture Special Revenue Fund remains stable with revenue projections continuing to exceed expenditure projections during the forecast period. Total Facility and programming revenue continues to recover from the pandemic and is expected to remain strong with the Tempe Center for the Arts being the new home for the Arizona Theater Company.

The forecast includes the annual debt service payment on revenue obligation bonds that were issued in August 2021 to fund the repairs needed on the Tempe Center for the Arts roof. Additionally, FY 2023/24 expenditures include cash transfer to the CIP of \$4.4 million. Future planned expanded programs and services, as outlined in the Tempe Arts and Culture Plan, are not included in the forecast. Expanded programs and services will be requested via the annual budget development process and, if approved, will be reflected in future forecasts.

## Long-Range Financial Forecast Update

Listed below are the forecast growth rate assumptions utilized in the forecast models.

### Forecast Growth Rates - November 2, 2023

<b>Revenues</b>	<b><u>FY 23/24</u></b>	<b><u>FY 24/25</u></b>	<b><u>FY 25/26</u></b>	<b><u>FY 26/27</u></b>	<b><u>FY 27/28</u></b>
Taxable Sales Growth	4.1%	0.0%	-0.4%	4.3%	4.2%
General Fund Sales Tax Revenue	3.4%	0.0%	-0.4%	4.3%	4.2%
Total Sales Tax Rate	1.8%	1.8%	1.8%	1.8%	1.8%
General Fund	1.2%	1.2%	1.2%	1.2%	1.2%
Transit Fund	0.5%	0.5%	0.5%	0.5%	0.5%
Arts & Culture Fund	0.1%	0.1%	0.1%	0.1%	0.1%
Primary Property Tax Levy Growth	4.0%	4.0%	4.0%	4.0%	4.0%
Bed Tax Revenue Growth	3.5%	6.2%	6.1%	6.3%	5.9%
Bed Tax Rate	5.0%	5.0%	5.0%	5.0%	5.0%
City Population Growth	1.1%	1.1%	1.1%	1.1%	1.1%
State Population Growth	1.2%	1.3%	1.3%	1.3%	1.3%
State Shared Income Tax Growth	41.4%	-19.0%	-1.8%	4.7%	4.9%
State Shared Sales Tax Growth	-0.1%	3.7%	4.5%	4.9%	4.9%
State Vehicle License Tax Growth	2.3%	4.8%	3.9%	3.9%	3.7%
Building and Trades Growth	-23.6%	1.5%	2.4%	2.4%	2.2%
Cultural and Recreational Growth	-7.2%	3.7%	3.5%	3.5%	3.3%
Fees, Fines, Forfeitures Growth	-18.2%	1.9%	1.8%	1.8%	1.8%
Licenses Growth	9.4%	2.6%	2.4%	2.4%	2.2%

<b>Expenditures</b>	<b><u>FY 23/24</u></b>	<b><u>FY 24/25</u></b>	<b><u>FY 25/26</u></b>	<b><u>FY 26/27</u></b>	<b><u>FY 27/28</u></b>
Personnel Costs Growth <sup>(1)</sup>	6.1%	2.2%	2.0%	1.3%	1.2%
FICA (% of payroll)	7.7%	7.7%	7.7%	7.7%	7.7%
State Retirement (% of payroll)	12.29%	12.37%	12.34%	12.22%	12.22%
Police Retirement (PSPRS Tiers 1 & 2)	21.90%	28.57%	30.21%	30.92%	31.60%
Police Retirement (% of payroll) <sup>(3)</sup>	69.10%	75.02%	72.45%	75.73%	75.96%
Fire Retirement (PSPRS Tiers 1 & 2)	24.03%	32.70%	32.20%	32.68%	33.11%
Fire Retirement (% of payroll) <sup>(2)(3)</sup>	76.67%	82.38%	80.77%	82.30%	83.12%
Health, Dental, Life Actives	2.4%	8.0%	8.0%	8.0%	8.0%
Health, Dental, Life Retirees	1.3%	8.1%	7.1%	9.6%	7.2%
Mediflex Growth	11.1%	5.6%	8.0%	8.0%	8.0%
Other Fringe Benefits Growth	7.2%	1.4%	1.8%	2.0%	1.9%
General Inflation	2.9%	2.6%	2.4%	2.4%	2.2%
Electricity Inflation	4.2%	22.3%	6.3%	6.3%	6.3%
Water Inflation	5.5%	5.5%	5.5%	5.5%	5.5%
Sewer Inflation	4.0%	4.0%	4.0%	4.0%	4.0%
Gasoline Inflation	-7.9%	6.0%	3.3%	2.7%	1.7%

#### Notes:

<sup>(1)</sup> Excluding OPEB Trust Fund Advance/Withdrawal

<sup>(2)</sup> Net of Fire Insurance Premium Tax credit

<sup>(3)</sup> Police & Fire Retirement percentages include the annual required payment on the Taxable Municipal Bonds.

Repayment of the bonds was structured to include lower annual payments for FY22 and FY23 only. This results in lower overall employer contribution rates for FY22 and FY23. Higher contribution rates start in FY24 when higher annual bond repayment amounts resume.

# Long-Range Financial Forecast Update

Work Study Session  
November 2, 2023



# Strategic Priority



Financial Stability  
& Vitality

- 5.04 Maintain highest general obligation bond (credit) rating
- 5.05 Maintain General Fund unassigned fund balance at a minimum of 20% and maximum 30% of General Fund revenue





# Public Meeting Dates



## CAPITAL

## OPERATING

CAPITAL		OPERATING
Public Forums	Feb/Mar	Public Forums
Proposed Projects	Feb 22	Updated Long-Range Forecast
Initial Recommended Projects	Mar 25	
Budget Review Session	Apr 18	Budget Review Session
Budget Review Follow-up (if needed)	May 2	Budget Review Follow-up (if needed)
Tentative Adoption	May 21	Tentative Adoption
Public Hearing/Final Adoption	Jun 6	Public Hearing/Final Adoption
	Jun 27	Property Tax Levy

# Forecast Assumptions



- Overall economy remains stable - no recessionary trend forecast
- The elimination of residential rental tax collections is effective January 1, 2025
- Inflation due to the impact of worker shortages and supply chain issues
- Continued salary plans and market adjustments with annual increases to insurance costs
- Reduction in State-shared revenue distributions due to decreases in income tax collections
- Increased investment earnings due to higher interest rates

# Updates From February Forecast



- Elimination of residential rental tax (Senate Bill 1131), effective January 1, 2025
- Revenue projections from non-residential rental, retail sales continue to modestly grow
- Hotel/motel tax revenues projections remain stable
- State-shared income tax revenues anticipated to decline beginning in FY 2024/25
- Ken McDonald and Rolling Hills long-term leases

# Residential Rental Tax Elimination



- Senate Bill 1131 was signed into law August 1, 2023
- Three operating funds with revenue loss (9% sales tax revenue loss)

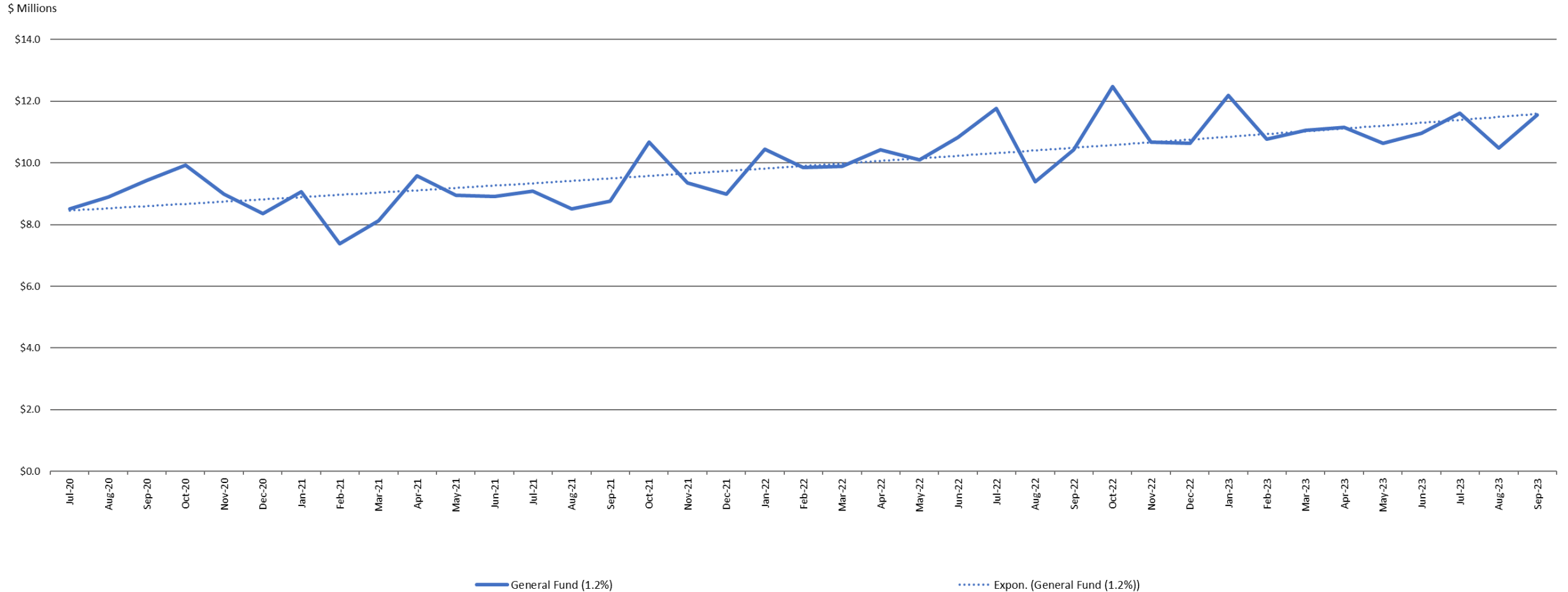
Effective January 1, 2025	FY24-25 (half-year)	FY25-26	FY26-27	FY27-28
General Fund	\$ 6.6M	\$ 13.8M	\$ 14.4M	\$ 15.0M
Transit Fund	\$ 2.8M	\$ 5.8M	\$ 6.0M	\$ 6.3M
Arts & Culture Fund	\$ 0.6M	\$ 1.2M	\$ 1.3M	\$ 1.4M
<b>Total</b>	<b>\$ 10.0M</b>	<b>\$ 20.8M</b>	<b>\$ 21.7M</b>	<b>\$ 22.7M</b>

M = Million

# Sales Tax Trends



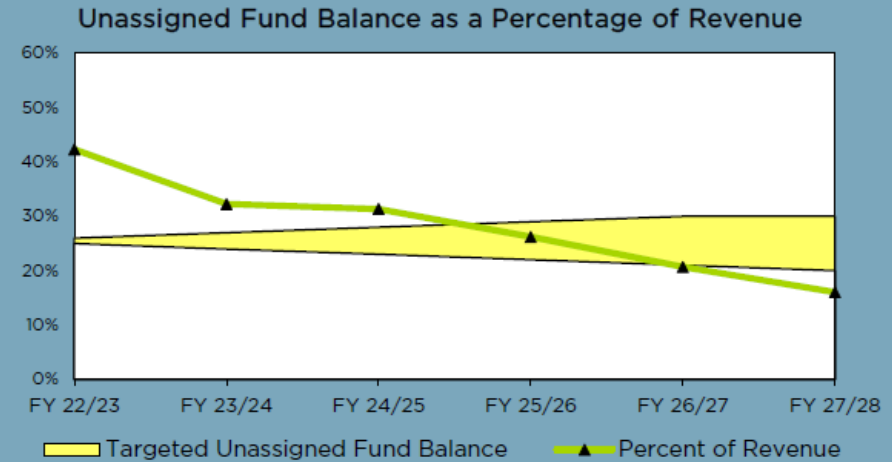
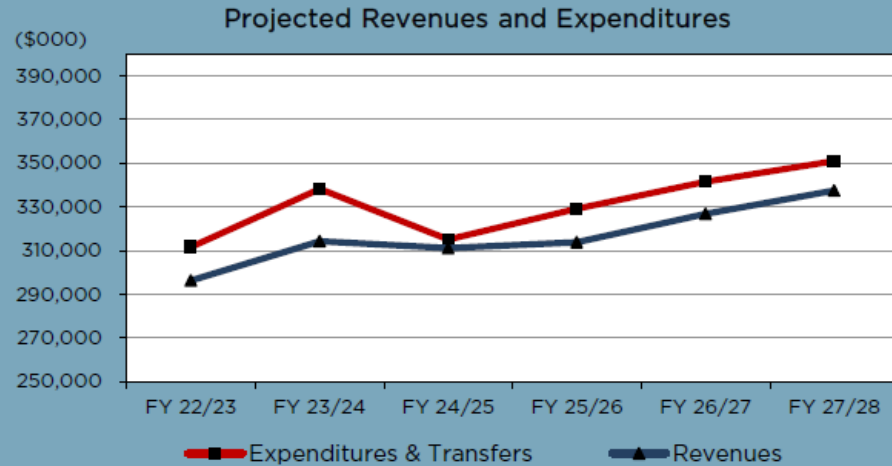
### General Fund - Privilege Tax Trends



# Potential General Fund Scenario

November 2023

## General Fund - Sample Evaluation of Variable Budget Options



Expressed in thousands (\$000)

	FY 22/23 Projected	FY 23/24 Projected	FY 24/25 Projected	FY 25/26 Projected	FY 26/27 Projected	FY 27/28 Projected
Revenues	296,329	314,246	311,225	313,915	326,889	337,523
Expenditures	284,311	335,890	306,118	319,586	332,732	342,263
Transfers/Assignments	27,367	2,387	925	1,585	848	755
Initial Estimated Surplus/(Deficit)	(15,349)	(24,031)	4,182	(7,256)	(6,691)	(5,495)

### Estimated New Funding for Analysis Purposes

Recurring Supplementals			5,000	5,000	5,000	5,000
One-Time Supplementals			1,000	1,000	1,000	1,000
CIP Cash Funded (Paygo)			2,000	2,000	2,000	2,000

Unassigned Fund Balance	125,444	101,413	97,595	82,339	67,648	54,153
% of Revenue	42%	32%	31%	26%	21%	16%

# General Fund Highlights



The annual residential rental tax collections loss, effective January 1, 2025, creates a \$14 - \$15 million/year structural deficit

Interest estimates continue to improve since February 2023 forecast

State-shared income tax collections were lower than the February 2023 forecast

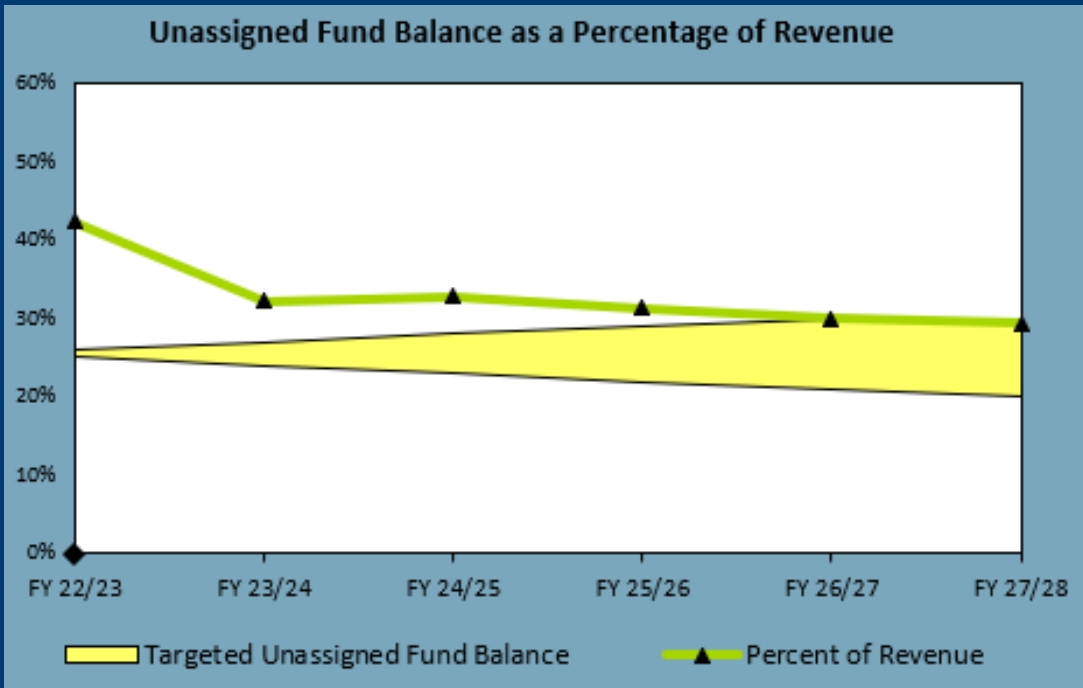
FY 22/2023 revenues interest earnings & vacancy savings were higher than projected and have bolstered fund balance

Building permit/Plan check/Engineering fees remain strong with forecasted growth

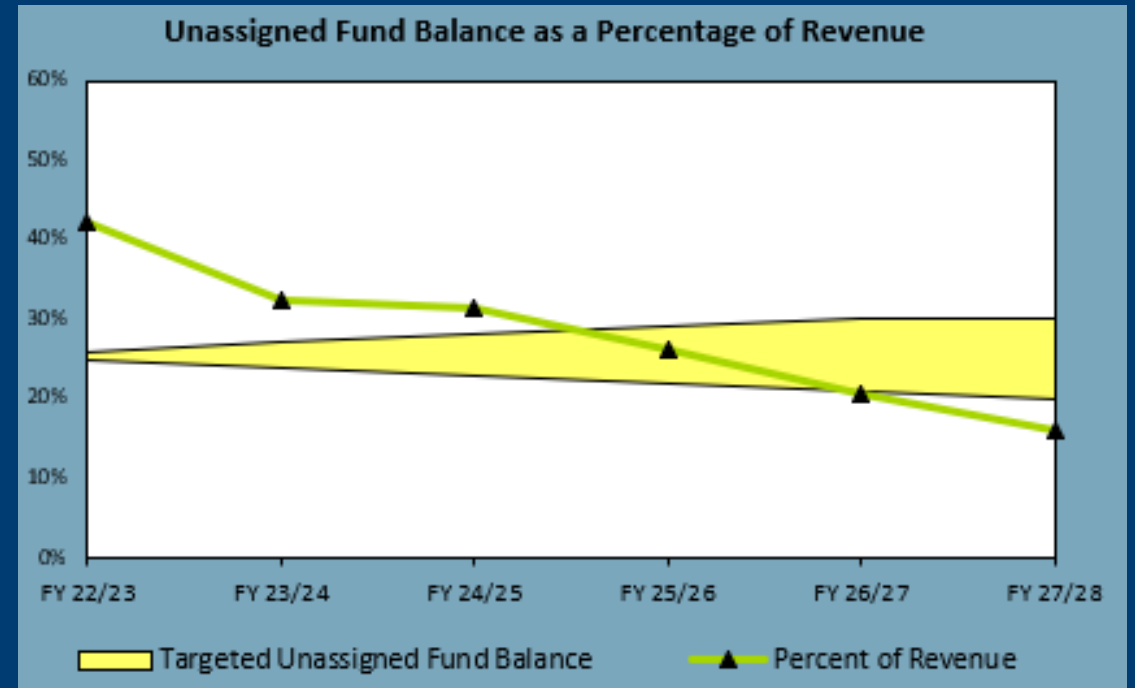
At this point, CIP pay-go (cash) funding remains consistent with the February 2023 forecast

# Impact of Residential Rental Tax Loss

## With Residential Rental Revenue



## Without Residential Rental Revenue





# Enterprise Fund Highlights



## Water/Wastewater

- Revenue amounts include rate adjustments from latest rate study and future planned adjustments
- Planned spend-down of fund balance, including cash (pay-go) funding of CIP projects

## Solid Waste

- Planned moderate rate increases included in revenue estimates
- Fund balance maintained within policy

## Emergency Medical Transport (Ambulance)

- Fund is stable with revenues significantly higher than forecasted
- Staff will work to refine capital reserve and fund balance policies

# Special Revenue Fund Highlights



## Transit

- Residential rental tax collections results in 9% tax revenue reduction
- Fund balance declining but forecasted to remain in policy over the forecast period
- Explore long-term strategies to ensure the fund remains stable
- Focus on maintaining existing assets (bus, rail, streetcar) and minimizing system expansion

## Transportation (HURF)

- HURF revenue projections are lower since last forecast based on ADOT projections
- Future revenues subject to pending legislation
- Continue to monitor fund to ensure expenditures are in-line with revenues

## Arts and Culture

- Despite residential rental tax collection revenue reduction, fund remains stable with balances maintained above policy level
- Facility and programming revenues remain strong post pandemic
- Tempe Center for the Arts is the new home for the Arizona Theater Company



## Questions?

