



City Council Report

Date: April 3, 2017
To: City Council
Through: Michael Kennington, Chief Financial Officer
From: Candace Cannistraro, Management and Budget Director
Subject: Fiscal Year 2017/18 Summary of Proposed Budget

Strategic Initiatives



economic development



quality of life



community engagement



financial stability



regional leadership

Overview of Proposed Budget

In February, the Council received an update on the financial status of the City and an overview of the forecast process. At that time, available resources were projected for FY16/17 and forecasted for FY17/18 and beyond. The cost of the current level of service was also projected for FY16/17 and forecasted for FY17/18 and beyond. The City currently has a gap between the level of on-going revenues and the level of on-going expenses. The result is reliance on reserve balances and savings experienced during the year. In FY15/16 expenditure reductions were made to narrow the funding gap. Recent changes in the City's contribution to the Public Safety Personnel Retirement System (PSPRS) have widened the funding gap.

Executive staff has met with each department to discuss and discern operational successes and concerns and to determine priorities for the upcoming fiscal year. The City has set a goal to align on-going expenses with on-going revenues to ensure that quality services and programs can be continued in the future. The FY16/17 budget was set without specific department reductions. Departments were asked to operate with targeted savings of 2%. This allowed for flexibility over the year to take advantage of operational savings opportunities rather than specifying reductions up front. The projected widened funding gap for FY17/18 requires City action to ensure sustainability of services.

The FY17/18 proposed budget continues the City's commitment to providing quality services to residents in a fiscally responsible manner. City senior staff and department staff have formulated a plan that will reduce the FY17/18 projected gap by about 50%. Effort was made to maximize the financial impact while minimizing the service impact. The proposed budget modifies both the projected expenditures and revenues from the original forecast.

The City of Mesa is a service organization and strives for service excellence. About 73% of the General Governmental fund expenses are related to the cost of personnel who provide the services. Public safety services are the largest component. The proposed budget uses four methods of cost containment/reduction related to personnel.

- Cost containment/limiting step pay expenses
- Cost minimization through civilianization of positions
- Protection of core services through repurposing of positions
- Elimination of positions

Limiting Step Pay Increases: Pay ranges for positions operate with minimum and maximum amounts. Movement through the pay range (step pay) is reviewed on an annual basis during an employee's performance review. Successful performance is required for an employee to be eligible for increased pay, but the increase is dependent on funding availability. Each year, as part of the budget process, citywide funding availability is determined. During the recession, funds were not available and step pay increases were not authorized. Since FY12/13, the authorized step pay amount has been 5% and was the amount included in the forecast. The proposed budget includes a step pay amount of 3%. This budget adjustment is estimated to reduce the expenses in the General Governmental Funds by \$2.4M and equates to the fully loaded costs of about 23 full-time positions.

Cost Minimization: The costs associated with sworn personnel continues to rise each year. The public safety departments have identified positions currently filled with sworn personnel whose duties could be performed by civilian personnel. Sixteen positions have been identified: 15 in the Police Department and 1 in the Fire and Medical Department. Civilian positions will be added and the sworn positions will be removed. The savings from these position conversions is about \$1.0M.

The sworn employees currently performing these duties will be reassigned to other budgeted positions. The full absorption into existing vacancies may take up to a year. One-year temporary funds are included in the FY17/18 budget to cover some of these employees until they can be placed into a different position.

Repurposing Existing Staff: As funding continues to be limited, existing resources are evaluated and repurposed occasionally to maintain the City's core services. The Fire and Medical Department has identified six sworn personnel that will be repurposed from support duties to first responder duties. This will allow for better coverage of minimum staffing and decrease the need to call in sworn personnel on overtime. The support duties currently being performed will be absorbed by other positions or will be done on an as-needed basis.

Elimination of Positions: Seventeen positions have been identified for reduction in FY17/18. One position is part-time so the full-time equivalent (FTE) amount is 16.5. Four positions (3.5 FTEs) are located in the Information Technology Department, one is in the Business Services Department and 12 are in the Police Department. Six of the police

positions are sworn personnel and six are civilian. All the civilian positions in the three departments are vacant. Four of the sworn positions are filled, however the employees will be reassigned to existing sworn positions when vacancies occur.

General Government Operating Budget

General Governmental revenues in the City of Mesa come from three primary sources: City sales and use tax, state shared revenues and a transfer from the Enterprise Fund. These resources are projected to increase in FY 16/17.

City sales tax, the largest of these sources, increased in FY 15/16. So far, that trend has continued into FY16/17. Part of the increase in sales tax is driven by increases in Contracting Sales Tax collections, which is increasing partially due to one-time construction projects in southeast Mesa. The last available month of sales tax data is for December sales, which showed increasing collections over that point last year. This fiscal year, the State of Arizona assumed control of sales tax collections, causing a significant lag in reporting. At this time, local sales tax is projected to end FY16/17 5.3% greater than FY15/16. For FY17/18, the forecast is a modest additional growth of 1.8%.

State-shared revenue consists of Urban Revenue Sharing (state-shared income tax), state sales tax and vehicle license tax. All state-shared revenue is based on population formulas. The growth in Urban Revenue Sharing is the result of gains in taxable income from individuals, corporations, and capital gains. Urban Revenue Sharing revenue has a two-year lag between the income reported and the receipt of revenues by the City so the budget is a known amount. It declined slightly in FY15/16 but is increasing by 9.3% in FY 16/17. The uneven collections in Urban Revenue Sharing is due in large part to changes to the State's corporate income tax, which are being phased-in over four years. FY 15/16 was the first year of the effect. There will be an increase of 2.6% in FY17/18 due to net effect of increasing personal income tax collections and declining corporate income tax collections. State-shared sales tax is increasing at a modest rate, like local sales tax, and is projected to be slightly higher than budget in FY16/17 with a projected increase of 5.1%. The FY 17/18 increase is forecasted at 3.9%. Vehicle License Tax revenue, the smallest contributor to state revenue sharing, is projected to be slightly higher than budget in FY 16/17 and increase 4.2% in FY 16/17.

The Enterprise Fund transfer is one of the city's methods of providing funding for general governmental services such as police and fire as well as library and parks. The Enterprise Fund generates a reasonable rate of return which is invested back into the city. The FY17/18 proposed budget includes an increase to the transfer amount equivalent to the growth of the Consumer Price Index (CPI). Currently, the growth is 2.52%.

Mesa faces significant pressure from increasing expenses. For various reasons, the pension rates for public safety personnel are increasing for FY17/18. Overall, Mesa's contribution to public safety pensions are forecasted to increase by \$12.7 million in FY 17/18.

The City receives transit revenues from the State and a portion of the fares for light rail ridership, however the revenues do not cover the costs. The remainder of the costs are covered by a transfer from the General Fund to the Transit Fund. The projected transfer for FY16/17 is \$9.8 million with an increase for FY17/18 to \$12 million. The large increase is due to the costs of adding two off-duty, uniformed officers to patrol Mesa's light rail stations as well as backfilling fare revenues for light rail and bus service that have not achieved projected revenue levels. The opening of the line extension to Gilbert Road is forecasted to occur in FY18/19.

New park facilities require additional ongoing funding to operate and maintain. The new and renovated parks approved in the 2012 parks bond election are scheduled in the capital improvement program. Last year some of the projects were placed on hold pending identification of funding to cover one-time start-up costs and on-going maintenance. The Parks, Recreation and Community Facilities Department experienced some savings in FY14/15 and FY 15/16. The one-time savings has been reallocated to start-up costs and the on-going savings has been reallocated to the on-going costs of these projects. All projects previously held have been released and are proceeding with design/construction.

The General Fund contributes to three trust funds related to liabilities (Property and Public Liabilities Trust Fund), employee benefits (Employee Benefits Trust Fund), and employee injuries (Workers' Compensation Trust Fund). There are significant one-time savings in FY 16/17 for the cost of claims in the Property and Public Liability Trust Fund, however the estimate for FY17/18 has been increased over the FY16/17 estimate by \$1.5 million due to unknown timing of pending claims. Some of the estimated savings in FY16/17 will be reallocated to the claims budget in FY17/18. This issue is discussed further in the trust fund section.

Continuing growth in health care costs remain a significant pressure to the Employee Benefit Trust Fund in FY16/17 and FY17/18. The City experienced an 18% increase in the cost of medical and dental claims in FY15/16 over prior year, and a 7-9% increase is forecasted for both FY16/17 and FY17/18. Cost avoidance measures continue to be implemented by the City, however continuing costs in health care will necessitate increases in City, retiree, and employee contribution rates. Medical premium rates are set on a calendar year (CY) basis. CY2018 rates are estimated to increase 8.0% resulting in an increased City contribution for six months of FY17/18.

The City's financial policies call for a forecasted fund balance (reserves) of 8-10% per fiscal year. The estimated budget for FY17/18 results in an ending balance within the financial policies, however the forecast of on-going revenues and expenses results in the reserves falling below the minimum balance in FY19/20. The proposed budget reduces the impact on the reserve balance and extends the ability to meet the financial policies for an additional year (Attachment 1).

For the "estimated budget": The level of General Government reserves is projected to

be \$89.4 million at the end of FY16/17 (21.0% of the FY17/18 expenditure budget) and forecasted to be \$71.9 million at the end of FY17/18 (16.1% of the FY18/19 forecasted expenditure budget).

For the “proposed budget”: The level of General Government reserves is projected to be \$89.4 million at the end of FY16/17 (21.4% of the FY17/18 expenditure budget) and forecasted to be \$78.4 million at the end of FY17/18 (17.8% of the FY18/19 forecasted expenditure budget).

An economic correction is anticipated within the next three to four years and has not been included in the current estimates. Revenues and expenditures are reviewed on an on-going basis to allow for proactive response to economic changes.

Enterprise Operating Budget

Planning for new accounts and incorporating utility rate adjustment recommendations, FY17/18 operating revenues are estimated at \$364.3 million, up from \$351.8 million projected for FY16/17.

As economic conditions have improved, Mesa has experienced an increase in the number of utility customers. However, increased efficiency in homes and appliances, and mild winter conditions have resulted in lower usage per account in several of the City’s utilities in years past.

With the increase in utility customers comes demand to provide additional capacity and infrastructure to meet future needs. Of importance is Mesa’s southeast region where little infrastructure is available but significant growth in development is anticipated. This is particularly true of water and wastewater utilities that need new and upgraded facilities in order to meet new and future customers’ growth demands.

The level of Enterprise Fund reserves is estimated to be \$82.1 million at the end of FY16/17 (22.1% of the FY17/18 expenditure budget) and \$74.7 million at the end of FY17/18 (19.4% of the FY18/19 expenditure forecast). The City’s financial policies call for a forecasted fund balance (reserves) of 8-10% per fiscal year. The City forecasts expenses, revenues and reserve balances over a multi-year period. The reserve balance allows the City to react to increased expenses by smoothing necessary rate increases over multiple years, therefore avoiding rate spikes. As in FY17/18, the City will sometimes carry a reserve balance greater than 10% due to this rate stabilization philosophy. The current forecast calls for slightly declining reserve balances for the next few years in anticipation of a scheduled increase in existing debt service expense beginning in FY17/18.

Restricted Funds Highlights

Transportation Related Funds

Transportation funds come from two sources. The State of Arizona collects Highway User Revenue Funds (HURF) and a portion of these are provided to cities. This is the fuel tax paid at the pump by the consumer. Arizona’s three largest cities also receive an additional allocation of the revenues referred to as HURF 3%. The other transportation source is a 0.30% Mesa city sales tax dedicated to street expenditures referred to as Local Street Sales Tax (LSST).

Highway User Revenue Fund (HURF). HURF and HURF 3% revenues experienced volatility due to adjustments in the distribution by the State. In FY16/17, the State distribution provided a one-time increase of \$1.4 million, increasing expected revenues to \$39.0 million. The FY17/18 revenue projection has a slight decrease to \$38.2 million due to the loss of the one-time funding provided in FY16/17.

Local Street Sales Tax (LSST) Fund. LSST revenue collection is tied to the rest of city sales tax and is experiencing increased growth recently.

HURF and LSST are managed together as both funds are restricted to streets related expenditures. The State’s previous diversion of HURF revenues and the reduced sales tax receipts due to the recession have caused some street maintenance activities to fall behind the schedule anticipated when the LSST was approved. The City’s street maintenance program outlines the highest priorities for allocation of available resources. Expenditures are modified to remain within available resources. The available ending reserve balance for HURF and LSST combined are estimated to decrease from \$34.2 million in FY16/17 to \$21.8 million in FY17/18. The decrease in the ending reserve balance is due to various projects started in FY16/17 that will continue into FY17/18. These projects include repaving streets, improving drainage, repairing sidewalks, and replacing traffic signals that have exceeded their useful life.

Trust Funds

Employee Benefit Trust Fund. The Employee Benefit Trust (EBT) Fund is used to fund employee health benefits and other employee benefit programs the City sponsors. Resources for the fund comes from the setting of medical and dental premiums paid partially by employee and retirees, and partially by the City. The City is estimated to contribute 71.1% of the EBT resources anticipated for FY17/18. Despite cost containment measures implemented by the City in FY11/12, total expenses and the cost of claims have increased as shown below:

		Total Expenses	Increase	Cost of Claims	Increase
Actual	FY 12/13	\$56.3M		\$49.8M	
Actual	FY 13/14	\$58.3M	3.6%	\$50.8M	2.0%
Actual	FY 14/15	\$68.4M	17.3%	\$56.8M	11.8%
Actual	FY 15/16	\$77.0M	12.6%	\$67.0M	18.0%

Projected	FY 16/17	\$82.7M	7.0%	\$72.1M	7.6%
Forecast	FY 17/18	\$90.5M	9.3%	\$78.0M	8.0%

Each year, staff reviews the plan design and benefits with consultants and risk managers. Staff also reviews and recommends Health and Wellness Center services and Wellness programs that provide easy access for health plan member patients, focuses on prevention and screening, identifies chronic disease management cases and previously undiagnosed conditions, supports and develops a Citywide culture of health and wellness and has a goal of long-term cost containment in health plans.

The City has experienced increased medical and prescription drug claims costs in recent years with additional increases projected for FY16/17 and FY17/18. Increases in these expenditures are largely driven by the frequency and severity of claims, an increase in high dollar claimants (over \$150,000), high dollar diagnostic categories, and nationwide medical and prescription drug trend increases membership and utilization increases.

Premiums are set on a calendar year basis. To address the increased costs, the FY17/18 budget includes an 8% increase on both City contributions to the medical premiums as well as employee contributions in CY18. During the summer of 2017, plan design and premiums will be reviewed. Specific rate recommendations will be presented to the City Council in the fall of 2017. The City contribution included in the FY17/18 proposed budget is \$63.7 million, \$5.8 million more than projected in FY16/17. The proposed budget includes an estimate increase of retirees in the retiree plan and an additional 8% increase in medical premiums for CY2018. The national average for increases in medical costs is 8 to 9% annually.

Worker's Compensation Fund. The Worker's Compensation Fund is used to fund claims related to employee work-related injuries and is completely funded by the City. Total annual expenses have remained consistent in the past several years, but are expected to rise in correspondence with health care as shown in the EBT fund.

The City contributes to the Worker's Compensation Fund each pay period based on the salary of each of employee. Rates are established based on the risk level of the job classification, calculated in the total cost of the position and included in the departments' operating budget. Expenses are reviewed during the fiscal year and rates can be modified if needed. Pending worker's compensation claims are valued at the total estimated payment, which may occur over many years based on the type of injury. The current reserve policy sets the reserve target at the amount sufficient to cover the current year portion of claims and related costs.

Staff sets contribution rates to coincide with the annual budget adoption to avoid affecting the departments' budgets mid-year. The reserve balance at the end of FY16/17 will be higher than budgeted due to City contributions being higher than expected. This will allow for a temporary reduction in rates for FY17/18 with a resulting City contribution estimate of \$5.1 million.

Property and Public Liability Fund (PPL). The Property and Public Liability Fund is used to pay claims related to lawsuits against the City. The value of claims paid can vary significantly by year, therefore, the PPL fund balance target is \$10.0 million. The length of time from the submission of a claim to its final resolution can take over a year, contributing to a high variability of annual costs. Claims are projected to be \$2.7 million in FY16/17, however outstanding claims may cause expenses to be greater in FY17/18. The cost of claims included in the FY17/18 budget is \$4.0 million.

The contribution needed to maintain the \$10.0 million reserve balance is estimated each year and included in the budget. The FY17/18 City contribution estimate is \$6.7 million. Expenses are reviewed during the year and the contribution amount is modified as necessary. Due to the reduced claims experienced in FY16/17, the original city contribution estimate can be reduced and still meet the reserve balance target.

Environmental Fee Fund (ECF)

The Environmental Compliance Fee is applied to each utility account customer to meet the projected costs of Federal, State and County unfunded environmental mandates. The current monthly fee of \$7.32 is anticipated to generate \$15.7 million in revenue in FY17/18. The fee funds the city's environmental activities such as air quality, storm water quality, hazardous waste management, and asbestos management. Budgeted on-going operational expenses are \$15.5 million therefore no fee adjustment is needed. Savings experienced each year are accumulated and applied to one-time expenditure needs. In FY17/18, the Environmental Compliance Fee Fund will fund one-time expenses for furniture, fixtures and equipment for the new Household Hazardous Waste facility.

Grants

The City pursues grants to fund projects, implement or enhance programs, and fund the acquisition of new equipment. While the application for grant funding requires preparation time by City staff as well as subsequent tracking of grant expenditures, grant awards provide the City with the means to fund services that would not otherwise be funded in the City's budget. Not all grants applied for are awarded to the City. The City includes grants currently being applied for in the adopted budget to allow for budget authorization capacity.

Police Grants

Mesa Police is budgeting for \$3.5 million in new grant awards for FY17/18. Notable grant awards include the following:

- \$900,000 Homeland Security Grants provide funds for training and equipment to support Homeland Security initiatives.
- \$390,000 Governor's Office of Highway Safety (GOHS) Grant provides resources overtime for DUI and traffic enforcement activities and safety equipment for the City's Traffic Safety Program.

- \$344,980 Mesa Family Advocacy Center (MFAC) Grants providing for the salaries and benefits for Victim Support Services and Police Awareness Community Education Portal.
- \$718,514 in multiple forensics grants. The National Institute of Justice DNA Backlog Program Grant provides resources for forensic personnel and equipment to enhance analyzing forensic DNA to reduce system backlog. The Coverdell Grant allows for the acquisition of equipment to assist in crime scene analysis and training for forensic personnel. The Forensics Crime Lab Grant provides funding for training and equipment. The Governor's Office of Highway Safety Grant may provide a Liquid Chromatograph Time of Flight Mass Spectrometer which will enhance the laboratory's ability to identify various toxicological substances.
- \$350,000 Arizona Criminal Justice Commission (ACJC) grant for microfilm conversion of Police Department records to digital media.
- \$30,000 The Arizona Automobile Authority provided funds for the purchase of License Plate Reader analytical software.
- \$250,000 Tribal Gaming Grants provides funding for training, public education tools, and equipment for various divisions in the Police Department.
- \$52,000 High Intensity Drug Trafficking Areas (HITDA) Grant provides funding for officer overtime to coordinate activities that address drug trafficking in specially designated areas of the United States.

Fire and Medical Grants

Mesa Fire and Medical planned for \$339,500 in grant awards for FY17/18 which is significantly less than the \$4.6 million planned for FY16/17. Centers for Medicare and Medicaid Services (CMS) Healthcare Initiative Grant expires in FY16/17. Notable grant awards include the following:

- \$200,000 Urban Area Security Initiative (UASI) Rapid Response Team (RRT) for salary & benefits, including travel, conferences and training for key fire personnel.
- \$139,500 various other grant awards which include grants to provide immunizations and provide support for Community Emergency Response Teams

Housing & Community Development Grants

The Housing and Community Development Department oversees a variety of programs designed to provide safe, decent, and affordable housing and a suitable living environment within the City of Mesa. To accomplish this task, the Department has assumed several vital roles within the community. One role is the management of the following U.S. Department of Housing and Urban Development (HUD) programs:

- Housing Choice Voucher Program (Section 8) - the HUD-funded program provides rental assistance to low-income families for decent, safe, and sanitary housing by contracting with private owners and subsidizing a portion of the family's monthly rent. Since housing assistance is provided on behalf of the family or individual, participants can find their own housing, including single-family homes, townhouses and apartments.
- Mainstream Voucher Program (Section 8) - mainstream program vouchers enable families having a person with disabilities to lease affordable private housing of their choice. Mainstream program vouchers also assist persons with disabilities who often face difficulties in locating suitable and accessible housing on the private market.
- The City of Mesa Housing Authority operates the HUD-Veterans Affairs Supportive Housing (VASH) program (Section 8), which provides rental assistance for chronically homeless veterans and their families, while the Veterans Administration in Phoenix provides case management and clinic services at its medical centers and community clinics.

These three Section 8 programs are funded at a combined \$13.6 million in FY16/17 and \$13.0 million in FY17/18.

The City is a designated entitlement community by the Department of Housing and Urban Development (HUD). The Department oversees the following Community Development programs designed to revitalize neighborhoods, promote economic development, and improve community facilities and services:

- Community Development Block Grant (CDBG) - ensures decent affordable housing, to provide services to the most vulnerable in our communities, and to create jobs through the expansion and retention of businesses. This program is funded at \$6.6 million in FY16/17 and \$6.4 million in FY17/18.
- HOME Investment Partnership (HOME) - helps communities expand the supply of decent, safe, sanitary and affordable housing, with primary attention to housing for low income families. The HOME Investment Partnerships Program (HOME) funds a wide range of activities including building, buying, and/or rehabilitating affordable housing for rent or homeownership or providing direct rental assistance to low-income people. This program is funded at \$3.1 million in FY16/17 and \$3.1 million in FY17/18.
- Emergency Solutions Grant (ESG) - provides essential services related to emergency shelter, rehabilitation and conversion of buildings to be used as emergency shelters, operation of emergency shelters, and homelessness prevention services. This program is funded at \$0.4 million in FY16/17 and \$0.4 million in FY17/18.

- Neighborhood Stabilization Program (NSP) – funding to revitalize housing in specific areas of the City to sell to qualified residents. The funding allows the City to acquire foreclosed or abandoned homes and to rehabilitate, resell, or redevelop these homes to stabilize neighborhoods and stem the decline of house values of neighboring homes. The program was funded at \$5.8 million in FY15/16 and \$5.8 million in FY16/17. NSP is still ongoing and uses unspent funds from prior years to accomplish revitalization of housing.
- The Affordable Rental Movement (ARM) of Save the Family, in partnership with the City of Mesa, was awarded a Shelter Plus Care Grant in FY12/13 through the U.S. Department of Housing and Urban Development (HUD). This was the first Shelter Plus Care Grant to be awarded in the east valley. The grant allows ARM to provide seven homes for chronically homeless families for up to five years. The City of Mesa Housing Authority determines program eligibility, refer families to the Shelter Plus Care Program and monitors the program. This program is funded at \$0.2 million in FY16/17 and \$0.2 million in FY17/18.

City-wide Adjustments Impacting Budget

Some budget adjustments affect all funds and departments across the City in varying degrees, such as changes in the cost of personal services. These types of adjustments are discussed here.

State Retirement Plan Contributions

FY17/18 contribution rates for State-run retirement plans increased as follows:

Retirement Plan	FY 16/17 Rate	FY 17/18 Rate	Rate Change	Increased Annual Cost (All Funds)
Arizona State Retirement System (ASRS)	11.3%	11.3%	0.00%	\$0.3 M
Elected Officials Retirement System (EORP)	95.6%	106.6%	11.50%	(\$0.1 M)
Public Safety Personnel Retirement System (PSPRS) - Fire*	41.2%	52.3%	26.90%	\$3.9 M
Public Safety Personnel Retirement System (PSPRS) - Police*	42.4%	54.9%	29.50%	\$8.8 M

*Includes forecasted cost of new Defined Contribution Plan for Tier 2 PSPRS employees

Public Safety Personnel Retirement System (PSPRS) rates increased significantly in FY17/18. These rate increases were caused by several factors including: Benefit changes from Statewide reforms, past investment earnings less than assumed, a lowering of the future investment return assumption, and differences from other actuarial assumptions.

Statewide Reform Benefit Changes

The State of Arizona, recognizing a decline in the funded status of PSPRS plans, approved several reforms in 2011 (in Senate Bill 1609). However, the 2011 reforms,

while valid for new employees, in 2014 were found to be unconstitutional for existing retirees (*Fields* case).

In 2016, the State approved another round of reforms for new employees (Senate Bill 1428). In 2016 Arizona voters also approved a State constitutional amendment adjusting future benefit increases for all PSPRS retirees and employees (Proposition 124). The 2016 reforms and constitutional amendment, while resulting in savings from the original (pre-2011) benefit structure, created less savings than the 2011 reforms. This reduction in savings (from the 2011 reforms to the 2016 reforms) resulted in lower funding levels in the plans and higher contribution rates in FY17/18.

The 2016 reforms also included a new defined contribution benefit for employees of participants (like Mesa) that don't contribute to Social Security for sworn personnel.

The additional cost of the 2016 reforms has pre-empted much of the future cost of the 2011 reforms being overturned for existing employees (*Hall* case). The impact of the *Hall* case, while lessened by the 2016 reforms, is expected to be included in the next fiscal year (FY18/19) rates. An additional \$6 million increase in PSPRS contributions has been included in the City's forecast in FY18/19 for the impact of the *Hall* case.

Past Investment Returns Less Than Assumed

Each year's gains or losses from investing plan assets is smoothed (spread) over the following 7 years. The investment returns for the past 7 years averaged 6.6% in FY15/16, which is less than the 7.85% assumed rate of return.

Future Investment Return Assumption Lowered

Since the recent investment returns are lower than assumed, the annual assumed rate of return in future years was lowered from 7.85% to 7.5%.

Other Assumptions

A variety of assumptions are necessarily included in the actuarial calculations. The length of time employees will work before quitting or retiring, how much employees will be paid, how many new employees will be hired, how many employees will be injured, how long retirees will live, etc. Since actual experience differs from the actuarial model assumptions, either savings or additional costs result from the differences.

The additional cost to the City is estimated to be \$12.6 million annually beginning in FY17/18. The additional cost estimate is shown by cause in the table below.

\$12.6M Estimated Contribution Increase – Causes

Cause	Amount (millions)	Explanation
Statewide Reform Benefit Changes	\$7.1	Difference between assumed savings from 2011 reforms versus 2016 reforms
Past Investment Returns Less Than Assumed	\$0.4	Past investment return of 6.6% (smoothed over 7 years) was less than 7.85% assumption
Future Investment Return Assumption Lowered	\$3.9	Change in future annual investment return assumption from 7.85% to 7.5%
Other Assumptions	<u>\$0.5</u>	Actual experience different from payroll and demographic assumptions
Total	\$11.9	

Note: Causes provided in annual PSPRS actuary reports for June 30, 2016

New Defined Contribution Benefit	\$0.7	New benefit added in 2016 reforms for employers that don't contribute to Social Security
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Step-Pay

Pay ranges for positions operate with minimum and maximum amounts. Movement through the pay range (step pay) is reviewed on an annual basis during an employee's performance review. Successful performance is required for an employee to be eligible for increased pay, but the increase is dependent on funding availability. Each year, as part of the budget process, citywide funding availability is determined. During the recession, funds were not available and step pay increases were not authorized. Since FY12/13, the authorized step pay amount has been 5% and was the amount included in the forecast. The proposed budget includes a step pay amount of 3%. This budget adjustment is estimated to reduce the expenses in the General Governmental Funds by \$2.4M and equates to the fully loaded costs of about 23 full-time positions.

Each year position costs are recalculated based on the employee in the position at the time. This accounts for promotions, reclassifications, terminations and retirements. The impact is not a comparison from one fiscal year to another, but from the recalculated base to the projected amount.

Health Plan Contributions – Employee Benefit Trust

In order to minimize cost, the City funds many of its employee and retiree benefits internally through the Employee Benefit Trust (EBT) Fund. This includes medical, dental and vision benefits. The FY17/18 budget anticipates increasing the city contribution by 8% effective January 2018 as health care premiums are updated on a calendar year basis. Premiums will be reviewed in full over the summer. The increase in medical premiums results in an increase in the costs of personal services for each department.

Capital Improvement Program (CIP) Highlights

As outlined in the Council's Economic Development strategic initiative, the City continues to place a high priority on infrastructure investment to attract and service future development. The proposed CIP includes an expansion of a water reclamation plant and the design and construction of a new water treatment plant as well as the associated distribution infrastructure. The funding of the projects is available through utility revenue bonds authorized by Mesa voters in November 2014. The debt service on utility revenue bonds is funded through the utility rates paid by customers. Therefore, the customers served by these plants will participate in the repayment of the new debt service related to them.

Continuation of citizen initiated and approved Parks projects, as well as several Transportation projects are included in the proposed CIP. Planned park improvements include Eagles Park (former Mesa Junior High site), Greenfield Park, and Pioneer Park in central Mesa. Scheduled street improvements approved by voters include improvements to several arterial roads citywide, the next phase of Mesa Drive and First Avenue in the downtown area, as well as the Elliot Road Corridor in east Mesa. These projects will use general obligation (GO) bond authorization approved by voters in 2013 to leverage regional grant dollars to complete projects that serve multi-modal transportation and safety needs. The debt service on GO bonds is funded through a secondary property tax as approved by voters in the ballot language for the bond authorization. In conjunction with the street projects, the City will replace and/or upgrade utility infrastructure. Coordinating this effort not only ensures the reliability of the utility service lines, but it also maximizes the life of the pavement. The utility infrastructure is funded with existing utility revenue bond authorization.

Also included in the proposed CIP are improvements at Falcon Field airport, various shared-use paths, and storm water infrastructure projects. These projects also use local funding sources to leverage grant dollars awarded to Mesa to complete projects that enhance the quality of life in the City of Mesa.

Secondary Property Tax

The FY17/18 proposed budget includes the same secondary property tax levy as FY16/17, \$33.4 million. Secondary property tax is limited in use to the repayment of general obligation debt.

The secondary property tax rate is calculated using property values for the City of Mesa as published by the Maricopa County Assessor's Office. The secondary property rate is applied to the limited property value (LPV) of a property to determine each property's tax bill.

The City's secondary property tax rate is adjusted to achieve the same total levy dollar amount. The FY17/18 rate is reduced to \$1.0968 per \$100 of net assessed value, down 5.3% from \$1.1578 per \$100 of net assessed value in FY16/17. This rate reduction is the result of both an increase in the value of existing property and the development of new property. Since property values have increased, the property tax rate is reduced to generate the same amount of total tax revenue.

In FY17/18, the \$1.0968 tax rate applied to a median home limited property value of \$119,063 results in an average bill of \$131 per year.

The City Council adopts the secondary tax levy and associated rate each year as a separate action from the budget adoption.

Lifecycle Replacement Program

The lifecycle replacement effort focuses on identifying and developing a multi-year plan for purchase/replacement/upgrade of items (or technology) that have a mid-range useful life and should be addressed on a regular basis. Scheduled replacement allows the city to avoid expenditure spikes that can impact the city's ability to deliver services. A citywide plan is evaluated and prioritized to meet the operational needs and available resources of the city. Examples include computer cycle replacement, pool equipment replacement, and the vehicle replacement program. On an ongoing basis, departments review and identify large periodic operational expenditures which cannot be covered within their annual budget.

The proposed budget includes the allocation of \$3.0 million to fund one third of the Police Departments radio replacement needs. Additional funding has been allocated for parking lot pavement treatments and various small utility equipment replacement. Many lifecycle needs were identified during the FY17/18 budget process that the city is not able to fund. Staff will continue to identify and analyze needs citywide to create a comprehensive plan to assist in prioritization for if/when additional funding is available.

Department Highlights

The following section highlights the budgetary impacts within each department and is not meant as an overall highlight of the wonderful and innovative activities occurring around the City.

Public Safety Departments

Communications

Communications has been able to partner with Mesa Public Schools to transition the non-public safety department radios off of the TOPAZ network and move them to the district's network and realize significant savings for the City. This effort also ensures the availability and reliability of the TOPAZ network for public safety needs.

The FY17/18 Communications budget includes \$1.1 million for lease payments to Motorola over the next three years for the TOPAZ Voice Radio Network Equipment Upgrade project. The project is included in the lifecycle replacement program and will upgrade the city's existing communications network to ensure reliable radio service for first responders. The budget does include a reduction of \$100,000 in maintenance and software needs for radios and infrastructure. This reduction is possible because of the reliability of newer equipment as well as more efficient troubleshooting of equipment issues.

In FY17/18, consulting services for the TOPAZ network were included in the budget and funded design and specification development for the Fire Hazard Zone Communications (VHF) System. The FY17/18 budget includes \$350,000 to complete the installation of the VHF system. The project is part of the recommended capital improvement program and so the budget is reflected in the Projects Department. The City of Mesa is responsible for about 75% of the cost with the remainder covered by the other members of the joint venture.

The Communications Department will be merging with the Information Technology Department over the next few months. The FY17/18 adopted budget will still reflect two separate departments as the merger is implemented, however the two areas will be managed as one by the Chief Information Officer.

Fire and Medical

During FY16/17, 3.5 FTEs were added mid-year. Three sworn positions in the dispatch center were converted to 5 civilian FTEs, 1 civilian FTE was added to support maintaining and repairing current MFMD apparatus and assist with the work done on external entities' fleets, and one part time employee was converted to full time. These additions were absorbed into the department's budget.

Additional information on Fire and Medical grants is included in the grant section of this report.

The FY17/18 proposed budget includes reducing \$1.4 million from the general fund budget. These reductions include:

- moving support staff to the leave pool to reduce overtime costs
- civilianization of 1 FTE
- decreased special assignments/projects
- reducing non-operations overtime
- various adjustments to commodities and other services

Municipal Court

The proposed budget for the Municipal Court is consistent with the FY16/17 budget. This year, the Arizona Supreme Court's FARE (Fine and Restitution Enforcement) Program will be implemented to assist in the collection of older accounts, bringing additional revenue to the City. Demand for specialty court services including Veteran's Court, Homeless cases, and the Rule 11 Court has been increasing and provides great service for the community.

Police

During FY16/17, 3 FTEs were added. These positions are funded through a Records Management Grant.

The Police department receives miscellaneous revenue from many resources; donations, seizures, range fees, grants etc. As new resources are identified during the year, the department budget is modified to create budget capacity to use the funds.

Information on Police grants is included in the grant section of this report.

The FY17/18 proposed budget includes reducing \$3.5 million from the general fund budget. These reductions include:

- civilianization of 15 sworn positions
- reduction in task force involvement (4 sworn positions)
- eliminating 2 vacant sworn positions
- eliminating 6 vacant civilian positions
- privatizing jail services

Utility Departments

Energy Resources

In FY17/18, Energy Resources forecasts modest customer growth for Natural Gas and Electric customers. The commodity cost for natural gas which is a pass-through cost to the customer is budgeted approximately \$2.3 million more than it was in FY16/17. Since that budget was passed, natural gas prices have been slowly but steadily increasing, causing the year-end estimate in FY16/17 to be almost \$1.3 million more than the adopted budget. This trend in higher prices is increasing the budget for FY17/18. The commodity cost for electric which is also a pass-through cost to the customer is budgeted approximately \$2.2 million less for FY17/18 than was budgeted in FY16/17. The main reason for the budget reduction is due to the new contracts that were agreed upon mid-way through FY16/17. These new electric contracts lower the cost to the City, which in turn lowers the cost to its residents.

Through greater budget efficiency, Energy Resources reduced the scheduled fixed rate adjustments from \$1.50 to \$1.25 per month for natural gas customers and from \$1.00 to \$0.75 per month for electric customers.

Energy Resources also reduced or absorbed almost \$300,000 within its FY17/18 budget without any change in the department's performance. For example, innovative programs such as the solar incentive program for Mesa residents were continued or expanded.

Environmental Management and Sustainability

For FY17/18, Environmental Management and Sustainability will see a decrease in budget needed for purchasing vehicles compared to FY16/17. The department has been working closely with the Fleet Services Department and the Performance Excellence team with the Office of management and Budget on the timing of the replacements and purchases of additional vehicles. The estimated savings is \$950,000 for the Enterprise Fund.

Due to an increase in customers over the last few years, the department had been covering the increased workload with overtime and using savings from other areas of the budget. In FY16/17, these budget resources were converted to five new operator positions. The conversion will reduce costs and increase safety. The budget for tipping fees in the Enterprise Fund is increasing \$575,000 due to customer growth and contractual rate adjustments at the landfills. Environmental Management and Sustainability will receive a \$157,500 intergovernmental agreement (IGA) from Phoenix and Tempe to create marketing material and trainings for the program: Water Use it Wisely.

Water Resources

The FY17/18 proposed budget includes changes in the cost of power, chemicals, water purchases, the city's participation in joint ventures with other municipalities,

and the start of operations and maintenance at the Signal Butte Water Treatment Plant. The cost for water commodity purchases is anticipated to increase by \$1.2 million and the cost for power and chemicals is expected to decrease by \$0.3 million due to lower prices than FY16/17 adopted budget or \$0.8 million less than prior forecasts of FY17/18. The city participates in joint ventures with other municipalities to provide water and wastewater services. The city's participation cost is expected to decrease by \$0.5 million in FY17/18.

The start of operations and maintenance of the Signal Butte Water Treatment Plant is responsible for the largest increase in the Department's budget totaling \$3.4 million in FY17/18. More information on the Signal Butte Water Treatment Plant can be found in the city's Capital Improvement Plan.

Other Departments

Arts & Culture

The Mesa Arts Center schedules shows and events prior to the time of the event. The budget provides an estimate of the expenses and related revenues. The level of Performing Live expenses and associated revenues can vary from year to year based on the number and size of shows that are scheduled. FY17/18 budget is \$300,000 higher in the Performing Live area than it was in FY16/17.

During FY16/17, 5.2 FTEs were added. One FTE is funded through a contribution from the Virginia G. Piper Charitable Trust, the others are funded through the conversion of temporary services budget and increased revenue generated from having the capacity to assist additional patrons.

The FY17/18 budget proposes reducing \$360,000 from their general fund subsidy amount. These reductions will include increased revenues and reductions in programs. Increased revenues include:

- increased rental rates for MAC
- expanded hours for the i.d.e.a. museum
- additional revenues from event services
- increased services fees
- reduction in discounts and free assistance offered to Resident Companies at the MAC.

Reductions include:

- reducing administrative and operational costs
- aggressive sponsorship solicitation for festival costs
- reduction of 0.5 FTE.

Business Services

For FY17/18, Business Services proposed budget includes eliminating 1 FTE for a Mail Services Supervisor. The responsibilities of the position will be covered through a reallocation of 2 positions allocated to the Print Shop. Estimated

savings will be \$33,000 for the General Fund and \$34,000 for Print Shop Internal Services Fund. Other reductions included are in on-going savings for the warehouse for print service charges for \$56,000 for the Warehouse.

A one-time addition of \$30,000 for the Customer Web Access (CWA) system replacement is included. The additional budget will cover the enhancements needed for the system replacement. The funding is from the Enterprise Fund.

In January 2018, Business Services will implement a credit card service fee. Currently the City pays the fees associated with citizens using credits cards for utility bills, but the new process will pass the handling of this to a 3rd party contract. This will reduce expenses \$0.6 million in FY17/18 and \$1.2 million annually thereafter. Most of the savings will occur in the Enterprise Fund as the majority of credit card transactions are related to the payment of utility bills.

City Attorney

The City Attorney's Office oversees the Property and Public Liability (PPL) Fund. The City uses the PPL Fund to pay third party liability claims; to pay the administrative costs for the litigation team; and to purchase insurance coverage to protect the City against major losses. The estimated claims paid for FY16/17 will be approximately \$2.7 million, which is \$1.3 million below the FY16/17 budgeted amount. Estimated claims in FY17/18 are expected to be \$4.0 million, consistent with the budgeted amount for FY16/17. The PPL insurance premiums are expected to increase 2.5% in FY17/18 due to national and local factors that affect municipal liability insurance. Pending high profile claims payouts are expected to occur in FY17/18 and/or FY18/19, but it is difficult to estimate when or if payouts may occur.

In FY17/18, the City Attorney's Office will reduce its Outside Legal Services budget by \$100k to \$250k as a part of citywide cost saving efforts.

City Auditor

The FY17/18 proposed budget is consistent with the FY16/17 budget.

City Clerk

The budget for City Clerk's Office is adjusted each year for the cost of possible elections. FY16/17 included a \$442,000 adjustment for estimated election costs. There are not any planned elections in FY17/18 and therefore no election costs are included in the FY17/18 budget.

City Manager

During FY16/17, 1 FTE was transferred from Development and Sustainability Department to the City Manager's Office, resulting in an increase in the FY17/18 budget. Otherwise, the proposed budget is consistent with the FY16/17 budget.

Community Services

Community Services oversees the City's Housing, Neighborhood Outreach, Animal Control, and Diversity initiatives. Community Services receives funding from both the General Fund and various grants. The Housing and Community Development Division's FY17/18 grant budget is projected to be \$19.5 million for new grants (31.1 million with carryover of existing grants) for grants supporting Housing Services and Community Planning and Development. As part of the citywide cost reduction efforts, the Community Services Department is moving a position from the General Fund to a grant fund.

Development Services

Over the last several years, increasing development activity has required the department to utilize temporary services to complete the additional workload and meet customer expectations resulting in the department's need for contingency funds. The increased development activity levels resulted in revenues above projections and covered the cost for the additional temporary services. The FY17/18 budget includes an increase in the estimated expenditures and revenues to address the anticipated continued higher level of development activity. The department tracks workload on a daily basis and makes adjustments in the use of temporary workers based on demand.

The project to replace the aging permitting system continued through FY16/17 and is expected to be online in FY17/18. The existing permitting system was obsolete and minimally supported by the vendor. Replacing the system will result in savings to the City and to the development community by reducing printing costs and increasing productivity of professionals responsible for preparing, submitting, and correcting development plans. The system is mainly funded through the technology fee which is charged on each permit and service charge in Development Services and is restricted for use on technology maintenance and improvements. Two Building Plans Examiner (one of which is being converted from part time), One Planner, One Building Inspector, and One Administrative Support Assistant are included in the proposed budget and funded with the revenues from the increased activity.

Economic Development

The FY17/18 proposed budget includes a reduction of \$50,000 from other services and consulting. Economic Development is continuing with the expansion of the Redevelopment Area (RDA) to the east and west from the current RDA area to include the light rail line. The cost for all three areas is included in the FY16/17 budget and will be carried over to be completed in FY17/18.

Engineering

Much of the Engineering Department is funded through the capital improvement program (CIP) through both direct and indirect support. The FY17/18 proposed budget includes the elimination of one full-time position that has been vacant for

several years. It also includes the conversion of one position from being fully funded by the general fund, to being partially funded with the Falcon Field Fund. Engineering will be taking over the lease duties that Falcon Field personnel currently performs.

Falcon Field

The FY17/18 proposed operational budget is consistent with the FY16/17 budget. In FY 17/18 the airport will fund half of the cost of a Real Estate (Engineering) position to assist with the airport's ground lease management. Included in the CIP is the completion of the Falcon Field master plan update which provides direction for future development of the airport.

The Falcon Field Fund is financially self-sustaining. All revenues are reinvested back into the airport.

Financial Services

FY17/18 proposed budget includes reductions of \$162,678 in non-personnel areas. This reduction will not impact their daily operations.

Fleet Services

The Fleet Services Department is funded through the Fleet Internal Services Fund. This is an internal service fund established to account for financing, on a cost reimbursement basis, of commodities or services provided by one program for the benefit of other programs within the City.

The Office of Management and Budget's Performance Excellence team has developed an analytical model using a vehicle's cost history to determine when to replace instead of repair a vehicle. The model's output is combined with information from the Customer Department and Fleet Services repair data, including information about the vehicle's configuration, safety, and availability. Fleet Services provides information about the vehicle's replacement cost, the cost of anticipated major repairs, and parts availability. Taken together, the decision to replace a vehicle has become more transparent and cost effective.

Human Resources

For the Employee Benefits Trust Fund, FY16/17 claims are projected to be \$72.1 million. FY 17/18 claims costs are expected to rise to \$78.0 million due to several factors including a nationwide medical and prescription drug trend increases, increased health care reform related, fees, taxes and plan design compliance changes that have introduced new cost factors or shifted cost share from members to the City, and an increase in amount and severity of catastrophic claims.

The FY17/18 budget for the Workers Compensation Trust Fund includes an increase in claims of \$336k to \$4.5 million due to increasing health care costs. As

a part of Citywide cost reduction efforts, the Safety Services team will continue to evaluate measures that can be taken to reduce claims and increase workers' safety.

A detailed update on the Employee Benefits and Workers Compensation Trust Funds was given to the Self-Insurance Trust Fund Board on February 13, 2017.

Information Technology

The proposed budget includes a reduction of 4 vacant positions (3.5 FTEs). The positions are: Management Assistant II, Assistant Chief Information Officer, Office Assistant II, and part-time Student COE. The department is continuing the work of relocating the City's data center to an AT&T Data Center located within Mesa. The existing location is an aging building that does not have redundant electric power and has the potential for extensive outages. Funds originally allocated for repairs/upgrades to the existing building have been reallocated to the relocation. The project will take two years for completion, requiring the purchase and set up of new equipment before operations can commence. The estimated cost is approximately \$1.4 million. A minimal presence will remain at the existing location for purposes of connectivity.

Library

The FY17/18 proposed budget is consistent with the FY16/17 budget.

Design work is wrapping up on THINKspot 2.0 at the Main Library. Programming will be based on learning-focused activities that directly support the Council's "What Works Cities" desired outcome of increasing educational attainment and the efforts of the Mayor's "Early Childhood Learning Task Force" to ensure Mesa's children arrive at kindergarten ready and able to learn.

The goal of both THINKspot sites is to continue to support Mesa's residents and children pre-k through university age.

Mayor and Council

In FY16/17, personal service costs will decrease due to changes in the Elected Officials pension system. Newly elected officials no longer contribute to the pension system. Otherwise, the FY17/18 budget is consistent with the FY16/17 budget.

Office of ERP Management

The FY17/18 proposed budget is consistent with the FY16/17 budget, but with a reduction of \$26k in expenses as a part of citywide cost reduction efforts.

Office of Management and Budget

The FY17/18 proposed budget is consistent with the FY16/17 budget, but with a reduction of \$78k in expenses as a part of citywide cost reduction efforts.

Parks, Recreation and Community Facilities

For FY17/18 proposed budget includes various reductions across the department's budget. The reductions are in unscheduled work, repair, and supplement contractual services for Facilities Maintenance and materials, supplies, and equipment for Red Mountain, Riverview, adult sports and others services for Parks and Recreation. Estimated savings from the reductions are \$780,000.

Due to Prop 206, the minimum wage increase passed by voters, the department is experiencing an increase in contractual costs for custodial and landscaping work. An on-going increase of \$470,000 to cover these pressures is included in the proposed budget. Other on-going enhancements are \$10,000 for marketing within the Mesa Public School district, \$95,000 for preventative maintenance of C-Cure, part of the city door security system, and \$8,500 additional budget for personal services to monitor the volleyball courts to retrieve lost revenue and oversee scheduling at Gene Autry. The additional revenue received by the volleyball courts will cover the cost of the additional personal services.

Public Information and Communication

The FY17/18 proposed budget is consistent with the FY16/17 budget, but with a reduction of \$37k in expenses as a part of citywide cost reduction efforts.

Transit

The Transit Services budget is largely determined by contracts with the Regional Public Transportation Authority (RPTA) and Metro Light Rail for bus, paratransit, and light rail operations. Light rail construction to extend the line to Mesa Drive completed in August 2015. The capital improvement program includes work pertaining to the extension of the light rail line to Gilbert Road. Operational funding for this extension is not needed in FY17/18, however it is included in the multi-year forecast.

The costs of services in FY17/18 are increasing. The FY17/18 proposed budget is \$2.0 million higher than the FY16/17 adopted budget mainly due to costs mandated by the RPTA including the addition of two off-duty uniformed officers to patrol Mesa's light rail stations, and backfilling fare revenues that have come under projected expectations.

Transportation

The FY17/18 proposed budget is consistent with the FY16/17 budget. The proposed budget includes the purchase of a new street sweeper specifically designed for pavement patching operations. Use of a standard street sweeper causes undue wear and tear and shortens the useful life. The funding is provided from a matching grant from the Maricopa Association of Governments, with the city's portion of the match provided from the environmental compliance fee.