
CITY COUNCIL REPORT

TO: Mayor and City Council

FROM: David Kriotor, Chair
2015 Expenditure Limit Task Force

SUBJECT: RECOMMENDED BALLOT PROPOSITION FOR FALL 2015 ELECTION

The 2015 Expenditure Limit Task Force recommends a Local Alternative Spending Limit (also known as a Home Rule Option) be presented to voters on the August 25, 2015 ballot. This recommended Home Rule Option would ask Phoenix voters to continue setting the annual spending limit equal to the annual budget. This alternative has been in place for 16 years. This would allow Phoenix residents to continue to control local expenditures through the annual budget process, rather than default to a state-imposed formula.

Members of the 2015 Expenditure Limit Task Force included: Chairman David Kriotor, CEO of Downtown Phoenix, Inc.; Kerwin Brown, President and CEO of the Greater Phoenix Black Chamber of Commerce; Leezie Kim, Vice President and General Counsel of Fox Restaurant Concepts; Jennifer Mellor, Vice President of Program Development of the Greater Phoenix Chamber of Commerce; and Armando G. Roman, Managing Principal of Axiom Financial Advisory Group, LLC. The recommended ballot language approved by the Task Force is provided in Attachment A and additional information is also attached. This report provides brief information on the process and deliberations resulting in this recommendation.

THE ISSUE

The City of Phoenix, like most Arizona cities and towns, has had an alternative expenditure limit in place for many years. This limit, most recently approved by voters in 2011, allows the City to locally control expenditures by deciding what programs, services and facilities will be provided in the community through the annual budget process. Without this alternative expenditure limit, services would be controlled by a formula that limits annual spending to 1979-80 levels, adjusted only for population and national inflation.

Phoenix residents have approved eight Home Rule Options since 1981. The current Home Rule Option provides for the Mayor and Council to set the limit at the adopted budget following budget hearings throughout the City and in each Council district. This Home Rule expires on June 30, 2016. On November 19, 2014, the Mayor and Council appointed the 2015 Expenditure Limit Task Force to study the provisions of the constitutional spending limit and to make a recommendation on a future approach to an alternative expenditure limit.

The consequence of not establishing some form of an alternative expenditure limit would require the City to drastically cut services and potentially incur the cost of issuing new debt.

Additional background information on the State Expenditure Limit is included in Attachment B.

TASK FORCE PROCESS

During a series of four public meetings, the Task Force reviewed and discussed the history of the Arizona Expenditure Limitation, previous spending limits for the City of Phoenix and expenditure and service demand forecasts for all major City funds. The Task Force also reviewed information on factors affecting expenditures since 1979-80 (Attachment C), other forms of modifying the limit, and a comparison of the Phoenix limit per capita to other Arizona cities and towns (Attachment D).

The forecasts assume moderate economic growth over the next several years, with no further period of recession. The analysis indicates that in 2016-17 the City's financial forecast for services to City residents will exceed the spending limit formula by over \$900 million. Conservatively, that gap will be approximately \$1.0 billion by 2019-20. These amounts are based on existing revenue sources and do not assume any new revenue sources, restoration of recently reduced or eliminated services or the addition of new City services.

The review by the Task Force of the factors impacting expenditures since 1979-80 identifies voter-approved enhancements for programs such as police, fire, transit and parks and preserves that are clearly desired by the community but that are not incorporated into the formula. Also evident is the impact of environmental and other mandates and regional services such as airports that are fully funded from airline and passenger fees having grown disproportionately faster than the state formula supports. Finally, Phoenix's limit per capita is one of the lowest of all Arizona cities and towns with populations of more than 100,000 yet the City provides many essential programs and services that benefit other communities in the region and state.

A permanent base adjustment was reviewed as an option to the Home Rule. Though there was some consideration and discussion, there are concerns with the permanent base adjustment. One reason is the permanent change would not be truly permanent because, similar to the original limit, it would only grow by inflation and population and not other factors. Another reason is that the periodic review and reconsideration by the community and tie to the annual, public budget process is lost with such an approach. Also, as demonstrated by the Great Recession, the City's revenue is difficult to predict decades into the future, making it more difficult to estimate the base amount.

After reviewing the issues related to the state-mandated spending limit and its potential impact on the City of Phoenix, the 2015 Expenditure Limit Task Force supported the current four-year alternative limit, which sets the annual limit equal to the annual budget and requires the Mayor and Council to continue to review the budget in public hearings before adoption. The budget, and therefore the expenditure limit, would be constrained to the resources available and approved through the annual process. The Task Force

agreed this is the most appropriate form of local alternative expenditure limitation for the City of Phoenix today.

Home Rule Options are utilized by 52 cities throughout the state. In all, 76 of 91 cities and towns throughout the state were reported by the League of Arizona Cities and Towns to have some type of modification of the state-imposed expenditure limits to meet community needs.

Continuing the current Home Rule Option recognizes the City's long-standing practice of seeking and providing opportunities for resident comment on an annual basis through hearings and other means of City input. This also allows residents and their locally elected representatives to decide what services will be provided. This commitment to transparency and involvement of the community in decision making by the City of Phoenix is further demonstrated by the formation of this Citizens' Task Force. State law does not require such an approach to develop and place an alternative expenditure limit before the voters.

RECOMMENDATION

The 2015 Expenditure Limit Task Force recommends referral to the August 25, 2015 ballot of a local alternative expenditure limitation that sets the limit equal to the budget after the Mayor and Council have publicly reviewed the budget. This limit will be in effect for four fiscal years beginning in 2016-17 through 2019-20. This limit recognizes:

- The Mayor and City Council, after receiving input from residents, will have the ability to spend already available funds for services such as police, fire, parks and recreation, libraries, neighborhood services, recycling, a safe and adequate water supply, and a modern, convenient airport that are deemed important by the local community.
- A locally established expenditure limit allows the City to implement previous voter-approved mandates for enhanced services such as improved public safety, improved transit services and the expansion of parks and desert preserves.
- The City of Phoenix has a proven track record of making needed reductions to balance its annual budget relying upon its long-established open budget process with many opportunities for residents to communicate their budget priorities to the Mayor, City Council and City Management.
- Unlike seeking a permanent adjustment to the base limit, this local alternative limit will continue the process of review and voter approval on a four-year cycle.

This recommended alternative limit will allow Phoenix residents and their locally elected representatives to continue to locally control expenditures to achieve the community's priorities.

With the Mayor and Council's approval, staff will prepare the necessary items to place this local alternative expenditure limitation on the August 25, 2015 ballot.

Also requested is authorization for the City Manager to set the dates of two public hearings required prior to placing a Local Alternative Expenditure Limitation on the August 25, 2015 ballot. The two hearings would be set at the following dates and times:

1. Wednesday, March 18, 2015 at 3:00 p.m.
2. Wednesday, March 25, 2015 at 3:00 p.m.

Immediately following the second public hearing on March 25, 2015, the Council will convene in a special session to consider adoption of the proposition for the ballot.

Attached to this report are copies of the ballot and publicity pamphlet language recommended by the Task Force (Attachment A). Final City Council adoption of the ballot language recommended by the Task Force is scheduled for April 22, 2015 after the two legally required public hearings.

ATTACHMENT A

2015

BALLOT PROPOSITION

PROPOSITION NUMBER XXX

OFFICIAL TITLE: Resolution No. XXX

A RESOLUTION OF THE COUNCIL OF THE CITY OF PHOENIX PROPOSING THE CONTINUANCE OF A LOCALLY CONTROLLED ALTERNATIVE EXPENDITURE LIMITATION. THIS ALTERNATIVE EXPENDITURE LIMITATION WOULD SET THE LIMIT EQUAL TO THE BUDGET ADOPTED BY THE CITY COUNCIL.

Descriptive Title

Article IX, Section 20 (9) of the Arizona Constitution allows the voters to extend the locally controlled alternative expenditure limitation for the City of Phoenix, continuing it for the next four years. This alternative expenditure limitation has been in place since fiscal year 2000-01. If approved, it would keep the City of Phoenix's expenditure limitation equal to the amount of the budget adopted by the City Council. Annually, the Mayor and City Council will adopt a budget after public hearings for each Council district. Constitutional and previously authorized voter exclusions shall continue to apply. If the alternative expenditure limitation, which is currently in effect for the City of Phoenix, is not extended, the state-imposed expenditure limitation will go into effect.

Effect

A "Yes" vote shall have the effect of continuing local control by allowing the Mayor and City Council, by a majority vote, and after public meetings and hearings to establish a local expenditure limitation.

A "No" vote shall have the effect of the city operating under the state imposed expenditure limitation formula based on 1979-80 expenditures adjusted for inflation and population. This will result in an estimated \$917 million reduction in the fiscal year 2016-17 budgeted expenditures and reductions in or eliminations across all City services.

Question

Shall the Alternative Expenditure Limitation set forth in Phoenix City Council Resolution No. XXX be adopted as part of the local expenditure control program of the City of Phoenix?

YES NO

2015

PUBLICITY PAMPHLET

OFFICIAL TITLE: Resolution No. XXX

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Question

Shall the Alternative Expenditure Limitation set forth in Phoenix City Council Resolution No. XXX be adopted as part of the local expenditure control program of the City of Phoenix?

YES NO

LANGUAGE FOR COUNCIL RESOLUTION – BALLOT REFERRAL

The Mayor and City Council of the City of Phoenix shall annually, as part of the annual budget process, adopt an expenditure limitation to govern the City of Phoenix budget for the fiscal year immediately following such adoption. The expenditure limitation shall be adopted each year after a series of hearings for each City Council district, at which the residents of the City of Phoenix may comment on the proposed spending plan. This continues previously adopted locally controlled alternative expenditure limitations approved in 1981, 1985, 1991, 1995, 1999, 2003, 2007 and 2011. No expenditures may be made in excess of such budget, nor may expenditures exceed available revenues. Constitutional and previously authorized voter exclusions shall continue to apply.

Applicability. In accordance with the provisions of Article IX, Section 20, Arizona Constitution, this locally controlled expenditure limit shall be effective for only the following four fiscal years: 2016-17, 2017-18, 2018-19, and 2019-20.

SUMMARY ANALYSIS

City of Phoenix, Arizona Locally Controlled Alternative Expenditure Limitation

The voters of Phoenix have previously approved locally controlled alternative expenditure limitations in 1981, 1985, 1991, 1995, 1999, 2003, 2007 and 2011. The purpose of this election is for the continued use of a locally controlled alternative expenditure limitation.

Pursuant to the Arizona Constitution, the City of Phoenix will seek voter approval to continue a Locally Controlled Alternative Expenditure Limitation for the next four fiscal years, beginning in 2016-17. Any and all dollar figures presented in the following summary are estimates only and are based on the best information available at the time of the analysis.

Under a locally controlled alternative expenditure limitation, if approved by the voters, the City estimates it will be allowed to expend the following approximate amounts (in thousands): \$3,661,761 in 2016-17, \$3,759,806 in 2017-18, \$3,896,098 in 2018-19, and \$4,061,503 in 2019-20.

The amount of revenue estimated to be available to fund the operation of your City government (in thousands) is \$3,661,761 in 2016-17, \$3,759,806 in 2017-18, \$3,896,098 in 2018-19, and \$4,061,503 in 2019-20. Revenue received from federal, state, and local sources will continue to fund the increased expenditure authority associated with the Locally Controlled Alternative Expenditure Limitation Plan. Expenditures will not exceed revenue. The revenue estimates are the same under the locally controlled alternative expenditure limitation and the State limitation. The City property tax levy shall remain limited to the amount prescribed by the Arizona State Constitution.

With voter approval, the City of Phoenix will utilize additional expenditure authority under this plan for all local budgetary purposes, including criminal justice, public safety, transportation, community development, community enrichment, environmental services, capital improvements, debt service, and general government. This additional expenditure authority shall be in effect only for fiscal years 2016-17, 2017-18, 2018-19, and 2019-20.

Under the State-imposed limitation, after considering the constitutionally allowed exclusions, the City estimates it will be allowed to expend the following approximate amounts (in thousands): \$2,745,078 in 2016-17, \$2,847,230 in 2017-18, \$2,941,951 in 2018-19, and \$3,060,239 in 2019-20 for the operation of your local government. If no alternative expenditure limitation is approved, the state-imposed expenditure limitation will apply to the City of Phoenix. This would result in a combination of service cuts and new debt estimated at (in thousands): \$916,683 in 2016-17, \$912,576 in 2017-18, \$954,147 in 2018-19 and \$1,001,264 in 2019-20.

All dollar figures presented in this summary are estimates only and are based on the best information available at the time of the analysis. The budget and actual expenditures in any of the four years may be more or less than the expenditures noted above depending on available revenue.

ATTACHMENT B

BACKGROUND INFORMATION ON THE STATE EXPENDITURE LIMIT

1. What is the State expenditure limit?

It is a State Constitutional limit approved by voters in 1980 which restricts annual spending limits of cities and towns. The limit applies to all local revenues.

- Limits spending to 1979-80 levels adjusted for:
 - Population; including annexations
 - Inflation; gross domestic product and inflation price deflator
 - Population and inflation factors are provided by the State
- Exempts certain expenditures:
 - Federal funds
 - Bond proceeds
 - Debt service
 - Arizona Highway User Revenue (AHUR)
 - Local Transportation Assistance (LTA)
 - Other jurisdictions' contributions (e.g. the Sub-Regional Operating Group for the 91st Avenue wastewater treatment plant)

2. What happens if we exceed the spending limitation?

The State will withhold state-shared income tax revenues in a formula-based amount set by statute. For Phoenix, this would result in the General Fund losing about \$58 million per year which would be redistributed to all other cities and towns in Arizona.

3. What options do cities have to change the limits?

There are four methods for obtaining approval to change the limits.

Alternative Expenditure Limitation (Home Rule Option)

- Only in effect for four years, then must be reapproved by voters.
- Any and all expenditures can be exempted from the limit.
- Must be voted on in the year preceding the first fiscal year to which the alternative expenditure limit will apply.
- Can only be voted on at a regularly scheduled election of the local governing board (city council).
- If the voters do not approve the alternative expenditure limitation, the city must wait two years before putting it on the ballot again.

Permanent Base Adjustment

- Permanently increases the base from which future spending limits are calculated.
- Does not provide for any increase in exemptions other than those constitutionally allowed.
- Can only be voted on at a regularly scheduled election of the local governing board (city council).

One-Time Override

- Applies in the following circumstances:
 - In the event of a natural or man-made disaster and approval by council – may exceed limit for expenditures directly necessitated by the disaster.
 - Upon affirmative vote of two-thirds of the council and approval by a majority of voters – may exceed limit by the specific amount approved.
- Can be voted on at either a regular or special election.
- Only good for the following fiscal year.

Capital Accumulation Exclusion

- Authorizes a permanent exclusion of a fixed level of operating funds for pay-as-you-go capital. Limited exclusions for Aviation, Water, Wastewater and Streets were authorized in 1981.

4. Can Phoenix go to another approach besides the Home Rule Option?

Phoenix could go to a permanent base adjustment. Concerns identified through prior citizen discussions include:

- This approach does not require periodic review by a citizens' group.
- A permanent base adjustment may not be truly permanent. Each year the expenditure limit will be calculated based on inflation and local population. At some point, it is possible that expenditures would again exceed the limit. All spending is subject to pressures not addressed by population and inflation factors such as environmental mandates and regional issues. This is especially true of Enterprise Departments, particularly the airport. Additionally, the ability to improve services in accordance with regional economic conditions and residents' wishes would be limited.
- Phoenix' previous attempts at permanent base adjustments have all failed. Permanent base adjustments for replacement of Federal Transit Assistance and Federal Revenue Sharing funds were defeated in 1985. A permanent base adjustment for transit expenditures was defeated in 1997.

ATTACHMENT C

FACTORS AFFECTING EXPENDITURES SINCE 1979-80 NOT ACCOUNTED FOR BY POPULATION AND INFLATION ONLY

The list below identifies several examples of changes experienced by the City of Phoenix since 1979-80. These changes are the result of many factors that are not accounted for in the state-imposed formulaic spending limit. The factors generally include growth in regional services provided to residents outside Phoenix boundaries, environmental mandates, additional security requirements, and additional services adopted by Phoenix voters and City Council including public safety, parks and preserves, transit, and improved infrastructure.

- Many of our services and facilities are regional and serve more than just Phoenix residents. As an example, there were 6.5 million airport passengers in 1979-80 but 45.0 million are projected for 2019-20, which greatly exceeds the rate of Phoenix population increase over that period.
- The airport has experienced significant facility expansion including the opening of new Terminals 3 (1980) and 4 (1990). Terminal 4 was further expanded in 2004 and 2005 including a new 14-gate concourse, additional parking facilities and a third runway as a result of growth. The consolidated Rental Car Center opened in 2005-06 and the first segment and second segments of the PHX Sky Train opened in 2013 and 2014.
- A new passenger facility charge allows more cost-effective pay-as-you-go financing rather than the use of debt for airport projects such as taxiway and runway improvements, PHX Sky Train design and implementation, voluntary land acquisition and noise mitigation efforts (first PFC program was in 1996).
- Many City facilities, including the airport and water facilities, have experienced significant increases in security costs since 9/11.
- Water and Wastewater have experienced increased capital improvement costs for aging and deteriorating infrastructure. Using pay-as-you-go financing, rather than debt, for some of these projects has kept overall costs to ratepayers down.
- Water and Wastewater's costs for electricity and chemical costs are impacted by usage, source, quality of water and regulatory demands.
- Infrastructure must expand ahead of growth to be sure services are available when needed.
- Solid Waste has added citywide recycling (1998), improvements to uncontained trash pick-up, two recycling facilities (1998 and 2007), the SR85 landfill (2006), and two transfer stations (1995 and 2006) have been added.
- Environmental mandates such as the Clean Water Act (1987), the National Pollution Discharge Elimination System (2000), the Safe Drinking Water Act

(1992), the Groundwater Management Act (2006), the Clean Air Act (1998), the Federal Solid Waste Disposal Act and Wastewater Reuse Regulation have all increased costs.

- The Phoenix Convention Center was expanded in the early 1980s and again in 2009 benefiting the entire region. The Herberger and Orpheum Theatres were added in the 1990s.
- Voters approved a new Transit tax in 2000 mandating additional services including new routes, route extensions, additional hours of operation, weekend and holiday service and enhancements to dial-a-ride.
- Operating costs associated with Light Rail began in December 2008.
- Voters approved a new Parks and Preserves Initiative tax in 1999 and reauthorized the tax for a 30-year period in 2008 mandating improved and expanded parks and open space.
- The Fire Department began providing ambulance service in 1985.
- Previously exempt Federal Revenue Sharing Funds and Federal Transit Assistance Funds were replaced with an increase in the sales tax that is subject to the limit in the mid-80s.
- Voters passed the Public Safety Enhancement tax (2005) on utilities with franchise agreements and increased sales tax for Public Safety Expansion (2007) to be used to hire and support Police and Fire.
- Funding from the telecommunications industry (1998) now exists to repay residents for use of the right-of-way.
- New Sports Facilities funding (1989) pays for arena and other sports-related costs.

ATTACHMENT D

Expenditure Limit Comparison by City Cities over 100,000 in Population

City	Population		FY 1979/80		Final FY 2014/15 Expenditure Limitation	1979/80 Limitation per Resident	2014/15 Limitation per Resident
	2013	1978	Base Limit				
Surprise	121,629	3,550	\$ 9,500,000	\$ 919,730,229	\$ 2,676	\$ 7,562	
Peoria	160,552	10,500	18,247,857	788,435,848	1,738	4,911	
Glendale	231,109	84,000	67,955,628	528,312,730	809	2,286	
Scottsdale	222,213	83,000	55,861,444	422,602,051	673	1,902	
Tempe	165,158	102,000	65,579,379	300,050,818	643	1,817	
Gilbert	227,603	4,250	2,346,450	355,081,813	552	1,560	
Tucson	525,154	311,400	138,097,586	658,085,359	443	1,253	
Mesa	450,310	130,000	54,090,640	529,442,050	416	1,176	
Phoenix	1,485,751	717,000	229,200,625	1,342,056,332	320	903	
Chandler	246,197	23,500	7,245,951	214,505,464	308	871	
			Average		\$ 858	\$ 2,424	