



Agenda

City Council Policy Session

Tuesday, February 21, 2023

2:30 PM

phoenix.gov

OPTIONS TO ACCESS THIS MEETING

Virtual Request to speak at a meeting:

- **Register online** by visiting the City Council Meetings page on phoenix.gov at least 2 hours prior to the start of this meeting. Then, click on this link at the time of the meeting and join the Webex to speak: <https://phoenixcitycouncil.webex.com/phoenixcitycouncil/onstage/g.php?MTID=e767b37e2ceb3e0624f114197fb6797bd>

- **Register via telephone** at 602-262-6001 at least 2 hours prior to the start of this meeting, noting the item number. Then, use the Call-in phone number and Meeting ID listed below at the time of the meeting to call-in and speak.

In-Person Requests to speak at a meeting:

- Register in person at a kiosk located at the City Council Chambers, 200 W. Jefferson St., Phoenix, Arizona, 85003. Arrive 1 hour prior to the start of this meeting. Depending on seating availability, residents will attend and speak from the Upper Chambers, Lower Chambers or City Hall location.

- Individuals should arrive early, 1 hour prior to the start of the meeting to submit an in-person request to speak before the item is called. After the item is called, requests to speak for that item will not be accepted.

At the time of the meeting:

- **Watch** the meeting live streamed on phoenix.gov or Phoenix Channel 11 on Cox Cable, or using the Webex link provided above.

- **Call-in** to listen to the meeting. Dial 602-666-0783 and Enter Meeting ID 2556 368 2110# (for English) or 2556 355 3390# (for Spanish). Press # again when prompted for attendee ID.

- **Watch** the meeting in-person from the Upper Chambers, Lower Chambers or City Hall depending on seating availability.

Para nuestros residentes de habla hispana:

- **Para registrarse para hablar en español**, llame al 602-262-6001 **al menos 2 horas antes del inicio de esta reunión** e indique el número del tema. El día de la reunión, llame al 602-666-0783 e ingrese el número de identificación de la reunión 2556 355 3390#. El intérprete le indicará cuando sea su turno de hablar.

- **Para solamente escuchar la reunión en español**, llame a este mismo número el día de la reunión (602-666-0783; ingrese el número de identificación de la reunión 2556 355 3390#). Se proporciona interpretación simultánea para nuestros residentes durante todas las reuniones.

- **Para asistir a la reunión en persona**, vaya a las Cámaras del Concejo Municipal de Phoenix ubicadas en 200 W. Jefferson Street, Phoenix, AZ 85003. Llegue 1 hora antes del comienzo de la reunión. Si desea hablar, regístrese electrónicamente en uno de los quioscos, antes de que comience el tema. Una vez que se comience a discutir el tema, no se aceptarán nuevas solicitudes para hablar. Dependiendo de cuantos asientos haya disponibles, usted podría ser sentado en la parte superior de las cámaras, en el piso de abajo de las cámaras, o en el edificio municipal.

CALL TO ORDER**COUNCIL INFORMATION AND FOLLOW-UP REQUESTS**

This item is scheduled to give City Council members an opportunity to publicly request information or follow up on issues of interest to the community. If the information is available, staff will immediately provide it to the City Council member. No decisions will be made or action taken.

CONSENT ACTION

This item is scheduled to allow the City Council to act on the Mayor's recommendations on the Consent Agenda. There is no Consent Agenda for this meeting.

CALL FOR AN EXECUTIVE SESSION

A vote may be held to call an Executive Session for a future date.

REPORTS AND BUDGET UPDATES BY THE CITY MANAGER

This item is scheduled to allow the City Manager to provide brief informational reports on topics of interest to the City Council. The City Council may discuss these reports but no action will be taken.

INFORMATION AND DISCUSSION (ITEM 1)**1 General Fund 2023-24 Preliminary Budget Status and
Five-Year Forecast**

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This report transmits the preliminary status for the General Fund (GF) Fiscal Year (FY) 2023-24 budget and a five-year GF forecast through FY 2027-28 (**Attachment A**). The five-year forecast is being presented to the Mayor and City Council for the 13th consecutive year and provides an essential tool in long-term budget discussions and decision making.

THIS ITEM IS FOR INFORMATION AND DISCUSSION.

Responsible Department

This item is submitted by City Manager Jeffrey Barton and the Budget and Research Department.

ADJOURN



General Fund 2023-24 Preliminary Budget Status and Five-Year Forecast

This report transmits the preliminary status for the General Fund (GF) Fiscal Year (FY) 2023-24 budget and a five-year GF forecast through FY 2027-28 (**Attachment A**). The five-year forecast is being presented to the Mayor and City Council for the 13th consecutive year and provides an essential tool in long-term budget discussions and decision making.

THIS ITEM IS FOR INFORMATION AND DISCUSSION.

Summary

The GF budget outlook for FY 2023-24 reflects a projected surplus of \$134 million, and is good news as we move forward with developing a proposed Trial Budget for next fiscal year. The surplus is a reflection of responsible decision making by the City Council and a strong local and state economy. The projected GF surplus includes an estimated \$69 million in ongoing resources and \$65 million in one-time funds primarily due to: strong revenue growth impacted by high inflation, significant vacancy savings due to the competitive labor market, and the carry-forward of fund balances including unspent contingency reserves as presented in the FY 2021-22 Year-End General Fund Budget Results on Sept. 27. These resources could be used for employee compensation increases and to provide new or expanded programs and services for the community. Staff will be updating revenue and expenditure estimates in the coming weeks, and will bring back revised estimates and recommendations on responsible cost additions using the combination of one-time and ongoing projected resources on March 28 with the City Manager's Trial Budget.

The attached Five-Year Forecast report includes estimates of future GF resources and expenditures for FY 2023-24 through FY 2027-28 based on several economic and budgetary assumptions. The forecast is not intended to precisely predict future GF capacity, but rather to present ranges of potential ending fund balances to be used as a framework for decision making and strategic budget planning.

General Fund 2023-24 Preliminary Status

The preliminary FY 2023-24 GF budget status reflects a surplus of \$134 million, and as mentioned above includes an estimated \$69 million in ongoing and \$65 million in

one-time resources available for spending initiatives. It is important to note significant economic uncertainty and volatility exists for 2023, which makes forecasting revenues very challenging. Additionally, several proposed State legislative bills would negatively impact ongoing revenues if passed and both of these variables present risks to the forecast. More information on economic assumptions and risks to the forecast are detailed in **Attachment A**. This uncertainty calls for a cautious approach to forecasting future revenues and careful consideration of new spending initiatives to ensure that the City can sustain a balanced budget in the future.

The GF preliminary estimated resources in FY 2023-24 are expected to increase 10.1 percent to \$2.015 billion from the FY 2022-23 estimate. GF revenue is estimated to increase 10.2 percent in FY 2023-24 and is largely due to growth from known state shared income tax revenues, which are based on collections from FY 2021-22. The State increased the percentage share of individual and corporate income tax collections with cities and towns from 15 percent to 18 percent effective in FY 2023-24, to offset impacts from reducing the individual income tax rate, causing an increase of 41.4 percent from FY 2022-23. Staff will further refine GF revenue estimates over the coming weeks in preparation for the City Manager's Trial Budget scheduled to be presented to City Council on March 28, and more information on each resource category is detailed in **Attachment A**.

The GF preliminary expenditure projections may change as cost estimates are further refined in the coming weeks; however at this time the preliminary FY 2023-24 GF expenditures to continue existing levels of service are projected to be \$1.881 billion. This compares to the adopted FY 2022-23 GF expenditure budget of \$1.779 billion, or an increase of \$102 million. The increase accounts primarily for higher costs associated with employee salaries and fringe benefits including health insurance and pension, increased costs for vehicle replacements and Fire apparatus, cost increases in capital equipment and expected pay-as-you-go projects, and higher contingency amounts. Inflation has also dramatically impacted several expenditure categories including commodities and contractals such as fuel, compressed natural gas, electricity, motor vehicle parts, plumbing supplies, custodial and security services, machinery and equipment repair, and facility maintenance costs.

For FY 2023-24, the City's combined GF civilian pension plan, the City of Phoenix Employees Retirement System (COPERS), and the City's sworn pension plan the Public Safety Personnel Retirement System (PSPRS), pension costs are expected to increase by approximately \$45 million as compared to the FY 2022-23 budget. PSPRS pension costs account for approximately \$40 million of the total increase, and COPERS pension costs account for \$5 million of the increase. Over the forecast horizon from the current fiscal year through FY 2027-28, total GF employee pension

costs are forecasted to increase \$99 million.

The FY 2023-24 preliminary GF budget includes capital pay-as-you-go projects totaling \$118 million primarily for funding information technology projects, including funds to procure a new time and labor management system and a new Municipal Court case management system. Funding is also earmarked to build a new Fire station located at 19th Avenue and Chandler Boulevard, perform necessary facility maintenance on aging City facilities, allocations for future infrastructure bill projects requiring City matching funds and General Obligation (GO) Bond projects that could require additional funds to complete, if approved by voters in the Nov. 2023 election. Additionally, funding for vehicle replacements has increased from \$25 million to \$33 million in FY 2023-24, to reduce the backlog of GF units currently valued at \$144 million, and will be used primarily to procure critical Fire apparatus and other public safety vehicles.

The FY 2023-24 preliminary GF budget also accounts for increasing the contingency fund from \$68 million to \$76 million, to reflect 4.5 percent of operating expenditures. It is increased by 0.25 percent over the five-year forecast period to achieve five percent of ongoing operating expenditures in FY 2026-27. In March 2010, the City Council agreed to gradually increase the contingency with a goal of achieving five percent of GF operating expenses. Achieving this goal will improve the City's ability to withstand potential future economic declines.

General Fund Five-Year Forecast

The attached Five-Year Forecast and Preliminary GF Status Report (**Attachment A**) includes economic, resource and expenditure assumptions used to develop the multi-year forecast. The report also includes possible risks and potential unfunded needs. The current forecast assumes no changes to existing labor contracts or service levels, and does not assume any increased ongoing operating cost impacts for new facilities or capital projects from a potential GO Bond Program. It does, however, assume any surplus is incorporated into the subsequent years' expenditures, whether in increased one-time and ongoing costs for added programs and services, labor increases, set-asides, or other uses of the funds. The forecast also assumes any deficit is resolved by reducing expenses in order to achieve a balanced budget. The current labor contracts expire at the end of FY 2022-23 and contract negotiations are underway. The City is also currently working with a consultant on a classification and compensation study, which is expected to result in increased costs to ensure the City can attract and retain employees. Estimated cost impacts from the study have been incorporated into the expenditure forecast.

The five-year forecast as presented includes a baseline, optimistic and pessimistic

projection, based on ranges for revenues and expenditures. The model illustrates how the GF baseline (midpoint) forecast reflects a potential surplus in FY 2024-25 of \$9 million, a possible \$9 million deficit in FY 2025-26 and surpluses in FY 2026-27 and FY 2027-28 of \$22 million and \$47 million, respectively. As we look ahead, areas which could impact the GF include revenue volatility, continued pension cost increases, higher costs for employee compensation, impacts from State legislative actions, and unfunded mandates. Additionally, if a recession were to occur in 2023, or legislation is passed that would dramatically reduce revenues, it's possible that deficits could occur in the future requiring strategic budget balancing actions by the City Council. This report also includes stress testing of the forecast, which has been done for the fifth consecutive year, to model the potential for a recession beginning in FY 2023-24 and lasting until FY 2025-26 of the forecast. The alternative models provide an opportunity to evaluate how declines in revenue could affect the GF's ending balance.

Next Steps and Community Input

The Phoenix City Charter requires a balanced budget each year. On March 28, a balanced City Manager's Trial Budget will be presented for City Council and community discussion along with the Preliminary Five-Year Capital Improvement Program (CIP). The CIP is a multi-year plan for capital expenditures that are needed to replace, expand, and improve infrastructure and systems.

Engaging residents in the budget process is a priority of the City Council, and this year staff plans to continue the practice of seeking community input on the proposed budget with several opportunities for residents to participate through community budget hearings to be held throughout the month of April. In addition, staff will make available to all residents the budget balancing tool, FundPHX, which will include the proposed City Manager's Trial Budget. Residents are also welcome to contact the Budget and Research Department directly to provide input or ask questions about the budget. Contact information is available on the Budget and Research Department's website, phoenix.gov/budget. Feedback received from residents will be provided to the City Council regularly as staff progresses through the budget adoption process.

Responsible Department

This item is submitted by City Manager Jeffrey Barton and the Budget and Research Department.



City of Phoenix

<p>RESEARCH REPORT BUDGET AND RESEARCH DEPARTMENT</p>	<p>B.R. REPORT NUMBER 2023-05</p>
	<p>DATE ISSUED February 16, 2023</p>

<p>TO: JEFF BARTON CITY MANAGER</p>	<p>FROM: AMBER WILLIAMSON BUDGET AND RESEARCH DIRECTOR</p>
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SUBJECT

FIVE-YEAR FORECAST AND FY 2023-24 PRELIMINARY GENERAL FUND BUDGET STATUS

BACKGROUND

Development and presentation of the five-year forecast is an important step in the City’s budget process. Evaluating projected available resources and identifying potential ongoing budget surpluses or funding gaps will allow management and City Council to develop strategic plans to ensure the continuation of operations and optimize services to the community.

The Five-Year Forecast estimates future revenues and expenditures of the General Fund for the current fiscal year through fiscal year 2027-28. The purpose of this forecast is to identify key trends in revenues and expenditures and to provide information about the financial landscape anticipated over the next few years. The information contained in this forecast is based on data available through January 2023.

The General Fund (GF) five-year forecast (**Attachment B**) is provided to the City Council and the community for consideration and provides City policy makers:

- A strategic financial management best practice
- A framework for strategic decision-making
- The opportunity to make policy changes to maximize City resources and service delivery
- A roadmap to continued fiscal health and award-winning budgetary and financial reporting

The forecast is not an official policy or legal budget document and does not enact any budgetary allocations. The forecast is also not intended to set or precisely predict future revenues or expenditures. Rather, the forecast presents current estimates based on several economic and financial assumptions of the future direction and ranges of growth rates for both resources and expenditures. The economic, revenue, and expenditures assumptions are provided in **Attachment C**.

The forecast is built on several assumptions outlined in **Attachment C** regarding:

- The national, state, and local economy
- Population and job growth

- Revenue growth
- Impacts of anticipated increasing pension liabilities
- Estimated additional costs anticipated for the Class and Comp study
- Cost management practices
- Future year expenses

All of these factors are subject to change and are detailed further in this report.

Projecting future available resources and expenses over multiple years is complex and involves several assumptions concerning how revenue and expenditures will grow over time. In order to model potential future budgetary scenarios under varying economic conditions, a range is provided for resources and expenditures. The differences between the upper and lower ends of the ranges increase in the later years of the forecast reflecting additional economic uncertainty. The top of each range represents the “optimistic” forecast, while the bottom of the range represents the “pessimistic” forecast. All of the ranges are based upon the assumptions described in this report.

It is important to note, if any of these assumptions as described were to change or modeled differently, the ranges of amounts presented in the forecast would need to be revised. Unexpected economic shocks, recessions, legislation, unfunded mandates or other risks to the forecast can also adversely impact projections.

Additionally, even slight variances in the revenue and expenditure growth rates in the initial years of the forecast result in substantial changes to the later years due to the compounding effect of the changes. For example, a revenue growth variance of only 1% in FY 2023-24 can result in a \$16.6 million change to the ending balance, which would impact the ending fund balances in the subsequent forecast years. Long term forecasts become less reliable the further they are from development because of the many underlying assumptions subject to frequent fluctuations.

Projections are formulated in the first six months of the fiscal year and are based on current estimates of where staff believes resources and expenditures will be for the current fiscal year and the subsequent five years. In order to create the most reliable revenue and expenditure projections, staff relies on several economic sources, months of actual collections and extensive technical reviews before recommending estimates to City management and ultimately the City Council for final consideration.

It has been more than three years since COVID-19 began in December 2019. Although the impact of COVID-19 has been mitigated, other issues emerged, including geopolitical conflicts, high inflation, supply-chain issues, tighter monetary policy, volatile markets, labor shortages and anticipated economic slowdown or mild recession in 2023. The baseline forecast for the remainder of FY 2022-23 and looking ahead to FY 2023-24 is projected to expand at a slower pace and with high uncertainty. The FY 2023-24 ending General Fund balance is estimated to be \$134 million (**Attachment B**), with approximately \$65 million from one-time resources and \$69 million representing ongoing resources. The one-time amount is primarily due to excess vacancy savings accumulated over the past two fiscal years and includes the additional \$39M in resources carried forward from the FY 2021-22 ending balance presented to the City Council on September 27, 2022. Staff will bring recommendations on how best to allocate the surplus to the City Council on March 28th in the proposed FY 2023-24 Trial Budget. To better prepare for future challenges, this report also includes stress testing for moderate and severe recessions, which is an essential fiscal tool to evaluate how revenues might respond to different levels of economic crisis (**Attachment D, E and F**).

OTHER INFORMATION

It is important to note the preliminary FY 2023-24 budget and forecast is based on existing state-shared revenue models and statutory obligations. Any changes to state-shared revenue formulas, or other revenue sources proposed in the Governor’s budget or in legislative bills that would impact the GF budget, are not reflected and would need to be addressed if adopted by the State.

General Fund FY 2023-24 Preliminary Budget Status

FY 2023-24 Resources- The chart below shows the preliminary resources projection:

GF Resource Category	2023-24 Preliminary Estimate (in millions)	2023-24 Preliminary Projected Annual Growth Rate %
Local Sales & Excise Taxes	\$699	2.9%
State-Shared Revenue ¹	\$771	22.4%
Primary Property Tax ²	\$207	3.5%
User Fees and Other	\$154	1.4%
Beginning Balance ³	\$191	N/A
Transfers/Recoveries ³	(\$7)	N/A
Total GF Resources	\$ 2,015	10.1%

¹ Does not reflect any impact to State-Shared Revenue resulting from the FY 2023-24 State budget, nor legislative changes that have recently been proposed or discussed during the current legislative session.

² Assumes the continuation of City Council adopted policy to maximize the primary levy in order to preserve GF services. Any deviation from this policy would require an ongoing reduction to GF programs.

³ Estimates for beginning balance and transfers/recoveries are not derived from annual growth rate projections or broader economic factors.

Revenue Forecasting Model - In the fall of 2014, Budget and Research consulted with the University of Arizona’s Eller College of Management, Economic and Business Research Center (EBRC) to enhance the City’s sales tax revenue forecasting process. Dr. George Hammond, EBRC Director, and Dr. Alberta Charney, Senior Research Economist, spent several months working with City staff to develop an enhanced econometric sales tax forecasting model for all categories of city and state sales tax. In the summer of 2017, staff worked with EBRC to update the tax forecasting model. In March 2021, the EBRC revised the City’s model again by including online sales tax. The City began collecting sales tax from online marketplace retailers effective October 2019 just prior to the pandemic, which helped to offset losses experienced in the leisure and hospitality sales tax categories. The EBRC leads the State of Arizona Forecasting Project, which provides in-depth economic forecast analysis and databases on a subscription basis to businesses, organizations, and government via membership. The additional consulting with Dr. Hammond has provided the City with solid, independent economic and statistical expertise used to develop a statistically valid forecasting model specifically for the City of Phoenix. The projected growth rates in each category of sales tax for the FY 2023-24 estimate and the out years of the forecast are based on projections developed with the enhanced econometric forecasting model.

2023-24 Expenditures - The preliminary expenditure estimates may change as cost estimates are further refined in the coming weeks. At this time, the preliminary FY 2023-24 General Fund expenditures are projected to be \$1.881 billion, representing an increase of \$102 million over the FY 2022-23 budget. The increase accounts primarily for higher costs for pension and vehicle replacements, increases in capital equipment and pay-as-you-go projects, and higher contingency amounts.

Pension Costs - Expected changes in COPERS and PSPRS pension costs are as follows:

- COPERS: GF pension costs in FY 2023-24 for civilian employees are expected to grow by approximately \$5 million compared to the current year budget. The overall trend in COPERS pension cost has been driven by recent actuarial changes, plan earnings, payroll growth and pension reform. As the five-year forecast shows, COPERS pension costs are estimated to increase \$9 million from the FY 2022-23 budget through FY 2027-28 (**Attachment B and G**).
- PSPRS: GF pension costs in FY 2023-24 for sworn Police and Fire are expected to increase by approximately \$40 million compared to the current year budget. The primary factors contributing to the growth over the current year budget are recent actuarial changes, plan earnings, and changes to the payroll base. As the five-year forecast shows, public safety pension costs are estimated to increase \$90M from the FY 2022-23 budget through FY 2027-28 (**Attachment B and G**), which adds significant pressure to the GF budget going forward and limits the City's ability to either expand program and services to residents or increase employee compensation.

Contingency – The contingency fund is assumed to increase from \$68 million to \$76 million in FY 2023-24 to reflect 4.5% of operating expenditures. It is increased by 0.25% in FY 2024-25 and FY 2025-26 to 4.75% and 0.25% in FY 2026-27 to achieve 5.0%. In March 2010, the City Council agreed to gradually increase the contingency with a goal of achieving 5.0% of GF operating expenses. Achieving this goal will improve the City's ability to withstand potential future economic declines.

Detailed preliminary estimates with multiple year-to-year comparisons are included in the Zero-Based Budget Inventory of Programs document, which is available online at phoenix.gov/budget. Revenue and expense estimates continue to be developed, and more definitive estimates will be presented along with the City Manager's Trial Budget on March 28th.

The GF preliminary FY 2023-24 budget status and Five-Year Forecast are provided for information and discussion.

ATTACHMENTS

Attachment B- Five-Year General Fund Forecast

Attachment C- Forecast Assumptions

Attachment D- Background, Methodology and Assumptions for Stress Testing

Attachment E- Stress Testing for Moderate Recession Scenario

Attachment F- Stress Testing for Severe Recession Scenario

Attachment G- Pension Cost Increases

ATTACHMENT B
5-Year General Fund Forecast (\$ Millions)

	2022-23	2023-24	For Planning Purposes Only		
	Adopted Budget	Preliminary Budget Estimate	2024-25 Forecast	2025-26 Forecast	2026-27 Forecast
Resources					
Local Taxes	\$632	\$699	\$727 - \$737	\$757 - \$779	\$788 - \$824
State Shared Revenues	621	771	734 - 745	718 - 741	744 - 780
Primary Property Tax	199	207	214 - 217	221 - 227	228 - 238
User Fees and Other	135	154	155 - 158	157 - 162	159 - 167
Other (Carryover Balance, Transfers, Recoveries)	135	116	35	26	27
Unused Contingency from Prior Year	57	68	76	86	89 - 88
Total Resources	\$1,779	\$2,015	\$1,941 - \$1,968	\$1,965 - \$2,021	\$2,035 - \$2,124
Expenditures					
Operating Expenditures	\$1,270	\$1,241	\$1,350 - \$1,343	\$1,392 - \$1,383	\$1,417 - \$1,407
Civilian Pension	107	112	106	107	114
Sworn Public Safety Pension	261	301	324	336	344
Contingency	68	76	86	89 - 88	96 - 95
Pay-As-You-Go Capital (Includes Technology Plan)	48	118	47	47	47
Minimum Vehicles	25	33	36	36	45
Total Expenditures	\$1,779	\$1,881	\$1,949 - \$1,942	\$2,007 - \$1,997	\$2,063 - \$2,052
PROJECTED (DEFICIT)/SURPLUS:	\$ -	\$134	\$(8) - \$26	\$(42) - \$24	\$(21) - \$117

Key Resource Forecast Assumptions:

- * The forecast assumes modest revenue growth with no recession from 2023-24 to 2027-28, no fee increases or decreases and no new revenue sources.
- * The forecast includes tax rate reduction: Laws 2021, Chapter 412 (Tax Omnibus) reduced the number of individual income tax brackets from 4 in Tax Year (TY) 2021 to 2 brackets in TY 2022. Starting from TY 2023, the individual income tax has been reduced to 2.5%.
- * Relative population share used in calculating state shared revenues in 2023-24 was based on the 2021 Census Bureau Population Estimate. It was projected to remain flat throughout the forecast period. The actual share will change annually based on Census Bureau Population Estimates. In addition, Laws 2021, Chapter 412 (Tax Omnibus) increased the Urban Revenue Sharing distribution from 15% to 18% starting in 2023-24.

Key Expenditure Forecast Assumptions:

- * The contingency fund is set as 4.5% in 2023-24, 4.75% in 2024-25 and 2025-26, and 5% for both 2026-27 and 2027-28 of the total General Fund operating expenditures.
- * Includes no additional future funding for program enhancements, unfunded mandates, expiring grants, etc.
- * 2023-24 employee costs are based on projections under the current Council-adopted pay plan ordinance and employee contracts. No assumptions have been made concerning future labor contract negotiations. Estimated costs of the Class and Comp study have been included in the forecast. Pension costs are based on required and projected contribution rates provided by the respective pension system actuaries.
- * Non-personnel related expenditures for 2023-24 and 2024-25 assume expenditure growth is in line with recent historical averages, and the out years are anticipated to align with the estimated CPI growth.

Other Forecast Notes:

- * Ranges provided for revenues and expenditures. Upper & lower ends of ranges increase slightly in the outer years of the forecast reflecting additional economic uncertainty in the later years.
- * Ranges include pessimistic and optimistic scenarios within assumptions provided by the primary sources of economic information mentioned in this report.
- * When a baseline deficit or surplus is projected, the next year's operating expenses are assumed to be decreased or increased by the baseline deficit/surplus amount prior to applying the assumed annual projected growth rate, as the City is required by Charter to balance the budget each year.

ATTACHMENT C

Forecast Assumptions

Economic Sources - Budget and Research staff relies on several different sources for economic data and forecasts to assist with developing revenue and expenditure projections.

The list below includes the primary sources of information:

- State of Arizona Finance Advisory Committee (FAC) which includes several economists and finance professionals from the private and public sectors
- State of Arizona Joint Legislative Budget Committee (JLBC)
- University of Arizona (UofA), Economic Business Research Center
- Global Insight, IHS
- Arizona State University (ASU) – WP Carey School of Business, and Western Blue Chip
- Arizona Department of Administration (ADOA) - Employment and Population Statistics Office
- JP Morgan Chase Economic Outlook Center
- Blue Chip Economic Indicators (BCEI)– National Level
- U.S. Bureau of Labor Statistics
- U.S. Census Bureau
- The Conference Board
- University of Arizona (UofA) Forecasting Project – A community-sponsored research program within the Economic and Business Research Center providing project members with economic forecasts for Arizona, the Phoenix-Mesa metro area, and the Tucson metro area. City staff attends the Forecasting Project quarterly meetings and receives quarterly reports and data/projections used to assist in developing our forecasts. Forecasting Project data relies on Global Insight, IHS which is a well-known economics organization that provides comprehensive economic and financial information. The data from this project is incorporated into an econometric software program used to forecast sales tax.

Economic Outlook

The U.S. economy exhibited surprising resilience in the second half of 2022 after real GDP had declined in each of the first two quarters and the war in Ukraine created a geopolitical crisis. Historical high inflation not experienced since the early 1980s also occurred in 2022, primarily due to pandemic-related federal stimulus and supply-chain issues. The Federal Reserve has been tasked with maintaining stable price growth by increasing interest rates to tame inflation, which may slow the economy. It is for this reason some economists forecast either a meaningful slowdown in the 2023 economy or a mild recession. However, historic low unemployment and wage growth may prevent a recession in the current year, which creates additional economic uncertainty.

At the national level, the Conference Board forecasts that economic weakness will intensify and spread more widely throughout the U.S. economy over the coming months, leading to a recession starting in early 2023. The estimated GDP is 0.2% for 2023 and 1.7% in 2024 (The Conference Board, January 2023). In addition, only 18% of the BCEI forecasters think the Federal Reserve will rein in inflation without precipitating a recession. More generally, the panel attaches a probability of 65% to a recession occurring in 2023 (BCEI, January 2023). However, the job report released in January by the U.S. Department of Labor shows over 500,000 jobs created pushing the unemployment rate down to 3.4 percent, the lowest level since 1969. This suggests the labor market had been even more resilient in recent months, and some economists are now suggesting the odds of a recession occurring in 2023 are falling, while other economists argue the strong job market may cause the Federal Reserve to continue with aggressive rate hikes that will weaken the

economy. Beyond the high inflation rates and rapid monetary tightening, falling consumer and business confidence, softening consumption and investment, the war in Ukraine, and supply-chain issues are all likely to pose risks to the economy in 2023.

Arizona's economy and revenue growth have outperformed the nation throughout the pandemic, and this trend is expected to continue, albeit at a slower pace affected by the national economy. According to the Governor's presentation for the FY 2023-24 budget, Arizona ranked 5th in personal income, 6th in GDP growth, 7th in job growth and 8th in population growth among all states. The movement and expansion of high-tech manufacturing firms in Arizona will continue to promote growth. However, Arizona has also experienced some of the highest inflation of all states because of persistently high housing prices. Due to the impact of the national economy, a significant slowdown in growth across all major economic indicators is anticipated for 2023, although Arizona and Phoenix are expected to outperform the national economy.

Other significant economic assumptions from trusted sources include the following:

- Personal income for the Phoenix Metro area is projected to grow from 3.0% in 2022 to 5.5% in 2023 and range from 5.8% to 6.6% from 2024 to 2028 (UofA Economic Business Research Center).
- Growth in population is expected to continue, but at lower rates than historical growth. Phoenix Metro population is projected to grow by the same rate of 1.7% in 2023 as in 2022 and range from 1.5% to 1.6% for the remaining forecast period (UofA Economic Business Research Center).
- Non-farm employment in metro Phoenix is estimated to slow down from the growth of 4.1% in 2022 to 1.3% in 2023 and range from 1.4% to 2.2% from 2024 to 2028 (UofA Economic Business Research Center).
- Arizona unemployment rate is estimated to increase from the rate of 3.5% in 2022 to 5.2% in 2023 and range from 4.7% to 5.7% for the remaining forecast horizon (UofA Economic Business Research Center).
- Arizona housing affordability declines due to home price inflation and interest rate hikes. In addition, single-family and multi-family permits are projected to decrease by 11.4% and 26.8% in 2023, respectively (59th ASU/PNC Bank Economic Forecasting Luncheon, November 2022).
- Inflation is expected to decelerate from 2022. The Consumer Price Index-All Urban Consumers (CPI-U) West region is estimated to decline from 8.2% in 2022 to 4.2% in 2023 and range from 2.2% to 2.5% for the remaining forecast period (UofA Economic Research Center). In the past 50 years, CPI-U has ranged from negative 0.4% in 2009, to a high of 13.5% in 1980 (U.S. Department of Labor Bureau of Labor Statistics).

Resource Assumptions- Revenue growth rates are determined using information from our above-mentioned trusted sources, analyzing actual revenue trends and averages, and factoring in any known policy or legislative changes.

Revenue assumptions beyond the broader economic considerations are described below:

- No further period of recession with modest revenue growth for the forecast horizon.
- Annual revenue growth rates range from 0.7% to 10.2% during the forecast period.
- No impact to current revenue tax base, as provided in applicable state statutes and City ordinances.

- The forecast includes tax rate reduction: Laws 2021, Chapter 412 (Tax Omnibus) reduced the number of individual income tax brackets from 4 in Tax Year (TY) 2021 to 2 brackets in TY 2022. Starting from TY 2023, the individual income tax has been reduced to 2.5%.
- Relative population share used in calculating state-shared revenues in FY 2023-24 was based on the 2021 Census Bureau Population Estimate. It was projected to remain flat throughout the forecast period. The actual share will change annually based on Census Bureau Population Estimates. In addition, Laws 2021, Chapter 412 (Tax Omnibus) increases the Urban Revenue Sharing distribution from 15% to 18% starting in FY 2023-24.
- No future fee increases or decreases and no new sources of revenue.
- Potential increases to revenue resulting from economic development efforts are not included in the forecast.
- Ranges provided for revenues: upper and lower ends of ranges increase slightly in later years of the forecast reflecting additional economic uncertainty.

Expenditure Assumptions- Assumptions regarding forecasted expenditures are described below:

- Annual operating expenditure growth rates, except for pension, are based on historical growth rates and the estimated CPIs throughout the forecast period.
- Pension costs are based on historical actuals and information provided by the COPERS and PSPRS actuaries. The forecast does not attempt to predict future pension liabilities, assets or other plan assumptions, but rather to account for the anticipated costs of both pension systems. COPERS' pension costs in FY 2023-24 are based on the Alternative Contribution Strategy provided by the system's actuary, which assumes slightly higher contribution rates as a strategy to pay down the unfunded COPERS pension liability sooner.
- The forecast does not include the impact of additional potential reform measures for COPERS or PSPRS or the impact of pending litigation or proposed legislation.
- The forecast includes no additional future funding for program enhancements, unfunded mandates, expiring grants, etc.
- Pay-as-you-go capital costs are based on the preliminary estimates in the five-year Capital Improvement Program and include costs for facility major maintenance and building a new fire station located at 19th Avenue and Chandler Boulevard, increases in funding for replacement of critical IT infrastructure, and money earmarked for future expenses, including one-time funds for costs of a potential General Obligation (GO) Bond Program and grant matching requirements for the Bipartisan Infrastructure Bill.
- The contingency fund is set as 4.5% in FY 2023-24, 4.75% in FY 2024-25 and FY 2025-26, and 5% for both FY 2026-27 and FY 2027-28 of the total General Fund operating expenditures.
- The FY 2023-24 total compensation costs are based on projections under the current Council- adopted pay plan ordinance and existing employee contracts. Estimated costs of the Class and Comp study have been included in the forecast.
- No other financial impact from changes to labor unit contracts resulting from future negotiations is assumed.
- In forecast years with a projected baseline deficit or surplus, the next year's operating expenses are assumed to decrease or increase by the baseline deficit/surplus amount prior to applying the assumed annual growth projection, as the City is required by Charter to balance

the budget each year.

- Ranges provided for operating expenditures: upper and lower ends of ranges increase slightly in later years of the forecast reflecting additional economic uncertainty.

Other Items that Could Impact the Base Budget or the Five-Year Forecast- The cost and revenue items below either will likely require additional funding or could adversely impact revenue and therefore could have a negative impact on the five-year forecast as it's currently presented. The cost items may need to be ultimately borne, in part or in whole, by the General Fund (GF) if no other funding source is identified by the time these costs are imminent.

- On December 12, 2022, the City Council approved the proposed \$500 million GO Bond Program as presented by the Executive GO Bond Committee. Staff has begun next steps to prepare election materials for City Council approval, and upon approval the GO Bond Program will go before voters in the November 2023 Election. The forecast includes one-time funding that could be used for initial operating costs and/or gap funding if needed. However, annual ongoing operating costs from a proposed GO Bond Program have not been incorporated into the forecast.
- The forecast reflects the continued funding of approximately \$16 million per year earmarked to address aging City infrastructure and critical equipment. Examples of these projects include upgrades and replacements of fire life safety, electrical, and cooling systems in City facilities. However, additional funding may be needed in future years to address facility needs. Also, under the direction of the City Manager, staff continues to identify critical needs in all City facilities and works with several external firms that specialize in facility assessments. Staff has also taken active steps to enhance facility maintenance oversight by centralizing GF facility maintenance funding and creating a review committee. This change has significantly enhanced the prioritization of GF facility projects.
- General Fund vehicle funding is estimated at \$33 million for FY 2023-24 and increases to \$45 million in FY 2027-28 to reduce the current backlog of critical public safety vehicles and other vehicles deferred during the Great Recession. The cost to replace vehicles and Fire apparatus has grown significantly due to inflation, roughly 30% in the past two fiscal years per the Public Works Department. For FY 2022-23, an additional \$10 million in one-time funds will be dedicated specifically to replacing critical Fire pumpers and ladder trucks. It should be noted the current GF backlog of vehicles is estimated by Public Works at over 1,400 units with a total backlog value of \$146 million, and more vehicle replacement funding might be needed during the forecast horizon.
- The Governor's budget includes an \$11.8 million transfer from the state General Fund to the Arizona Department of Revenue (ADOR) to replace the outdated tax system, which is the second of eight deposits. The City was required to share the cost, and the forecast includes an annual payment from \$1.1 million to \$1.3 million through the forecast period. However, the actual payments might be higher, as assessments for the future years will be determined annually by ADOR based on the amounts paid.

- Beyond the potential risks and headwinds stated in the economic outlook section, several proposed legislative bills listed below could also negatively impact revenue estimates and the Five-Year Forecast if passed.

Residential Rental Sales Tax Exemption (HB 2067 and SB 1184):

Both House and Senate bills prohibit cities and towns from levying residential sales tax, but with different effective dates. If HB 2067 passed, GF revenue would be reduced by an estimated **\$199 million to \$209 million**, and all voter approved sales tax funds including Transportation 2050, Parks and Preserves, and Public Safety Specialty funds would be decreased by **\$381 million to \$400 million** over the five-year forecast horizon. Although SB 1184 involves a phase-in approach and has a less severe impact than HB 2067 during the current forecast period, the effect is the same after January 1, 2028.

Corporate Income Tax Reduction (HB 2003):

This bill reduces the corporate income tax rate by 0.9% from 4.9% to 4.0% for 2023 and continues to reduce the tax rate by 0.5% for each year thereafter until the rate reaches 2.5% in 2026. Due to the 2-year lag, the revenue reduction will start in FY 2025-26, and the total GF loss is estimated at **\$56 million** through FY 2027-28 based on the JLBC fiscal notes.

Vehicle License Tax (VLT) Only be Used for Transportation Purposes (SB 1245):

SB 1245 restricts all state shared VLT to transportation purposes, reducing the GF revenue by an estimated **\$361 million to \$379 million** over the five-year forecast horizon.

Food Tax Exemption (HB 2061):

HB 2061 prohibits cities and towns from levying a food for home consumption tax. Although the City does not currently collect sales tax on food for home consumption, we have in the past as a strategy to balance the budget. If it were eliminated, this would prevent the City Council in the future from electing this option if needed.

Beyond the items mentioned above, there are also a few bills which would negatively impact property tax revenues and increase the amount of income tax credits, which would also negatively impact stated-shared income tax collections.

ATTACHMENT D

Stress Testing for General Fund

Background – According to the National Bureau of Economic Research, the longest economic expansion on record was ended by COVID-19 in February 2020. The COVID-19 recession is one of the deepest but shortest in U.S. history. With federal stimulus packages and more than anticipated revenue collections, the City was not forced to cut the budget. However, after two years of rapid, stimulus-fueled growth, the specter of another recession is beginning to take shape. Although many economists warn of a downturn in 2023, it is far from certain when a recession will occur, how significant the impact will be, and for what duration. Thus, stress testing is crucial, as it helps estimate potential financial shortfalls resulting from adverse events. To help the City plan ahead, avert or limit a fiscal emergency and keep long-term priorities on track, staff conducted stress testing for the General Fund.

Methodology/Assumptions- "Stress test" in financial terminology, is an analysis or simulation designed to determine the ability of a given entity to deal with an economic crisis. Instead of doing a financial projection on a "best estimate" basis, a company or its regulators may do stress testing to estimate how robust an entity performs in certain negative circumstances, a form of scenario analysis. There are two scenarios for this stress testing: moderate and severe recession scenarios.

Attachment E shows a hypothetical moderate recession estimated to start in FY 2023-24. This scenario assumes General Fund revenue, except state-shared income tax, will decline by 1% for two consecutive years. According to Moody's Analytics, a recession typically affects budgets for at least two years (except for the COVID-19 recession, which was interfered with the federal stimulus packages). Although a moderate recession may impact revenue by more than 1%, the model is simulated with a 1% decrease. State-shared income tax distributed to cities and towns is based on the collections from two years prior, so the state-shared income tax decrease due to a moderate recession will not affect revenues until FY 2025-26.

Attachment F shows a hypothetical severe recession estimated to start in FY 2023-24. This scenario assumes General Fund revenue, except state-shared income tax, will decline by 3% for three consecutive years. Although a severe recession may impact revenues by more than 3%, for simulation purposes, this stress test used a 3% decrease. Similar to the moderate scenario, the state-shared income tax decrease caused by the economic recession will not affect revenues until FY 2025-26.

Assumptions for recoveries, fund transfers and expenditures remain the same as the model shown in **Attachment B**. However, the expenditures for the forecast period will be different due to the methodology applied in the model. When a deficit or surplus is projected, the next year's operating expenses are assumed to be decreased or increased by the deficit/surplus amount prior to applying the assumed annual projected growth rate, as the City is required by Charter to balance the budget each year.

ATTACHMENT E
5-Year General Fund Forecast – Moderate Recession Scenario (\$ Millions)

	2022-23	2023-24	For Planning Purposes Only			
	Adopted Budget	Preliminary Budget Estimate	2024-25 Forecast	2025-26 Forecast	2026-27 Forecast	2027-28 Forecast
Resources						
Local Taxes	\$632	\$664	\$658 - \$668	\$684 - \$705	\$712 - \$745	\$739 - \$786
State Shared Revenues	621	752	697 - 708	676 - 698	685 - 719	712 - 759
Primary Property Tax	199	198	195 - 198	201 - 207	207 - 217	213 - 228
User Fees and Other	135	149	146 - 148	147 - 152	149 - 156	152 - 160
Other (Carryover Balance, Transfers, Recoveries)	135	115	15	26	27	25
Unused Contingency from Prior Year	57	68	76	84	81	89 - 88
Total Resources	\$1,779	\$1,946	\$1,787 - \$1,813	\$1,818 - \$1,872	\$1,861 - \$1,945	\$1,930 - \$2,046
Expenditures						
Operating Expenditures	\$1,270	\$1,241	\$1,302 - \$1,295	\$1,235 - \$1,227	\$1,272 - \$1,263	\$1,300 - \$1,289
Civilian Pension	107	112	106	107	114	116
Sworn Public Safety Pension	261	301	324	336	344	351
Contingency	68	76	84	81	89 - 88	91 - 90
Pay-As-You-Go Capital (Includes Technology Plan)	48	118	47	47	47	46
Minimum Vehicles	25	33	36	36	45	45
Total Expenditures	\$1,779	\$1,881	\$1,899 - \$1,892	\$1,842 - \$1,834	\$1,911 - \$1,901	\$1,949 - \$1,937
PROJECTED (DEFICIT)/SURPLUS:	\$ -	\$65	\$(112) - \$(79)	\$(24) - \$38	\$(50) - \$44	\$(19) - \$109

Key Resource Forecast Assumptions:

* The forecast assumes moderate recession in 2023-24 and 2024-25, no fee increases or decreases and no new revenue sources.
 * The forecast includes tax rate reduction: Laws 2021, Chapter 412 (Tax Omnibus) reduced the number of individual income tax brackets from 4 in Tax Year (TY) 2021 to 2 brackets in TY 2022. Starting from TY 2023, the individual income tax has been reduced to 2.5%.

* Relative population share used in calculating state shared revenues in 2023-24 was based on the 2021 Census Bureau Population Estimate. It was projected to remain flat throughout the forecast period. The actual share will change annually based on Census Bureau Population Estimates. In addition, Laws 2021, Chapter 412 (Tax Omnibus) increased the Urban Revenue Sharing distribution from 15% to 18% starting in 2023-24.

Key Expenditure Forecast Assumptions:

* The contingency fund is set as 4.5% in 2023-24, 4.75% in 2024-25 and 2025-26, and 5% for both 2026-27 and 2027-28 of the total General Fund operating expenditures.
 * Includes no additional future funding for program enhancements, unfunded mandates, expiring grants, etc.
 * 2023-24 employee costs are based on projections under the current Council-adopted pay plan ordinance and employee contracts. No assumptions have been made concerning future labor contract negotiations. Estimated costs of the Class and Comp study have been included in the forecast. Pension costs are based on required and projected contribution rates provided by the respective pension system actuaries.
 * Non-personnel related expenditures for 2023-24 and 2024-25 assume expenditure growth is in line with recent historical averages, and the out years are anticipated to align with the estimated CPI growth.

Other Forecast Notes:

* Ranges provided for revenues and expenditures. Upper & lower ends of ranges increase slightly in the outer years of the forecast reflecting additional economic uncertainty in the later years.
 * Ranges include pessimistic and optimistic scenarios within assumptions provided by the primary sources of economic information mentioned in this report.
 * When a baseline deficit or surplus is projected, the next year's operating expenses are assumed to be decreased or increased by the baseline deficit/surplus amount prior to applying the assumed annual projected growth rate, as the City is required by Charter to balance the budget each year.

ATTACHMENT F
5-Year General Fund Forecast – Severe Recession Scenario (\$ Millions)

	2022-23	2023-24	For Planning Purposes Only				2027-28
	Adopted Budget	Preliminary Budget Estimate	2024-25 Forecast	2025-26 Forecast	2026-27 Forecast	2027-28 Forecast	
Resources							
Local Taxes	\$632	\$649	\$627 - \$637	\$607 - \$627	\$633 - \$662	\$656 - \$698	
State Shared Revenues	621	745	684 - 694	632 - 653	632 - 664	633 - 676	
Primary Property Tax	199	194	187 - 190	180 - 186	185 - 195	191 - 205	
User Fees and Other	135	146	140 - 142	134 - 139	136 - 143	138 - 146	
Other (Carryover Balance, Transfers, Recoveries)	135	114	15	26	27	25	
Unused Contingency from Prior Year	57	68	76	82	79 - 78	81 - 80	
Total Resources	\$1,779	\$1,916	\$1,729 - \$1,754	\$1,662 - \$1,713	\$1,692 - \$1,769	\$1,724 - \$1,830	
Expenditures							
Operating Expenditures	\$1,270	\$1,241	\$1,274 - \$1,267	\$1,176 - \$1,169	\$1,114 - \$1,106	\$1,131 - \$1,121	
Civilian Pension	107	112	106	107	114	116	
Sworn Public Safety Pension	261	301	324	336	344	351	
Contingency	68	76	82	79 - 78	81 - 80	82	
Pay-As-You-Go Capital (Includes Technology Plan)	48	118	47	47	47	46	
Minimum Vehicles	25	33	36	36	45	45	
Total Expenditures	\$1,779	\$1,881	\$1,870 - \$1,862	\$1,781 - \$1,773	\$1,745 - \$1,736	\$1,771 - \$1,761	
PROJECTED (DEFICIT)/SURPLUS:	\$ -	\$35	\$(141) - \$(108)	\$(119) - \$(60)	\$(53) - \$33	\$(47) - \$69	

Key Resource Forecast Assumptions:

- * The forecast assumes severe recession in 2025-26 and 2026-27, no fee increases and no new revenue sources.
- * The forecast includes tax rate reduction: Laws 2021, Chapter 412 (Tax Omnibus) reduced the number of individual income tax brackets from 4 in Tax Year (TY) 2021 to 2 brackets in TY 2022. Starting from TY 2023, the individual income tax has been reduced to 2.5%.
- * Relative population share used in calculating state shared revenues in 2023-24 was based on the 2021 Census Bureau Population Estimate. It was projected to remain flat throughout the forecast period. The actual share will change annually based on Census Bureau Population Estimates. In addition, Laws 2021, Chapter 412 (Tax Omnibus) increased the Urban Revenue Sharing distribution from 15% to 18% starting in 2023-24.

Key Expenditure Forecast Assumptions:

- * The contingency fund is set as 4.5% in 2023-24, 4.75% in 2024-25 and 2025-26, and 5% for both 2026-27 and 2027-28 of the total General Fund operating expenditures.
- * Includes no additional future funding for program enhancements, unfunded mandates, expiring grants, etc.
- * 2023-24 employee costs are based on projections under the current Council-adopted pay plan ordinance and employee contracts. No assumptions have been made concerning future labor contract negotiations. Estimated costs of the Class and Comp study have been included in the forecast. Pension costs are based on required and projected contribution rates provided by the respective pension system actuaries.
- * Non-personnel related expenditures for 2023-24 and 2024-25 assume expenditure growth is in line with recent historical averages, and the out years are anticipated to align with the estimated CPI growth.

Other Forecast Notes:

- * Ranges provided for revenues and expenditures. Upper & lower ends of ranges increase slightly in the outer years of the forecast reflecting additional economic uncertainty in the later years.
- * Ranges include pessimistic and optimistic scenarios within assumptions provided by the primary sources of economic information mentioned in this report.
- * When a baseline deficit or surplus is projected, the next year's operating expenses are assumed to be decreased or increased by the baseline deficit/surplus amount prior to applying the assumed annual projected growth rate, as the City is required by Charter to balance the budget each year.

ATTACHMENT G Pension Cost Increases

The below chart illustrates the rise in General Fund (GF) pension costs for PSPRS and COPERS. The forecast for fiscal years 2023-24 through 2027-28 is based on projected employer contribution rates from the plan actuaries and on the valuations dated June 30, 2022. Projected amounts account for changes made by the PSPRS Board, which updated the salary, inflation, and demographic assumptions. The Board also continued the decrease in the payroll growth assumption from 3.0% to 2.0% by a factor of 0.5% each fiscal year, resulting in increased employer contribution rates. The projected amounts for COPERS in FY 2023-24 assume the employer rates are based on the Alternative Contribution Strategy recommended by the system actuary to pay down the unfunded liability sooner.

