

MONTHLY FINANCIAL UPDATE

NOVEMBER 2008

REPORT HIGHLIGHTS

- Based upon the prognosis that the economy will not achieve any significant recovery or growth in the near term our current overall deficit projection for the General Fund is in the \$30 M. - \$40 M. range for the next 12-24 months.
- City departments have been working to identify budget reductions equal to 10% of their operating budgets to address these long-term revenue base budget changes.
- As the single greatest revenue source for the General Fund, fiscal year-to-date revenues are down 11% or \$4.1 M. compared to prior fiscal year. The current Sales Tax annualized forecast has been revised down \$15.8 M. from the adopted budget plan.
- Development Permits and Fees fiscal year-to-date revenues are down 45% or \$2.3 M. compared to prior year and our current annualized forecast predicts a \$6 M. decrease in building permits this fiscal year.
- Consumer Confidence is at its lowest point since the report's inception in 1967.

FY 2008/09 GENERAL FUND ESTIMATED YEAR END BALANCE

The following table compares the FY 2008/09 budget plan to the current General Fund balance forecast, incorporating the latest economic estimates and impacts of economic contingency plans.

Estimated Fiscal Year End 2009 General Fund Balance (In Millions)	FY 2008/09 Approved Budget	FY 2008/09 Current Forecast	Variance Favorable/ (Unfavorable)
<i>Actual</i> Beginning Balance July 1, 2008	\$ 40.6	\$ 44.2	\$ 3.6
Sources of Funds	286.8	262.8	(24.0)
Uses of Funds (Operating Expenses)	259.1	259.1	-
Transfers Out	22.9	21.3	1.6
Debt Service	6.0	3.7	2.3
<i>Estimated</i> Ending Balance June 30, 2009:			
Operating Contingency	4.8	4.8	-
Photo Enforcement Loop 101	0.6	-	(0.6)
General Fund Reserve	29.9	29.9	-
Unreserved Fund Balance	4.1	(11.8)	(15.9)
<i>Estimated</i> Ending Fund Balance June 30, 2009	\$ 39.4	\$ 22.9	\$ (16.5)

Table may display minor rounding variances in the aggregate due to reflecting amounts in millions.

Estimated Ending Fund Balance

Scottsdale is experiencing an unprecedented recessionary impact across revenue categories, with the most significant factors including retail sales, construction, and auto dealers. The current revenue forecast for FY 2008/09 is included in the GF Summary table above but the Estimated Ending Balance does not (yet) take into consideration budget balancing strategies currently being discussed/evaluated by City management and staff. Based upon the prognosis that the economy will not achieve any significant recovery or growth in the near term our current overall deficit projection is in the \$30 M. - \$40 M. range for the next 12-24 months. Budget balancing strategies will be aimed at providing current benefit/relief from lower revenues, as well as structural changes to help address our deficit prognosis and balance the budget in FY 2009/10 and beyond. As these strategies are evaluated and implemented, their estimated results will be reflected in future financial reports as the budget is balanced (see Budget Update section on page 3 for an update on the 08/09 budget review process).

GENERAL FUND REVENUE – FY2008/09 FORECAST

The following table summarizes key revenues that affect the City's General Fund. The table compares year end revenue forecast to the budget plan. The latest adjustments to forecast are reflected in the table. The current net impact of these adjustments to the revenue bottom line is (\$24.0) million under the FY 2008/09 budget plan, reflecting ongoing recessionary forces at the national and local level, factors related to the financial market turmoil, a depressed housing market, and dropping retail, automotive, and construction activity. We will continue to closely monitor revenues and make further adjustments to forecast as necessary.

FY 2008/09 General Fund Revenues (In Millions)	FY 08/09 Adopted Budget	FY 08/09 Current Forecast	Variance Favorable/ (Unfavorable)
Transaction Privilege (Sales) Tax ⁽¹⁾	\$ 116.6	\$ 100.8	\$ (15.8)
Transient Occupancy (Bed) Tax ⁽¹⁾	2.0	1.6	(0.4)
Property Tax	22.4	21.4	(1.0)
State Shared Sales Tax	22.0	20.8	(1.2)
State Shared Income Tax	34.0	35.5	1.5
Auto Lieu Tax	9.7	7.7	(2.0)
Business & Liquor License	1.8	1.8	-
Development Permits & Fees	14.5	8.5	(6.0)
Interest Earnings	4.5	3.6	(0.9)
Other	47.6	49.4	1.8
Total Revenue	\$ 275.1	\$ 251.1	\$ (24.0)
Transfers In	11.7	11.7	-
Total Sources of Funds⁽²⁾	\$ 286.8	\$ 262.8	\$ (24.0)

Table may display minor rounding variances in the aggregate due to reflecting amounts in millions.

- (1) *Privilege & Use Tax and Transient Occupancy Tax collections lag by one month (September activity reported in October results).*
- (2) *Reconciles to Sources of Funds line item in "General Fund Balance" table, page 2.*

Below are highlights related to the table above.

Sales Tax

As the single greatest revenue source for the General Fund, fiscal year-to-date revenues are down 11% or \$4.1 M. compared to prior fiscal year. Consumer confidence is at an all-time low and an anemic holiday shopping season is expected. Couple that with drops in construction activity, auto sales, and related dealership closings and relocations have resulted in Financial Services staff revising the current Sales Tax forecast down \$15.8 M. from the adopted budget plan. Category fiscal year-to-date changes over prior year: automotive -27.6%, construction -18.3%, food stores -3.5%, hotels and motel -10.3%, major department stores -11.4%, miscellaneous retail -15.9%, other taxable activity +17.6%, rental +0.4%, restaurants -11.1%, utilities +3.5%. We will continue to closely monitor sales tax activity and make additional revisions as necessary, especially as the critical holiday shopping season approaches.

Bed Tax

Fiscal year-to-date revenues are down 61% or \$0.5 M. compared to prior fiscal year. Staff has reduced the current forecast by \$0.4 M. The outlook for hoteliers and the travel industry as a whole remains dim until the economy starts showing signs of a significant turnaround.

Property Tax

Variance reflects recent utility settlement, and City's portion of \$29 M. legislative proposed rebate (\$730K Scottsdale share) to the State's General Fund.

State Shared Revenues

Adjustments reflect latest state shared estimates provided by the Arizona Department of Revenue.

Development Permits and Fees

Fiscal year-to-date revenues are down 45% or \$2.3 M. compared to prior year. Coinciding with a decline in the City's construction sales tax revenues, the real estate market bust is causing a drop in building permit revenues. Our current forecast takes into consideration two plus years of double-digit decreases in development activity as measured by permits issued and property valuations and predicts a \$6 M decrease in building permits for this fiscal year.

Interest Earnings

\$(0.9) M. unfavorable variance reflects revised forecast based on latest financial market forces.

Other Revenue

Adjustments to forecast for Other Revenue category include projected minor increases to parking and court fines, light and power franchise fees, and intergovernmental revenue.

BUDGET UPDATE

Budget Process Update:

Financial Services staff continues to estimate a revenue decline of 10% over the prior fiscal year actuals, with a deficit impact range of \$30 M. - \$40 M. for the combined General and Transportation Funds for this year and into FY 2009/10.

The departments have been working to identify budget reductions equal to 10% (\$30 M.) of their operating budgets to address these long-term revenue base budget changes. The department heads were asked to re-examine their current budgets and look for savings in supplies, equipment and manage every contract with a focus on efficiency and cost reduction or savings opportunities. The evaluation process will focus on City priorities and level of service impacts. Budget reduction proposals will be reviewed to determine what can be scaled back while minimizing service impacts to our citizens. A budget review team comprised of the City Manager, Assistant City Managers, Public Safety Chiefs, Human Resources GM, and Financial Services GM met with each of the department heads during November to review their proposed budget modifications. The review team is slated to hold additional review sessions in early December to determine which of the departmental proposed budget modifications they will recommend to City Council.

Additionally, staff from the City Manager's Office, Human Resources, and Financial Services continue to meet every other week to review vacant positions. The objective is to ensure filling a vacant position is consistent with only our highest service needs and priorities. The strategic management of vacant positions is a key component of mitigating the impact of the revenue reduction while considering service delivery impacts to our citizens.

Staff has also continued to review the "pay as you go" existing Capital Improvement Plan (CIP) and identifying areas of possible changes, such as reducing short-term funding for maintenance projects. Examples of other solutions being looked at include use of reserves, reducing fuel consumption, and overhead cost allocations to CIP projects.

As these solutions materialize, staff will provide timely updates to the City Council, citizens, employees, other stakeholders, and the media. Finally, because these modifications will be necessary to balance this year's budget as well as deal with longer-term economic downturn, our objective is to simultaneously achieve a balanced FY 2009/10 budget proposal.

Contingency Budget Update:

- General Fund Operating Budget Contingency. During the fiscal year, Financial Services staff monitors the \$5,000,000 General Fund Operating Budget Contingency. The City Council has approved the following uses of cash from the General Fund Operating Budget Contingency:

- July 8, 2008: \$208,000 WestWorld – to bring feed and bedding program in-house.

The total FY2008/09 General Fund Operating Budget Contingency approved by City Council to date is \$208,000, leaving a cash balance of \$4,792,000.

- Capital Budget Contingency. During the fiscal year, Financial Services staff monitors the use of the \$4,500,000 million Capital Budget Contingency. The City Council has approved the following uses of cash from the Capital Budget Contingency:

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- o September 9, 2008: \$236,000 Camelback Park – funds required to cover additional costs.
- o October 7, 2008: \$241,873 Traffic Signal Program – funds required to close-out two projects (Y0723 abd Y0823) and to record the related projects in the City's fixed asset records.

The total FY 2008/09 total Capital Budget Contingency approved by City Council to date is \$477,873, leaving a cash balance of \$4,022,127.

NATIONAL, STATE, AND LOCAL ECONOMIC TRENDS

The following table summarizes some key national and state economic indicators, compares the results to previous actual or forecast, and provides a positive, negative, or neutral trend. Unless otherwise indicated, previous and current values represent a month-to-month comparison in the same year.

Economic Indicators	Month or Quarter	Current Value	Overall Trend***	2008 Estimate
<u>National</u> – Leading Economic Index	October	99.6	Negative	-
Consumer Confidence	October	38.0	Negative	-
Consumer Price Index	October	216.573	Negative	-
Unemployment Rate	October	6.5%	Negative	-
<u>State</u> – Business Leader Confidence Index	Q4 2008	42.4	Negative	-
Retail Sales Growth	Forecast*	-1.8	Negative	2.0
Personal Income Growth	Forecast*	3.8	Negative	4.0
Wage and Salary Employment Growth	Forecast*	-1.0	Negative	0.8
Single Family Housing Permits	Forecast*	-31.3	Negative	1.5
Population Growth	Forecast*	2.1	Negative	2.2
Hotel/Motel Room Rate (Scottsdale)	September**	\$141.28	Neutral	-
Hotel/Motel Occupancy Rate (Scottsdale)	September**	55.4%	Negative	-

*Reflects Arizona Blue Chip Consensus Economic Forecast annual percent change 2008 from 2007 and projected 2009 from 2008, as of November 2008.

**Reflects over-the-year comparison.

***Overall Trend considers performance of indicators over a three-to-six-month period, not necessarily a month-to-month comparison.

NATIONAL:

Consumer Confidence

- **The Conference Board's gauge of confidence sunk to 38 in October**, from a score of 61 in September. Economists expected a score of 52 and this is the lowest score since the report's inception in 1967.
- **U.S. households are expected to spend an average of \$418 on gifts during the holiday season, down from last year's estimate of \$471.** "Consumers are in a cost conscious mood heading into the holiday season and they intend to spend less this year than last year on gifts," says Lynn Franco, Director of The Conference Board Consumer Research Center. "This is shaping up to be one of the most challenging holiday seasons in years and it's going to take more than the usual discounts and incentives from retailers to get consumers to spend more freely."

Inflation

- **The Fed reduced the target interest rate by 50 points to a 1%.** Cheap money could boost inflation, although chatter about deflationary concerns is increasing amongst economist.

- **The Consumer Price Index for All Urban Consumers (CPI-U) decreased 1.0 percent in October**, before seasonal adjustment, reported the U.S. Department of Labor. The October level of 216.573 (1982-84=100) was 3.7 percent higher than in October 2007.

Economic Growth

- **GDP officially contracted in the third quarter**, reported the Commerce Department. The economy shrank 0.3%. Wall Street expected a 0.5% decline. That is the biggest quarterly decline in seven years, when the U.S. entered a post-tech bust recession.
- **In the third quarter of 2008, consumers reduced their spending by the greatest margin in 17 years.** Consumer purchases now make up over 70% of economic activity in the U.S. Recent GDP data shows that the Commerce Department's measure of consumer spending fell by an annual rate of negative 3.1%. This is the biggest pullback since 1980.
- **America's Research Group Chairman Britt Beemer predicts holiday sales will decrease at least 4 percent, the first decline since he started forecasting in 1979**, as consumers grapple with sinking home and stock values. His projections have been correct in 16 of the past 17 years. Also lenders and retailers are tightening up on their financing offers. "Banks just don't have the money," said David Bassuk, a New York-based managing director at consulting firm AlixPartners, LLP. The tightening credit is putting retailers "at big risk to lose those sales or lose those customers," he said. "There is a big concern there with the holiday spending." Retailers that offer zero- or low-interest financing, which is often backed by banks, may rein in the credit they extend to shoppers to avoid being left with bad loans when customers can't pay them back.

Economic Predictions

- **According to The Arizona Blue Chip Panel composite forecast, the fourth quarter of 2008 is expected to be the low point for the current economic cycle**, with exports offering the only source of real growth. Consumer spending recovers in the second quarter of 2009, according to the composite forecast, but this is not enough to get GDP back on track. In the fourth quarter of 2009, business spending on equipment begins to recover, residential building improves, and the consumer gets back in the game.
- **The current composite forecast calls for negative or no growth for a total of four consecutive quarters (2008 Q3 - 2009 Q2), and anemic recovery beginning in the second half of 2009.** The housing slump ends in the fourth quarter of 2009, but unemployment rates will continue to rise and job growth is likely to be weak.

Employment

- **Nonfarm payroll employment fell by 240,000 in October, and the unemployment rate rose from 6.1 to 6.5 percent**, reported the U.S. Department of Labor. October's drop in payroll employment followed declines of 127,000 in August and 284,000 in September, as revised. Employment has fallen by 1.2 million in the first 10 months of 2008; over half of the decrease has occurred in the past 3 months. In October, job losses continued in manufacturing, construction, and several service-providing industries. Health care and mining continued to add jobs.

Housing & Real Estate

- **Foreclosures grew by 71% in the third quarter compared with the same time in 2007.** About 766,000 homes received at least one foreclosure notice during the period, according to RealtyTrac. 250,000 properties were repossessed. However, September foreclosures did back off their August highs. Also, the worst of the foreclosure crisis is relatively contained to particular areas. California, for example, makes up more than 25% of all U.S. foreclosures. California, Florida, **Arizona**, Ohio, Michigan and Nevada together equal 60% of the total.
- **The S&P/Case Shiller home price index confirms the decline in home prices. Year-over-year declines in home prices are down by another annual record, 17.7% for its 10-city composite, 16.6% for the 20-city.** Nine of the 20 regions report record annual declines. The last region to report a positive change in annual home prices was Charlotte, in April.

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- **Nearly one in five American homeowners** owe more on their homes than the homes can bring on the market. At least 7.5 million homeowners, according to First American CoreLogic, are in this situation and another 2.1 million homeowners are "on the brink," by having less than 5% real home equity. In order, Nevada, Michigan, **Arizona**, Florida, and California have the highest prevalence of such "underwater" loans. In Nevada, 47.8% have negative equity while in California the number is 27.4%.

Pensions

- **Public pension funds are facing increasing pressure.** Significant losses may lead to tax increases or increased contributions from members. This from the *Financial Times*:

"In the nine months to the end of September, the average state pension fund lost 14.8 per cent, according to Northern Trust, a fund company. The loss has grown since, as financial markets slumped further in October. The previous highest loss for state funds was 7.9 per cent for the full year in 2002.

State and local pension funds comprise a patchwork of 2,700 funds that manage \$1,400bn on behalf of 21m employees, including teachers, firefighters and other municipal workers. About 40 per cent are underfunded, meaning that they would not be able to pay the future pensions that employees have been promised.

Critics say the underfunding is worse than official data show. The calculation is based on an assumption of annual returns of 8 per cent, but few funds will reach that in the next few years."

ARIZONA:

- **According to local economist Elliott Pollack**, "while Arizona historically is first, second, or third in terms of employment growth, so far in 2008 it is **49th out of 50 states in terms of such growth**. This is a remarkably poor performance. Even during the real estate debacle of 1988 through 1992, Arizona's worst relative performance was 38th in 1988.

Arizona is now paying the piper for the housing boom, which led to substantial overbuilding of single family homes. One need only look at Arizona construction employment, down 23.2 percent from the peak compared to 8.6 percent nationally, to see such an effect".

- **The Arizona Business Leaders Confidence Index gained 3.9 points for a reading of 42.4.** That's the largest upward move since the first quarter of 2006, and marks the second consecutive quarterly gain. Although the index remains below 50, which indicates that conditions are still expected to remain sluggish while its upward movement suggests that the worst may be behind us.

SCOTTSDALE BUSINESS ACTIVITY (PROVIDED BY ECONOMIC VITALITY)

- **Scottsdale Quarter**, under construction on the former Dial Corporate Headquarters site, announced a handful of chic new retail tenants slated to open in phase I of the project. Among the newest Scottsdale retail and dining establishments are Williams-Sonoma Home, West Elm, Oakville Grocery, H&M, Brio Tuscan Grille, Cameron's Steakhouse, Martini Park, and Parc lounge. The majority of these retailers are new to the market place, opening their first Arizona location in Scottsdale.
- A new partnership formed between the State of Arizona, the Ministry of the Economy of Mexico and **ASU's SkySong** will help provide a broader platform for interaction through avenues such as building knowledge-based businesses. In partnership with the United States-Mexico Foundation for Science and the Ministry of the Economy of Mexico, SkySong will operate a new business accelerator called TechBA Arizona. Representatives of knowledge-based Mexican businesses will be brought to Arizona through the new venture, providing companies with office space and support. Additionally, SkySong has partnered with the Consular Corps of Arizona in an effort to aid foreign businesses and entrepreneurs. Each consul is the liaison between the country represented and the Government and the citizens of Arizona. Their presence onsite at SkySong will provide invaluable support to the foreign businesses and entrepreneurs being targeted by the project.
- Westcor announced an impressive lineup of new stores for the **Scottsdale Fashion Square** expansion anchored by Barney's New York. Bulgari, Cartier and True Religion will be among the newest retailers to take occupancy at the mall. Additionally, the new 160,000sf expansion is almost fully leased.