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## INTRODUCTION

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### Purpose

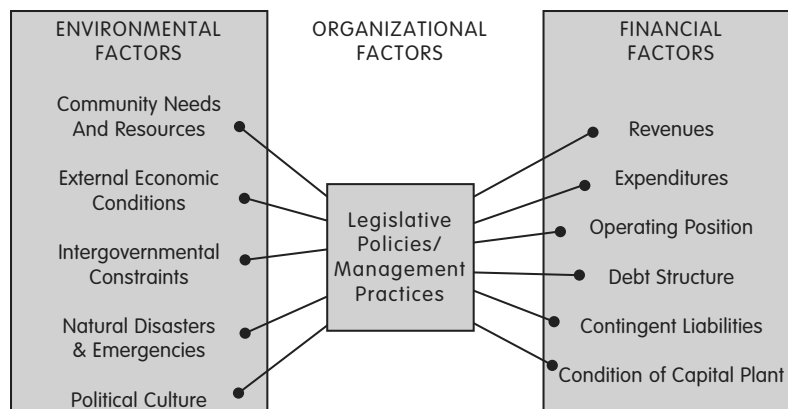
This financial trend analysis provides Scottsdale’s citizens, elected officials, management, staff, and other stakeholders with information regarding existing and potential environmental, organizational, and financial problems that may impact the City’s future fiscal health. As a useful management tool, it combines budgetary and financial information with economic and demographic data to create a series of local government indicators that are used to monitor changes in the City’s financial condition.

The analysis does not provide solutions to negative trends, nor does it provide a single number or index to measure the City’s financial condition. When all of the financial indicators are considered together, interested stakeholders can gain a better understanding of the City’s overall financial condition, i.e., similar to a credit rating agency analysis. Using this trend analysis and the framework of the financial policies adopted by City Council enables management to strategically plan and budget, provide solutions to negative trends, and ultimately preserve the financial health of Scottsdale.

### Organization

The analysis, as designed by the International City/County Management Association (ICMA), encompasses three primary factors that affect the City’s financial condition: environmental factors, organizational factors, and financial factors. These factors are divided into twelve categories that influence financial conditions. As the chart below illustrates, the factors are arranged as inputs and outputs to each other representing cause-and-effect relationships. The factors are interrelated and, taken collectively, represent an inventory of considerations when evaluating financial conditions.

FINANCIAL CONDITION FACTORS



For this reason, the trend information, whether positive, negative or neutral, should be viewed collectively. A specific trend, if analyzed on its own, may provide a misleading representation of the City’s financial condition. For example, the City’s revenue per capita trend remained strong from fiscal year 2004 to 2008. However, expenditures per capita and the community’s ability to pay for services also must be considered to

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determine an overall trend of the City's ability to cover cost of operations with future revenue streams.

The financial factors are separated into specific trend indicators. Scottsdale's financial policies, community needs and resources, overview of external economic conditions, and intergovernmental constraints are incorporated into the analysis. Other environmental and organizational factors cannot be quantified and, therefore, are not part of this analysis.

### **Sources**

This financial trend analysis is based on publications of the International City Management Association (ICMA) on the evaluation of local government financial condition. The analysis draws on the expertise of governmental finance researchers, credit rating agencies, and the City's Financial Services staff. Trend indicators are based primarily on the City's economic base along with other external factors promulgated by such organizations as the Government Finance Research Center (GFRC), the National Advisory Council on State and Local Budgeting (NACSLB), the International City/County Management Association (ICMA), the Government Finance Officers Association (GFOA), Moody's Investors Service, Fitch Ratings, and Standard and Poor's Corporation.

The analytical techniques that are part of this evaluation system are similar to the analytical approaches used by the municipal credit rating industry. For example, certain indicators are adjusted for inflation, as measured by the Consumer Price Index (CPI), to yield constant dollars, thus representing the real growth or decline of the indicators. This technique can help the City analyze and interpret key financial, economic, and demographic trends and can provide management with information needed to improve the City's overall financial position and aid in the decision-making process. In order to ensure validity and consistency of the indicators, most data are tied to data published in the City's Comprehensive Annual Financial Report (CAFR). In addition, many indicators relate directly to information required by municipal credit rating agencies. The rating agencies, bond buyers, and other interested parties consider the annually audited and published CAFR as the most reliable financial information source for the City. The City presents its CAFR in accordance with Generally Accepted Accounting Principles (GAAP) and in a consistent format as promulgated by the GFOA.

### **Executive Summary**

The 2008 City of Scottsdale Trends report shows the City in overall solid financial position through the five year measured period, fiscal year 2004-2008. Conservative financial policies and prudent management practices allowed the City to continue providing ongoing core services to its citizens, as well as adding new and enhanced programs and services based on a growing population, citizen demand, and City Council direction.

The reader should be reminded that the purpose of this report is to show historical trends and past economic / financial performance of the City – it does not take into account current and future macro and micro-economic, demographic, and other financial factors

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as a measurement tool. This is particularly important to remember during severe economic downturns, such as the one we are currently in.

The nation is seeing a shake-up within its core financial sectors that is causing serious economic impacts that have not been seen since the last depression. Economists recognize ‘recessions’ based upon two consecutive negative quarters of GNP. The current U.S. recession began one year ago, so the downturn already exceeds the postwar average of 10 months. It is becoming increasingly evident that this recession will be among the worst in the postwar period, and before it is over, it may hold that dubious distinction without quarrel from anyone.

As we headed into the second half of 2008, we saw further deterioration of financial markets, national retail sales posted the largest decline (-11%) in seventeen years and continued bottoming out of the housing market. Economists seem to agree that the nation entered into a recession back in December 2007.

Scottsdale began experiencing a local recession around the same time – even if on a national scale it wasn’t (yet) being characterized as one. The measurement was based upon measurements of the City’s major ‘elastic’ revenues sources (revenues that vary directly with economic fluctuation) and that fund the City’s operating budget and pay-as-you-go capital program: sales tax, gas tax, bed tax, building permit fees and State shared sales and income taxes.

Putting this ‘recession’ into perspective by comparing to Scottsdale’s past...Scottsdale has historically seen only slower growth during past recessions, with only negative growth (a modest 1% decline) being in 2001/02 after the terrorist attacks. Last fiscal year we realized a 4% decline in sales tax and recent months revenues have dropped 13% in the major sales tax categories over the prior anemic year. These impacts are unprecedented and news from surrounding cities is just as glum – we are not unique in this. The local economic forecast is dismal for the next year or more, which will result in the deepest and longest recession Scottsdale has ever experienced.

In order for Scottsdale to retain a high quality of place, the City will have to address many critical issues. These issues include redevelopment and in-fill projects as the City reaches build-out, a shifting of the City’s economic base, as ample tax revenues from new growth will no longer exist, a slowing in the City’s population growth resulting in lower state-shared revenues, and intense competition from other communities in the region. The ongoing challenge for Scottsdale will be its ability to manage limited financial resources, especially during the current economic crisis, while addressing increasing operational and capital costs associated with growing demands for quality public services and an aging infrastructure in parts of the City.

The Financial Services staff will continue to closely monitor the City’s financial trends. If action is required to address unfavorable trends, staff will alert the City Manager and the City Council in a timely manner and bring forward strategic options for their consideration.

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### Financial Indicators

The following is a summary of the financial factor categories and the general five-year trend for each respective indicator.

**Community Needs and Resources** – These indicators reflect the community’s ability to pay for services, as well as factors that impact the City’s financial condition. The indicators reflect an overall steady performance for Scottsdale over the five-year span. The City’s growing population and employment base, increasing property values, and constant personal income levels all contributed to the City’s positive financial condition and the community’s ability to pay for services. However, looking forward, several of these indicators are expected to negatively reflect the economic troubles of the current year and into future years until the economy rebounds.

<i>Indicator</i>	<i>Five-Year Trend</i>
Population	Increase
Population Density	Increase
Inflation	Increase
Residential Development	Neutral
Hotel/Motel Occupancy Rates	Neutral
Employment Base	Increase
Business Activity	Increase
Median Age	Neutral
Personal Income per Capita	Neutral
Property Value	Increase
Crime Rate	Decrease

**Revenues** - Sales tax, building permit fees, property tax, intergovernmental revenues, and user-fee revenue trends were mixed over the five-year trend period, generally trending upward from 2004-2006 during the end of the economic growth cycle and housing market boom, and beginning to tail off in 2007-2008, reflecting a slowing economy and looming recessionary forces.

<i>Indicator</i>	<i>Five-Year Trend</i>
Revenue per Capita	Neutral
Elastic Revenue	Neutral
Property Tax Revenue	Neutral
Uncollected Property Tax	Increase
Intergovernmental Revenues	Neutral
User Charge Coverage	Neutral
Restricted Revenue	Neutral

**Expenditures** – The expenditure indicators show expenditure levels remaining proportional to the City’s population. Increases in total operating expenditures reflect increased demands for public services due to an increase in population and additional staffing and maintenance requirements pertaining to both new and current facilities, including new parks, pools, libraries, water/wastewater operations, and public safety.

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Escalating health care, social security, and pension costs negatively impacted fringe benefit expenditures.

<i><b>Indicator</b></i>	<i><b>Five-Year Trend</b></i>
Expenditures per Capita	Increase
Operating Expenditures – Service Area	Increase
Employees per Capita	Increase
Fringe Benefits	Increase

**Operating Position** - The City's operating position indicators reflect an overall solid financial base as the City headed into the recent national and local economic downturn. Enterprise Funds also show positive earnings – portions of these fund balances are set-aside for emergencies and enterprise infrastructure and replacement. The City's liquidity remains strong.

<i><b>Indicator</b></i>	<i><b>Five-Year Trend</b></i>
General Fund Balance	Neutral
Enterprise Fund Operating Margin	Increase
Liquidity	Increase

**Debt Structure** - Net direct debt per capita increases are due to voter-approved bonds issued to pay for the five-year Capital Improvement Program. However, the City's increasing assessed valuation and tax base helps mitigate the increasing debt.

<i><b>Indicator</b></i>	<i><b>Five-Year Trend</b></i>
Net Direct Debt per Assessed Valuation	Neutral
Net Direct Debt per Capita	Increase
Overlapping Net Debt	Decrease
Debt Service	Decrease
Debt Margin – 20 percent Bonds	Neutral
Debt Margin – 6 percent Bonds	Neutral

**Contingent Liabilities** - The City's employee pension benefit obligations continue to see a decline in percent of benefits funded from fiscal year 2004 forward, which can be attributed to the downturn in the economy, sharply lower returns on investments, expanded coverage needs, and changing population demographics as average life expectancy increases. Unrestricted fund balances and self-insurance reserves were positive trends for the City's financial condition over the five year period.

<i><b>Indicator</b></i>	<i><b>Five-Year Trend</b></i>
Pension Benefit Obligation	Decrease
Compensated Absences	Increase
Self-Insurance	Positive

**Condition of Capital Plant** - The condition of capital plant indicators reflect prudent methodologies for maintenance and replacement of the City's capital assets. The overall trends demonstrate that the City is maintaining capital investments rather than deferring maintenance costs for short-term benefits.

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<i>Indicator</i>	<i>Five-Year Trend</i>
Maintenance Effort	Neutral
Capital Outlay	Positive
Depreciation	Neutral

## **FINANCIAL POLICIES**

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### **City of Scottsdale's Comprehensive Financial Policies**

The following City financial policies adopted by Resolution by the City Council establish the framework for Scottsdale's overall fiscal planning and management. They set forth guidelines against which current budgetary performance can be measured and proposals for future programs can be evaluated. Scottsdale's publicly adopted financial policies show the credit rating industry and prospective investors (bond buyers) the City's commitment to sound financial management and fiscal integrity. The financial policies also improve the City's fiscal stability by helping City officials plan fiscal strategy with a consistent approach. Adherence to adopted financial policies promotes sound financial management, which can lead to improvement in City bond ratings and lower cost of capital.

#### **Operating Management Policies**

1. All departments will participate in the responsibility of meeting policy goals and ensuring long-term financial health. Future service plans and program initiatives will be developed to reflect current policy directives, projected resources and future service requirements. In order to ensure compliance with policy, sunset provisions will be required on all grant program initiatives and incorporated into other service plans, as appropriate.
2. The budget process is intended to weigh all competing requests for City resources, within expected fiscal constraints. Requests for new, ongoing programs made outside the budget process will be discouraged.
3. Budget development will use strategic multi-year fiscal planning, conservative revenue forecasts, and modified zero-base expenditure analysis that requires every program to be justified annually in terms of meeting intended objectives ("effectiveness criteria") and in terms of value received for dollars allocated ("efficiency criteria"). The process will include a diligent review of programs by staff, management, citizens and City Council.
4. The full City Council will solicit citizen input and review the operating and capital budget recommendations from a departmental, program, and goals perspective.
5. Revenues will not be dedicated for specific purposes, unless required by law or generally accepted accounting practices (GAAP). All non-restricted revenues will be deposited in the General Fund and appropriated by the budget process.
6. Current revenues will fund current expenditures and a diversified and stable revenue system will be developed to protect programs from short-term fluctuations in any single revenue source. To ensure that Scottsdale does not become overly reliant on 'growth' revenues for operating needs, a minimum of 25% construction privilege tax revenues will be transferred annually to the Capital Improvement Program for one-time capital project use.

## **FINANCIAL POLICIES**

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7. Addition of personnel will only be requested to meet program initiatives and policy directives; after service needs have been thoroughly examined and it is substantiated that additional staffing will result in increased revenue or enhanced operating efficiencies. To the extent feasible, personnel cost reductions will be achieved through attrition.
8. Enterprise (Water, Sewer, Solid Waste Management, and Airport) user fees and charges will be examined annually to ensure that they recover all direct and indirect costs of service and be approved by the City Council. Any unfavorable balances in cost recovery will be highlighted in budget documents. Rate adjustments for enterprise operations will be based on five-year financial plans.
9. All non-enterprise user fees and charges will be examined annually to determine the direct and indirect cost of service recovery rate. The acceptable recovery rate and any associated changes to user fees and charges will be approved by the City Council.
10. Development impact fees, as permitted by state law, for capital expenses attributable to new development will be reviewed annually to ensure that fees recover all direct and indirect development-related expenses and be approved by City Council. Any unfavorable balances in cost recovery will be highlighted in budget documents.
11. Capital equipment replacement will be accomplished through the use of a "rental" rate structure. The rates will be revised annually to ensure that charges to operating departments are sufficient for operation and replacement of vehicles and other capital equipment (fleet, computers, phones and copier systems). Replacement costs will be based upon equipment lifecycle financial analysis.
12. Grant funding will be considered to leverage City funds. Inconsistent and/or fluctuating grants should not be used to fund ongoing programs. Programs financed with grant monies will be budgeted in separate cost centers, and the service program will be adjusted to reflect the level of available funding. In the event of reduced grant funding, City resources will be substituted only after all program priorities and alternatives are considered during the budget process.
13. Balanced revenue and expenditure forecasts will be prepared to examine the City's ability to absorb operating costs due to changes in the economy, service demands, and capital improvements. The forecast will be updated annually, focus on a three-year horizon, but include a five-year outlook.
14. Alternative means of service delivery will be evaluated to ensure that quality services are provided to our citizens at the most competitive and economical cost. Departments, in cooperation with the City Manager, will identify all activities that could be provided by another source and review options/alternatives to current

## **FINANCIAL POLICIES**

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- service delivery. The review of service delivery alternatives and the need for the service will be performed annually or on an “opportunity” basis.
15. Cash and Investment programs will be maintained in accordance with the City Charter and the adopted investment policy and will ensure that proper controls and safeguards are maintained. City funds will be managed in a prudent and diligent manner with an emphasis on safety of principal, liquidity, and financial return on principal, in that order.
  16. The City will follow an aggressive, consistent, but sensitive to the circumstances policy of collecting revenues to the limit of our ability. Collection policy goal will be for all adjusted uncollectible accounts to be no more than .5 of 1% of the total City revenue being adjusted for bad debts annually.

### **Capital Management Policies**

17. A five-year Capital Improvement Plan will be developed and updated annually, including anticipated funding sources. Capital improvement projects are defined as infrastructure or equipment purchases or construction which results in a capitalized asset costing more than \$25,000 and having a useful (depreciable life) of two years or more.
18. The capital improvement plan will include, in addition to current operating maintenance expenditures, adequate funding to support repair and replacement of deteriorating infrastructure and avoidance of a significant unfunded liability.
19. Proposed capital projects will be reviewed and prioritized by a cross-departmental team regarding accurate costing (design, capital, and operating) and overall consistency with the City’s goals and objectives. Financing sources will then be identified for the highest ranking projects.
20. Capital improvement lifecycle costs will be coordinated with the development of the Operating Budget. Future operating, maintenance and replacement costs associated with new capital improvements will be forecast, matched to available revenue sources and included in the Operating Budget. Capital project contract awards will include a fiscal impact statement disclosing the expected operating impact of the project and when such cost is expected to occur.
21. Dedicated two tenths of percent (.2%) privilege tax revenue for transportation improvements will be restricted to funding the planning, design, construction and acquisition costs associated with building, renovating, or enhancing capital projects for streets, highways, traffic control, transit and aviation and transportation improvement operating costs.
22. Pay-as-you-go Capital Improvement Plan financing should account for a minimum of 25 percent of all capital improvement projects for each five-year planning period.

## **FINANCIAL POLICIES**

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Pay-as-you-go financing is defined as all sources of revenue other than City debt issuance, i.e., fund balance contributions, developer contributions, grants, endowments, etc.

23. Pay-as-you-go contributions up to 10% or \$500,000, whichever is less, may be authorized by City Council towards any single utility undergrounding improvement district. Any unused annual budget authorization may carryforward towards a maximum \$2 million appropriation for utility undergrounding capital projects that benefit the community as a whole.

### **Debt Management Policies**

24. The City will seek to maintain and, if possible, improve our current bond rating in order to minimize borrowing costs and preserve access to credit.
25. An analysis showing how the new issue combined with current debt impacts the City's debt capacity and conformance with City debt policies will accompany every future bond issue proposal.
26. The City will communicate, and, where appropriate, coordinate with all jurisdictions with which we share a common tax base concerning our collective plans for future debt issues.
27. For all debt security transactions, the City will utilize bond legal counsel that is familiar with municipal law to ensure that the securities are issued in compliance with the City's governing statutes and regulations. The selection of any outside bond counsel to assist in debt security transactions will be subject to the City Attorney's review and involvement.
28. City Debt Service costs (GO, MPC, HURF, Revenue Bond, McDowell Sonoran Preservation and Contractual Debt) should not exceed 25% of the City's operating revenue in order to control fixed costs and ensure expenditure flexibility. Improvement District (ID) and Community Facility District (CFD) debt service is not included in this calculation because it is paid by district property owners and is not an obligation of the general citizenry. Separate criteria have been established regarding ID and CFD debt policies.
29. General Obligation debt, which is supported by property tax revenues and grows in proportion to the City's assessed valuation and/or property tax rate increases, will be utilized as authorized by voters. Other types of voter-approved debt (e.g., water, sewer, and HURF) may also be utilized when they are supported by dedicated revenue sources (e.g., fees and user charges).
30. General Obligation debt issuances will be managed on an annual basis to match funds to Capital Improvement Plan cashflow requirements while being sensitive to

## **FINANCIAL POLICIES**

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- the property tax burden on citizens. Careful management of bond issuances will allow the City to not exceed \$1.50 property tax per \$100 assessed value.
31. Municipal Property Corporation and contractual debt, which is non-voter approved, will be utilized only when a dedicated revenue source (e.g., golf course revenue, privilege tax, bed tax) can be identified to pay debt service expenses. The following considerations will be made to the question of pledging of project (facility) revenues towards debt service requirements:
- a. The project requires monies not available from other sources.
  - b. Matching fund monies are available which may be lost if not applied for in a timely manner.
  - c. Catastrophic conditions.
  - d. The project to be financed will generate net positive revenues (i.e., the additional tax revenues generated by the project will be greater than the debt service requirements). The net revenues should not simply be positive over the life of the bonds, but must be positive each year within a reasonably short period (e.g., by the third year of debt service payments).
32. McDowell Sonoran Preservation debt service will be funded by the dedicated .35% privilege tax. The City's privilege tax to revenue bond debt service goal will be at least 1.5:1 for senior lien debt to ensure the City's ability to pay for preserve debt from this elastic revenue source.
33. Improvement District (ID) and Community Facility District (CFD) Bonds shall be permitted only when there is a general City benefit. ID and CFD bonds will be utilized only when it is expected that they will be issued for their full term. It is intended that ID and CFD bonds will be primarily issued for existing neighborhoods desiring improvements to their property such as roads, water lines, sewer lines, streetlights, and drainage.
- a. Improvement District debt will be permitted only when the full cash value of the property, as reported by the Assessor's Office, to debt ratio (prior to improvements being installed) is a minimum of 3/1 prior to issuance of debt and 5/1 or higher after construction of improvements. Should the full cash value to debt ratio not meet the minimum requirements, property value may be determined by an appraisal paid for by the applicant and administered by the City. In addition, the City's cumulative improvement district debt will not exceed 5 percent of the City's secondary assessed valuation. Bonds issued to finance improvement district projects will not have maturities longer than ten years.
  - b. Community Facility District debt will be permitted only when the full cash value of the property, as reported by the Assessor's Office, to debt ratio (prior to improvements being installed) is a minimum of 3/1 prior to issuance of debt and 5/1 or higher after construction of improvements. In

## **FINANCIAL POLICIES**

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addition, the City's cumulative facility district debt will not exceed 5 percent of the City's secondary assessed valuation. The landowner/developer shall also contribute \$.25 in public infrastructure improvement costs of each dollar of public infrastructure improvement debt to be financed by the district.

34. Debt financing should not exceed the useful life of the infrastructure improvement with the average (weighted) bond maturities at or below ten years.
35. A ratio of current assets to current liabilities of at least 2/1 will be maintained to ensure the City's ability to pay short-term obligations.
36. Bond interest earnings will be limited to funding changes to the bond financed Capital Improvement Plan, as approved by City Council, or be applied to debt service payment on the bonds issued for construction of this plan.
37. Utility rates will be set, as a minimum, to ensure the ratio of revenue to debt service meets our bond indenture requirement of 1.2/1. The City goal will be to maintain a minimum ratio of utility revenue to debt service of 1.6/1 or greater, to ensure debt coverage in times of revenue fluctuations attributable to weather or other causes, and to ensure a balanced pay-as-you-go Capital Improvement Plan.

### **Reserve Policies**

38. All fund designations and reserves will be evaluated annually for long-term adequacy and use requirements in conjunction with development of the City's balanced five year financial plan.
39. General Fund Stabilization Reserve of 10 percent of annual general governmental (General and Transportation funds) operating expenditures will be maintained for unforeseen emergencies or catastrophic impacts to the City. Funds in excess of 10 percent, but not to exceed \$5 million, may be used for economic investment in the community when justified by the financial return to the City.
40. Debt Service Reserve will be funded with secondary property taxes, levied by City Council, sufficient to pay the bonded indebtedness for General Obligation bond principal and interest. A debt service sinking fund will be maintained to account for these restricted revenues and debt payments, as well as any additional debt amounts deemed to be advisable and necessary for any public or municipal purposes. An excise tax debt reserve will be funded at no less than the annual debt service for all currently outstanding (1%) excise tax supported debt.
41. Water and Sewer Fund Reserves will be maintained to meet three objectives: (1) ensure adequate funding for operations; (2) to ensure infrastructure repair and replacement; and, (3) to provide working capital to provide level rate change for customers.

## **FINANCIAL POLICIES**

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- a. An Operating Reserve will be funded not to exceed 90 days of budgeted system operating expenditures to provide sufficient expenditure flexibility during times of unusual weather resulting in variations in average consumption and associated operating expenses.
  - b. A Replacement and Extension Reserve will be maintained, per bond indenture requirements, to meet the minimum requirement of 2% of all tangible assets of the system to ensure replacement of water and sewer infrastructure.
  - c. In addition, Working Capital will be funded based upon a multi-year financial plan to provide adequate cash for water and sewer capital improvements and to level the impact of rate increases upon our customers.
42. Solid Waste Management Fund Reserve will be funded not to exceed 90 days of budgeted system operating expenditures to provide contingency funding for costs associated with solid waste disposal. Costs may include site purchase, technology applications, or inter-governmental investment to maximize the value of waste disposal activities.
43. Aviation Fund Reserve will be funded not to exceed 90 days of budgeted system operating expenditures to provide contingency funding for costs associated with airport operations. Costs may include site purchase, technology applications, or inter-governmental investment to maximize the value of airport activities.
44. Self-Insurance Reserves will be maintained at a level, which, together with purchased insurance policies, will adequately indemnify the City's property, liability, and health benefit risk. A qualified actuarial firm shall be retained on an annual basis in order to recommend appropriate funding levels, which will be approved by Council.
45. Fleet Management Reserve will be maintained based upon lifecycle replacement plans to ensure adequate fund balance required for systematic replacement of fleet vehicles and operational contingencies. Operating departments will be charged for fleet operating costs per vehicle class and replacement costs spread over the useful life of the vehicles.
46. Contingency Reserves to be determined annually will be maintained to offset unanticipated revenue shortfalls and/or unexpected expenditure increases. Contingency reserves may also be used for unanticipated and/or inadequately budgeted events threatening the public health or safety. Use of contingency funds should be utilized only after all budget sources have been examined for available funds, and subject to City Council approval.

## **FINANCIAL POLICIES**

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### **Financial Reporting Policies**

47. The City's accounting and financial reporting systems will be maintained in conformance with all state and federal laws, generally accepted accounting principles (GAAP) and standards of the Governmental Accounting Standards Board (GASB) and the Government Finance Officers Association (GFOA).
48. An annual audit will be performed by an independent public accounting firm, with an audit opinion to be included with the City's published Comprehensive Annual Financial Report (CAFR). The independent auditor will present CAFR and discuss audit findings concerning internal controls and operational efficiencies at a public meeting.
49. The City's CAFR will be submitted to the GFOA Certification of Achievement for Excellence in Financial Reporting Program. The financial report should be in conformity with GAAP, demonstrate compliance with finance related legal and contractual provisions, disclose thoroughness and detail sufficiency, and minimize ambiguities and potentials for misleading inference.
50. The City's CAFR will also be submitted to Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) as a continuing commitment to disclose thoroughness to enable investors to make informed decisions.
51. The City's Budget will be submitted to the GFOA Distinguished Budget Presentation Program. The budget should satisfy criteria as a financial and programmatic policy document, as a comprehensive financial plan, as an operations guide for all organizational units and as a communications device for all significant budgetary issues, trends and resource choices.
52. Financial systems will maintain internal controls to monitor revenues, expenditures, and program performance on an ongoing basis.

## **EXTERNAL ECONOMIC CONDITIONS**

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### **External Economic Conditions**

External economic conditions relate to the macro economy and the impact on the City. The most relevant and measurable conditions are local economic indicators. However, national and state economic trends also are important since they can indicate future impacts and changes to the local economy, such as changes in state-revenue sharing. The following is an overview of some external economic conditions.

#### **Local Economic Conditions at the Close of 2008 Fiscal Year**

##### Retail Sales

Scottsdale's largest revenue source is sales tax generated from several business categories including automotive, construction, food stores, hotels/motels, department stores, retail stores, restaurants, utilities and rentals. The City saw FY 2008 retail sales tax drop -4% from the previous year – the first negative revenue results since 9/11, which was down only -1%. Major sales tax categories responsible for the revenue decline in FY 2008 included automotive -12.4%, construction -9.2%, hotel/motel -4.6%, and major department stores -3.2%. This negative trend in retail sales is expected to continue well into 2009.

##### Construction Activity

The real estate market (“bust”) is causing a drop in construction-related sales tax and building permit revenues – two of Scottsdale's largest ‘elastic’ General Fund revenues. Overbuilding of residential and commercial property in recent years combined with financial market turmoil has made it more difficult for businesses and developers to secure financing and pursue new growth projects. And absorption of the current vacancies in Arizona, Scottsdale and the metro area has slowed significantly as people in other parts of the country struggle to sell their homes or business property in the depressed real estate market (in order to make the move to Arizona). The current outlook for the City takes into consideration the two plus years of double digit decreases in development activity as measured by permits issued and property valuations and predicts a continuing decline in construction sales tax and building permits for this fiscal year and contributing further to a pessimistic budget prognosis for the next several years.

##### Employment and Job Growth

Scottsdale remains a net importer of labor, where there are more jobs within the City than there are residents in the labor force. This provides employment opportunities for Scottsdale residents and adds a significant business component to the local tax base. Scottsdale's unemployment rate at the end of 2007 was 2.4 percent, which was lower than state and metropolitan levels.

Scottsdale recruited five new targeted firms with nearly 1,400 new jobs over the past year, with average annual salaries of approximately \$72,000. The City benefits from population growth and higher income levels due to the addition of such higher wage jobs. Major new employers to announce moves to Scottsdale last year included Locallife, Hypercom, Ticketmaster, and Semafore Pharmaceuticals.

## **EXTERNAL ECONOMIC CONDITIONS**

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### Vacancy Rates

Scottsdale's citywide office vacancy rate was approximately 19.7 percent at the end of FY 2008, which falls in line with the Valley-wide average. Scottsdale has nearly 600,000 square feet of new office space under construction, with most of the new construction occurring in the Scottsdale Airpark.

### Tourism

Tourism is one of Scottsdale's largest and most important industries and is a significant contributor to the City's economy. Scottsdale visitors contribute approximately 20% of the City's overall privilege tax revenue. Scottsdale continues to be a popular destination for visitors year-round, offering over 17,000 retail shops, nearly 600 restaurants, national and international events, and a unique southwest Sonoran desert setting. A variety of lodging properties, including several world-class resorts and "boutique" hotels, provide nearly 10,000 guest rooms, along with high-end spas, unique and trendy restaurants, and one-of-a kind Sonoran desert golf courses. Room supply in Scottsdale is expected to remain relatively stable in 2009.

Hotel and resort transient occupancy tax receipts in FY 2008 were flat to FY 2007 receipts, reversing four straight years of post 9/11 revenue and occupancy growth. The current assessment for tourism in 2009 is negative. The effects of steep declines in the stock market, in real estate values, rising unemployment, and weak consumer confidence in 2008 are expected to continue well into 2009. Companies are reducing meeting and travel costs, and consumers either have less or are unwilling to spend discretionary funds, all of which are anticipated to result in fewer visitors to Scottsdale.

### **Economic Outlook for 2009 and Beyond**

The two persistent questions about this economic downturn are (1) how deep it will be; and, (2) how long it will last. Latest forecasts now calls for real Gross Domestic Product (GDP) to decline by 4.5 percent in the fourth quarter of 2008, and by an additional 3.0 percent in the first quarter of 2009. Analysts predict the economy bottoms out in the second quarter of 2009 and modest positive growth is expected in the second half of the year. Consumer spending is expected to continue to fall and does not recover until the third quarter of 2009 and nonresidential building is projected to contract at an increasing rate through the first three quarters of 2009. The expectation among analysts is that the combination of weak consumer spending, negative job creation, and the ongoing credit crisis will inhibit office, commercial, warehousing, and other nonresidential structures. Exports are projected to fall in the last quarter of 2008 and through 2009, as the global slowdown intensifies. Analysts expect that GDP growth will be negative next year for major nations including the UK and Germany, and China's real growth will dip out of the double-digit range.

The current U.S. recession began one year ago, so the downturn already exceeds the postwar average of 10 months. It is becoming increasingly evident that this recession will be among the worst in the postwar period, and before it is over, it may hold that dubious distinction without quarrel from anyone.

## **EXTERNAL ECONOMIC CONDITIONS**

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As for the Arizona economy, recession continues to grip Arizona and several more months are likely to pass before the economy bottoms and then begins to recover. By the middle of 2009, housing markets should bottom, credit will once again be expanding, and consumers will begin to release some pent-up demand. The business cycle will turn up and by mid-2010, economic growth will return once again.

The capsule conclusion is that 2009 is not positioned to bring a real turnaround. The recession may register a trough after mid-year, with some modest gains after that. But the overall pattern of growth for Arizona will be “bumping along the bottom,” not a significant rebound.

The future strength of Scottsdale’s economy and financial condition will hinge on many factors from both a local and macro view. Retail sales and tourism is essential to the City’s financial wellbeing, as is the performance of the City’s two other key privilege tax categories, automotive, and construction. The City will have to address a shifting of the City’s economic base, as ample tax revenues from new growth will no longer exist, a slowing in the City’s population growth resulting in lower state-shared revenues, and intense competition from other communities in the region. The ongoing challenge for Scottsdale will be its ability to manage limited financial resources, especially during the current economic crisis, while addressing increasing operational and capital costs associated with growing demands for quality public services and an aging infrastructure in parts of the City.

## **INTERGOVERNMENTAL CONSTRAINTS**

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### **Intergovernmental Constraints**

Unfortunately, the City's economic fate is not completely under its control. Scottsdale is constrained by the imposition of other governmental units. These impositions affect both the City's ability to collect revenue and necessitate expenditures for regulatory items that do not necessarily provide a direct service to Scottsdale residents. The following is an overview of key intergovernmental constraints affecting Scottsdale's operations.

#### **Property Tax Limit**

In 1980, Arizona voters approved two measures to contain local government spending in response to California's Proposition 13. By a Constitutional amendment the property tax was split into two distinct components, primary and secondary. The primary levy is limited as to amount that may be used for any purpose. The levy is limited to a two percent increase over the previous year's "maximum allowable levy", plus the addition of any new property not previously taxed. The secondary levy is unlimited as to amount, but can only be used to repay voter approved debt service. The City must notify the State by November 1<sup>st</sup> of the year before the tax is levied of any annexations in order for them to be included on the tax rolls. Any annexations after November 1<sup>st</sup> must wait until the following year to be included in the City's levy. In addition, cities have the right to levy property taxes to pay for the cost of involuntary tort judgments.

#### **Expenditure Limit**

The expenditure limit, imposed by the State, is tied to the amount spent in the established "base year" (fiscal year 1979/80). Each year, the State adjusts the City's base year expenditure limit for changes in population and the implicit price deflator. Some items specifically excluded from the expenditure limitation are Federal grants, debt service payments, and involuntary tort judgments. Scottsdale voters have previously approved three adjustments to the expenditure limitation: a permanent exclusion for capital improvement expenditures approved in 1982, a \$12.5 million base adjustment approved in 2000, and a \$12 million adjustment approved in 2006. Penalties for exceeding the expenditure limit include the loss of State-shared revenues in the fiscal year following the violation.

#### **State-Shared Revenues**

Scottsdale receives a share of monies collected by the State since cities and towns in Arizona are not permitted to levy an income tax. Some money, such as State-Shared Sales Tax and State-Shared Income Tax, are unrestricted as to use. Other revenues, such as Highway User Fuel Tax and Local Transportation Assistance Funds, are restricted to transportation purposes only.

In addition to the restrictions on use of these funds, there are also differing methods of distribution that impact Scottsdale's revenue share. In some cases, United States Census figures are used to calculate revenue distribution. State revenues allocated based on city population are of particular concern to Scottsdale in the near-future since the City's population growth has slowed compared to other rapidly growing Phoenix metropolitan

## **INTERGOVERNMENTAL CONSTRAINTS**

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cities that stand to benefit the most. Other revenue distribution methods are based on the county in which the revenue originated.

State-Shared Income Tax receipts are received by the City based on income earned two years prior to distribution. The State of Arizona income tax calculations are tied to the federal tax system and, therefore, fluctuations in federal income tax levels caused by economic downturns or tax cuts can negatively impact the State's income tax revenues. In future years, it is expected that state-shared revenues received by Scottsdale will decrease as the City's population growth slows relative to other rapidly growing cities in the Valley.

### **Unfunded Mandates**

Increasing demands for government services and regulatory mandates at the Federal and State levels may result in the City incurring unfunded mandates, i.e., programs that cities are required to provide with no identified source of funding. For example, the U.S. Department of Justice (FBI) required all computer systems that connect to their network to AES encrypt and apply two-factor authentication to users that are connecting over a public circuit, including wireless. This unfunded Federal requirement had to be placed in operation by the City to avoid possible sanctions.

Mandated environmental regulations continue to impact Scottsdale's budget as well. Many aspects of City business are affected by environmental mandates, particularly land acquisition, water, wastewater, and refuse operations. Scottsdale is required to comply with Federal and State regulations regarding treating storm water runoff, testing for drinking water chemicals, and underground storage tank leaks. The City must also comply with State surface water quality standards, industrial pretreatment requirements, and non-hazardous liquid waste processes.

Other examples of unfunded environmental mandates include the 1980 Groundwater Management Act, which requires the City to work toward eliminating the reliance on mined groundwater, and the National Pollution Discharge Elimination System (NPDES), which requires the City to meet strict storm water quality levels.

### **Restricted Revenues**

Restricted revenue is legally earmarked for specific use as may be required by State law, bond covenants, or grant requirements. For example, the State of Arizona requires that gas tax revenue be used only for street maintenance or construction. As the percentage of restricted revenue increases, the City loses its flexibility to respond to changing conditions. The overdependence on restricted revenues makes the City's programs vulnerable to dictates by the funding agencies and may signal a future inability maintain current service levels, at a minimum.

### **Bonding and Bond Capacity**

All General Obligation and Revenue bonds must be approved by a vote of the citizens. Additionally, the Arizona Constitution imposes limits on the principal amount of General Obligation bonds allowed to be outstanding at any point in time depending on the use of the bond proceeds. Subject to voter approval, bonds amounting to 20 percent of the

## **INTERGOVERNMENTAL CONSTRAINTS**

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assessed value of taxable property in the City can be issued for water, wastewater, artificial light, open space preserves, parks, playgrounds, and recreational facilities. The City is limited to 6 percent of the assessed value of taxable property for all other types of capital expenditures, such as transportation, public safety, and general governmental facilities. Bond capacity is the portion of the legal debt limit available for bonding.

Several different kinds of Revenue bonds are available to the City. Revenue bonds are not included in the 20 percent and 6 percent capacity calculation. These bonds generally carry a higher risk and, therefore, higher interest rates than General Obligation bonds that are supported by the full faith and credit of the City. Water and wastewater revenue bonds are payable from the water and wastewater system user charges. Highway User Revenue Fund bonds are payable from Highway User revenues. Both water and wastewater revenue bonds and Highway User Fund revenue bonds require voter approval.

### **Reporting Requirements**

State law requires that the City establish at least two funds – the General Fund for recording “general” City operations and the Highway User Reserve Fund (HURF), which records the monies from highway user revenues. In addition to these requirements, additional funds are established to respond to reporting requirements for Federal grants, bond rating agencies, and regulatory accounting agencies. For example, the City’s Grant fund is used to account for federal, state, and local grant revenues received and expended by the City according to the stated purpose in each approved grant agreement. Also, the City’s Debt Service fund is used to account for secondary property taxes and other revenues restricted for repayment of City debt obligations.

## **COMMUNITY NEEDS AND RESOURCES**

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### **Community Needs and Resources**

Community Needs and Resources encompass various economic and demographic characteristics including population, employment, personal income, property value, and business activity. These indicators describe and quantify a community's wealth and economic condition. They provide insight into the community's collective ability to generate revenue relative to the community's demand for public services such as public safety, capital improvements, and social services.

Community needs and resources are all closely interrelated and affect each other in a continuous cycle of cause and effect. In addition, changes in these characteristics tend to be cumulative. These characteristics are the most difficult to formulate into indicators because the data is not easy to gather. The indicators detailed in this section represent only those for which data is reasonably available.

In addition to analyzing these indicators, the City also considers more subjective issues, such as economic geography, location advantages, and land-use characteristics, as they all relate to the City's ability to generate revenue and, therefore, provide convenient, efficient public services. Also important are the City's plans and potential for future development. The diversification of the commercial and industrial tax base is considered for its revenue-generating ability, employment-generating ability, vulnerability to economic cycles, and relationships to the larger economic region. While difficult to quantify using indicators, this information is useful in evaluating the City's financial condition.

An examination of local economic and demographic characteristics can identify the following types of situations:

- A declining tax base and correspondingly, the community's ability to pay for public services.
- A need to shift public service priorities because of demographic changes in the community.
- A need to shift public policies because of a loss in competitive advantage of the City's businesses to surrounding communities or because of a surge in inflation or other changes in regional or national economic conditions.

## COMMUNITY NEEDS AND RESOURCES

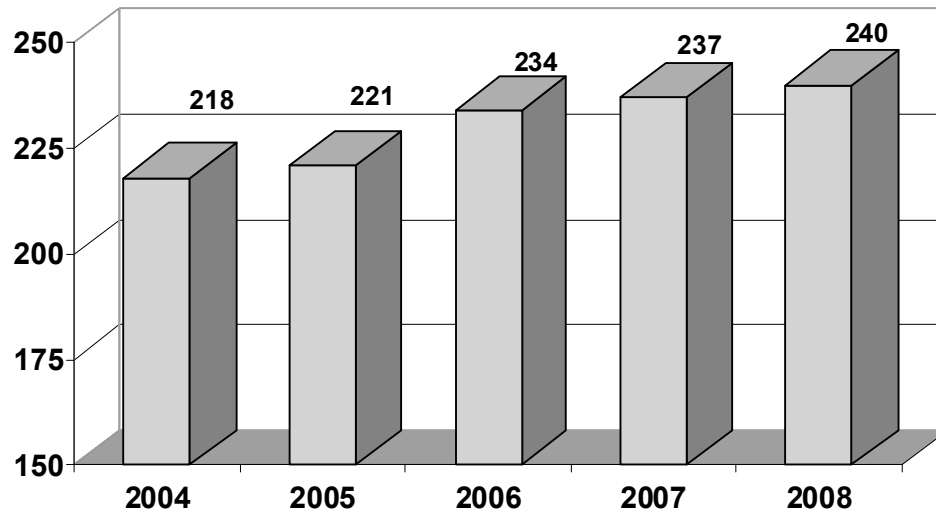
### Population

#### Description

Changes in population can directly affect City revenues, such as property tax collections and distribution of state-shared revenues. Population level indirectly relates to such issues as employment, income, and property value.

#### Analysis

Scottsdale continued to experience steady, but moderate, population growth, with a small spike in 2006 related to the mid-decade census adjustment. Compared to previous decades, the City's rate of growth has slowed in recent years with the decline of new residential development as the City reaches build-out. A gradually increasing population trend is considered favorable, although it typically will result in higher demand for public programs and services, which can put a strain on a municipality's budget depending on the strength of the economy and the community's tax base and income levels. Looking ahead, the City's slowing population growth relative to other Phoenix-metropolitan cities will have an impact on intergovernmental revenues distributed to Scottsdale based on population levels.



(in thousands)	<u>FYE 04</u>	<u>FYE 05</u>	<u>FYE 06</u>	<u>FYE 07</u>	<u>FYE 08</u>
Population	218	221	234	237	240
Percent Change	1.6%	1.4%	5.9%	1.3%	1.3%

FYE: Fiscal Year Ending

## COMMUNITY NEEDS AND RESOURCES

### Population Density

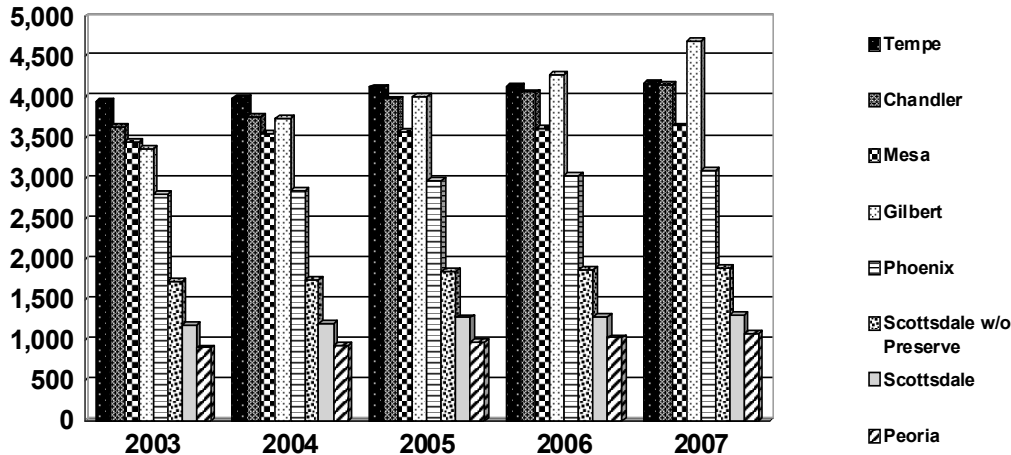
#### Description

Population Density indicates the number of residents living in an occupied area (usually measured by square mile). Density readings can lend insight into the age of a city, growth patterns, zoning practices, new development opportunities, the level of multi-family unit housing, and the cost efficiency of public service delivery. High population density can also indicate whether a city may be reaching build-out, as well as service and infrastructure needs, such as additional public transit or street routes.

#### Analysis

The City of Scottsdale has one of the lowest population densities per square mile compared with other major Phoenix-metropolitan cities. This can be attributed to the City's strict zoning and open space requirements, especially in the northern part, as well as preservation efforts for undeveloped land, such as the McDowell Sonoran Preserve. To demonstrate the impact of the Preserve area on the City's overall population density, excluding the 56.875 square miles of Preserve area increases the City's population density by approximately 45 percent – although still well below many other Phoenix-metropolitan cities.

(per square mile)



(population density  
per square mile)

	FYE 03	FYE 04	FYE 05	FYE 06	FYE 07
Chandler	3,644	3,766	3,981	4,061	4,158
Gilbert	3,362	3,743	4,006	4,283	4,705
Mesa	3,454	3,550	3,580	3,606	3,645
Phoenix	2,800	2,846	2,976	3,036	3,101
Peoria	900	925	975	1,024	1,068
Scottsdale w/ Preserve	1,187	1,208	1,273	1,288	1,308
Scottsdale w/o Preserve	1,716	1,747	1,840	1,861	1,890
Tempe	3,953	3,999	4,125	4,128	4,176

Calculation: Population/Area (SqMi)

## COMMUNITY NEEDS AND RESOURCES

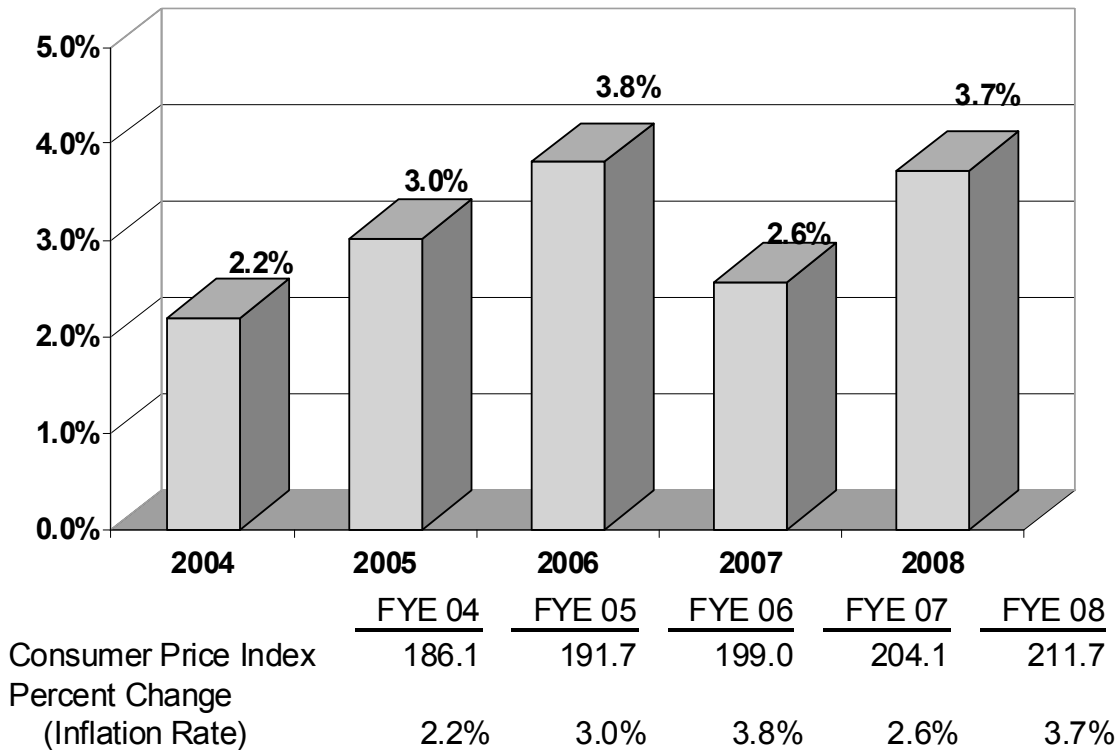
### Inflation

#### Description

The Consumer Price Index (CPI) is one of the most widely recognized and used measures of the average change in prices paid by consumers for goods and services over a period of time. The CPI is based on a weighted-average of prices for a market basket of goods from eight different groups: food and beverages, housing, apparel, transportation, medical care, recreation, education and communication, and other goods and services (e.g., tobacco and smoking products, haircuts and other personal services). Stability in price level changes and continued low rates of inflation are generally beneficial and indicate a positive trend.

#### Analysis

The overall rate of inflation during the measured period trended upward over the five-year period and was at or above the 3% average annual rate of inflation for three of the five years. The 2007 decline in inflationary pressures is mainly a combination of the slowdown in the economy, the Federal Reserve lowering the borrowing rate to spur economic activity, and declining fuel prices at the time.



Calculation:  $(\text{Current CPI} - \text{previous CPI}) / \text{Previous CPI} (*100)$

## COMMUNITY NEEDS AND RESOURCES

### Residential Development

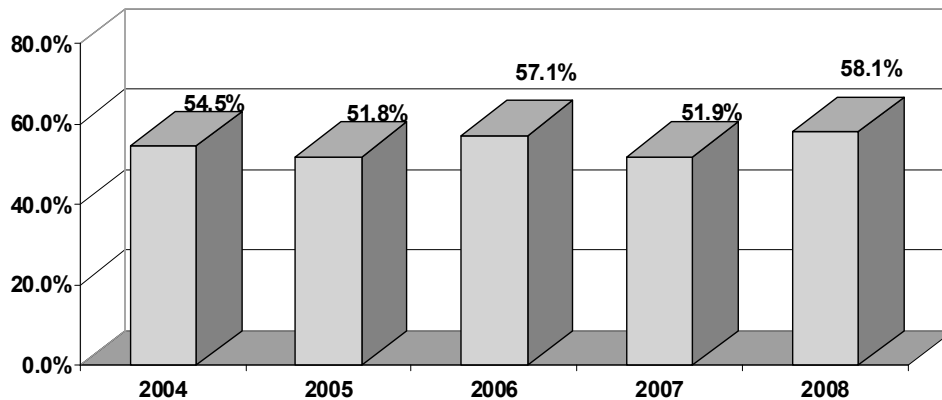
#### Description

Generally, the net cost of servicing residential development is higher than the net cost of servicing commercial or industrial development. Under this set of circumstances, the ideal condition would be to have sufficient commercial and industrial development to more than offset the costs of the residential development. There are exceptions to this situation. For example, a high-density residential area occupied by middle-aged, wealthy families whose children have already left home, who are heavy consumers, and who look to the government for very few services, can generate more revenues than service costs.

#### Analysis

The City's residential development as a percent of total property remained above 50 percent from 2004-2008, helped mostly by the 2004-2006 construction rebound and hot housing market spurred by historically low interest rates. The increase in assessed values in FYE 2008 is due to the timing of when the valuations were determined. The numbers for 2008 pertain to property tax year 2007 and such numbers are based on assessor valuations that were determined in the fall of 2005. The fall of 2005 was during the peak of property valuation increases and is mainly the reason for the large increase of AV's pertaining to FY 2008. In the near-term, the market share of custom residential construction in Scottsdale will be higher than new mass-market homes due to the lack of inventory of subdivision parcels available for standard residential construction. Also, residential reinvestment should take on an increased share of residential development because of infill and redevelopment projects, especially in the City's southern areas.

(as % of total property)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Assessed Value Residential Property	\$2,373,446	\$2,460,307	\$2,792,337	\$2,919,838	\$4,583,036
Assessed Value All Property	\$4,352,442	\$4,753,407	\$4,888,698	\$5,629,925	\$7,892,133
Percent Residential Development/Total Property	54.5%	51.8%	57.1%	51.9%	58.1%

Calculation: (Assessed Value Residential/Assessed Value All Property)\*100

## COMMUNITY NEEDS AND RESOURCES

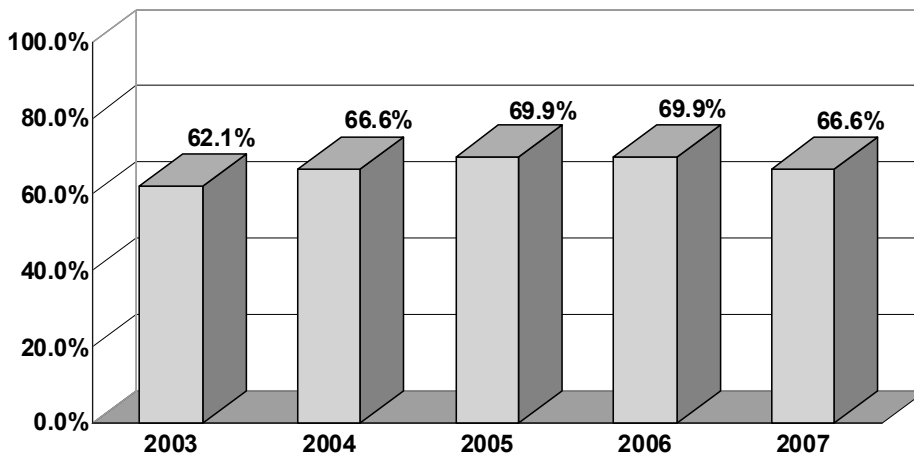
### Hotel/Motel Occupancy Rates

#### Description

If the economy is sluggish or declining, the demand for hotel and motel rooms can go down and occupancy rates may decrease. Conversely, a growing economy may lead to higher demand for hotel and motel room rentals and, therefore, higher occupancy rates. This indicator can provide early warning of more serious economic problems.

#### Analysis

After 9/11 and the 2001 recession, the tourism industry had seen a slow but steady increase in leisure and business travelers from 2003-2006. 2007 reflects the start of another downturn for the tourism industry due to the second economic recession of the decade. The outlook for hoteliers and the travel industry as a whole remains dim until the economy starts showing signs of a significant turnaround. In addition to the overall health of the tourism industry based on the economy, Scottsdale's occupancy rates are impacted by competition from new hotels in neighboring cities, as well as growth in the number of rooms within Scottsdale due to newly added and remodeled hotels.



Scottsdale Room Total	9,035	8,848	8,932	9,021	9,034
	CYE 03	CYE 04	CYE 05	CYE 06	CYE 07
Hotel/Motel Occupancy	62.1%	66.6%	69.9%	69.9%	66.6%
Percent Change	2.5%	7.2%	5.0%	0.0%	(4.7%)

CYE: Calender Year Ending

Calculation: (Current year less previous year)/Previous year (\*100)

## COMMUNITY NEEDS AND RESOURCES

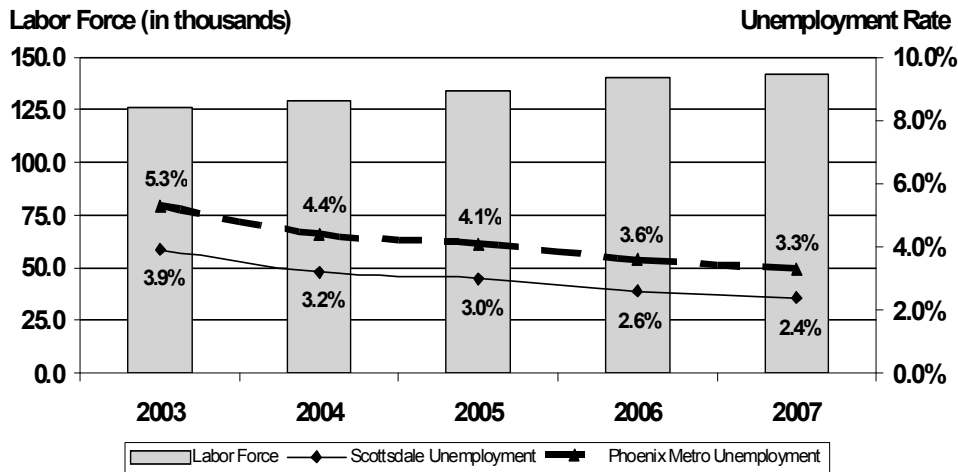
### Employment Base

#### Description

Changes in the rate of employment of the community's citizens are related to changes in personal income and, accordingly, are a measure of and an influence on the community's ability to support its local business sector. A decline in employment base, as measured by lack of employment, can be an early warning signal that overall economic activity and governmental revenues may be declining.

#### Analysis

Scottsdale experienced steady growth in the labor force over the five year period. Also, Scottsdale's unemployment rate remained lower than the unemployment rates of surrounding cities and is significantly lower than the State and national unemployment rates – results of a well-educated and highly trained workforce and available employment from the City's business segment.



	CYE 03	CYE 04	CYE 05	CYE 06	CYE 07
Scottsdale Labor Force	125,900	129,400	133,600	140,100	142,000
Scottsdale Unemployment Rate	3.9%	3.2%	3.0%	2.6%	2.4%
Phoenix-Metro Unemployment Rate	5.3%	4.4%	4.1%	3.6%	3.3%

## COMMUNITY NEEDS AND RESOURCES

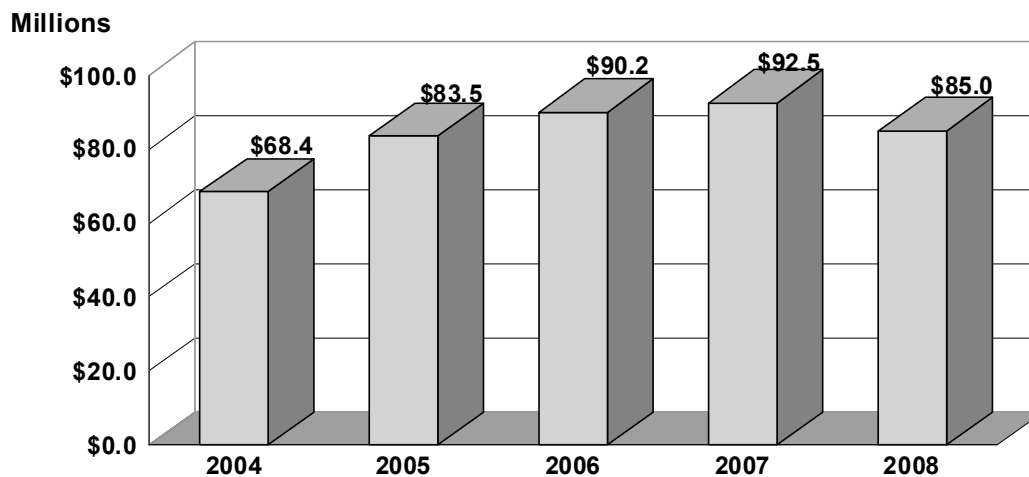
### Business Activity

#### Description

The level of business activity directly affects the City's financial condition by revenue sources, such as sales tax and bed tax receipts, and indirectly to the extent that a change in business activity affects other demographic and economic areas, such as employment base, personal income, or property values. Changes in business activity also tend to be cumulative, causing a positive or negative impact on all related factors such as employment base, income, and property value.

#### Analysis

After the economic downturn related to 9/11 and the 2001 recession, subsequent years showed a rebound in sales tax and bed tax revenues and corresponding business activity for the City due to the economic recovery during this period. Net constant dollars reflect dollar amounts adjusted for inflation, based on buying power in a base year. Higher consumer confidence and consumer spending, strong retail sales activity, the resurgence of tourism, and newly added business segments from companies locating to Scottsdale all contributed to the City's growth in sales tax revenues through FYE 2007. The decline in revenues for FYE 2008 begin to show the signs of the economic downturn and recession that economists report started around December 2007.



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Total Sales/Bed Tax Revenue	\$127,383	\$160,148	\$179,400	\$188,717	\$179,866
Consumer Price Index	186.1	191.7	199.0	204.1	211.7
Net Constant Dollar Sales Tax Revenue (Business Activity)	\$68,449	\$83,541	\$90,151	\$92,463	\$84,963

Calculation: Sales and Bed Tax/CPI (\*100)

## COMMUNITY NEEDS AND RESOURCES

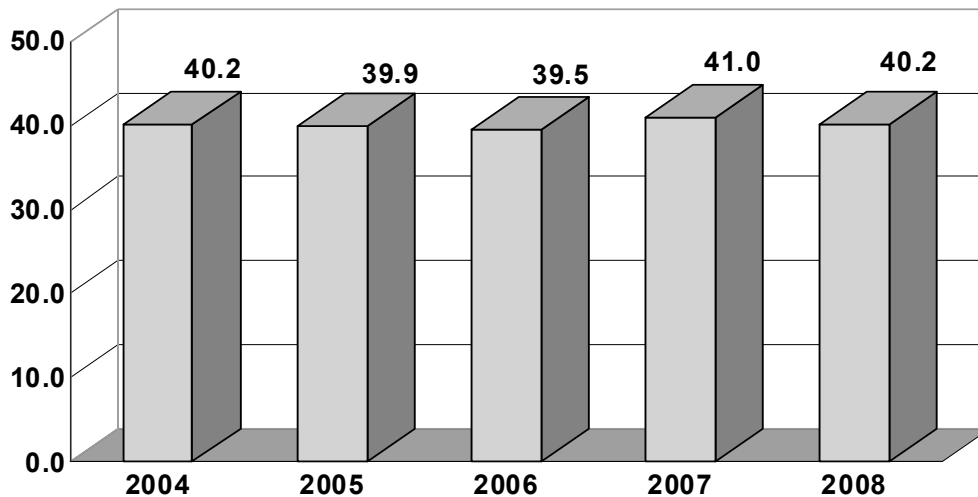
### Median Age

#### Description

Median age of population may affect both City revenues and expenditures. Income of seniors in the form of social security and pension payments are not subject to tax and seniors tend to spend less than younger persons. Expenditures may be affected by seniors requiring higher public service costs, such as health and welfare, and families with young children demanding services for schools, recreational, and related programs. A younger median age for a city may pose different opportunities and challenges, such as the community's ability to reinvest in businesses, neighborhoods and homes, the availability of secondary and postsecondary education, and the number of bars and clubs in its entertainment districts.

#### Analysis

The median age of Scottsdale's population is within the midrange portion of the working age (35-45). Scottsdale's downtown revitalization and the ASU/Scottsdale Center for New Technology and Innovation site are contributing to an urban setting that are expected to appeal to young, creative, and high-tech individuals.



	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Median Age	40.2	39.9	39.5	41.0	40.2
Percent Change	-0.7%	-0.7%	-1.0%	3.8%	-2.0%

Calculation: (Current less previous year)/Previous year (\*100)

## COMMUNITY NEEDS AND RESOURCES

### Personal Income Per Capita

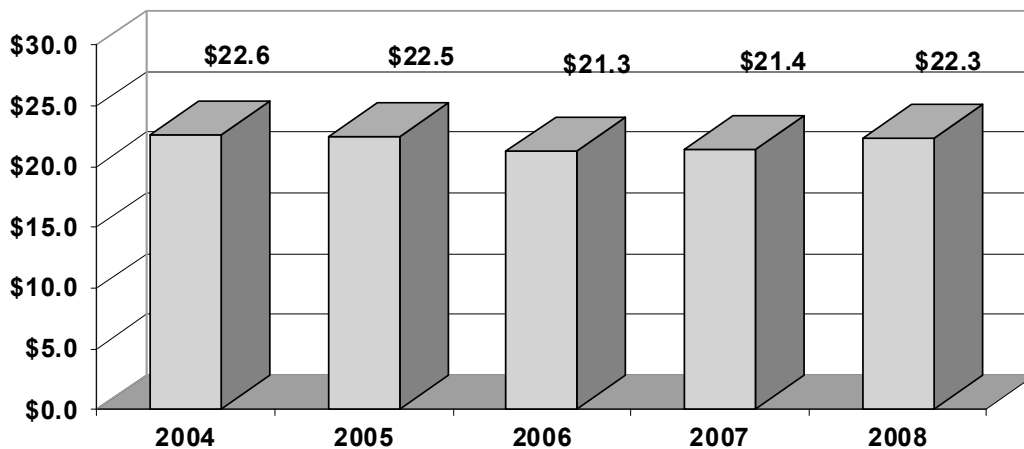
#### Description

Personal income is one measure of a community's ability to pay taxes. Generally, the higher the per capita income, the more property taxes, sales taxes, income taxes, and business taxes the City can generate. If income is distributed evenly, a higher per capita income will usually mean a lower dependency on governmental services, recreation, and welfare. A decline in per capita income results in loss of consumer purchasing power and can provide advance notice that businesses, especially in the retail sector, will suffer a decline that can ripple through the rest of the City's economy. Credit rating firms use per capita income as an important measure of a City's ability to meet its financial obligations.

#### Analysis

The City's per capita personal income remained relatively strong during the five-year measurement period. The slight decline in 2006 and into 2007 can be attributed to inflationary factors from a rising CPI, which affects the value of the dollar. The overall consistent trend indicates that Scottsdale consumers have strong purchasing power and the ability to pay for public services.

Thousands (in constant dollars)



	<u>FYE 04</u>	<u>FYE 05</u>	<u>FYE 06</u>	<u>FYE 07</u>	<u>FYE 08</u>
Personal Income (millions)	\$9,158	\$9,515	\$9,896	\$10,367	\$11,329
Consumer Price Index	186.1	191.7	199.0	204.1	211.7
Population (in thousands)	218	221	234	237	240
Net Constant Dollar Personal Income (in 000s)	\$22.6	\$22.5	\$21.3	\$21.4	\$22.3

Calculation: (Per Capita Income \* Population)/CPI/Population \*100

## COMMUNITY NEEDS AND RESOURCES

### Property Value

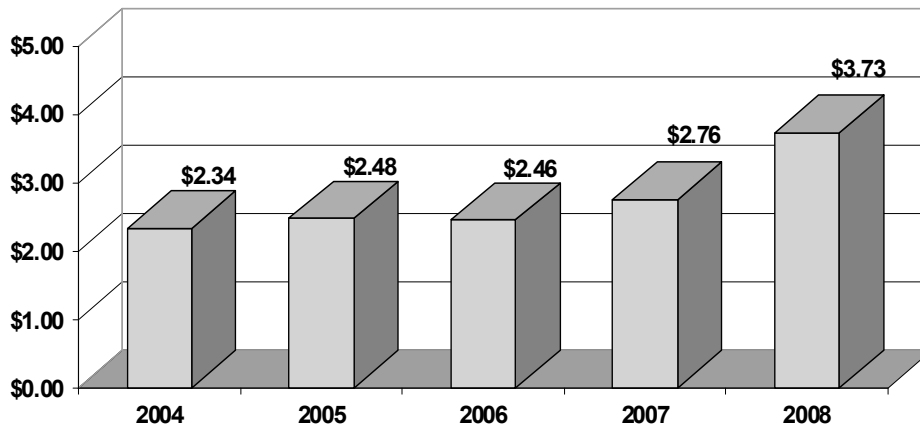
#### Description

Property value is an important indicator since general property taxes (primary tax) account for approximately eight percent of City operating revenue. The net assessed value is used as an indicator of the City's aggregate property value on which the property tax rate is applied to compute City property tax revenue.

#### Analysis

Scottsdale's assessed valuation experienced solid overall growth from fiscal years 2004-2008, which is a good indicator of the community's economic well-being and revenue base. This positive trend indicates that the community's tax base and its ability to pay for public services and capital projects are healthy. In FYE 2006, CPI increased at a greater rate than assessed valuations increased, resulting in a slight negative percentage. The increase in assessed values in FYE 2008 is due to the timing of when the valuations were determined. The numbers for 2008 pertain to property tax year 2007 and such numbers are based on assessor valuations that were determined in the fall of 2005. The fall of 2005 was during the peak of property valuation increases and is the primary reason for the large increase of AV's pertaining to FY 2008.

Net Assessed Valuations (in billions of constant dollars)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Net Assessed Valuations	\$4,352,442	\$4,753,407	\$4,888,698	\$5,629,925	\$7,892,133
Consumer Price Index	186.1	191.7	199.0	204.1	211.7
Net Constant Dollar					
Assessed Valuations	\$2,338.77	\$2,479.61	\$2,456.63	\$2,758.41	\$3,727.98
Percentage Change Net Constant Dollar Assessed Valuations	5.3%	6.0%	-0.9%	12.3%	35.1%

Calculation: Net Assessed Value/CPI

## COMMUNITY NEEDS AND RESOURCES

### Crime Rate

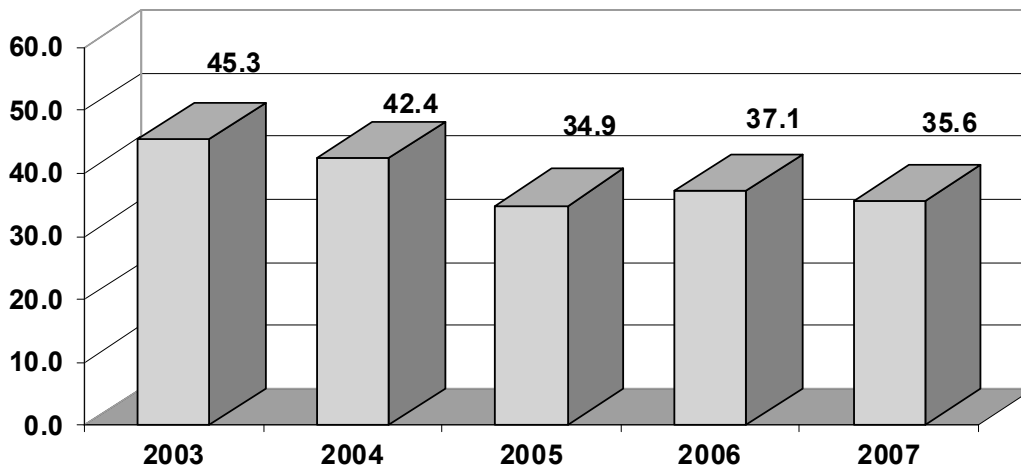
#### Description

A city's crime rate can significantly impact all aspects of a community's well-being. Rising crime rates may not only ruin a city's reputation, but may also result in additional direct and indirect financial burdens to the city, such as additional police enforcement, increased costs for repair or replacement of damaged or stolen property, higher rates for property and auto insurance, and declines in tourism and overall population. In general, a city with growing population tends to experience an increase in crime activity. The goal should be to keep criminal activity in check with minimal spikes to the crime rate in order to ensure the safety of its residence and visitors, and to maintain a high quality of place and destination.

#### Analysis

Despite the City's growing population, Scottsdale has seen a downward trend in Part I Offenses since 2003, indicating effective public safety efforts by the City. Part I Offenses are eight crime categories identified by the Federal Bureau of Investigation to measure criminal activity. The categories include theft, car theft, burglary, robbery, assault, homicide, rape, and arson.

(per 1,000 population)



(per 1,000 population)	CYE 03	CYE 04	CYE 05	CYE 06	CYE 07
Total Part I Crimes	10,013	9,498	8,228	8,870	8,607
Population	220,860	224,230	235,720	238,900	241,750
Crime Index per 1,000	45.3	42.4	34.9	37.1	35.6

Calculation: Total Part I Crimes/Population (\*1000)

## **REVENUES**

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### **Revenue**

Revenue determines the capacity of the City to provide services. Important issues to consider with respect to revenue are economic growth, diversity, reliability, flexibility, and administration. Under ideal conditions, revenue should be growing at a rate equal to or greater than the combined effects of inflation and expenditures. Revenue should be sufficiently unrestricted to allow for necessary adjustments to changing economic and operational conditions. Revenue should be balanced between elastic and inelastic sources with respect to economic base and inflation. Some revenue sources should grow with the economic base and inflation, while others should remain relatively constant. Revenue should be diversified by source so as not to be overly dependent on residential, commercial, or industrial land uses, or external funding sources such as Federal grants or discretionary State aid. User fees should be regularly reevaluated to cover the full costs of services.

Analyzing the City's revenue structure will help to identify the following types of problems:

- Deterioration of revenue base.
- Internal procedures or legislative policies that may adversely affect revenue yields.
- Overdependence on obsolete or external revenue sources.
- Changes in tax burden.
- Lack of cost controls and poor revenue estimating practices.
- Inefficiency in the collection and administration of revenue.

The indicators detailed on the following pages can be used to monitor changes in revenue.

## REVENUES

### Revenue Per Capita

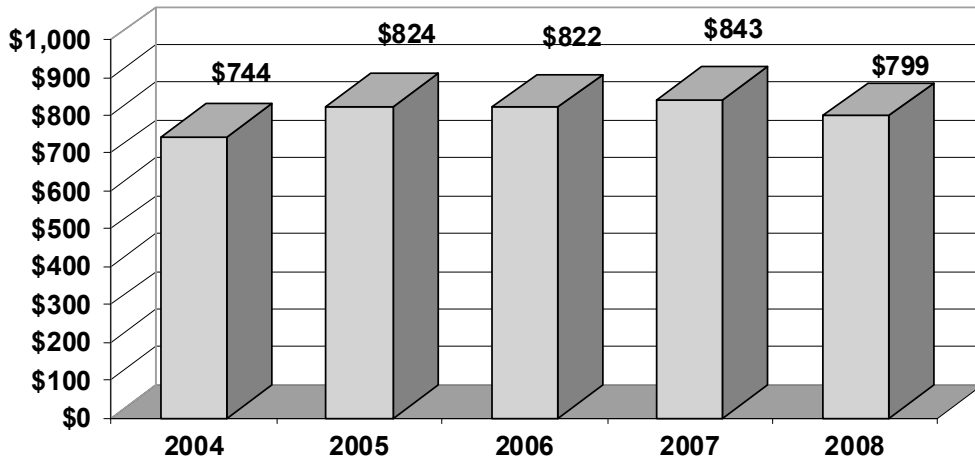
#### Description

Per capita revenue illustrates revenue changes relative to population changes. As population increases, it may be expected that the need for services would increase proportionately and, therefore, the level of per capita revenue should remain at least constant in real terms. If per capita revenue is decreasing, it would be expected that the City would be unable to maintain existing service levels unless it were to find new revenue sources or financial savings, assuming cost of service correlates to population.

#### Analysis

Net constant dollar revenue per capita (non-enterprise operations) reflected an overall neutral trend during the five year period. The 2005 operating revenue increase reflects new public safety tax approved by voters in 2004, which has an impact on several other trend indicators, as discussed throughout this report. The 2008 revenues show initial signs of the economic recession.

(in constant dollars)



(in thousands)	<u>FYE 04</u>	<u>FYE 05</u>	<u>FYE 06</u>	<u>FYE 07</u>	<u>FYE 08</u>
Operating Revenue	\$301,690	\$348,914	\$382,549	\$407,567	\$405,805
Consumer Price Index	186.1	191.7	199.0	204.1	211.7
Current Population	218	221	234	237	240
Net Constant Dollar Revenue Per Capita	\$744	\$824	\$822	\$843	\$799

Calculation: Operating Revenue/CPI/Population (\*100)

## REVENUES

### Elastic Tax Revenue

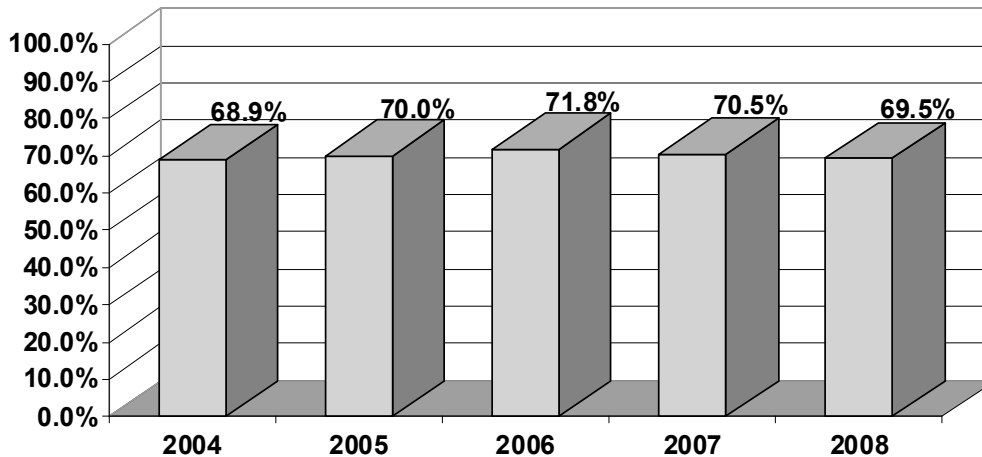
#### Description

Elastic revenues are highly responsive to changes in the economy and inflation. As the economy grows and inflation increases, elastic revenues increase in approximately the same proportion, and vice versa. For example, sales tax revenues rise and fall with increases and decreases in retail sales and corresponding economic growth or retrenchment. Inelastic revenues, such as fixed license fees or user charges, are relatively unresponsive to changes in economic conditions. The following City revenues are elastic revenues: Sales Tax, Transient Occupancy Tax (hotel/motel tax), State-Shared Sales Tax, State Revenue Sharing, Auto Lieu Tax, Highway User Tax (fuel tax), State-Shared Transit Revenue, Local Transportation Assistance Fund Revenue (Lottery), and Development Permits and Fees.

#### Analysis

Scottsdale's elastic tax revenue as a percent of net operating revenue remained consistent over the five-year period. However, Scottsdale's heavy reliance upon elastic revenue sources places a higher degree of risk upon the City's ability to maintain services during economic downturns. For example during the current economic recession, FYE 2008 began to reflect significant drops in automotive, construction, and building permit fees, which are all highly elastic revenues that move with the economy.

(as % of operating revenue)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Elastic Tax Revenues	\$207,742	\$244,273	\$274,500	\$287,529	\$281,834
Net Operating Revenue	\$301,690	\$348,914	\$382,549	\$407,567	\$405,805
Percent Elastic Tax/ Net Operating Revenue	68.9%	70.0%	71.8%	70.5%	69.5%

Calculation: Elastic Tax Revenues/Operating Revenue (\*100)

## REVENUES

### Property Tax Revenue

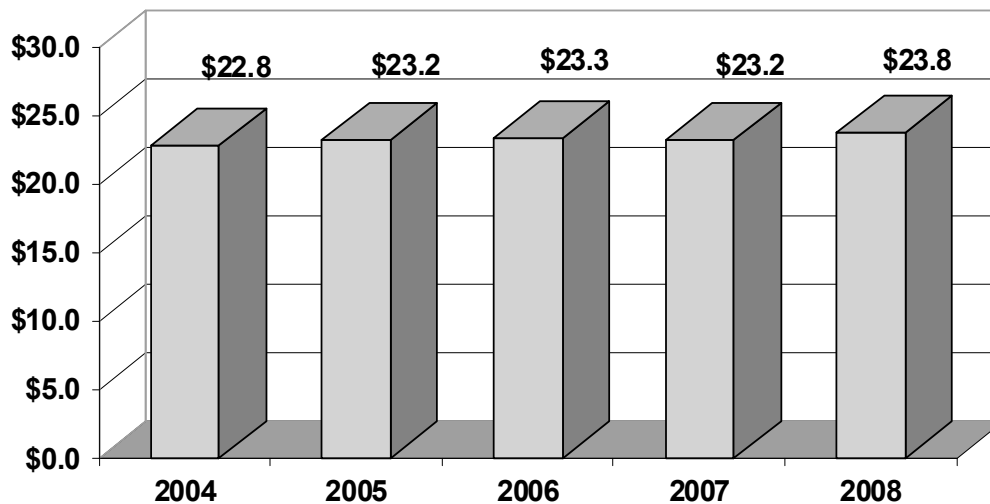
#### Description

Property tax is an important revenue source to consider when evaluating financial condition. Property tax revenue represents the City's second largest revenue source. There are two main components of property tax. Primary property taxes are levied for maintenance and operations of the City and secondary property taxes are levied solely for debt retirement related to capital improvements. In contrast to sales taxes, property taxes are relatively inelastic due to a State imposed 2.0 percent annual levy limitation on the primary property tax rate.

#### Analysis

Despite reductions in property tax rates, property tax revenues continue to remain stable, primarily due to assessed value growth and new construction. Property tax revenue may also increase depending on future voter-approved debt issuances for capital improvements and related changes in Scottsdale's secondary tax rates.

#### Millions (in constant dollars)



(in thousands)	<u>FYE 04</u>	<u>FYE 05</u>	<u>FYE 06</u>	<u>FYE 07</u>	<u>FYE 08</u>
Property Tax Revenue	\$42,377	\$44,464	\$46,431	\$47,313	\$50,320
Consumer Price Index	186.1	191.7	199.0	204.1	211.7
City Property Tax Rate	1.1207	1.0702	1.0439	0.9704	0.7945
Constant Dollar Property Tax Revenue	\$22,771	\$23,195	\$23,332	\$23,181	\$23,769

Calculation: Property Tax Revenue/CPI (\*100)

\*Property Tax Rates per \$100 Assessed Valuation.

## REVENUES

### Uncollected Property Taxes

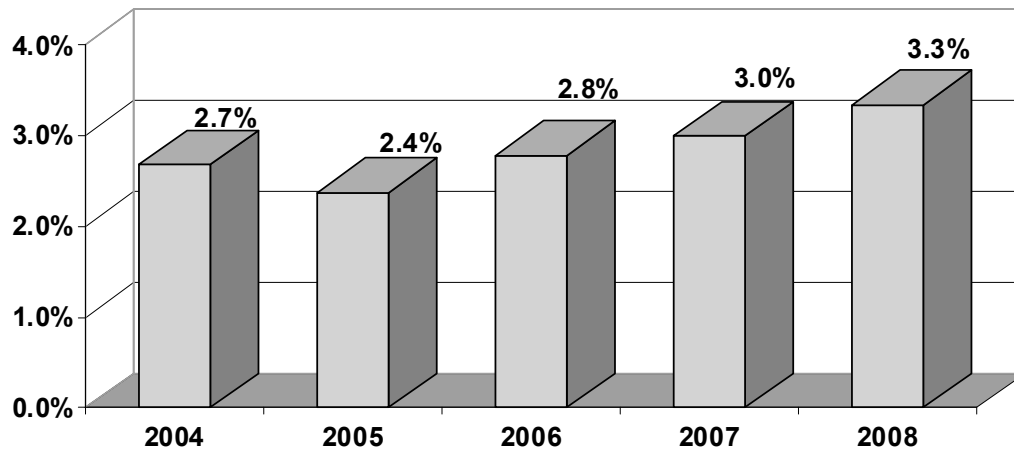
#### Description

A certain percentage of property taxes are not collected because of certain property owners' inability to pay, deficiencies in collection methods, policies and procedures, or a declining economy. The credit rating agencies consider an uncollectible rate of 2 or 3 percent per year normal. If the delinquency rate rises for two consecutive years or to more than 5 to 8 percent, it may signal potential problems in the stability of the property tax base or collection methods.

#### Analysis

Maricopa County collects and distributes property taxes to the City. Uncollected property taxes as a percentage of the total property tax levy have slowly increased over the last four years, resulting in a growing trend of uncollected taxes. However, the uncollected percentage is within bond rating agency benchmarks and does not (yet) signal an alarming trend. Given the current economic downturn and related housing bust and record number of foreclosures, the City will closely monitor this measurement in the future.

(as % of total levy)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Uncollected Property Taxes	\$1,143	\$1,057	\$1,325	\$1,459	\$1,696
Net Property Tax Levy	\$42,756	\$44,731	\$47,659	\$48,778	\$50,838
Percent Uncollected Property Taxes/Tax Levy	2.7%	2.4%	2.8%	3.0%	3.3%

Calculation:  $\text{Uncollected Property Taxes} / \text{Net Property Tax Levy} (*100)$

## REVENUES

### Intergovernmental Revenue

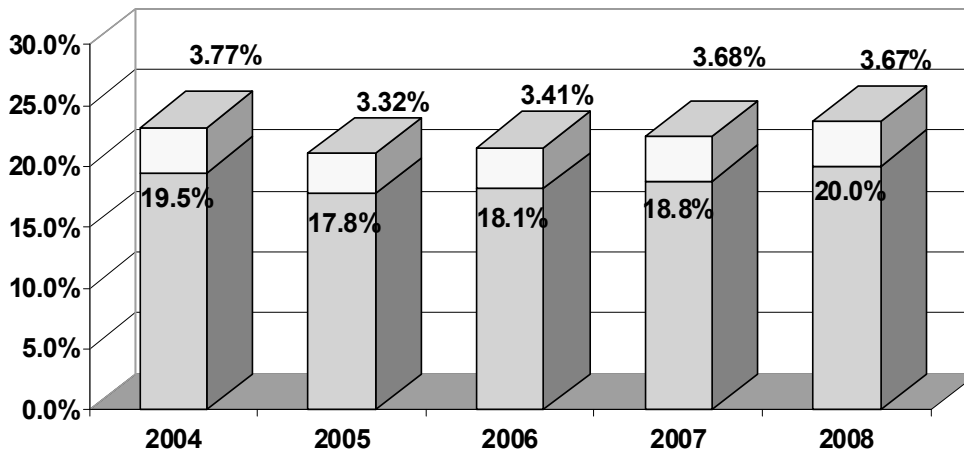
#### Description

Intergovernmental revenues are received from other governmental entities. An overdependence on intergovernmental revenues can have an adverse impact on financial condition due to restrictions or stipulations that the other governmental entity attaches to the revenue. The overriding concern in analyzing intergovernmental revenues is to determine whether the City is controlling its use of the revenues or whether these revenues are controlling the City.

#### Analysis

Generally, Scottsdale is not becoming overly dependent on intergovernmental revenue sources that, if reduced, could have an adverse impact on financial condition. Intergovernmental revenues as a percentage of operating revenues have remained relatively stable over the measurement period. The decrease in 2005 is primarily due to the increase in operating revenues related to the tax rate approved by voters to support public safety services. Future concerns include Scottsdale's slowing population growth relative to other Valley cities, which will impact the distribution of state-shared revenues.

(as % operating revenue)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Intergovernmental Revenue (Excluding Grant Revenue)	\$58,716	\$61,948	\$69,413	\$76,545	\$81,246
Grant Revenue	\$11,366	\$11,581	\$13,052	\$14,996	\$14,874
Operating Revenue	\$301,690	\$348,914	\$382,549	\$407,567	\$405,805
Percent Intergovernmental of Gross Operating Revenue	19.5%	17.8%	18.1%	18.8%	20.0%
Percent Grant Revenue of Gross Operating Revenue	3.8%	3.3%	3.4%	3.7%	3.7%

Calculations: Intergovernmental Revenues/Operating Revenues (\*100), Grant Revenues/Operating Revenues (\*100).

## REVENUES

### User-Charge Coverage

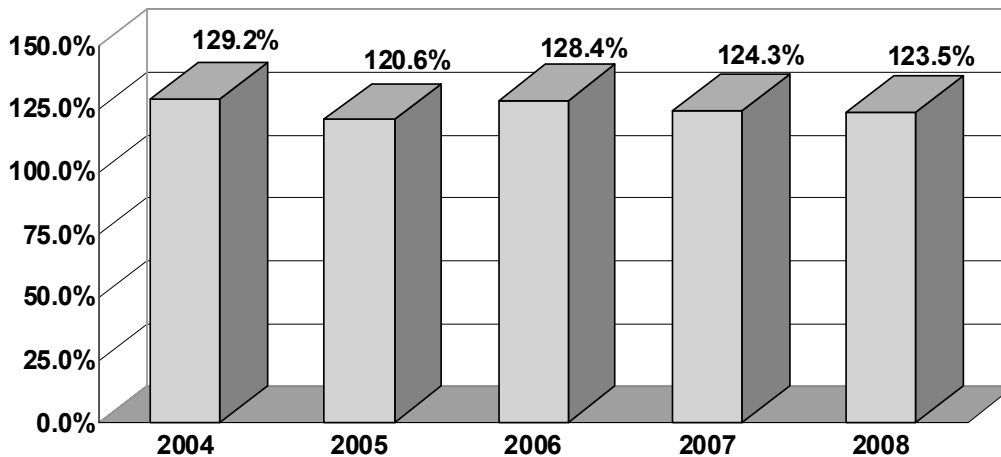
#### Description

User-charge coverage refers to whether user fees and charges recover the cost of providing a service. Cost recovery from user fees and charges applies to the City's enterprise operations: Water and Wastewater, Solid Waste, and Aviation. User fees and charges are established in Enterprise Funds to promote efficiency by shifting payment of costs to specific users of services and to avoid general taxation. Moderate rate increases are included as part of the budget to offset inflationary operating cost increases, mandated (and often unfunded) environmental standard compliance, and pay-as-you-go capital costs attributable to repair and replacement of infrastructure. Service costs, user fees and charges should be reviewed and adjusted where necessary to maintain cost recovery.

#### Analysis

On a combined basis (Water and Wastewater, Solid Waste, and Aviation), the user-charge coverage ratio maintained a neutral trend over the five-year period, indicating prudent management practices of balancing incremental fee increases with rising operating and capital costs. Fees and user charges in excess of related service expenditures are planned for debt retirement, pay-as-you-go capital expenditures, or retained for future repair and replacement and/or peaks in projected operating costs.

(as % of expenses)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Fees and User Charges	\$116,323	\$121,082	\$129,827	\$139,068	\$148,392
Related Service Expenses	\$90,067	\$100,383	\$101,146	\$111,857	\$120,198
Percent Coverage User Fees/ Enterprise Expenditures	129.2%	120.6%	128.4%	124.3%	123.5%

Calculation: Fees & User Charges/Related Service Expenses (\*100)

## REVENUES

### Restricted Revenue

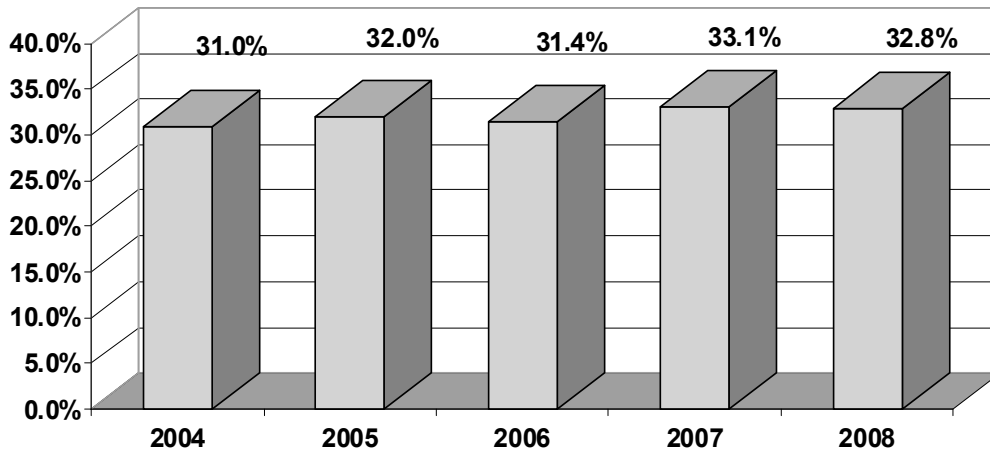
#### Description

Restricted revenue is legally earmarked for specific use, as may be required by State law, bond covenants, or grant requirements. For example, the State of Arizona requires that gas tax revenue be used only for street maintenance or construction. As the percentage of restricted revenue increases, the City loses its flexibility to respond to changing conditions. Overdependence on restricted revenues would make the City's programs vulnerable to dictates by the funding agencies and may signal a future inability to maintain current service levels at the least.

#### Analysis

Scottsdale's restricted revenues reflected a neutral trend over the five years, indicating that the City has flexibility in spending its revenue sources and is not becoming overly dependent on restricted revenues to run its operations. Scottsdale's restricted revenue is composed primarily of property taxes and special assessment collections, both of which are levied by the City and are secured by real property, and the dedicated preserve and transportation sales taxes. The remaining restricted revenue is received from grants, gas tax revenue and lottery funds.

(as % of operating revenue)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Restricted Operating Revenue	\$93,425	\$111,690	\$120,303	\$135,030	\$133,266
Operating Revenue	\$301,690	\$348,914	\$382,549	\$407,567	\$405,805
Percent Restricted/Net Operating Revenue	31.0%	32.0%	31.4%	33.1%	32.8%

Calculation: Restricted Operating Revenue/Operating Revenue (\*100)

## **EXPENDITURES**

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### **Expenditures**

Expenditures are an approximate measure of the City's service output. Generally, the more the City spends in constant dollars, the more service it is providing. This reasoning does not account for service delivery efficiency and effectiveness.

The first issue to consider is the expenditure growth rate to determine whether the City is operating within its revenues. Since the City of Scottsdale is required to have a balanced budget, it would seem unlikely that expenditure growth would exceed revenue growth. Nevertheless, the City may balance its annual budget yet create a long-run imbalance in which expenditure outlays and commitments grow faster than revenues. Some of the more common ways in which this happens are to use bond proceeds for operations, use reserve funds, and defer maintenance on streets, buildings, or other capital stock, or by deferring funding of contingent liabilities. In each of these cases, the budget remains balanced, but the long-run budget is developing a deficit.

A second issue to consider is the level of mandatory or fixed costs. This is also referred to as expenditure flexibility, which is a measure of the City's freedom to adjust its service levels to changing economic, political, and social conditions. A city with a growing percentage of mandatory costs will find itself proportionately less able to make adjustments. As the percentage of debt service, matching requirements, pension benefits, State and Federal mandates, contractual agreements, and commitments to existing capital plant increase, the flexibility to make spending decisions decreases.

Ideally, the City will have an expenditure growth rate that does not exceed its revenue growth rate and will have maximum spending flexibility to adjust to changing conditions. Analyzing the City's expenditure profile will help identify the following types of problems:

- Excessive growth of overall expenditures as compared to revenue growth in community wealth.
- An undesired increase in fixed costs.
- Ineffective budget controls.
- A decline in personnel productivity.
- Excessive growth in programs that create future expenditure liabilities.

The indicators detailed on the following pages can be used to monitor changes in expenditures.

## EXPENDITURES

### Expenditures Per Capita

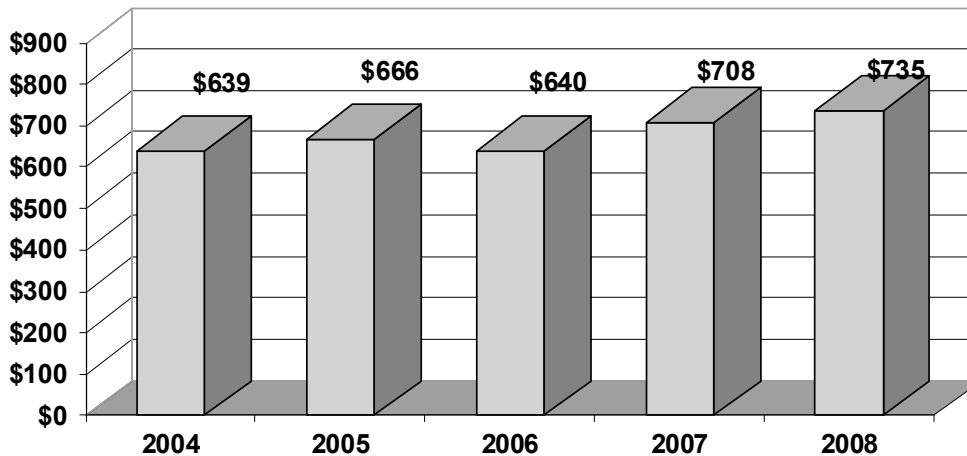
#### Description

Per capita expenditures reflect changes in expenditures relative to changes in population. Increasing per capita expenditures may indicate that the cost of providing services is outstripping the City's ability to pay, especially if spending is increasing faster than the City's property, sales, or other relevant tax base. If the increase in spending is greater than would be expected from continued inflation and cannot be explained by the addition of new services, it can be an indicator of declining productivity.

#### Analysis

The City's expenditures per capita (non-enterprise operations) trended downward from 2003-2004, reflecting continued cost saving measures reflecting a slowly recovering economy. The increase in expenditures per capita in 2005 is a result of increased public safety efforts related to the 2004 sales tax approved by voters, as well as one-time start-up costs for the new municipal fire department. 2006 reflects greater-than-expected year-end department savings primarily related to contractual and personal services. 2007-2008 operating expenditures address compensation and staffing needs for public safety and operating costs associated with new or expanded capital facilities related to service growth and citizen/Council priorities, including the new McDowell Mountain Ranch Aquatic Center, Arabian Library, Chaparral park and Scottsdale Ranch park expansions, and increased maintenance levels at youth sports fields, per City Council direction.

(in constant dollars)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Operating Expenditures	\$259,378	\$282,269	\$298,049	\$342,634	\$373,659
Consumer Price Index	186.1	191.7	199.0	204.1	211.7
Current Population	218	221	234	237	240
Net Constant Dollar Expenditures Per Capita	\$639	\$666	\$640	\$708	\$735

Calculation: Net Expenditures/CPI/Population (\*100)

## EXPENDITURES

### Operating Expenditures – Service Areas

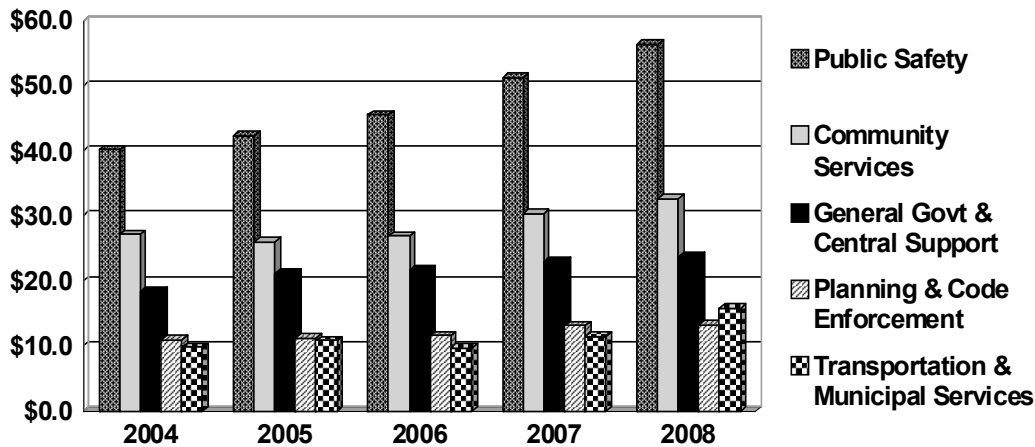
#### Description

Tracking a city's operating expenditures by service areas can be a useful tool in analyzing developing trends that may indicate need for further attention or resources. Shifting trends may reflect a city's efforts to address goals and objectives, specific needs of the community, or may indicate an underlying problem that requires a shift in focus and/or resources.

#### Analysis

The City's operating expenditures by service area (Governmental Funds) over the five-year period reflect requested service level needs by the community, as well as increased operating costs related to both new and current capital facilities. The year-over-year increases to Public Safety (Police and Fire) expenditures can be attributed to general inflationary costs related to City operations, the addition of a new municipal fire department, and increased service level demands by the community, as reflected by the voter-approved 2004 Public Safety Sales Tax. Expenditure increases for Community Services reflect staffing and operating needs for newly opened or expanded capital facilities, such as McDowell Mountain Ranch Aquatic Center, Arabian Library, Chaparral park and Scottsdale Ranch park, as well as increased maintenance levels at youth sports fields, per City Council direction. Note: Expenditures by individual service areas do not reflect net constant dollars.

(in millions)



(in millions)

	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Public Safety	\$40.2	\$42.4	\$45.5	\$51.4	\$56.5
Planning & Code Enforcement	\$10.8	\$11.2	\$11.6	\$13.0	\$13.2
Transportation & Public Works	\$9.8	\$10.7	\$9.5	\$11.3	\$15.8
Community Services	\$27.1	\$26.1	\$26.9	\$30.3	\$32.7
General Govt & Central Support	\$18.2	\$21.1	\$21.6	\$22.9	\$23.7
<b>Total Expenditures (constant dollars)</b>	<b>\$106.2</b>	<b>\$111.4</b>	<b>\$115.1</b>	<b>\$129.0</b>	<b>\$141.8</b>

## EXPENDITURES

### Employees Per Capita

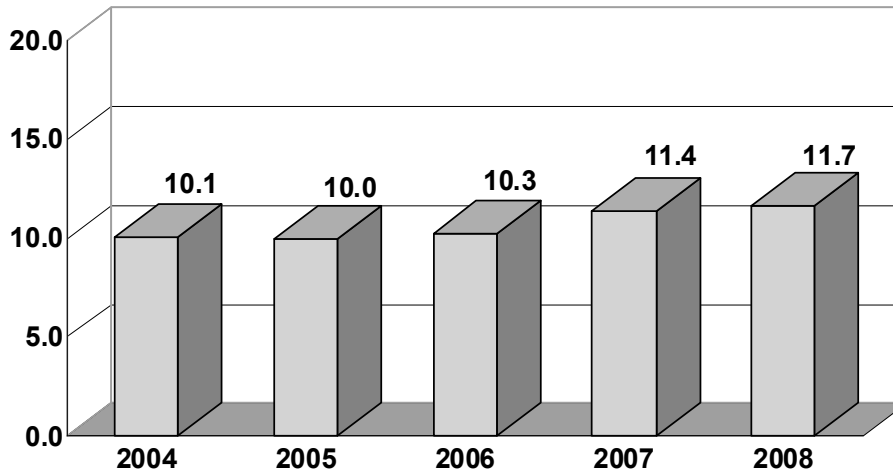
#### Description

Personnel costs are the largest portion of the City's operating budget. Tracking changes in the number of employees to population is a means to measure changes in expenditures. An increase in employees to population may indicate that expenditures are rising faster than revenues, the City is becoming more labor intensive, or that productivity is declining.

#### Analysis

Full Time Equivalents (FTEs) include full time, part time, and grant funded employees. The trend shown in the table below suggests that the City is providing increased service levels for the five year period, including additional police officers for public safety related to the 2004 sales tax approved by voters, the creation of a municipal fire department, and new staffing for large capital facility openings and expansions, including Chaparral Water Treatment Plant, CAP Basin Sports Complex, Arabian Library, McDowell Mountain Ranch Aquatic Center, and Chaparral park and Scottsdale Ranch park expansions.

(full-time equivalents per thousand citizens)



(in thousands)	<u>FYE 04</u>	<u>FYE 05</u>	<u>FYE 06</u>	<u>FYE 07</u>	<u>FYE 08</u>
Full-Time Equivalents (FTE)	2.2	2.2	2.4	2.7	2.8
Population	218	221	234	237	240
Full-Time Equivalents Per 1,000 Citizens	10.1	10.0	10.3	11.4	11.7

Calculation: FTE/Population (\*1000)

## EXPENDITURES

### Fringe Benefits

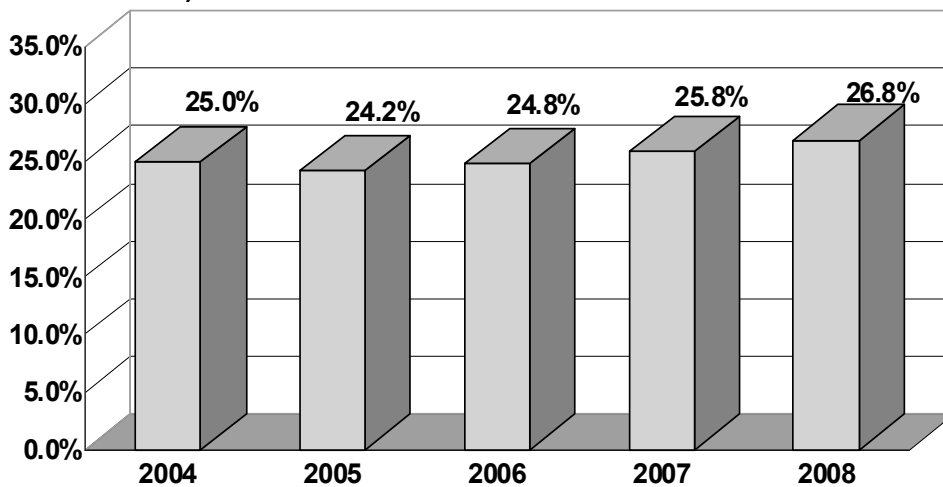
#### Description

Fringe benefits can be divided into two categories: direct and indirect. Direct fringe benefits requiring an immediate cash outlay include Social Security taxes, retirement system contributions, worker's compensation, life and health insurance, tuition reimbursement, and vehicle allowances. Indirect benefits, which include accumulated holiday, vacation, and sick leave, do not require immediate cash outlay but may require paying the opportunity cost of not having the work done or paying others to do the work.

#### Analysis

Fringe benefits as a percentage of salaries trended slightly upward over the five-year period. The increasing trend is attributable to rising health care costs, Social Security taxes and retirement system contributions, all of which are nationwide trends.

(as % of salaries)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Fringe Benefit Expenditures	\$26,366	\$27,395	\$34,247	\$39,192	\$45,156
Salaries and Wages	\$105,567	\$113,256	\$138,106	\$151,762	\$168,375
Percent Fringe Benefits/ Salaries and Wages	25.0%	24.2%	24.8%	25.8%	26.8%

Calculation: Fringe Benefits/Salaries and Wages (\*100)

## **OPERATING POSITION**

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### **Operating Position**

Operating position refers to the City's ability to balance its budget on a current basis, maintain reserves for emergencies, and maintain sufficient cash to pay its bills on a timely basis.

During a typical year, a city will usually generate either an operating surplus, when revenues exceed expenditures, or an operating deficit, when expenditures exceed revenues. An operating surplus or deficit may be created intentionally as a result of a conscious policy decision, or may be created unintentionally because it is difficult to precisely forecast revenues and expenditures. When deficits occur, they are usually funded from accumulated fund balances; when surpluses occur, they are usually dedicated to funding future years' operations.

Reserves are built through the accumulation of operating surpluses. Reserves are maintained for the purposes of financial security in the event of loss of a revenue source, economic downturn, unanticipated expenditure demands due to natural disasters, insurance loss, need for large-scale capital expenditures or other non-recurring expenses, or uneven cash flow.

Sufficient cash, or liquidity, refers to the flow of cash in and out of the City treasury. The City receives many of its revenues in large installments at infrequent intervals during the year. It is to the City's advantage to have excess liquidity or cash reserves as security in the event of an unexpected delay in receipt of revenues, an unexpected decline or loss of a revenue source, or an unanticipated need to make a large expenditure.

An analysis of operating position can help identify the following situations:

- Emergence of operating deficits.
- Decline in reserves.
- Ineffective revenue forecasting techniques.
- Ineffective budgetary controls.
- Inefficiencies in management of enterprise operations.

The indicators detailed on the following pages can be used to monitor changes in operating position.

## OPERATING POSITION

### General Fund Balance

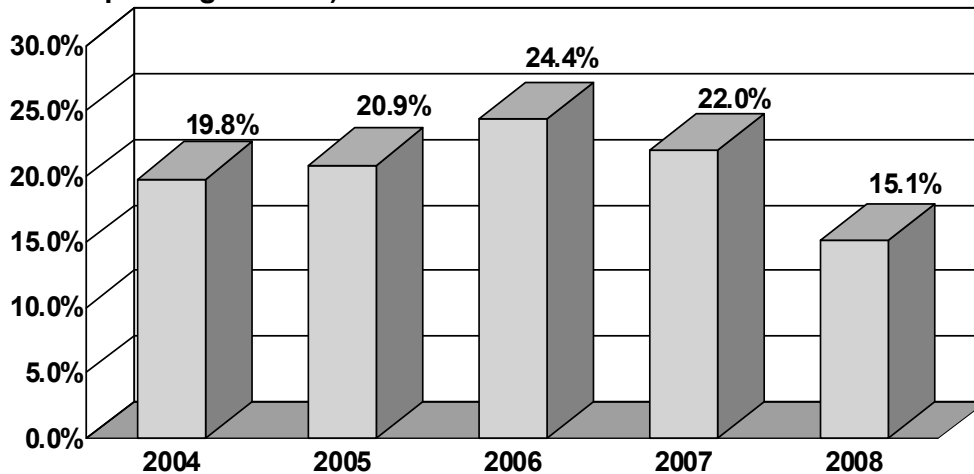
#### Description

The level of fund balances may determine the City's ability to withstand unexpected financial emergencies that may result from natural disasters, revenue shortfalls, or steep rises in inflation. Fund balances may also determine the City's ability to accumulate funds for large-scale purchases without having to borrow. Unrestricted fund balance includes financial policy designated reserves, contingencies, and unreserved fund balances.

#### Analysis

Scottsdale's unrestricted fund balance as a percent of operating revenue over the measured period showed an overall neutral trend, with increases during economic growth years and higher revenues, and decreases as the economy began to head south. The two year increase in fund balance from 2004-2006 is a result of the growing economy at the time, with higher actual revenues than forecasted and better-than-expected year-end department savings. FYE 2007 and 2008 reflect the transfer of funds as pay-as-you-go contribution to help pay for approved capital projects.

(as % of operating revenue)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Unrestricted Fund Balance	\$59,707	\$72,772	\$93,243	\$89,534	\$61,379
Operating Revenue	\$301,690	\$348,914	\$382,549	\$407,567	\$405,805
Percent Fund Balance/ Fund Operating Revenue	19.8%	20.9%	24.4%	22.0%	15.1%

Calculation: Unrestricted/Operating Revenue (\*100)

## OPERATING POSITION

### Enterprise Fund Operating Margin

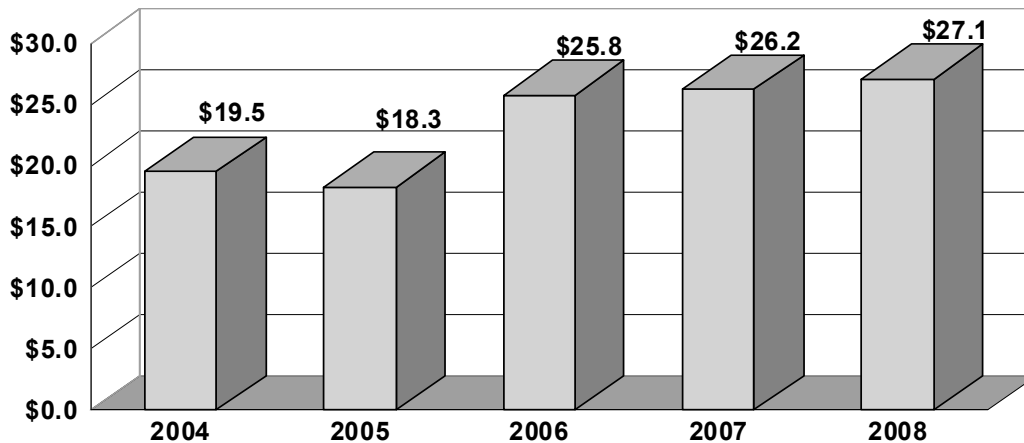
#### Description

Enterprises Funds are expected to function as if they are self-sufficient entities which are fully supported by user rates and fees that provide for the full cost of service as opposed to Government Funds which are supported by taxes. The Enterprise Funds use moderate rate increases as part of the budget to offset increasing operating costs, mandated (and often unfunded) environmental standard compliance, and pay-as-you-go capital costs attributable to repair and replacement of infrastructure. Positive operating results allow the Enterprise Funds to stabilize rate increases to a moderate level even in years where large expenditures must be made, e.g., the construction of a new plant. In times of financial strain, a city can raise taxes to increase support for governmental programs, however the Enterprise Funds must rely on annual rate increases and positive operating results in prior years.

#### Analysis

Operating margin fluctuations for 2004-2008 reflect forecast to actual variances, primarily due to the impacts of weather and rainfall on the water and wastewater fund revenues. User rates and fees in excess of related service expenditures are planned for debt retirement, pay-as-you-go capital expenditures, or are retained for future repair and replacement and/or peaks in projected operating costs.

Millions (in constant dollars)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Enterprise Operating Margin	\$36,266	\$35,045	\$51,332	\$53,480	\$57,441
Consumer Price Index	186.1	191.7	199.0	204.1	211.7
Net Constant Dollar					
Enterprise Fund Earnings	\$19,487	\$18,281	\$25,795	\$26,203	\$27,133

Calculation: Enterprise Results/CPI (\*100)

## OPERATING POSITION

### Liquidity

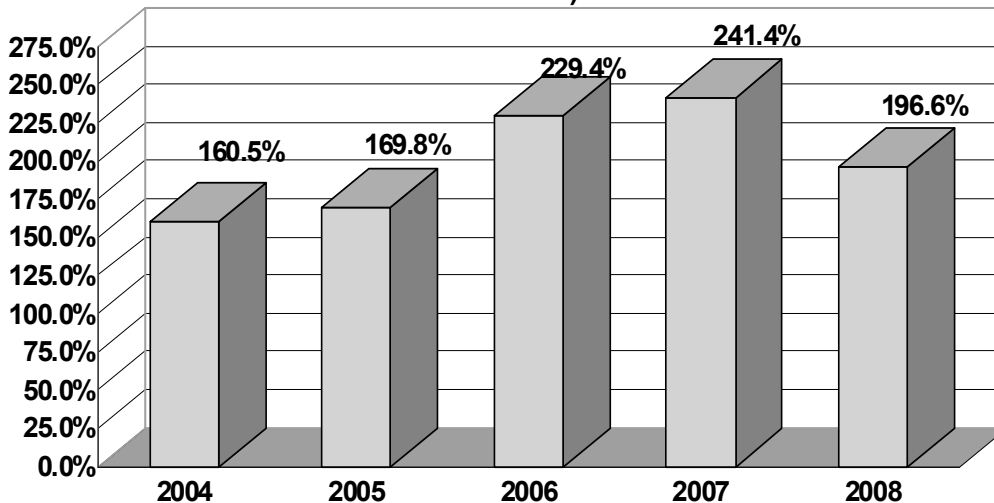
#### Description

A measure of the City's short-run financial condition is its cash position. Cash position includes cash on hand and in the bank, as well as other assets that can be easily converted to cash, such as short-term investments. The level of this type of cash is referred to as liquidity. Liquidity measures the City's ability to pay its short-term obligations. Low or declining liquidity can indicate that the City has overextended itself in the long term.

#### Analysis

The liquidity ratio has remained well over 100% over the measured period, which would be termed a current account surplus. The liquidity ratio indicates that the City's ability to pay short-term obligation is excellent. Fiscal year 2004 reflects the defeasance of Municipal Property Corporation (Asset Transfer) debt using General Funds. The sharp increases in 2006 and 2007 can be attributed to strong revenue gains due to economic growth, higher interest rates on short-term investments, and unexpended funds for pending capital projects.

(cash & investments as % of current liabilities)



(in thousands)	<u>FYE 04</u>	<u>FYE 05</u>	<u>FYE 06</u>	<u>FYE 07</u>	<u>FYE 08</u>
Cash and Investments	\$127,526	\$135,878	\$191,266	\$204,267	\$163,377
Current Liabilities	\$79,464	\$80,029	\$83,373	\$84,607	\$83,118
Percent Cash and Investments/ Current Liabilities	160.5%	169.8%	229.4%	241.4%	196.6%

Calculation: Investments/Liabilities (\*100)

## **DEBT STRUCTURE**

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### **Debt Structure**

Debt structure is important because debt is an explicit expenditure obligation that must be satisfied when due. Debt can be an effective tool to finance capital improvements and to smooth out short-term revenue flows; however, its misuse can cause serious financial problems. Even a temporary inability to repay debt can result in loss of credit rating, increased borrowing costs, and loss of autonomy to State and other regulatory bodies.

The most common forms of long-term debt are general obligation, special assessment, and revenue bonds. When the City issues debt for capital projects, it must ensure that aggregate outstanding debt does not exceed the community's ability to pay debt service as measured by the property value or personal or business income.

Under the most favorable circumstances, the City's debt should be proportionate in size and growth to the City's tax base; should not extend past the useful life of the facilities which it finances; should not be used to balance the operating budget; should not require repayment schedules that put excessive burdens on operating expenditures; and should not be so high as to jeopardize the City's credit rating.

An examination of the City's debt structure can reveal the following conditions:

- Inadequacies in cash management procedures.
- Inadequacies in expenditure controls.
- Decreases in expenditure flexibility due to increased fixed costs in the form of debt service.
- Use of short-term debt to finance current operations.
- Existence of sudden large increases or decreases in future debt service.
- The amount of additional debt that the community can absorb.

The indicators detailed on the following pages can be used to monitor changes in debt structure.

## DEBT STRUCTURE

### Net Direct Debt Per Assessed Valuation

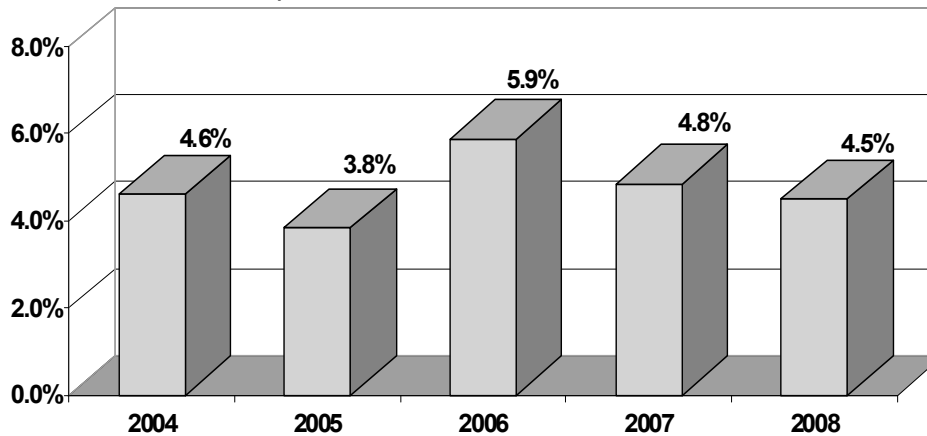
#### Description

Net direct debt is general obligation debt paid by secondary property tax levy, less self-supporting debt (e.g., enterprise and preserve debt) and current debt service reserves. The assessed value is the most generally available measure of community wealth. Generally, long-term debt should not exceed the City's resources for paying debt service.

#### Analysis

The percent of net direct long-term debt as a percent of assessed valuation reflected an overall neutral trend for the measurement period. Increases in 2006 and 2008 were due to new Bond 2000 debt issuances to support planned capital improvement projects. Current debt pay down, coupled with well-managed new debt issuances to support growing infrastructure needs has kept the direct debt to citizens affordable. On average, assessed value growth outpaced net direct long-term debt growth over the measured period. This, coupled with the community's personal income levels, indicates the community's increasing ability to pay for the City's required debt obligations.

(as % of assessed valuation)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
General Obligation Debt*	\$204,729	\$187,940	\$299,650	\$282,316	\$364,335
Less: General Obligation Bond					
Debt Service Reserve	(\$3,469)	(\$5,602)	(\$12,436)	(\$9,383)	(\$9,520)
Net Direct Long-Term Debt*	\$201,260	\$182,338	\$287,214	\$272,933	\$354,815
Assessed Valuation	\$4,352,442	\$4,753,407	\$4,888,698	\$5,629,925	\$7,892,133
Percent Net Direct Debt/ Assessed Valuation	4.6%	3.8%	5.9%	4.8%	4.5%

Calculation: Net Direct Long-Term Debt/Assessed Valuation (\*100)

\*The City's Preservation General Obligation Bonds are excluded from Net Direct Long-Term Debt. The City intends to pay debt service on these bonds from the dedicated McDowell Mountain Preserve sales taxes approved by the voters in 1995 and 2004.

## DEBT STRUCTURE

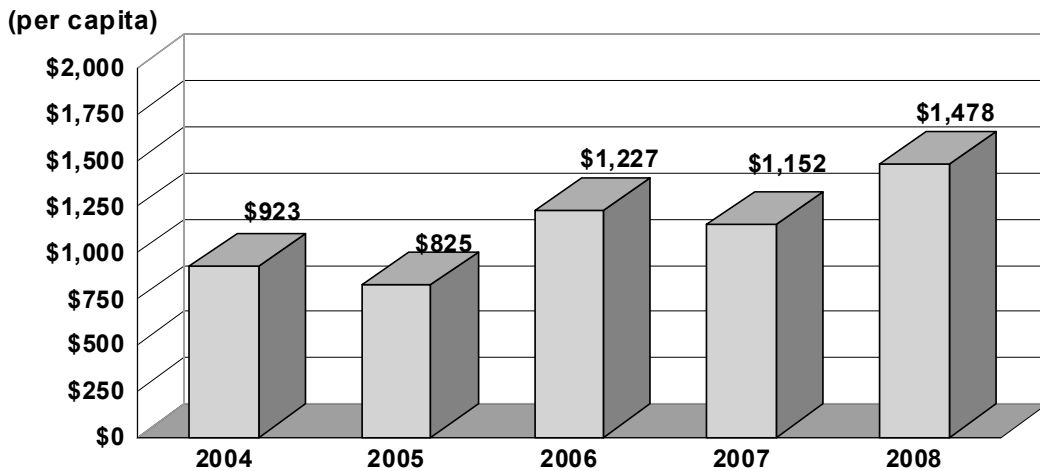
### Net Direct Debt Per Capita

#### Description

Net direct debt is general obligation debt paid by secondary property tax levy, less self-supporting debt (e.g., enterprise and preserve debt) and current debt service reserves. The net direct debt per capita measure illustrates how the growth in debt is changing relative to population changes. As population increases it would be expected that capital needs and the associated long-term debt would also increase. If long-term debt is increasing in the face of a stabilizing or declining population, debt levels may be reaching or exceeding the City's ability-to-pay.

#### Analysis

The level of net direct debt per capita reflects a rising trend due to the issuance of new general obligation debt approved by Scottsdale citizens. A city with a positive population trend is expected to have associated debt burden in order to finance infrastructure needs. As discussed in the analysis of Net Direct Debt Per Assessed Valuation, the City's assessed value growth exceeded net direct debt growth indicating the community's ability to pay the obligations. The increases in 2006 and 2008 were primarily due to new Bond 2000 debt issuances to support approved capital improvement projects.



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
General Obligation Debt*	\$204,729	\$187,940	\$299,650	\$282,316	\$364,335
Less: General Obligation Bond					
Debt Service Reserve	(\$3,469)	(\$5,602)	(\$12,436)	(\$9,383)	(\$9,520)
Net Direct Long-Term Debt*	\$201,260	\$182,338	\$287,214	\$272,933	\$354,815
Population	218	221	234	237	240
Net Direct Debt Per Capita	\$923	\$825	\$1,227	\$1,152	\$1,478

Calculation: Net Direct Long-Term Debt/Population

\*The City's Preservation General Obligation Bonds are excluded from Net Direct Long-Term Debt. The City intends to pay debt service on these bonds from the dedicated McDowell Mountain Preserve sales taxes approved by the voters in 1995 and 2004.

## DEBT STRUCTURE

### Overlapping Net Debt

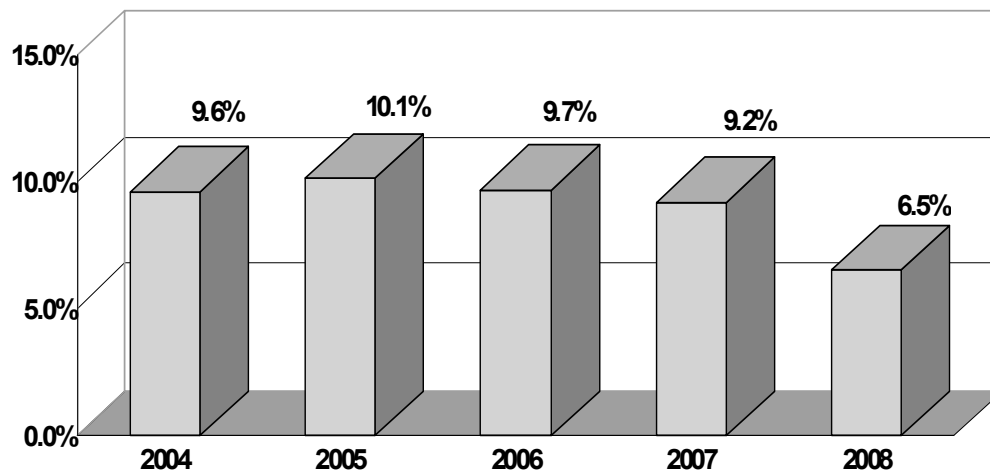
#### Description

Overlapping net debt is the net direct debt of all local government jurisdictions that is issued against a tax base within part or all of the geographic boundaries of the City. Examples of other jurisdictions that may overlap the City are Maricopa County, Maricopa County Community College District, Tempe, Paradise Valley, and Scottsdale school districts. This is an important evaluation criteria used by rating agencies as well.

#### Analysis

The overlapping net debt as a percent of assessed valuation declined over the measurement period. The five-year period showed a positive trend, as assessed value growth outstripped overlapping debt growth.

(as % of assessed valuation)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Overlapping Net Debt	\$417,824	\$482,045	\$471,837	\$517,147	\$515,817
Assessed Valuation	\$4,352,442	\$4,753,407	\$4,888,698	\$5,629,925	\$7,892,133
Percent Overlapping Net Debt/Assessed Valuation	9.6%	10.1%	9.7%	9.2%	6.5%

Calculation: Overlapping Debt/Assessed Valuation (\*100)

## **DEBT STRUCTURE**

### **Debt Service**

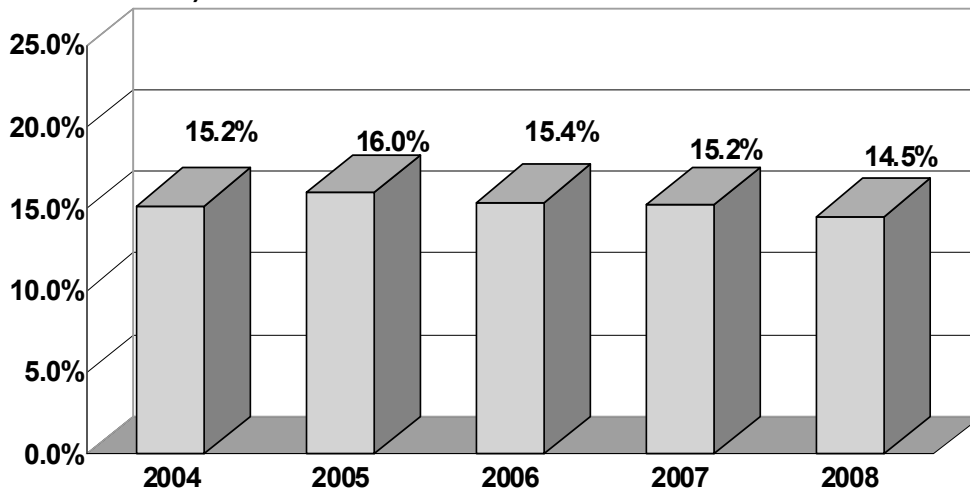
#### Description

Debt service is defined as the amount of principal and interest that the City must pay each year associated with its outstanding debt. As the debt service increases, it adds to the City's obligations and reduces the City's expenditure flexibility. Debt service can be a major part of the City's fixed costs and its increase may indicate excessive debt and fiscal strain.

#### Analysis

The level of debt service declined as a percent of Governmental and Enterprise Fund operating revenues, a positive trend for Scottsdale over the measurement period. As the economic rebound took hold in 2004, the higher revenues resulted in sufficient resources to meet growing service demands. Increased debt service dollars in recent years attributable to bonds related to SkySong, WestWorld land, and Bond 2000 CIP program.

(as % of revenue)



(in thousands)	<u>FYE 04</u>	<u>FYE 05</u>	<u>FYE 06</u>	<u>FYE 07</u>	<u>FYE 08</u>
Debt Service	\$63,308	\$76,289	\$79,689	\$85,179	\$82,985
Governmental/Enterprise Funds Revenue	\$416,415	\$477,762	\$517,331	\$559,549	\$570,508
Percent Debt Service/Total Operating Revenue	15.2%	16.0%	15.4%	15.2%	14.5%

Calculation: Debt Service/Operating Revenue (\*100)

## DEBT STRUCTURE

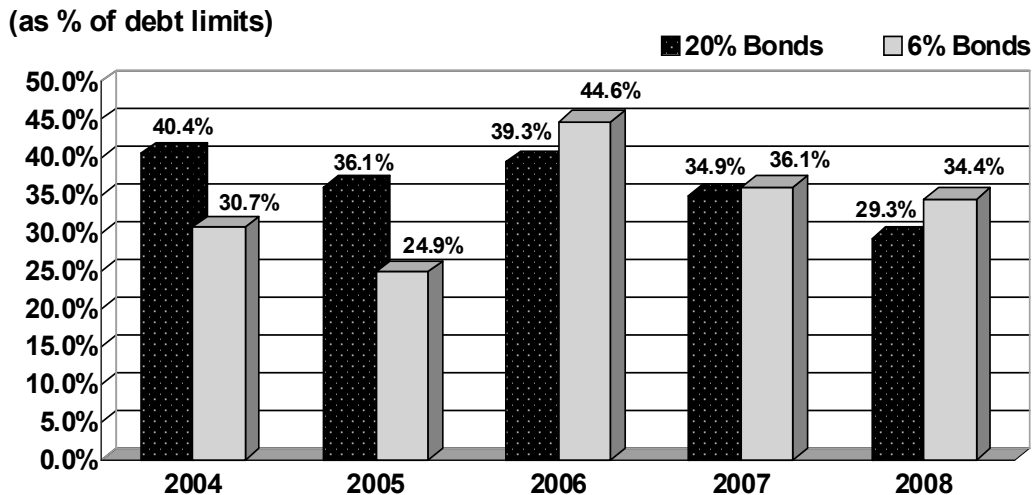
### Debt Margin

#### Description

Under Arizona law, cities can issue general obligation bonds up to an amount not exceeding specific debt limits. General obligation bonds issued for purposes of water, wastewater, artificial light, open space preserves, parks, playgrounds, and recreational facilities cannot exceed 20 percent of assessed valuation. General obligation bonds issued for all other purposes cannot exceed 6 percent of assessed valuation. The debt margin is that portion of the legal debt limit available for bonding.

#### Analysis

The City's percent of debt outstanding as a percent of the legal debt limit for the five-year period shows an overall neutral trend for both 20 percent and 6 percent bonds. Increased activity in 2006 and 2008 is related to new issuances that occurred in these fiscal years. Both debt margins are favorable, as the percent of debt outstanding is well within the debt limits. This indicates that the City has available capacity to issue additional general obligation bonds.



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
20% Debt Outstanding	\$321,460	\$313,786	\$372,545	\$363,455	\$424,865
20% Debt Limit	\$795,104	\$868,691	\$947,151	\$1,041,889	\$1,448,765
Outstanding Debt as a Percent of Debt Limit	40.4%	36.1%	39.3%	34.9%	29.3%
6% Debt Outstanding	\$73,290	\$64,799	\$126,820	\$112,745	\$149,580
6% Debt Limit	\$238,531	\$260,607	\$284,145	\$312,567	\$434,629
Outstanding Debt as a Percent of Debt Limit	30.7%	24.9%	44.6%	36.1%	34.4%

Calculation: Debt Outstanding/Debt Limit (\*100)

## **CONTINGENT LIABILITIES**

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### **Contingent Liabilities**

A contingent liability is an existing condition or situation whose ultimate disposition may not be known or does not have to be paid until a future year, and for which reserves have been set aside. A contingent liability is similar to debt in that it represents a legal commitment to pay in the future. Due to the potential magnitude, if these types of obligations grow substantially over time, they can have a significant impact on the City's financial condition.

The contingent liabilities considered here are significant because they are not readily apparent in ordinary financial records, making it difficult to assess their respective impacts. Additionally, the contingent liabilities may accumulate gradually over time, making it difficult to notice them until the problem is severe.

An analysis of the City's contingent liabilities can reveal the following:

- An increase in the City's pension liability.
- Inadequacies in pension plan contributions, pension system assets, and whether the investment earnings are keeping pace with the growth in benefits.
- An increasing amount of unused employee vacation and sick leave.
- Inadequacies of City policies for payment of unused vacation and sick leave as compared to the City's ability to pay.
- An increase in the amount of lawsuits and other claims against the City.

The indicators detailed on the following pages can be used to monitor changes in contingent liabilities.

## CONTINGENT LIABILITIES

### Pension Benefit Obligation

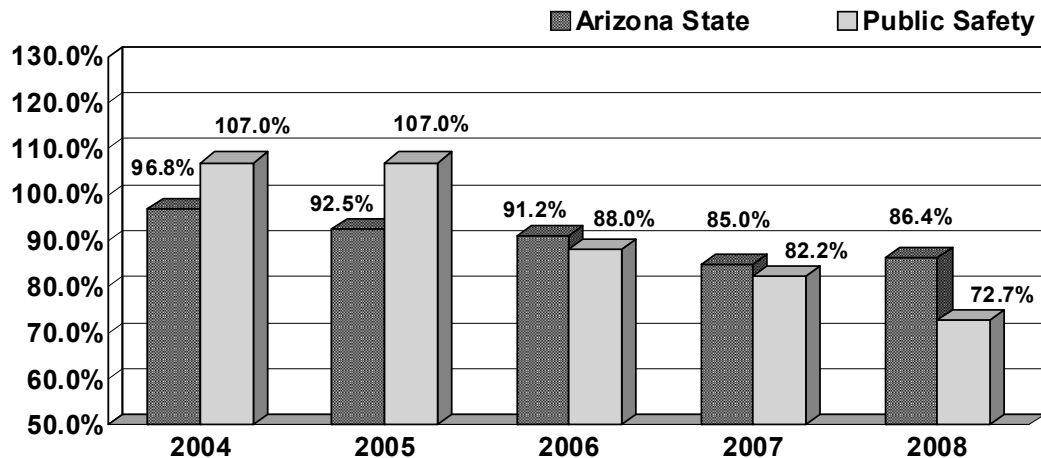
#### Description

Pension plans represent a significant expenditure for the City. There are two basic ways to fund pension plans: (1) Fund them when benefits need to be paid (pay-as-you-go), or (2) Fund them as benefits accrue and reserve cash for when benefits will have to be paid (full funding). The State of Arizona administers the pension plans that cover City employees and have required employee and employer contributions in order to fully fund all pension benefit obligations.

#### Analysis

Full funding of the Arizona State Retirement Plan and the Public Safety Retirement Plan had been a favorable trend over previous measurement periods. The decline in percent of benefits funded from fiscal year 2004 forward can be attributed to the downturn in the economy, sharply lower returns on investments, expanded coverage needs, and changing population demographics as average life expectancy increases. In light of this declining trend, increased contributions to the plans by employee and employer have been necessary to ensure continued funding.

(as % of pension benefit obligation)



Percent of Pension Benefit Obligation Funded	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Arizona State Retirement Plan (Other Employees)	96.8%	92.5%	91.2%	85.0%	86.4%
Public Safety Retirement Plan (Police Employees)	107.0%	107.0%	88.0%	82.2%	72.7%

## CONTINGENT LIABILITIES

### Compensated Absences

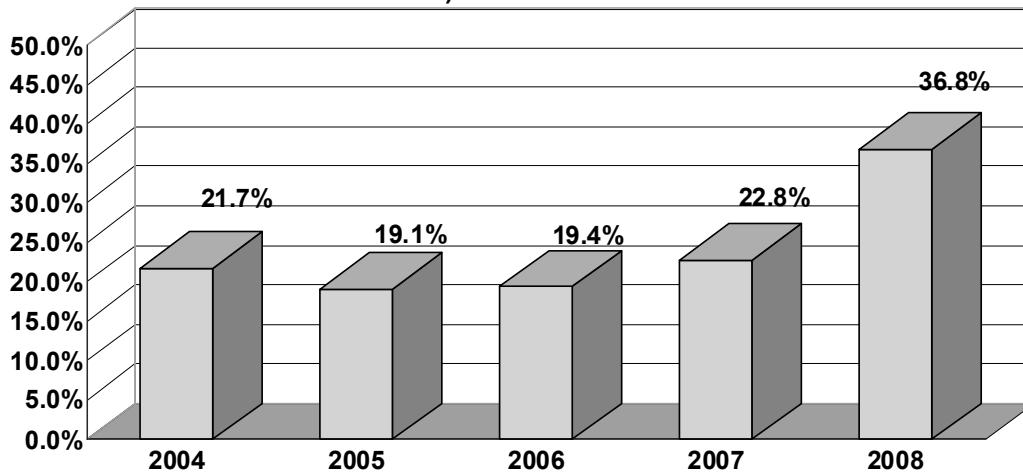
#### Description

Compensated absences consist of vacation accruals for active employees and medical leave conversion for retirees. These accumulated employee benefits are payable to the employee/retiree, subject to certain limitations, and represent an unfunded, long-term liability to the City.

#### Analysis

The City's liability for compensated absences has shown an increasing trend over the five-year period. Actuarial studies have been used since fiscal year 2002 to determine the actual liability of a benefit provision in the City Code that allows long-term employees to use unused sick leave to pay insurance premiums after retirement. The trend reflects increased wages, health insurance costs, and the aging employee population that is nearing retirement. Also, accounting policy changes resulted in an increased compensated absence balance at June 30, 2006, by matching the amount to be paid from current resources against payments from future resources.

(as % of unrestricted fund balances)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Compensated Absences	\$13,038	\$13,880	\$18,886	\$21,219	\$23,088
Unrestricted Governmental Fund Balances*	\$60,042	\$72,784	\$97,324	\$93,143	\$62,679
Percent Compensated Absence/ Unrestricted Gov't Fund Balance	21.7%	19.1%	19.4%	22.8%	36.8%

Calculation: Compensated Absences/Fund Balance (\*100)

\*Includes Governmental Funds and HURF.

## CONTINGENT LIABILITIES

### Self-Insurance

#### Description

The City is subjected to lawsuits and other claims occurring in the ordinary course of its operations. Since the City is largely self-insured, these potential and costs liabilities are to be paid from the fund balance established for self-insurance purposes. The City receives an actuarial study each year that outlines the recommended actuarial fund balance based on an estimate of outstanding losses. The self-insurance fund balance should be at a level sufficient enough to cover all estimated outstanding losses in the near-term.

#### Analysis

In 2004, the City changed to fully self-insuring employee health benefits. The self-insurance recommended fund balance reflected an overall positive trend over the measured period.

(self-insurance fund balance as % of recommended actuarial fund balance)



(in thousands)	FYE 04*	FYE 05	FYE 06	FYE 07	FYE 08
Property/Liability Balance	\$12,877	\$14,159	\$12,294	\$16,667	\$17,813
Recommended Fund Balance	\$12,181	\$13,792	\$12,889	\$10,725	\$11,570
Percent Liability Coverage	105.7%	102.7%	95.4%	155.4%	154.0%
Employee Benefits Balance	6,853	6,424	\$7,056	\$7,512	\$8,390
Recommended Fund Balance	5,474	5,125	\$5,056	\$6,180	\$6,467
Percent Liability Coverage	125.2%	125.3%	139.6%	121.6%	129.7%

Calculation: Self Insurance Fund Balance/Recommended Actuarial Fund Balance (\*100)

\*FY 04 include claim projections for the new fire department effective FY 2005/06 and beyond.

## **CONDITION OF CAPITAL PLANT**

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### **Condition of Capital Plant**

The bulk of the City's wealth is invested in its physical assets or capital plant – 75 percent of its streets, buildings, utility network, and equipment. If these assets are not maintained in good condition, or if they are allowed to become obsolete, the result is often a decrease in the usefulness of the assets, an increase in the cost of maintaining and replacing them, and a decrease in the attractiveness of the City as a place to live or do business.

Cities often defer maintenance and replacement because it is a relatively painless short-run method to reduce expenditures and ease current financial strain. Continued maintenance deferral, however, can create serious long-term problems that become exaggerated because of the large sums of money invested in capital facilities.

The following are some of the problems associated with continued deferred maintenance:

- Creation of safety hazards and other liability exposures.
- Reduction in the residential and business value of the City.
- Decreased efficiency of equipment due to obsolescence and deferred maintenance.
- Increased costs of bringing the facility up to acceptable levels after continued maintenance deferral.
- Creation of a large unfunded liability in the form of a backlog in maintenance that can result in accelerated deterioration.

The indicators detailed on the following pages can be used to monitor changes in the condition of capital plant.

## CONDITION OF CAPITAL PLANT

### Maintenance Effort

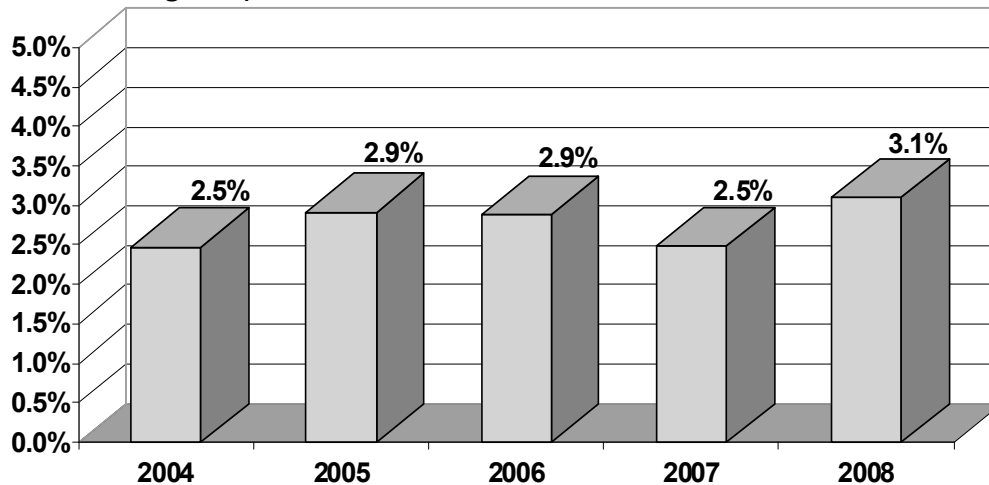
#### Description

The condition of the City's long-lived assets, such as buildings, is significant because of the tremendous cost and far-reaching consequences their decline can have on business activity, property values, and operating expenditures. Deferral of maintenance on the assets and their subsequent deterioration can create a significant unfunded liability. Maintenance expenditures should remain relatively constant in relation to the cost and nature of assets maintained. If the ratio is declining, it may be a sign that the City's assets are deteriorating.

#### Analysis

Maintenance expenditures as a percent of building and improvement costs have remained consistent over the measured period. This trend is favorable as it indicates that the City's buildings and improvements are being maintained in good working condition and that the maintenance expenditures on a per unit basis are not increasing due to deterioration of the assets.

(as % of building cost)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Maintenance Expenditures	\$6,861	\$8,336	\$9,020	\$10,431	\$13,911
Building & Improvements Costs	\$277,215	\$286,146	\$313,781	\$421,106	\$449,685
Percent Maintenance Expenditures/Building Costs	2.5%	2.9%	2.9%	2.5%	3.1%

Calculation: Maintenance Expenditures/Building and Improvement Costs (\*100)

## CONDITION OF CAPITAL PLANT

### Capital Outlay

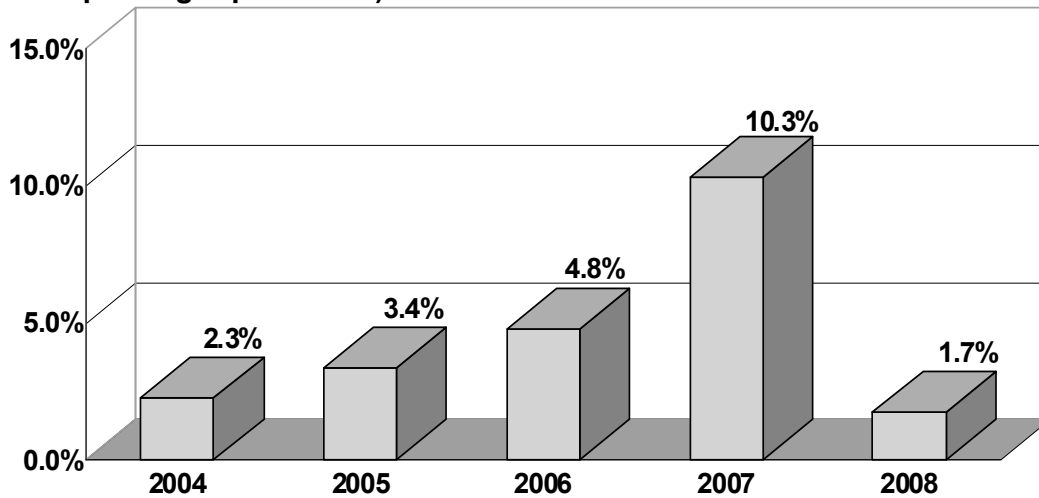
#### Description

The expenditure for equipment, such as vehicles, radios, and computer and office equipment purchased is referred to as capital outlay. It includes equipment that will last longer than two years and costs more than \$5,000. Capital expenditures may remain constant or even decline in the short run as new and replacement equipment is purchased. If the decline persists over three years, it can be an indicator that capital outlay needs are being deferred, resulting in the use of obsolete equipment and the creation of an unfunded liability.

#### Analysis

Capital outlay expenditures (all funds) as a percent of net operating expenditures reflect an overall positive trend over the five-year measured period. 2007 includes asset additions of major equipment and vehicles, including solid waste and fire trucks, trolleys, and equipment for the new Chaparral Water Treatment plant. Considering the adjustments to capital outlay spending, the overall trend indicates that operating equipment is being maintained in good condition, thus avoiding the use of obsolete and inefficient equipment and the creation of an unfunded liability.

(as % of operating expenditures)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
Capital Outlay	\$7,952	\$12,866	\$19,173	\$46,994	\$8,501
Operating Expenditures	\$349,445	\$382,652	\$399,195	\$454,491	\$493,857
Percent Capital Outlay/Net Operating Expenditures	2.3%	3.4%	4.8%	10.3%	1.7%

Calculation: Capital Outlay/Operating Expenditures (\*100)

## CONDITION OF CAPITAL PLANT

### Depreciation

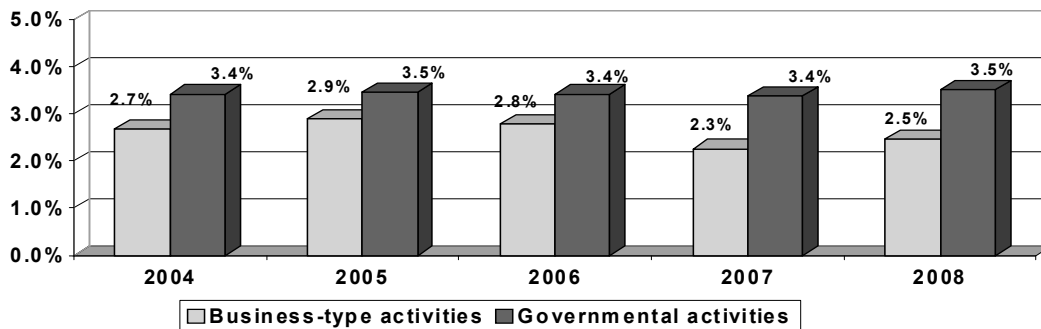
#### Description

Depreciation is the cost associated with the use of a fixed asset over its useful life. Depreciation should remain a relatively stable portion of asset cost assuming older assets, which are fully depreciated, are removed from service and replaced with newer assets. If depreciation costs start to decline as a portion of asset cost, the assets are probably being used beyond their useful lives, the estimated useful lives had been initially underestimated, or the scale of operations was reduced.

#### Analysis

Depreciation expense has remained a stable portion of fixed asset costs, which indicates that assets are being fully depreciated and replaced with newer assets on a timely basis. This will prevent a large expense, in any one year, to replace outdated assets. In addition, for the fiscal year ended June 30, 2002, the City was required to adopt Governmental Accounting Standards Board Statement No. 34 which required the depreciation of all governmental assets.

(depreciation expense as % of assets)



(in thousands)	FYE 04	FYE 05	FYE 06	FYE 07	FYE 08
<b>Business-type Activities</b>					
Depreciation Expense	\$23,756	\$26,143	\$26,490	\$27,983	\$33,139
Fixed Asset Costs	\$884,960	\$902,456	\$954,063	\$1,241,459	\$1,344,125
Percent Depreciation Expense/ Fixed Asset Costs	2.7%	2.9%	2.8%	2.3%	2.5%
<b>Governmental Activities</b>					
Depreciation Expense	\$85,861	\$89,209	\$92,511	\$98,536	\$106,041
Fixed Asset Costs	\$2,512,539	\$2,584,079	\$2,704,140	\$2,926,149	\$3,016,140
Percent Depreciation Expense/ Fixed Asset Costs	3.4%	3.5%	3.4%	3.4%	3.5%

Calculation: Depreciation Expense/Fixed Asset Costs (\*100)

Note: With the implementation of Governmental Accounting Standard Board Statement No. 34 at June 30, 2002, the City is required to depreciate all governmental assets.