



## AUDIT, FINANCE & ENTERPRISE COMMITTEE

August 27, 2020

The Audit, Finance & Enterprise Committee of the City of Mesa met via a virtual format streamed into the lower level meeting room of the Council Chambers, 57 East 1st Street, on August 27, 2020, at 8:17 a.m.

COMMITTEE PRESENT	COMMITTEE ABSENT	STAFF PRESENT
Jennifer Duff, Chairperson* Mark Freeman* David Luna*	None	Christopher Brady Dee Ann Mickelsen Jim Smith

(\*Committeemembers participated in the meeting through the use of video conference equipment.)

Chairperson Duff conducted a roll call.

In response to a question from Chairperson Duff regarding whether the Audit, Finance & Enterprise Committee meetings are televised for the public, City Manager Christopher Brady indicated the public has access to listen to the live meeting telephonically using the meeting code located on the agenda.

1. Items from citizens present:

There were no items from citizens present.

2-a. Hear a presentation and discuss the City's fiscal year 2019-20 sales tax revenue.

Management and Budget Director Candace Cannistraro explained at the last Audit, Finance and Enterprise Committee meeting staff was asked to return with a sales tax update once Fiscal Year (FY) 2019/20 has been closed. She introduced Management and Budget Deputy Director Brian Ritschel, who displayed a PowerPoint presentation. **(See Attachment 1)**

Mr. Ritschel presented the year over year sales tax revenue chart which shows consumer activity by month. He discussed the consistent trend over the last three years until April 2020, when the federal stimulus payments were sent, and unemployment began to increase due to the pandemic. He advised Mesa is known as a bedroom community which led to higher sales tax coming from online sales and shopping locally; while other cities who rely on entertainment sales tax dropped as much as 30% in revenue. (See Page 2 of Attachment 1)

In response to a question from Committeemember Luna regarding how the City collects sales tax from online sales, Mr. Ritschel explained if a company has a nexus in the City of Mesa, meaning they have an active presence in the taxing jurisdiction, Mesa receives the sales tax. He remarked if the company is located outside of the taxing jurisdiction, the sales tax for that purchase will be remitted to the State using a commodity code to differentiate the out-of-state sales tax, at which point the sales tax will be figured using the delivery address and will go to the City of Mesa. He stated the tax revenue is submitted to the State monthly; however, there is approximately a two-month lag before Mesa sees the reports.

In response to a question posed by Committeemember Freeman, Mr. Ritschel advised Business Services does do a tax and license audit and would defer to that department on specifics.

Mr. Brady stated a lot of the revenue auditing has been taken over by the State, leaving cities with limited purview on auditing.

Business Services Director Ed Quedens commented that starting in 2015 the auditing function was transferred to the Department of Revenue (DOR) and now the City has to request an audit, at which time DOR will assess whether it is better for the audit to be conducted at the State level or by the municipality. He reported any audit that is conducted is done on behalf of all jurisdictions. He mentioned while DOR has added additional audit staff, they have many tasks. He noted the City prefers the audits focus on issues with a specific company.

In response to a question from Chairperson Duff regarding whether Amazon is treated the same since they do not have a location in Mesa, Mr. Ritschel explained Amazon is a third-party platform where many different companies sell their products. He pointed out that even if the company is out of state, Mesa receives the sales tax if the product is delivered to a Mesa address.

Mr. Brady stated Legislation changed October 1, 2019 that allows the sales tax to be retained by the city where the product is being delivered. He explained this change, along with the increase in online purchasing, has caused the sales tax revenue to increase in months that are typically low.

Mr. Quedens added that nexus was previously defined by presence within the state; and after the Wayfair case, nexus has been redefined as economic nexus that requires companies who conduct business and sell products within Arizona to pay sales tax to the cities where the products are being delivered. He commented the amount of sales for out-of-state vendors triggering the Transaction Privilege Tax (TPT) is currently set at \$200,000 and will transition down to \$150,000 in October of this year, then \$100,000 in 2021.

In response to a question posed by Chairperson Duff, Mr. Quedens reported the two ways Amazon conducts business is by selling product themselves from their warehouses, which are taxed because the warehouses have physical nexus in Arizona, and the third-party businesses who sell through Amazon are now taxed through economic nexus when shipping products to Mesa.

Mr. Brady noted that the increase seems to be from the stimulus dollars and the fact that more people are staying closer to home and shopping locally.

Mr. Ritschel shared some of the concerns that will be monitored moving forward including whether another federal stimulus will go out, when the unemployment benefits will be eliminated or reduced, and whether the spending patterns will remain the same. He mentioned the City is keeping an eye on payment delinquencies for Salt River Project (SRP) and City utility accounts that have risen during the pandemic, adding that October is when utilities can be shut off if residents are not on a payment plan. (See Page 3 of Attachment 1)

Mr. Ritschel compared the national and Arizona trends in initial claims for unemployment benefits, stating the dark bars indicate employees whose employers contribute to unemployment and the lighter bars indicate self-employed individuals. He noted the level for Arizona at the end of July is the same as it was during the great recession. (See Pages 4 and 5 of Attachment 1)

Mr. Ritschel reviewed the unemployment rate for the City of Mesa from 2007 to 2020. He indicated the spike above 12% occurred in April when the pandemic hit, and businesses shut down. He stated the City of Mesa has approximately 225,000 workers and 12% of those workers were unemployed. (See Page 6 of Attachment 1)

Mr. Ritschel reported from April to the beginning of August the past due utility amount grew from just over \$2 million to \$4 million. He indicated staff will be monitoring whether the past due amounts trend will decrease in October when the City is able to disconnect for non-payment. (See Page 7 of Attachment 1)

In response to a question from Committeemember Luna, Mr. Brady commented he met with SRP representatives a few weeks ago because of their concern with the rising past due amounts. He mentioned SRP has sent out notifications to all past due accounts of the possibility of disconnection in October if payments are not made; and the City will be doing the same, notifying customers of the days and amount the account is past due. He added the City will continue the campaign for utility assistance and informing customers of available programs. He stated originally \$1 million was set aside for utility assistance, including SRP and Southwest Gas, and staff will be bringing a proposal to Council to increase that to \$8 million.

Committeemember Luna acknowledged August has been a very hot month and keeping homes cool has been a costly challenge. He supports using CARE funding to offer additional assistance and continue working with Mesa CAN.

In response to a series of questions from Committeemember Freeman, Mr. Brady confirmed that the utility suspension ends in October. He mentioned suspending the cut-offs began in March, which helped individuals affected by the pandemic; however, many have let the utilities go which have accumulated to significant amounts. He said the City has CARES dollars that need to be spent based on current federal guidelines by the end of the calendar year. He pointed out the past due utility bills include electric, water, gas, and solid waste. He advised staff will bring to Council an updated presentation on the Utility Assistance Program in a few weeks.

Mr. Ritschel expanded by saying that there are approximately 8,000 past due accounts with 3,200 accounts eligible for shut off.

In response to a question posed by Chairperson Duff, Mr. Ritschel explained the \$4 million past due amount represents around 1% of the utility revenue. He reported due to higher temperatures, the residential utility revenue has increased.

In response to a question posed by Chairperson Duff regarding what the normal delinquency rate is, Mr. Quedens advised between 5% to 10% of accounts can be delinquent at any given point, which includes accounts that may only be one day delinquent. He stated based on the dollar figure, the City is approximately two times higher in delinquencies than in April.

Mr. Quedens informed the Committeemembers that the City looks at the delinquent balance as an amount owed to the City, that a significant amount of that balance will be collected and is listed as revenue. He emphasized the amount that becomes bad debt and is written off are the accounts where the customers walk away and do not pay.

Mr. Ritschel shared the next steps will be to continue monitoring the sales tax revenue and economic trends, the shopping behavior of residents, the business closures and reopening's, and the stimulus and unemployment benefits over the next few months. He stated staff will return in January of 2021 with an update. (See Page 8 of Attachment 1)

Chairperson Duff thanked staff for the presentation.

2-b. Hear a presentation and discuss the Utility Enterprise Fund forecast.

Management & Budget Deputy Director Brian Ritschel introduced Budget Coordinator Chris Olvey and displayed a PowerPoint presentation. **(See Attachment 2)**

Mr. Ritschel provided an overview of the forecast and explained in two weeks the Office of Management and Budget will return with Department representatives with a final recommendation.

Mr. Ritschel highlighted the sources and uses, as well as the financial principles utilized when creating the forecast. (See Pages 3 through 5 of Attachment 2)

Mr. Ritschel provided a rate adjustment history for FY 19/20 and displayed information on the forecast and adopted rates for FY 19/20. (See Page 6 of Attachment 2)

Mr. Ritschel commented that taking those principles, revenues, and expenditures into account, staff came up with revenue scenarios for planning purposes. He stated in the first scenario with a 0% adjustment throughout the forecast period, the negative net sources and uses would be approximately negative \$38 million. He added that scenario would leave the reserve balance at negative 2.4%, while the goal is to keep the reserve balance at 20%. He remarked that this scenario would have a significant impact on utilities. (See Page 8 of Attachment 2)

Mr. Ritschel presented a scenario that uses principles that will create positive net sources and uses and will leave the reserve balance at 20% or higher. He mentioned this scenario will have an impact on the customers. (See Page 9 of Attachment 2)

Mr. Ritschel explained Office of Management and Budget (OMB) staff collaborates with utilities to determine what is needed for an adjustment to stay affordable to customers but also keep the utilities sustainable.

Mr. Ritschel identified the next steps will be to work with the departments to finalize FY20/21 recommendations and return to the Audit, Finance & Enterprise Committee in two weeks to present those recommendations. (See Page 11 of Attachment 2)

Mr. Brady highlighted the goal of keeping the fund balance at 20% or higher while also achieving a balance between revenues and expenditures. He stated that keeping increases consistent and spread out eliminates larger increases in the future. He added if Council is comfortable with the financial principles, staff will work with the scenarios presented and come up with a proposal that achieves the financial goal while limiting the impact.

In response to a question from Committeemember Luna related to keeping an increase between 2% and 2.5%, Mr. Brady commented these scenarios demonstrate two extremes. He clarified Council will only adopt the percentage for the first year, and the rest are just planning numbers. He concluded by saying the proposed scenario will be somewhere between the two scenarios presented today.

In response to a comment from Committeemember Freeman regarding the scenarios and the recent 12% rate increases the City of Phoenix implemented over the last two years, Mr. Brady explained he has spoken with the Phoenix City Manager regarding their deferral of smaller increases which led to larger increases. He added staff will bring back these two scenarios as well as an additional scenario to the committee for consideration.

In response to a question from Chairperson Duff, Mr. Ritschel indicated FY 20/21 rate increases will be effective January 1, 2021.

Mr. Brady indicated Council must vote on a notice of intent to increase the rates and must wait 60 days before final action can be taken. He advised the plan is to have the rates go into effect at the beginning of the calendar year.

In response to a question posed by Chairperson Duff regarding the ending reserve balance for FY 19/20, Mr. Ritschel explained the column for FY 20/21 shows the beginning reserve balance, which is also the FY 19/20 ending fund balance. He stated the current reserve balance is approximately 30%.

In response to a comment from Chairperson Duff on the wastewater losses and whether there is anything that can be done, Mr. Ritschel acknowledged that wastewater is in the negative throughout the forecast, adding the reason is due to the reallocation of the General Fund contribution.

Mr. Brady elaborated stating the negative number is a consequence of the new formula being used to allocate the contributions to the General Fund and at end of day the fund has not materially changed. He said wastewater treatment plants have a lot of overhead costs and the treatment plants are driving a lot of the debt service.

In response to a series of questions from Committeemember Freeman, Mr. Brady remarked staff have frequent communication with SRP regarding water quality changes that might be occurring which will result in using more chemicals during the treatment process.

Ms. Cannistraro reported the Smart Meter Program is a program that will allow customers to be versed in their usage patterns by giving them the ability to see their water consumption the next day. She commented that currently there is only one data point per month that shows the usage and this program will give utility users a greater opportunity to control their water usage.

In response to a question from Chairperson Duff, Mr. Ritschel clarified customers will pay for the amount of water used in the current tier, then once their usage moves up to the next tier the customer will only pay the higher tier price for the amount used in that tier.

Chairperson Duff suggested bringing the water and tier information forward to a study session to provide clarity on the rate increases.

Mr. Ritschel verified information on the rate increases will be included in the presentation when staff comes back to Council with the recommended rates.

Chairperson Duff indicated her preference to stay between 0% to 2.5% for the rate increases because of the economic distress that has occurred due to the pandemic, and that hopefully the following year will return to normal.

Chairperson Duff thanked staff for the presentation.

### 3. Adjournment.

Without objection, the Audit, Finance & Enterprise Committee meeting adjourned at 9:33 a.m.

I hereby certify that the foregoing minutes are a true and correct copy of the minutes of the Audit, Finance & Enterprise Committee meeting of the City of Mesa, Arizona, held on the 27<sup>th</sup> day of August 2020. I further certify that the meeting was duly called and held and that a quorum was present.

  
DEE ANN MICKELSEN, CITY CLERK

la/dm  
(Attachments – 2)

# City of Mesa

## Transaction Privilege (Sales) Tax FY 2019/20 Review

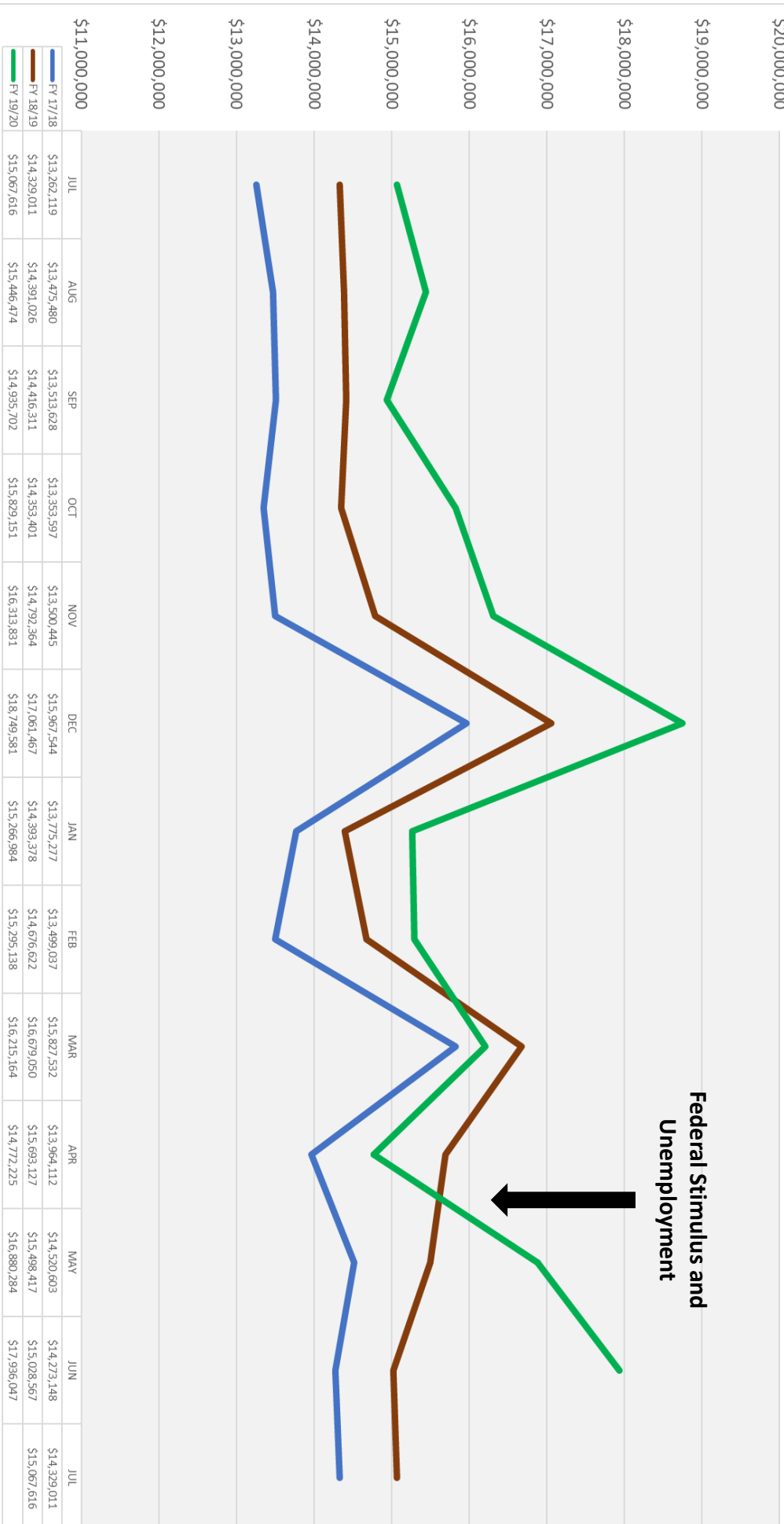
Audit, Finance & Enterprise Committee  
August 27, 2020

Presented by:

Candace Cannistraro – Management & Budget Director  
Brian Ritschel – Management & Budget Assistant Director

# Year Over Year Sales Tax Revenue Chart

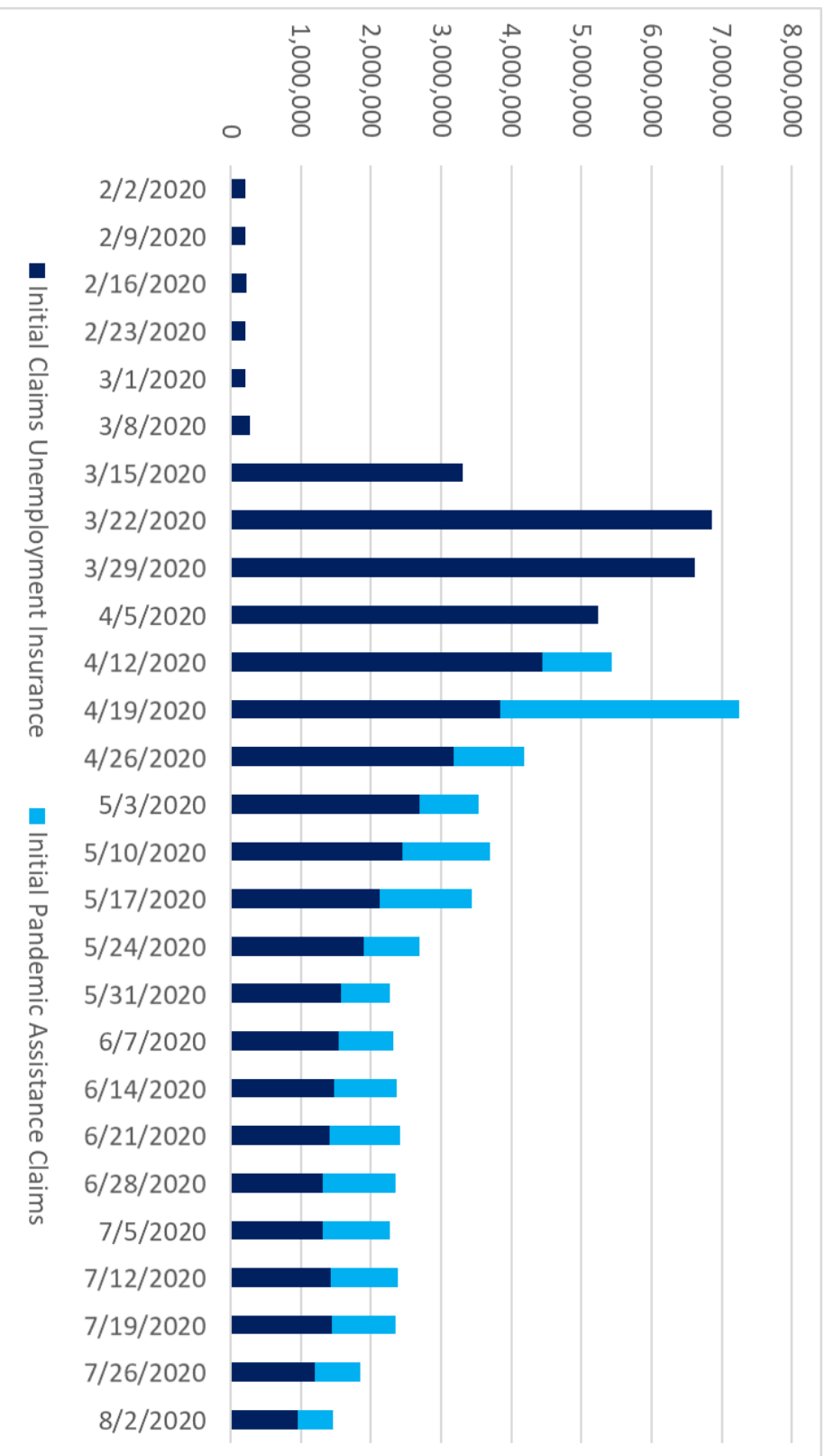
City Sales Tax - Year Over Year - Consumer Activity by Month (source: Tax Revenue Summary Report)  
 Public Safety Sales Tax Revenues Not Included for Comparison Purposes (Effective March 1, 2019)



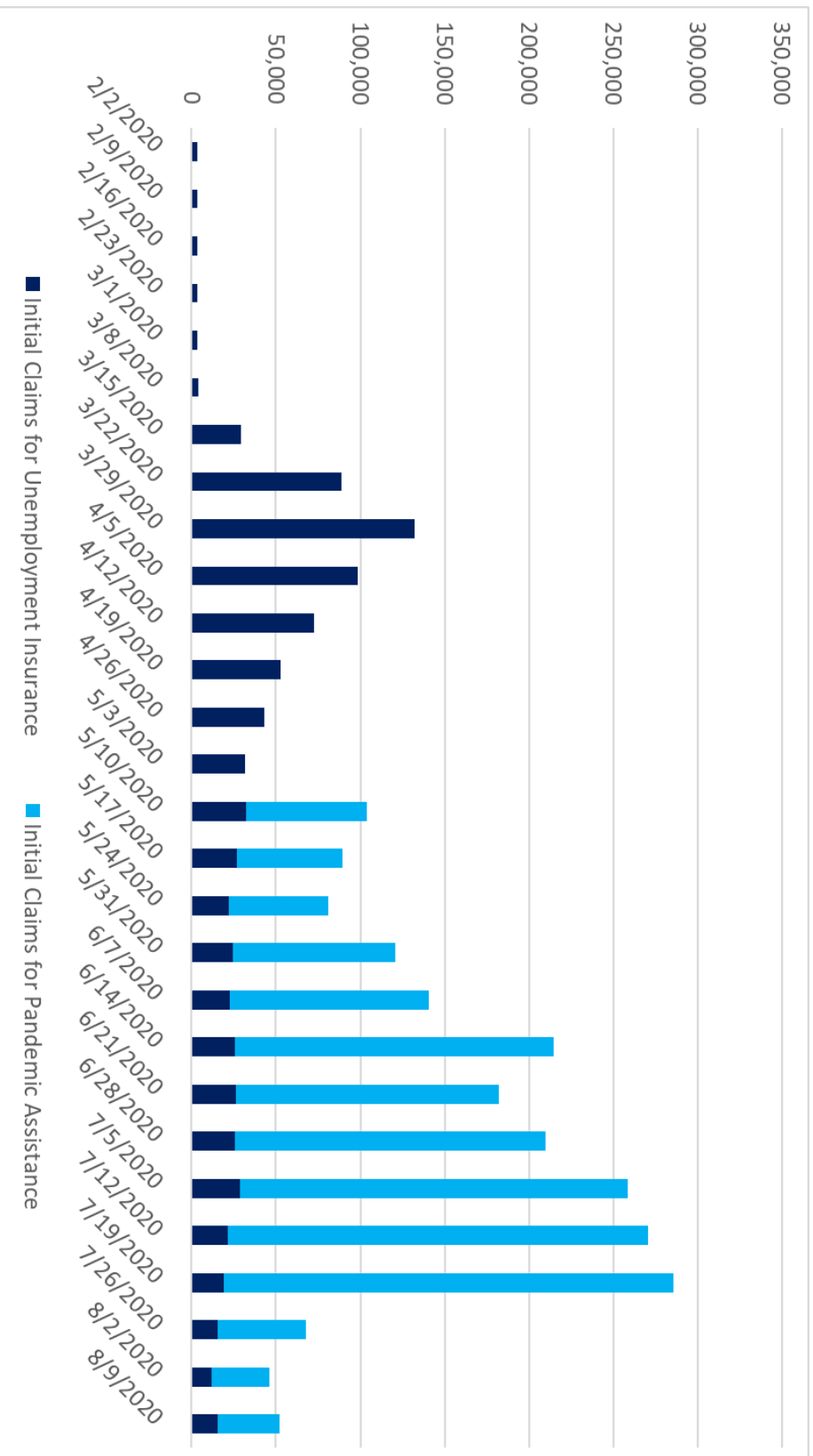
## Sales Tax Revenue Concerns

1. Will there be another Federal stimulus
2. Elimination/reduction of Federal unemployment benefits
3. Stay at home executive order, shopping local (including on-line nexus purchases)
4. If/when businesses can fully open, will Mesa residents go back to shopping outside of Mesa
5. Significant delinquencies in SRP and City utility accounts
6. Eviction postponement

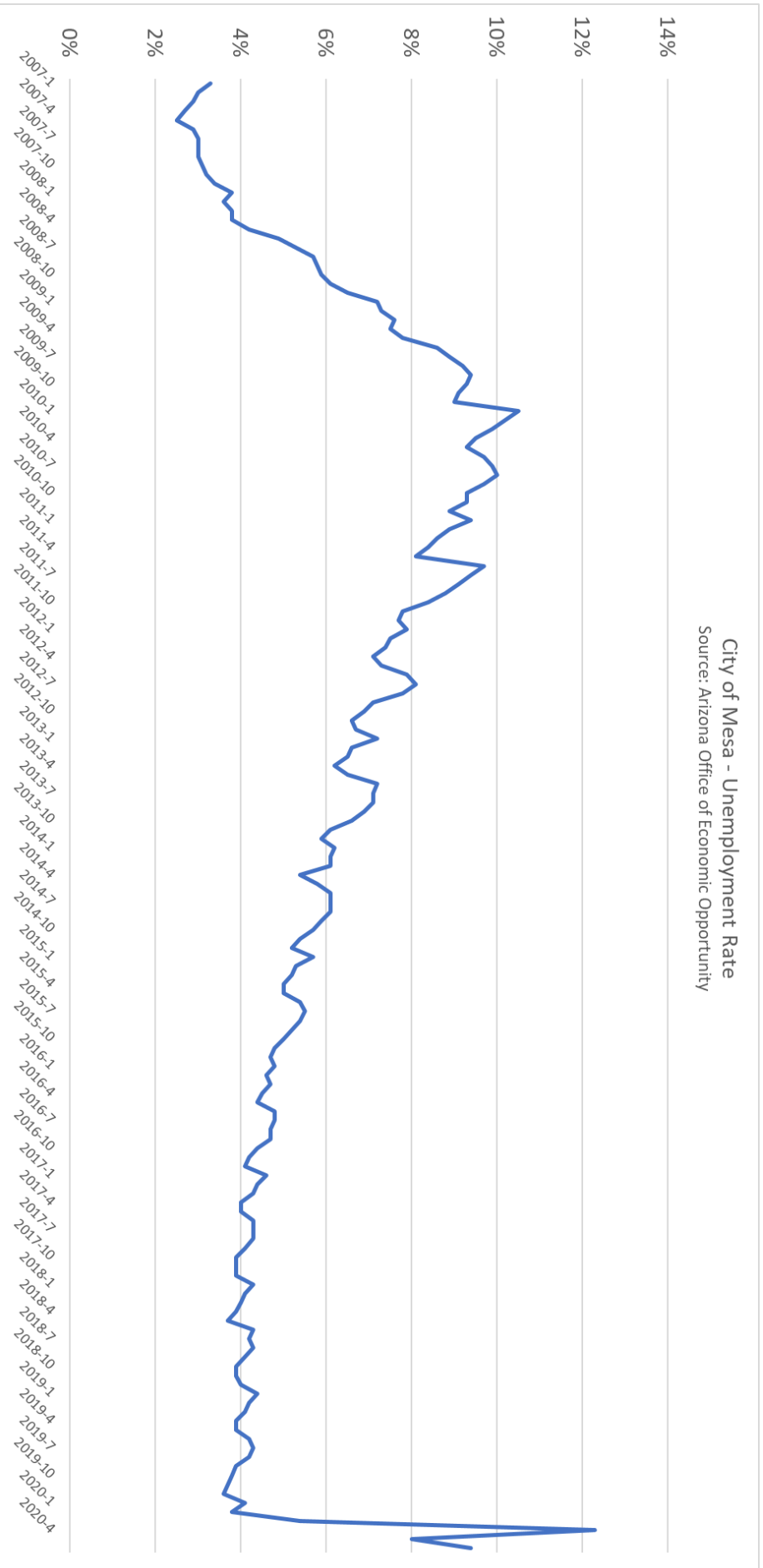
# Initial Claims for Unemployment Benefits – United States



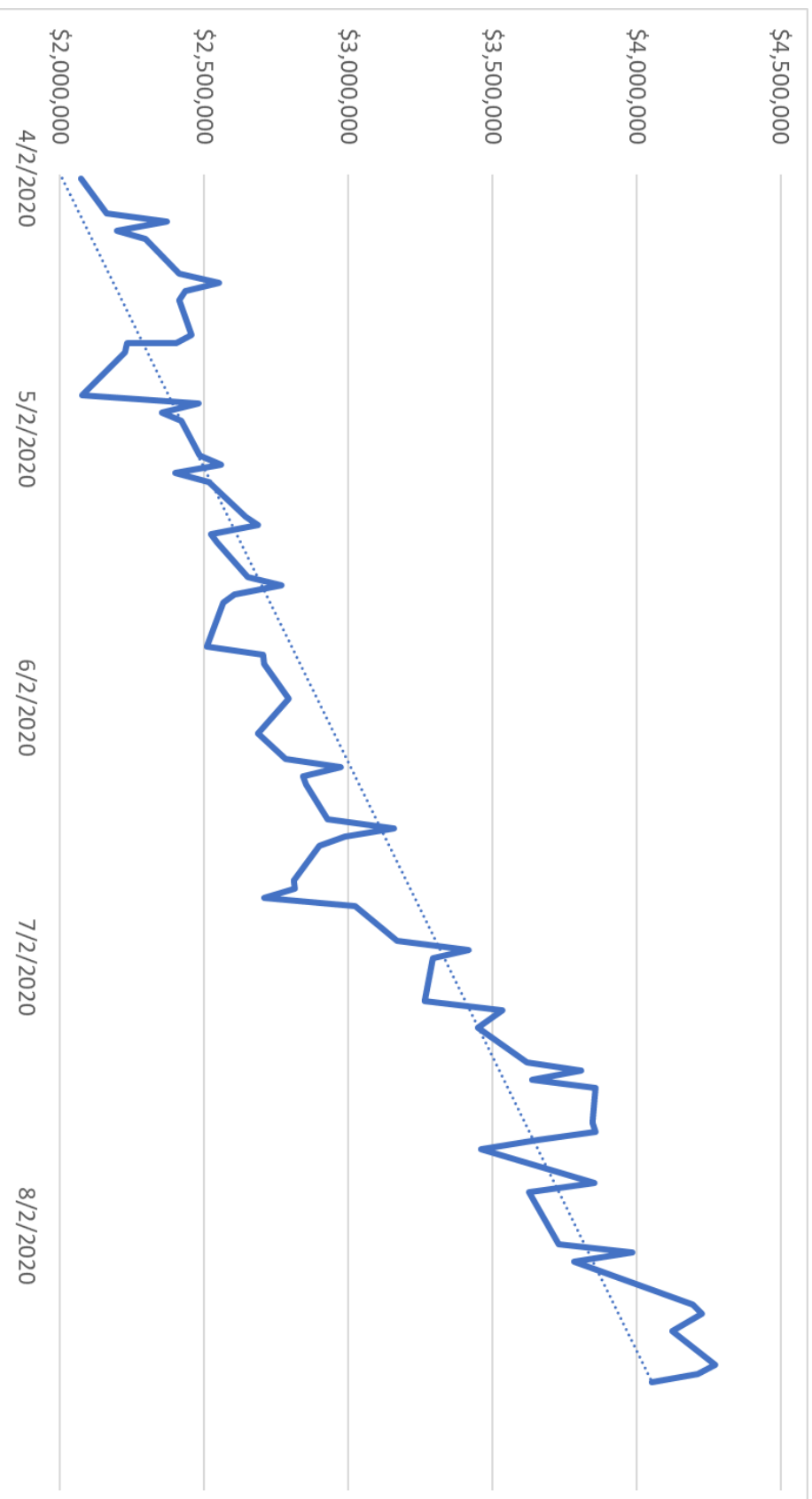
# Initial Claims for Unemployment Benefits - Arizona



# City of Mesa – Unemployment Rate



# City of Mesa Utility Bills – Total Past Due Amount



# Next Steps

- Continue to monitor
  - Sales tax revenue and economic trends
  - Shopping behavior
  - Business closures/re-openings
  - Stimulus & unemployment benefits
- Return to the AF&E Committee in January 2021 with an update



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# City of Mesa

FY 2020/21

## Utility Enterprise Fund Forecast

Audit, Finance & Enterprise Committee

August 27, 2020

Presented by:

Brian A. Ritschel – Management & Budget Assistant Director

Chris Olvey – Management & Budget Forecast Coordinator

What's included in  
the forecast?

## Sources (Revenue) Forecasting

- The City's forecasting approach to utility revenues includes statistical analysis and collaboration with Departments
- Statistical software is applied in house to analyze the correlation between economic trends and the City's utility sources
- Relevant economic indicators are considered, such as population growth, along with reviewing historical trends in account growth and consumption/usage
- Mesa specific factors are applied such as economic development activities, additional large customers, etc.
- Impact of pandemic on utilities

## Uses (Expense) Forecasting

- Departments provide specific forecasts for large budget items where costs can fluctuate over time, including water commodity purchases, water and wastewater treatment plant chemicals, and solid waste tipping fees
- Debt service payments are included in the Utility Enterprise Fund forecast, where funds are transferred according to utility debt service schedules
- Other departmental operating expenses, such as, step pay increases, salary benchmark study, and General Fund contribution.

# Financial Principles

- **Balanced net sources and uses**
- **20% or higher reserve fund balance**
- **Rate adjustments that are predictable and smoothed throughout the forecast**
- **Equity between residential and non-residential rates**
- **Affordable utility services**

# Rate Adjustment History

FY 19/20 Forecasted

	FY 17/18	FY 18/19	FY 19/20
WATER Residential	3.50%	2.00%	3.85%
WATER Non-Residential	3.50%	2.00%	3.85%
WASTEWATER Residential	4.00%	2.50%	4.35%
WASTEWATER Non-Residential	4.00%	2.50%	4.35%
SOLID WASTE Residential	3.50%	2.00%	3.85%
SOLID WASTE Commercial	2.50%	2.00%	2.00%
SOLID WASTE Rolloff	0.00%	0.00%	2.00%
ELECTRIC Residential -svc charge only	\$1.25	\$1.00	\$2.25
ELECTRIC Non-Residential	\$0.00	\$0.00	\$0.00
GAS Residential - svc charge only	\$0.75	\$0.45	\$0.75
GAS Non-Residential - svc charge only	\$0.75	\$0.45	\$0.75

FY 19/20 Adopted

	FY 17/18	FY 18/19	FY 19/20*
WATER Residential	3.50%	2.00%	0.00%
WATER Non-Residential (usage only)	3.50%	2.00%	6.00%
WASTEWATER Residential	4.00%	2.50%	0.00%
WASTEWATER Non-Residential	4.00%	2.50%	4.35%
SOLID WASTE Residential	3.50%	2.00%	0.00%
SOLID WASTE Commercial	2.50%	2.00%	3.80%
SOLID WASTE Rolloff	0.00%	0.00%	2.40%
ELECTRIC Residential - svc charge only	\$1.25	\$1.00	\$0.25
ELECTRIC Non-Residential - svc charge only	\$0.00	\$0.00	\$2.50
GAS Residential - svc charge only	\$0.75	\$0.45	\$0.75
GAS Non-Residential - svc charge only	\$0.75	\$0.45	\$2.00

\*FY 19/20 Effective date shifted from July to March/April

# Revenue Scenarios

# Utility Enterprise Fund Forecast: No Rate Adjustments

\*For Planning Purposes Only\*

As of 08/16/2020	FY 20/21 Projected	FY 21/22 Forecast	FY 22/23 Forecast	FY 23/24 Forecast	FY 24/25 Forecast	FY 25/26 Forecast
WATER	(\$170,094)	(\$4,984,116)	(\$7,460,577)	(\$6,779,287)	(\$13,052,033)	(\$15,116,050)
WASTEWATER	(\$13,491,202)	(\$12,754,447)	(\$13,146,817)	(\$15,845,832)	(\$16,714,813)	(\$17,843,866)
SOLID WASTE	\$3,725,506	\$963,766	\$1,394,272	(\$393,794)	\$875,847	\$1,013,800
ELECTRIC	\$1,386,515	\$152,000	(\$454,956)	(\$1,400,619)	(\$1,419,666)	(\$2,023,613)
NATURAL GAS	\$1,958,550	(\$1,057,181)	(\$2,253,111)	(\$3,333,798)	(\$3,238,758)	(\$3,729,172)
DISTRICT COOLING	(\$251,566)	(\$110,159)	(\$156,107)	(\$150,469)	(\$238,691)	(\$390,925)
<b>TOTAL NET SOURCES AND USES</b>	<b>(\$6,842,292)</b>	<b>(\$17,790,137)</b>	<b>(\$22,077,297)</b>	<b>(\$27,903,799)</b>	<b>(\$33,788,113)</b>	<b>(\$38,089,827)</b>
Beginning Reserve Balance	\$135,470,845	\$128,628,553	\$110,838,417	\$88,761,120	\$60,857,321	\$27,069,207
<b>Ending Reserve Balance</b>	<b>\$128,628,553</b>	<b>\$110,838,417</b>	<b>\$88,761,120</b>	<b>\$60,857,321</b>	<b>\$27,069,207</b>	<b>(\$11,020,619)</b>

Ending Reserve Balance Percent*	31.6%	26.7%	20.9%	14.0%	6.1%	-2.4%
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\*As a % of Next Fiscal Year's Expenditures

WATER Residential	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
WATER Non-Residential	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
WASTEWATER Residential	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
WASTEWATER Non-Residential	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
SOLID WASTE Residential	4.00%	2.00%	2.00%	2.00%	2.00%	2.00%
SOLID WASTE Commercial	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
SOLID WASTE Rolloff	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
ELECTRIC Residential - svc charge only	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
ELECTRIC Non-Residential - svc charge only	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
GAS Residential - svc charge only	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
GAS Non-Residential - svc charge only	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00

# Utility Enterprise Fund Forecast: FY 25/26 Balanced Net Sources & Uses

\*For Planning Purposes Only\*

As of 08/17/2020	FY 20/21 Projected	FY 21/22 Forecast	FY 22/23 Forecast	FY 23/24 Forecast	FY 24/25 Forecast	FY 25/26 Forecast
WATER	\$596,627	(\$1,048,693)	(\$205,484)	\$3,935,297	\$1,237,726	\$2,764,980
WASTEWATER	(\$12,984,174)	(\$10,092,584)	(\$8,207,513)	(\$8,515,511)	(\$6,908,221)	(\$5,422,729)
SOLID WASTE	\$4,028,650	\$1,904,900	\$3,175,091	\$2,272,961	\$4,473,500	\$5,591,629
ELECTRIC	\$1,526,727	\$574,495	\$310,320	(\$288,041)	\$44,675	(\$203,048)
NATURAL GAS	\$2,310,474	\$4,995	(\$311,780)	(\$476,115)	\$536,357	\$979,911
DISTRICT COOLING	(\$251,566)	(\$110,159)	(\$156,107)	(\$150,469)	(\$238,691)	(\$390,925)
<b>TOTAL NET SOURCES AND USES</b>	<b>(\$4,773,261)</b>	<b>(\$8,767,045)</b>	<b>(\$5,395,474)</b>	<b>(\$3,221,879)</b>	<b>(\$854,653)</b>	<b>\$3,319,819</b>
Beginning Reserve Balance	\$135,470,845	\$130,697,584	\$121,930,539	\$116,535,065	\$113,313,186	\$112,458,533

**Ending Reserve Balance** **\$130,697,584** **\$121,930,539** **\$116,535,065** **\$113,313,186** **\$112,458,533** **\$115,778,352**

Ending Reserve Balance Percent\* **31.7%** **28.7%** **26.5%** **25.1%** **24.1%** **24.1%**

\*As a % of Next Fiscal Year's Expenditures

WATER Residential	2.50%	2.50%	2.50%	2.50%	2.50%	1.50%
WATER Non-Residential (usage only)	5.00%	5.00%	5.00%	5.00%	5.00%	3.00%
WASTEWATER Residential	4.00%	4.00%	4.00%	4.00%	4.00%	3.50%
WASTEWATER Non-Residential	4.00%	4.00%	4.00%	4.00%	4.00%	3.50%
SOLID WASTE Residential	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
SOLID WASTE Commercial	4.00%	3.00%	3.00%	3.00%	3.00%	3.00%
SOLID WASTE Rolloff	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
ELECTRIC Residential - svc charge only	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50
ELECTRIC Non-Residential - svc charge only	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00
GAS Residential - svc charge only	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50
GAS Non-Residential - svc charge only	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50	\$2.50

# Next Steps

## Next Steps

- Finalize FY 20/21 rate recommendations with the utility departments
- Present to the AF&E Committee the rate recommendations for FY 20/21 and a forecast that balances the financial principles.

## Schedule for FY 2020/21 Utility Rates Adjustment Recommendation

- Sept 3** – AF&E Committee Discussion of Utility Rates
- Sept 21** – City Council Action on Notice of Intent
- Oct 1** – City Council Discussion of Utility Rates
- Nov 16** – Introduce Utility Rate Resolutions & Ordinances
- Dec 1** – City Council Action on Utility Rates
- Jan 1** – Effective date for Utility Rate changes



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