



City Council Report

Date: May 20, 2024
To: City Council
Through: Michael Kennington, Deputy City Manager/Chief Financial Officer
From: Brian A. Ritschel, Management and Budget Director
Subject: Consideration of the proposal for a Permanent Base Adjustment to the City of Mesa's 1979-80 expenditure base limit.

Purpose and Recommendation

The Permanent Base Adjustment option allows the City to permanently adjust the FY1979/80 expenditure base limit used to calculate the annual expenditure limit. Similar to Home Rule, the City may only spend the resources it has. The new base limit will remain the same unless future adjustments are voter approved. Because a base adjustment is permanent, it allows the City to better predict and plan its future budgets for critical functions such as public safety.

The Office of Management and Budget recommends that the City Council approves a resolution to refer to the voters a permanent adjustment to the City's 1979/80 expenditure base limit of \$148 million, which will not increase taxes, and which is estimated to provide expenditure capacity for 30 years. If the resolution is approved, this item would be added to the November 2024 ballot.

Background and Discussion

The Arizona State Constitution requires the adoption of a balanced budget where the estimated revenues and resources equal the appropriated expenditures. In addition to the requirement for a balanced budget, Article 9, Section 20 of the Arizona State Constitution imposes an expenditure limitation for all cities and towns based on the FY1979/80 budget adjusted for inflation and population growth.

Cities and towns that wish to exceed this expenditure limitation may do so with voter approval of one of three different methods: 1) Home Rule which allows a city to determine its own expenditure limitation within available revenues and resources for a period of four fiscal years; 2) Permanent Base Adjustment which allows a city to permanently adjust the expenditure limitation base and 3) One-Time Override Alternative which allows a city to exceed the State imposed expenditure limitation for a specific amount for one fiscal year.

The City of Mesa is currently under the Home Rule alternative approved by voters in November 2022 and which will expire June 30, 2027. As allowed by the Arizona Constitution, the City of Mesa seeks a permanent adjustment of \$148 million to the 1979/80 expenditure base limit that is used to calculate the City's annual expenditure limitation. This will not increase taxes and is estimated to provide expenditure capacity for 30 years.

The method for calculating the expenditure limit used by the State does not consider dedicated funding sources approved by Mesa voters after 1979/80. Examples are the Quality-of-Life sales tax that is currently funding police officers and fire fighters, Public Safety Sales Tax that is currently funding police and fire services, and the Local Streets sales tax that funds street repairs and maintenance. Also not taken into account is Mesa's portion of the regional sales tax dedicated to street construction projects. These funding sources are estimated to be \$165 million for FY2024/25.

Fiscal Impact

If a city exceeds the State imposed expenditure limitation, a portion of the following year's share of the state income tax allocation is withheld. If the city exceeds the limitation by less than 5%, the penalty will equal the excess amount. If the city exceeds the limitation by more than 5% but less than 10%, the penalty will be three times the excess amount. And if the city exceeds the limitation by more than 10%, the penalty will be five times the excess amount or one-third of the state income tax allocation, whichever is less.

For example, if the expenditure limitation alternative is in effect for FY2023/24, the City's budget would have exceeded the State imposed expenditure limitation by approximately \$1.1 billion. If the City spent the full budget, it would have resulted in a loss of approximately \$32.2 million of the state income tax allocation in FY2022/23 as a penalty.

Alternatives

The Council could choose not to refer a permanent base adjustment expenditure limitation alternative to the voters. The City would then pursue a continuation of the Home Rule Alternative on the November 2026 ballot