



City Council Report

Date: May 16, 2022
To: City Council
Through: Michael Kennington, Chief Financial Officer
Candace Cannistraro, Management and Budget Director
From: Brian A. Ritschel, Management and Budget Assistant Director
Subject: Consideration of the proposal of continuation of a locally controlled alternative expenditure - Home Rule option

Purpose and Recommendation

The Home Rule option allows the City to retain local control over the annual budget amount adopted by the City Council. Without a Home Rule option in affect, the City would be subject to the State's expenditure limitation formula and resulting budget amount.

The Office of Management and Budget recommends that the City Council approves a resolution to refer to the voters the continuation of a locally controlled alternative expenditure (Home Rule). If the resolution is approved, this item would be added to the November 2022 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 voters have approved the continuance of a Home Rule expenditure limitation option since 2000. The current approval expires on June 30, 2023.

The method for calculating the expenditure limit used by the State does not consider dedicated funding sources approved by Mesa voters. 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. In FY2021/22, these revenue receipts are estimated to total \$28.9 million.

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 Home Rule expenditure limitation alternative had not been in effect for FY2021/22, the City's budget would have exceeded the State imposed expenditure limitation by approximately \$810 million, excluding contingency appropriation. If the City spent the full budget, it would have resulted in a loss of approximately \$32.4 million of the state income tax allocation in FY2022/23 as a penalty.

Alternatives

The Council could choose to pursue a Permanent Base Adjustment which would require forecasting the budget needed in the future and setting the limitation at that dollar level through an election question and the approval of Mesa voters.

The Council could choose to pursue a one-year override for FY2023/24 by including the override in the November 2022 election or by calling a special election in May 2023. The City would then need to call a special election in May 2024 for a one-year override for FY2024/25.

The Council could choose not to refer an expenditure limitation alternative to the voters. The City would then be subject to the State expenditure limit. The City must then reduce the overall budget starting in FY2022/23 by approximately \$859 million or be subject to the financial penalties referred to above.