Town of Prescott Valley

Financial Trends Analysis
For Fiscal Years
2008 - 2012

December 2012

Prepared by
Management Services Department

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Introduction

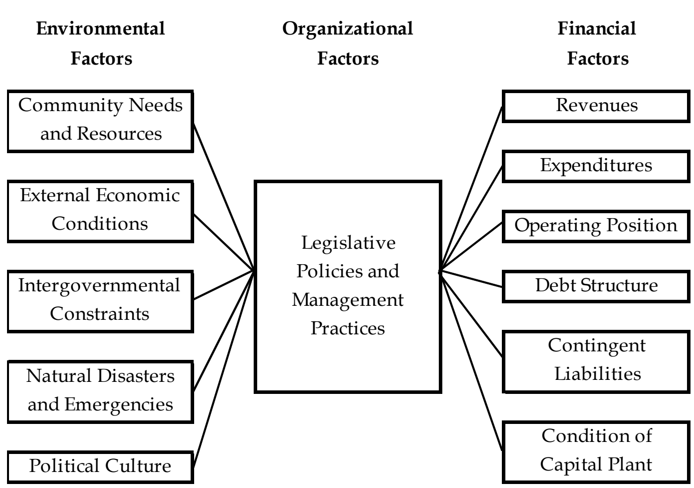
The purpose of the financial trends analysis is to provide the Town of Prescott Valley (Town) citizens, elected officials, management, staff and other stakeholders with information regarding existing and potential organizational and financial problems that may impact the Town's future fiscal health. As a useful management tool, it combines budgetary, financial, economic and demographic data to create a series of government indicators that can be used to monitor changes in the Town's financial condition.

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

This report contains an analysis of the financial trends for the Town (excluding Community Facilities Districts) for the five-year period of 2008 to 2012. By analyzing these trends, the financial condition of the Town can be monitored, which allows Town officials to better understand the forces that affect the financial condition of the Town and the obstacles associated with measuring the financial condition. It will also allow officials to identify existing and emerging financial problems and develop action plans to remedy these problems. The term financial condition has many meanings. From an accounting standpoint, it refers to the Town's ability to generate enough cash to pay its bills (e.g. cash solvency). It also refers to the Town's ability to generate enough revenues over a normal budgetary period to meet its expenditures and not incur deficits (e.g. budgetary solvency). It also includes the ability of the Town in the long run to pay all costs of doing business, including those that are annually budgeted and those that appear only in years in which they must be paid (e.g. long-run solvency). Service level solvency refers to the ability of the Town to support municipal services at an adequate level.

The analysis, as designed by the International City/County Management Association (ICMA), encompasses three primary factors that affect the Town'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



Evaluating a government's financial condition is a complex process. 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 Town's financial condition.

This report uses numerous indicators, covering separate issues including external revenues, fund balance, liquidity, unfunded liabilities and business activity. Town officials can use these indicators to achieve the following:

- Gain a better understanding of the government's financial condition
- Identify existing and emerging problems before they reach serious proportions
- Present a straightforward picture of the government's financial strengths and weaknesses
- Introduce long-range considerations into the annual budgeting process
- Provide a starting point for setting financial policies

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

Executive Summary

During fiscal year 2011/12, the national and state economies continued to struggle with the slowdown in the housing market and rising unemployment. Governments continued to struggle to balance their budgets under declining revenue results.

The national economy based on Gross Domestic Product (GDP) has an average quarterly growth rate of 3.25 percent from 1947 until present. Although this economic index began trending downward in fiscal year 2007/08, we have seen continued positive quarterly growth since the third calendar quarter of 2009. The second calendar quarter of 2012 continues to follow this trend with a reported 1.3 percent expansion in GDP. Although this is a sign that the economic recession has ended, there continues to be concerns about the economy and our weak labor market. The national unemployment rate as of October 2012 was at 7.9 percent. Since economic performance tends to be cyclical in nature, there are short-term and long-term uncertainties that could have an impact on the strength and longevity of the current economic cycle as we head into fiscal year 2012/13. These uncertainties include housing and construction markets, energy prices, inflation, consumer confidence, job market and geopolitical activity.

Arizona has been hard hit by the recession and continues to struggle through this tough economic time. The state economy is currently feeling the effects of some signs of economic expansion, but the recovery will be at a very slow pace. Analysts expect growth to be positive, but slow in the quarters ahead.

The Town's building permit activity has seen improvement; however, there is a 43.5 percent decline in building permits issued compared to fiscal year 2007/08. Building activity is projected to continue seeing a positive growth trend in fiscal year 2012/13, improving the local economy in the housing and construction markets.

The Town continues to strive to bring new businesses and jobs to the area. Two commercial projects were completed during the year; a Family Dollar store and Carl's Jr. Restaurant. Yavapai Regional Medical Center East also began construction on an expansion to the hospital emergency department. Wal-Mart is planned to open in the Glassford Hill Marketplace complex, however a specific date for ground-breaking has not been determined.

The Town continues to complete capital projects funded by a variety of sources including impact fees, grants, Yavapai County funding and .33 percent sales tax revenue.

During fiscal year 2011/12, the Town purchased and remodeled a new Public Works and Parks and Recreation facility, the beginning stages of several multiuse path projects are underway, and in partnership with the Yavapai County Flood Control District, the Western Boulevard Phase II storm water drainage project was finished. The Town also continued roadway improvement projects on Loos Drive, Navajo Drive, Viewpoint Drive and Robert Road.

Based on fiscal year 2011/12 and the outlook for 2012/13, guarded optimism best describes the Town's current economic prospects. Nationally and locally, the construction and housing industries experienced a significant drop-off beginning at the end of fiscal year 2005/06 which continued through 2010/11. Although 2011/12 showed signs of improvement in construction and housing, it is at a very slow pace. Prudent long-term fiscal planning dictates a conservative financial approach, focusing on the highest Council and citizen priorities. The challenge for the future is the Town's ability to absorb, within available resources, increasing operational costs (i.e. rising health insurance costs, utilities, infrastructure maintenance, public safety, etc.) associated with the current population base and continued demands for public services. The use of economic resources to fund future development will have an immediate impact on the Town's current resources as well.

The budget for the 2012/13 year includes a conservative economic forecast with increased revenues projected over the prior year. The Management Services staff will continue to monitor the Town's financial trends on an annual basis. If action is required to address unfavorable trends, the Director of Management Services will alert the Town Manager in a timely manner and bring forward strategic options for future consideration.

Community Needs and Resources

The leveling of population in the area is a result of the weak economy and declining jobs in construction and housing. As a result of the weak economy, tax receipts have reduced as spending in the Town has decreased. Inflation has recently increased which has a negative effect by increasing prices for goods. Recent declines in residential development and business activity have had a negative effect on the Town's condition. Concerns in these areas will continue until the local economy experiences a rebound from the 2008 recession. Indicators in the current fiscal year are showing some signs of economic expansion, but there are many concerns on the stability and sustainability of any substantial economic rebound at this time.

Indicator	2010/11	2011/12
Population	Neutral	Neutral
Inflation	Positive	Neutral
Residential Development	Negative	Neutral
Business Activity	Negative	Neutral
Personal Income	Negative	Negative

Revenues

Operating revenues as well as sales tax revenues increased in 2011/12 as the Town is beginning to experience a slight improvement to the economy. Revenues per capita remain unchanged in 2011/12. Restricted revenues are down 3.7 percent mainly due to a decrease in grant receipts received. Intergovernmental revenues had a slight increase in fiscal year 2011/12 and are expected to continue improving in fiscal year 2012/13.

Indicator	2010/11	2011/12
Revenues per Capita	Negative	Negative
Restricted Revenues	Neutral	Positive
Intergovernmental Revenues	Positive	Neutral
Elastic Revenues	Positive	Positive

Expenditures

The Town experienced an increase in expenditures per capita during fiscal year 2011/12. Staffing and salaries and wages remained constant in 2011/12. This was expected as the Town has taken measures to reduce expenditures in response to reduced revenues over the past few fiscal years. These measures include implementing a hiring freeze and cost reduction controls.

Indicator	2010/11	2011/12
Expenditures per Capita	Positive	Neutral
Employees per Capita	Neutral	Neutral
Fringe Benefits	Neutral	Negative

Operating Position

The operating position indicators reflect an overall solid financial base. Enterprise funds show an increase in earnings due to increased rates implemented in November of 2011 and reduced administrative expenses. Although the Town is gradually using more of its cash on hand, a majority of the fund balances are unassigned. The percentage of current liabilities to cash and investments remains above industry averages and the Town's liquidity is strong even with a slow economy.

Indicator	2010/11	2011/12
General Fund Balance	Neutral	Neutral
Enterprise Fund Earnings	Positive	Positive
Liquidity	Positive	Positive

Debt Structure

Current liabilities decreased approximately $890 thousand at the end of the year. Currently the Town has the available funds to make payments for outstanding debt. Net direct debt per capita decreased due to debt service payments made during 2011/12. During fiscal year 2011/12, the Town's total bonded debt decreased by approximately $1.9 million.

Indicator	2010/11	2011/12
Current Liabilities	Negative	Negative
Net Direct Debt per Capita	Positive	Positive
Debt Service	Neutral	Positive
Excise Tax	Positive	Positive
Overlapping Debt	Neutral	Negative

Contingent Liabilities

The Pension Benefit Obligation - Arizona Public Safety Personnel Retirement System (APSPRS) experienced a decline in fiscal year 2011/12 as a result of changing population demographics, expanded coverage needs and a downturn in the economy resulting in sharply lower returns on investments. The Town has experienced increased funding needs for the pension obligation for the past eight periods. The Defined Contribution Benefit Obligation - ICMA is one hundred percent funded.

Indicator	2010/11	2011/12
Pension Benefit – APSPRS	Negative	Negative
Defined Contribution Benefit - ICMA	Positive	Positive
Compensation Absences	Negative	Negative

Condition of Capital Plant

The Town's maintenance and replacement of capital assets decreased during 2011/12. This is due to the Town reducing expenditures to offset decreases in revenue caused by the slowed economy.

Indicator	2010/11	2011/12
Maintenance Effort	Neutral	Positive
Capital Outlay	Neutral	Negative

Sources

The following information has been analyzed using the information and analysis suggestions as described in the ICMA publication *Evaluating Financial Condition – A Handbook for Local Government* and the Town's Finance staff. Trend indicators are based primarily on the Town's economic base.

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 Town analyze and interpret key financial, economic and demographic trends and can provide management with information needed to improve the Town's overall financial position and aid in the decision-making process.

In order to ensure validity and consistency of the indicators, most data is tied to data published in the Town'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 Town. The Town presents its CAFR in accordance with Generally Accepted Accounting Principles (GAAP) and in a consistent format as promulgated by the Government Finance Officers Association (GFOA).

Comprehensive Financial Policies

The following excerpts are from the Town-adopted financial policies and establish a framework for 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.

Adopted financial policies reflect the Town's commitment to sound financial management and fiscal integrity to the credit rating industry and prospective investors (bond buyers). The financial policies also improve the Town's fiscal stability by helping Town officials plan fiscal strategy with a consistent approach. Adherence to adopted financial policies promotes sound financial management, which can lead to improvement in Town bond ratings and lower cost of capital. The Town is in compliance with the comprehensive financial policies adopted.

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.

2. Budgets for governmental fund types will be adopted on a basis of accounting consistent with GAAP. The budget process is intended to weigh all competing requests for Town resources, within expected fiscal constraints. Requests for new, ongoing programs made outside the budget process will be discouraged.

3. The budget shall be adopted at the fund level. Budget development will use strategic multi-year fiscal planning, conservative revenues forecasts and modified zero-base expenditure analysis that require 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 the Town Manager and Town Council.

4. Revenues will not be dedicated for specific purposes, unless required by law or GAAP. The only exception is .33 percent of the transaction privilege taxes which have been dedicated to the Street Improvement Fund. All non-restricted revenues will be deposited in the General Fund and appropriated by the budget process. Special one-time revenue sources will be used to purchase non-recurring items like capital equipment or projects.

5. Current revenues will fund current expenditures and a diversified and stable revenue system will be developed to protect programs from short-term fluctuations in revenue.

6. 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 staff will result in increased revenues or enhanced operating efficiencies. Personnel cost reductions will be achieved through attrition to the extent feasible.

7. Utility (Water and Wastewater) user charges will reflect cost of service and will be established so that operating revenues are at least equal to operating expenditures. User fees and charges will be examined annually to ensure that they recover all direct and indirect costs of service and will be approved by the Town Council.

8. 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 Town Council.

9. Development impact fees, as permitted by State law, for capital expenses attributable to new development will be reviewed as necessary to ensure that fees recover all direct and indirect development-related expenses and will be approved by Town Council.

10. Capital equipment replacement will be accomplished through the use of a replacement fund. The Town will appropriate funds to the replacement fund annually during the budget process to provide for the timely replacement of equipment. Replacement costs will be based upon equipment lifecycle financial analysis.

11. Grant funding will be considered to leverage Town funds. Inconsistent and/or fluctuating grants should not be used to fund ongoing programs. Programs financed with grant monies will be budgeted in a separate fund and the service program will be adjusted to reflect the level of available funding. In the event of reduced grant funding, Town resources will be substituted only after all program priorities and alternatives are considered during the budget process.

12. 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 Town Manager, will identify all activities that could be provided by another source and review options/alternatives to current service delivery. The review of service delivery alternatives and the need for the service will be performed annually or on an "opportunity" basis.

13. Cash and investment programs will be maintained in accordance with the Town Charter and the adopted investment policy and will ensure that proper controls and safeguards are maintained. Town 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.

14. The Town will follow an aggressive and consistent policy of collecting revenues to the limit of our ability with sensitivity to individuals' circumstances. Collection policy goal will be for all adjusted uncollectible accounts to be no more than .5 percent of the total Town revenues being adjusted for bad debts annually.

Capital Management Policies

1. A five-year Capital Improvement Plan will be developed and updated annually, including anticipated funding sources. Capital improvement projects are defined as infrastructure, land improvements, equipment purchases or construction projects which result in a capitalized asset costing more than $25,000 and having a useful (depreciable) life of two years or more.

2. Proposed capital projects will be reviewed and prioritized by the Town Manager in discussion with the director of the department and overall consistency with the Town's goals and objectives. Financing sources will then be identified for the highest ranking projects.

3. 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.

4. A portion (.33 percent of the 2.33 percent) of the privilege tax revenues will be restricted for purposes of funding improvements for street and roadway projects.

Debt Management Policies

1. The issuance of long-term debt is limited to capital projects and assets that the Town cannot finance from current revenues or resources.

2. The Town will seek to maintain and, if possible, improve our current bond rating in order to minimize borrowing costs and preserve access to credit.

3. An analysis showing how the new issue combined with current debt impacts the Town's debt capacity and conformance with Town debt policies will accompany every future bond issue proposal.

4. General Obligation (GO) debt, which is supported by property tax revenues and grows in proportion to the Town'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 and sewer) may also be utilized when they are supported by dedicated revenue sources (e.g., fees and user charges).

5. Municipal Property Corporation (MPC) and contractual debt, which is non-voter approved, will be utilized only when a dedicated revenue source (e.g., transaction privilege taxes and state-shared revenues) 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 (e.g., 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).

6. Town debt service costs should not exceed 25 percent of the Town’s operating revenues in order to control fixed costs and ensure expenditure flexibility. Improvement District (ID) and Community Facilities 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.

7. ID and CFD bonds shall be permitted only when there is a general Town benefit. Both 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 developments or existing neighborhoods desiring improvements to their property such as roads, water lines, sewer lines, streetlights, parks and drainage.

   a. ID 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 Town. In addition, the Town's cumulative improvement district debt will not exceed 15 percent of the Town's secondary assessed valuation. Bonds issued to finance improvement district projects will not have maturities longer than ten years.

   b. CFD 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 addition, the Town's cumulative facilities district debt will not exceed 15 percent of the Town's secondary assessed valuation. The landowner/developer shall also contribute $.30 in public infrastructure improvements of each dollar of public infrastructure improvement debt to be financed by the district.

8. Debt financing should not exceed the useful life of the infrastructure improvement with the average (weighted) bond maturities at or below ten years.

9. Utility rates will be set, at a minimum, to ensure the ratio of revenues to debt service meets our bond indenture requirement of 1.25:1. The Town goal will be to maintain a minimum ratio of utility revenues 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

1. The Town will maintain a stabilization fund or "Rainy Day Fund" as a committed fund balance in the general fund of no less than 10 percent of general fund revenues, excluding transfers.

2. The Town's general fund will maintain an "unassigned" fund balance with a target of a minimum of 25 percent (25%) of general fund revenues, excluding transfers.

3. Contingency and reserve funds in the Water and Wastewater utility operating funds should be equal to a minimum of ninety days operating expenditures.

4. 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.

Financial Reporting Policies

1. Contingency and reserve funds in the Water and Wastewater utility operating funds should be equal to ninety days operating expenditures to meet unforeseen emergencies.

2. The Town's accounting, budgetary and financial reporting systems will be maintained in conformance with all State and Federal laws, GAAP, standards of the Governmental Accounting Standards Board (GASB) and the GFOA.

3. An annual audit will be performed by an independent public accounting firm, with an audit opinion to be included with the Town's published CAFR.

4. The Town'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.

5. The Town's CAFR will also be submitted to national repositories identified by the Electronic Municipal Market Access (EMMA) as a continuing commitment to disclose thoroughness to enable investors to make informed decisions. The Town budget will be submitted to the GFOA Distinguished Budget Presentation Program.

6. The budget should satisfy criteria as a financial and programmatic policy document, a comprehensive financial plan, an operations guide for all organizational units and a communications device for all significant budgetary issues, trends and resource choices.

7. Financial systems will maintain internal controls to monitor revenues, expenditures and program performance on an ongoing basis.

Intergovernmental Constraints

The following is an overview of various intergovernmental constraints affecting the Town's operations.

State-Shared Revenues

The Town receives a share of its monies collected by the State since cities and towns in Arizona are not permitted to levy an income tax. This year, the Town received revenues for general fund intergovernmental taxes and Highway User Revenue Fund (HURF). Some money, such as State-Shared Sales Tax and State Income Tax, are unrestricted as to use. Other revenues, such as HURF are restricted to transportation purposes only.

In addition to the restrictions on the use of these funds, there are also differing methods of distribution that impact the Town's share of revenues. In some cases, United States Census figures are used to calculate revenue distribution. Other revenue distribution method calculations are based on the county in which the revenues originated.

State-shared income tax receipts are received by the Town 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. The distribution of the State income tax to the Town is projected to increase in fiscal year 2012/13.

State-shared sales tax receipts to the Town are projected to increase in fiscal year 2012/13 due to an expected increase in state-wide revenues.

Restricted Revenues

Restricted revenues are 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 revenues be used only for street maintenance or construction. As the percentage of restricted revenues increases, the Town loses its flexibility to respond to changing conditions. An over-dependence on restricted revenues makes the Town's programs vulnerable to dictation by the funding agencies and may signal a future inability to at least maintain current service levels.

Reporting Requirements

State law requires that the Town establish at least two funds – the general fund for recording "general" Town operations and HURF, which records the monies received 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.

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 revenues 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. Changes in these characteristics tend to be cumulative.

In addition to analyzing these indicators, the Town may also want to study more subjective issues, such as land-use characteristics, as they relate to the Town's ability to generate revenues and, therefore, provide convenient, efficient public services. Also important are the Town's plans and potential for future development. The diversification of the commercial and industrial tax base should be considered for its revenue generating ability, employment generating ability, vulnerability to economic cycles and relationships within the larger economic region.

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 Town's businesses to surrounding communities or because of a surge in inflation or other changes in regional or national economic conditions

Population

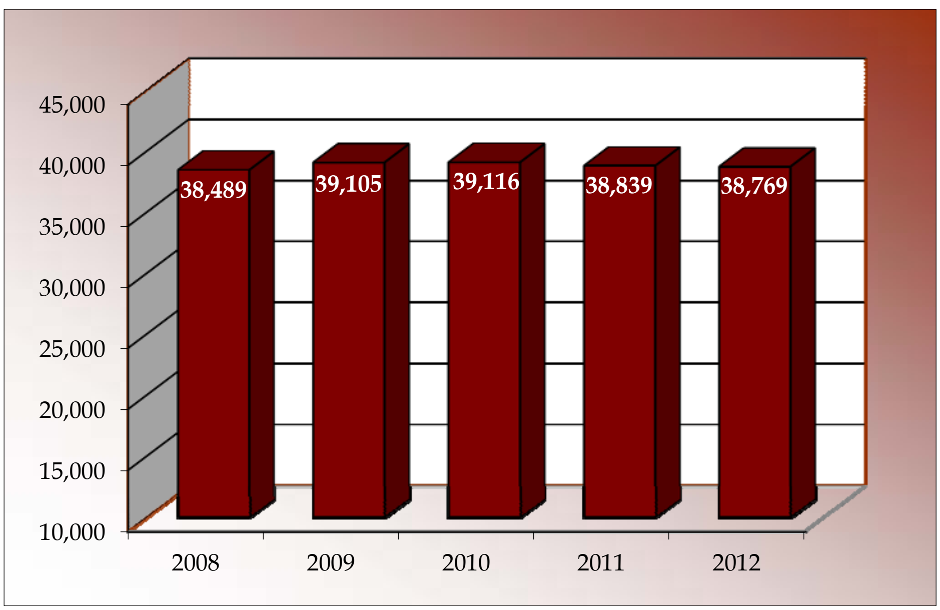
Description

Although the exact relationship between population change and other economic and demographic factors is difficult to evaluate, it is important to realize the effects that both increases and decreases in population may have on a local government. An increase in population will create pressures for new capital outlay and higher levels of service which are offset by a proportionate increase in revenues. A decline in population would, at first glance, appear to relieve pressures for expenditures, because the population is getting smaller. But in practice, a local government faced with a declining population is rarely able to make reductions in expenditures that are proportional to the loss in a critical revenue stream.

Analysis

The Town has experienced a leveling in population in recent years. The leveling of population growth is related to the downturn in economic conditions in the region. The construction industry has dramatically declined, creating a reduction of jobs in the area. Businesses have struggled in this economy and the Town has experienced business closures and lost revenues.

A decline in population tends to have a negative effect on revenues for the Town and adverse effects on employment, income, housing and business activity. If forecasts are correct, the Town should begin to see a slow recovery over the next few years. This could contribute to an upward trend in population for the region.



Population	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Population	38,489	39,105	39,116	38,839	38,769
% Change[1]	0.3%	1.6%	0.0%	-0.7%	-0.2%

Source: Arizona Department of Commerce, Population Statistics Unit

[1] Calculation: (Current Year - Previous Year)/Previous Year

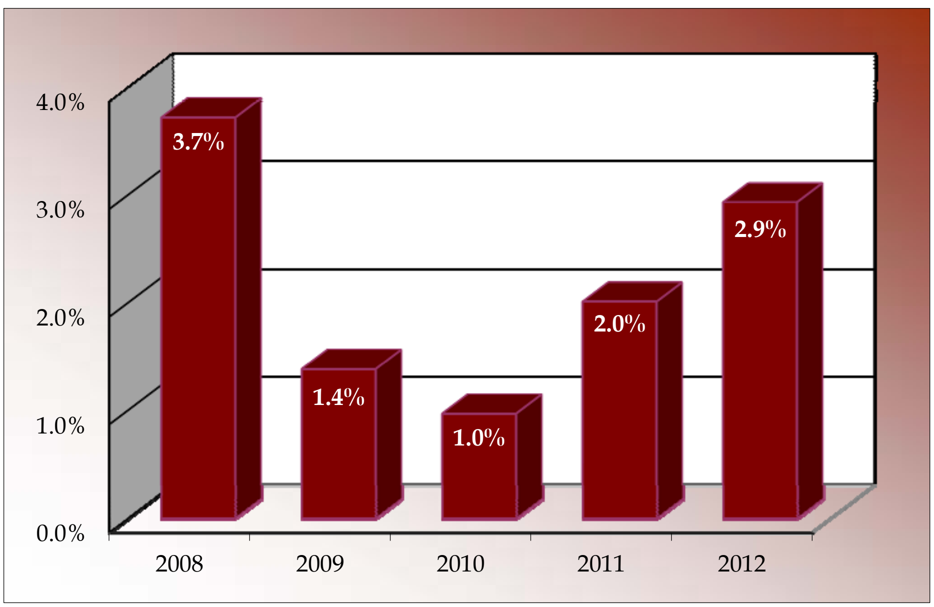
Inflation

Description

The Consumer Price Index (CPI) is one of the most widely recognized and used measures of the average change over time in the prices paid by consumers for goods and services. The CPI is based on a weighted average of prices for a variety of goods from eight different groups: food and beverage, 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 is generally beneficial and continued low rates of inflation indicate a positive trend.

Analysis

The rate of inflation has increased to 2.9% in fiscal year 2011/12 due mainly to energy prices and transportation costs creating a sustained rise in the prices of consumer goods. Overall inflation is still relatively low. The Federal Reserve Board has kept interest rates low in an attempt to stimulate the economy. Low inflation helps prevent costs from rising faster than consumers' paychecks, allowing them to buy more with each dollar. Low inflation also increases incentives for shop owners to increase their inventories. However, with the decline in jobs, the increase in the unemployment rate, the unwillingness of financial institutions to lend and consumers' unwillingness to borrow continues to hold back the consumer spending necessary for a robust recovery. Many factors play into inflation and this analysis is not intended to offer predictions.



Inflation	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Consumer Price Index	211.7	214.7	216.7	221.1	227.6
Inflation Rate [1]	3.7%	1.4%	1.0%	2.0%	2.9%

Source: U.S. Bureau of Labor Statistics - CPI

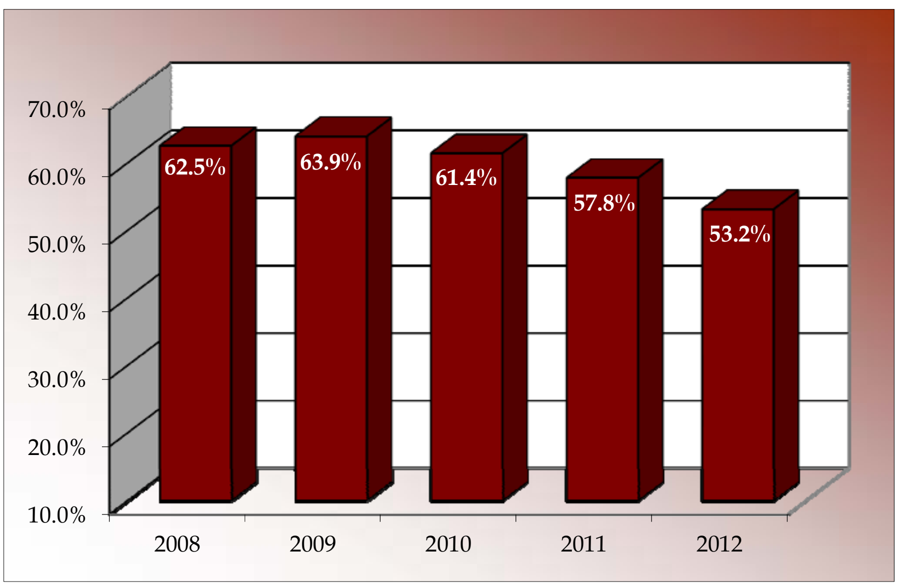
Note: Consumer Price Index is presented using fiscal year averages

[1] Calculation: (Current Year CPI - Prior Year CPI)/Prior Year CPI

Residential Development

Description
Generally, the net cost of servicing residential development is higher than the net cost of servicing commercial or industrial development. 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
Residential assessed value as a percent of total assessed property has decreased over the last three fiscal years. The Town has experienced a decrease in residential development in recent years due to the financial credit crisis and problems experienced in the banking industry within the home mortgage market. The devaluation of residential property has occurred at a much higher pace than all other property types including commercial. However, recent improvements in the housing market indicate this trend is changing. During this time of uncertainty of assessed values, it is difficult to evaluate the actual trend. Commercial development continues in the Town, but at a much slower rate than in prior years. Because the cost of servicing residential development is generally greater than servicing commercial development, this may become a positive trend in the future. The type of development should be taken into consideration in forecasting service levels and the associated service costs.



Residential Development (in thousands)	Calendar Year 2008	2009	2010	2011	2012
Assessed Value Residential Property	$ 206,616	$ 278,908	$ 256,518	$ 219,527	$ 177,675
Assessed Value All Properties	$ 330,513	$ 436,242	$ 417,511	$ 379,921	$ 334,287
% Residential Development [1]	62.5%	63.9%	61.4%	57.8%	53.2%

Source: Arizona Department of Revenue - Abstract by Tax Authority and Legal Class for the County

[1] Calculation: Assessed Value Residential/Assessed Value All Property

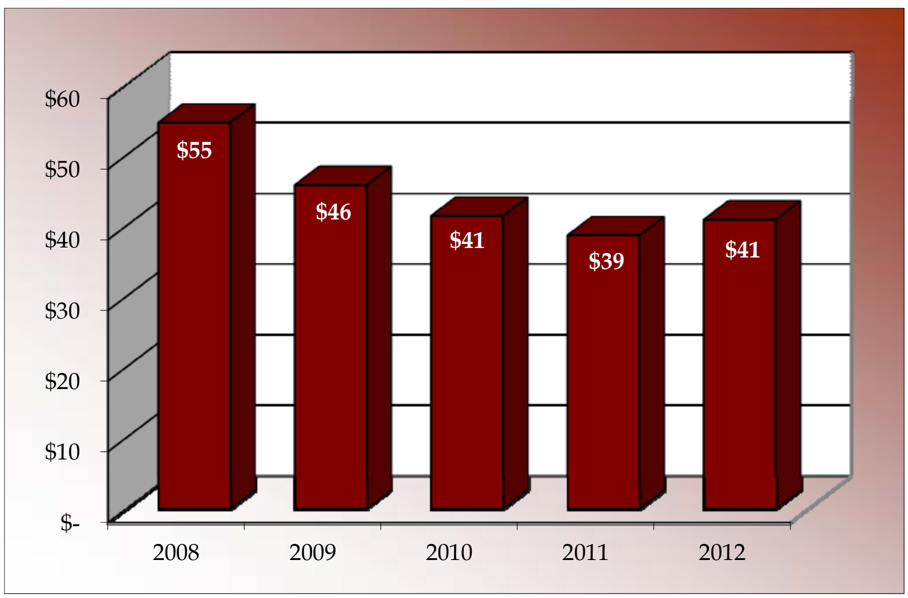
Business Activity

Description

The levels of business activity directly affect the Town's financial condition by revenue sources such as sales 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

In the previous three fiscal years the Town experienced a decrease in net sales tax collections. This reduction in sales tax collections is related to the slow economic conditions faced nationwide during this time. In fiscal year 2011/12, sales tax collections were the highest seen since fiscal year 2008/09 resulting in an increase in net sales tax collected. The Town has several development agreements in place which allow for current and future sales tax rebates to fund infrastructure expansions. These rebates reduce net sales tax collections and are included in the calculation of net sales tax collections.



Business Activity (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Sales Tax Revenue	$ 12,500	$ 11,169	$ 10,473	$ 10,241	$ 10,959
Rebated to Developers	934	1,340	1,497	1,694	1,651
Total Net Sales Tax	$ 11,566	$ 9,829	$ 8,976	$ 8,547	$ 9,307
Consumer Price Index	211.7	214.7	216.7	221.1	227.6
Net Constant Dollar					
Sales Tax Revenues [1]	$ 55	$ 46	$ 41	$ 39	$ 41
% Change Tax Revenue [2]	-20.4%	-16.2%	-9.6%	-6.7%	5.8%

Source: U.S. Bureau of Labor Statistics- CPI, Town of Prescott Valley Finance Division, Comprehensive Annual Financial Report (CAFR) - General Governmental Tax Revenues by Source - Table 5

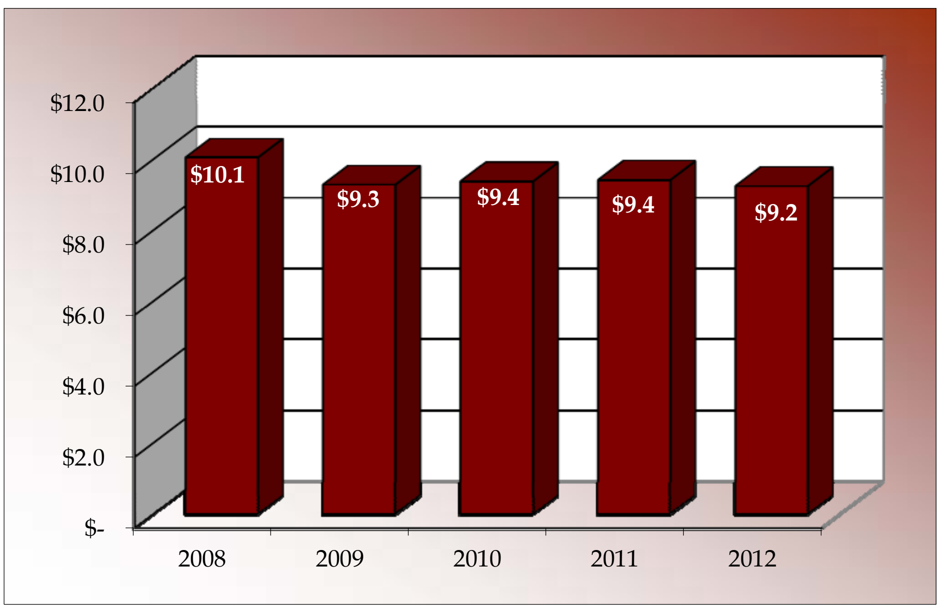
[1] Calculation: Net Sales Tax/CPI

[2] Calculation: (Current Year Net Constant Dollar Revenues - Prior Year Net Constant Dollar Revenues)/Prior Year Net Constant Dollar Revenues

Personal Income

Description
Personal income is one measure of a community's ability to pay taxes. Generally, the higher per capita income, the more property taxes, sales taxes, income taxes and business taxes the Town can generate. If income is distributed evenly, a higher per capita income will usually mean a lower dependency on government 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 Town's economy. Credit rating firms use per capita income as an important measure of a Town's ability to meet its financial obligations.

Analysis
The Town continues to experience a downward trend in its per capita personal income. This trend is related to the economic conditions faced regionally and nationally. This indicates a loss of consumer purchasing power and has had a negative impact on the Town's revenue sources due to decreases in consumer spending. The Town may also experience an increase in demand for services as families in the community face loss of jobs and uncertainty of future income. Businesses struggle with reduced revenues as consumers reduce spending. This may not only place additional demands for services provided by the Town, but limit the ability for the Town to maintain those services.



Personal Income	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Per Capita Income	$ 21,287	$ 19,935	$ 20,328	$ 20,828	$ 21,045
Consumer Price Index	211.7	214.7	216.7	221.1	227.6
Population	38,489	39,105	39,116	38,839	38,769
Net Constant Dollar Personal Income (in thousands) [1]	$ 10.1	$ 9.3	$ 9.4	$ 9.4	$ 9.2

Source: U.S. Bureau of Labor Statistics - CPI, Arizona Department of Commerce - Population Statistics Unit, Comprehensive Annual Financial Report (CAFR) - Demographic and Economic Statistics - Table 15

[1] Calculation: Per Capita Personal Income/CPI/10

Revenues

Revenues determine the capability of the Town to provide services. Important issues to consider in revenue analysis are economic growth, diversity, reliability, flexibility and administration. Revenues should be growing at a rate equal to or greater than the combined effects of inflation and expenditures. Revenues should be sufficiently unrestricted to allow for necessary adjustments to changing economic and operational conditions. Revenues should be balanced between elastic and inelastic sources with respect to economic base and inflation while others should remain relatively constant. Revenues 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 Town's revenue structure will help to identify the following types of problems:

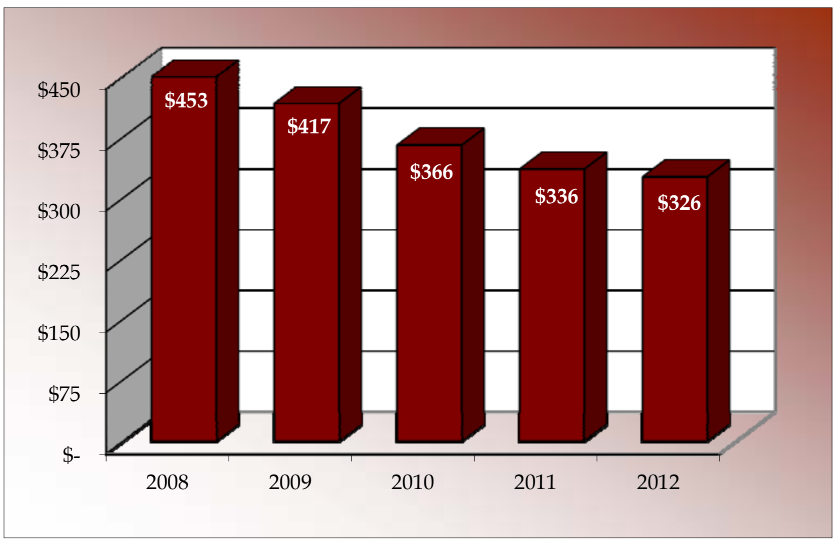
- Deterioration of the revenue base
- Internal procedures or legislative policies that may adversely affect revenue yields
- Inefficiency in the collection and administration of revenues
- Over dependence on obsolete or external revenue sources
- Changes in tax burden on various segments of the population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

Changes in revenues can be monitored by using the indicators entailed on the following pages.

Revenues per Capita

Description
Per capita revenues illustrate operating revenue changes relative to population changes. Operating revenues are comprised of local taxes (transaction privilege, cable TV franchise, and gas franchise taxes), intergovernmental taxes (state revenue sharing, auto lieu, state-shared sales tax and intergovernmental agreements), licenses and permits, charges for services, fines and forfeitures, special assessments, property rental, interest earnings and other revenue. As population increases, it might 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 Town would be unable to maintain existing service levels unless it were to find new revenue sources or reduce expenditures.

Analysis
In fiscal year 2011/12 the Town has continued to experience a decrease in revenues per capita. This is mainly the result of a decrease in federal grants of 33.1 percent and a decrease of 62.0 percent in interest earnings adjusted for CPI and population changes. A continued decline in revenues per capita could indicate the Town may have future difficulties in funding services for the community.



Revenues per Capita (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Operating Revenues	$ 36,925	$ 35,007	$ 30,990	$ 28,873	$ 28,800
Consumer Price Index	211.7	214.7	216.7	221.1	227.6
Current Population	38,489	39,105	39,116	38,839	38,769
Net Constant Dollar Revenues Per Capita [1]	$ 453	$ 417	$ 366	$ 336	$ 326
Revenues Per Capita (% change) [2]	-12.4%	-8.0%	-12.3%	-8.0%	-2.9%

Source: U.S. Bureau of Labor Statistics - CPI, Arizona Department of Commerce - Population Statistics Unit, Comprehensive Annual Financial Report (CAFR) - Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds, CAFR - Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Non-major Funds

Note 1: Prior fiscal years operating revenues have been restated for new calculation method

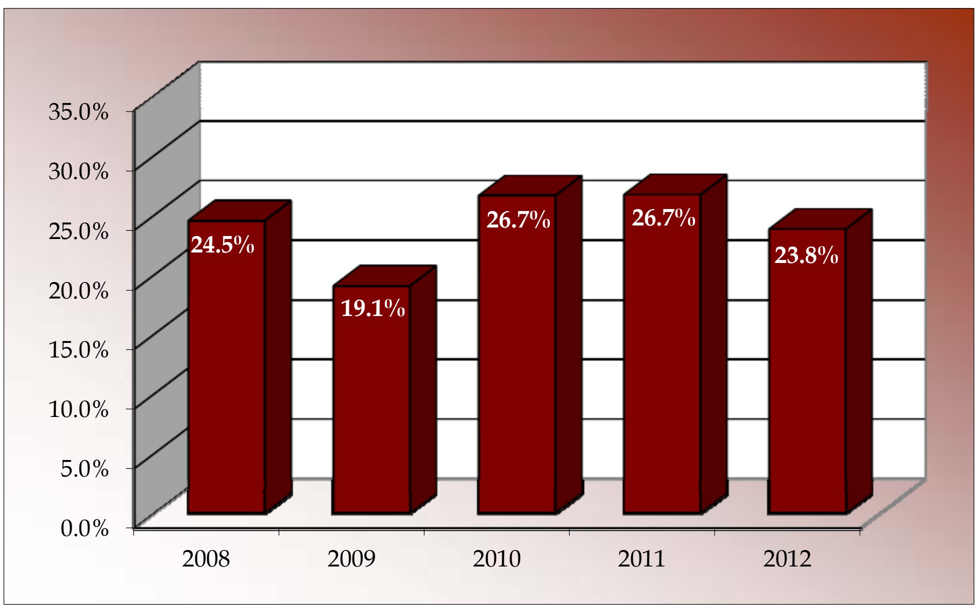
[1] Calculation: Operating Revenues/CPI/Population*100,000

[2] Calculation: (Current Year Revenues Per Capita - Prior Year Revenues Per Capita)/Prior Year Revenues Per Capita

Restricted Revenues

Description
Restricted revenues are legally earmarked for a specific use, as may be required by state law, bond covenants or grant requirements. The Town's restricted revenues include grants, impact fees and developer contributions. As the percentage of restricted revenues increases, the Town loses its flexibility to respond to changing conditions. An over dependence on restricted revenues makes the Town's programs vulnerable to restrictions imposed by the funding agencies and may signal a future inability to maintain current service levels.

Analysis
The percent of restricted revenues to operating revenues declined in fiscal year 2008/09. However, due to an increase in grants received by the Town, the trend increased in fiscal year 2009/10 and 2010/11. These grants included several awards from the Department of Homeland Security for improvements to safety and communication. During fiscal year 2011/12 restricted revenues to operating revenues declined due to a 33.1 percent reduction in grants received offset by an increase of 28.5 percent in impact fee revenues collected. Restricted revenues have historically been used to fund infrastructure and enhance public safety. A decline in these revenues could delay needed infrastructure and protection for the community.



Restricted Revenues (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Restricted Operating Revenues	$ 9,064	$ 6,679	$ 8,260	$ 7,716	$ 6,864
Operating Revenues	$ 36,925	$ 35,007	$ 30,990	$ 28,873	$ 28,800
% Restricted [1]	24.5%	19.1%	26.7%	26.7%	23.8%

Source: Comprehensive Annual Financial Report (CAFR) - Statement of Revenues, Expenditures and Changes in Fund Balances - Government Funds

Note 1: Prior fiscal years operating and restricted revenues have been restated for new calculation method

[1] Calculation: Restricted Operating Revenues/Operating Revenues

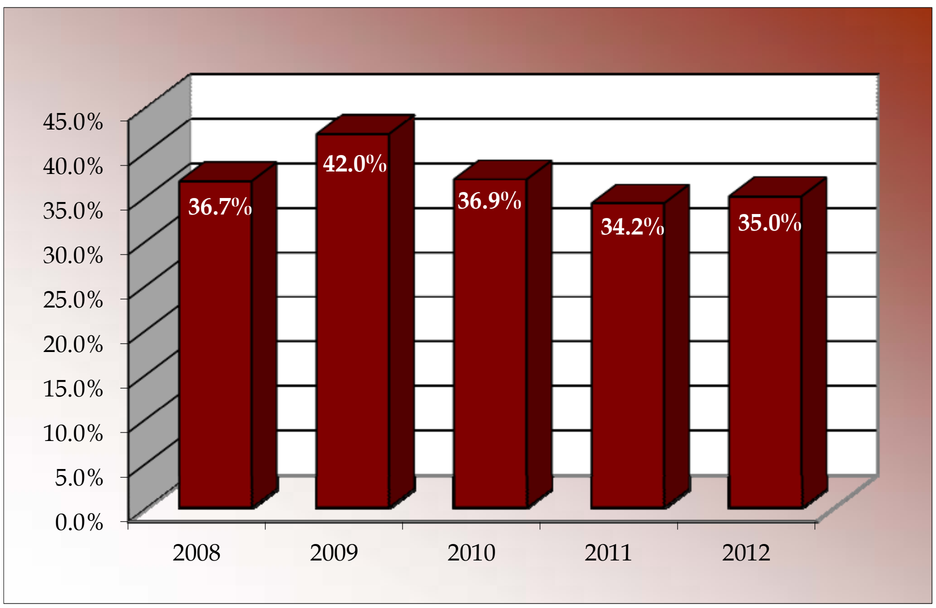
Intergovernmental Revenues

Description

Intergovernmental revenues are received from other governmental entities. Intergovernmental revenues for the Town encompass state revenue sharing, auto lieu, state-shared sales tax and intergovernmental agreements. An over dependence on intergovernmental revenues can have an adverse impact on financial conditions due to restrictions or stipulations that the other governmental entities may attach to the revenues. During declining economic times, state and federal governments may withdraw or reduce payments to local governments.

Analysis

The warning trend for this indicator is an increasing amount of intergovernmental operating revenues as a percentage of operating revenues. Beginning in fiscal year 2009/10, the Town has experienced a decline in this indicator primarily due to a significant decrease in state revenue sharing distributions. In fiscal year 2011/12 several intergovernmental revenues saw an increase including a 10.1 percent increase in auto lieu and 16.5 percent increase in state-shared sales tax. Forecasts have projected an increase in state-shared revenues for fiscal year 2012/13 which would advance the Town's financial position and improve the Town's ability to maintain current service levels.



Intergovernmental Revenues (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Intergovernmental Revenues	$ 13,548	$ 14,699	$ 11,434	$ 9,877	$ 10,075
Operating Revenues	$ 36,925	$ 35,007	$ 30,990	$ 28,873	$ 28,800
% Intergovernmental [1]	36.7%	42.0%	36.9%	34.2%	35.0%

Source: Comprehensive Annual Financial Report (CAFR) - Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds

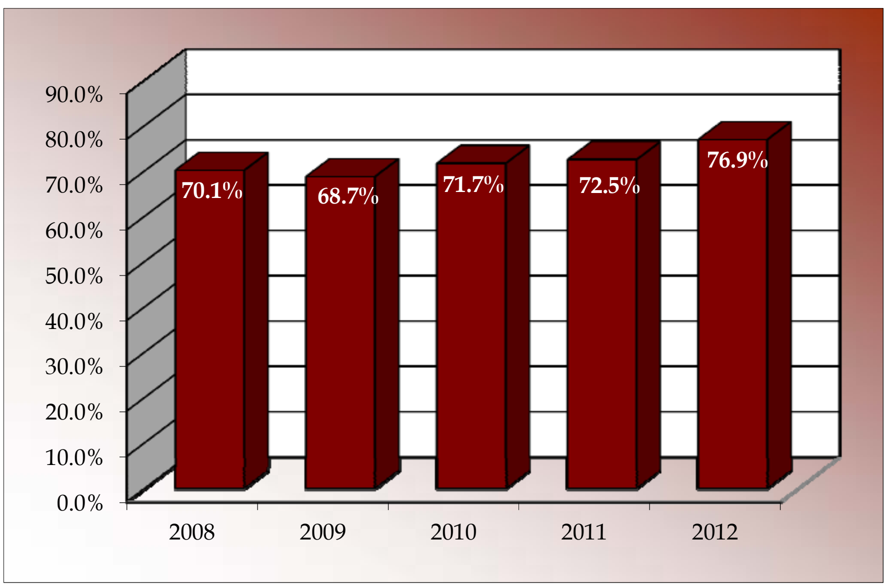
Note 1: Prior fiscal years operating revenues have been restated for new calculation method

[1] Calculation: Intergovernmental Revenues/Operating Revenues

Elastic Tax Revenues

Description
Elastic tax 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. Inelastic revenues, such as fixed license fees or user charges, are relatively unresponsive to changes in economic conditions unless there are business closures. The following Town revenues fall within the elastic revenues category: general sales tax, state-shared sales tax, state revenue sharing, auto lieu tax, highway user revenue fund tax (fuel tax) and local transportation assistance fund (portion of state lottery revenues).

Analysis
The change in a municipality's elastic revenues as a percent of operating revenues can be attributed to the growth or decline of retail businesses and population. As a result of a slowly improving economy, the elastic revenue rate increased slightly in 2011/12. These ratios are still well within the desired high range to keep pace with inflation which attributes to the higher prices government must pay for its services. The outlook for fiscal year 2012/13 is slightly higher total elastic tax revenues. Since elastic tax revenues represent a significant portion of operating revenues, the percentages are not expected to change dramatically from year to year. Further reductions in these taxes would hamper the Town in maintaining current infrastructure and will limit building any new infrastructure.



Elastic Tax Revenues (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Elastic Tax Revenues	$ 25,899	$ 24,066	$ 22,209	$ 20,928	$ 22,151
Operating Revenues	$ 36,925	$ 35,007	$ 30,990	$ 28,873	$ 28,800
% Elastic Tax Rev. [1]	70.1%	68.7%	71.7%	72.5%	76.9%

Source: Comprehensive Annual Financial Report (CAFR) - Statement of Revenues, Expenditures and Changes in Fund Balances - Budget and Actual - GAAP Basis - Governmental Funds

Note 1: This chart includes General Fund, HURF, LTAF and Streets .33%

Note 2: Prior fiscal years operating revenues have been restated for new calculation method

[1] Calculation: Elastic Tax Revenues/Operating Revenues

Expenditures

Expenditures are an approximate measure of the Town's service output. Generally, the more the Town spends in constant dollars, the more service it is providing. These measures do not provide accountability for service delivery efficiency and effectiveness.

The first issue to consider is the expenditure growth rate to determine whether the Town is operating within its revenues. The Town makes every attempt to have a balanced budget, where expenditure growth matches revenue growth. The Town may plan additional capital expenditures in excess of revenues and use fund balances for these projects. The long-run balance between revenues and expenditures warrants separate attention. Common ways to create future problems where expenditures exceed revenues are to use reserve funds, defer maintenance on streets and buildings or by deferring funding of contingent liabilities. In each of these cases, the current budget remains balanced; however, the long-run budget is developing a deficit.

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

Ideally, the Town 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 Town's expenditure profile will help to identify the following types of problems:

- Excessive growth of overall expenditures as compared to revenue growth or growth in community wealth (personal and business income)
- An undesired increase in fixed costs
- Ineffective budgetary controls
- A decline in personnel productivity
- Excessive growth in programs that create future expenditure liabilities

Changes in expenditures can be monitored by using the indicators detailed on the following pages.

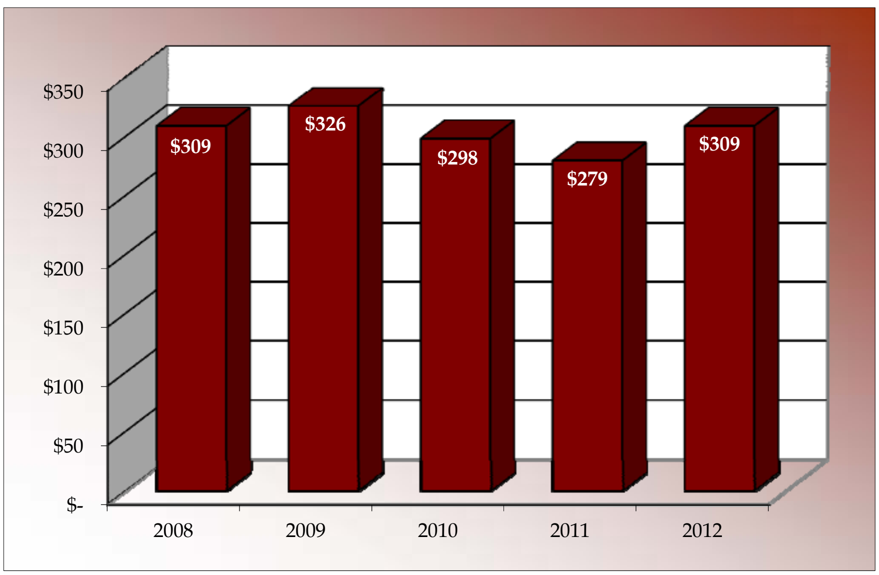
Expenditures per Capita

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 Town's ability to pay, especially if spending is increasing faster than the Town's sales 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

Expenditure increases or decreases normally follow a similar trend as revenues change. Expenditure changes tend to lag revenue changes (e.g. as revenues decline, expenditures may continue increasing until services can be adjusted to reflect the reduced revenue levels). Under the economic conditions recently seen by the Town, to balance revenues and expenditures, either expenditures have to be decreased or revenues increased. Another alternative is to use fund balances to cover operating expenditures. For 2011/12, operating expenditures increased 13.6 percent while operating revenues increased 2.6 percent. The larger increase to operating expenditures is mainly due to a one-time developer reimbursement required by a development agreement entered into by the Town.



Expenditures per Capita (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Operating Expenditures	$ 25,176	$ 27,347	$ 25,279	$ 23,997	$ 27,259
Consumer Price Index	211.7	214.7	216.7	221.1	227.6
Current Population	38,489	39,105	39,116	38,839	38,769
Constant Dollar					
Expenditures per Capita [1]	$ 309	$ 326	$ 298	$ 279	$ 309
(% change) [2]	-3.2%	5.5%	-8.5%	-6.3%	10.6%

Source: U.S. Bureau of Labor Statistics - CPI, Arizona Department of Commerce - Population Statistics Unit, Comprehensive Annual Financial Report (CAFR) - Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds, CAFR - Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Non-major Governmental

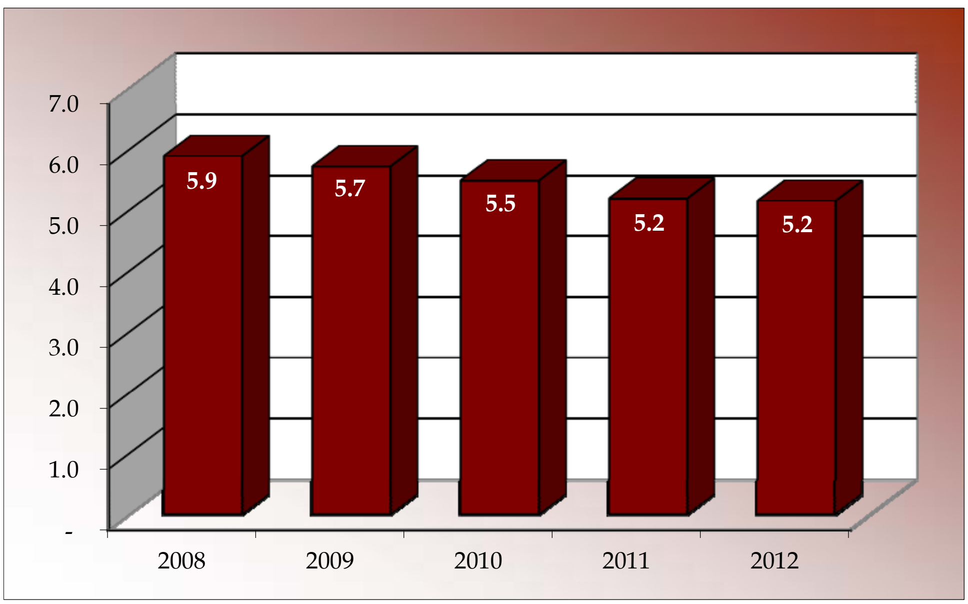
[1] Calculation: Operating Expenditures/CPI/Population*100,000

[2] Calculation: (Current Year Expenditures per Capita - Prior Year Expenditures per Capita)/Prior Year Expenditures per Capita

Employees per Capita

Description
Personnel costs are a major portion of the Town'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 Town is becoming more labor intensive or that productivity is declining. A decrease may be indicative of an insufficient number of employees on staff to provide increased or existing services and infrastructure maintenance to a growing community. This indicator needs to be evaluated in conjunction with other measurements (e.g. services provided, efficiency and effectiveness of service levels).

Analysis
Full-time equivalents (FTE) include full-time, part-time and seasonal employees. For 2011/12, there was a 1.0 percent decrease in FTE which is attributed to the hiring freeze instituted by the Town in 2007/08 to control expenditures. This calculation is not a measurement of types of service directly provided by Town staff (e.g. work that is contracted out, services provided by other government agencies or the private sector). The trend may suggest that the Town is providing increased service levels and productivity while not becoming more labor intensive.



Employees per Capita	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Full-time Staffing Equivalents	227	224	215	202	200
Current Population	38,489	39,105	39,116	38,839	38,769
Full-time Staffing Equivalents (FTE) per Capita [1]	5.9	5.7	5.5	5.2	5.2

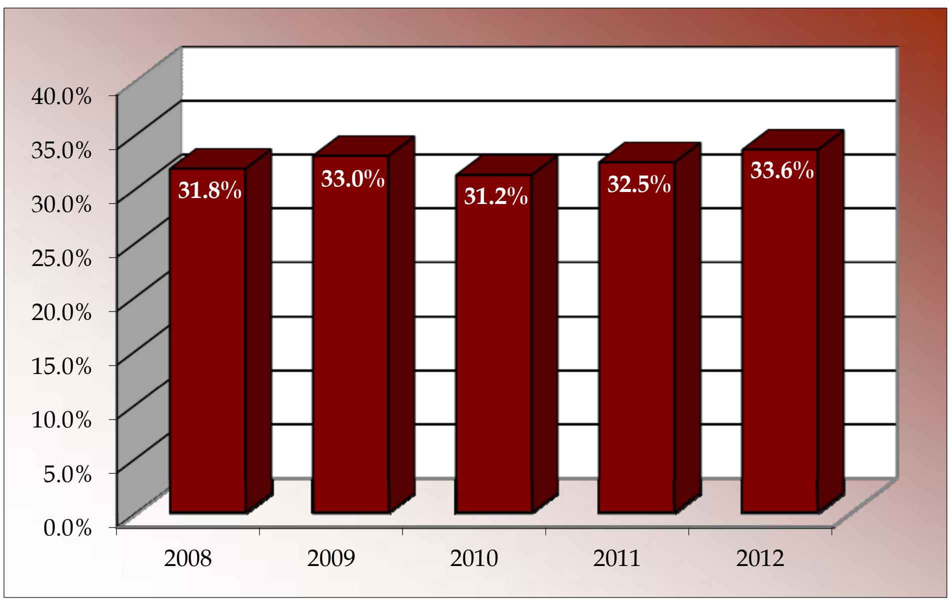
Source: Arizona Department of Commerce - Population Statistics Unit, Comprehensive Annual Financial Report (CAFR) - Full-time Equivalent Town Government Employees by Function - Table 17

[1] Calculation: Full-time Staffing Equivalents/Population*1000

Fringe Benefits

Description
Fringe benefits comprise a significant portion of operating costs. Direct fringe benefits requiring an immediate cash outlay include retirement system contributions, worker's compensation, life and health insurance. 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
The increases over the years in fringe benefit expenditures were primarily attributable to increased retirement contributions, medical and dental insurance increases offset by a small reduction of employees and lower worker's compensation costs. In 2009/10 the Town decreased the employer retirement contribution from 12 percent to 8 percent, decreased the employer retirement healthcare savings contribution from 2 percent to 1 percent and implemented a 5 percent furlough. In 2011/12, health care premiums increased accounting for the slight increase in fringe benefit costs. The cost reduction measures and hiring freeze in place during this period have enabled the Town to control the salaries and benefit cost during the recession.



Fringe Benefits (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Fringe Benefit Expenditures	$ 3,901	$ 4,049	$ 3,554	$ 3,544	$ 3,683
Salaries and Wages	$ 12,257	$ 12,257	$ 11,373	$ 10,921	$ 10,962
Number of Employees	227	224	215	202	200
% Fringe Benefits [1]	31.8%	33.0%	31.2%	32.5%	33.6%

Source: Town of Prescott Valley Finance Division, Comprehensive Annual Financial Report (CAFR) - Full-time Equivalent Town Government Employees by Function - Table 17

[1] Calculation: Fringe Benefit Expenditures/Salaries and Wages

Operating Position

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

During a typical year, a town 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 a deficit occurs, it is usually funded from accumulated fund balances; when a surplus occurs, it is usually dedicated to building prior years' fund balances or to funding future years' operations.

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

Sufficient cash or liquidity refers to the flow of cash in and out of the Town treasury. The Town receives many of its revenues in large installments at infrequent intervals during the year. It is to the Town's advantage to have excess liquidity or cash reserves as a cushion 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:

- A pattern of operating deficits
- A decline in reserves
- A decline in liquidity
- Ineffective revenue forecasting techniques
- Ineffective budgetary controls

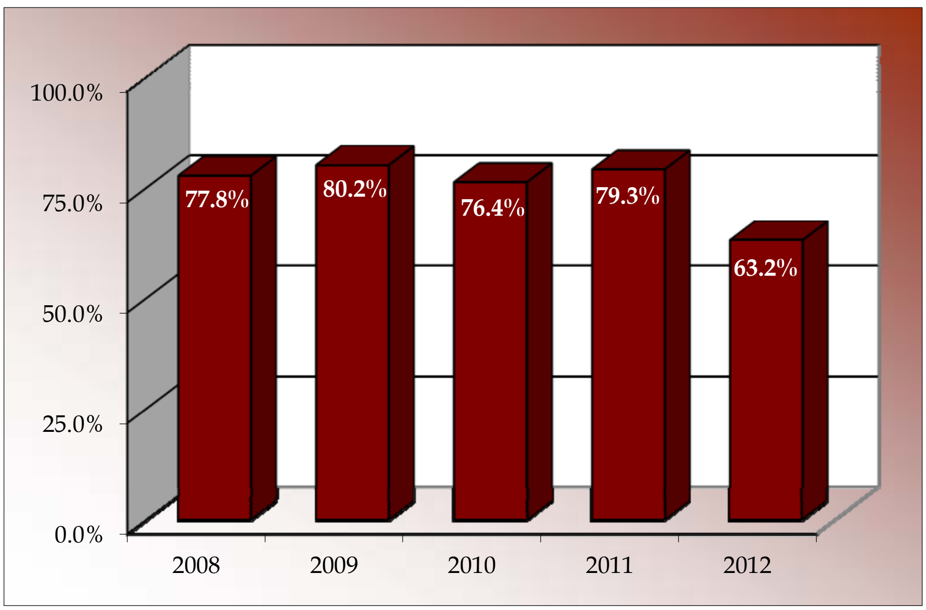
Changes in operating position can be monitored by using the indicators detailed on the following pages.

General Fund Balance

Description
The level of fund balances may determine the Town'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 Town's ability to accumulate funds for large-scale purchases without having to borrow.

Analysis
The Town's unrestricted fund balance as a percent of operating revenues decreased in 2011/12. The decrease in fund balance is the result of planned use of general fund balance to supplement the slower revenue collections. Spending down the unrestricted fund balance becomes a negative trend when the use is unplanned or if fund balances are dropping lower than is desirable. All fiscal years in the measured period have adopted an annual budget that planned for spending into fund balance.

The Town's financial policy states that the Town will maintain an unassigned general fund balance that represents at least 25 percent of general fund revenues, excluding transfers. Also, the Town must maintain a "Rainy Day Fund" equivalent to 10 percent of general fund revenues, excluding transfers.



General Fund Balance (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
General Fund Unrestricted Fund Balance	$ 21,669	$ 22,710	$ 17,307	$ 16,734	$ 13,855
Operating Revenues General Fund Only	$ 27,836	$ 28,302	$ 22,661	$ 21,110	$ 21,914
% Fund Balance [1]	77.8%	80.2%	76.4%	79.3%	63.2%

Source: Comprehensive Annual Financial Report (CAFR) - Balance Sheet - Governmental Funds, CAFR - Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds

Note 1: Prior fiscal years operating revenues have been restated for new calculation method.

[1] Calculation: General Fund Unrestricted Fund Balance/Operating Revenues General Fund

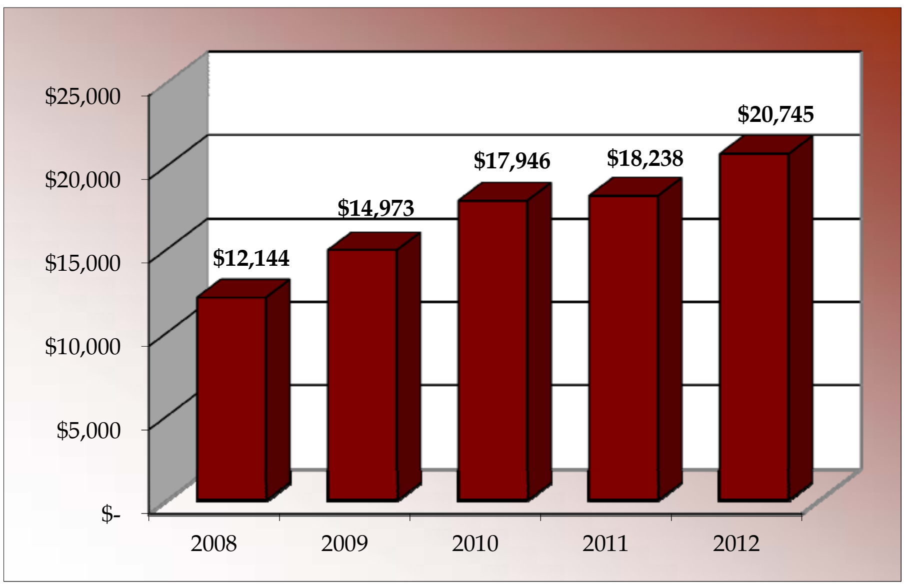
Enterprise Fund Earnings

Description

Enterprises are expected to function as if they were a commercial "for profit" entity and supported by user fees as opposed to a governmental "not for profit" entity supported by taxes. Moderate rate increases are included as part of the budget to offset increasing operational costs, mandated environmental standard compliance and capital assets attributable to repair and replacement of infrastructure, as well as to maintain a net revenue ratio to remain in compliance with bond covenants and the Town financial policy. Positive operating results allow enterprise funds to stabilize rates even in years when large capital expenditures must be made (e.g. the construction of a new plant).

Analysis

The enterprise funds for the Town are the Prescott Valley Water System and Wastewater System. The separate entity of the Prescott Valley Water District was dissolved as of April 30, 2008, and consolidated into the Municipal Water System creating the Prescott Valley Water System. A rate study was complete in 2011/12 with new rates effective November 1, 2012. The new rates included an increase to wastewater volume rates of 14 percent and no change to the water service rates. During 2011/12 the number of Water System customers increased by 38 and consumption increased by 3.6 percent.



Enterprise Fund Earnings (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Enterprise Funds Operating Income (Loss)	$ (1,979)	$ (1,508)	$ (739)	$ (317)	$ 404
Depreciation and Amortization	$ 4,550	$ 4,722	$ 4,628	$ 4,349	$ 4,317
Consumer Price Index	211.7	214.7	216.7	221.1	227.6
Enterprise Funds Operating Results [1]	$ 12,144	$ 14,973	$ 17,946	$ 18,238	$ 20,745

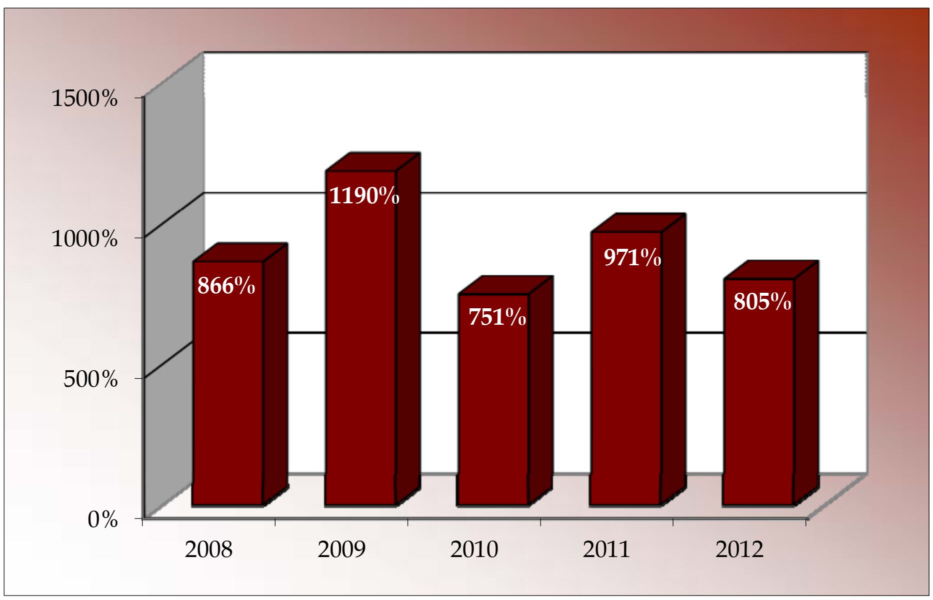
Source: U.S. Bureau of Labor Statistics - CPI, Comprehensive Annual Financial Report (CAFR) - Statement of Revenues, Expenses and Changes in Fund Net Assets - Proprietary Funds

[1] Calculation: (Enterprise Funds Operating Income (Loss) + Depreciation and Amortization)/ CPI*1000

Liquidity

Description
A measure of the Town'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 Town's ability to pay its short-term obligations. Low or declining liquidity can indicate that the Town has overextended itself in the long-term.

Analysis
Liquidity is a controversial indicator because the ratio changes constantly depending on the time of year for receipt of revenues and the need for expenditures. Fiscal year 2011/12 shows a decrease in liquidity as a result of continued draws on reserves and a decrease in cash on hand. Historically, this trend has fluctuated. Per the International City/County Management Association handbook, if this ratio is less than one to one (or less than 100 percent), the commercial entity is considered to be facing liquidity problems. The Town's percentage of current liabilities to cash and investments remains above industry averages, indicating its ability to meet its short-term obligations.



Liquidity (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
General Fund Cash and Investments	$ 34,287	$ 24,665	$ 16,220	$ 13,867	$ 10,298
Less: Library Bond Proceeds	13,023	2,530	-	-	-
Adjusted Cash and Investments	$ 21,264	$ 22,135	$ 16,220	$ 13,867	$ 10,298
Current Liabilities General Fund Only	$ 2,455	$ 1,860	$ 2,159	$ 1,428	$ 1,279
% Cash and Investments [1]	866%	1190%	751%	971%	805%

Source: Comprehensive Annual Financial Report (CAFR) - Balance Sheet - Governmental Funds
[1] Calculation: Adjusted Cash and Investments/Current Liabilities

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 a reduction of the Town's credit rating, increased borrowing costs and loss of autonomy to state and other regulatory bodies.

The Town's most common forms of long-term debt are Municipal Property Corporation (MPC), Certificates of Participation (COP), special assessments, loans and revenue bonds. When the Town 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 Town's debt should be proportionate in size and growth to the Town's tax base. It should not extend past the useful life of the facilities which it finances, be used to balance the operating budget, require repayment schedules that put excessive burdens on operating expenditures or be so high as to jeopardize the Town's credit rating.

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

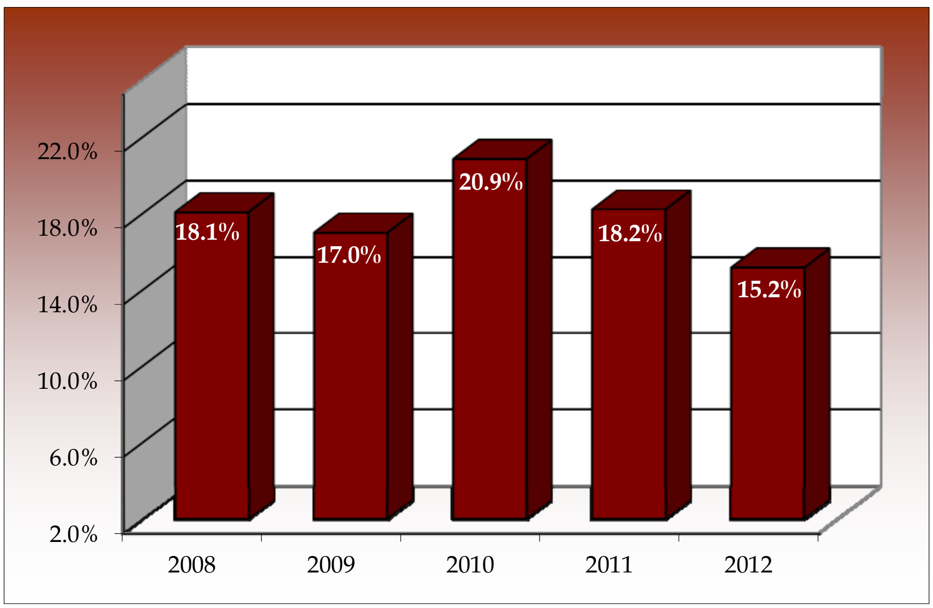
- Inadequacies in cash management procedures
- Inadequacies in expenditure controls
- Decreases in expenditure flexibility due to increased fixed costs in the form of debt service
- Use of short-term debt to finance current operations
- Existence of sudden large increases or decreases in future debt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

Changes in debt structure can be monitored by using the indicators detailed on the following pages.

Current Liabilities

Description
Governmental current liabilities are defined as the sum of all liabilities due at the end of the fiscal year, including short-term debt, current portion of long-term debt, accounts payable, accrued liabilities and other current liabilities. Although short-term borrowing is an acceptable way to deal with uneven cash flow, an increasing amount of short-term debt outstanding at the end of successive years can indicate liquidity problems, deficit spending or both.

Analysis
Current liabilities outstanding at the end of the year exceeding five percent of operating revenues are considered a negative trend. According to credit industry benchmarks, the Town has exceeded the five percent threshold for the past five years. Fiscal year 2011/12 saw a decrease in current liabilities from the prior year by 16.9 percent. This decrease is primarily due to a decrease in accounts payable in the general fund, HURF and grant funds.



Current Liabilities (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Current Liabilities	$ 6,675	$ 5,956	$ 6,464	$ 5,262	$ 4,372
Operating Revenues	$ 36,925	$ 35,007	$ 30,990	$ 28,873	$ 28,800
% Current Liabilities [1]	18.1%	17.0%	20.9%	18.2%	15.2%

Source: Comprehensive Annual Financial Report (CAFR) - Balance Sheet - Governmental Funds, CAFR - Combining Balance Sheet - Non-major Governmental Funds, CAFR - Notes - Changes in Long-term Liabilities

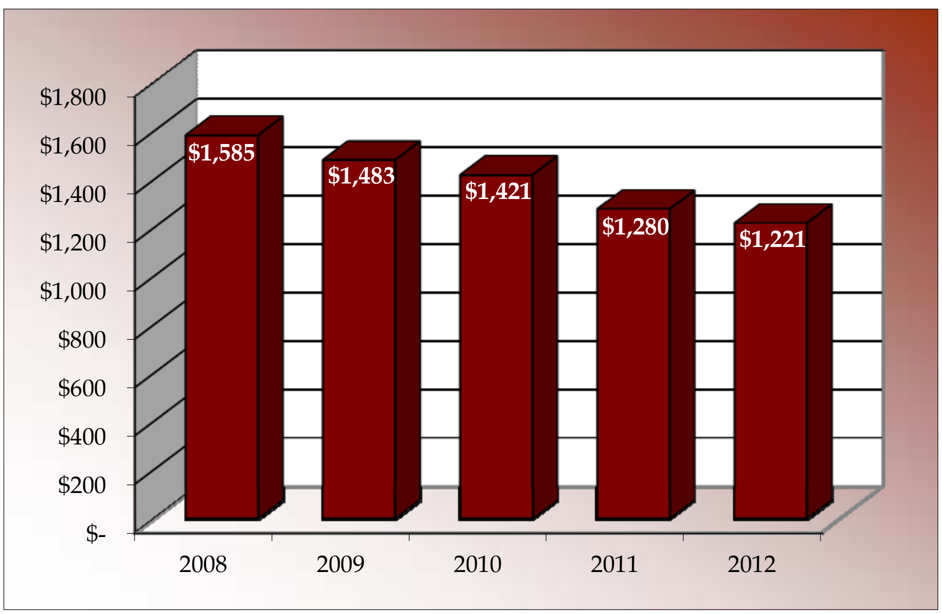
Note 1: Prior fiscal years operating revenues have been restated for new calculation method

[1] Calculation: Current Liabilities/Operating Revenues

Net Direct Debt per Capita

Description
The 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 Town's ability to pay. Net direct debt per capita does not include CFDs, only Town-obligated debt.

Analysis
Population has stabilized, most likely due to the slowed economy, and can be expected to increase as the economy recovers. A growing town is expected to have associated debt burden to support its growing infrastructure needs. For fiscal year 2008/09 and 2009/10, no new long-term debt was acquired and debt decreased due to scheduled principal payments. Debt was further reduced during fiscal year 2010/11 due to the defeasance of the North Wells bonds and regularly scheduled principal payments. In 2011/12, no new long-term debt was acquired and debt decreased due to scheduled principal payments. This calculation includes MPC, COP, special assessment, long-term obligations and compensated absences (excluding enterprise fund bonded debt).



Net Direct Debt Per Capita (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Net Direct Long-term Debt	$ 61,017	$ 58,003	$ 55,597	$ 49,707	$ 47,353
Population	38,489	39,105	39,116	38,839	38,769
Net Direct Debt Per Capita [1]	$ 1,585	$ 1,483	$ 1,421	$ 1,280	$ 1,221

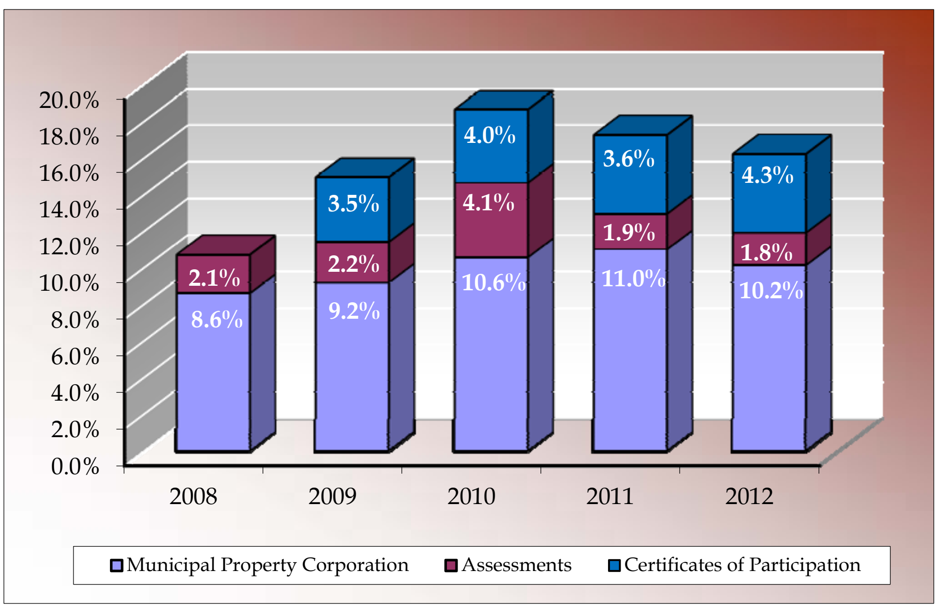
Source: Arizona Department of Commerce - Population Statistics Unit, Comprehensive - Annual Financial Report (CAFR) - Notes - Changes in Long-term Liabilities

[1] Calculation: Net Direct Long-term Debt/Population*1,000

Debt Service

Description
Debt service is defined as the amount of principal and interest that the Town must pay each year on net direct bonded long-term debt plus the interest it must pay on direct short-term debt. As the debt service increases, it adds to the Town's obligations and reduces the Town's expenditure flexibility. Debt service can be a major part of the Town's fixed costs and its increase may indicate excessive debt and fiscal strain.

Analysis
The level of debt service as a percent of governmental fund operating revenues continued to decrease in 2011/12. The increases for 2008/09 and 2009/10 relate to higher scheduled debt service requirements on previous debt, new debt service requirements for the Library Building Certificates of Participation and Water Importation Municipal Facilities Revenues Bonds, and decreased operating revenues due to the current economic conditions. The decrease for 2010/11 was due to the North Wells bond defeasance. According to the International City/County Management Association handbook, debt service on net direct debt exceeding 20 percent of operating revenues is considered a potential problem; 10 percent is considered acceptable. Per the Town's Financial Policy, debt service costs shall not exceed 25 percent of the Town's operating revenues, so this rate is within limits.



Debt Service (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Governmental Debt Service	$ 3,961	$ 5,239	$ 5,782	$ 4,988	$ 4,677
Operating Revenues	$ 36,925	$ 35,007	$ 30,990	$ 28,873	$ 28,800
% Debt Service [1]	10.7%	15.0%	18.7%	17.3%	16.2%

Source: Comprehensive Annual Financial Report (CAFR) - Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds, CAFR - Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Non-major Governmental Funds
Note 1: Prior fiscal years operating revenues have been restated for new calculation method
[1] Calculation: Governmental Debt Service/Operating Revenues

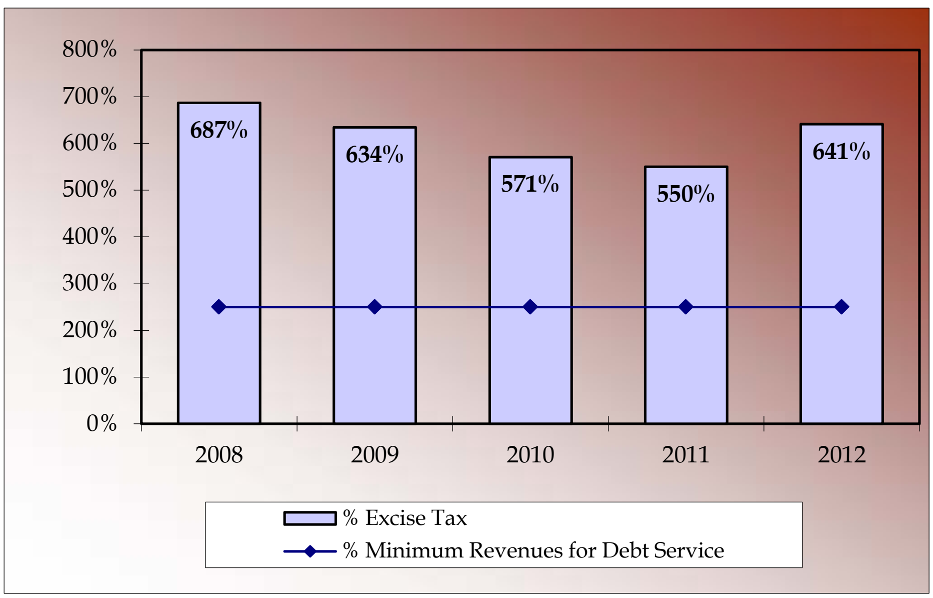
Excise Tax

Description

Excise taxes as a percent of MPC debt service are presented as a measure of the Town's compliance with its bond indenture requirements. Excise tax is a tax levied on the manufacture, sale or consumption of certain (particular) non-essential goods or services (e.g. airline tickets, gasoline, alcohol, tobacco, etc.). An excise tax is levied on a particular product in contrast to sales and use taxes, which are levied because sales occurred, rather than on the product purchased. For the Town, excise tax includes transaction privilege tax, franchise taxes, charges for services, state-shared revenues and fines and forfeitures.

Analysis

Since 2007/08 excise tax revenues have decreased 14.2 percent primarily due to reduced transaction privilege tax collections and reduced state-shared revenues. For 2011/12, the percentage of excise tax with relation to MPC debt service increased, attributable to both a $1.2 million increase in revenues and a decrease of $258,415 in MPC debt service. Excise tax continues to exceed the minimum requirements of bond indentures which are two and one half times the debt service payments.



Excise Tax (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Excise Tax	$ 21,844	$ 20,446	$ 18,719	$ 17,505	$ 18,744
MPC Debt Service	$ 3,180	$ 3,222	$ 3,281	$ 3,182	$ 2,924
% Excise Tax [1]	687%	634%	571%	550%	641%

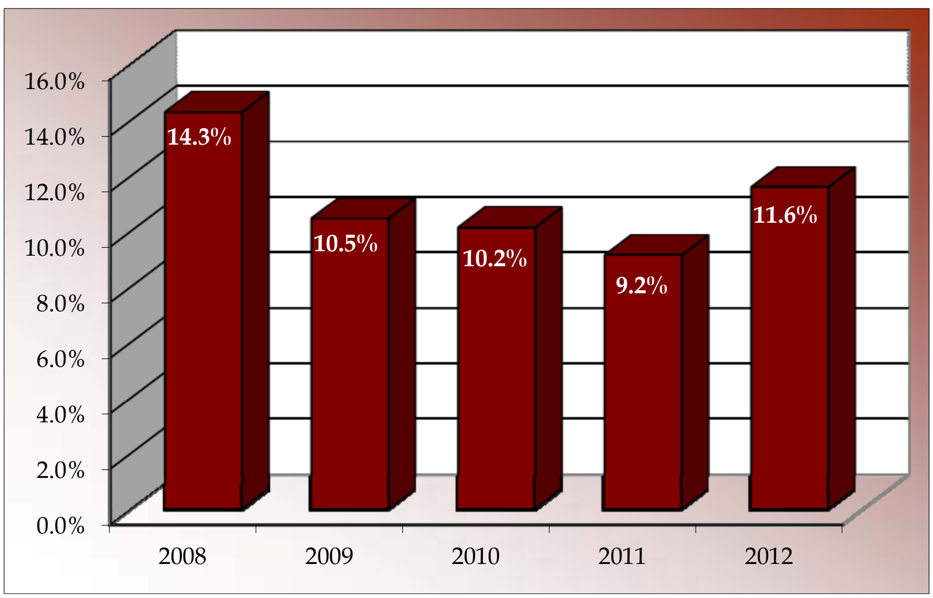
Source: Town of Prescott Valley Financial Policies, Comprehensive Annual Financial Report (CAFR) - Statement of Revenues, Expenditures and Changes in Fund Balances - Budget to Actual - GAAP Basis - Governmental Funds - General Fund, CAFR - Schedule of Revenues, Expenditures and Changes in Fund Balances - Budget to Actual - GAAP Basis - Streets Capital Improvement Fund, CAFR - Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds

[1] Calculation: Excise Tax/MPC Debt Service

Overlapping Debt

Description
Overlapping debt is the net direct bonded debt of another jurisdiction that is issued against a tax base within all or part of the boundaries of the community. Examples of other jurisdictions are school districts and the County. The overlapping debt indicator measures the ability of the community's tax base to repay the debt of obligations issued by all of its governmental jurisdictions. Overlapping debt needs to be considered in assessing total indebtedness. Although the probability that the community of Prescott Valley would have to repay the debt may be slim, the potential exists. Overlapping debt does not include CFDs.

Analysis
Prior to 2011/12, overlapping net debt as a percent of assessed valuation has decreased each year since 2007/08. Beginning in 2009/10 a decline in assessed valuation is seen which continues through 2011/12. In 2008/09, Yavapai Community College (YCC) decreased its net debt by $5 million while Humboldt Unified School District's (HUSD) net debt remained equal to the prior year. During 2009/10, YCC had a decrease of $13 million and HUSD of $6 million. In 2010/11, YCC had a decrease of $3.5 million and HUSD of $3 million. For fiscal year 2011/12 YCC had a decrease of $3.5 million and HUSD of $3.4 million. The assessed valuation for both YCC and HUSD decreased from the prior year and can be expected to maintain this trend for 2012/13.



Overlapping Debt (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Long-Term					
Overlapping Debt	$ 47,298	$ 45,721	$ 42,385	$ 34,785	$ 38,835
Assessed Valuation	$ 330,513	$ 436,242	$ 417,511	$ 379,921	$ 334,287
% Overlapping Debt [1]	14.3%	10.5%	10.2%	9.2%	11.6%

Source: Arizona Department of Revenue - Abstract by Tax Authority and Legal Class for the County of Yavapai, Comprehensive Annual Financial Report (CAFR) - Direct and Overlapping Governmental Activities Debt - Table 12

[1] Calculation: Overlapping Debt/Assessed Valuation

Contingent Liabilities

A contingent liability is an existing condition or situation for which the 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 sometime in the future. Due to the potential magnitude, if these types of obligations are permitted to grow over a long period of time, they can have a significant impact on the Town'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 relative impacts. Additionally, contingent liabilities build up gradually over time making it difficult to notice them until the problem is severe.

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

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

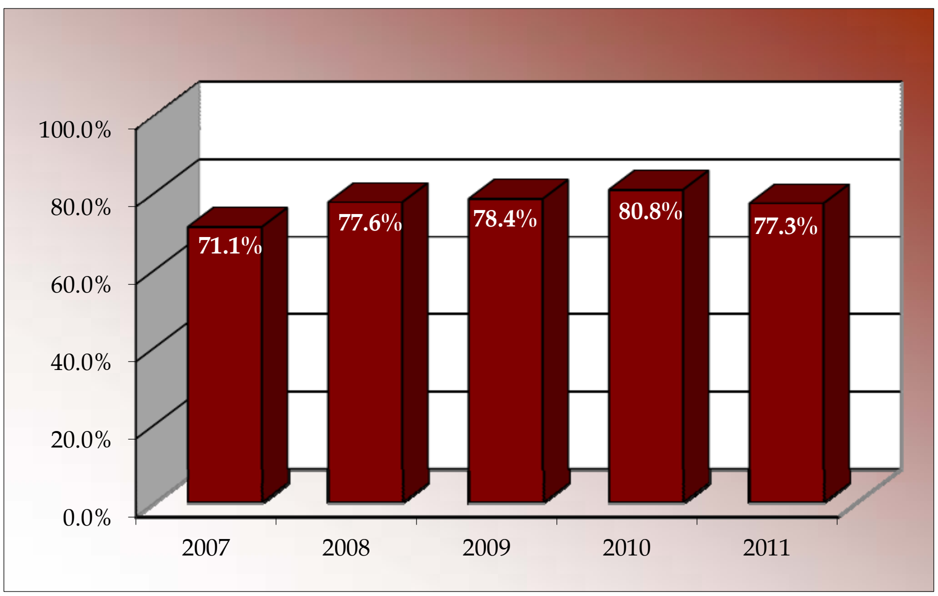
Pension Benefit Obligation Public Safety Employees

Description

Pension plans represent a significant expenditure for the Town. There are two basic ways to fund the pension plans: (1) fund when benefits need to be paid (pay-as-you-go) or (2) fund as benefits accrue and reserve cash for when the benefits will have to be paid (full funding). The State of Arizona administers the Arizona Public Safety Personnel Retirement System (APSPRS) pension plan for the public safety employees. This defined benefit pension plan provides retirement and disability benefits, annual cost-of-living adjustments and death benefits to plan members and beneficiaries. APSPRS members are required to contribute 8.65 percent of their annual salary. The Town is required to contribute at an actuarially determined rate. The rate for the year ended June 30, 2012 was 15.09 percent of annual covered payroll.

Analysis

The plan continues to be funded at a level below the desired 100 percent. This 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. The decrease may also be attributable to an increased number of officers retiring. In light of the declining trend, increased contributions to the plans by employees and employers have been necessary to ensure full funding when the returns are less than 100 percent.



Pension Benefit Obligation (in thousands)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Actuarial Value of Assets	$ 6,289	$ 7,316	$ 8,800	$ 9,628	$ 10,538
Actuarial Accrued Liability	$ 8,845	$ 9,433	$ 11,221	$ 11,915	$ 13,640
% Plan Funded[1]	71.1%	77.6%	78.4%	80.8%	77.3%

Source: Comprehensive Annual Financial Report (CAFR) - Retirement and Pension Plans - Table 20b

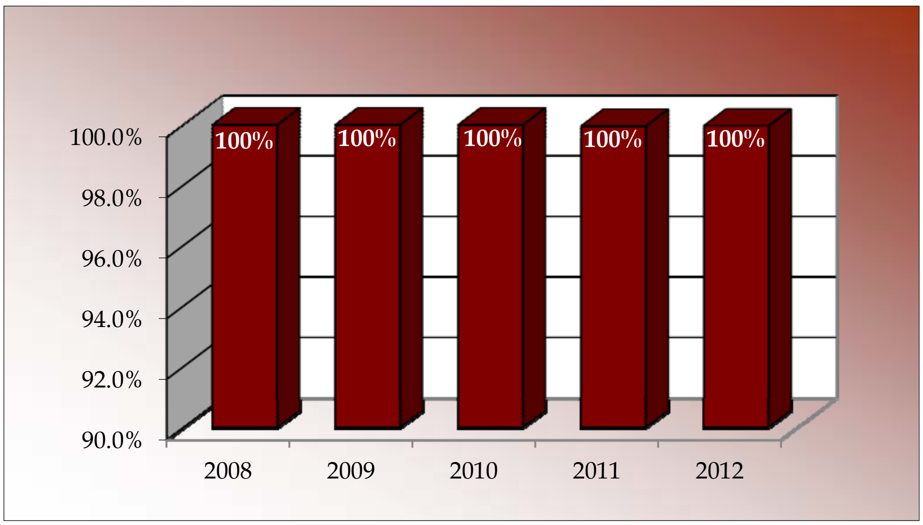
Note: Arizona Public Safety Personnel Retirement System report as of June 30, 2012 was not available at the time of this report

[1] Calculation: Actuarial Value of Assets/Actuarial Accrued Liability

Defined Contribution Plan Obligation Non-Public Safety

Description
In lieu of participating in Social Security, the Town has a defined contribution plan created in accordance with Internal Revenue Code Section 401(a). The plan is available to all full-time employees of the Town, except sworn police personnel who are covered under the Arizona Public Safety Personnel Retirement System. In fiscal year 2007/08, the Town began a mandatory Retirement Health Savings Plan (RHS). The Town currently contributes 1 percent and employees contribute 1 percent of their salary.

Analysis
The employee's contribution is 100 percent funded at all times. The vesting schedule for the employer's contribution is 20 percent per year of service, thus employees are one hundred percent vested after five years of service. The ICMA defined contribution plan has been funded at one hundred percent by the employer over the measured periods. In fiscal year 2009/10 the Town reduced the percent of contribution for the 401(a) by 4 percent and RHS by 1 percent.



Defined Contribution Obligation

(in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Actual Contribution	$ 901	$ 888	$ 554	$ 510	$ 495
Required Contribution	$ 901	$ 888	$ 554	$ 510	$ 495
% Plan Funded[1]	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Comprehensive Annual Financial Report (CAFR) - Notes to the Financial Statements - Retirement and Pension Plans

[1] Calculation: Actual Contribution/Required Contribution

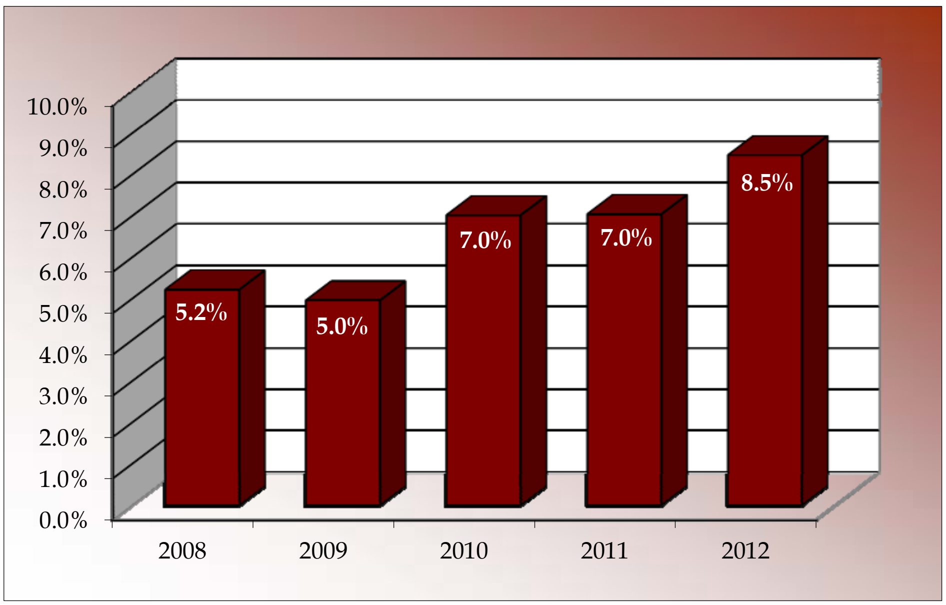
Compensated Absences

Description

Accumulated unpaid general leave is accrued in governmental funds based on time of service and employee status. These accumulated employee benefits are payable to the employee, subject to certain limitations, and represent an unfunded, long-term liability to the Town.

Analysis

The liability for compensated absences has experienced an increase in recent fiscal years. This trend is due primarily to increases in employee compensated absences balances due to a 5 percent furlough implemented in 2008/09, the elimination of the one-week vacation buy-back program and a decrease in unreserved fund balances due to the slow economy.



Compensated Absences (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Compensated Absences	$ 1,167	$ 1,179	$ 1,344	$ 1,338	$ 1,348
Unrestricted Fund Balance	$ 22,361	$ 23,778	$ 19,145	$ 18,991	$ 15,912
% Compensated Absences [1]	5.2%	5.0%	7.0%	7.0%	8.5%

Source: Comprehensive Annual Financial Report (CAFR) - Notes to the Financial Statements - Changes in Long-term Liabilities, CAFR - Balance Sheet - Governmental Funds

[1] Calculation: Compensated Absences/Unrestricted Fund Balance

Condition of Capital Plant

Much of the Town's wealth is invested in its physical assets and infrastructure. 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 Town as a place to live or do business.

Many towns 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 Town
- 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 monitor changes in the condition of capital plant.

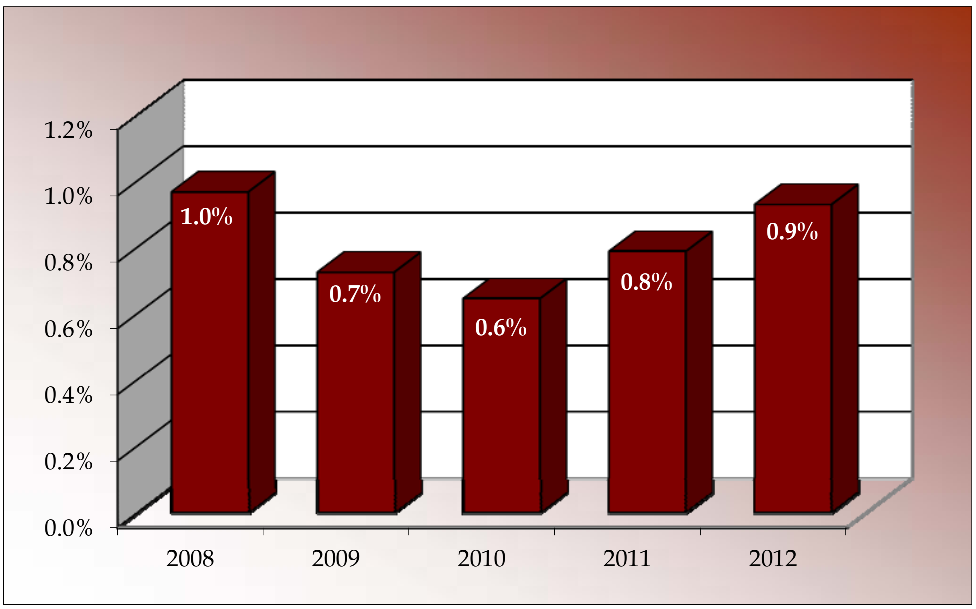
Maintenance Effort

Description

The condition of the Town's long-lived assets, such as buildings, is significant because of the tremendous cost and far-reaching consequence their decline can have on business activity, property values and operating expenditures. Deferral of maintenance on the assets and the 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 Town's assets are deteriorating. This calculation excludes streets and other infrastructure and only focuses on building and building improvements.

Analysis

Maintenance expenditures as a percent of depreciable assets increased in fiscal year 2011/12. Depreciable assets increased during the period as did maintenance expenditures. The downward trend experienced in 2008/09 and 2009/10 can be attributed to cost savings measures implemented to offset the slowed economy. The Town continues to replace assets regularly as they break down or become obsolete.



Maintenance Effort (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Maintenance Expenditures	$ 1,772	$ 1,350	$ 1,335	$ 1,667	$ 1,993
Depreciable Assets	$ 183,246	$ 186,191	$ 206,768	$ 211,682	$ 214,521
% Maintenance Expenditures [1]	1.0%	0.7%	0.6%	0.8%	0.9%

Source: Town of Prescott Valley Finance Division, Comprehensive Annual Financial Report (CAFR) - Notes to the Financial Statements - Capital Assets

Note 1: Prior fiscal years maintenance effort and depreciable assets have been restated for new calculation method

[1] Calculation: Maintenance Expenditures/Building & Improvement Costs

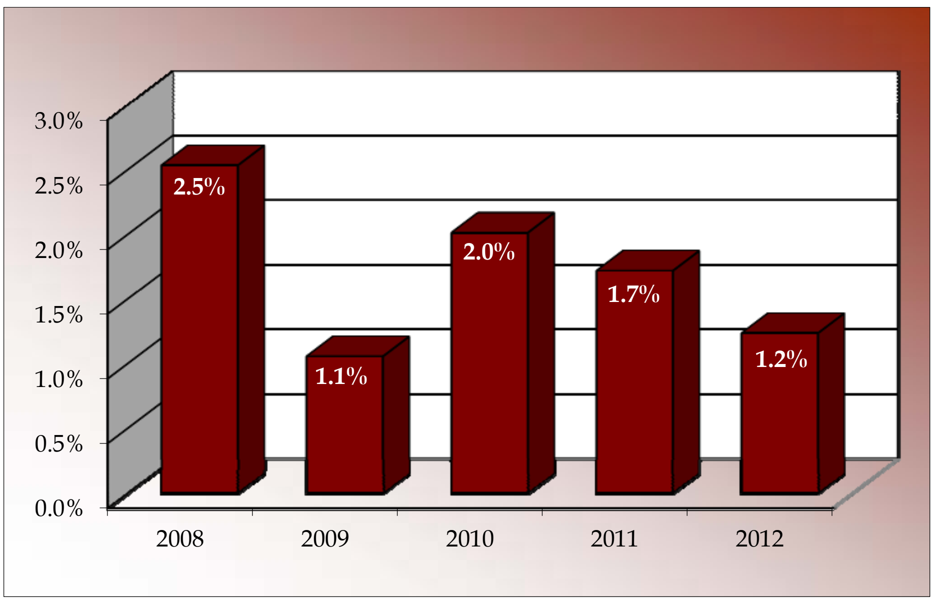
Capital Outlay

Description

The expenditures for operating equipment, such as vehicles, computers and office equipment purchased from the budget is referred to as equipment capital outlay. It includes equipment with a useful life of greater than one year and a cost of greater than $3,000. 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 as a percent of net operating expenditures decreased in fiscal year 2011/12 for the second year straight. The continued decrease in capital outlay is due to the continued slow economy and spending restrictions imposed on the Town. This trend indicates that operating equipment is not being replaced at as high of a rate, thus requiring the use of obsolete and inefficient equipment and the creation of an unfunded liability.



Capital Outlay (in thousands)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Capital Outlay	$ 638	$ 289	$ 510	$ 413	$ 337
Operating Expenditures	$ 25,176	$ 27,347	$ 25,279	$ 23,997	$ 27,259
% Capital Outlay [1]	2.5%	1.1%	2.0%	1.7%	1.2%

Source: Comprehensive Annual Financial Report (CAFR) - Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds, CAFR - Combining Funds Statement of Revenues, Expenditures and Changes in Fund Balances - Non-major Governmental Funds

[1] Calculation: Capital Outlay/Operating Expenditures (*100)