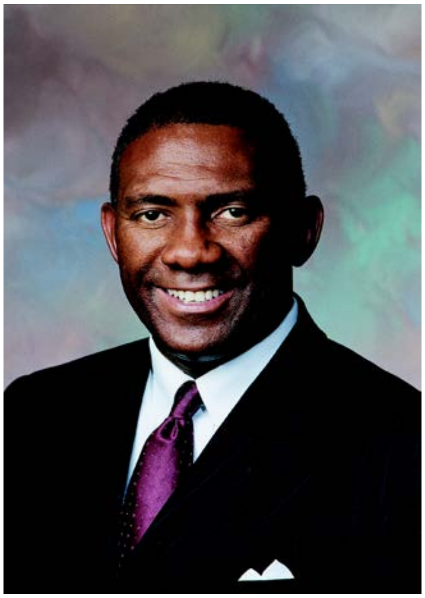


Honorable Mayor and Council:

While the current economic environment has presented its share of challenges for local and state government, the City of Glendale continues to look towards the future with optimism, flexibility and resilience. Vision, innovation, partnerships, and dedicated employees continue to play a central role in making the city's future efforts rewarding and successful despite the difficult economy.

This outlook is a result of City Council's continued focus on enhancing long-term fiscal strength and sustainability for the community. This outcome is being accomplished through quality economic development and the continuation of strategic investments that build upon those made over the last several years. This outlook also is the result of the strategic management of constrained city resources during the long and deep recession that hit Arizona particularly hard. As a result, the city's FY 2012 budget continues to provide resources to maintain high quality, core services and minimizes the impact of budget reductions in other areas of city services. The FY 2012 budget also continues to position ourselves to be proactive and responsive to opportunities that benefit the community.

The FY 2012 budget total across all funds is $638 million. The total of $638 million is the third consecutive year of decline from the peak of $925 million in FY 2009. Despite the declines, the overall budget continues to focus on the Mayor and Council's vision of 'one community' and the supporting strategic goals that Council reconsidered at a December 2010 retreat.

- One community that is fiscally sound,
- One community with strong neighborhoods,
- One community committed to public safety,
- One community with quality economic development,
- One community with a vibrant city center,
- One community with an active partnership with Luke Air Force Base, and
- One community with high quality services for citizens.

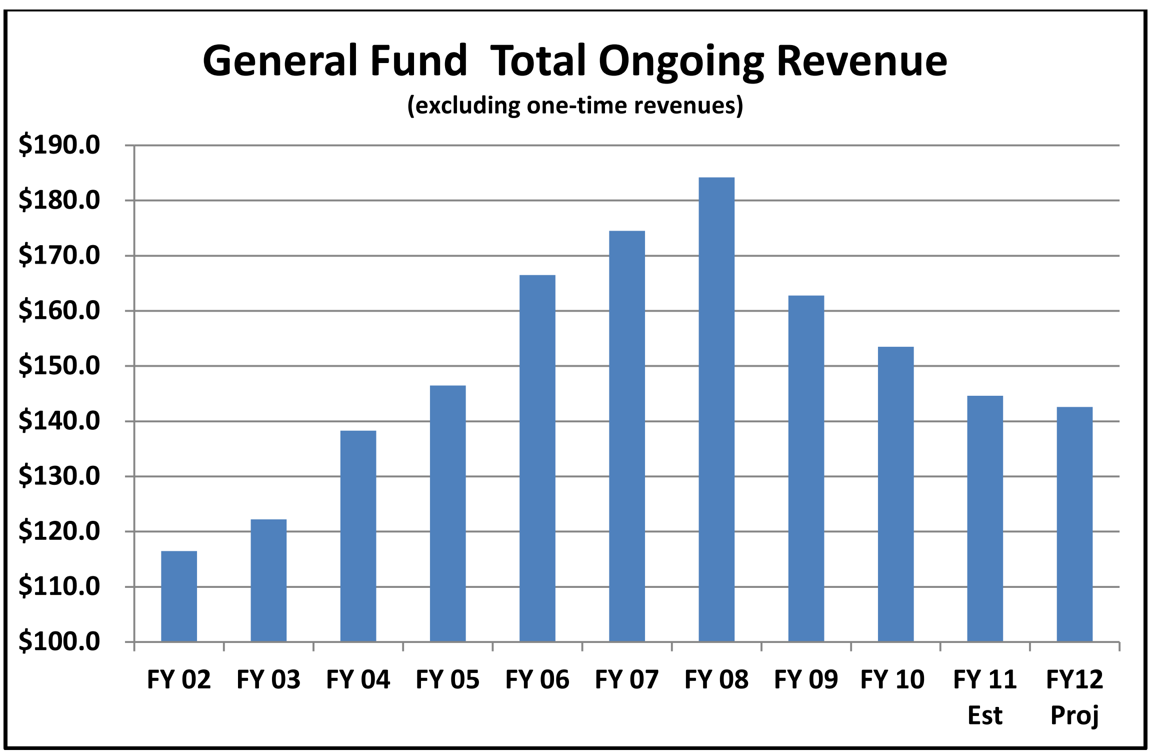
The FY 2012 budget also continues to reflect the enduring challenges of the post-recession economy. Many expenditure management measures were implemented since FY 2009 while keeping our focus on providing exceptional city services that sustain Council's strategic goals. While public safety remains a top priority for Council, the represented public safety labor groups have fully participated in helping to balance the budget. They have made reductions in their operating budget, implemented operational efficiencies, absorbed vacancies, and made concessions on labor-related items.

Discussion – Principal Issues
The same two principal issues that had to be addressed for the FY 2011 budget remain for the FY 12 budget. They are explained below. The budget actions taken to address these two principal issues are addressed in the subsequent section.

Economic Conditions. One principal issue for the FY 2012 budget continues to be the recession and the impact it had, and continues to have, on the city's resources to fund services to the community and the city's capital plan. Arizona was substantially impacted by the recent recession as indicated by the unprecedented decline in property values (discussed later in this message) and 35 consecutive months of year-over-year job losses that just ended in January 2011. As a result, economic recovery is expected to occur over an extended period of time.

According to the academic, private and government experts on the Arizona economy, recovery across the state will rely on business growth and investment that translates into improved employment conditions and population growth. These are the traditional drivers of economic growth in Arizona. Also key to Arizona's recovery is a clearing of the excess inventory of vacant homes and office and retail space that still dominate the Phoenix metropolitan area.

The impact of the economic conditions that have prevailed in Arizona for the past few years are most evident in the major sources of operating and capital budget revenue. For the General Fund (GF) operating budget, ongoing revenue collections peaked in FY 2008 at $184.2 million. The FY 2012 projection of $142.6 million is $41.6 million or 22.6% less than the peak. Overall, we expect to collect less in FY 2012 than we received in FY 2005.



The two major sources of GF operating budget revenue continue to be city sales taxes and state-shared revenues. The FY 2012 city sales tax projection is $51.9 million, an 18% decline from the peak of $63.6 million in FY 2007. The good news is that we believe the positive sales tax performance since the start of FY 2011 means the erosion in this critical revenue source has leveled off. Despite the recent volatility of gas prices and other essential commodities, we believe price stability will return, as it has in the past. Therefore, the FY 2012 projection of $51.9 million reflects a modest increase of 2.7% from the FY 2011 estimate of $50.5 million.

State shared revenue for FY 2012 is expected to be $44.3 million, a 33% decline from the peak of $66.1 million in FY 2008. This is the fourth consecutive year of decline for this critical revenue source. The continued decline is the result of the lagging impact of the economic downturn on income tax receipts and the state's subsequent distribution of them, as well as population changes reflected in the 2010 Census. Glendale formerly comprised almost 5% of the state's population; with the 2010 Census figures, Glendale's population now comprises about 4.5% of the state's total. That seemingly minor change in population distribution resulted in a loss of $5.4 million in state-shared revenue for Glendale, an amount already incorporated into the budget balancing for FY 2012.

On the capital side, Glendale's secondary assessed valuation has plummeted almost 50% from a high of $2.2 billion in FY 2009, which reflected the real estate market of calendar year 2006, to an estimated low of $1.1 billion in FY 2013 (calendar year 2010 real estate market). The unprecedented valuation decline has resulted in a corresponding dive in secondary property tax revenue, from $29.1 million in FY 2010 to $18 million in FY 2012. Another decline is expected for FY 2013 – to an estimated $15.6 million – based on the preliminary valuation notices sent to property owners in February 2011.

City-Owned Jobing.com Arena and the Coyotes Hockey Team. In 2001, the City of Glendale entered into various agreements for the purpose of creating a high-quality, diversified economic engine. The purpose of this economic center was to generate new and sustainable revenue sources to support exceptional city services for the community and to develop a signature destination area for tourism. Offices, hotels, entertainment, retail and restaurant facilities were planned to complement the city-owned Jobing.com Arena. A key tenant of the Jobing.com Arena has been the National Hockey League's (NHL) Coyotes team.

In May 2009, the former owner of the Coyotes hockey team unexpectedly filed for federal bankruptcy protection. During the bankruptcy proceedings, the National Hockey League purchased the assets of the Coyotes but did not assume the arena management, use and lease agreement. Therefore, for the past two years the city has been working with potential buyers of the Coyotes to structure an arrangement that would retain the team in Glendale.

City Council established criteria to guide the development of a new arrangement. They include

- Retention of the team for the full length of the lease at the city's Jobing.com Arena,
- Retention of existing arena revenues to support the annual debt service requirements for the capital construction of the city's Jobing.com Arena, and

- Creation of opportunities for the city to share in new revenue streams that could support exceptional city services to the community and ensure a sustainable future for the city.

These criteria were established because the expenses of managing the arena are currently offset with the revenue earned by having the Coyotes as the arena's main tenant. Further, an independent economic impact study showed that keeping the team for the term of the arena lease and management agreement was valued at between $270 million and $338 million. That is the value to the city today so losing the team to another city would cause significant damage to the Glendale community.

In May 2011, the NHL confirmed its intention to keep the team in Glendale by agreeing to an extension of the management agreement between the NHL and the city. This extension of the agreement allows the team to remain in Glendale for the NHL's 2011-12 season. It also allows the NHL and the city additional time to complete the required agreement with an ownership group that will be committed to retaining the team in Glendale at the Jobing.com Arena. Therefore, the FY 2012 GF operating budget assumes the general terms of the current agreement moving forward will be in place. The most significant is retention of the team as the anchor tenant of Glendale's Jobing.com Arena. The FY 2012 budget also incorporates the addition of a $20 million arena management fee.

Discussion – Actions Taken To Address Principal Issues
The budget balancing strategy that was presented to Council as part of the FY 2011 operating budget remains in place. It is important we continue with this strategy until we see sustained growth in retail sales, income taxes and other critical revenue sources because ongoing revenues have not recovered sufficiently to fully support the city's ongoing operating expenses. While this budget strategy is designed to adapt operations to constrained resources, it also positions the city to be ready for the time when the economy is fully recovered.

This budget strategy is marked by a strategic, business-based and phased approach. This budget strategy also sustains core city services as defined by Council's strategic goals. These core services are health and safety related such as emergency response services provided by the Police and Fire Departments. This strategy also ensures the smooth operation of the overall organization. Finally, to the extent possible, this strategy minimizes the impact to other services provided to the community in recognition of the fact that a municipality is fundamentally a service organization.

One critical element of the city's budget strategy that deserves recognition is the city's Innovate Initiative. This initiative is directly tied to the budget process and the city's strategic business model. Employees have been, and continue to be, actively engaged in making business-based recommendations for adjustments that help us in balancing the budget.

Operating Budget. I have very good news for employees for FY 2012 regarding furloughs and the pay-related reductions offered by the represented labor groups: these measures will be scaled back by 50%. For FY 2012, furloughs will be at 2.5% (52 hours) and the pay-related reductions for the represented labor groups will be changed accordingly.

Also for FY 2012, step increases will be implemented for eligible employees in the represented public safety labor groups. The increases are necessary for Glendale to remain competitive for essential public safety-related recruitment and retention efforts.

The FY 2012 operating budget includes a mix of ongoing and one-time budget measures, debt refunding and use of the GF fund balance as was done for the FY 2009 and FY 2010 operating budgets. Use of the GF fund balance during challenging economic cycles is a legitimate and widely-used course of action for many state and local governments here in Arizona and across the United States.

The City of Glendale established a healthy GF fund balance after the 2001 recession through prudent financial management that resulted in the development of a robust reserve totaling more than $66 million at the end of FY 2008. This was a prudent course of action because that healthy fund balance has enabled the city to continue providing exceptional city services over the past few years and again for FY 2012. The alternative would have been severe ongoing reductions to city services, including core services, to match the $41.6 million or 22.6% decline in GF ongoing revenue sources that was discussed earlier in this message.

By the end of FY 2010, the GF fund balance had declined to $38.8 million. The decline in fund balance during the recession led to a downgrade in the city's bond rating, as has happened with several valley cities given the recession's deep impact on Arizona. While the city's bond rating remains strong, the downgrade is a signal that we must begin rebuilding the city's GF fund balance. Therefore we must make deliberate steps toward a gradual rebuilding of the GF fund balance to a more healthy level.

The recommended mix of ongoing and one-time measures results in a balanced budget plan for FY 2012, as required by state statutes. A summary of the mix of GF ongoing and one-time measures for FY 2012 follows.

- Hold open 64 GF vacancies as they become available. At the time this message was written, 30 GF positions were vacant. **$4.7 million in savings.**
- Continuation of phased, sworn positions (22 FTEs) originally put in place for FY 2011. **$1.6 million in savings.**
- Continue the furlough program but at one-half the level in place for FY 2011. This means that furloughs will be at 2.5% (52 hours) for FY 2012. All non-represented employees participate in the furlough plan. Also similarly modify the pay-related deferrals for the represented employees. **$1.3 million in savings.**
- Five percent (5%) reductions to base budgets plus further reductions to internal service and replacement fund premiums to correspond with the increased number vacancies to be held frozen. **$1.8 million in savings.**
- Restructure lease debt and Municipal Property Corporation debt service to take advantage of more favorable repayment terms. **$8.6 million in savings.**
- One time revenue related to the amended parking agreement for the mixed use development in the sports and entertainment district that City Council approved in January 2011 plus a contribution from the enterprise funds with the refund of the

escrow established to retain the Coyotes team as a primary tenant at the Glendale Arena. This refund makes the funds available for GF use, as a one-time investment, to reduce the amount of transfers from the GF. **$17.5 million in one-time revenue.**
- Use GF fund balance to close the remaining between GF operating revenues and expenditures. **$9.6 million in GF fund balance.**

It is very important to note the use of $17.5M in one-time revenue and $9.6 million in fund balance to balance the GF operating budget for FY 2012 in order to avoid drastic reductions to city services for the community. That one-time revenue and use of fund balance is a one-time fix for the $27.1 million gap between GF ongoing revenue and GF ongoing expenditures. This means the gap will have to be addressed for the FY 2013 budget given that it is unlikely revenues will grow sufficiently to close that gap.

For the enterprise funds, an annual review of the rates charged for water, sewer, sanitation collection, and landfill disposal services was completed. No rate adjustments will be made for FY 2012. These annual reviews of the enterprise funds are done to ensure incoming revenues are sufficient to support operating and capital expenditures for those individual operations. Other fees, such as those charged for plan review and building inspections, are adjusted periodically per the consumer price index (CPI).

Capital Program. Given Council's prior direction to keep the secondary property tax rate unchanged, the first five years of the of the G.O. component of FY 2012-21 CIP was restructured to push back into the last five years of the plan all but two projects (plus any carryover from projects underway in the current FY). The two projects retained in the first five years of the G.O. component of the CIP are listed below.

- One is in the Public Safety category and is related to ongoing improvements to the public safety digital communication system.
- The second project is in the Flood Control category and addresses the cost of a regulatory permit the city is required to maintain.

Notable G.O. projects on hold are the completion of the new Municipal Court and the new West Area Library. Both projects are now in the last five years of the FY 2012-21 capital plan.

As mentioned briefly earlier in this message, the impact of the steep valuation decline on the city's secondary property tax revenue stream directly affects the city's capacity to support debt service on existing General Obligation bonds, as well as support additional debt service for new capital projects. Additional factors affecting the city's secondary property tax revenue are the following:

- Accelerated reduction in the assessment ratio for commercial properties per recent state statutes, and
- Reduction of the city's secondary property tax rate in FY 2008 and FY 2009

The significantly changed landscape necessitates an evaluation of the city's secondary property tax rate over the next year. This is especially true if the city is not able to restructure existing General Obligation bond debt service along more favorable terms so annual debt service payments can more closely match the diminished revenue stream. The plan of action for FY 2012 is to evaluate debt restructuring options through this upcoming fall and return to Council with a revised debt management plan and recommended options for Council's annual retreat. This timeframe allows us to evaluate fully the range of options as well as assess the 2011 real estate market, which will affect the secondary property tax revenue to be received in FY 2014.

Given the sustained decline in total water consumption and the number of bills issued, combined with no rate adjustments for FY 2012, the water and sewer capital plan was modified to reflect the following:

- The deferral of non-essential growth-related capital projects
- Ongoing improvements in operational efficiencies to minimize cost increases related to fuel, equipment and electricity
- Continuation of critical repair, maintenance and replacement of existing capital assets such as underground pipes
- Continuation of capital projects that ensure compliance with applicable federal, state and county regulations

The Glendale Onboard transportation capital program is primarily supported by the designated sales tax for transportation, with federal, state and regional transportation funds used for some projects. As expected, the economy continues to impact this program's capital plan although significant progress on key projects has been made.

Of particular note is the pavement management program that is included in the transportation sales tax capital plan. The pavement management program will be funded at $2 million per FY for FY 2012 through FY 2016, and $10 million for the last five years of the plan. If an opportunity arises to increase this level of funding level through changes to the debt management plan, we will present this information to Council during the year.

For FY 2012, two major projects planned are the start of construction for Northern Parkway and Grand Avenue improvements. Northern Parkway is a 12.5 mile high-capacity expressway running west to east, and will be a major transportation corridor across Glendale from the Loop 303 east to Grand Avenue. The first segment, from the Loop 303 to Dysart Road, is set to start construction in the summer of 2011. Grand Avenue improvements will improve traffic flow, enhance safety and improve the overall appearance of the roadway with landscaping, sidewalks, and undergrounding utilities. Other capital projects include design of a transit center in north Glendale, intersection safety improvements at 51st Avenue and Camelback Road, Glendale Airport runway improvements, and several bicycle/pedestrian multiuse pathway projects.

The Glendale transportation capital program also has benefitted tremendously from the federal stimulus program. Glendale was approved for over $6 million in federal stimulus funding for capital projects that will help lower ongoing maintenance expenses for roads. Street pavement overlays enhanced the life of the pavement on two arterial streets, Litchfield Road and Glendale Avenue. Also completed were the application of long-term pavement markings on 25 miles of arterial streets and improvements to the existing signal system that reduce the burden on local funds to maintain older equipment prone to breakdowns and emergency repairs.

Conclusion

As we progress through FY 2012, we will continue to evalute revenues and expenditures and to ensure we are on the path the Council has charted for the city. We will continue providing quarterly reports to Council on the performance of the General Fund and the designated sales tax funds. These reports will keep you apprised of how revenues and expenditures are doing when compared with the revenue and expenditure budgets established for FY 2012.

Even with the ongoing challenges of the economy, employees will remain focused on implementing City Council's strategic goals. The provision of exceptional city services will continue as will collaborative, innovative efforts to:

- Strengthen neighborhoods,
- Ensure Glendale is a safe community,
- Retain and attract quality economic development opportunities,
- Foster sustainable downtown development, and
- Continue the dedicated partnership with Luke Air Force Base.

It is important to thank employees for their active participation in and valuable contributions to the development of the FY 2012 budget. As a service organization focused on providing exceptional services to the community, the employees remain the city's most critical resource.

In closing, I believe the FY 2012 budget is a plan that provides resources to maintain core city services while moving forward with strategies that ensure a positive, sustainable future.
I continue to be confident that the Mayor and Council's vision will ensure an outstanding quality of life for the Glendale community and further enhance our position as a world-class destination city.

Sincerely,

Ed Beasley

Ed Beasley
City Manager