

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the City of Peoria, Arizona (the City), we offer this narrative overview and analysis of the financial activities of the City of Peoria, Arizona for the fiscal year ended June 30, 2012. This discussion and analysis is designed to (1) assist the reader in focusing on significant financial issues, (2) provide an overview of the City's financial activity, (3) identify changes in the City's financial position, (4) identify any material deviations from the financial plan (the approved annual budget), and (5) identify individual fund issues or concerns.

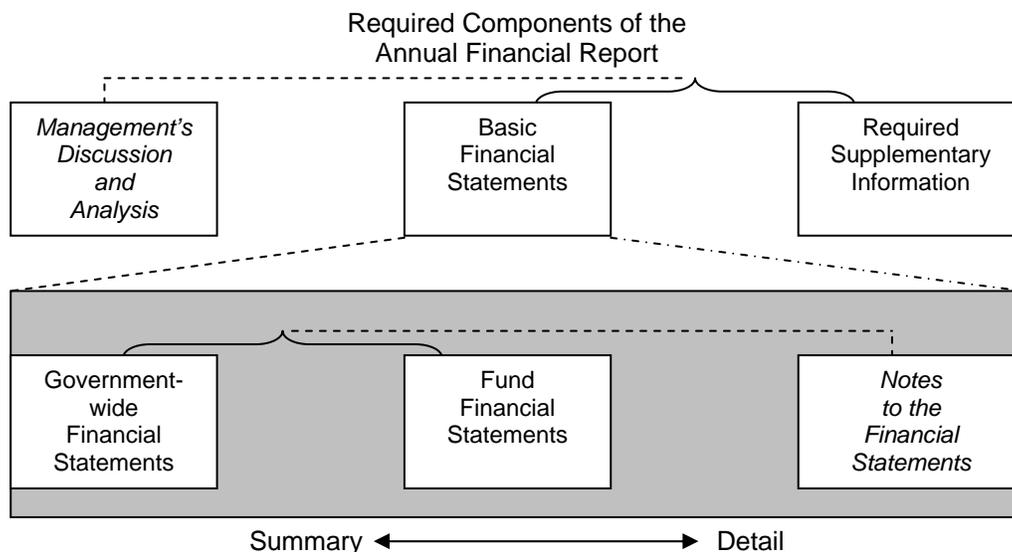
This discussion and analysis (MD&A) has a different focus and purpose than the transmittal letter presented on pages v-xv of this report and is designed to be read in conjunction with the transmittal letter as well as the financial statements beginning on page 19 and the accompanying notes to the financial statements. The City also issues a separate financial report, including management's discussion and analysis, for the Vistancia Community Facilities District, which is a blended component unit of the City.

Financial Highlights

- ◆ The City's total net assets increased \$23.0 million (1.5%) in fiscal year 2012, an increase of \$14.8 million (1.4%) in governmental activities and an increase of \$8.2 million (1.5%) in business-type activities.
- ◆ Total net assets of the City are \$1,610.5 million, of which \$172.6 million is unrestricted (up \$8.3 million, 5.1%, from last year's \$164.3 million unrestricted net assets).
- ◆ The governmental activities program revenues decreased by approximately \$7.1 million (10.8%) from the previous year. This was primarily due to a decrease in donated capital assets with fewer large developments being completed in fiscal year 2012.
- ◆ The business-type activities program revenues increased by approximately \$7.6 million (11.3%) from the previous year. Charges for services increased \$4.7 million (7.6%) and development fees increased \$0.9 million (43.0%) reflecting a small improvement in development activity.
- ◆ At June 30, 2012, total fund balance of the governmental funds was \$270.2 million, up \$7.7 million (2.9%) from the previous year. Of this, \$12.8 million (down 4.7%) was unassigned (available for spending at the government's discretion).
- ◆ General Fund inflows (on a budgetary basis) were higher than budgeted inflows by \$4.1 million for fiscal year 2012. Budgetary basis outflows of the General Fund were 83.3% (\$21.7 million in savings) of the final budgeted outflows.
- ◆ At June 30, 2012, unassigned fund balance for the General Fund was \$12.9 million, or 13.5% of General Fund expenditures for fiscal year 2012.
- ◆ During fiscal year 2012, the City issued \$28.4 million in General Obligation (GO) Bonds (\$14.7 in new monies and \$13.7 refunding bonds) and \$23.3 million in Water and Wastewater Revenue Refunding Bonds.

OVERVIEW OF THE FINANCIAL STATEMENTS

As pictured below, the financial section of the Comprehensive Annual Financial Report (CAFR) for the City of Peoria, Arizona consists of this discussion and analysis, the basic financial statements, other required supplementary information and other non-required financial schedules. The basic financial statements include the government-wide financial statements, fund financial statements, including the budgetary statements for the general fund and major special revenue funds, and notes to the financial statements. The additional non-required information includes combining schedules and other supplementary schedules presented after the basic financial statements (Combining Statements, Supplemental Information and Statistical Sections of this report).



Government-wide Financial Statements

The government-wide financial statements (see pages 19-21) are designed to provide a broad overview of the City's finances in a manner similar to those used by private businesses. All of the activities of the City, except those of a fiduciary nature, are included in these statements.

The activities of the City are broken into two columns on these statements – governmental activities and business-type activities. A total column for the City is also provided.

- The *governmental activities* include the basic services of the City including general government (administration), culture and recreation, police, fire, development services, highways and streets, public works, and human services. These activities are generally supported by taxes and general revenues.
- The *business-type activities* include the private sector type activities such as the water, wastewater solid waste, and storm drain utilities, the stadium and public housing. These activities are primarily supported through user charges or fees.

The *statement of net assets* presents information on all of the City's assets and liabilities (excluding fiduciary funds), both current and long-term, with the difference between assets and liabilities reported as net assets. The focus on net assets is designed to be similar to the emphasis for businesses. Over time, increases or decreases in net assets may serve as a useful indicator of how the financial position of the City may be changing. Increases in net assets may indicate an improved financial position; however, even decreases in net assets may reflect a changing manner in which the City may have used previously accumulated funds (i.e. cash funding of capital projects). To assess the overall health of the City, other indicators, including non-financial indicators such as the City's property tax base and condition of its infrastructure, should also be considered.

The *statement of activities* presents information showing how the City's net assets changed over the most recent fiscal year. Since full accrual accounting is used for the government-wide financial statements, all changes to net assets are reported at the time the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also focuses on both the gross and net costs of the various functions of the City, based only on direct functional revenues and expenses. This is designed to show the extent to which the various functions depend on general taxes and revenues for support.

Fund Financial Statements

Also presented are fund financial statements for governmental funds, proprietary funds and fiduciary funds. The fund financial statements focus on major funds of the City. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or conditions. Funds are used to ensure and demonstrate compliance with finance-related legal requirements as well as for managerial control to demonstrate fiduciary responsibility over the assets of the City.

Governmental funds – Governmental funds are used to account for most of the City's basic services. These are essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the governmental activities column on the government-wide financial statements, these fund financial statements (pages 22-34) focus on near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in determining what financial resources are available in the near future to finance the City's programs.

Since the governmental fund financial statements focus on near-term spendable resources, while the governmental activities on the government-wide financial statements have a longer-term focus, it may be useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. To facilitate this comparison, reconciliations of the differences between the two are provided immediately following the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances and in Note 2 (pages 60-64).

The City maintains several individual governmental funds organized according to their type (special revenue, debt service, and capital projects). Information is presented separately in the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances for the General Fund, Half-Cent Sales Tax Fund, Highway User Revenue Fund, Transportation Sales Tax Fund, Development Fee Fund, and GO Bond Debt Service Fund, which are considered to be major funds of the City. Data from the remaining governmental funds are combined into a single, aggregated presentation. Individual fund data for each of the non-major governmental funds is provided in the form of combining statements (pages 100-103).

Proprietary funds – Proprietary funds are used to account for services primarily supported by user fees. The proprietary fund financial statements (pages 36-43) are prepared with the same long-term focus as the government-wide financial statements. The City maintains the following two types of proprietary funds.

Enterprise funds are used for activities that primarily serve customers outside the governmental unit. The enterprise funds generally provide information similar to the business-type activities column of the government-wide financial statements, but provide more detail and additional information such as cash flows. Any reconciliation necessary between the enterprise funds and the business-type activities column of the government-wide financial statements is provided on the face of the fund statements. The City's enterprise funds are the Water, Wastewater, Storm Drain and Solid Waste utilities, as well as the sports complex (Stadium Fund) and public housing activities. All of the enterprise funds are considered to be major funds of the City. The Storm Drain Fund was reclassified in fiscal year 2012 from a governmental fund to an enterprise fund. This change was due to a change in the revenue source from primarily transfers from other governmental funds to a user fee to external customers. For better comparative analysis in this MD&A, the 2011 data has been restated, where applicable, to reflect the Storm Drain Fund as an enterprise fund.

Internal service funds are used for activities where the primary customer is the City itself. Because the primary customers of the internal service funds are the governmental activities, the assets and liabilities of those funds are included in the governmental activities column of the government-wide statement of net assets. The costs of internal service funds are allocated to the various user functions on the government-wide statement of activities. The internal service funds are combined into a single column on the proprietary fund statements. Additional detail of the internal service funds

is provided in combining statements (pages 124-126). The internal service funds of the City include the Motor Pool, Self-Insurance, Facilities Maintenance, and Information Technology Funds.

Fiduciary funds – Fiduciary funds are used to account for resources held for the benefit of others. Fiduciary funds are not included in the government-wide financial statements because the resources of those funds are not available to support programs of the City. The fiduciary fund statements (pages 44-45 and 132-133) are prepared on the same basis as the government-wide and proprietary fund statements.

Notes to the financial statements – The notes to the financial statements (pages 47-89) provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements and should be read with the financial statements.

Required supplementary information other than MD&A – Governments have an option of including the budgetary comparison statements for the general fund and major special revenue funds as either part of the fund financial statements within the basic financial statements, or as required supplementary information after the footnotes. The City has chosen to present these budgetary statements as part of the basic financial statements.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

The following tables, graphs and analysis discuss the financial position and changes to the financial position for the City as a whole as of and for the year ended June 30, 2012, with comparative information for the previous year.

Net Assets

Net assets may serve over time as a useful indicator of a government's financial position. The following table reflects the condensed Statement of Net Assets of the City for June 30, 2012, compared to the prior year.

	Governmental Activities		Business-type Activities		Total Primary Government		Percent Change
	2012	2011	2012	2011	2012	2011	
Current and other assets	\$ 328.2	\$ 317.4	\$ 94.4	\$ 86.0	\$ 422.6	\$ 403.4	4.8%
Capital assets	1,108.4	1,106.4	615.6	622.6	1,724.0	1,729.0	(0.3)
Total assets	1,436.6	1,423.8	710.0	708.6	2,146.6	2,132.4	0.7
Other liabilities	27.4	26.0	7.3	6.1	34.7	32.1	8.1
Long-term liabilities outstanding	363.4	366.8	138.0	146.0	501.4	512.8	(2.2)
Total liabilities	390.8	392.8	145.3	152.1	536.1	544.9	(1.6)
Net assets:							
Invested in capital assets, net of related debt	816.1	803.8	478.8	478.3	1,294.9	1,282.1	1.0
Restricted	118.1	118.4	24.9	22.7	143.0	141.1	1.4
Unrestricted	111.6	108.8	61.0	55.5	172.6	164.3	5.1
Total net assets	\$ 1,045.8	\$ 1,031.0	\$ 564.7	\$ 556.5	\$ 1,610.5	\$ 1,587.5	1.5

The net assets of the City increased \$23.0 million (1.5%) in fiscal year 2012. Net assets of governmental activities increased \$14.8 million (1.4%), while the business-type activities increased \$8.2 million (1.5%).

Net Assets consists of three components. The largest portion of net assets (\$1,294.9 million or 80.4%) reflects the City's investment in capital assets net of accumulated depreciation and any related outstanding debt used to acquire or construct those assets. The City uses these capital assets to provide services to its citizens. Consequently, it is not the City's intention to sell these assets and they are therefore not available for future spending. Although the capital assets are reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves are not intended to be used to liquidate these liabilities. This category of Net Assets increased \$12.9 million in fiscal year 2012 due to \$31.1 million in capital asset expenditures, \$18.7 million in donated assets, and a \$17.8 million decrease in net capital related debt, offset by \$54.7 million in depreciation expense, and asset disposals.

The second portion of the City's net assets (\$143.0 million or 8.9%) represents resources that are subject to external restrictions on how they may be used. The increase of \$1.9 million includes an increase of \$2.3 million in restricted for development fees with increased development fee revenues; a decrease of \$2.1 million in reserved for debt service due to early payoff of the 2003 MDA bonds; and \$2.3 million increase in net assets restricted for capital projects. The increase in the reserve for capital projects is primarily due to increased expansion fee revenues in the Water and Wastewater Funds.

The third portion consists of Unrestricted Net Assets of \$172.6 million (10.7%). These net assets may be used to meet the City's ongoing obligations to citizens and creditors. This category increased \$8.3 million (5.1%) in fiscal year 2012. Unrestricted net assets is the balance of net assets remaining after calculating the other two categories discussed above. Unrestricted net assets of governmental activities increased \$2.8 million, while unrestricted net assets of business-type activities increased \$5.5 million.

Changes in Net Assets

The following table compares the government-wide revenue and expenses for the current and previous fiscal year.

	Changes in Net Assets (in millions of dollars)							
	Governmental Activities		Business-type Activities		Total Primary Government		Percent Change	
	2012	2011	2012	2011	2012	2011		
REVENUES:								
Program revenues:								
Fees, fines & charges for services	\$ 17.3	\$ 16.9	\$ 66.1	\$ 61.4	\$ 83.4	\$ 78.3	6.5%	
Federal grants	2.2	5.0	0.1	0.2	2.3	5.2	(55.8)	
Capital contributions	9.9	17.2	8.4	5.4	18.3	22.6	(19.0)	
Other grants and entitlements	29.0	26.4	-	-	29.0	26.4	9.8	
General revenues:								
Property taxes	22.2	26.0	-	-	22.2	26.0	(14.6)	
Sales and use taxes	60.7	58.1	-	-	60.7	58.1	4.5	
Franchise taxes	4.1	4.0	-	-	4.1	4.0	2.5	
State shared sales tax	12.1	11.6	-	-	12.1	11.6	4.3	
Urban revenue sharing	13.2	13.4	-	-	13.2	13.4	(1.5)	
Auto-in-lieu taxes	4.9	4.5	-	-	4.9	4.5	8.9	
Investment earnings	1.0	1.4	0.3	0.3	1.3	1.7	(23.5)	
Gain on sale of capital assets	0.1	0.1	-	-	0.1	0.1	-	
Forgiveness of debt	0.0	0.8	-	-	0.0	0.8	(100.0)	
Miscellaneous	3.5	5.1	-	-	3.5	5.1	(31.4)	
Total revenues	<u>180.2</u>	<u>190.5</u>	<u>74.9</u>	<u>67.3</u>	<u>255.1</u>	<u>257.8</u>	(1.0)	
EXPENSES:								
Program activities:								
Governmental activities:								
General government	20.9	27.4	-	-	20.9	27.4	(23.7)%	
Culture and recreation	23.5	21.1	-	-	23.5	21.1	11.4	
Police	35.9	35.5	-	-	35.9	35.5	1.1	
Fire	22.3	21.2	-	-	22.3	21.2	5.2	
Development services	5.4	6.1	-	-	5.4	6.1	(11.5)	
Highways and streets	31.8	25.6	-	-	31.8	25.6	24.2	
Public works	7.4	7.7	-	-	7.4	7.7	(3.9)	
Human services	1.7	2.0	-	-	1.7	2.0	(15.0)	
Interest expense on debt	12.6	12.6	-	-	12.6	12.6	-	
Unallocated depreciation	0.6	0.6	-	-	0.6	0.6	-	
Business-type activities:								
Water utility	-	-	30.8	29.6	30.8	29.6	4.1	
Wastewater utility	-	-	21.9	19.9	21.9	19.9	10.1	
Solid Waste utility	-	-	10.8	9.8	10.8	9.8	10.2	
Stadium	-	-	5.3	5.0	5.3	5.0	6.0	
Storm Drain utility	-	-	0.8	0.7	0.8	0.7	14.3	
Housing	-	-	0.4	0.4	0.4	0.4	-	
Total expenses	<u>162.1</u>	<u>159.8</u>	<u>70.0</u>	<u>65.4</u>	<u>232.1</u>	<u>225.2</u>	3.1	
Excess (deficit) before transfers	<u>18.1</u>	<u>30.7</u>	<u>4.9</u>	<u>1.9</u>	<u>23.0</u>	<u>32.6</u>	(29.4)	
Transfers	(3.3)	(11.1)	3.3	11.1	-	-	-	
Increase (decrease) in net assets	<u>\$ 14.8</u>	<u>\$ 19.6</u>	<u>\$ 8.2</u>	<u>\$ 13.0</u>	<u>\$ 23.0</u>	<u>\$ 32.6</u>	(29.4)	

For fiscal year 2012, total governmental activities revenues decreased \$10.3 million (5.4%), and total business-type activities revenues increased \$7.6 million (11.3%). Expenses increased \$2.3 million (1.4%) and \$4.6 million (7.0%) for the governmental activities and business-type activities, respectively. While some functions had increased expenses with a slowly recovering economy, general government

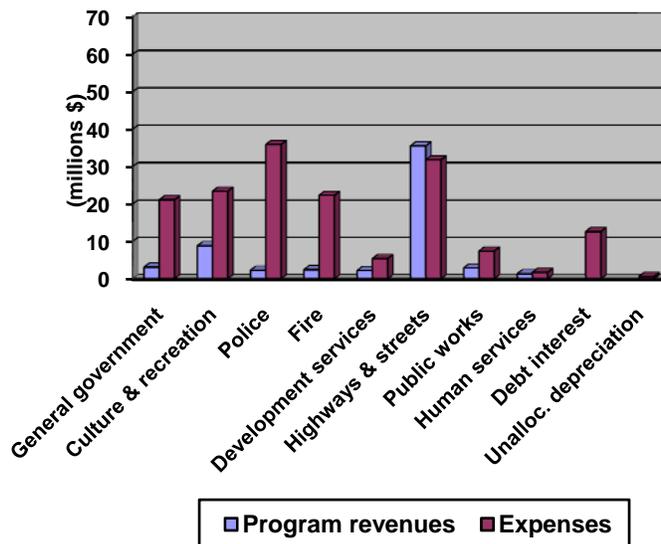
expenses decreased by \$6.5 million (23.7%); development services expenses decreased by \$.7 million (11.5%); public works decrease \$.3 million (3.9%); and human services decreased \$.3 million (15.0%) with the City turning the Section 8 Housing program over to the County. Culture & recreation expenses increased by \$2.4 million (11.4%); police expenses increased \$.4 million (1.1%); fire expenses increased by \$1.1 million (5.2%); and highways and streets expenses increased by \$6.2 million (24.2%). The increase in the business-type activities expenses are primarily in the Water Utility (\$1.2 million, 4.4%), Wastewater Utility (\$2.0 million, 10.1%) and the Solid Waste Utility (\$1.0 million, 10.2%). For further explanation of these expense changes, refer to the financial analysis of the City's funds later in this document.

The general revenues of governmental activities decreased \$3.2 million (2.6%) from the previous year. The primary drivers were decreases in property tax and reimbursement revenue, offset by increased local and state sales taxes. Property tax revenues decreased by \$3.8 million (14.6%) in fiscal year 2012 as assessed values continued to decline. Miscellaneous revenues, including reimbursement revenue, decreased by \$1.6 million (31.4%) in fiscal year 2012. Local sales and use taxes increased \$2.6 million (4.5%) as retail and restaurant & bar sales taxes increased \$2.2 million and \$0.3 million respectively while state shared sales taxes increased \$.5 million (4.3%).

Program revenues of governmental activities decreased \$7.1 million (10.8%) mainly as a result of the following changes: Federal grants decreased by \$2.8 million (56.0%) with the substantial completion of the Energy grant in 2011, while donations of capital assets decreased by \$7.3 million (42.4%) with fewer large developments being completed in 2012. The program revenues of business-type activities increased \$7.6 million (11.3%) primarily due to a \$4.7 million increase in charges for services revenues as water and wastewater rates increased 4.5% after three years of no changes. Development fee revenues also increased \$0.9 million reflecting a slight improvement in development activity.

The following graph shows the functional revenues and expenses of governmental activities to demonstrate the extent to which the governmental functions produce direct revenues to offset the program costs. It should be noted that this is not intended to represent full cost allocation to these

Governmental Activities Program Revenues & Expenses

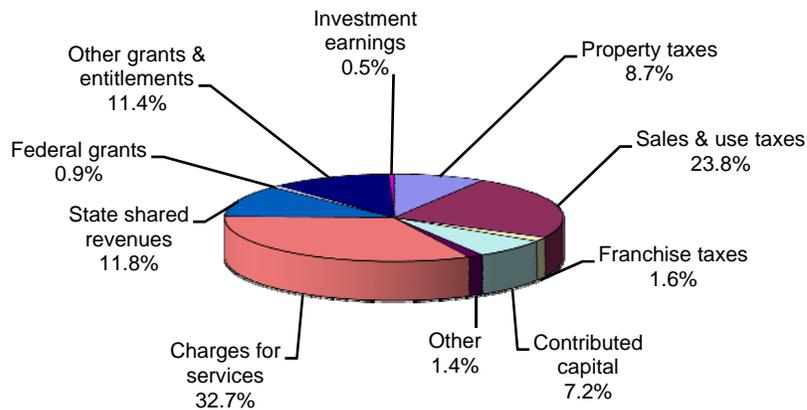


functions. Expenses not covered by direct program revenues are covered by general revenues of the City, primarily taxes and state shared revenues. In the governmental activities, the program revenues of \$58.4 million are 36.0% of the governmental activities expenses for fiscal year 2012, down from 41.0% in fiscal year 2011. In the business-type activities, program revenues of \$74.6 million are 106.6% of the business-type expenses for fiscal year 2012. This compares to \$67.0 million and 102.5% in fiscal year 2011.

Governmental activities account for 70.6% of the total revenues of the City and 69.8% of the total expenses in fiscal year 2012. These percentages were 73.9% and 71.0% respectively in fiscal year 2011.

As seen in the following graph, one of the largest financing sources for the City in fiscal year 2012 is charges for services (32.7%), primarily because this is the major funding source of the business-type activities (88.2% of business-type revenues in fiscal year 2012). The major funding sources of the governmental activities are property, franchise and sales/use taxes (34.1% of total revenues, 48.3% of governmental revenues) and state shared revenues (11.8% of total revenues, 16.8% of governmental revenues).

Government-Wide Revenue Sources Fiscal Year 2012

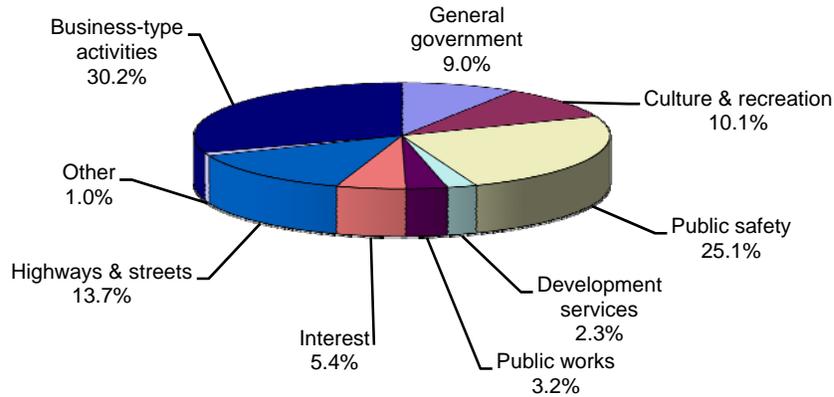


Property taxes decreased 14.6% from fiscal year 2011 with a continued decline in assessed value. The tax rates did not change in fiscal year 2012 compared to the previous year.

Total government-wide expenses (not including transfers out) of the City increased \$6.9 million (3.0%) in fiscal year 2012. Expenses of the governmental activities increased \$2.3 million (1.4%). This includes increases of \$6.2 million (24.2%) for highways and streets, and \$2.4 million (11.4%) for culture and recreation offset by a decrease of \$6.5 million (23.7%) for general government. Highways and streets expenses increased primarily due to an increase of \$4.8 million in depreciation expense. Culture and recreation expenses increased primarily due to an increase of \$2.5 million additional depreciation expense. General government expenses decreased with \$4.0 million in lower depreciation expense. Expenses in Business-type activities increased \$4.6 million (7.0%) primarily due to increased depreciation expense. The various increases in depreciation expense were due to a thorough review of work-in-progress assets during 2012 and beginning depreciation on a number of assets. The decrease in general government depreciation expense is due to the completion of depreciation on a large information technology asset in fiscal year 2011.

As shown in the following Government-Wide Functional Expenses graph, business-type activities account for 30.2% of the functional expenses of the City for fiscal year 2012, while governmental activities account for 69.8% of the functional expenses. For the governmental activities, the largest users of resources are public safety (25.1% of total expense, 35.9% of governmental expenses), general government (9.0% of total expenses, 12.9% of governmental expenses), highways and streets (13.7% of total expenses, 19.6% of governmental expenses), and culture and recreation (10.1% of total expenses, 14.4% of governmental expenses).

Government-Wide Functional Expenses Fiscal Year 2012



FINANCIAL ANALYSIS OF THE CITY'S FUNDS

The City maintains fund accounting to demonstrate compliance with budgetary and legal requirements. The following is a brief discussion of financial highlights from the fund financial statements.

Governmental funds

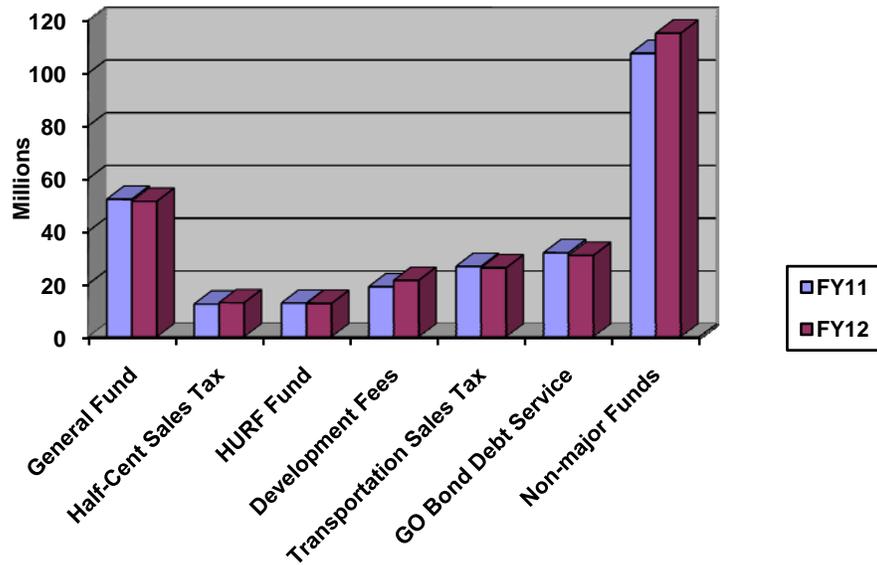
The focus of the governmental fund financial statements (pages 22-29) is to provide information on near-term inflows, outflows and balances of spendable resources. All major governmental funds are discretely presented on these financial statements, while the non-major funds are combined into a single column. Combining statements for the non-major funds may be found on pages 100-103. Although the Half-Cent Sales Tax Fund, Highway User Revenue Fund and Transportation Sales Tax Fund do not meet the GASB 34 criteria of a major fund, the City has chosen to present them as major funds due to local significance or outstanding debt.

The fund balance of the governmental funds is \$270.2, an increase of \$7.7 million, or 2.9%, from the previous year. Of this, \$169.5 million (down \$1.1 million (0.6%) from the previous year) is classified as Unspendable or Restricted because it is not appropriable for expenditure or is legally segregated for a specific future use. The decrease in restricted fund balance is caused by a decrease in restricted for debt service of \$2.1 million, including \$1.4 million in the MDA Debt Service Fund and \$1.1 million in the GO Bond Debt Service Fund, due to the early payoff of bonds in 2012; a decrease of \$0.9 million in restricted for capital projects due to decreased reimbursement revenue; a decrease of \$0.8 million was recorded in restricted for transportation purposes due to increased capital expenditures; offset by a \$2.4 million increase in restricted for development fees due to increased development fee revenues.

An additional \$87.9 million of the governmental fund balance (up \$9.4 million (12.0%) from the previous year) has been committed or assigned for specific purposes by council or administrative action. These commitments include various stabilization reserves (\$38.6 million), debt service reserves (\$1.0 million), capital projects (\$34.0 million) and arts capital and various other purposes (\$14.3).

The remaining \$12.8 million of governmental fund balance is classified as Unassigned. This balance may serve as a useful indicator of a government's net resources available for spending at the end of the year. By Council policy, these resources are used to fund one-time needs of the City including capital facilities and transportation improvements. The unassigned fund balance decrease of \$0.6 million (4.5%) during fiscal year 2012 is primarily due to the net loss in the General Fund.

Governmental Funds - Fund Balance



The General Fund is the chief operating fund of the City and accounts for many of the major functions of the government, including public safety, parks and recreation, community development and general administrative services. The General Fund revenues increased \$1.3 million (1.5%) from the previous year. Urban revenue sharing decreased \$.2 million (1.3%). Urban revenue sharing is from the collection of state income tax two years prior, so distributions in fiscal year 2012 are still from the economic recession. Also, property taxes decreased by \$.4 million (13.8%) as assessed values continue to decrease, and investment earnings decreased \$.03 million (15.2%) due to continuing low interest rates. The City's sales tax revenues in the General Fund increased \$1.4 million (4.4%) and state shared sales tax revenues increased \$.4 million (3.8%) due to a recovering retail sales and restaurant & bar sales. Auto-in-lieu revenue (licensing fees) increased .4 million (8.7) with an increase in auto sales. Total General Fund expenditures decreased \$4.4 million (4.4%). Personnel costs decreased \$1.3 million while other costs (contractual services and commodities) decreased \$1.2 million with various cost saving measures. Capital outlay decreased by \$1.6 million (40.1%) with fewer projects being funded by the General Fund. The unassigned fund balance of the General Fund was 13.5% of expenditures at June 30, 2012, compared to 13.6% at June 30, 2011.

The Half-Cent Sales Tax Fund tracks the revenues from a \$.05 sales tax committed for specific purposes by Council policy. Revenues in this fund increased \$.6 million (4.3%) from the previous year due to increased sales tax revenues. Expenditures in this fund decreased \$1.7 million (30.5%) due to increased debt service payments on development agreements in fiscal year 2011 that did not repeat in fiscal year 2012. Transfers out from the Half-Cent Fund increased \$.7 million with higher debt service transfers. Total fund balance of the Half-Cent Sales Tax Fund increased by \$.4 million (3.4%) in fiscal year 2012.

The Highway User Revenue Fund (HURF Fund) is required by state statute to track the receipt of the state allocation of gasoline taxes and other state revenues shared with local governments that are required to be used for transportation purposes. Also, there is a sales tax on utilities and property tax revenues from street light improvement districts included in this fund. Revenues decreased by \$.2 million (2.1%) due to decreased highway user revenues (\$.3 million or 3.8%) and a small increase in sales taxes. Expenditures increased by \$.5 million (4.4%) in fiscal year 2012 primarily due to an increase in street repairs expenditures. Fund balance decreased \$.2 million (1.5%) in fiscal year 2012.

The Transportation Sales Tax Fund tracks the collection and expenditure of the .3% voter approved sales tax to address transportation issues. Revenues in this fund increased \$.4 million (4.7%) while expenditures increased \$1.9 million (56.2%). The increased revenues are due to increasing sales tax

revenue while the increased expenditures are primarily capital outlay. The fund balance decreased \$.6 million (2.2%) in fiscal year 2012. All fund balance in this fund is restricted.

Another major governmental fund of the City is the Development Fee Fund, which collects governmental impact fees for parks and recreational facilities, public safety, and streets and intersections. Revenues in the Development Fee Fund increased \$2.5 million (52.6%) with a moderate increase in development activity in the City, while expenditures increased \$.9 million (23.3%) in fiscal year 2012 due to increased capital outlay. Fund balance increased \$2.4 million (12.6%) in fiscal year 2012, primarily due to increased revenues. All fund balance in this fund is restricted.

The GO Bond Debt Service Fund accounts for the payment of general obligation bonds and the related interest. Revenues in this fund decreased \$3.3 million (16.3%) due to decreased secondary property tax revenues and investment earnings. The secondary assessed value of the City decreased 20.7% in fiscal year 2012 while the secondary tax rate was unchanged. Expenditures decreased by \$5.6 million (23.5%) due to decreased principal payments on general obligation bonds issued in fiscal year 2009. The Series 2009 bond debt service was structured with large payments in fiscal year 2010 and 2011 to lower the fund balance in this fund. Fund balance decreased \$1.1 million (3.4%) in fiscal year 2012.

All non-major governmental funds of the City are combined into one column on the governmental fund statements.

Proprietary funds

The proprietary fund financial statements are prepared on the same accounting basis and measurement focus as the government-wide financial statements, but provide additional detail since each major enterprise fund is shown discretely. Although the Solid Waste, Stadium Fund, Storm Drain Fund, and Public Housing Fund do not meet the GASB 34 criteria of a major fund, the City has chosen to present them as major funds due to local significance.

Total net assets of the enterprise funds increased \$8.7 million (1.6%) in fiscal year 2012. Net assets invested in capital assets, net of related debt, increased \$.5 million (.1%) with the addition of utility infrastructure in the Water Fund. Restricted net assets increased \$2.2 million (9.6%), primarily due to increased balances for capital construction due to increased expansion fees in the Water and Wastewater Funds. The unrestricted net assets increased \$6.0 million (11.1%) primarily due to increased net income in the utility operating portions of the Utility Funds. The Water Utility Fund, Wastewater Utility Fund, and Solid Water Utility Fund experienced increases in total net assets of \$7.3 million (2.7%), \$.6 million (0.2%) and \$1.3 million (5.5%) respectively. The Storm Drain Utility Fund net assets increased \$8,863 (1.2%) while the Stadium Fund decreased \$0.4 million (1.6%), and the Public Housing Fund total net assets decreased \$0.1 million (5.2%). The Water Utility unrestricted net assets increased \$4.5 million (16.9%), the Wastewater Utility unrestricted net assets increased \$0.4 million (2.7%), and the unrestricted net assets of the Solid Waste Fund increased \$1.4 million (10.8%).

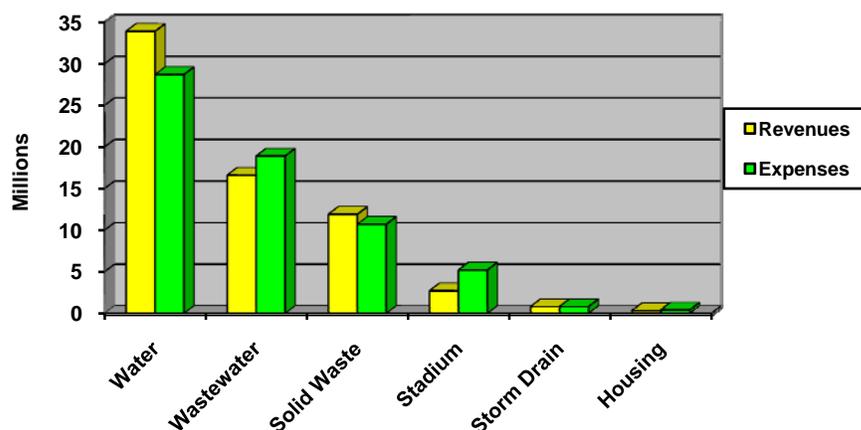
Operating revenues of the enterprise funds increased \$4.6 million (7.5%) in fiscal year 2012. Charges for services increased \$3.9 million (13.1%) in the Water Utility Fund and \$0.7 million (4.4%) in the Wastewater Utility Fund due to increased usage and rate increases of 4.6% in water and 4.5% in wastewater. Operating expenses of the enterprise funds increased \$5.0 million (8.4%) in fiscal year 2012. The Water Utility Fund operating expenses increased \$1.7 million (6.3%) primarily due to an increase in depreciation of \$1.9 million (27.5%). In the Wastewater Utility Fund, operating expenses increased \$2.0 million (11.9%) due to an increase in depreciation of \$1.6 million (18.6%), an increase in contractual services/commodities of \$0.3 million (5.3%), and an increase in salaries/wages of \$0.1 million (5.0%). In the Solid Waste Fund, operating expenses increased \$0.9 million (9.0%) due to an increase of \$0.2 million (6.7%) in salaries/wages and \$0.7 million (11.6%) in contractual services/commodities primarily in landfill services and internal charges for other City services. Operating expenses in the Stadium Fund increased \$0.2 million (4.3%) due to a \$0.2 million (7.8%) increase in contractual services/commodities of which a significant portion is one-time expenses from a catch-up on team splits of revenues.

Operating income for the Water Utility Fund increased by \$2.2 million (73.4%) from fiscal year 2011 due to the higher charges for service. Operating income for the Wastewater Utility decreased by \$1.3 million

(133.6%) to an operating loss in fiscal year 2012 with the expense increases discussed above. The Solid Waste Utility Fund operating income decreased \$.9 million (42.0%) based on increased expenses as discussed above. The Stadium Fund and the Public Housing Fund had operating losses in fiscal years 2011 and 2012. The Stadium Fund's operating loss is substantially covered by transfers from the Half-Cent Sales Tax Fund for governmental use and support of this facility. The Public Housing Fund operating loss is higher in fiscal year 2012 than 2011 due to decreasing federal subsidies and increased expenses. The Storm drainage fund essentially broke even in fiscal year 2012.

The following graph shows the operating revenues and expenses for the enterprise funds for fiscal year 2012.

Fiscal year 2012 Enterprise Fund Operating Revenues and Expenses



BUDGETARY HIGHLIGHTS

The City's annual budget is the legally adopted expenditure control document of the City. Budgetary comparison statements are required for the General Fund and all major special revenue funds and may be found on pages 30-34. These statements compare the original adopted budget, the budget as amended throughout the fiscal year, and the actual expenditures prepared on a budgetary basis. Budgetary schedules for the other governmental funds as well as the proprietary funds are also presented on pages 94-95, 104-113, 116-121, and 127-130.

Amendments to the adopted budget may occur throughout the year in a legally permissible manner (see Note 1.E on page 53 for more information on budget policies). Some of these amendments include transfers from contingency to cover approved carryovers from the previous budget, capital projects with budget overages (or whose timing was accelerated), and other unanticipated costs. Also, throughout the year, budget amendments are processed to provide expenditure authority from unanticipated revenue sources. These include new or increased grants and intergovernmental agreements. It is generally the policy of the City to not include revenues and operational expenditure authority for these types of items in the operational budgets unless the funding is reasonably assured at the time of completion of the annual budget. Instead, the City budgets contingency accounts to allow for later transfer to operational budgets if and when the funding is received.

No amendments increasing the City's total adopted budget of \$460 million occurred during fiscal year 2012. Budget amendments between funds or departments or from budgeted contingencies into operational expense/expenditure accounts did occur.

General Fund inflows (revenues and other sources) of \$108.6 million, on a budgetary basis, exceeded budgeted inflows of \$104.5 million by \$4.1 million (3.9%) while budgetary basis outflows (expenditures and other uses) of \$108.5 million were 83.3% of final budgeted outflows. Revenues, on a budgetary

basis, exceeded budgeted revenues in sales tax, franchise tax, state shared sales tax, charges for other services, licenses and permits, while falling short in investment earnings and miscellaneous revenues. Reduced General Fund outflows resulted primarily from delayed capital projects and unspent contingency. There were no expenditure overages for any of the functional categories although the fire department budget was increased \$0.25 million from the General Fund contingency to cover higher overtime expenditures.

During the fiscal year, the original General Fund expenditures and other uses budget of \$134.0 million was amended by \$3.8 million to the final expenditure and other uses budget of \$130.2 million. Notable General Fund transfers were as follows:

- Contingency appropriation of \$0.3 million was transferred to General Fund from the Fleet Replacement Reserve Fund when the Police Department no longer required their supplemental for a REACT vehicle due to the State/County continuing their program when it had been anticipated that it would be turned over to the cities.
- Excess appropriation of \$0.1 million was transferred to General Fund contingency appropriation from the MDA Debt Service Fund associated with the GRIC Water Rights debt payoff being lower than estimated.
- Appropriation of \$0.3 million was transferred from General Fund contingency to the Motor Pool Fund for increased fuel costs.
- Per council approval in April 2012, the 2003 MDA bonds were defeased in fiscal 2012. There was a transfer from General Fund contingency appropriation of \$2.9 million to the MDA Debt Service Fund for expenditure authorization necessary to complete the defeasance.
- Citywide health insurance cost savings resulted in \$0.2 million transfer to General Fund contingency from the Self-Insurance Fund.
- Contingency appropriation of \$1.2 million was transferred from the General Fund contingency to the Self-Insurance Fund for increased costs associated with two large Worker's Compensation claims.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

As of June 30, 2012, the City had \$1.3 billion invested in various capital assets, net of accumulated depreciation and related debt, up 1.0% from the previous year. The capital assets of the City (net of depreciation, but not capital debt) are \$1.7 billion. This is a net decrease of \$5.0 million from June 30, 2011. Net assets of business-type activities decreased \$7.0 million while governmental activities increased \$2.0 million.

Major additions to capital assets during the fiscal year included the following:

- ✓ The City spent an additional \$1.3 million on major repair and rehabilitation of all sewer lines 15 inches and larger throughout the whole city. These trunk sewer lines collect the wastewater from multiple areas. Repair and rehabilitation of these sewer lines will correct deficiencies identified during the inspection process; thereby, ensuring continuous and reliable service.
- ✓ The community center was built in 1987 in Old Town Peoria. It is a multi-use recreation center utilized by the citizens for Peoria. The 2006 Parks Recreation and Open Space Master Plan identified the citizens' need for a larger multi-use recreation center as the number one facility requirement. An additional \$5.5 million was spent to renovate the existing facility, while constructing an additional 10,000 square feet. These facilities will serve the residents of south Peoria and include a game room, an exercise room and a classroom.

- ✓ Traffic projections indicate that Lake Pleasant Pkwy should be widened to four lanes between Westwing Pkwy (Dynamite Blvd) and Loop 303 to accommodate the increased traffic anticipated following connection of Loop 303 to Lake Pleasant Pkwy. Land was purchased for \$1.9 million to accommodate the additional lanes.
- ✓ Construction continued on the south half-street improvements of Beardsley Road between 99th Avenue and Lake Pleasant Road. The original half-street was field constructed by Maricopa County in the late 1980s to rural standards. Eventually the road was annexed into the City. The City spent \$3.1 million to construct curbs, gutter and sidewalks.
- ✓ Located at the southeast corner of 83rd and Olive Avenue, the City is constructed a second community park. The park will comprise approximately 80 acres of area to include six baseball/softball fields with associated concessions, restrooms, spectator areas and parking, four lighted soccer fields and support facilities, a five-acre lake, a skate park, a dog park, a splash park, picnic areas and gardens. The City spent an additional \$1.7 million in fiscal year 2012. This project is estimated to cost \$19.7 million.

The following table provides a breakdown of the capital assets of the City at June 30, 2012, and 2011. Additional information on the City's capital assets may be found in Note 12 on pages 72-73.

	Governmental Activities		Business-type Activities		Total Primary Government		Percent Change
	2012	2011	2012	2011	2012	2011	
	Buildings and building improvements	\$ 133.3	\$ 133.1	\$ 23.7	\$ 24.6	\$ 157.0	
Furniture	.6	.7	.1	.1	.7	.8	(12.5)
Equipment	12.3	14.8	2.8	2.1	15.1	16.9	(10.7)
Vehicles	7.1	7.6	3.7	4.2	10.8	11.8	(8.5)
Surface water system	60.6	47.2	-	-	60.6	47.2	28.4
Street system	370.2	340.9	-	-	370.2	340.9	8.6
Park system	48.4	19.2	-	-	48.4	19.2	152.1
Water system	-	-	241.2	230.2	241.2	230.2	4.8
Water rights	-	-	11.6	11.8	11.6	11.8	(1.7)
Wastewater system	-	-	281.2	285.4	281.2	285.4	(1.5)
Land	336.7	332.3	17.0	17.0	353.7	349.3	1.3
Work in progress	139.2	210.6	34.3	47.3	173.5	257.9	(32.7)
Total	\$ 1,108.4	\$ 1,106.4	\$ 615.6	\$ 622.7	\$ 1,724.0	\$ 1,729.1	(0.3)

The City has adopted a ten year capital improvement plan budgeted at \$463.0 million, including \$170.4 million in fiscal year 2013. Anticipated funding for this plan for fiscal year 2013 is through a combination of impact fees (13.6%), general obligation bonds (25.2%), municipal development authority bonds (17.6%), operating revenues (15.4%), City (10.7%) and County (15.7%) transportation sales taxes and other outside funding sources (1.8%). The estimated operating budget impact of the capital improvement program over the next five fiscal years is expected to be \$11.5 million. The capital improvement plan is updated annually as part of the City's budget process.

Long-term Debt

The City's outstanding non-current long-term debt, including bonds, loans, notes, leases, contracts, compensated absences, and deferred bond premiums, net of deferred loss on bond refunding, was \$460.5 million at June 30, 2012. Of this total, \$332.5 million was in governmental activities and \$128.0 million was in business-type activities. The City's outstanding non-current debt decreased \$16.3 million in fiscal year 2012. In fiscal year 2012, the City issued \$14.7 million in General Obligation Bonds to fund various parks, trails and municipal operations projects and \$13.7 million to refinance outstanding debt. The City also issued \$23.3 million in Water and Sewer Revenue Refunding Bonds to prepay several outstanding loans with the Water Infrastructure Finance Authority. See Note 15 on pages 79-80 for additional information on the refunding debt.

Of the total outstanding bonds of \$412.6 million, \$171.0 million is general obligation bonds backed by the full faith and credit of the City. An additional \$4.7 million is special assessment bonds where the City is

contingently liable in the event that the assessment revenues are insufficient to pay the debt payments. The outstanding debt also includes \$56.2 million in Community Facilities District bonds where the City has no obligation for payment. All other outstanding debt is secured by pledges of specific revenue sources of the City.

The State constitution imposes certain debt limitations on the City of six percent (6%) and twenty percent (20%) of the assessed valuation of the City. The City's available debt margin at June 30, 2012, is \$73.8 million in the 6% category and \$87.0 million in the 20% category. Additional information on the debt limitations and capacities may be found in Note 14 (page 74) and also in Table XXIII in the statistical section of this report (page 181).

The following schedule shows the outstanding debt of the City (both current and long-term) as of June 30, 2012, and 2011. Further detail on the City's outstanding debt may be found in Note 14 on pages 74-79.

Outstanding Debt
(in millions)

	Governmental Activities		Business-type Activities		Total Primary Government		Percent Change
	2012	2011	2012	2011	2012	2011	
General obligation debt	\$ 171.0	\$ 167.6	\$ -	\$ -	\$ 171.0	\$ 167.6	2.0%
Municipal Development Authority debt	52.5	58.4	-	0.4	52.5	58.8	(10.7)
Special assessment debt	4.7	6.2	-	-	4.7	6.2	(24.2)
Water/Sewer Revenue bonds	-	-	128.3	137.8	128.3	137.8	(6.9)
Community Facilities District bonds	56.2	58.6	-	-	56.2	58.6	(4.1)
Contracts payable	62.9	67.4	6.9	7.1	69.8	74.5	(6.3)
Compensated absences	7.0	6.1	0.8	0.6	7.8	6.7	16.4
Total	\$ 354.3	\$ 364.3	\$ 136.0	\$ 145.9	\$ 490.3	\$ 510.2	(3.9)

The City currently maintains the following ratings on its general obligation debt: "AA+" from Standard & Poor's, "Aa1" from Moody's and "AA+" from Fitch. For the water and sewer revenue bonds, the ratings are "AA" from Standard & Poor's, "Aa3" from Moody's and "AA" from Fitch.

ECONOMIC FACTORS

The unemployment rate in the metropolitan Phoenix region for June 2012 was 7.5%, which remains below both the state (8.2%) and national average (8.2%). The regional economy continues to recover at a slow pace with population growth in the 1% range and modest increases in construction activity. Overall employment growth was positive with a year-over-year increase of 2.4% for the state. Moderate growth in the education, healthcare, construction, retail, transportation and utilities, and leisure and hospitality services sectors helped create the job gains. Within Peoria, the local economy has experienced a slight increase in residential construction with activity continuing in the planned communities developed over the past few years. Commercial construction remains lower than historical levels.

The adopted fiscal year 2013 budget is \$473 million, an increase of 2.8% from the fiscal year 2012 budget as the City anticipates slight revenue increases due to a slowly recovering economy. The operating budget totals \$302.6 million, which is an increase of 0.2% from 2012. The capital projects portion of the budget, \$170.4 million (a 7.8% increase), is divided in the following manner: \$1.4 million for drainage projects, \$6.7 for operational facilities, \$64.6 million for parks, trails and open space, \$3.7 million for public safety projects, \$62.3 million for streets and traffic control projects, \$8.3 million for economic development projects, \$9.1 million for wastewater projects, and \$14.3 million for water projects.

The General Fund operating budget (not including contingency) is \$117.6 million, up 10.1% from the prior year budget. With the continued sluggish economy, the citizens' needs for City services were balanced with a slowly increasing revenue base. For the first time in four years, budget cuts were not needed, but the approach was to allow modest one-time budget needs while avoiding ongoing commitments. The budget continues to focus on preserving the City's excellent quality of life.

The fiscal year 2013 budget no longer required staff cuts, but adhering to the commitment to avoid ongoing commitments, only one new employee was added in the budget.

The City has maintained cash balances over the last few years, both for financial stability and in anticipation of the capital and ongoing operational needs of an ever-changing city. The City has established several stabilization reserves within the General Fund and Half-Cent Sales Tax Fund in accordance with the City's adopted financial policies – The Principles of Sound Financial Management. These reserves totaled \$33.2 million in the General Fund and \$5.4 million in the Half-Cent Sales Tax Fund at June 30, 2012. The City also maintains working capital policy reserve, rate stabilization, and debt stabilization reserves in the Utility Funds. At June 30, 2012, those reserves were \$11.9 million in the Water Utility, \$8.1 million in the Wastewater Utility, and \$2.1 million in the Solid Waste Utility. It should be noted that while these reserves are established to address immediate and dramatic fiscal difficulties, they are not intended to cover structural budget shortfalls. With this in mind, the fiscal year 2013 budget does not anticipate the use of reserves to address recurring expenses.

FINANCIAL CONTACT

This financial report is designed to provide a general overview of the City of Peoria, Arizona's finances and to demonstrate accountability for the use of public funds. Questions about any of the information provided in this report, or requests for additional financial information should be addressed to the City's Finance Director at the following address: City of Peoria, 8401 W. Monroe Street, Peoria, Arizona 85345.