
Management's Discussion and Analysis

The management of Shelby County Government (County) presents this narrative overview and analysis of the County's financial activities for the fiscal year ended June 30, 2017. We encourage readers to consider the information presented here in conjunction with information in the transmittal letter found at the front of this report and the basic financial statements, which follow in this section.

Accounting principles generally accepted in the United States of America for governmental entities are established by the Governmental Accounting Standards Board (GASB). This annual financial report uses the standards established by the GASB's Statement No. 34 *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. Shelby County follows all GASB standards in addition to Statement No. 34 as well as other authoritative literature known collectively within the accounting profession as "generally accepted accounting principles."

Financial Highlights

- At June 30, 2017 the unassigned fund balance for the General Fund was \$109.8 million, 28.4% of total General Fund revenue, an increase of \$4.0 million during the year. The unassigned fund balance at the end of the previous year was \$105.8 million, or 27.3% of General Fund revenue. Although the unassigned fund balance increased, the committed fund balance decreased by \$4.8 million; this decrease was primarily due to a reduction in the amount of budgeted planned use of fund balance for FY 2018. While the FY 2017 budget called for use of \$7.8 million of the fund balance, the FY 2018 budget only plans a reduction of \$3.3 million. The General Fund in total had a positive net change in fund balance of \$9,827 for FY 2017.
- Fund balance for the Debt Service Fund decreased \$2.5 million to \$60.7 million, which is 39.8% of total revenue of the Debt Service Fund. The balance is consistent with our debt plan to provide for future debt service requirements.
- Grant fund expenditures decreased from \$82.0 million to \$76.8 million, and revenues correspondingly decreased from \$78.9 million to \$75.3 million primarily due to decreases in housing and infrastructure related grant funding. Fund balance increased slightly from \$16.1 million to \$16.3 million.
- The change in net position for Business-type activities – enterprise funds was a decrease of \$8.6 million during the year, reducing the net position to a negative \$11.0 million.
- Total government-wide net position increased \$86.8 million as a result of activity for the fiscal year, with an increase of \$94.6 million from governmental activities and a decrease of \$7.8 million from business-type activities. After the positive results for the year the County's negative net position at June 30, 2017 was \$464.5 million.
- Total long-term liabilities of governmental activities increased \$108.7 million to \$1,596.1 million. The increase was primarily due to an increase of \$172.1 in the net unfunded pension obligation offset by a net decrease of \$65.0 million in bonds and notes payable. The County is continuing efforts to pay off more long-term debt than new debt issued each year.

More details on these highlights and other information are in the remainder of this discussion and analysis.

Overview of the Financial Report

The Comprehensive Annual Financial Report includes three major sections – Introductory Section, Financial Section, and Statistical Section. The Introductory Section includes a transmittal letter and general information about the County. The Statistical Section includes financial and non-financial data, some from sources other than financial records and often covering up to ten years. The Financial Section is the major part of the financial report. The Independent Auditor's Report applies only to the Financial Section. This discussion and analysis applies only to the Financial Section.

The Financial Section includes the following statements and schedules:

- Basic Financial Statements
 - Government-wide financial statements
 - Fund financial statements
 - Notes to financial statements
- Required Supplementary Information
- Combining and Other Statements and Schedules
- Other Budgetary Comparison Schedules

BASIC FINANCIAL STATEMENTS

Differences between government-wide and fund financial statements. The government-wide financial statements are much more aggregated and summarized than the fund financial statements. The government-wide Statement of Net Position includes capital assets and long-term debt, whereas the fund Balance Sheet includes neither. The government-wide Statement of Activities does not report the issuance or repayment of long-term debt during the year and reports depreciation expense but not amounts expended for capital assets during the year. The fund Statement of Revenues, Expenditures and Changes in Fund Balances includes as other financing sources the amount of long-term debt incurred during the year and as expenditures the amount of principal repaid. This statement also includes amounts expended for capital assets but not depreciation. These are some of the most common, significant differences but there are others. Following the fund Balance Sheet and the Fund Statement of Revenues, Expenditures and Changes in Fund Balances is a reconciliation of those statements to the government-wide Statement of Net Position and the Statement of Activities.

Government-wide financial statements. The *government-wide financial statements* are designed to provide a broad overview of Shelby County's finances in a manner similar to a private-sector business. The two government-wide financial statements present highly summarized information for all of County government.

The *Statement of Net Position* presents information on all of Shelby County's assets plus deferred outflows of resources and liabilities plus deferred inflows of resources, with the difference between the two reported as *net position*. Over time, increases or decreases in net position may serve as a useful indicator of changes in the financial position of Shelby County. The County has in prior years issued substantial amounts of debt for capital assets of others, such as the Shelby County Schools.

This debt is a liability of the County but the buildings constructed with the funds are not assets of the County; thus the County has a deficit net position. In some years the County may issue enough similar debt that an annual decrease in net position occurs.

The *Statement of Activities* presents information showing how the government's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying economic event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of Shelby County that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of Shelby County include general government, hospital, planning & development, public works, corrections, health services, community services, law enforcement, judicial, other elected officials, education and interest on debt. The business-type activities of Shelby County consist of codes enforcement, fire services and corrections center.

The government-wide financial statements include not only Shelby County itself - known as the *primary government* - but also four legally separate entities for which Shelby County is financially accountable. These entities are the Shelby County Board of Education, Shelby County Health Care Corporation (Regional One), Agricenter International, and the Emergency Communications District (9-1-1). Financial information for these *component units* is reported separately from the financial information presented for the primary government itself. This discussion and analysis is devoted to Shelby County Government rather than the component units.

Fund financial statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Shelby County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of Shelby County can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds. *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements 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 evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is 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. Both the governmental fund Balance Sheet and the governmental fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

Shelby County maintains fourteen individual governmental funds. Information is presented separately in the governmental fund Balance Sheet and in the governmental fund Statement of Revenues, Expenditures and Changes in Fund Balances for the General Fund, Debt Service Fund, Capital Projects Fund, Education Fund, and Grants Fund, all of which are considered to be major funds. Data from the other nine governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the nonmajor governmental funds *combining statements* elsewhere in this report.

Proprietary funds. Shelby County maintains two types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. Shelby County uses enterprise funds to account for Consolidated Codes Enforcement, Fire Services and Correction Center. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among Shelby County's various functions. Shelby County uses internal service funds to account for its Central Services, Group Health, Tort Liability and Employer Insurance funds. Because these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements. The Corrections Center is reported as a major enterprise fund and all internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the nonmajor enterprise funds and internal service funds are provided in the form of *combining statements* elsewhere in this report.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial statements because the resources of those funds are *not* available to support Shelby County's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. The Fiduciary Funds statements report the Agency Fund and the combined Shelby County Retirement System and the Shelby County OPEB Trust, which are reported separately in a *combining statement* elsewhere in this report.

Component units combining statement. Component units are not "funds" of Shelby County as the primary government. However, the government-wide financial statements include one column for all component units as discussed above. In order to provide details on each component unit, a *Combining Statement of Net Position* and a *Combining Statement of Activities* are included in the fund financial statements section of the basic financial statements. Complete, separately issued financial statements for each component unit may be obtained from those component units as described in Note I(A) in the Notes to the Financial Statements.

Budgetary Comparison Statements. Within this section are budgetary comparison statements for the general fund and other “major” special revenue funds (the Education Fund and the Grants Fund) to demonstrate compliance with their budget. Other budgetary comparison schedules not fitting the criteria defined for this section are presented under “Combining and Other Statements and Schedules” and “Other Budgetary Comparison Schedules.”

Notes to Financial Statements. The Notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. “Notes” is the traditional term applied to this information; however the term is misleading in that the Notes can vary in length from one paragraph to several pages.

REQUIRED SUPPLEMENTARY INFORMATION

This section contains other information that financial reporting standards specify should be included under this caption. Supplementary information is presented for the Shelby County Retirement System and the Shelby County OPEB Trust.

COMBINING AND OTHER STATEMENTS AND SCHEDULES

Combining fund statements for the non-major enterprise funds, non-major special revenue funds, and internal service funds are included in this section of the report. Supplemental schedules include budgetary comparisons, detail of county charter officers’ activities and schedules of debt by debt issue.

Government-wide Financial Analysis (Reporting the County as a Whole)

FINANCIAL POSITION

Table 1 shows a condensed version of the Statement of Net Position (see the government-wide financial statements for the full version as of June 30, 2017). This statement shows the financial position of the County as a whole at specific points in time – in this case as of June 30, 2017 and as of June 30, 2016.

Property taxes receivable is by far the largest portion of Shelby County’s assets and deferred outflows (38.4% at June 30, 2017 and 42.1% at June 30, 2016). The June 30, 2017 property taxes receivable includes \$781.7 million, offset by an equal unavailable revenue amount in deferred inflows of resources, which became a property lien on January 1, 2017 but are levied for next fiscal year’s operations. The similar amount at June 30, 2016 was \$766.7 million. Total assets and deferred outflows of resources increased by \$221.6 million. This includes increases in deferred outflows of \$140.8 million, \$50.9 million in capital assets, and \$14.1 million in property taxes receivable.

Deferred inflows increased by \$3.6 million during the year and other liabilities decreased by \$8.0 million. Increases of \$139.3 million in long-term liabilities occurred during the year.

Table 1
Condensed Statement of Net Position
As of June 30, 2017 and June 30, 2016

	June 30, 2017	June 30, 2016*	Change
<u>Governmental Activities</u>			
Property taxes receivable	\$ 822,980,524	\$ 808,828,306	\$ 14,152,218
Current and other assets	372,788,863	354,857,963	17,930,900
Capital assets	603,894,356	553,737,921	50,156,435
Total assets	1,799,663,743	1,717,424,190	82,239,553
Deferred outflows of resources	250,713,368	133,925,232	116,788,136
Total deferred outflows of resources	250,713,368	133,925,232	116,788,136
Total assets and deferred outflows	2,050,377,111	1,851,349,422	199,027,689
Long-term liabilities	1,596,108,397	1,487,379,582	108,728,815
Other liabilities	84,541,844	92,149,278	(7,607,434)
Total liabilities	1,680,650,241	1,579,528,860	101,121,381
Deferred inflows of resources	822,268,797	818,995,257	3,273,540
Total deferred inflows of resources	822,268,797	818,995,257	3,273,540
Total liabilities and deferred inflows	2,502,919,038	2,398,524,117	104,394,921
Net investment in capital assets	441,217,120	412,812,239	28,404,881
Restricted	43,196,013	40,532,614	2,663,399
Unrestricted	(936,955,060)	(1,000,519,548)	63,564,488
Total net position	(452,541,927)	(547,174,695)	94,632,768
<u>Business-Type Activities</u>			
Current and other assets	24,955,690	27,017,834	(2,062,144)
Capital assets	25,585,305	24,878,501	706,804
Total assets	50,540,995	51,896,335	(1,355,340)
Deferred outflows of resources	40,874,035	16,905,546	23,968,489
Total deferred inflows of resources	40,874,035	16,905,546	23,968,489
Total assets and deferred outflows	91,415,030	68,801,881	22,613,149
Long-term liabilities	99,960,828	69,344,996	30,615,832
Other liabilities	2,203,619	2,677,047	(473,428)
Total liabilities	102,164,447	72,022,043	30,142,404
Deferred inflows of resources	1,191,900	889,643	302,257
Total deferred inflows of resources	1,191,900	889,643	302,257
Total liabilities and deferred inflows	103,356,347	72,911,686	30,444,661
Net investment in capital assets	23,335,305	24,878,501	(1,543,196)
Unrestricted	(35,276,622)	(28,988,306)	(6,288,316)
Total net position	(11,941,317)	(4,109,805)	(7,831,512)

Table 1 (continued)
Condensed Statement of Net Position
As of June 30, 2017 and June 30, 2016

	June 30, 2017	June 30, 2016*	Change
<u>Total Primary Government</u>			
Property taxes receivable	822,980,524	808,828,306	14,152,218
Current and other assets	397,744,553	381,875,797	15,868,756
Capital assets	629,479,661	578,616,422	50,863,239
Total assets	1,850,204,738	1,769,320,525	80,884,213
Deferred outflows of resources	291,587,403	150,830,778	140,756,625
Total deferred outflows of resources	291,587,403	150,830,778	140,756,625
Total assets and deferred outflows	2,141,792,141	1,920,151,303	221,640,838
Long-term liabilities	1,696,069,225	1,556,724,578	139,344,647
Other liabilities	86,745,463	94,826,325	(8,080,862)
Total liabilities	1,782,814,688	1,651,550,903	131,263,785
Deferred inflows of resources	823,460,697	819,884,900	3,575,797
Total deferred inflows of resources	823,460,697	819,884,900	3,575,797
Total liabilities and deferred inflows	2,606,275,385	2,471,435,803	134,839,582
Net investment in capital assets	464,552,425	437,690,740	26,861,685
Restricted	43,196,013	40,532,614	2,663,399
Unrestricted	(972,231,682)	(1,029,507,854)	57,276,172
Total net position	\$ (464,483,244)	\$ (551,284,500)	\$ 86,801,256

*FY 2016 for business-type activities has been restated for a prior period adjustment as disclosed in the Notes to the Financial Statements

“Net Position” is the difference between assets plus deferred outflows and liabilities plus deferred inflows and, in a general sense, may be considered the recorded financial “net worth” of the County. The most obvious concern that can be noted about net position is the large negative net position amount. The major factor causing this negative net position amount relates to debt issued for capital assets (buildings, roads, etc.) where the capital asset values are *not* recorded in the County’s financial records but the debt *is* in the County’s records. Some of this debt has been issued to provide capital assets to component units of the County, including the Shelby County Board of Education and the Shelby County Health Care Corporation (Regional One). These component units report the capital assets but not the debt. Other debt is issued for entities not a part of the County reporting entity, including the municipal school districts within Shelby County. As a result of reporting the debt liabilities without reporting the assets acquired with the proceeds of the debt, a negative net position amount is reported in the County’s Statement of Net Position. If the related capital assets were reported by the County or the debt were reported by the benefiting entities, the County would have a significant, positive net position. The net unfunded pension obligation also adds to the negative net position reported by Shelby County.

The following long-term debt and notes payable are reported by the County for which related capital assets are not recorded by Shelby County:

	June 30,2017	June 30,2016
Shelby County and Municipal Public School Systems	\$ 817,008,700	\$ 824,234,883
Shelby County Health Care Corp. (Regional One)	25,108,448	31,118,413
Memphis and Shelby County Port Commission	17,407,500	17,980,000
Other	20,663,497	26,454,898
Total	<u>\$ 880,188,145</u>	<u>\$ 899,788,194</u>

Shelby County, the component units, and other entities use these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although Shelby County’s investment in its capital assets is reported net of related debt, the resources needed to repay this debt must be provided from other sources since the capital assets themselves cannot be used to liquidate these liabilities.

The County’s total net position for governmental activities improved by \$94.6 million for the year. The significant reasons for these changes can be generally understood from information in the sections below about “Changes in Net Position” and the “Financial Analysis of the Government’s Funds.” It will be noted that the net positive changes in deferred outflows and deferred inflows of resources were the significant factor in the current fiscal year. Changes in net position are discussed below.

CHANGES IN NET POSITION – REVENUES, EXPENSES AND TRANSFERS

For governmental activities, program revenues are those generated by the department or program as a result of the activities engaged in by the department or program. General revenues are those revenues not generated through activities of the County. Property taxes are the primary source of general revenue. Program revenues increased by 16.7% or \$33.6 million, due to a 197.1% increase or \$32.7 million in capital grants and contributions, and an increase of 1.4% or \$0.9 million in grant funding. The increase in capital grants is primarily due to lake expansion, site improvements, constructed buildings and other assets at Shelby Farms Park that were contributed by Shelby Farms Park Conservancy, the management organization overseeing operations of the park. Total general revenues increased 1.3% or \$11.6 million. Property taxes increased \$8.3 million (1.1%) and other taxes increased \$3.4 million (3.6%).

Total expenses for the year in governmental activities increased \$48.6 million (5.0%). Significant increases occurred in General Government (\$9.4 million, 19.0%), Education (\$14.0 million, 3.3%), and Law Enforcement (\$24.9 million or 15.0%). Debt expenses decreased \$15.6 million (or 24.7%). The increase in Education expenditures is a result of increased capital funding provided to schools through the Capital Projects fund. The increase in Law Enforcement is primarily driven by an increase in the pension costs and liability while the increase in General Government is made up of a combination of the increase in pension cost and additional payments from the Capital Project Fund for joint City-County economic development projects. The reduction in Debt expenses is the result of prior year refinancing efforts to reduce the interest incurred on outstanding debt.

Table 2 summarizes the financial activity for the County as a whole for the fiscal year ended June 30, 2017, with comparative amounts for the fiscal year ended June 30, 2016.

Table 2
Shelby County Changes in Net Position
Fiscal Years Ended June 30, 2017 and 2016

	FY 2017	FY 2016	Change
Governmental activities:			
<u>Revenues:</u>			
Program revenues:			
Charges for services	\$ 120,409,721	\$ 120,427,794	\$ (18,073)
Operating grants and contributions	65,387,691	64,477,734	909,957
Capital grants and contributions	49,320,234	16,598,389	32,721,845
Total program revenues	<u>235,117,646</u>	<u>201,503,917</u>	<u>33,613,729</u>
General revenues:			
Property taxes	793,849,791	785,510,158	8,339,633
Other taxes	99,933,038	96,502,351	3,430,687
Other	2,796,271	2,987,126	(190,855)
Total general revenues	<u>896,579,100</u>	<u>884,999,635</u>	<u>11,579,465</u>
Total revenues-governmental activities	<u>1,131,696,746</u>	<u>1,086,503,552</u>	<u>45,193,194</u>
<u>Expenses:</u>			
General Government	58,915,452	49,498,317	9,417,135
Hospital	28,408,000	27,408,000	1,000,000
Planning and Development	6,584,020	8,161,874	(1,577,854)
Public Works	40,891,577	42,627,074	(1,735,497)
Corrections	1,009,258	861,727	147,531
Health Services	58,867,774	54,693,350	4,174,424
Community Services	39,447,369	36,559,794	2,887,575
Law Enforcement	191,292,866	166,408,318	24,884,548
Judicial	77,119,835	69,577,458	7,542,377
Other Elected Officials	34,686,605	31,238,977	3,447,628
Education	442,353,584	428,358,249	13,995,335
Debt interest and swap termination cost	47,567,862	63,166,615	(15,598,753)
Total expenses-governmental activities	<u>1,027,144,202</u>	<u>978,559,753</u>	<u>48,584,449</u>
Increase (decrease) in net position before transfers	104,552,544	107,943,799	(3,391,255)
Transfers	(9,919,776)	(15,090,727)	5,170,951
Increase (decrease) in net position	94,632,768	92,853,072	1,779,696
Net position - beginning of year	(547,174,695)	(640,027,767)	92,853,072
Net position - end of year	<u>(452,541,927)</u>	<u>(547,174,695)</u>	<u>94,632,768</u>

Table 2 (continued)
Shelby County Changes in Net Position
Fiscal Years Ended June 30, 2017 and 2016

	FY 2017	FY 2016*	Change
Business-type activities:			
<u>Revenues:</u>			
Operating revenues:			
Charges for services	\$ 70,967,027	\$ 68,356,064	\$ 2,610,963
Operating grants and contributions	1,503,345	1,503,168	177
Capital grants and contributions	---	287,387	(287,387)
Total operating revenues	<u>72,470,372</u>	<u>70,146,619</u>	<u>2,323,753</u>
Non-operating revenues	160,759	37,248	123,511
Total revenues	<u>72,631,131</u>	<u>70,183,867</u>	<u>2,447,264</u>
<u>Expenses:</u>			
Operating expenses	90,382,419	85,469,269	4,913,150
Total expenses	<u>90,382,419</u>	<u>85,469,269</u>	<u>4,913,150</u>
Increase (decrease) in net position before transfers	(17,751,288)	(15,285,402)	(2,465,886)
Transfers	9,919,776	15,090,727	(5,170,951)
Increase (decrease) in net position	(7,831,512)	(194,675)	(7,636,837)
Net position - beginning of year	(4,109,805)	(3,915,130)	(194,675)
Net position - end of year	<u>(11,941,317)</u>	<u>(4,109,805)</u>	<u>(7,831,512)</u>
Total primary government:			
Increase (decrease) in net position	86,801,256	92,658,397	(7,636,837)
Net position - beginning of year	(551,284,500)	(643,942,897)	(194,675)
Net position - end of year	<u>\$ (464,483,244)</u>	<u>\$ (551,284,500)</u>	<u>\$ (7,831,512)</u>

*FY 2016 for business-type activities has been restated for a prior period adjustment as disclosed in the Notes to the Financial Statements

In business-type activities, operating revenues increased slightly by only \$2.3 million or 3.3%. Operating expenses increased by \$4.9 million (5.7%) with the increase coming primarily from the Fire Services Fund. Fire Services expenses increased \$4.5 million (25.0%). This is a result of the termination of the contracted ambulance service in December 2016. The Fire Services Fund acquired additional ambulance vehicles and increased personnel to begin providing the ambulance services in-house for the remainder of the fiscal year and going forward.

CHANGE IN FINANCIAL POSITION DURING YEAR

The overall change in the financial position of Shelby County during the current fiscal year was an increase in net position of \$86.8 million. The County's governmental activities operated with an increase in net position of \$94.6 million. The business-type activities had a net decrease of \$7.8 million. This resulted in the County's overall net position changing from a deficit balance of \$551.3 million to a deficit balance of \$464.4 million.

Financial Analysis of the Government's Funds

As noted earlier, Shelby County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of Shelby County’s *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable resources*. Such information is useful in assessing Shelby County’s financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Governmental accounting standards prescribe fund balance categories in a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed on the use of the resources reported in governmental funds. The categories, in order of the constraints, are nonspendable, restricted, committed, assigned and unassigned. More details on these classifications are presented in the Notes to Financial Statements I(E) under “Net Position and Fund Balance.”

As of the end of the current fiscal year, Shelby County’s governmental funds reported a combined ending fund balance of \$255,205,597. The components of the balances are:

	June 30, 2017	June 30, 2016
General Fund	\$ 115,606,342	\$ 115,596,515
Debt Service Fund	60,731,484	63,212,957
Special Revenue Funds	44,827,708	40,228,212
Total, except Capital Projects Fund	221,165,534	219,037,684
Capital Projects Fund	34,040,063	22,188,880
Total all governmental funds	<u>\$ 255,205,597</u>	<u>\$ 241,226,564</u>

There was a \$2.1 million net increase in fund balance, excluding capital projects. There was an increase of \$9,827 in the General Fund and \$4.6 million in special revenue funds. There was a decrease of \$2.5 million in the Debt Service Fund. There was also an increase of \$11.9 million in the Capital Projects Fund. Each of these changes is discussed below.

The *General Fund* is the chief operating fund of Shelby County and operated with a net increase in fund balance of only \$9,827, compared to an increase of \$6.85 million in the previous year. The General Fund revenue in total remained constant with a decrease of only \$29,247 from the prior year. Property taxes increased \$2.5 million (1.0%). Other local taxes remained constant, State revenue increased slightly by \$0.7 million (3.2%) and federal and local revenue were \$1.2 million lower (13.8%). Charges for services, fines, fees, and other revenues decreased in the aggregate \$2.2 million (3.1%). Total revenues in FY 2017 exceed expenditures by \$14.1 million compared to revenues over expenditures of \$24.1 million in FY 2016. General Fund expenditures increased \$9.96 million (2.7%) and net other financing uses decreased \$3.1 million. Significant increases were \$3.7 million (2.3%) in law enforcement, primarily for vehicle fleet replacement costs, \$1.5 million (7.1%) in public works, and \$1.3 million (5.2%) in health services, primarily for inmate medical care. Net transfers out

decreased by \$3.2 million. \$5.25 million in support from the General Fund to the Correction Center (a major enterprise fund) were not needed in the current year. Offsetting that reduction in transfers out was a \$2.5 million Commission approved transfer to the Education Fund for school operations in the current year. The General Fund unassigned fund balance increased \$4.0 million to \$109.8 million; this amount is available for spending at the government's discretion.

As a measure of the General Fund's liquidity, it may be useful to compare the unassigned fund balance to total fund revenue. Unassigned fund balance represents 28.4% of total General Fund revenue. Management is committed to maintaining an unassigned fund balance in the General Fund between 25% and 30% of General Fund revenue. The increase in unassigned fund balance results from a reduction in the budgeted planned use of fund balance from \$7.8 million in the FY 2017 budget to only \$3.3 million in the FY18 budget.

The *Debt Service Fund* total fund balance decreased \$2.5 million during the year to \$60.7 million, all restricted or committed for the payment of debt service. Tax revenue decreased \$20.4 million during the year as the result of eliminating the allocation of wheel taxes designated for payment of debt and allocating those revenues to the Education Fund. Bond anticipation notes totaling \$100 million issued over the past two years were refinanced in the Debt Service Fund by a new general obligation bond issue. Debt Service expenditures decreased by \$32.2 million primarily due to a refunding bond issue from prior year reducing the current year's principal and interest payments due.

The fund balance of the *Capital Projects Fund* fluctuates significantly as funds are borrowed or transferred in for capital project purposes and are then expended for the projects. This fund balance increased \$11.8 million during the year, from \$22.2 million to \$34.0 million. Expenditures for various capital projects were \$47.7 million and net transfers in of \$6.7 million were received. Short term debt of \$50 million was issued during the year; see Note IV(H) to the financial statements. All fund balances of the Capital Projects Fund are restricted or committed.

The *Education Fund* is used to provide local funding to the Shelby County Board of Education and six municipal school districts. A portion of the County property tax is specifically assessed for the schools. To the extent the property tax revenues are less than the expenditure amount appropriated, wheel tax revenues are allocated to the Education Fund to provide the total funding appropriated. There is usually no net change in fund balance and no fund balance in the Education Fund; the fund balance at June 30, 2017 was zero. Total appropriated expenditures, and corresponding revenues, increased in the Education Fund by \$23.2 million (5.9%). As noted above this increase in expenditures was funded by increasing the allocation of wheel tax and a \$2.5 million transfer in from General Fund.

The *Grants Fund* fund balance increased slightly from \$16.1 at June 30, 2016 to \$16.3 million at June 30, 2017. Total revenue decreased \$3.6 million to \$75.3 million. Total expenditures also decreased \$5.2 million during the year. Net transfers in decreased by \$1.2 million during the year.

All the *Nonmajor Governmental Funds* are special revenue funds. All these special revenue fund balances are used for the specific purposes designated by the provider of the funds or the legislation establishing the fees and charges that generate the revenue. These funds in total had a net increase of

\$4.4 million in fund balances during the year. Significant changes in individual fund balances were increases of \$1,969,787 in the Roads and Bridges Fund, primarily as a result of reallocating sales tax revenue from the Debt Service fund to reduce the cycle for repaving of unincorporated County roads. The increase of \$1,510,352 in the Hotel Motel Tax Fund, and \$1,461,398 in the Sheriff Forfeitures Fund are due to timing of receipt of revenues and required expenditures of the funds.

Proprietary funds. Shelby County's proprietary funds report financial information on the same basis as the government-wide financial statements (full accrual accounting based on the economic substance of transactions), but in more detail. Proprietary funds consist of two types of funds: business-type activities - enterprise funds and governmental activities - internal service funds.

The County has three business-type activities; these are essentially self-supporting activities. In total these funds had an decrease of \$8.6 million in net position during the year. Total net position balances at year-end are a deficit of \$11.0 million, of which a negative \$34.3 million is unrestricted and a positive \$23.3 is net investment in capital assets. The negative unrestricted balances are the result of recent financial reporting standards that requires proprietary funds to record unfunded net pension liabilities.

Corrections Center Fund. The Corrections Center receives reimbursement from the State of Tennessee for housing State prisoners, which accounts for approximately 85% of the prison population. The General Fund provides the remaining cost, excluding depreciation. The prior year's estimated receivable from the State was overstated, thus inflating the revenues and ending total net position. Therefore beginning net position was restated accordingly as disclosed in Notes IV(Q) of the Notes to the Financial Statements. Taking into consideration the restatement, operating revenues remained consistent with prior year; within 2%. Operating expenses also remained constant with prior year. Net transfers to cover the cost of non-State prisoners were \$8.6 million, a \$14.1 million decrease from prior year. Thus overall net position decreased \$8.8 million to a negative \$6.5 million.

Consolidated Codes Enforcement Fund. Operating revenue increased \$0.75 million to \$9.0 million and operating expenses increased \$1.4 million to \$11.1 million. The County's general fund and the City of Memphis contributed \$1.5 million each to support operations, consistent with the previous year. The change in net position was a positive \$760,704. The negative net position at June 30, 2017 of \$1.3 million consists of a positive \$1.6 million investment in capital assets and a negative unrestricted balance of \$2.9 million.

Fire Services Fund. This fund operates primarily on user fees collected from residents and businesses in the unincorporated areas of the County served by the department. In the current year revenue from fees was \$20.2 million, an increase of \$1.4 million and other operating revenue was \$2.2 million, an increase of \$1.3 million. Operating expenses increased \$4.8 million from \$18.2 million to \$23.0 million. Net operating loss was \$596,326. The increase in revenues and expenses is due to the termination of the outside contracted ambulance service as mentioned above. The Fire Services Fund acquired several ambulance vehicles and increased personnel and training to man these vehicles so as to provide the needed services to the unincorporated County. The change in net position for the year

was a negative \$575,529. Total net position changed from a negative \$2.6 million at June 30, 2016 to a negative \$3.2 million at June 30, 2017.

The County has four internal service funds. These funds are reported using full accrual accounting. For the government-wide financial statements, these funds are combined with governmental activities. Internal service funds provide goods or services to other funds or departments on a cost-reimbursement basis. At June 30, 2017, these funds combined had net position of \$31.7 million, an increase of \$6.8 million. The Group Health Insurance Fund had an increase of \$6.3 million to a total net position of \$13.1 million. While revenues remained constant there was a significant decline in the amount of health claims in the current year. The Employer Insurance Fund had an increase of \$752,578 to a net position of \$7.3 million. The Tort Liability Fund had a decrease of \$1.1 million to a net position of \$4.1 million. The Central Services Fund had a net increase of \$819,278 to a net position of \$7.2 million.

Fiduciary funds. Shelby County reports three fiduciary funds. The largest is the Shelby County Retirement System. The funds in this trust are available only for retirement benefits of current and retired County employees. The actuarial value of accumulated funds in the Retirement System at June 30, 2017 was 63.8% of the currently calculated actuarial accrued liability. The County provides funding as required each year for the increased liability for benefits being earned by current employees. At June 30, 2017 the Retirement System had net position held in trust of \$1,140 million, an increase of \$88.2 million, primarily due to increased market value of investments.

The Shelby County OPEB Trust was created as of July 1, 2007 to accumulate funds and pay other post-employment benefits to terminated County employees. At June 30, 2017 the Trust had net position held in trust of \$232.1 million, an increase of \$33.4 million for the year. Investment income for the year was a net gain of \$26.6 million compared to net loss of \$7.9 million in the prior year. The ratio of current funding to the actuarial liability was 83.3% at the latest actuarial valuation (June 30, 2017), an improvement from 65.6% the prior year.

The County also maintains agency funds for a number of the County's county charter officers. These funds do not belong to the County, but are funds held for others. There are no "fund balances" for agency funds.

Governmental Fund Budgetary Highlights

Differences between the original budget and the final amended budget and between the final budget and actual results for the General Fund can be briefly summarized as follows:

- The total revenue budget increased by only \$.5 (.1%) million from original to amended.
- The original budget for expenditures was increased by about \$1 million (.3%) in total during the year, including amounts carried forward from prior year for open encumbrances. Budget amendments were also approved by the County Commission with the use of General Fund balance for various staffing needs identified during the year. These recurring costs were included in the FY18 Budget.

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- Actual revenues exceeded the amended budget by \$.6 million in total (.2%), largely due to State reimbursements to the Sheriff for the jail population. Current property taxes were slightly below budget by \$1.2 million (.5%). Delinquent taxes have declined as the current tax collection rate increased over the past several years.
 - Actual total expenditures were \$8.2 million (2.2%) less than the amended budget, attributed almost entirely to personnel savings resulting from vacancies and attrition. Significant favorable variances were recorded for the Sheriff and several offices within the Judicial and Other Elected Official divisions. These actual savings exceeded the planned salary restriction budgeted for the General Fund.
 - Planned use of fund balance of \$9.4 million in the adopted budget was completely absorbed by the operating surplus for the year.

Capital Asset and Debt Administration

Capital Assets. Shelby County Government's investment in capital assets for its governmental and business type activities as of June 30, 2017 amounts to \$629.5 million (net of accumulated depreciation). This investment in capital assets includes land, artwork, buildings and system improvements, machinery and equipment, park facilities, roads and other infrastructure. Additions for the year were \$80.6 million and depreciation was \$29.3 million. Construction in progress as of the end of the current fiscal year was \$25.9 million. Additional information on Shelby County Government's capital assets can be found in Note IV (E) of the Notes to Financial Statements of this report.

Major capital asset events during the current fiscal year included the following:

- Expenditures of \$4.0 million were made for continued work on the Fite Road project.
- Expenditures of \$4.9 million were made for the Crosstown Development project a joint City-County economic development project.
- Expenditures of \$1.1 million were made for the relocation of Fleet Services facilities.
- Electronic court case management system projects totaling \$8.5 million were completed and placed in service during the fiscal year.
- Several road and bridge replacement projects including Houston Levee Road, Raleigh-Millington Bridge, and Sledge Road Bridge, all totaling \$20.2 million were completed and placed in service during the fiscal year.
- Building and park improvements of \$37.8 million were completed at Shelby Farms Park.
- Expenditures of \$26.1 million were made for the continued renovation projects of the Shelby County Schools. Appropriations of an additional \$23.4 million were approved for the local school systems based on the average daily attendance for specific projects of which \$5 million was expended in the fiscal year.
- Construction and design services continued on various projects around the County to improve transportation and environmental conditions under the Congestion Management and Air Quality (CMAQ) grant program. Expenditures on this project for the fiscal year were approximately \$7.3 million.

Long-term debt. At June 30, 2017 Shelby County’s general obligation bonded debt (bonds payable) totaled \$989.7 million, which represented approximately 5.5% of assessed value of taxable property. The County’s bonds, notes, and loans payable decreased by approximately \$15.6 million (1.6%) during the year. Debt, generally, may be issued without regard to any limit on indebtedness. The ad valorem tax levy is also without legal limit.

Annually the County adopts a five-year capital projects plan. Based on this plan for the current year and capital projects cash flow projections, a notes payable program may be established with a maximum borrowing amount. Borrowing occurs as needed for up to two years. After completion of each program, the notes payable are converted to bonds payable to be repaid within 25 years. In December 2014 the Shelby County Board of Commissioners authorized the issuance of Capital Outlay Extendible Municipal Commercial Paper (EMCP) Notes, 2015 Series A Program in an aggregate amount not to exceed \$120 million. The actual bond anticipation notes totaled \$100 million and were refinanced by June 30, 2017 by the General Obligation Public Improvement and School Bonds 2017 Series A issue. See Note IV (H) for more detailed information on this bond issue.

During FY 2013, as part of a capital lease agreement, the State of Tennessee issued Tax Exempt revenue bonds for the construction of a Regional Forensic Center. The County has agreed to provide the State the funds, as they become due, to make principal and interest payments over the next twenty (20) years on \$8 million of the bonds, which had a balance of \$5,397,468 at June 30, 2017. In September 2011 the County and the City of Memphis agreed to provide the funds necessary to pay the principal and interest on \$20 million each of bonds issued by the Memphis and Shelby County Port Commission for a specific economic development project. At June 30, 2017 the County’s principal obligation was \$17.4 million. The Port Commission debt is reported with bonds and other long-term debt as detailed in Note IV(H) of the financial report.

The County maintains ratings from Moody’s Investors Service (“Moody’s”), Standard & Poor’s Corporation (“Standard & Poor’s”) and Fitch IBCA, Inc. (“Fitch”) on its previously issued general obligation bonds not secured by letter of credit as follows:

<u>Moody’s</u>	<u>Standard & Poor’s</u>	<u>Fitch IBCA, Inc.</u>
Aa1	AA+	AA+

Moody’s issues ratings from Aaa to C to designate the relative investment qualities of bonds. The Aa rating is in the second highest of the rating categories. The modifier 1 indicates that the bonds are in the top range of the Aa category. Moody’s describes its Aa ratings as “Bonds which are rated Aa are judged to be a high quality by all standards. They are rated lower than the best bond because margins of protection may not be as large as in Aaa or fluctuation of protection elements may be of greater amplitude or there may be other elements present which make the long term risk appear somewhat larger than Aaa securities.”

Standard & Poor’s and Fitch issue ratings from AAA to D to designate the relative investment qualities of bonds. The AA rating is the second highest of the ten such ratings. Standard & Poor’s and Fitch describe their rating as “Debt rate AA+ has a very strong capacity to pay interest and repay principal

and differs from the highest rated issues only in small degree. Plus or minus signs are used to show relative standing within the major rating categories.”

Additional information on Shelby County Government's long-term debt can be found in Note IV(H) of the Notes to Financial Statements of this report.

Economic Factors and Next Year's Budgets and Rates

Economic Factors. According to the Tennessee Department of Labor, the unemployment rate for Shelby County as of October 31, 2017 was 3.7%, as compared to the state's rate of 3.0% and the national rate of 3.9%. (All rates are seasonally adjusted.)

Next Year's Budgets and Rates.

- A property reappraisal conducted in 2017 confirmed substantial increases in property values throughout the county. As a result, the certified property tax rate for FY18 was reduced from \$4.37 to \$4.137. The County Commission voted to further reduce the tax rate to \$4.11. The budget includes estimated growth of about 2.0% in property taxes over prior year collections.
- A higher share of the tax rate was allocated to the General Fund for increased services. The allocation to Education was reduced, although the Maintenance of Effort funding level of \$419.5 million was maintained due to overall property tax growth and allocation of all wheel tax revenue. A lower allocation to Debt Service reflects significant reductions to outstanding debt achieved over the past decade.
- Total general fund revenue is budgeted at \$24.5 million (6.3%) more than the prior year level, primarily due to the expected property tax growth as well as strong collections of fines and fees by elected officials and the courts.
- Total general fund expenditures for FY18 are budgeted at \$17.3 million (4.5%) more than the prior year. That amount includes a 3.0% general salary raise, 26 new positions, increased support for the Corrections, full funding for the actuarial pension rate increase, and \$3.3 million for non-recurring expenditures approved with the use of fund balance.
- General Fund reserves will remain within the level specified by County policy at about 28%. Debt Service reserves are currently higher than the required level at 37% of revenue.
- The Shelby County Schools continue to face significant budgetary challenges as the issues of OPEB liability, declining enrollment and aging capital infrastructure are addressed.

Requests for Information

This financial report is designed to provide a general overview of Shelby County's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Administrator, Department of Finance, Shelby County Government, 160 North Main Street, Suite 800, Memphis, Tennessee 38103.