

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, 2016. 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, 2016 the unassigned fund balance for the General Fund was \$105.8 million, 27.3% of total General Fund revenue, a decrease of \$2.0 million during the year. The unassigned fund balance at the end of the previous year was \$107.8 million, or 28.2% of General Fund revenue. Although the unassigned fund balance decreased slightly, the committed fund balance increased by \$9.1 million; this increase was primarily due to the FY 2017 budget including a planned use of fund balance of \$7.8 million. The General Fund in total had a positive net change in fund balance of \$6.9 million for FY 2016.
- Fund balance for the Debt Service Fund decreased \$28.2 million to \$63.2 million, which is 36.3% 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 revenues increased from \$73.8 million to \$78.9 million and expenditures increased from \$76.9 million to \$82.0 million, primarily due to small increases in grant funding. Fund balance decreased slightly from \$16.2 million to \$16.1 million.
- The change in net position for Business-type activities was an increase of \$4.2 million during the year, improving the net position to a positive \$0.3 million. This positive result included net transfers in of \$13.9 million to the Corrections Center
- Total government-wide net position increased \$97.1 million as a result of activity for the fiscal year, with an increase of \$92.9 million from governmental activities and an increase of \$4.2 million from business-type activities. After the positive results for the year the County's negative net position at June 30, 2016 was \$546.9 million.
- Total long-term liabilities of governmental activities increased \$10.5 million to \$1,487.4 million. The increase was due to the increase of \$112.2 in the net unfunded pension obligation and a decrease of \$101.7 due to the County's continuing effort 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.

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, 2016). This statement shows the financial position of the County as a whole at specific points in time – in this case as of June 30, 2016 and as of June 30, 2015.

Property taxes receivable is by far the largest portion of Shelby County's assets and deferred outflows (42.0% at June 30, 2016 and 43.6% at June 30, 2015). The June 30, 2016 property taxes receivable includes \$766.7 million, offset by an equal unavailable revenue amount in deferred inflows of resources, which became a property lien on January 1, 2016 but are levied for next fiscal year's operations. The similar amount at June 30, 2015 was \$763.6 million. Total assets and deferred outflows of resources increased by \$66.1 million. This includes increases in deferred outflows of \$68.7 million and \$12.5 million in capital assets. Decreases of \$13.7 million occurred in cash, investments and other assets and \$1.4 million in property taxes receivable.

Deferred inflows decreased by \$54.9 million during the year and other liabilities decreased by \$6.7 million. Increases of \$30.7 million in long-term liabilities occurred during the year.

Table 1
Condensed Statement of Net Position
As of June 30, 2016 and June 30, 2015

	June 30, 2016	June 30, 2015	Change
<u>Governmental Activities</u>			
Property taxes receivable	\$ 808,828,306	\$ 810,261,727	\$ (1,433,421)
Current and other assets	354,921,206	371,226,452	(16,305,246)
Capital assets	553,737,921	542,433,908	11,304,013
Deferred outflows of resources	133,925,232	76,707,887	57,217,345
Total assets and deferred outflows	1,851,412,665	1,800,629,974	50,782,691
Long-term liabilities	1,487,379,582	1,476,836,312	10,543,270
Other liabilities	92,149,278	99,307,714	(7,158,436)
Deferred inflows of resources	818,995,257	864,513,715	(45,518,458)
Total liabilities and deferred inflows	2,398,524,117	2,440,657,741	(42,133,624)
Net investment in capital assets	412,812,239	328,439,765	84,372,474
Restricted	40,532,614	42,020,008	(1,487,394)
Unrestricted	(1,000,519,548)	(1,010,487,540)	9,967,992
Total net position	(547,174,695)	(640,027,767)	92,853,072
<u>Business-Type Activities</u>			
Current and other assets	30,793,511	28,168,003	2,625,508
Capital assets	24,878,501	23,652,254	1,226,247
Deferred outflows of resources	16,905,546	5,406,725	11,498,821
Total assets and deferred outflows	72,577,558	57,226,982	15,350,576
Long-term liabilities	69,344,996	49,171,366	20,173,630
Other liabilities	2,083,782	1,663,863	419,919
Deferred inflows of resources	889,643	10,306,883	(9,417,240)
Total liabilities and deferred inflows	72,318,421	61,142,112	11,176,309
Net investment in capital assets	24,878,501	23,583,102	1,295,399
Unrestricted	(24,556,121)	(27,498,232)	2,942,111
Total net position	322,380	(3,915,130)	4,237,510
<u>Total Primary Government</u>			
Property taxes receivable	808,828,306	810,261,727	(1,433,421)
Current and other assets	385,714,717	399,394,455	(13,679,738)
Capital assets	578,616,422	566,086,162	12,530,260
Deferred outflows of resources	150,830,778	82,114,612	68,716,166
Total assets and deferred outflows	1,923,990,223	1,857,856,956	66,133,267
Long-term liabilities	1,556,724,578	1,526,007,678	30,716,900
Other liabilities	94,233,060	100,971,577	(6,738,517)
Deferred inflows of resources	819,884,900	874,820,598	(54,935,698)
Total liabilities and deferred inflows	2,470,842,538	2,501,799,853	(30,957,315)
Net investment in capital assets	437,690,740	352,022,867	85,667,873
Restricted	40,532,614	42,020,008	(1,487,394)
Unrestricted	(1,025,075,669)	(1,037,985,772)	12,910,103
Total net position	\$ (546,852,315)	\$ (643,942,897)	\$ 97,090,582

“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* on 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:

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Shelby County and Municipal Public School Systems	\$ 824,234,883	\$ 941,290,513
Shelby County Health Care Corp. (Regional One)	31,118,413	37,264,353
Memphis and Shelby County Port Commission	17,980,000	18,542,500
Other	<u>20,843,436</u>	<u>23,856,567</u>
Total	<u>\$ 894,176,732</u>	<u>\$ 1,020,953,933</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 \$92.9 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

Table 2 summarizes the financial activity for the County as a whole for the fiscal year ended June 30, 2016, with comparative amounts for the fiscal year ended June 30, 2015.

Table 2
Shelby County Change in Net Position
Fiscal Years Ended June 30, 2016 and 2015

	FY 2016	FY 2015	Change
Governmental activities:			
<u>Revenues:</u>			
Program revenues:			
Charges for services	\$ 120,427,794	\$ 117,498,955	\$ 2,928,839
Operating grants and contributions	64,477,734	62,656,592	1,821,142
Capital grants and contributions	16,598,389	10,340,712	6,257,677
Total program revenues	201,503,917	190,496,259	11,007,658
General revenues:			
Property taxes	785,510,158	790,149,240	(4,639,082)
Other taxes	96,502,351	93,386,259	3,116,092
Other	2,987,126	2,117,748	869,378
Total general revenues	884,999,635	885,653,247	(653,612)
Total revenues-governmental activities	1,086,503,552	1,076,149,506	10,354,046
<u>Expenses:</u>			
General government	49,498,317	43,713,313	5,785,004
Hospital	27,408,000	26,816,000	592,000
Planning and development	8,161,874	7,907,742	254,132
Public works	42,627,074	43,737,574	(1,110,500)
Corrections	861,727	1,058,422	(196,695)
Health services	54,693,350	50,765,349	3,928,001
Community services	36,559,794	40,742,530	(4,182,736)
Law enforcement	166,408,318	156,314,046	10,094,272
Judicial	69,577,458	69,221,549	355,909
Other elected officials	31,238,977	28,753,179	2,485,798
Education	428,358,249	385,396,412	42,961,837
Debt interest and swap termination cost	63,166,615	76,735,064	(13,568,449)
Total expenses-governmental activities	978,559,753	931,161,180	47,398,573
Increase (decrease) in net position before transfers	107,943,799	144,988,326	(37,044,527)
Transfers	(15,090,727)	(9,166,673)	(5,924,054)
Increase (decrease) in net position	92,853,072	135,821,653	(42,968,581)
Net position - beginning of year	(640,027,767)	(775,849,420)	135,821,653
Net position - end of year	\$ (547,174,695)	\$ (640,027,767)	\$ 92,853,072

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 5.8% or \$11.0 million, due to a 2.5% increase or \$2.9 million in charges for services, and an increase of 11.1% or \$8.1 million in grant funding, with the largest amount being for capital projects. The County considers grant and reimbursement revenues from other governments associated with the current fiscal year to be available if collected within one year of the end of the current fiscal year. Total general revenues decreased slightly by \$0.7 million. Property taxes decreased \$4.6 million (0.6%) and other taxes increased \$3.1 million (3.3%). Other revenue increased \$0.9 million (41.1%) but the total amount of \$3.0 million was still relatively small.

Total expenses for the year in governmental activities increased \$47.4 million (5.1%). Significant increases occurred in general government (\$5.8 million, 13.2%), education (\$43.0 million, 11.1%), health services (\$3.9 million or 7.7%) and law enforcement (\$10.1 million or 6.5%). Decreases occurred in community services (\$4.2 million or 10.3%) and public works (\$1.1 million or 2.5%). Debt expenses decreased \$13.6 million (or 17.7%).

Table 2 Continued

Business-type activities:	FY 2016	FY 2015	Change
<u>Revenues:</u>			
Operating revenues:			
Charges for services	\$ 72,194,984	\$ 81,119,037	\$ (8,924,053)
Operating grants and contributions	1,503,168	1,414,323	88,845
Capital grants and contributions	287,387	0	287,387
Total operating revenues	73,985,539	82,533,360	(8,547,821)
Non-operating revenues	37,248	39,976	(2,728)
Total revenues	74,022,787	82,573,336	(8,550,549)
<u>Expenses:</u>			
Operating expenses	84,876,004	83,994,080	881,924
Total expenses	84,876,004	83,994,080	881,924
Increase (decrease) in net position before transfers	(10,853,217)	(1,420,744)	(9,432,473)
Transfers	15,090,727	9,166,673	5,924,054
Increase (decrease) in net position	4,237,510	7,745,929	(3,508,419)
Net position - beginning of year	(3,915,130)	(11,661,059)	7,745,929
Net position - end of year	322,380	(3,915,130)	4,237,510
Total primary government:			
Increase (decrease) in net position	97,090,582	143,567,582	(46,477,000)
Net position - beginning of year	(643,942,897)	(787,510,479)	143,567,582
Net position - end of year	\$ (546,852,315)	\$ (643,942,897)	\$ 97,090,582

In business-type activities, operating revenues decreased by \$8.5 million or 10.4%. The Corrections Center operating revenue decreased \$9.3 million (or 17.3%), primarily the result of a significant decrease in the reimbursement rate from the State of Tennessee. Operating expenses of the Corrections decreased only slightly (\$0.5 million or 0.9%). Net transfers into the Corrections Center increased by \$5.8 million (71.7%) with the increase coming from the General Fund. Code Enforcement’s charges for services decreased only \$105,850 (1.3%) while both the City of Memphis and Shelby County increased support by \$100,156 each to a total of \$1.5 million each. Codes Enforcement expenses increased \$1.0 million (11.5%), with 50.8% of the increase related to increased fringe benefit rates. There was an increase of \$458,351 (2.4%) in Fire Services operating revenue. Fire operating expenses increased \$433,715 (2.4%)

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 \$97.1 million. The County’s governmental activities operated with an increase in net position of \$92.9 million. The business-type activities had a net increase of \$4.2 million. This resulted in the County’s overall net position changing from a deficit balance of \$643.9 million to a deficit balance of \$546.9 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 \$241,226,564. The components of the balances are:

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
General Fund	\$ 115,596,515	\$ 108,743,411
Debt Service Fund	63,212,957	91,413,446
Special Revenue Funds	<u>40,228,212</u>	<u>39,743,999</u>
Total, except Capital Projects Fund	219,037,684	239,900,856
Capital Projects Fund	<u>22,188,880</u>	<u>38,710,489</u>
Total all governmental funds	<u>\$ 241,226,564</u>	<u>\$ 278,611,345</u>

There was a \$20.9 million net decrease in fund balance, excluding capital projects. There was an increase of \$6.85 million in the General Fund and \$0.5 million in special revenue funds. There was a decrease of \$28.2 million in the Debt Service Fund. There was also a decrease of \$16.5 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 \$6.85 million, compared to an increase of \$5.35 million in the previous year. The General Fund Revenue in total increased \$5.6 million over the prior year. Property taxes decreased \$1.5 million (0.6%). Other local taxes were \$0.3 million higher (0.8%), State revenue was \$2.6 million (12.6%) higher and federal and local revenue were \$1.6 million higher (22.3%). Other revenues had smaller dollar increases and decreases. Total revenues in FY 2016 exceed expenditures by \$24.1 million compared to revenues over expenditures of \$22.2 million in FY 2015. General Fund expenditures increased \$3.7 million (1.0%) and net other financing sources/uses decreased \$0.4 million. Significant increases were \$4.7 million (3.0%) in law enforcement, \$1.3 million (6.9%) in public works and \$1.2 million (4.4%) in general government. A significant decrease was \$5.5 million (8.1%) in Judicial due to one-time costs in the previous year. Net transfers out increased by \$0.4 million. The General Fund unassigned fund balance decreased \$2.0 million to \$105.8 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 27.3% 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 decrease in unassigned fund balance results from a planned use of fund balance in the FY 2017 budget of \$7.8 million.

The *Debt Service Fund* total fund balance decreased \$28.2 million during the year to \$63.2 million, all restricted or committed for the payment of debt service. Tax revenue decreased \$14.2 million during the year as the result of a lower allocation of wheel taxes designated for payment of debt. Over \$40 million was used as part of a refunding bond issue. Debt Service expenditures increased by \$119.4 million primarily due to a refunding bond issue.

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 decreased \$16.5 million during the year, from \$38.7 million to \$22.2 million. Expenditures for various capital projects were \$56.9 million and net transfers in of \$6.2 million were received. Short term debt of \$30 million was issued during the year; see Note IV(H) to the financial statements. All fund balances of the Capital Projects Fund are restricted, committed or assigned.

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, 2015 was zero.

The *Grants Fund* fund balance decreased slightly from \$16.2 at June 30, 2015 to \$16.1 million at June 30, 2016. Total revenue increased \$5.1 million to \$78.9 million. Total expenditures also increased \$5.1 million during the year. Net transfers in increased by \$162,032 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 \$599,807 in fund balances during the year. Significant changes in individual fund balances were increases of \$1,031,901 in the Roads and Bridges Fund and \$318,881 in the Storm Water Fees Fund and a decrease of \$665,322 in the Hotel Motel Tax Fund.

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 increase of \$4.1 million in net position during the year. Total net position balances at year-end are \$2.1 million, of which a negative \$22.8 million is unrestricted and a positive \$24.9 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. Operating revenues decreased \$9.3 million to \$44.2 million, of which \$9.1 million was the decrease in revenue from the State. Operating expenses decreased \$0.5 million from \$57.5 million to \$57.0 million. Net transfers to cover the cost of non-State prisoners were \$13.9, a \$5.8 million increase. The overall net position increased \$1.1 million to a positive \$6.7 million.

Consolidated Codes Enforcement Fund. Operating revenue decreased \$0.1 million to \$8.3 million and operating expenses increased \$1.0 million to \$9.8 million. The County's general fund and the City of Memphis contributed \$1.5 million each to support operations, an increase of \$0.1 million each from the previous year. The change in net position was a positive \$1.3 million. The net negative position at June 30, 2016 of \$2.1 million consists of a positive \$1.6 million investment in capital assets and a negative unrestricted balance of \$3.7 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 \$18.8 million and other operating revenue was \$0.9 million, an increase of \$0.5 million. Net nonoperating revenue was \$44,277. Operating expenses increased \$0.4 million from \$17.8 million to \$18.2 million. The change in net position for the year was a positive \$1.8

million. Total net position changed from a negative \$4.4 at June 30, 2015 to a negative \$2.6 million at June 30, 2016.

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, 2016, these funds combined had net position of \$25.0 million, an increase of \$0.7 million. The Group Health Insurance Fund had an increase of \$1.6 million to a total net position of \$6.8 million. The Employer Insurance Fund had a decrease of \$0.25 million to a net position of \$6.6 million. The Tort Liability Fund had a decrease of \$0.6 million to a net position of \$5.2 million. The Central Services Fund had a net decrease of \$18,449 to a net position of \$6.4 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, 2016 was 73.2% 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, 2016 the Retirement System had net position held in trust of \$1,052 million, a decrease of \$63.0 million, primarily due to decreased 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, 2016 the Trust had net position held in trust of \$198.7 million, an increase of \$0.8 million for the year. Investment income for the year was a net loss of \$7.9 million compared to net gain of \$1.4 million in the prior year. The ratio of current funding to the actuarial liability was 66.0% at the latest actuarial valuation (June 30, 2015), an improvement from 56.8% 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 overall increase in the revenue budget from original to amended was \$3.4 million (.9%), primarily due to an adjustment to recognize the increased level of business tax collections (\$2 million).
- The original budget for expenditures was increased by less than \$1 million (.2%) in total during the year, including amounts carried forward from prior year for open encumbrances. An increase in the amended budget for "Transfers Out" includes a transfer of \$3.0 million to

the Corrections Fund to partially offset the impact of OPEB liabilities now recorded in this Enterprise Fund.

- Budget amendments were approved by the County Commission with the use of General Fund balance for some non-recurring expenditures, including a grant to a non-profit agency and facility repairs for Juvenile Court.
- Actual revenues exceeded the amended budget by \$3.5 million in total (.9%), largely due to fees collected by the County Clerk, Register, and Trustee. State revenues received for Bank Excise and TVA Replacement taxes also exceeded budget, along with reimbursements to the Sheriff for the jail population.
- Actual total expenditures of \$4.4 million (1.2%) less than the amended budget were 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.

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, 2016 amounts to \$578.6 million (net of accumulated depreciation). This investment in capital assets includes land, buildings and system improvements, machinery and equipment, park facilities, roads and other infrastructure. Additions for the year were \$40.7 million and depreciation was \$28.2 million. Construction in progress as of the end of the current fiscal year was \$42.5 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 \$4.5 million were made for continued work on the Fite Road project.
- Expenditures of \$2.4 million were made for the HVAC retrofit project at 201 Poplar Avenue.
- Expenditures of \$31.9 million were approved for continued renovation projects of the Shelby County Schools. Appropriations of an additional \$33.0 million were approved for the local school systems based on the average daily attendance for specific projects, of which \$6.9 million was expended in the fiscal year.
- Construction and design services continued on the Downtown District Cooling Loop. Expenditures on this project for the fiscal year were approximately \$2.1 million.

Long-term debt. At June 30, 2016 Shelby County's general obligation bonded debt (bonds payable) totaled \$1,005 million, which represented approximately 5.6% of assessed value of taxable property. The County's bonds and loans payable decreased by approximately \$148 million (12.8%) 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. The aggregate outstanding principal amount may not exceed \$120 million at any time. The amount of \$50 million was outstanding at June 30, 2016 and was reported as short-term debt.

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 \$5,762,440 at June 30, 2016. 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, 2016 the County’s principal obligation was \$18.0 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:

Moody’s	Standard & Poor’s	Fitch IBCA, Inc.
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 September 30, 2016 was 5.8%, as compared to the state's rate of 4.6% and the national rate of 5.0%. (All rates are seasonally adjusted.)

Next Year's Budgets and Rates.

- The property tax rate for the FY2017 budget has been maintained at \$4.37, with the same allocations to Education, Debt and the General Fund. The budget includes estimated growth of 1.5% in property taxes over prior year actual collections.
- Total general fund revenue is budgeted at \$2.4 million (.6%) more than the prior year level, primarily due to the expected property tax growth offset by small reductions in other revenue categories.
- Total general fund expenditures for FY2017 are budgeted at \$12.8 million (3.3%) more than the prior year. That amount includes the 2.0% general salary raise and \$7.8 million for increases approved by the County Commission with use of fund balance for requests by the Sheriff, various Elected Officials and the Schools. The overall increase also reflects an election cycle that includes two non-reimbursable elections at a cost of \$2.1 million and an additional \$1.3 million for blight abatement efforts by Public Works.
- General Fund reserves will remain within the level specified by County policy at about 27%, including the \$7.8 million planned use of fund balance in FY2017.
- An additional \$28 million was allocated to the Education Fund for FY2017 from property tax growth, shifting 100% of the Wheel Tax from Debt Service to Education, and a transfer of \$2.5 million from the General Fund. The Shelby County Schools continue to face significant budgetary challenges as the issues of OPEB liability and declining enrollment 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.