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ARIZONA TAX RESEARCH ASSOCIATION

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Property tax levies exceed $4 billion statewide

Arizona property tax levies increased $287.3 million over last year, or 7.4%, just slightly less than last year's record-breaking increase of $289.4 million. Since 1997, property tax levies have increased consistently between 7% and 9% every year. Total statewide levies are currently at $4,161,975,569. Since the state property tax rate was eliminated in 1996, levies have increased $1.3 billion (45%), which is mainly attributed to increases in primary property taxes.

PRIMARY & SECONDARY COMBINED PROPERTY TAX LEVIES

	2000	2001	Difference	Percent Change
State	$22,532,038	$17,905,200	-$4,626,838	-20.53%
Counties	$774,109,451	$829,896,505	$55,787,054	7.21%
Cities	$283,484,895	$310,596,571	$27,111,676	9.56%
Comm. Colleges	$364,261,318	$397,569,955	$33,308,637	9.14%
Schools	$2,222,605,046	$2,380,393,548	$157,788,502	7.10%
Other	$207,695,920	$225,613,790	$17,917,870	8.63%
TOTAL	**$3,874,688,668**	**$4,161,975,569**	**$287,286,901**	**7.41%**

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SESSION SET TO CLOSE BUDGET DEFICIT

ATRA makes recommendations

With agreement reached on the size of the fiscal year (FY) 2002 budget deficit, now pegged at $675 million, the Legislature and Governor will begin work on November 13 to eliminate it.

The size of the budget in the second year of the biennium (FY 2003) will be contingent on the methods used to close the FY 2002 deficit.

The $675 million deficit is 9.5% of the $7.045 billion general fund budget and 4% of the total operating budget of the state which approaches $16.8 billion.

BUDGET REDUCTIONS

While there is general agreement that significant budget cuts have to be made to balance the budget, there is little agreement on the amount. To date, Governor Hull has called for a 1% ($102 million) decrease in general fund spending and a 0.6% cut in the total operating budget. The Governor's budget reduction effort was limited by a decision to insulate up to 60% of the general fund from the budget cutting exercise. After taking $3.8 billion "off the table" under the theory that it is all voter protected spending, the Governor recommended a 4% across the board reduction in the remaining 40% of the budget.

The Legislature's budget staffers, on the other hand, have developed a lengthy list of budget reduction options, many directed at specific programs and formulas that drive the state spending.

RAINY DAY FUND

When the budget stabilization fund (BSF), or so-called "rainy day fund," was established in the early 1990s, it was the subject of considerable debate. There is little debate now that the current balance of $326 million will come in handy to help close the FY 2002 deficit. However, the arguments used against its creation should be used as cautions in its use now. Specifically, the use of the BSF in a manner that simply masks the current deficit with the hope that revenues will rebound in FY 2003 is dangerous. For that reason, Governor Hull's argument that the FY 2002 cannot be addressed in isolation of the FY 2003 is correct. The size of the budget deficit in the second year is even greater and every effort

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needs to be made not to exacerbate that problem.

BUDGET GIMMICKS

State government was infamous for its use of gimmickry in addressing budget deficits in the late 1980s. Shifting expenditures into future budgets or pulling forward revenues avoids the need to address deficits through more straightforward means. Top on the list of budget gimmicks for this session will be proposals to sell revenue bonds to free up cash available for other general fund programs.

Punting this budget problem to the future is particularly problematic considering that the size of the estimated deficit in FY 2003 is higher than that for FY 2002.

TAX INCREASES

Despite the fact that the state just imposed a record voter-approved tax increase in June, there is some interest in looking for additional revenue to close the deficit. As was the case in the late 1980s, some are blaming this budget crisis on a "structural deficit." In an effort to shift focus away from spending reductions, some are pointing to problems with the State's tax structure.

Attempting to avoid talk of tax increases, some legislators have talked of "closing loopholes" or eliminating "special interest tax exemptions." Most of the interest centers on the state transaction privilege tax (sales) tax base, where the focus on the labels "exemptions" and "loopholes" grossly exaggerates the issue.

While there are some major activities that have been removed from the sales tax base (e.g. food & commercial leases), the majority of activities being looked at have ***never*** been subject to tax in Arizona.

It is safe to say that despite some efforts to define such expanding of the tax base as something other than a tax increase, the affected industries and citizens will not buy it. In addition, any effort to address the budget crisis through any measure that raises state revenues, regardless of the label, will require a two-thirds vote of the Legislature.

ATRA RECOMMENDATIONS:

1. *Balance FY 2002 and repeal FY 2003*

There has been considerable confusion and debate about the size of the deficit, some of which was caused by the fact that there are two budget years in question. When the FY 2003 budget is included in the estimates the size of the deficit skyrockets. The Governor has estimated the deficit for the biennium to be as high as $1.6 billion. One of the reasons the deficit jumps even higher in FY 2003 is that spending jumps significantly over the current FY 2002 budget.

Knowing what we do now about the economy and slumping state revenues, most should agree that the FY 2003 spending plan is simply unrealistic and should be repealed. The special session in November should focus on balancing the current budget with an eye toward ensuring that those changes do not make building a new FY 2003 budget more difficult. After repealing the FY 2003 budget in November, the Legislature, with more up-to-date revenue information available, could develop a new spending plan for FY 2003 in the Spring.

2. *All budgets should be "on the table"*

Arizona's slumping economy and the dramatic downturn in state revenue argues for significant reductions in state spending. Further, meaningful reductions can only be accomplished by including all state programs and agencies. Taking 60% of the budget "off the table" will only result in deeper cuts than necessary into those programs "on the table" or fail to generate the necessary spending reductions to solve the problem.

The 1.5% reduction in the general fund budget that has been called for by Governor Hull only addresses 15% of the current $675 million deficit.

In addition to across the board reductions, the Legislature should focus reductions on programs and spending on a targeted basis. Not all state spending is created equal and budget-reducing exercises can be an effective way of re-prioritizing state spending. The potential savings through targeted reductions could and should exceed those done in an across the board fashion.

3. *Carefully tap the Rainy Day Fund*

The rainy day fund was established in order for the state to use it. However, as mentioned earlier, caution must be exercised not to use a one-time revenue source to fund ongoing expenditures that must be met again in FY 2003.

4. *Avoid shifting problems to the future*

Every effort should be made to match current spending with current revenue and avoid the use of budget gimmicks to resolve the problem. Specifically, selling revenue bonds to free up general fund spending capacity should be opposed. While providing short-term budget relief, this gimmick has tremendous long-term costs.

5. *No tax increases*

Following a huge tax increase in June, and the struggling economy, it should go without saying that the Legislature and Governor should avoid raising taxes. Taxes are generated by establishing a ***tax base*** and applying a ***tax rate*** to that base. Changes in either the base or the rate in an effort to generate more taxes is a ***tax increase.***

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Ways & Means debates deseg levy cap in Tucson

A foreshadowing of legislative resolve?

The Arizona House Ways and Means Committee met in Tucson this month to discuss school district desegregation levies and unanimously, though not officially, approved draft legislation that would cap desegregation levies at last year's levels.

The hearing, held as part of the Arizona Tax Conference, was attended not only by conferees but also included numerous residents from the Tucson Unified School District (TUSD) in response to local media coverage of the event.

Committee members present included Henry Camerot, Gabrielle Giffords, Jeff Hatch-Miller, Steve Huffman, James Kraft, and Chairman Steve May.

ATRA staff testified in support of the draft language, which first appeared as part of a discussion in a joint legislative working group on English acquisition programs.

TUSD superintendent Stan Paz and Arizona School Boards Association staff testified in opposition to the proposal.

The draft bill, which has not been officially introduced, freezes district desegregation levies at the levels budgeted in fiscal year (FY) 2000-2001.

Districts using agreements with the federal Office for Civil Rights (OCR) to levy property taxes would no longer be allowed to do so starting July 1, 2007.

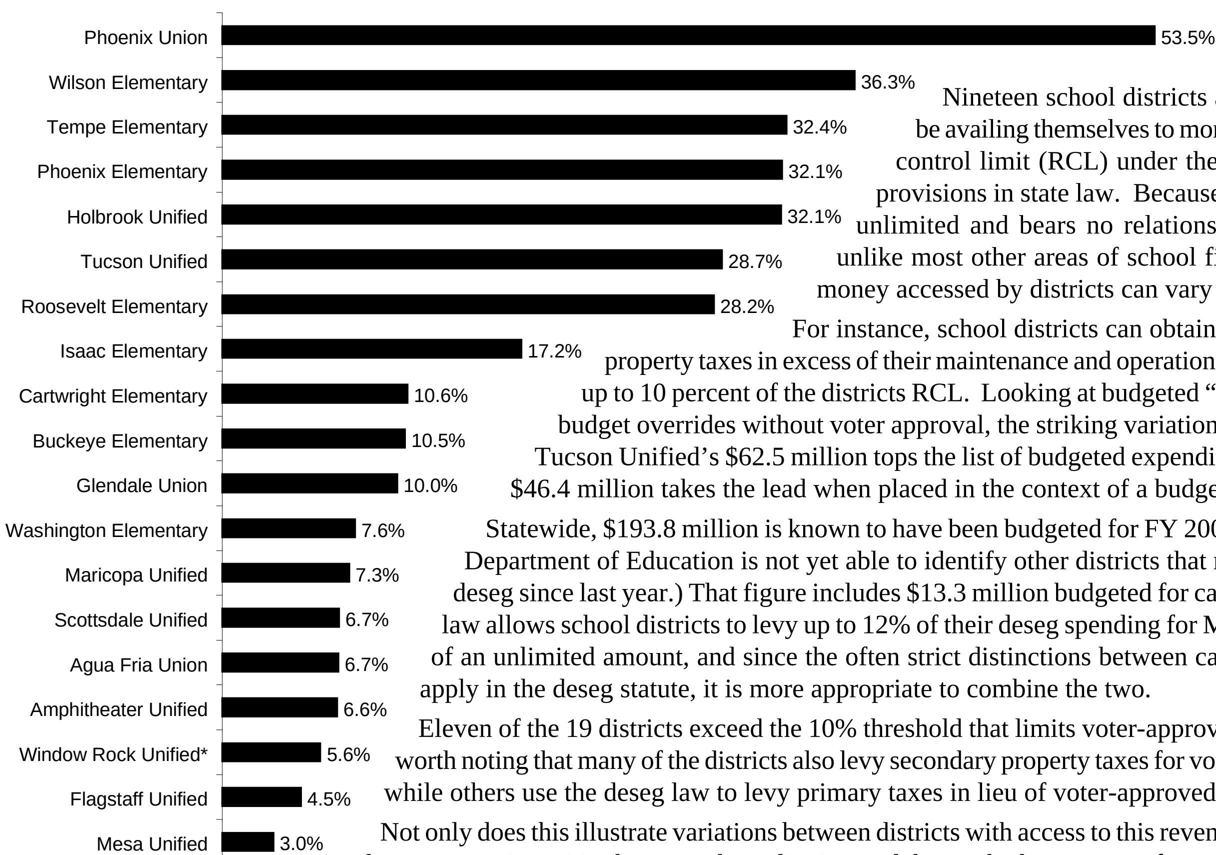
Districts with federal court orders to desegregate would be required to petition the court every three years to discharge the court order.

The committee also heard testimony from two local citizens in support of the bill: Emmett McLoughlin, former state legislator and property owner in Tucson; and Judy Bernal whose children have been excluded from local public schools because of race and ethnicity-based enrollment policies.

Although the committee vote holds no power, it may provide a glimpse of the increasing resolve on the part of the legislature to deal with the desegregation issue.

Budgeted desegregation as a percent of RCL

FY 2001-2002



Source: District budgets

*Window Rock data from FY 01

Nineteen school districts are currently known to be availing themselves to monies outside the revenue control limit (RCL) under the current desegregation provisions in state law. Because this revenue stream is unlimited and bears no relationship to student counts, unlike most other areas of school finance, the amounts of money accessed by districts can vary considerably.

For instance, school districts can obtain voter approval to levy property taxes in excess of their maintenance and operations (M&O) budget limits, up to 10 percent of the districts RCL. Looking at budgeted "deseg" expenditures as budget overrides without voter approval, the striking variation is revealed. Although Tucson Unified's $62.5 million tops the list of budgeted expenditures, Phoenix Union's $46.4 million takes the lead when placed in the context of a budget override.

Statewide, $193.8 million is known to have been budgeted for FY 2001-2002. (The Arizona Department of Education is not yet able to identify other districts that may have budgeted for deseg since last year.) That figure includes $13.3 million budgeted for capital purposes. Current law allows school districts to levy up to 12% of their deseg spending for M&O. Since the 12% is of an unlimited amount, and since the often strict distinctions between capital and M&O do not apply in the deseg statute, it is more appropriate to combine the two.

Eleven of the 19 districts exceed the 10% threshold that limits voter-approved overrides. It is also worth noting that many of the districts also levy secondary property taxes for voter-approved overrides, while others use the deseg law to levy primary taxes in lieu of voter-approved overrides.

Not only does this illustrate variations between districts with access to this revenue, it more importantly demonstrates inequities between these districts and those who have not yet figured out that state law can make getting in trouble with the Feds very rewarding.

Michael Hunter

Primary property tax levies increase 8.38%

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Primary property taxes, typically levied for maintenance and operations purposes, increased $215 million in 2001. However, since the 8.4% increase in levies almost equals the 8.6% increase in primary net assessed values (NAV), the statewide average primary rate dropped by a mere 2 cents, from $8.56 in 2000 to $8.54 in 2001. Primary taxes have risen steadily since 1996, reflecting a 43% increase over the last five years.

Secondary levies, which fund bonds, overrides, and special districts, climbed $72,498,112, a 5.5% increase over last year. The 5.5% growth in secondary levies was significantly lower than the 8.3% growth in secondary NAV's, resulting in an 11-cent decrease in the secondary average state tax rate, with the rate dropping from $4.12 in 2000 to $4.01 in 2001.

PRIMARY LEVIES

K-12 Schools

The aggregate primary levy increase is, yet again, driven by K-12 schools, with levies increasing over $134 million (9.3%) from last year.

School primary levies climbed despite the fact that the state complied with the truth-in-taxation (TNT) law and made adjustments to both the qualifying tax rate (QTR) and county education rate.

Since 1999, the state has been required to adjust the QTR for schools to account for changes in property values (excluding new construction). The QTR for elementary and unified districts was decreased again by the state from $2.1265 and $4.2530 in 2000 to $2.0647 and $4.1294 in 2001, respectively.

The state's compliance with the TNT law provided welcome relief from increasing property taxes. According to the Joint Legislative Budget Committee, the TNT law will save taxpayers an estimated $38.3 million this tax year.

A significant amount of the increase was driven by Tucson Unified School District's $26 million dollar increase in primary levies, $10.6 million of which was budgeted for desegregation funding (see *ATRA Newsletter* for September 2001). Desegregation levies, totalling approximately $193 million this year, represent only the largest of several exemptions from state budget limits funded solely through school district property taxes.

Community Colleges

Community College levies increased $23.4 million (7.6%) in 2001, with the total levies increasing from $308,128,064 to $331,557,464. Pinal Community College led the community colleges with the highest percentage increase at 11.3%, from $13,465,923 to $14,982,948. Right behind Pinal in largest percentage increases was Maricopa Community College, with over a $17 million (9.1%) rise in primary levies, also making it the largest dollar increase of all the community colleges. Yavapai Community College increased its primary levy 8.4%, a $1.5 million dollar increase. Five of the ten community colleges increased primary tax levies over TNT limits, which included Yavapai and Maricopa colleges.

Cities

City primary levies rose by 5.7%, from $113,901,648 in 2000 to $120,334,471 in 2001. The City of Surprise dramatically increased their primary levy by 112.1%, representing the largest percentage increase of all cities. With a 31% increase in NAV and a 25-cent increase in the primary rate, the City of Surprise more than doubled its primary levy from $657,800 to $1,394,949. Other cities showing a significant percentage increase in primary levies include Florence (36.7%), Goodyear (31.4%), Duncan (23.5%), and Tolleson (20.2%). The City of Phoenix led the way in highest dollar increases with a $2.3 million jump in primary levies.

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PRIMARY PROPERTY TAX LEVIES

	2000	2001	Difference	Percent Change
State	$22,532,038	$17,905,200	-$4,626,838	-20.53%
Counties	$667,674,925	$722,310,800	$54,635,875	8.18%
Cities	$113,901,648	$120,334,471	$6,432,823	5.65%
Comm. Colleges	$308,128,064	$331,557,464	$23,429,400	7.60%
Schools	$1,451,826,663	$1,586,744,192	$134,917,529	9.29%
TOTAL	**$2,564,063,338**	**$2,778,852,127**	**$214,788,789**	**8.38%**

Secondary property tax levies increase 5.53%

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Counties

County levies climbed 8.2% in 2001, a $55 million dollar increase over last year. This year's largest percentage increase was led by Gila County, with the county's levy increasing 16.8%, or $2.2 million, which was largely the result of a 44-cent increase in the primary rate. Maricopa County's primary levy rose by 10.6%, or $34.3 million, reflecting the largest dollar increase out of all counties. Pima County followed Maricopa in the line up with the second largest primary levy increase of $10.8 million. Both Gila and Maricopa were required to hold TNT hearings since their primary levies exceeded TNT limits. Out of Arizona's 15 counties, eight raised taxes above TNT limits in 2001.

SECONDARY LEVIES

K-12 Schools

K-12 schools increased their levies $22.9 million, down from last years' increase of $59 million, still coming out ahead with the largest dollar increase in statewide secondary property tax levies. School secondary levies fund voter-approved overrides and bonded indebtedness.

Apparent in tax year 2001 is the rise in Joint Technological Education Districts, from two districts in tax year 2000 to nine districts in 2001. Joint Technological districts are multi-jurisdictional voter-approved special districts that provide vocational training to students of participating school districts. Total secondary levies for these districts increased almost 13% from last year, from approximately $6.6 million to $7.5 million.

Community Colleges

For the second year in a row, the largest percentage increase in secondary levies occurred at the community college level, increasing secondary levies 17.6%, or $9,879,237. The 2001 secondary levy for Yavapai Community College is over four times what it was in 2000, escalating over $4.5 million from $1,091,840 to $5,598,026. Maricopa Community College increased its levy $3,553,234 (11.3%) and Pima Community College, with an increase of $1,662,589 (10.2%).

Cities

City secondary levies increased by a significant 12.2%, or $20.7 million in 2001. The City of Buckeye led the way with the largest percentage increase in secondary levies of 112.4%, which was accomplished by increasing the secondary rate 42-cents, with only a 29.2% increase in total NAV's. Coming in with the second largest percentage increase was Fountain Hills, which increased its levy 89.1% to $1,338,094, easily overshadowing the 12.4% increase in total secondary NAV. The largest dollar increase occurred, once again, in the City of Phoenix, with a $9.9 million dollar increase, accounting for almost 50% of the total statewide increase in secondary levies. The City of Scottsdale had the second largest secondary levy increase of over $2.9 million. Four other cities increased their secondary levies just over $1 million, including Glendale, Chandler, Peoria, and Tempe.

Counties

The largest dollar increase in county secondary levies occurred in Greenlee County, with the levy increasing from $9,952 to $1,709,952. The jump in Greenlee's secondary levy is due to an 89-cent override that will generate approximately $1.7 million. Maricopa County's secondary levies dropped $3 million as a result of the county paying down its debt service. Maricopa County's $3 million decrease helped to offset Greenlee's $1.7 million increase, thereby minimizing the impact on total secondary levies, which rose by a modest 1.1%, or $1,151,179, over last year.

Jennifer Schuldt

SECONDARY PROPERTY TAX LEVIES

	2000	2001	Difference	Percent Change
Counties	$106,434,526	$107,585,705	$1,151,179	1.08%
Cities	$169,583,247	$190,262,100	$20,678,853	12.19%
Comm. Colleges	$56,133,254	$66,012,491	$9,879,237	17.60%
Schools	$770,778,383	$793,649,356	$22,870,973	2.97%
Other	$207,695,920	$225,613,790	$17,917,870	8.63%
TOTAL	**$1,310,625,330**	**$1,383,123,442**	**$72,498,112**	**5.53%**

Hayden taxpayers now saddled with $43 combined property tax rate

Annual rate hikes show no sign of abating

Hayden taxpayers expressed shock in 1999 when the combined property tax rate of the Hayden-Winkelman Unified School District, within the Town of Hayden, had reached the incredible level of $33.9083 per $100 of assessed value.

In 2000, taxpayers expressed outrage when they were again burdened with an unprecedented tax hike and a combined rate of $40.4615.

Now in 2001 it is hard to find words to express the sentiments of Hayden property owners as they receive tax bills showing a combined rate of $43.2070.

Cheryl Chester who, with her husband Warren, owns *Eddie Tire & Auto Parts* in Hayden, paid $6,000 in taxes this year on property with a full cash value of $55,547. Last year she told ATRA that "There are only nine or ten businesses left and I know several are talking about closing up and walking away," she said. Things have not improved.

Jean Slater used to operate a business in Hayden. Now that business is closed. She still owns the property but has not had any success leasing it out. "Things are just dead here," she said.

Slater blames part of the situation on the fact that most of the residents of this small community work for local government, including the school district. If most of the voters work the government it is in their interest to see revenues and taxes increase, "especially when businesses are taxed more than homes," she said.

Precipitous drops in value have been the norm in this community in recent years. The school district's secondary value, for example dropped 9% from last year's $10,634,757 to $9,973,020 in tax year 2001.

Hayden-Winkelman Unified's primary rate climbed 24% to $7.5050. The secondary rate increased 6% to $14.7854.

Taxpayers are also facing an additional five-cent rate added this year when voters approved a new joint technological education district (JTED) last November.

Meanwhile, Gila County hiked its primary tax rate by 44 cents to $4.9074. It's secondary rate climbed slightly to $0.8892. The secondary rate for Gila Pueblo College also increased slightly to $0.5892.

The Town of Hayden decreased its levy by about $83,000, which dropped the rate by only 2 cents to $15.0700.

Hayden Mayor Joe Aranda had justified last year's tax increase with a list of operational expenses, adding that "The increase will not affect homeowners because they are at the one-percent cap. The tax increase was passed onto businesses."

When asked last year to comment on the commercial taxpayers who are considering closing down their businesses Aranda said, "That's their option."

Cheryl Chester and Jean Slater think the Hayden Town Council may have been influenced against a proposed levy increase by a well-attended town hall meeting in August where commercial and other taxpayers made their concerns known.

It is unlikely, however, that the situation will turn around any time soon, said Jean Slater. "Who would want to open a business in Hayden with the taxes the way they are?"

Michael Hunter