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Legislature Wraps up Regular Session

Special Session grows state budget deficit

Commentary and Analysis, Kevin McCarthy

The Arizona State Legislature adjourned sine die on July 1 after finally sending Governor Brewer a fiscal year (FY) 2010 state budget. While the budget reflected a negotiated agreement with the Legislature, the Governor vetoed most of the budget because the Legislature failed to deliver on her demand for a referral of a temporary sales tax increase to the ballot this fall.

In line-iteming various appropriations, Governor Brewer actually vetoed the entire appropriation for state aid to K-12 schools. As a result, that issue became the first order of business when the Legislature was called back into special session on July 6, 2009. In stark contrast to the six-month long regular session, the effort to restore the K-12 appropriation was handled in one day as all of the recorded votes were in favor.

Regrettably, the effort to recover from the veto of the K-12 appropriation resulted in a $485 million **increase** over the FY 2010 K-12 appropriation that was vetoed. However, in what was clearly a unique legislative action, some of that $485 million in increased funding cannot be budgeted by districts until October 1, 2009. Those items include budget capacity for soft capital and some utility, desegregation, and career ladder expenses. If the Legislature fails to repeal those session laws by October 1, 2009, the districts will be free to increase their budgets for those items. Moreover, the special session fix also eliminated numerous budget reforms that were in the vetoed bill. Most of those reforms were ATRA recommendations that focused on improving the state's fiscal management while also reducing the size of the on-going structural deficit.

Although the restoration of the K-12 appropriation eased the fears of lawmakers that were concerned that state aid payments could not be made on July 15, the reality is that the state continues to operate in mid-July without even the appearance of a balanced budget. Following the passage of the K-12 budget, the Joint Legislative Budget Committee (JLBC) estimated the FY 2010 budget deficit at $2.6 billion. However, the structural shortfall between actual on-going revenue and spending jumped to $3.8 billion.

While there has always been debate regarding the constitutional requirement for a "balanced" state budget, there is no question that the Constitution calls for the fiscal year to commence on July 1 and the Legislature is provided the authority to levy a tax if revenues are insufficient to cover estimated expenditures. Clearly, state policymaker's comfort level with on-going massive structural deficits has now morphed into rationalizing some legal basis for operating without a final budget plan in mid July.

Part of the exercise in passing another comprehensive FY 2010 budget will include dealing with a number of issues that were in the vetoed budget reconciliation bills (BRBs). Arguably the most significant issue that is left unaddressed as a result of the vetoes is the fate of the state equalization property tax. That tax is slated to return to tax bills this summer unless the Legislature and Governor can agree to stop the tax increase. County supervisors across the state will set property tax rates by the third

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Governor Brewer Signs Three ATRA Bills

Among the 180 bills Governor Brewer signed between July 9 and July 13 were three ATRA bills that provide important protections for taxpayers across the state. These bills include 1) SB1421 special districts; secondary levy limits, 2) HB2360 general obligation bond reform, and 3) HB2285 fire district assistance tax; mergers. As ATRA's efforts of recent years successfully limited unreasonable growth in primary property taxes, these three bills focused on a number of areas in the secondary property tax where taxpayers remained exposed to significant tax increases.

SB1421 secondary levy limits:

Sponsored by Senate Finance Chairman Jim Waring, the Senate engrossed version of SB1421 was a compromise between ATRA and the fire district associations. The bill, as signed by the Governor, places annual levy limits on fire districts. Beginning in tax year 2010, the limit will allow up to an 8% annual levy increase plus an additional increase for any district annexations.

Additionally, SB1421 provides fire districts the authority—after obtaining

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What's inside…

Primary Assessed Values Continue to Climb;

Minimal Growth in Secondary Values Statewide

As the overheated real estate market of the recent past has undergone a precipitous decline in value, this year's change in primary net assessed values, to many, may seem counterintuitive.

Statewide, primary values for 2009 increased $7.26 billion or 10.75% over the 2008 values. More than half of this increase resulted from the $4.79 billion (10.68%) increase in the primary values of properties located in Maricopa County. Primary values in Pima County increased by 9.17% and accounted for the next largest portion of the statewide increase—just over $754 million.

Several counties saw property values increase by even more than the 10.75% statewide average. The largest percentage increase, 26.61%, occurred in Graham County. The next largest percentage increases occurred in Pinal, Gila, and Yuma with increases of 16.46%, 15.02%, and 13.28%, respectively. In no county did primary values increase by less than 9%.

Secondary net assessed values, on the other hand, declined in three of the 15 counties—most notably by $319.6 million (-0.55%) in Maricopa County. In addition to the decrease in Maricopa County, secondary values also declined in Mohave County by $173.1 million (-5.36%) and in Pinal County by $50.8 million (-1.47%). These decreases partially offset the increased secondary values of the remaining counties resulting in a 2009 increase of only 0.5% or $434.7 million.

County	2008 PNAV	2009 PNAV	$ Change	% Change
Apache	$435,342,926	$480,466,523	$45,123,597	10.37%
Cochise	$903,521,761	$986,677,834	$83,156,073	9.20%
Coconino	$1,686,709,736	$1,840,775,046	$154,065,310	9.13%
Gila	$513,379,379	$590,487,639	$77,108,260	15.02%
Graham	$175,244,227	$221,874,583	$46,630,356	26.61%
Greenlee	$445,025,593	$485,624,596	$40,599,003	9.12%
La Paz	$191,349,824	$209,757,376	$18,407,552	9.62%
Maricopa	$44,881,602,698	$49,675,117,156	$4,793,514,458	10.68%
Mohave	$2,286,744,927	$2,533,640,810	$246,895,883	10.80%
Navajo	$908,393,696	$998,764,550	$90,370,854	9.95%
Pima	$8,230,966,534	$8,985,711,830	$754,745,296	9.17%
Pinal	$2,473,499,660	$2,880,540,107	$407,040,447	16.46%
Santa Cruz	$352,686,375	$389,942,565	$37,256,190	10.56%
Yavapai	$2,954,598,732	$3,274,078,347	$319,479,615	10.81%
Yuma	$1,079,816,171	$1,223,205,142	$143,388,971	13.28%
Total	**$67,518,882,239**	**$74,776,664,104**	**$7,257,781,865**	**10.75%**

County	2008 SNAV	2009 SNAV	$ Change	% Change
Apache	$471,596,971	$525,498,401	$53,901,430	11.43%
Cochise	$1,018,740,280	$1,060,241,909	$41,501,629	4.07%
Coconino	$2,057,478,154	$2,160,427,866	$102,949,712	5.00%
Gila	$574,203,136	$656,411,106	$82,207,970	14.32%
Graham	$189,364,668	$260,032,536	$70,667,868	37.32%
Greenlee	$445,239,742	$485,792,425	$40,552,683	9.11%
La Paz	$235,112,575	$244,805,893	$9,693,318	4.12%
Maricopa	$58,303,635,287	$57,984,051,727	-$319,583,560	-0.55%
Mohave	$3,231,835,989	$3,058,747,225	-$173,088,764	-5.36%
Navajo	$998,760,072	$1,099,723,540	$100,963,468	10.11%
Pima	$9,594,861,519	$9,840,619,641	$245,758,122	2.56%
Pinal	$3,449,599,026	$3,398,761,197	-$50,837,829	-1.47%
Santa Cruz	$404,365,519	$450,858,960	$46,493,441	11.50%
Yavapai	$3,746,625,208	$3,824,935,514	$78,310,306	2.09%
Yuma	$1,369,161,501	$1,474,364,566	$105,203,065	7.68%
Total	**$86,090,579,647**	**$86,525,272,506**	**$434,692,859**	**0.50%**

The largest increase in secondary values occurred in Pima County where secondary values increased by $245.8 million (2.56%). Yuma, Coconino, and Navajo also contributed significantly to the statewide increase in secondary property values—each with increases of just over $100 million. Similar to its change in primary values, Graham County also saw the largest percentage increase in secondary values—37.32%. Gila County experienced the next largest relative increase in secondary values with an increase of 14.32%.

These counterintuitive increases in assessed values result partially from the necessary delay between changes in market values and the reflection of those changes in assessed values. In order to allow time for property owners to appeal an assessor's estimate of a parcel's full cash value (which becomes the secondary assessed value), the 2009 assessed values were established and mailed to

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property owners on or before March 1 of last year. This means none of the market decline that occurred over the last 17 months is reflected in the 2009 secondary assessed values. The increases on the primary side of the equation are a function of the secondary values and, thereby, are also influenced by this delay.

Additionally, growth in primary values is limited to the greater of a 10% increase over the previous year or an increase equal to 25% of the difference between a parcel's current full cash value and the previous year's primary value. Due to this limit on growth, primary values statewide grew by just over 15% in both 2007 and 2008 while the secondary values grew by 32.1% and 19.8%, respectively. As a result, the 2008 primary values of many properties were substantially lower than the property's 2009 full cash value even after the 2009 values reflected market declines as of March 2008. As the primary values are less than the full cash value, these primary values continue to increase within the described limits until they reach the secondary values.

An example using countywide values provides a clearer picture of this chasing characteristic of the primary value. The secondary value of all properties located in Maricopa County decreased to $57.98 billion for the 2009 tax year. Notwithstanding the decrease, this full cash value still exceeds the $44.88 billion sum of the countywide primary assessed values in 2008. For that reason, the primary values of these properties increased by 10.68% (following the limits described) to $49.68 billion for 2009. These primary values will not decline until the secondary values drop below the primary values of the previous year.

Justin Olson

STATE BUDGET, *Continued from page 1*

Monday in August. The majority of the Republicans that supported the June 30 budget that was vetoed strongly supported the repeal of the state rate in order to avoid a major property tax increase. However, Governor Brewer, as well as House and Senate Democrats, have supported the return of the tax to help balance the FY 2010 and FY 2011 budgets.

Another major issue for property taxpayers will be the fate of new secondary property tax authority that was extended to K-12 school districts in the form of a 50% increase in district override levies and expanded general obligation bonding authority. Those measures were in the vetoed K-12 BRB (HB2648) but not in the K-12 budget bill passed in special session on July 6.

Those increased K-12 secondary property taxes drew considerable opposition from lawmakers concerned about their impact on Arizona's already high business property taxes. In an effort to balance the effect of the new levies, the June 30 budget agreement contained a reduction in the class one (commercial and industrial property) assessment ratio from 20% to 16% for future voter approved bonds and overrides beginning in tax year 2012. That provision, along with the repeal of the state property tax rate, was in the vetoed HB2644.

Arizona's budget deficit continues to be one of the largest in the United States and challenges state policymakers to make very difficult decisions regarding both spending and taxes. However, despite the overwhelming size of the deficit, there continues to be considerable effort on the part of some policymakers to protect spending from the reductions that obviously need to be made.

ATRA's Board of Director's has supported the Governor's request to allow voters the opportunity to decide if sales taxes should be increased to help balance the budget. However, ATRA's FY 2010 budget recommendations in March made clear that even a one-cent sales tax increase would not come close to fully addressing the state's on-going deficit. To that end, ATRA again calls on both the Legislature and Governor to not allow a proposed tax increase to simply sustain current spending levels and ignore the long term deficit facing the state.

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voter approval—to override their levy limit using one of the following two options: 1) a permanent override that maintains the district's tax rate within the $3.25 rate cap or 2) a 5-year temporary override that exceeds the $3.25 rate cap. The second option is only allowed when the total net assessed value of the district decreases by more than 20% over two consecutive years.

Without this bill, taxpayers were exposed to significant levy increases as the only limit to fire district property taxes was the $3.25 rate cap. This rate cap substantially exceeds the rates of many fire districts providing them excessive capacity to increase levies. What's more, without a levy limit the rate cap provides no protection against tax increases when assessed values climb. When secondary property values soared in 2007, fire district levies climbed by 26%—with the top 20 increases ranging from 43% to 140% (see *ATRA Newsletter*, November 2007). Most of these increases resulted from the districts' refusal to decrease rates in response to the rising values. With the Governor's signature on SB1421, taxpayers will no longer be subject to such increases.

HB2360 general obligation bond reform:

House Ways and Means Chairman Rick Murphy sponsored HB2360, which sought to more adequately educate voters regarding the potential tax consequences associated with approving a general obligation bond and to eliminate local governments' ability to dramatically increase debt service levies by refinancing a bond issue without voter approval.

In many cases, property tax increases of recent years resulted from the debt service levies on voter-approved general obligation bonds. In an effort to educate voters regarding the

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impact of these bonds, each voter receives a publicity pamphlet prior to the election. HB2360 made two changes to the required information that must be included in these publicity pamphlets. The first reform affected the calculation of the estimated average tax rate for the bond. Prior to this bill, local governments would project annual increases in the jurisdiction's total assessed values. The increased values resulted in lower annual tax rates necessary to produce the fixed debt service levy of each year. The average of each year's estimated tax rate was then applied to a hypothetical residential and commercial property to demonstrate the estimated tax impact of the bond. But this example assumed that the value of the hypothetical properties remained constant for the life of the bond, thus, artificially deflating the actual cost of the bond. To more accurately describe the actual cost of the bond, HB2360 requires the jurisdictions to also project an increase in the value of the sample properties. The value of the sample properties now must increase by 50% of the relative increase in the total assessed value of the jurisdiction.

The second change to the publicity pamphlet requires taxing jurisdictions to disclose to the voters if the proposed bond amount, when added to the jurisdiction's outstanding debt, would exceed the constitutional debt limit of the political subdivision. Similarly, HB2360 requires the call for a bond election to state the political subdivision's current outstanding debt and its constitutional debt limit as well as the total amount of the proposed bond.

In addition to the publicity pamphlet reforms, HB2360 also made two reforms designed to protect taxpayers from unanticipated and excessive increases in debt service levies. To accomplish this, first, the bill requires the call for a bond election to establish the minimum (along with the already required maximum) number of years a bond series will run from its date of issuance. Second, HB2360 requires political subdivisions to obtain voter-approval before issuing new bonds to refund an existing issue if the average life of the new bonds is less than three quarters of the average life of the bonds being refinanced.

In response to higher than anticipated assessed values in recent years, several political subdivisions failed to reduce their debt service tax rates. Maintaining the same tax rate in the face of climbing assessed values resulted in dramatic increases in debt service levies. These subdivisions used the increased revenue to significantly accelerate the repayment schedule of their bonded indebtedness. By imposing the described limitations, HB2360 will now protect property taxpayers from the levy increases that result from these dramatic changes to the agreed upon debt service schedule.

HB2285 fire district assistance tax; mergers:

Sponsored by Representative Steve Yarbrough, HB2285 eliminates the unintended ability of merging fire districts to dramatically increase the fire district assistance tax (FDAT) that they are entitled to after merging. Every county that has a fire district must levy a countywide property tax to contribute to the operations of the county's fire districts. The FDAT levy cannot exceed a rate of $0.10. Provided the levy does not exceed this rate cap, each fire district receives an FDAT distribution equal to 20% of the fire district's own property tax levy but not more than $300,000. In order to prevent this per-district cap from discouraging fire district mergers that generally create more efficient operations, merged fire districts are allowed to exceed the per-district FDAT cap. Prior to HB2285, the FDAT distribution for a merged fire district was equal to the total FDAT distributed to each of the component fire districts in the year prior to the merger.

In 2008, three fire districts in Pima County took advantage of the FDAT cap exception for merged fire districts. These fire districts, Heritage Hills, North Ranch Linda Vista, and La Canada, merged in October 2008. But in August 2008—just before merging—each district dramatically increased its property tax levy in order to maximize its FDAT distribution. Each increased the district's property tax to $1.5 million (an increase of 126%, 124%, and 263%, respectively). With this levy, each district was due the per-district maximum FDAT distribution of $300,000 prior to the merger—and the merged district, therefore, was due $900,000. As Pima County's FDAT rate is below the $0.10 rate cap, the resulting $550,000 increase in the FDAT distribution to these merged districts was a direct tax increase on all the property owners in the county. Without HB2285, the merged district would continue to receive three times the FDAT cap indefinitely.

As the exception to the FDAT cap was never intended to provide fire districts this ability to dramatically increase FDAT distributions, HB2285 now caps a merged fire district's FDAT distribution at the sum of the average amount received by each of the component districts over the three years prior to the merger. The bill was enacted with a retroactivity clause that applies the new cap to all districts that merged after December 31, 2007, including the Pima County merger just described.

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