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ARIZONA TAX RESEARCH ASSOCIATION

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Goldwater Institute Challenges Pinal PRTA Tax

Last November, Pinal County voters narrowly approved Prop 417 authorizing the county to levy another half-cent sales tax to fund a new regional transportation plan. As originally recommended by the Pinal Regional Transportation Authority (PRTA) in 2016, the tax would have applied to all sales tax classifications; however, the proposal was revised in 2017 to have the tax apply only to retail purchases up to a certain amount, solely intended to avoid local opposition. That action ultimately prompted the Goldwater Institute to file a lawsuit in Superior Court to challenge the legality of the newly enacted tax.

See GOLDWATER LAWSUIT, Page 2

Two Lesser Known School Finance Problems: "Transpo Delta" & "Small School Adjustment"

Lost in the school finance shuffle are smaller problems which disrupt equity in a system designed for the same student to have the same purchasing power no matter the public school they enroll. There is plenty to discuss on big ticket items like bonds, overrides, Deseg/OCR levies, and charter additional assistance. But those heavy stones will be tough to move up the hill.

Policymakers often ask ATRA to identify problems they have a practical chance of solving in K-12 school finance. We point to low hanging fruit which can represent "baby steps" and good faith efforts which can pave the road towards larger reforms.

See SCHOOL FINANCE ISSUES, Page 3

Revisiting the Phx Convention Center

Few things seem to hoodwink taxpayers faster than a fancy suit clicking through a smooth PowerPoint presentation. If a consultant is dazzling an audience with rosy revenue projections and shocking "mulitpliers"—hold onto your wallets and consider the case of the Phoenix Convention Center.

It's understandable that a June bombshell from the Arizona Auditor General (OAG) went largely unnoticed; the local media apparently doesn't have the time to read their reports. Short version: the growth projections didn't materialize and the state simply subsidized a local project with little benefit to state taxpayers.

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Since current statute doesn't allow for a sales tax carve out, the county pursued legislation in 2017 that would provide the county the authority to exempt from the tax retail purchases above a certain threshold and to levy the tax at different rates among the various tax classifications. ATRA and others in the business community opposed the bill as it would set an extremely bad precedent by further complicating an overly complicated system. Despite the inability to advance the bill out of the House Rules Committee, the county proceeded with the ballot language.

ATRA originally surfaced legal questions regarding Prop 417 in an op-ed to the Arizona Capitol Times in September and included the following:

- The resolution approved by the county that the half-cent sales tax apply only to tangible personal property sold at retail is not currently authorized in state statute. The tax rate applied must be the same across all classifications.
- The resolution also specifies that the tax rate shall be levied at a "variable" rate of zero on transactions above $10,000. Current statute allows a "variable" rate to be applied that is up to a half-cent rate but does not outright authorize an exemption to the tax.

The information pamphlet subsequently mailed to voters contained language that conflicted with the county resolution. In describing the Plan to voters, the pamphlet stated the new tax would apply to all TPT classifications, not just the retail class. Conversely in that same document, text of the ballot question stated that the new tax would only apply to retail transactions.

Concerned voters were misinformed, the Goldwater Institute sent a letter to the Pinal County Board of Supervisors regarding the inconsistent language between the Resolution and voter information pamphlet. For the county to avoid litigation, Goldwater requested the county immediately remove the proposition from the ballot until the county passed a new resolution that accurately defines the tax as publicized. The County's lack of response or action triggered the recent Goldwater lawsuit.

The legal questions originally raised by ATRA are echoed in the Goldwater Institute lawsuit against Pinal County and specifically highlights the inconsistent language between the voter information pamphlet and the county resolution.

Goldwater references four counts in its complaint filed in Arizona Tax Court. First, there is "substantial uncertainty as to what activities are subject to the tax" due to the conflicting language in the resolution and ballot language. Second, state statute allows the county to collect the tax at a "variable rate" but does not allow the county to levy the tax solely on the sale of tangible personal property under the retail classification and doing so exceeds its legal authority. Third, exempting items above $10,000 violates the Equal Protection clause by arbitrarily taxing individuals at different amounts "solely for the purpose of obtaining political support for

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Proposition 417." And last, the tax is an "unconstitutional special law, because the classification consisting of single items exceeding $10,000 does not encompass all transactions of the relevant class, namely all sales of tangible personal property at retail."

With the tax scheduled to go into effect on April 1, 2018, taxpayers are anxiously awaiting the decision of the tax court.

-Jennifer Stielow

SCHOOL FINANCE ISSUES, *Continued from Page 1*

Transpo Delta

One of the more curious features of Arizona's school finance system is the hold harmless formula for transportation. The Transportation Support Level (TSL) is a formula based on route miles actually driven. This TSL is added to a district's equalization base and is therefore cost shared between the state and local taxpayers with the rest of the general fund budget. However a school district may actually budget for its Transportation Revenue Control Limit (TRCL) which essentially is the highest their TSL ever was and remains as such, becoming a "hold harmless" fund. The money is unrestricted, meaning it goes to the general fund along with other monies and isn't necessarily spent on transportation.

The theory supporting this hold harmless fund was that despite a school needing to drive fewer miles, they may still have the same number of buses and staff. Lawmakers were sympathetic to the concept but were unwilling to pay for it. Therefore the difference between the TRCL and TSL or Transpo Delta is funded with an additional local property tax.

For most districts, this represents a small but growing figure as some school districts witness declining enrollment or fewer miles driven, meaning their TSL is shrinking while the TRCL remains static. The total take for the Transpo Delta was $60M in 2009, $75M in 2014 and $79M in FY 2018. These increases happened despite the largest Transpo Delta user Phoenix Union dropping from $5.5M in 2009 to $3.9M because of its recent student growth. This was a rather unique phenomenon though as most of the largest levies for Transpo Delta are in districts who continue to contract in size.

$$\text{TSL} = \text{TSL (Budget Year) Daily Route Miles} \times \text{State Support Level per Mile} + \text{Bus Tokens and Passes} + \text{Field Trip Support Level} + \text{Extended Year Support Level}$$

$$\text{TRCL}^{**} = (\text{TSL Budget Year} - \text{TSL Current Year})^{*} + \text{TRCL Current Year}$$

*If less than zero, use zero ** If TRCL > 120% of TSL, use TRCL Current Year

In the 2018 legislative session, ATRA will support an effort to cap the Transpo Delta at current levels in HB2282 to stem the growth in this inequitable tax (See the ATRA 2017 December Newsletter for more).

Continued on next page

District	TSL	TRCL	TRCL-TSL	Diff per ADM	Tax Rate
Tucson Unified District	$14,484,377.00	$19,484,449.71	$5,000,072.71	$113.64	0.1555
Flagstaff Unified District	$4,276,168.00	$5,819,851.51	$1,543,683.51	$170.60	0.1352
Scottsdale Unified District	$5,020,461.00	$8,101,259.69	$3,080,798.69	$146.70	0.0612
Phoenix Union High School District	$5,375,871.00	$9,337,670.46	$3,961,799.46	$158.47	0.0838
Deer Valley Unified District	$5,747,182.00	$8,694,165.80	$2,946,983.80	$77.06	0.1205
Window Rock Unified District	$846,818.00	$2,839,769.98	$1,992,951.98	$900.37	*16.3805
Ganado Unified School District	$1,650,358.00	$3,530,580.37	$1,880,222.37	$1,350.77	*9.7526
Mesa Unified District	$17,122,898.00	$20,329,349.00	$3,206,451.00	$53.22	0.1103
Yuma Union High School District	$3,325,142.00	$4,718,120.49	$1,392,978.49	$131.08	0.1337

*These districts typically fund this amount with Federal Impact Aid as opposed to local property tax rates.

Small School Adjustment

State law allows a budget exemption for very small school districts which is inaptly named "small school adjustment (SSA)." The "adjustment" is actually an exemption from budget limitations and it is not for "small schools" but for tiny school districts with fewer than 125 K-8 pupils or 100 pupils in grades nine through twelve. There are many districts with more than 125 pupils in grades K-8 who qualify because they have fewer than 100 high schoolers. Roughly 50 school districts qualify for SSA and while the total amount spent is not shocking, the per-pupil amounts and taxes to fund them are significant.

State budget laws limit spending in K-12 schools but struggled to complete a formula that would address the lack of economies of scale in very small school districts. While there are added funding weights for being rural and small, policymakers understood that these might not be sufficient for these very small districts. Therefore instead of creating a separate formula or some type of spending ceiling, they simply created the SSA, which allows the governing board to adopt an additional amount of funding it needs in addition to formulaic monies and a local property tax to support it.

The SSA tax is not equalized by the state; it is borne solely by local property taxpayers. If a district faces a dramatic loss in property value or the area declines slowly over time, the rate to fund that adjustment balloons. By contrast, a value-rich district can fund a far more lavish SSA at a modest tax rate. It is prototypical of pre-reform school finance where schools were funded based on their zip code and their local taxpayer's willingness to tax themselves.

School District	FY18 SSA Totals	TY 2017 Primary Rate	levy as rate	RCL	% RCL
Paloma School District	$3,193,300	$5.0625	$4.0072	$794,828	401.76%
Pine Strawberry Elementary District	$1,656,650	$4.8389	$2.7323	$1,104,619	149.97%
Grand Canyon Unified District	$1,500,000	$14.7370	$10.1457	$1,988,740	75.42%
Gila Bend Unified	$1,300,000	$4.0016	$1.0072	$2,418,440	53.75%
Ash Fork Joint Unified District	$1,231,589	$8.4911	$4.2435	$1,595,557	77.19%
San Simon Unified District	$1,123,667	$12.0446	$7.5818	$855,905	131.28%
Seligman Unified District	$1,054,775	$7.7237	$3.0673	$963,110	109.52%
Bowie Unified District	$932,838	$11.1018	$6.6369	$765,524	121.86%
Hayden-Winkelman Unified District	$816,100	$11.8875	$5.5708	$1,885,287	43.29%
Hyder Elementary District	$757,582	$2.4430	$1.1236	$817,705	92.65%
Young Elementary District	$756,000	$6.5216	$4.1661	$308,211	245.29%
Maine Consolidated School District	$749,537	$5.2916	$2.5492	$1,130,018	66.33%
Cochise Elementary District	$700,000	$5.1560	$2.5429	$585,097	119.64%
Pearce Elementary District	$551,102	$5.3276	$2.6827	$670,085	82.24%
Tonto Basin Elementary District	$550,000	$6.8236	$3.7905	$735,730	74.76%

The statewide total for SSA is $25.7 million and cost an average rate for $2.93 per $100 of assessed value; a sizeable amount given the expected local contribution rate (the Qualifying Tax Rate) is $4.04. The average SSA is 76% of a school district's formula budget.

Several districts have leveraged significant gains in value to levy higher amounts of SSA. Famously Paloma Elementary (along Interstate 8) leveraged a new solar farm to raise their levy from a few hundred thousand to $3.2 million annually. Pine-Strawberry Elementary levies an additional 150% of their budget to the tune of an additional $1.65 million in SSA. Gila Bend Unified qualified for SSA for the first time in at least several decades and promptly levied an additional $1.3 million in FY 2018.

Most taxpayers have little idea they are paying for these hold harmless programs because they are not outlined on their tax bill; it's buried in the primary K-12 school rate. The SSA also contributes to Arizona's 1% Cap problem, where high local property tax rates shift costs to the state General Fund due to the Constitutional limitation on homeowner property taxes at $10.00 per $100 on the primary rate. High primary rates push 19 SSA school districts into this category of the 30 total 1% Cap school districts.

Dismissing smaller problems as too insignificant for the investment of time and energy to reform them is the on of the primary reasons they remain on the books year later.

-Sean McCarthy

CONVENTION CENTER, *Continued from Page 1*

Background: In 2003 the City of Phoenix convinced the Arizona Legislature it was in the state's interest to pay for $300 million (not including interest) of a billion dollar Phoenix Convention Center expansion by way of advanced appropriation through 2044, similar to the 2017 University bonding deal. City taxpayers paid for the remainder. Tripling the size of the convention center was projected to triple attendance, despite not having a shred of evidence from other major cities undertaking a similar investment. The OAG audit shows attendance only doubled and has never hit their low-ball expectation of 350,000 attendees.

During the debate the heaviest critique of the economic impact analysis came from an investigative report from the Phoenix New Times. They pointed out the expectations for growth largely came from industry supported lobbying groups. The academics they interviewed scoffed at the data. The expectation of 375,000 annual delegates was derived by comparing attendance and the total square footage at seven of the most popular convention centers such as New Orleans and applying that ratio to the new square footage in Phoenix. The notion that Phoenix could triple attendees by tripling its size was not supported by historical data or a similar circumstance.

	Estimate	Actual
Annual attendees	350K-375K	211K avg (high: 310K, low: 118K)
Total annual room nights	1.26 million	608K avg (high: 826K, low: 368K)
Direct Spending by 2013	$500 million	$204 million avg since 2013

Worse were the revenue projections. The analysis projected attendees would stay 3.37 room nights per person. Phoenix was averaging roughly 1.95 room nights pre-expansion. The number was not taken from reliable data: it was the number suggested by the International Association of Convention and Visitor Bureaus (IACVB), a group which advocates for the convention industry. The average room nights has remained below 3 per person. The combination of the lower attendance and lower room occupancy per person led to realizing less than half the expected total annual room nights.

Those two gross overshoots were multiplied by all the direct and indirect spending expected at conventions, which means all the downstream revenue impacts were also wrong.

> "A critical economic enterprise for the City and the State of Arizona, the Phoenix Convention Center currently welcomes more than 135,000 convention delegates each year – a figure that is expected to nearly triple by 2013."
> –City of Phoenix FACT SHEET on the Phoenix Convention Center, 2009

The OAG is required by law to routinely audit the convention center and the state will short the City of Phoenix state-shared revenues if the state's return on revenues to the general fund did not exceed its investment to convention center. The audit suggests the investment was net positive, if barely. But the larger point is disguised, the investment returns are not trending well.

The state investment ramped up slowly while the revenue impacts were immediate because of the construction sales tax remittance (Figure 4-4 and 4-5). So while state taxpayers invested less than $20 million in debt service in the first four years, revenues from construction sales tax were a quick shot in the arm— but debt service payments rose to $20.5 million per year in 2013 and over time slowly elevate to $30 million per year. Debt service payments run through 2044. In almost each year thus far the revenue benefit to the state general fund did not exceed $20 million. In fact 2015 was the first and only year. If attendance does not rise, the state's investment in Phoenix will not come close to meeting expectations.

FIGURE 4-4
CONVENTION CENTER DEVELOPMENT FUND DISTRIBUTIONS 2009 TO 2015

Bond Year*	Fund Distribution
2009	$5,000,000
2010	10,000,000
2011	0
2012	5,595,000
2013	20,449,000
2014	20,449,000
2015	20,449,000
Total	$81,942,000

*Beginning July 1

Source: Arizona Revised Statute 9-602 (D)

With interest, state taxpayers will have invested a total of $852 million and assuming 2% growth in each year in generating revenues, the state may recoup roughly $950 million in state tax dollars. The next time a consultant claims a 7 to 1 return, consider this example.

Apologists will blame the recession and negative reactions to SB1070. Recessions are a normal part of economic cycles and ought to be accounted for; either way the projections have not materialized in any year. There's no way to separate the impact of SB1070 from the recession but it seems unlikely SB1070 could still be blamed years after the controversy died down.

FIGURE 4-5
ESTIMATED NET GENERAL FUND IMPACT

	Impact
Annual Qualified Revenue	
2009	$17,797,000
2010	15,062,000
2011	15,809,000
2012	13,974,000
2013	9,352,000
2014	15,397,000
2015	21,006,000
Total Qualified Revenue	$108,397,000
Construction Impacts	26,445,000
Sub-total	$134,842,000
Less Fund Distributions 2009-2014	(81,942,000)
Qualified Revenue Less Distributions	$52,900,000

Sources: AECOM, State of Arizona, and HVS

The convention center wasn't the boon to the state as promised. The data the economists used to sell the investment was exaggerated. At best the state got its money back. At worse, it will be a loser for state taxpayers for years until it's paid off in 2044.

Naturally the convention center is useful for the City of Phoenix. But the list of local projects which could theoretically benefit the entire state is a long one. Policymakers would do well to recall this episode the next time they're asked to open their wallets.

-Sean McCarthy