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ARIZONA TAX RESEARCH ASSOCIATION

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Legislature Adjourns

ATRA Legislative Program Successful

The Second Regular Session of the 50th Legislature adjourned this month, concluding a very successful session for ATRA. ATRA's top-priority tax legislation all passed, and with the exception of one bill, those that ATRA opposed all failed.

As previously reported in last month's *Newsletter*, ATRA's recommendation to simplify and stabilize the property tax system by eliminating our dual assessed valuation system as well as capping annual assessed valuation growth at 5% passed. That measure was sponsored by Senator Steve Yarbrough (SCR1025) and will be on the November General Election ballot in the form of Proposition 117.

Also passed was ATRA's long-standing recommendation that Arizona conform to the federal code on net operating losses for corporate income tax. That measure, sponsored by Senator Michelle Reagan, was finally adopted as one of many components of House Bill (HB) 2815, sponsored by Representative J.D. Mesnard.

Another major legislative priority of ATRA's was to reverse the current effort on the part of some county assessors to expand the personal property tax to computer software. Sponsored by Senator Steve Yarbrough and supported by Governor Brewer, Senate Bill (SB) 1279 creates a distinction between operating and application software and makes clear that application software is not included in the value of personal property.

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ATRA's Property Valuation Limit Measure Timely

If there is any silver lining to the recession that ravaged real estate values in Arizona, it is that it provided an opportunity to simplify Arizona's complicated property tax system. ATRA's property valuation limit measure, which will be on the ballot this November, takes advantage of this rare opportunity. The reason for this is simple: the variance between the statewide Secondary Net Assessed Value (SNAV) and the Primary Net Assessed Value (PNAV) is negligible.

SCR1025, which was sponsored by Senator Steve Yarbrough, eliminates the SNAV for tax purposes, leaving the PNAV as the only taxable value. Additionally, the annual growth in PNAV for locally assessed property will be limited to 5%, versus the current growth rate of 10% or 25% of the difference between the current year SNAV and previous year PNAV, whichever is greater.

For the third straight year since tax year 2010, property assessments have declined. For tax year 2012, total statewide SNAV dropped 8.8% to $56.3 billion while the statewide PNAV dropped 8.3% to a total of $55.9 billion, representing only a 0.76%

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On the bad-bill front, ATRA successfully stopped several bills that were bad for taxpayers. Along with a host of other organizations, ATRA opposed HB2060 which would have created a new real estate tax for selected cities. This new tax would have been imposed on the square footage of residential, commercial and industrial buildings, private schools, and church property for the payment of municipal fire services. The bill would have granted the county treasurer the authority to collect the tax in the same manner as other property taxes. The bill was introduced on behalf of the Town of Paradise Valley. ATRA argued strongly against the precedent of creating another mechanism to tax property for general city services outside of the current primary property tax.

Another bill that would have had significant legal and tax implications for the state was HB2405. This bill would have created a four-year window for K-12 school districts to exceed their Class B statutory debt limits. In addition, new debt incurred during the four-year window would not ever count toward the Class B limits. In addition to increasing property taxes in a very unstable economic environment, ATRA argued that the measure would increase inequities in the K-12 school capital finance system and undermine Arizona's response to the *Roosevelt v. Bishop* lawsuit in the 1990's. ATRA also reminded lawmakers that the charter schools are currently suing the state on grounds that the current school capital finance system is inequitable and unconstitutional. Increasing the current inequities could significantly undermine the state's ability to defend itself in that litigation.

ATRA opposed refundable tax credits for the motion picture industry for the second year in a row. This bill died in the House, only to be resurrected in the Senate, where it passed 16-13 after an initial failure on the Senate floor. In its final form, this refundable credit created a potential $700 million liability for the state over the next 10 years. This measure died in the House without a final vote. However, on literally the last day of the session, the Legislature loaded a new refundable credit for qualified manufacturing businesses onto HB2815. This new credit was boot-strapped onto the existing $70 million annual allowance for refundable tax credits for renewable energy companies. Passed as a part of HB2815, this new refundable credit was never even the subject of a formal committee hearing.

Finally, tax increment financing (TIF) returned to the Capitol in 2012 in a couple of different forms. ATRA successfully opposed the effort to expand the TIF for the much maligned Rio Nuevo project in Tucson. Despite the highly publicized problems associated with the Rio Nuevo TIF, HB2467 would have actually expanded TIF to property taxes, as well as expand the current sales TIF. The TIF bill that did pass was a prime contracting TIF in SB1442. SB1442 creates a new TIF to redirect state sales tax revenues to fund city or county public infrastructure costs for major manufacturing facilities. To qualify for state funding, a project in Maricopa and Pima counties will have to make an investment of at least $500 million, and all other counties, an investment of $50 million. Interestingly, the cities, which were strongly in favor of SB1442 when the TIF was tapping just state revenues, flipped to strong opposition after a late amendment from the Governor's office ensured that the prime contracting taxes did not actually reach the state sales tax distribution formula. Without the amendment, the state would actually lose more than the state prime contracting taxes being redirected back to the city or county.

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Mesa Unified Considers Bonds Well in Excess of Debt Limit

K-12 school district debt limits have been a high profile issue at the state capitol in recent years. Some school districts have strongly advocated for an increase to K-12 debt limits in order to sell bonds already approved by their voters. Schools are allowed to seek approval for bonds without regard to their debt capacity. As a result, it is not uncommon for a district to have bonds that have been approved by the voters that cannot be sold because their debt capacity is exhausted.

While the current debt limit challenges that some districts face are aggravated by recent declines in property valuations, some districts' debt limit challenges are created by design. Current discussions for a bond proposal in Mesa provide a perfect example of this. A panel of citizens in the Mesa Public School District has made a request to the governing board to hold an election this November for the approval of $285 million in General Obligation bonds. Records indicate that the district has roughly $65 million in debt capacity, meaning $220 million would be inaccessible until property values increase in the district. In other words, less than one-quarter of the new bonds could even be used in the near future and most of the proposed projects would need to be postponed until years later. In fact, district property value would have to increase 83% to achieve an adequate debt limit to accommodate the new bonds.

If the Mesa School Board proceeds with the bond election in November, it will have to convince voters that the district's property valuations will increase at a rapid rate in order to sell the bonds and complete the

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Phoenix Ignores Debt Cash Reserves by Maintaining Combined Tax Rate

There are some taxing jurisdictions that base their decisions on tax rates rather than the taxes levied that are necessary to fund basic government services. The City of Phoenix is one jurisdiction that continues to levy the same overall tax rate, which consists of both primary and secondary tax rates, regardless of the change in value, and more importantly, without regard for need.

The proposed FY 2013 budget for the City of Phoenix reflects the city's long-term practice of maintaining the same combined tax rate of $1.82. The proposed primary property tax rate of $1.2397 will result in a levy that is $5 million (3.9%) more than last year, resulting in a total primary levy of $133.9 million, the maximum amount allowed under the constitution.

The proposed secondary property tax rate of $0.5803, which is levied to pay the debt service on voter-approved General Obligation bonds, will generate approximately $63 million (33.4% decrease). This year's proposed secondary levy is $5 million shy of this year's annual debt service payment of $68 million; however, the city holds a substantial amount in reserves in its debt service fund, $337 million to be precise. Not only will the current reserves cover the difference in this year's levy and debt service payment, but the city could pay the required annual debt service over the next five years without levying a secondary tax rate.

The decision-making process for the City of Phoenix in setting the secondary tax rate doesn't have anything to do with the required debt service nor does the city take into consideration the change in value. Instead, the city defaults to the secondary rate in order to maintain the overall tax rate of $1.82. As property values grew at extraordinary clips prior to the recession, the city levied secondary taxes in amounts that were much greater than what was necessary. According to Arizona state statutes, the secondary levy should equal the amount necessary to fund the annual debt service and nothing more.

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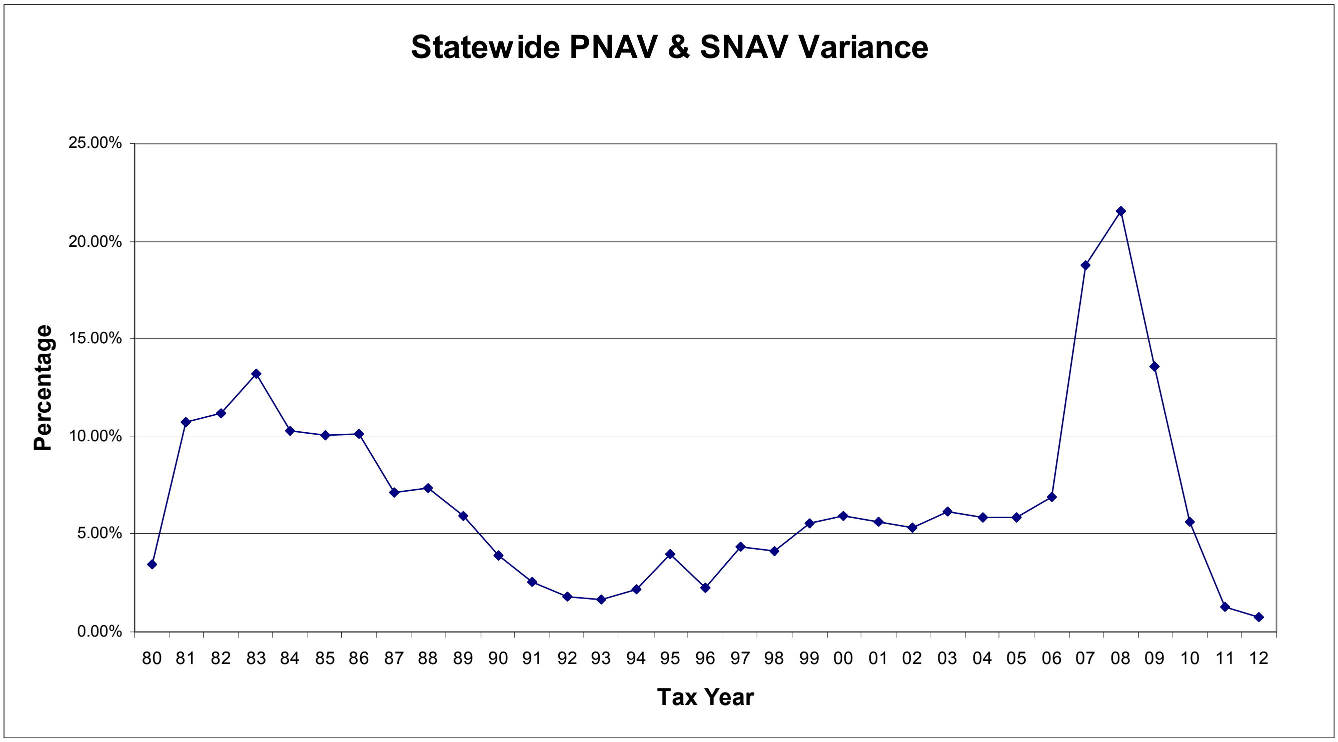
($426 million) difference between the two values.

Since the two values are nearly identical, transitioning to levying taxes on only the PNAV will result in minimal loss in property tax revenue to local governments. In fact, since Arizona's current property tax structure was implemented in 1980, there has been no other instance in which the variance between the two values has been smaller. The lowest the two values came to the current level was in tax year 1993 when the difference was 1.68%. This reform would be too difficult to accomplish if we were still in the 2008 environment when statewide SNAV peaked over $86 billion and PNAV was $67.5 billion, which amounted to the significant gap of 21.6% between the two.



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projects requested. It is not uncommon for districts to use optimistic value estimates in the publicity pamphlet selling the bond question. In the middle part of the last decade, these pamphlets were riddled with optimistic valuation growth assumptions that oversold the ability to complete projects and undersold the tax rates necessary to meet the debt service payments. Mesa Unified's property valuation has fallen 44% since 2007.

In addition to the strain the bonds would place on Mesa's debt limit, there will be a significant monetary impact to taxpayers. For FY 2012, Mesa levied a secondary property tax of $43 million for debt service for the district's outstanding Class A and Class B bonds. The resulting tax rate for the combined debt service was $1.39 per $100 of assessed valuation. According to news reports, the estimated tax rate on the new bonds will be $0.59, an increase of 42%. In terms of dollars, Mesa homeowners are paying $158, on average, for debt service on outstanding bonds in FY 2012. With the new bonds, the average tax on homeowners climbs to $224. Industrial property taxpayers would see an average increase in debt service property tax from $11,554 to $16,417 with the proposed bonds.

Ben Nowicki