MEMORANDUM

Date: April 15, 2019

To: The Honorable Chairman and Members
Pima County Board of Supervisors

From: C.H. Huckelberry,
County Administrator

Re: **Transition to Pay-as-you-go Capital Financing**

For the last 45 years, the County has provided capital improvements for public facilities and buildings through debt financing where the County has asked the voters to approve General Obligation or Highway User Revenue bonds. The County has also financed major capital replacement, repair and rehabilitation improvements for our Regional Wastewater Treatment and Conveyance facilities by issuing a combination of sewer revenue bonds and sewer obligation bonds. Over the years, Pima County has financed approximately $3.0 billion of capital improvements using these debt financing structures.

As of July 1, 2019, the outstanding debt on these various issuances are:
- General Obligation Bonds - $227,335,000
- Highway User Revenue Bonds - $65,510,000
- Sewer Revenue Bonds/Sewer Obligations - $458,482,871

For years, this capital financing strategy has worked well with the low interest environment for debt instruments. For General Obligation bonds issued since 2012, the average interest rate has been 2.29 percent, for Highway User Revenue Bonds the average interest rate has been 2.16 percent and for sewer obligations 2.67 percent.

While these programs have been successful, the defeat of recent bond issues indicates the need to develop another option for providing necessary capital public facilities. One such option is to develop a Pay-as-you-go (PAYGO) Capital Financing strategy. In the upcoming budget, I will introduce the development of such an option.

In 2012, Maricopa County financed the South Court Tower at an approximate cost of $330 million from their primary property tax revenues. They continue to finance capital improvements in information technology, facilities management and parks, through the General Fund, which is primarily supported by primary property tax revenues. Funding capital improvements through annual tax revenues is simply known as Pay-as-you-go (PAYGO) Capital Financing. I have now begun the process of transitioning our Capital Improvement Program financing from bond or debt supported to PAYGO funding. This transition will be fully complete within the next five years.

This transition is complete for the Library and Regional Flood Control Districts. Beginning in this budget year, four cents of the Library tax rate is now permanently dedicated for PAYGO capital facilities. The libraries at the Southeast Regional Park off Houghton Road and Mary Ann Cleveland Way and the new Sahuarita Library will be the first facilities built using this funding strategy. In addition, two cents of the Regional Flood Control tax rate will also be dedicated to PAYGO capital facilities.

This process is also being implemented with Regional Wastewater Reclamation where their PAYGO amount will be $45 million per year of capital investment. This amount can be achieved without any foreseeable utility rate increase in the future.

For the General Fund, this strategy was started in small amounts last fiscal year using one-time primary levy funds, but you will see increasing reliance on PAYGO Capital Financing next year and in the coming few years using recurring funding. This transition is made possible by the rapidly declining secondary property tax rate and levy. The table below shows the estimated secondary property tax levy for debt service for the next five fiscal years as well as how the fund grows over the next few fiscal years.

Pay As You Go General Fund Primary Tax Levy						
	FY18-19	**FY19-20**	**FY20-21**	**FY21-22**	**FY22-23**	**FY23-24**
Debt Service[1] Secondary Tax Collection Rate	0.690	0.690	0.520	0.470	0.320	0.220
Secondary Tax Levy Decrease[2]		-	0.170	0.050	0.150	0.100
1/2 of Decrease[3]			0.085	0.025	0.075	0.050
Cumulative Decrease			0.085	0.110	0.185	0.235
Primary Tax Levy of 1 cent		851,771	899,641	936,616	975,579	1,013,237
Primary PAYGO Levy by Fiscal Year			7,646,947	10,302,777	18,048,218	23,811,063
Primary Tax Levy NAV Increase[4]			19,953,148	15,438,883	16,232,546	15,691,878
Primary Growth PAYGO 1/2 of NAV Increase			9,976,574	7,719,442	8,116,273	7,845,939
Total Available for Pay as you go[5]			17,623,521	18,022,219	26,164,491	31,657,002

[1] Secondary property tax rate necessary to pay principal and interest payments for all County outstanding general obligation bond debt.
[2] Year to year secondary debt service tax rate difference.
[3] As the debt service tax rate decreases only one half of the decrease will be used to build the PAYGO general fund in the primary tax levy. The remaining half will be used to decrease the overall County tax rate.
[4] As the tax base expands or grows, one-half of the growth per year will be dedicated to the PAYGO fund until the annual recurring revenues in the fund equal $50,000,000 per year.
[5] Annual amounts per fiscal year available in the PAYGO fund.

The listed tax rates are necessary to complete the early and rapid repayment of our outstanding bond indebtedness. As the secondary debt service rate decreases, I will begin transferring approximately half of the reduction to the primary property tax rate, where the amount levied can be segregated into a separate PAYGO Capital account with a goal of raising, over a period of time, an amount generated of $50 million per year, which should sustain capital expansion and replacement without future debt financing.

While reduction in the debt service tax rate levy will assist in building a PAYGO Capital Fund, it will also be necessary to reserve a component of the annual tax base growth tax rate as well as allow the primary property tax rate to continue to be reduced over time. This simply means that the primary property tax rate will not decrease as much as it could based on continued tax base growth. Once achieved, the secondary property tax rate for the debt service will eventually be zero. This milestone could easily be reached in the next seven years. At that time County General Obligation Bond debt will have been retired. In addition, it is likely that within five years, the County would be able to continue to meet truth in taxation standards, assuming continuing modest expansion of the tax base. This should reduce the primary property tax rate of $4.07 to $3.64 within the next five years or sooner.

Because of expenditure limitation requirements, it is also likely that this annual capital financing will have to be financed using short-term three-year limit debt instruments to ensure the County does not exceed the constitutionally imposed expenditure limit. In other words, even after all of our debt has been retired, you will continue to see Certificates of Participation issued for debt periods no longer than three years, which meets the Auditor General's definition of debt and allow an appropriate offset to the annually calculated expenditure limit.

CHH/anc

c: Jan Lesher, Chief Deputy County Administrator
Tom Burke, Deputy County Administrator for Administration
Carmine DeBonis, Jr., Deputy County Administrator for Public Works
Michelle Campagne, Director, Finance and Risk Management
Robert Johnson, Deputy Director, Finance and Risk Management
Nicole Fyffe, Executive Assistant to the County Administrator
Patrick McGee, Budget Manager, Finance and Risk Management