MEMORANDUM

Date: August 31, 2016

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

From: C.H. Huckelberry
County Administrator

Re: **Arizona Tax Research Association Newsletter Article Regarding The Maricopa Integrated Health System**

Attached is an article featured in the August 2016 Arizona Tax Research Association newsletter regarding the Maricopa Integrated Health System (MIHS). The article indicated the Hospital District is projecting a $19 million loss for Fiscal Year (FY) 2017/18. As you will recall, Maricopa County, through special legislation, was able to transfer their hospital from a General Fund supported agency to an independent secondary property taxing special district.

The table below shows the five-year history of the property tax levy of the MIHS.

Maricopa Special Health Care District (Maricopa Integrated Health System)					
District Tax Levy	**FY 2012/13**	**FY 2013/14**	**FY 2014/15**	**FY 2015/16**	**FY 2016/17**
Maintenance & Operations Levy	$57,895,470	$62,499,144	$65,124,108	$67,273,204	$70,777,141
Bond Interest & Principal Levy				37,341,000	39,747,000
Total District Tax Levy	$57,895,470	$62,499,144	$65,124,108	$104,614,204	$110,524,141
District Tax Rate	**FY 2012/13**	**FY 2013/14**	**FY 2014/15**	**FY 2015/16**	**FY 2016/17**
Maintenance & Operations Rate	$0.1683	$0.1939	$0.1856	$0.1943	$0.1955
Bond Interest & Principal Rate				0.1078	0.1098
Total District Tax Rate	$0.1683	$0.1939	$0.1856	$0.3021	$0.3053
District Valuation	**FY 2012/13**	**FY 2013/14**	**FY 2014/15**	**FY 2015/16**	**FY 2016/17**
Taxable Net Assessed Value	$34,400,455,716	$32,229,006,810	$35,079,646,593	$34,623,670,323	$36,198,108,538
Source: Maricopa County Tax Levy, various years.					

An operating loss must be paid with some revenue source, and it can be inferred to be a property tax liability. Hence, the property tax direct payment and subsidy for FY 2017/18 would equal approximately $130 million. Such compares with our General Fund transfer of $15 million to the Banner University Medical Center (BUMC) system for their support of the South Campus, a County-owned facility leased to BUMC to provide medical and health services. On a per capita basis, this amounts to $14.86 for a Pima County resident and $31.89 for a Maricopa County resident. Hence, our strategy to lease our hospital to a nonprofit system with direct responsibility for medical education has been and continues to be a cost effective strategy.

CHH/anc

Attachment

c: Jan Lesher, Deputy County Administrator for Community and Health Services
Dr. Francisco Garcia, Director, Health Department

The taxpayer's watchdog for over 75 years

ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER VOLUME 76 NUMBER 6 AUGUST 2016

FIRE DISTRICTS IN DESPERATE NEED OF REFORM

For years, Arizona's fire districts have lobbied the Legislature for unlimited taxing power and met heavy resistance from lawmakers. During the 2016 legislative session, fire district representatives unsuccessfully lobbied the Legislature to eliminate their $3.25 tax rate cap. ATRA aggressively opposed the effort, and as a result, the bill was never heard in committee. ATRA argued that to increase funding to an unsustainable system without reform is irresponsible.

Following the failed legislative effort by the fire districts to remove the rate cap, ATRA worked with district officials on a temporary solution that would allow time to analyze the inefficiencies in the statewide fire district system while providing

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Save the Date!

ATRA Golf Tournament:

Nov 4, 12:00 pm

McCormick Ranch

ATRA Outlook Conference:

Nov 18, 8:00 am

Scottsdale Hilton

Pima County Wins 1% CAP Lawsuit

State GF Back on hook for high tax spending

Pima County successfully challenged a provision in the Fiscal Year (FY) 2016 state budget that shifted the majority of the responsibility for 1% Cap payments from the state general fund back to the local governments in counties with high 1% Cap costs. (*For info on the 2015 legislation see the ATRA May 2015 Newsletter.)*

The decision shifts $19.8 million in 1% Cap payments from Pima County, Pinal County, Pinal Community College, and several Pinal County cities back to the state general fund – the source of 1% Cap funding responsibility since 1980. Pima County government was relieved of $15.8 million in payments to several Pima County school districts; of which $15.7 million would have gone to Tucson Unified School District. Pinal County was relieved of $1.7 million in payments to various Pinal County school districts.

Maricopa County Superior Court Judge Christopher Whitten ruled that the FY 2016 budget provision was an unconstitutional delegation of power to the Property Tax Oversight Commission (PTOC). The legislation gave PTOC the responsibility for calculating which local governments were responsible for making the required 1% Cap payments.

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In addition to putting a $20 million hole in the state's FY 2017 budget, the court decision will jump start another round of debate on 1% Cap reform in the next legislative session. ATRA was publicly critical of the 2015 law because it exposed property taxpayers in the highest tax areas of the state to even higher taxes. The failure of the law to provide any caps on high property tax rate jurisdictions that cause 1% Cap payments ensured ever increasing tax rates over time. In fact, Pima and Pinal Counties raised property taxes last year in anticipation of having to make 1% Cap payments. To their credit, both of those entities returned those taxes back to property taxpayers following the court decision. On the contrary, Pinal Community College District imposed a 23% levy increase following the passage of the 2015 legislation, none of which was returned to taxpayers this year.

Reform efforts next session will no doubt include an effort on the part of state policymakers to again cut their losses on the state's exposure for making the 1% Cap payments. The majority of state lawmakers represent areas where there are little or no 1% Cap payments because overall property tax rates are not excessive. Those lawmakers have little desire to use state funds to subsidize the high spending in areas that have high tax rates. However, ATRA will insist that any reform that again shifts 1% Cap exposure back to local governments be combined with rate caps that provide some protection to local taxpayers.

ATRA has repeatedly encouraged lawmakers to also recognize that the 1% Cap overages are mostly concentrated in the following key problem areas of Arizona's property tax system that the 1% constitutional cap was not designed to handle:

First, high K12 primary tax rates. Arizona's system contemplates K12 district primary rates to be levied somewhere in the neighborhood of the Qualifying Tax Rate (QTR). Where this is the case there are few examples of 1% Cap exceedances. However, two notable features of our current school finance system allow significant levies in excess of the QTR causing taxpayers to breach the 1% Cap – Desegregation/Office of Civil Rights (OCR) spending and the Small School Adjustment (SSA). These two features of Arizona's school finance system are primarily responsible for the majority of the 1% Cap payments from the state general fund. There are 19 school districts that annually levy $211 million in non-voter approved primary property taxes. Tucson Unified School District, where the lion's share of the 1% Cap payments are directed, has a FY2016 primary rate of $6.5217, 56% above the QTR. That extraordinarily high rate is driven by a $63.7 million deseg levy that adds another $2.0678 to the primary rate. Roosevelt Elementary District's OCR levy of $13.6 million adds another $2.0678 to the primary rate. Roosevelt's $4.3869 primary rate is 111% above the elementary QTR.

The SSA, used by 50 school districts in FY 2016, allows school districts with K-8 student counts below 125 or 9-12 below 100 to exceed the school budget caps without limit. The costs for the SSA are financed through a non-voter approved primary property tax. While the state general fund exposure for 1% Cap payments driven by the SSA are less than Deseg/OCR, exposure to taxpayers is greater.

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With few exceptions, annually the highest K12 primary tax rates are in small, mostly rural districts, availing themselves to the budget limit exemption. This year, Grand Canyon Unified imposed a $12.0990 primary rate, 190% higher than the QTR. Hayden-Winkelman levied an $11.88 primary rate, 186% higher than the QTR. Without considering the incentives created by the 1% Cap, state policymakers no doubt counted on local oversight and control to ensure that the tax rates in these districts remained reasonable. However, the 1% Cap clearly undermines any accountability for the high taxes with the homeowner/voter in these districts. To complicate matters further, most districts that qualify for the SSA do not need to seek voter approval for overrides and bonds resulting in the state subsidizing expenditures that other districts are financing with secondary property taxes.

ATRA is on record recommending that state policymakers should phase out the Deseg/OCR spending. That single change would dramatically reduce the state's exposure for 1% Cap payments. State policymakers should reform small school district funding in a manner that acknowledges their lack of economies of scale but ultimately requires small districts operate within reasonable spending constraints like all other districts.

Second, high city primary rates. Historically, city governments have relied mostly on sales tax and state shared revenue for their operational budgets. When the 1% Cap was created in 1980, no city or town had a primary rate in excess of $3.00 and only a few exceeded $2.00. For FY 2017, only 50 of the 91 cities and towns actually impose a primary rate. However, currently there are a handful of cities or towns with primary rates above $4.00.

Maybe the most notable examples of the perverse incentives associated with the cap and the state subsidy were the elections to create a primary property tax in two Pinal County towns. The Town of Superior (1995) and the Town of Maricopa (2006) both moved fire protection from existing fire districts funded through secondary property taxes (secondary property taxes are not subject to the 1%) into town fire departments funded through a primary property tax. In both instances, town officials were quite open about their strategy to leverage the 1% Cap on primary taxes thereby shifting existing homeowner tax obligations to the state general fund.

Lawmakers should consider requiring these two jurisdictions, through a public vote, to transfer those property tax obligations back to the secondary property tax. Lawmakers should also prohibit any future city primary property tax elections in areas where homeowners are already at or near the 1% Cap.

Third, high county primary rates. Clearly the majority of 1% Cap problems occur in counties with high primary rates. In fact, 90% of the $24.3 million in total 1% Cap payments for FY 2016 were in Pima and Pinal Counties. The high primary rates of those counties provide little cushion for the higher rates for other jurisdictions that have been previously discussed. Pima County (responsible for 70% of the total 1% Cap payments) is the only county that has not accessed the state authorized half-cent sales tax because they have been unable to secure the required unanimous vote. Last session, ATRA supported Pima County's effort to reduce that vote to a simple majority in return for a dollar for dollar reduction in county property taxes. This change would provide a meaningful reduction in property taxes county-wide thereby reducing 1% Cap payments.

Reforming these areas will not only provide significant reductions in 1% Cap problems across the state, they will also ensure accountability for spending decisions that impact the primary property tax. In addition, these reforms would dramatically reduce the need for the tax rate caps that are so critical if the state simply resorts again to shifting the cap payments back to local governments.

-Kevin McCarthy

MIHS Budget Still in the Red

Asks State Lawmakers to Increase Subsidy

The Maricopa Integrated Health System (MIHS), the County's hospital district, is projecting a $19 million loss for Fiscal Year (FY) 2017. After several years of running deficits, one wonders how a district can keep its doors open. For FY15 and FY16, the district used $36 million in bond money to "pay itself back" for previously incurred capital expenses. This short-term cash infusion was quickly absorbed and the district must now find other options.

MIHS recently sold the Maricopa Health Plan (MHP) to UnitedHealthcare which includes roughly 82,000 enrolled clients. Per their financial statements, operating a managed care plan for Medicaid and Medicare patients was a primary source of income for MIHS. While this sale may provide a short term cash infusion, it is a curious move to shed a revenue generating service.

Despite reducing expenses on salaries, benefits and supplies by 6% or approximately $24.7 million last year, MIHS' operating losses are projected to grow. Net patient service revenue has declined several years in a row. Per their annual audit, the operating loss grew $20 million in FY2015. What this means is the district will continue to require increased taxpayer subsidy at a time when taxpayers face rising healthcare costs on several fronts.

In addition to maximizing their operational property tax levy on Maricopa County taxpayers each year, the district will continue to lobby for increased appropriations from the State Legislature.

The district points to the loss of Safety Net Care Pool dollars (SNCP) for the present financial crisis. SNCP was a bridge program created in 2011 and terminated on December 31, 2013 which annually provided about $50 million to the district for care for uninsured and underinsured populations. The Affordable Care Act and related legislation is moving away from pools of funding for providers and instead funding or subsidizing insurance.

The district should admit in their SNCP phase-out discussions that their access to AHCCCS spiked. Indeed, MIHS' net cost of charity care dropped from $97.4 million to $58.1 million from FY2014 to FY2015; the change mostly a result of additional AHCCCS payments from the restoration of childless adults and Medicaid expansion populations. The removal of SNCP is not the underlying issue.

The district's message to state lawmakers is an increasing amount of federal Disproportionate Share (DSH) dollars should go to MIHS. The state of Arizona has long accessed DSH dollars to offset costs to participate in Medicaid through AHCCCS. MIHS argues most of the money is simply reverted to the state general fund, which is a historically inaccurate perspective. The state has many uncompensated care requirements outside of Maricopa County's hospital.

MIHS' current strategy to alleviate its financial crisis is to lobby state lawmakers for increased subsidies for a county asset. From their financial statement: "MIHS feels that it has a compelling case for more funding from the DSH program and is working closely with Arizona policy makers to address this disparity." The DSH program is slated to expire although Congress presently appears willing to reauthorize the money until the transition away from providing pools of funding such as DSH to funding insurance programs is complete.

It is ironic that the Maricopa County Hospital, an outdated model of providing care, is staking its long-term financial solvency on an outdated financing model like DSH. These federal dollars are not likely to be around forever and when they phase out, taxpayers can expect to be relied upon to foot the bill.

ATRA continues to recommend that the MIHS Board of Directors find a niche role for this County asset which does not rely on increasing taxpayer subsidy into the future. *For more on this topic please see the ATRA July 2015 and May 2016 newsletters.*

-Sean McCarthy

FIRE DISTRICT REFORM, *Continued from Page 1*

districts some flexibility in the meantime. With the passage of SB1244, voters may be asked this November to approve a five-year override to allow their fire districts to exceed the $3.25 tax rate cap up to $3.50. There are a number of fire districts that will have questions on the ballot asking voters for either the temporary tax override or a bond approval.

Through much of the debate, it's regrettable that many districts have placed blame for their fiscal problems on Prop 117. Prop 117 was designed to limit local governments' ability to ride significant valuation increases to large tax increases. In fact, the fire districts were the poster child for Prop 117 as a result of their failure to responsibly manage their tax rates during the boom years. For example, despite the fact that property values doubled between 2005 and 2009, fire districts dropped their tax rates only 5.6% on average and caused taxes to rise an overwhelming 80%. It is clear that fire districts would prefer to have unlimited taxing power, but the property tax system cannot sustain the level of funding fire districts desire. In fact, the current $3.25 tax rate cap for fire districts rivals that of which property taxpayers pay for the operational budgets of K-12 schools.

Some fire districts became comfortable increasing taxes over the years and they likely are the ones struggling most with the reasonable limits set by Prop 117. Particularly in a growth market, Prop 117 provides stability for taxpayers without unnecessarily damaging local government budgets. Unlike the very restrictive Prop 13 cap on value of 2%, Prop 117 allows a 5% annual growth that will represent reasonable growth over time.

Simply blaming Prop 117 for all fire district problems is not only inaccurate, it diverts attention from a variety of very serious fiscal challenges they face statewide. Like many taxing jurisdictions, fire districts are burdened by spiraling pension costs in the Public Safety Pension Retirement System, as well as other employee-related expenses. Many fire districts have evolved from small volunteer operations into costly full-time departments despite the fact that the property tax base cannot sustain such an operation.

ATRA has been focusing its efforts lately on the way in which emergency medical services are delivered, particularly in rural Arizona. Based on a recent study by the National Fire Protection Association, medical calls account for nearly 70% of all fire department calls. At the same time, fire calls make up only 4%. Services provided and service delivery continue to evolve. Lawmakers must seriously examine the way fire and emergency medical services are delivered and how those services are funded. Simply put, ever increasing property tax rates can't and shouldn't be the answer to funding challenges for Arizona fire districts.

-Jennifer Stielow