MEMORANDUM

Date: February 3, 2015

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

From: C.H. Huckelberry
County Administrator

Re: **Homeowners Rebates Regarding Primary Property Tax Rates and State Proposal to Have Homeowners Rebates Paid by Property Taxing Jurisdictions, Including Pima County**

On January 23, 2015, I reported to the Board of Supervisors that the Governor's proposed budget transferred nearly $10 million in expense liabilities to the County that could not be absorbed and would result in a property tax increase within the County to fund State agencies, departments and programs. This new shift is in addition to the nearly $81 million already transferred by the County to the State at their request to support State programs and agencies. Nearly one third of our primary property tax is levied on behalf of the State.

Unfortunately, taxpayers do not discern the difference between a State-required property tax increase and an increase to provide County services. This property tax increase, if required for Fiscal Year 2015/16, will be one that has been mandated by the State – either administratively imposed on the County or authorized by the Arizona Legislature.

In my January 23 memorandum, I indicated I would provide the Board with additional information when received regarding the most perplexing component of the State budget, which is the proposal to transfer previously State-paid homeowner tax rebates to the County and the primary property tax levying jurisdictions within the County.

Unfortunately, there is little new to report, since we are unable to obtain any specific information regarding this tax shift to local governments from the State. We do believe the proposal is likely to be challenged; and it is potentially unconstitutional, as well as not very well thought out.

Table 1A below shows the original proposal as shown on Page 29 of the Governor's January 16, 2015 presentation entitled *Fiscal Year 2016 Executive Budget Recommendation* and our analysis of who would pay this proposed State tax transfer. Table 1B below is our approximation of the impacts base on the amounts included in the Governor's original Executive Summary and broken out by just five of the taxing entities that levy a primary property tax in Pima County, one of which is Pima Community College (PCC).

Table 1A
One-percent Cap Example (State).

Jurisdiction	Tax Rate	Percent-age	Prorated Cost ($millions)
State*	$0.51	4.4	$ 1.58
TUSD**	4.96	42.9	8.0
County	5.61	48.5	9.0
City	0.48	4.2	0.8
Total	**$11.56**	**100.0**	**$19.5**

*State share includes the first million over the cap. **The TUSD (Tucson Unified School District) rate is reduced by $1.84 due to the Homeowner's Rebate.

Table 1B
One-percent Cap Example (Separating Pima County and PCC).

Jurisdiction	Tax Rate	Percent-age	Prorated Cost ($millions)
State*	$0.51	4.4	$ 1.8
TUSD**	4.96	42.9	8.0
County	4.28	37.0	7.0
City	0.48	4.2	0.8
PCC	1.33	11.5	2.0
Total	**$11.56**	**100.0**	**$19.6**

*State share includes the first million over the cap. **The TUSD rate is reduced by $1.84 due to the Homeowner's Rebate.

To provide the Board with some actual basis of analysis, it is important to provide background information regarding the subject of homeowner property tax rebates and how they are developed and paid. The concept of a homeowner property tax rebate arises from a constitutional amendment approved by the voters in 1980. This amendment states:

> *"18. Residential ad valorem tax limits; limit on increase in values; definitions Section 18. (1) The maximum amount of ad valorem taxes that may be collected from residential property in any tax year shall not exceed one per cent of the property's full cash value as limited by this section."*

This amendment essentially precludes homeowner-occupied properties, or Class 3 properties, from paying more than one percent of their full cash value in primary property taxes. In our property taxing system, this means the combined primary property taxes of all tax levying jurisdictions cannot exceed $10 per $100 of assessed valuation. If such occurs, the tax liability for the excess rests with the State as codified in legislation enacted by the State Legislature in 1981 to operationalize the Constitutional amendment of 1980. This system has been in place for 34 years without modification or challenge.

The current proposal would result in a property tax transfer from a limited number of residential Class 3 properties to all other classes, including the business and commercial property taxpayers within the County.

In the Governor's budget presentation, this was first indicated to be a cost shift to the property taxing jurisdictions, including Pima County, the school districts and other primary property tax levying jurisdictions. If tax rates are raised to compensate for this shift, those who would likely pay this levy, for only the County portion of $7,850,548 based on Fiscal Year 2014/15 assessed values, are shown in Table 2 below. If the other primary property taxing entities also raise their rates, the stated amount would increase.

Table 2: Tax Increase for Additional State Aid.

Property Class	**Estimated Tax Increase**
Class 1, Commercial Centrally Valued Properties	$687,161
Class 1, Commercial Locally Valued Properties	2,211,453
Class 2, Vacant Land/Agricultural	512,018
Class 3, Primary Residence	2,681,650
Class 4, Non-primary Residence	1,696,640
Class 5, Railroads	13,362
Classes 6 – 9, Other Properties	48,264
Total	**$7,850,548**

Table 2 Note. Tax increases for Class 3 parcels would not apply in TUSD, San Fernando Elementary, Redington Elementary or Altar Valley Elementary school districts, since all properties in these school districts are already at the one percent limit, and any tax increase would be offset by an increase in Additional State Aid. Depending on the size of the tax increase, some properties in other school districts may be "held harmless" as well, but they are not reflected in this chart.

Please note the existing residential Class 3 property is approximately 45 percent of the total Net Assessed Value, but the estimated additional tax in Table 2 above is only 34 percent of the total estimated additional tax. This is because only 62 percent of the Class 3 tax base will pay the additional amount. Having the same class of property paying two different levels of property tax is problematic.

Based on the State budget presentation, PCC would bear $2 million of this expense. The County share was projected to be $9 million based on the Governor's presentation. We have more accurately forecasted this at $7 million plus. Also, the State believes TUSD would pay $8 million; but based on the Constitution, the owner-occupied Class 3 properties within TUSD would be exempt. Does this mean the businesses within TUSD would bear the entire cost? We could not determine whether this is correct, but it would appear to be the case. If PCC and TUSD also increase their primary taxes to cover the State shift, the difference between residential properties becomes even larger.

Our analysis, as shown in Table 3 below, indicates 38 percent of Class 3 parcels would not pay any additional tax; but 62 percent of the total assessed value of Class 3 properties would pay an additional tax, as well as all other classes of property in the base.

Table 3: Class 3 Parcels Receiving Additional State Aid in 2014 by School District.

School District	Net Assessed Value (NAV)
TUSD	1,251,387,630
Marana	1,062,475
Flowing Wells	-
Amphitheater	16,441,984
Sunnyside	-
Tanque Verde	-
Ajo	-
Catalina Foothills	-
Vail	792,110
Sahuarita	175,804
San Fernando	74,866
Empire	-
Continental	-
Baboquivari	-
Redington	189,290
Altar Valley	13,352,646
Unorganized School District	-
Total NAV of Class 3 parcels receiving Additional State Aid, including mobile homes	1,283,476,805
Total NAV of Class 3 parcels in Pima County, including mobile homes	3,401,121,728

Class 3 parcels receiving Additional State Aid as a percentage of total Class 3 parcels	38%

Table 3 Note. Class 3 parcels receiving Additional State Aid make up a smaller percentage of total Class 3 parcels on an NAV basis than they do on a parcel count basis because the average NAV of Class 3 properties in TUSD is lower than the average NAV of all Class 3 properties in Pima County.

This budget proposal is simply a tax shift to primarily business and commercial property, and the shift becomes even larger if PCC and TUSD increase their primary rates to offset the State tax shift.

We are anxious to examine any data and information that can be provided regarding this proposal in order to prepare an accurate assessment. However, with the information currently available, we cannot discern the exact intent or impact of this proposal. We are able, though, to determine the unintended, adverse tax consequences will be significant to commercial properties, business interests and centrally assessed properties, as well as residential rental properties.

As additional information becomes available, I will provide it to the Board.

CHH/mjk

c: Tom Burke, Director, Finance and Risk Management
Robert Johnson, Budget Manager, Finance and Risk Management