MEMORANDUM

Date: October 18, 2017

To: Chair and Members
Sales Tax Advisory Committee

NLF FOR
From: C.H. Huckelberry
County Administrator

Re: **Half-Cent Sales Tax for Road Repair and Property Tax Reduction Over 15 Years**

Background

At the last Pima County Sales Tax Advisory Committee meeting, we provided you with a table showing that a new County half-cent sales tax could generate about $880 million over 10 years, and showed how this $880 million could be distributed to cities, towns and unincorporated areas of the County by population if all of it was allocated to funding road repair. This 10 year road repair program would effectively fix all of the roads in unincorporated Pima County and most of the roads within the City of Tucson, while maintaining what are mostly fair to good condition roads within the other cities and towns. The Committee also heard Mr. Steve Huffman, representing Tucson Association of Realtors, in support of the sales tax because of its potential to reduce Pima County's dependency on property taxes. Since then, Committee member Mr. Dennis Minano asked me if it was possible to allocate half-cent sales tax revenue in such a way that it could address both objectives of funding road repair and reducing property taxes. This memorandum is in response to Mr. Minano's request. It should be considered only one alternative or scenario among many the Committee may wish to examine.

The 1 Percent Arizona Constitutional Property Tax Cap

Reducing property taxes in any amount is obviously a worthy goal. However for it to be meaningful to all homeowners in Pima County, we need to reduce primary property taxes by an amount that is enough to address the one percent Arizona constitution property tax cap issue. This is a complicated issue and I will ask staff to brief you on the issue in more detail at your next Committee meeting. But in short, it is important to understand that the State is subsidizing property tax bills for homeowners living within the Tucson Unified School District (TUSD). The State does this because of a referendum, referred to the ballot in 1980 by the State legislature and ultimately approved by voters, that limits total primary property taxes on primary residences in Arizona to one percent of the taxable value of a home. This equates to $1,000 on a home with a limited property value of $100,000. In Pima County, this occurs largely in areas within TUSD. TUSD's primary property tax rate is higher than most other school districts across the state due to the fact that they are still under a court ordered desegregation program. Combined with Pima County's primary property tax rate, Pima Community College's primary property tax rate, the State of Arizona's primary education tax rate, and the primary tax rate of either the City of Tucson or City of South Tucson, this results in an overall total primary property tax rate greater than the one percent cap.

This subsidy to property tax payers living in TUSD cost the State $16.6 million, this year. This is up from $13.8 million last year because Pima County increased its primary property taxes for the new road repair property tax. Of this $16.6 million, $4.7 million subsidizes primary residences within the unincorporated areas of TUSD, $11.9 million subsidizes primary residences within the City of Tucson areas of TUSD, and $33,000 subsidizes primary residences within the City of South Tucson areas of TUSD. In essence, whenever any of these taxing jurisdictions raise primary property taxes, homeowners living in TUSD do not pay the increase – instead the State pays it for them. For example, homeowners in TUSD are not really paying more taxes for the new road property tax adopted by the County for this year; instead the State is paying it for them. As you can imagine, the State is not pleased with this. It is also an equity issue as the State funds this subsidy with taxes paid by other tax payers across Pima County and Arizona. Attachment 1 shows how this State subsidy has varied year-to-year since 1999. In the attachment, the subsidy is referred to as the Additional 1% Aid.

To be clear, owners of commercial property and other property that is not considered a primary residence would benefit from any amount of property tax reduction as the one percent cap does not apply to them. So would those paying taxes for primary residences located outside of the TUSD tax area as their primary property taxes are not exceeding one percent of their homes' taxable value. But those paying property taxes for primary residences within the TUSD tax area would only see a reduction in their property taxes if we can reduce the property taxes by an amount that is enough to get the total primary property taxes below one percent of the taxable value of their home. About 42 percent of primary residences in Pima County are located within the TUSD taxing area.

Analysis

Based on the above discussion, the goal of this analysis was to determine whether it was possible in the near term to:

1. Allocate revenues from a half-cent sales tax to reduce property taxes to an amount low enough that property taxes would not exceed one percent of the taxable value of a home within the TUSD tax area; and

2. Provide enough revenue to fully repair all the roads in unincorporated Pima County and most of the roads within the City of Tucson.

Attached are several tables produced by our Finance Department, providing five different scenarios. All the scenarios would dedicate $812 million to road repair and $638 million to property tax reduction over 15 years, while gradually reducing the amount for road repair and increasing the amount for property tax reduction. But the scenarios differ in how soon the primary property tax rate could be reduced low enough to eliminate the state subsidy to homeowners in TUSD. Scenarios 1, 3 and 4 eliminate this state subsidy within 5, 7 or 9 years. Scenario 5 eliminates this state subsidy within 16 years. Scenario 2 does not eliminate this state subsidy within the 16 year window. Attachment 2 includes a Summary of Scenarios.

To run an analysis like this requires many assumptions. Below are the key assumptions that were applied to all of the scenarios.

1. For FY 2018/19, Pima County eliminates the new $0.25 road property tax, reducing its primary tax rate to $4.2096. Future years also have no road property tax.

2. The sales tax revenues are distributed as follows over three year increments:
   - Year 1-3 (FY2018/19 through FY2020/21), 100 percent is allocated to road repair, with zero allocated to property tax reduction.
   - Year 4-6 (FY2021/22 through FY2023/24), 80 percent is allocated to road repair, with 20 percent allocated to property tax reduction.
   - Year 7-9 (FY2024/25 through FY2026/27), 60 percent is allocated to road repair, with 40 percent allocated to property tax reduction.
   - Year 10-12 (FY2027/28 through FY2029/30), 40 percent is allocated to road repair, with 60 percent allocated to property tax reduction.
   - Year 13-15 (FY2030/31 through FY2032/33), 20 percent is allocated to road repair, with 80 percent allocated to property tax reduction.
   - Year 16 and onward (FY2033/34 and onward), 100 percent is allocated to property tax reduction.

3. The County's primary tax levy in future years is only allowed to increase from the FY 2018/19 base levy due to inflation and population growth.

4. TUSD's primary property tax levy includes $63,711,047 for desegregation expenses. It appears State law caps this desegregation expense at $63,711,047 for the future. So, the analysis caps the desegregation part of TUSD's levy at $63,711,047 as well.

5. The non-desegregation portion of TUSD's primary property tax is only allowed to increase due to inflation and population growth, while the desegregation levy is held constant at $63,711,047 each year.

6. Both Pima Community College and the City of Tucson are assumed to levy each year at their respective Maximum Levy Limit.

7. City of Tucson also levies an Involuntary Tort Judgment primary tax. For FY 2018/19 the Tort levy is assumed to be a dollar amount equal to the average Tort levy since FY 2010/11. In future years, the Tort levy increases based on inflation.

8. Primary taxes such as the State School Equalization Tax Rate (SETR) are subject to statewide Truth In Taxation requirements. Recent growth in statewide property values used to determine the SETR has been 3 percent. Therefore, it is assumed the growth rate for statewide property values remains at 3 percent throughout the analysis.

9. Another recession does not occur during this time period. Recessions can decrease property values or revenues, thus delaying when the state subsidy can be eliminated.

Below are assumptions that differ depending on the scenario:

1. Scenarios 2, 4, and 5 allow an additional tax levy for "additional program expenses" to ascertain the effect of adding to Pima County's and TUSD's tax levy because of program expansion.

2. Scenarios 1 and 2 assume the valuation for property that existed in the tax roll during the previous year ("existing property") increases at a constant 2 percent per year throughout the analysis. An annual 2 percent "existing property" growth rate is what we are now experiencing. In addition, the value of new construction property ("new growth" property) is a constant 2 percent each year throughout the analysis. We are currently slightly below a 2 percent new construction growth rate.

3. Scenarios 3, 4, and 5 assume the valuation for property that existed in the tax roll during the previous year increases at a constant 3 percent per year throughout the analysis and the growth rate for new construction growth is 2 percent.

<u>Example: Scenario 1 Only</u>

Staff will be available at the next Committee meeting to answer questions on any of the scenarios. For sake of simplicity, let us focus on Scenario 1. Scenario 1 assumes that property values will grow at rates of growth similar to what we are experiencing today. Scenario 1 also assumes that while the cost of existing services provided by TUSD and Pima County will need to be increased based on inflation, TUSD and Pima County will not add new services or new service costs. Scenario 1 also assumes Pima Community College and the City of Tucson will levy property taxes at the maximum rates allowable.

With those assumptions in mind, it is estimated that by Year 9 (FY2026/27) the State subsidy would be eliminated, homeowners living in TUSD would begin to see their primary property taxes decline, and that decline in revenues would get larger each year as the percent of sales tax revenue dedicated to property tax reduction increases to the maximum of 100 percent. Between Year 1 and Year 15, a total of $638 million in sales tax revenues will have been invested in property tax reduction and the net primary property tax rate for all taxing jurisdictions will have been reduced by $2.04.

In addition, by Year 9, $615 million would have been spent on road repair throughout the County, with another $197 million to be spent by Year 15, for a total of $812 million spent on road repair.

<u>Summary</u>

This analysis shows it is possible to achieve both objectives, fully funding road repair and providing meaningful property tax reduction. But to do so under the scenarios provided, would require a 15 year road repair program as opposed to the 10 year road repair program example provided to you at your last meeting.

CHH/dr

Attachments

c: Jan Lesher, Chief Deputy County Administrator
Carmine DeBonis, Deputy County Administrator for Public Works
Tom Burke, Deputy County Administrator for Administration
Ana Olivares, Director, Transportation Department
Keith Dommer, Director, Finance and Risk Management
Nicole Fyffe, Executive Assistant to the County Administrator

ATTACHMENT 1