MEMORANDUM

Date: February 5, 2015

To: Chairman and Members
Pima County Bond Advisory Committee

From: C.H. Huckelberry
County Administrator

Re: **General Obligation Bonding Amount for a New Voter Authorization – Not More than $650 Million**

Introduction and Issuance Variables

I have previously corresponded with the Bond Advisory Committee (BAC) on the subject of varying amounts of bonds for a possible voter authorization. These amounts varied from $500 million to $650 million. As discussed before, there are a number of constraints that govern the amount of bonds that could be issued. The primary constraint is the voluntary secondary property tax debt service cap. The cap has previously been set by the BAC and approved by the Board of Supervisors at $0.815. The current rate for Fiscal Year 2014/15 is $0.7000. Table 1 below shows the tax rate for the last 10 years, as you can see it has been as low as $0.6050 and as high as $0.7800.

Table 1
Secondary Debt Service Tax Rate

Fiscal Year	Debt Service Tax Rate
FY 2005/06	$0.7150
FY 2006/07	0.7150
FY 2007/08	0.6850
FY 2008/09	0.6050
FY 2009/10	0.7100
FY 2010/11	0.7500
FY 2011/12	0.7800
FY 2012/13	0.7800
FY 2013/14	0.7800
FY 2014/15	0.7000

We have clearly stayed below the limit set in 2004 and I have assumed this voluntary limit will remain in place for a new debt issuance.

Three additional constraints limit the amount of bonds to be issued. The first, is the life of the bond program. We have traditionally selected 10 years, meaning if a bond authorization of $600 million was authorized by the voters, the average sale of bonds over a 10 year period would equal $60 million per year. The second constraint is the retirement schedule; the County has limited this to 15 years. Typically, after 10 years, 90 percent of the debt is retired. We also do not artificially alter the debt schedule, for example interest only in the first few years and then aggressive principal payments at the end of the debt period. Our debt retirement schedule is simple, level principal and interest payments over the whole period of debt.

Finally, and third, the most important constraint is the tax base. As the tax base increases and the tax rate is held constant we have more capacity to retire debt. The tax base of Pima County has contracted significantly; in fact the largest contraction in our history occurred during this recent great recession. The bond debt service tax base dropped from a value of $9.86 billion in Fiscal Year 2009/10 to $7.58 billion today, a 23.1 percent reduction. For the first time in five years we are now forecasting a very slight increase in our net assessed value for bond debt service, rising from $7.58 billion to $7.62 billion for Fiscal Year 2015/16. We also forecast the tax base to rise to $8.7 billion in Fiscal Year 2019/20, essentially five years from now.

Criticism of County Bond Debt

If the BAC recommends and the Board were to approve asking voters to authorize another bond program, it is likely that one of the criticisms the County will face is the amount of debt we have today. This criticism was raised among several in the recent Animal Care bond issue that was approved by the voters in November of 2014.

To put Pima County's debt in perspective, it is first important to realize almost all of our debt comes from voter authorization. Prior to the issuance of sewer obligations, almost all of our debt and capital financing debt instruments were approved by the voters, as opposed to being only approved by a jurisdictional governing body.

Most new debt by other jurisdictions in Pima County has been authorized by the governing body of that jurisdiction without voter approval. Pima County remains one of the few large jurisdictions in Arizona to ask the voters to approve debt for bonds.

We are typically compared to Maricopa County, which often cited as having no debt; yet most forget or are unaware that Maricopa County transferred their hospital system to a secondary property taxing special district with the approval of the Arizona Legislature. Recently, Maricopa County voters approved the issuance of capital debt in the amount of $935 million for a new hospital system.

In addition, Maricopa is actively discussing how to finance nearly $188 million of capital improvements for their detention facilities. The method of financing most often discussed is to issue Certificates of Participation (COPs) without voter approval. Hence, as much as $1.1 billion in new debt ($935 million in general obligation bonds for hospital and $188 million in COPs for detention facilities) may be issued in Maricopa County in the near future. This is a substantial debt incurrence by Maricopa County, much more than is being considered by Pima County.

The next fact to consider is that we have a long history of issuing bond debt. Since May 1974, voters in Pima County have approved bond proposals at countywide elections 12 separate times. A total of 54 bond proposition questions have been approved by the voters and only four have been disapproved. In total, $2.064 billion in bonds, general obligation, sewer revenue and Highway User Revenue Fund (HURF) have been approved over the last 41 years. The most recent approval is for a new animal care facility in November of 2014 for $22 million.

Of the $2.064 billion in bonds approved by the voters, $1.950 billion has been issued and $1.257 billion has been repaid. The remaining debt of $693 million, which is $407 million in general obligation bonds, $157 million in sewer revenue bonds and the Water Infrastructure Finance Authority of Arizona (WIFA) loans and $129 million in HURF bonds is being repaid at an approximate rate of 10 percent per year. Hence in 10 years if no new debt is issued Pima County will be almost completely out of bond debt. In fact over this 10 year period this debt will be reduced by 94 percent from what it is today.

Debt financing is an important capital development strategy for a growing and expanding community. In particular, short-term capital debt it is the most appropriate and equitable way to have community beneficiaries, both existing residents and future residents, pay for capital public facilities.

In short, how much debt a county has incurred is not particularly important. What is important is how well that debt is managed. County debt has been well managed and the implementation of our capital debt programs through bonding have withstood serious but unfounded criticism.

In 2012 the Arizona Legislature passed unprecedented legislation directing the Auditor General to audit Pima County's bond programs. This legislation essentially rose out of the dispute between Pima County and the Town of Marana over sewer facilities. After an extensive and costly audit, for which the state is required to pay, the Auditor General found that:

1. <u>Pima County takes a collaborative approach in administering its bond programs, which is unique in all of Arizona</u>.
   While other jurisdictions in the state typically issue general obligation bonds for specific projects that benefit only their own jurisdictions, Pima County has established a 25-member BAC that includes seven members appointed by other jurisdictions within Pima County. Projects are prioritized based on public benefit, regardless of jurisdictional boundaries. The BAC then votes on each project, considering both the cost of the project and its public benefit.

2. <u>Bond proceeds have been fairly used for authorized purposes</u>.
   Auditors analyzed each change in approved expenditures or in anticipated completion date of projects and found they were approved by the BAC and the Board of Supervisors and properly accounted for, without any indication that changes were made to reward or punish any other entities.

3. Bond projects benefited citizens throughout Pima County.
   Projects tended to benefit individual jurisdictions in approximate proportion to the secondary property taxes paid by citizens within those jurisdictions. Auditors determined some differences are to be expected when projects are weighed based on public benefit. The greatest deviation occurred regarding the City of Tucson, which paid 43 percent of the taxes and received 50 percent of the value of the completed projects, and unincorporated Pima County, which paid 43 percent of the taxes and received 36 percent of the value.

These findings by a completely independent auditor confirms the integrity of the County bond program and instills confidence in continuing the program.

Putting Into Perspective the Amount of General Obligation Bond Debt Issuance and the Aggregate Tax Base Value

Given the unprecedented decline in the Pima County tax base since 2009, as previously discussed, with a 23.1 percent reduction, one might conclude that perhaps it would not be appropriate to issue more debt now and simply wait until the tax base had more fully recovered. To evaluate this concern, it is necessary to compare the magnitude of the previous general obligation bond debt voter authorizations as compared to the value of the tax base at the time of voter authorization. Table 2 below shows the immediate past voter authorizations that occurred in 1997, 2004, 2006 and 2014, with 2004 being the single largest at $582 million.

Table 2
Bond Authorizations Compared with Assessed Value

Authorization Date	Assessed Value	Total Authorization
May 20, 1997	$3,700,269,211	$256,980,000
May 18, 2004	5,633,321,019	582,250,000
May 16, 2006	6,887,803,879	54,000,000
November 4, 2014	7,579,898,868	22,000,000

As can be seen, the tax base at the time of the 2004 voter authorization of $582 million is nearly $2 billion less than it is today. From a tax base fiscal capacity, issuing nearly the same amount of debt or $650 million using today's tax base is not nearly as risky as it may have been in 2004. This is particularly true, if you look at the total value of the tax base as one measure of the capacity to repay.

New Authorization - Best Forecast of the Amount of Bonds

In developing the most probable and maximum voter authorization of new general obligation bond indebtedness the following assumptions are made:

- The program remains a 10 year program;
- Debt service remains at the aggressive repayment schedule of 15 years;
- A secondary property tax cap remains in place at $0.815;
- The growth in net assessed value is conservative and constrained by legislation that specifies how assessed value is displayed in a voter publicity pamphlet; and

- The net assessed value increases only at 2.76 percent for the first five years and only at 0.5576 percent thereafter. Although we anticipate much greater growth in the net assessed value, the statutes controlling the publicity pamphlet mandate a cap for the first five years at the average for the preceding 10 years and a cap thereafter at 1/5 of the 10 year average.

These are conservative debt principals. Applying these principals, as well as continuing to pay off the County's previous general obligation debt of $407 million, as well as issue new debt over ten or eleven years, the forecast below shows that the projected tax rate would increase from the current $0.7000 tax rate to the $0.8150 cap by Fiscal Year 2018/19 and remain at the cap for eight years. By scheduling the projects over a ten year period and timing the bond sales to that schedule, the debt service tax rate cap would not be exceeded for a $640 million authorization. In fact, $650 million is possible. In reality, the County would expect the tax rate to be even lower, but we are required by state statute to project tax base growth using an unreasonably low estimate of growth in the net assessed values.

Table 3
Pima County Proposed Bond Sales – Projected Tax Rates

Fiscal Year	Aggregate Debt Service[1]	Projected Tax Rate	Sales[2]	Statutorily Calculated Net Assessed Value[3]	County's Estimate of Assessed Value[4]
2014-15	53,084,200	0.7000		7,579,898,868	7,579,898,868
2015-16	53,916,984	0.7000		7,620,361,635	7,620,361,635
2016-17	61,091,995	0.7800	48,000,000	7,832,481,249	8,169,396,772
2017-18	64,900,990	0.8062	48,000,000	8,050,505,403	8,437,574,563
2018-19	67,441,180	0.8150	48,000,000	8,274,598,455	8,702,322,344
2019-20	69,318,293	0.8150	55,000,000	8,504,929,339	8,963,392,014
2020-21	71,243,353	0.8150	55,000,000	8,741,671,690	9,232,293,775
2021-22	71,658,072	0.8150	55,000,000	8,790,338,147	9,509,262,588
2022-23	72,035,920	0.8150	65,000,000	8,839,275,540	9,794,540,466
2023-24	72,434,692	0.8150	65,000,000	8,888,485,375	10,088,376,680
2024-25	72,844,623	0.8150	65,000,000	8,937,969,171	10,391,027,980
2025-26	73,249,839	0.8150	70,000,000	8,987,728,451	10,702,758,819
2026-27	73,492,651	0.8132	66,000,000	9,037,764,751	11,023,841,584
2027-28	73,566,853	0.8095		9,088,079,612	11,354,556,831
2028-29	69,027,728	0.7553		9,138,674,584	11,695,193,536
2029-30	65,826,992	0.7163		9,189,551,228	12,046,049,343
2030-31	59,989,848	0.6492		9,240,711,111	12,407,430,823
2031-32	52,363,465	0.5635		9,292,155,811	12,779,653,747
2032-33	47,254,714	0.5057		9,343,886,912	13,163,043,360
			640,000,000		

1 - Assumes relatively level debt service payments with interest rates at 3.5 percent for fiscal years 2017 and 2018; at 4.0 percent for fiscal years fiscal years 2019 and 2020; and 4.5 percent thereafter.
2 - Assumes $640,000,000 sold over between fiscal years 2017 and 2027.
3 - ARS § 35-454 requires that growth in Net Assessed Value for the next five years be equal to the average of the growth in the previous ten years and that growth thereafter be at 20 percent of the ten year average.
4 - County estimates are based on economic growth models for 2017, 2018 and 2019 and at 3 percent thereafter.

As can be seen in the table above, sales of new authorized bonds would begin in 2017 and continue through 2026-2027 and begin at a rate of $48 million per year and peak in year 2025-26 at $70 million a year. The voluntary property debt service tax rate would be capped at $0.8150 of interest. This table shows the comparison between the statutorily calculated net assessed value versus our economic forecast of our assessed value. In this analysis we have used the assessed value that has been specified to be used in any bond publicity pamphlet which sets artificial parameters. It is with this lower assessed value that we have calculated our ability to incur debt and remain within the voluntary tax rate cap. In the far right column of the table is our estimate of real County assessed value based on our economic forecast that has been consistently verified as both conservative and relatively accurate based on response of the tax base to both appreciation and growth. As can be seen in the first few years there is little difference but over time there is significant difference. If we were calculating our debt capacity based on actual economic forecast of County assessed value, the tax rate would be significantly lower than the projected tax rate shown in this table after the first few years. Hence, this forecast is very conservative and even though it is conservative, I will not recommend that any bond authorization be in excess of $650 million.

<u>Tax Base Equity of Debt Repayment and Project Benefits</u>

This potential bond program for voter authorization has essentially been under development by the BAC since 2007. Under a separate memorandum dated February 5, 2015, an analysis of the program that could be placed before the voters in the near future versus what was placed before the voters in 2004 and 1997, shows that the program is providing more regional benefits than local isolated benefits.

An analysis of the projects that could move forward are mostly regional. Regional projects are the most equitable and are defined as providing benefits to all taxpayers within Pima County. A measure of equity regarding who pays and who benefits is in the assessed value distribution by jurisdiction. A comparison of project benefits to the amount of debt paid by that jurisdiction or population is helpful in defining equity.

The tables below provide an update to population and net assessed property values for both residential and other property classes by jurisdiction. Table 4 below shows the population distribution by jurisdiction, including the unincorporated area, and the distribution of the net assessed value of residential property. This information is an indicator of the amount of taxes paid for bonded indebtedness by residential property owners by jurisdiction.

Perhaps the best measure of equity comes from net assessed value of residential property, but of course one could use total net assessed value by jurisdiction which is shown in a following table. Residential value is a measure of taxes paid by actual residents of a community or residents of a geographic area. When using total net assessed value included are commercial properties that have corporate ownership, with owners who do not reside in Pima County, for example Walmart and Target. Hence, the best measure of tax equity in bond project benefits versus debt repayment is reflected by the residential tax base.

Table 4
Population Distribution and Net Assessed Value of Residential Property

Jurisdiction	**July 1, 2014, Population** (Arizona Department of Administration)	**Population Percentage of Total**	**FY 2015/16 Net Assessed Valuation** (January 9, 2015, Assessment Roll)	**Net Assessed Valuation Percentage of Total**
Marana	40,342	4.00	$283,274,524	5.72
Oro Valley	42,190	4.19	441,966,100	8.92
Sahuarita	27,476	2.73	161,880,175	3.27
South Tucson	5,751	0.57	6,036,967	0.12
Tucson	529,336	52.56	1,718,815,854	34.70
Unincorporated County	362,067	35.95	2,340,783,537	47.26
Total Pima County	**1,007,162**	**100.00**	**$4,952,757,157**	**100.00**

In addition to the distribution of net assessed value of residential property by jurisdiction, Table 5 below reflects the distribution of total net assessed value for all property classes by jurisdiction.

Table 5
Net Assessed Value of All Property by Jurisdiction

Jurisdiction	**FY 2015/16 Net Assessed Valuation** (January 9, 2015, Assessment Roll)	**Net Assessed Valuation Percentage of Total**
Marana	$445,006,943	5.84
Oro Valley	572,696,599	7.51
Sahuarita	203,179,337	2.67
South Tucson	20,327,664	0.27
Tucson	3,123,679,235	40.99
Unincorporated County	3,255,471,857	42.72
Total Pima County	**$7,620,361,635**	**100.00**

Additional pertinent information is the assessed valuation by property class as shown in Table 6.

Table 6
Net Assessed Value by Property Class

Property Class	**FY 2015/16 Net Assessed Valuation** (January 9, 2015, Assessment Roll)	**Net Assessed Valuation Percentage of Total**
Residential	$4,952,757,157	64.99
Commercial	2,230,175,324	29.27
Agricultural and Vacant Land	385,042,986	5.05
Railroads and Other	52,386,168	0.69
Total	**7,620,361,635**	**100.00**

- Most of the value of commercial property is owned by individuals or corporations that are not residents of the County.

In reviewing these tables, the single largest property tax payer by class for County bonded indebtedness is the residential property class paying 65 percent of total bond repayment property taxes. Of the residential distribution of net assessed value by jurisdiction in 2015, taxpayers in the unincorporated area continue to pay the most in bond debt repayment at 47 percent of the total residential value, with the City of Tucson following at 35 percent.

Assessed valuations for residential property have dropped significantly over the past 5 years. Table 7 below compares values from 2010 with the 2015.

Table 7
Comparison Between Net Assessed Value of Residential Property in 2010 and 2015

Jurisdiction	**FY 2010/2011 Net Assessed Valuation**	**Net Assessed Valuation Percentage of Total**	**FY 2015/16 Net Assessed Valuation** (January 9, 2015, Assessment Roll)	**Net Assessed Valuation Percentage of Total**
Marana	$279,401,025	4.67	$283,274,524	5.72
Oro Valley	487,035,684	8.13	441,966,100	8.92
Sahuarita	164,664,701	2.75	161,880,175	3.27
South Tucson	9,523,084	0.16	6,036,967	0.12
Tucson	2,204,031,199	36.80	1,718,815,854	34.70
Unincorporated County	2,844,568,986	47.49	2,340,783,537	47.26
Total Pima County	**$5,989,224,679**	**100.00**	**$4,952,757,157**	**100.00**

All of the previous information regarding distribution of values of the tax base, whether they be total or residential, are factors that need to be taken into consideration when considering tax equity of a bond program. Equity, sometimes, is a difficult thing to define in fact it may often vary from person to person and be reflected in the eye of the beholder. But one can use basic facts and information to assess fundamental fairness of a proposed General Obligation bond program for all of the voters of Pima County to consider.

Construction Job Creation from County Bond Programs

Since 2006, County staff have been tracking the number and value of County capital improvement projects, and the number of construction jobs created as a result of these projects. Over this time period, approximately 280 awarded construction projects totaled more than $1.58 billion invested in Pima County's capital infrastructure, creating approximately 17,125 construction jobs in the region. If Pima County voters were to approve a $640 million bond package, similar to the package recommended by the BAC Chairs and myself, it would include approximately $400 million in construction costs and create approximately 4,350 construction jobs in the region. This job estimation comes from the American Recovery and Reinvestment Act (ARRA) of 2009 formula of "$92,000 of government spending creates 1 job-year," a direct job creation of one job for one year.

CHH/dr

c: The Honorable Chair and Members, Pima County Board of Supervisors
Nicole Fyffe, Executive Assistant to the County Administrator
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