MEMORANDUM

Date: January 6, 2014

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

From: C.H. Huckelberry
County Administrator

Re: **Historical Perspective on the Property Tax Base, Tax Levy, and Fund Balances for the Various Tax Levies Imposed by the Board of Supervisors**

As we begin to prepare for the Fiscal Year (FY) 2014/15 budget, it is important to reexamine and gain perspective on various revenue budget components that support the overall County Budget. The Board of Supervisors is responsible for only 4 property tax levies out of a total of 94 that are included in the tax bills mailed annually in September. Understanding the relationship between the property tax base, tax rate and levy is important in planning and forecasting future revenues to provide the services necessary for County residents and businesses.

Attached to this memorandum is a series of figures that help illustrate the issues that will be outlined regarding the property tax base, tax levy and various fund balances associated with each tax levy (Figures 1 through 8).

We are now in what is forecast to be the last year of a contracting overall property tax base. The tax base has shrunk since FY 2009/10 from a peak of $8.985 billion to what is now forecasted at $7.564 billion for next year and this year $7.559 billion. This is a 16 percent reduction from FY 2009/10, more than at any time in our history. The largest previous reduction in the tax base was caused by the national savings and loan crisis. During the period 1991 through 1994, the tax base shrunk by 1.4 percent.

As you can see, it is likely the decline of the property tax base has bottomed out. Our forecast, which will be provided to the Board in a separate memorandum, indicates we expect increasing growth in the property tax base in the future but not in significant amounts. The tax base will likely grow in value at approximately 1 to 2 percent per year. Please note that a new constitutional amendment limits this aggregate growth to no greater than 5 percent.

The first tax base levy and fund balance to be discussed is the General Fund.

Primary Property Tax

The primary property tax funds all of the various County services that require General Fund support. By far, the largest expenditure from our General Fund relates to supporting the various entities, agencies and departments that comprise the criminal justice system. In total, 53 percent of the County General Fund budget supports these agencies. Figure 1 shows the adopted General Fund reserve or fund balance and the actual ending fund balance for the FYs 2009/10 through 2013/14. Figure 2 shows the primary property tax levy, as well as assessed value, for the same years. In reviewing the General Fund balances, it is clear that historically there has been a significant planned increase in the actual General Fund ending balance versus that budgeted. The primary reason for employing conservative budgeting principles was to retain a larger than normal ending fund balance in recognition of the fiscal uncertainty during the recovery from the recession. Over time, this deviation between actual and budgeted ending fund balance is decreasing as we approach the bottom in the decline of the tax base for Pima County. This higher than normal fund balance allowed the County to weather the recession without significant reductions in services or adverse impacts to our workforce, such as layoffs in essential service functions or furloughs.

As we approach the end of the tax base contraction, these two amounts – budgeted versus actual fund balances – will converge as indicated in Figure 1. It is important to recognize that our primary property taxes levied and assessed against homeowners and businesses within Pima County are and still remain lower today than four years ago. It is, in fact, nearly $20.6 million, or 7 percent, lower. Given the continuing decline, as well as the forecasted bottoming of the assessed value, we cannot continue to provide the same level of services without increasing the primary property tax levy. Last year, while we increased the primary tax rate by 25 cents, the actual primary levy only increased $1.2 million or 0.4 percent of the total levy. More importantly, the total tax levy, including secondary taxes, decreased by $4.1 million over the previous year. Our tax levies have also now bottomed out and will need to increase to maintain services.

Debt Service Tax Rate and Levy

The Debt Service Fund is for the purpose of paying debt service on the County's General Obligation bond indebtedness. Over the years, the County has built our primary infrastructure through General Obligation bond indebtedness. Since 1974, we have issued over $1.3 billion in General Obligation bonds. Our present indebtedness is $456.7 million, after issuing debt on the largest single General Obligation bond issue ever passed in Pima County in 2004 for $582.2 million.

At 15 years, our debt is short term compared to other governmental jurisdictions. The present debt principal will decline rapidly in the coming years. While the debt is a primary constitutional obligation and the property tax rate is not limited by statute, the County has by Board direction limited the secondary property tax rate for debt service to assure voters they could expect a consistent tax levy in future years to repay debt. The present rate is $0.78 per $100 of assessed value; it was as low as $0.71 four years ago in FY 2009/10. The levy necessary to support this debt is declining and will continue to do so rapidly as we repay this voter authorized General Obligation debt, which is different than the non-voter authorized debt incurred by many local jurisdictions.

For FY 2014/15, I will be proposing the Board decrease this debt service property tax rate from $0.78 to $0.70, which is consistent with our debt repayment that is occurring on an annual basis. This reduction in tax rate will translate into a real tax levy reduction for homeowners and businesses paying taxes to retire our General Obligation debt. It is expected that this tax rate will continue to decline as our debt is retired rapidly over the next few years.

Library District

Pima County assumed full obligation and liability for operating the library system on a regional basis on July 1, 2006. This essentially transferred an annual operating and maintenance obligation of $20 million from the City of Tucson to Pima County. The County, in accepting this obligation, increased the Library District tax rate from 21 cents in FY 2004/05 to 40 cents in FY 2007/08. The County also conservatively budgeted for unknown cost drivers associated with the merger of the library system. Today, the Library District operates effectively and efficiently and is delivering services in an exemplary manner to a multitude of beneficiaries, including those involved in employment-related searches. The library has also been fully integrated into the County's job development program at the County OneStop; thereby providing significant additional library and economic development services to the general public.

In reviewing Figure 5, it is clear the Library District fund balance has declined over the years. It has, in fact, been significantly higher than necessary. Most standard accounting practices and principles indicate that a fund balance should be equivalent to 10 percent of the annual operating budget. In the case of the library system, a budget of approximately $33 million would indicate a fund balance of $3 million.

The primary reason for the large fund balance was due to the uncertainty related to fiscal obligations that would arise after the merger with the City of Tucson. The merger has now been completed, and liabilities associated with this merger have been integrated into the

County system. Therefore, the need to carry a large fund balance has been mitigated. As can be seen in Figure 5, the Library District fund balance is now tracking a trajectory to achieve an approximate 10 percent plus fund balance in relation to the Library District's annual budget. We will reduce the Library District fund balance to that amount, since it will be sufficient to carry the Library District into future years.

It is important to understand that the Library District secondary tax levy is less than the actual expenditure budget. At approximately $28 million, the levy is several million dollars lower than the continuing expenditures of the library system. Therefore, the levy needs to increase in order to equal or exceed the annual expenditures, which are approximately $33 to 34 million per year.

To begin to equalize and allow the Library District to obtain a sustainable budget, I will be recommending that the Board increase the Library District property tax rate by five cents from approximately $0.38 to $0.43 for FY 2014/15, which will increase the levy about $3.8 million to address the existing structural deficit. This proposed tax rate is only slightly higher than it was in FY 2007/08, the year of the library system merger.

Regional Flood Control District

The Regional Flood Control District (RFCD) was authorized by the Arizona Legislature in 1978 after significant flood damages in Maricopa County, where all of the bridges crossing the Salt River were destroyed or significantly compromised. A few years later in 1983, Pima County suffered our own catastrophic flooding, where damage to County public infrastructure alone was estimated at $105.8 million.

In addition to the major flood damage to public infrastructure, 154 residential structures were destroyed, 160 suffered major damage and another 222 had minor damage. Nineteen businesses were significantly damaged, and another 22 incurred minor damage.

Most tragic was the loss of human life – 13 victims in Arizona, including two Arizona Department of Public Safety employees who were killed while performing rescue activities. Of the 221 people reported injured, 11 were hospitalized. Most of those injured were residents of Pima and Pinal Counties.

Over the years, the RFCD tax levy has risen and fallen based on the damages or repairs necessitated by flooding. Historically, a 100-year flood event occurred almost on a 10-year cycle in Pima County. Fortunately, we have not experienced such in the last few years; however, our RFCD obligations are ongoing and require funding.

The RFCD tax levy is not only for the purpose of repairing past flood damages. It is, more importantly, for preparing to ensure that future flood damages never occur to the extent they have occurred in the past. This is a cost effective investment. Over the last four years, the RFCD tax levy, as well as tax base, has declined.

Over the years, we have used a very diverse approach in funding our obligations to maintain the river park system within the County. At one time, it was entirely an RFCD obligation; later it was transferred to the General Fund as a Natural Resources, Parks and Recreation Department (NRPR) obligation. The legal requirement to provide the river park system is grounded in an obligation of Pima County when we received a Clean Water Act Section 404 Permit to stabilize the riverbank system after devastating floods in 1977, 1983, 1997, and 2006. Hence, the legal obligation to maintain and provide a river park system adjacent to our major waterways is an RFCD obligation. The RFCD tax rate has been as high as 37.5 cents in FYs 2005/06 and 2006/07 and as low as 26 cents today. I will be recommending that the Board this year increase our RFCD secondary tax rate by 4 cents from 26 cents to 30 cents, which is still lower than the rate from FY 2005/06 through FY 2007/08. This will allow the transfer of river park system maintenance and operation responsibilities from NRPR to the RFCD. The relief NRPR will receive should allow them to continue their existing services without increased General Fund support for the near term.

<u>Summary</u>

This memorandum provides the Board a summary of the various tax bases, property tax levies and fund balances of the various property tax levy entities: the General Fund, Debt Service, Library District, and RFCD. The County has managed these funds and levies responsibly and properly in the face of a declining tax base caused by the prolonged recession. We have achieved a budget soft landing this year by lowering various tax fund balances while continuing to reduce total tax levies. Going forward, these tax levies must increase to maintain County services. As the economic recovery begins, it is appropriate for the County to consider these issues and obligations when formulating various budgets for County services in FY 2014/15.

CHH/anc

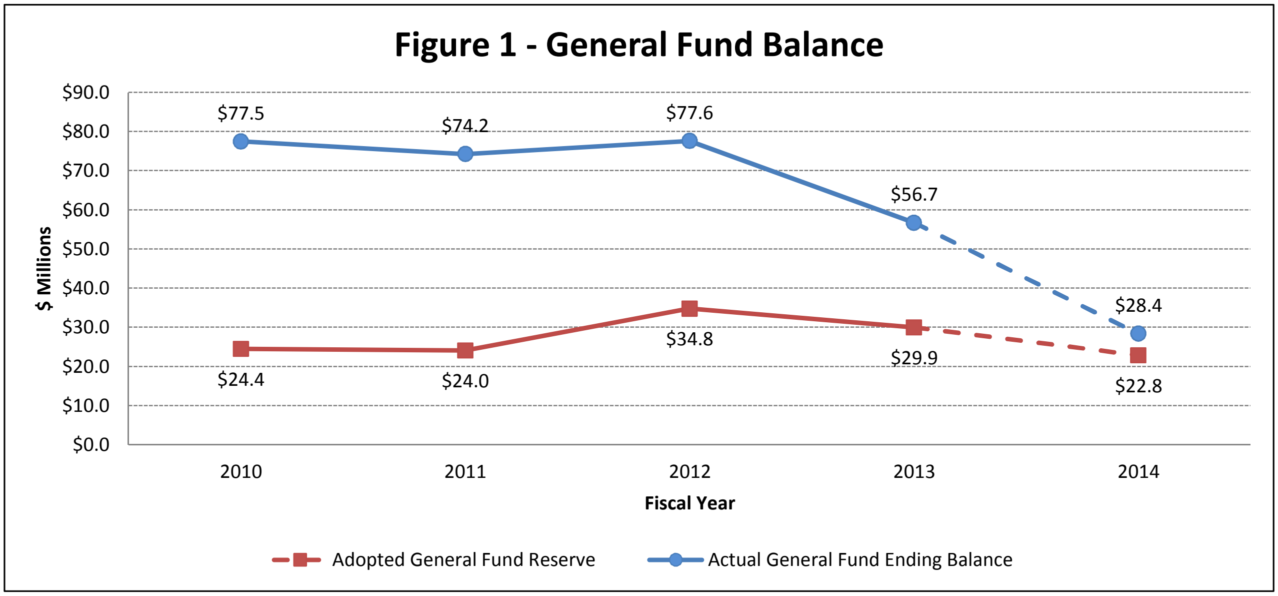
Attachments

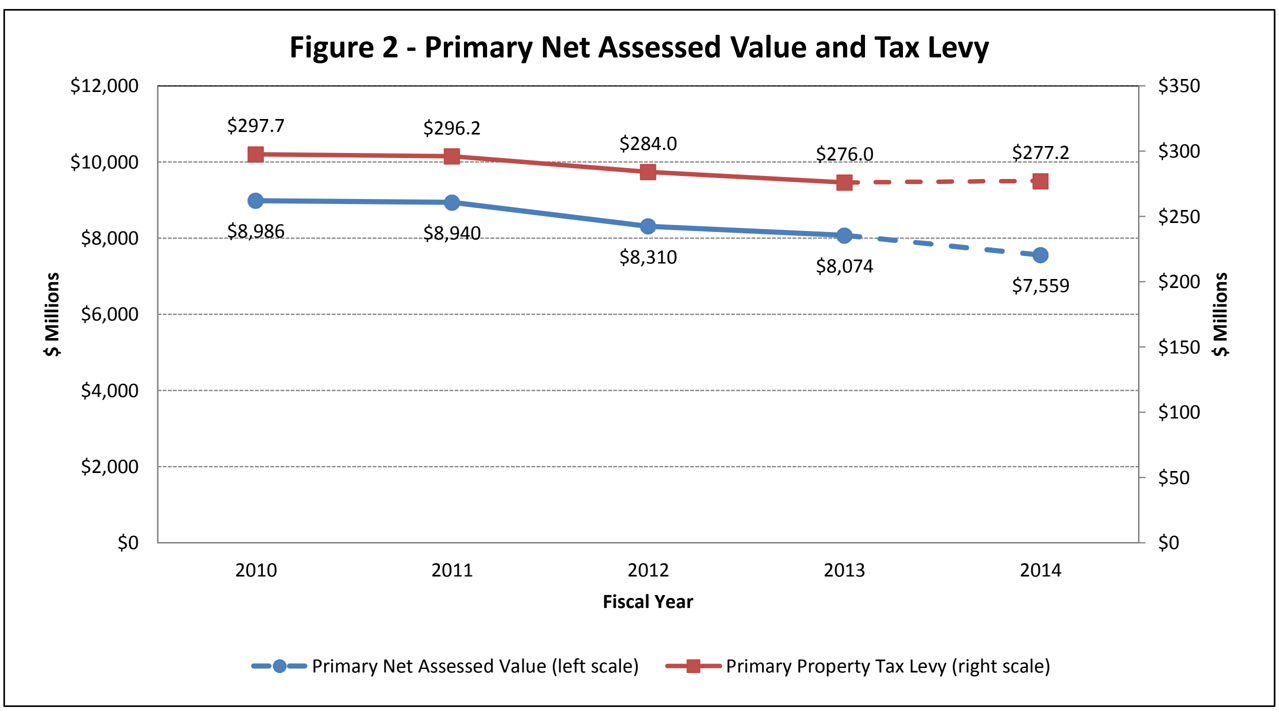
c: The Honorable Sally Simmons, Presiding Judge, Superior Courts
Elected Officials
Appointing Authorities

PROPERTY TAX BASE, TAX LEVY AND FUND BALANCE

GENERAL FUND

	Fiscal Year				
	2010	**2011**	**2012**	**2013**	**2014**
Adopted General Fund Reserve	$24,447,921	$24,040,215	$34,774,388	$29,930,587	$22,800,043
Actual General Fund Ending Balance	$77,451,391	$74,238,644	$77,555,580	$56,684,092	$28,353,200
Primary Net Assessed Value	$8,985,711,830	$8,939,647,260	$8,310,120,212	$8,073,937,734	$7,559,129,097
Primary Property Tax Levy	$297,723,590	$296,197,333	$284,023,289	$275,951,044	$277,155,468
Primary Property Tax Rate	$3.3133	$3.3133	$3.4178	$3.4178	$3.6665





PROPERTY TAX BASE, TAX LEVY AND FUND BALANCE

DEBT SERVICE

	Fiscal Year				
	2010	2011	2012	2013	2014
Adopted Debt Service Ending Fund Balance	$15,774,352	$23,615,587	$12,796,686	$31,013,082	$35,641,736
Actual Debt Service Ending Fund Balance	$40,868,082	$35,902,558	$28,297,978	$25,639,661	$23,111,013
Debt Service Secondary Net Assessed Value	$9,860,980,900	$9,342,561,193	$8,448,281,586	$8,171,211,922	$7,623,691,280
Debt Service Property Tax Levy	$70,012,964	$70,069,209	$65,896,596	$63,735,453	$59,464,792
Debt Service Property Tax Rate	$0.7100	$0.7500	$0.7800	$0.7800	$0.7800

Figure 3 - Debt Service Fund Balance

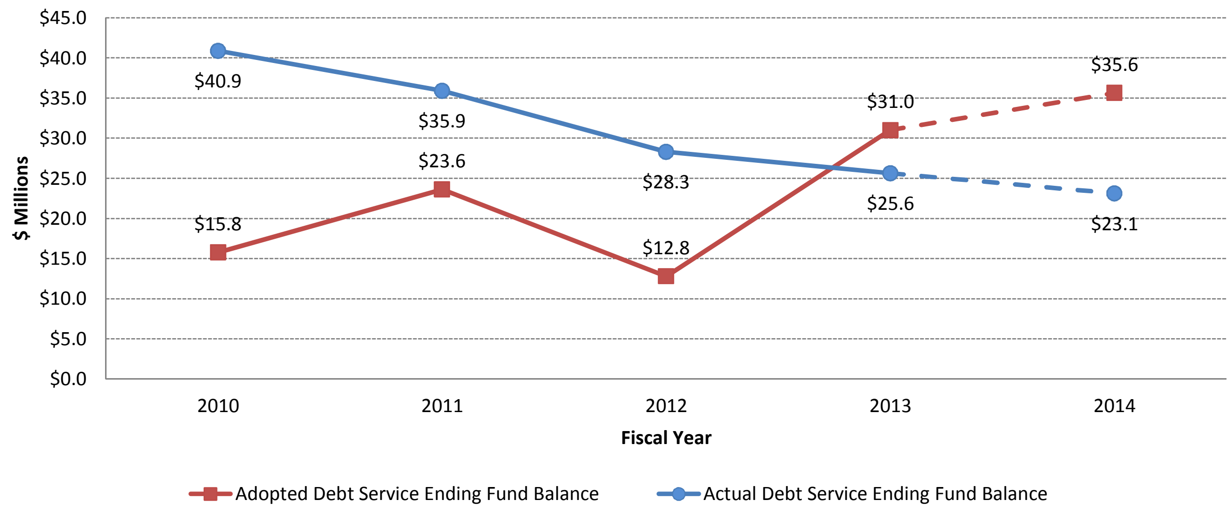
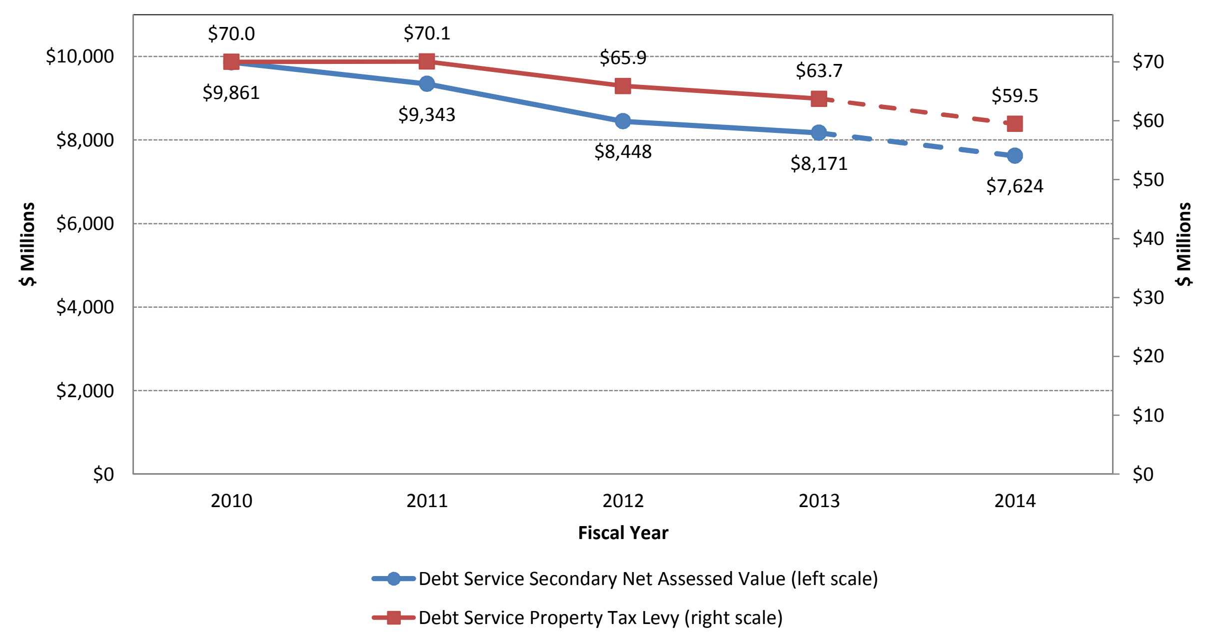


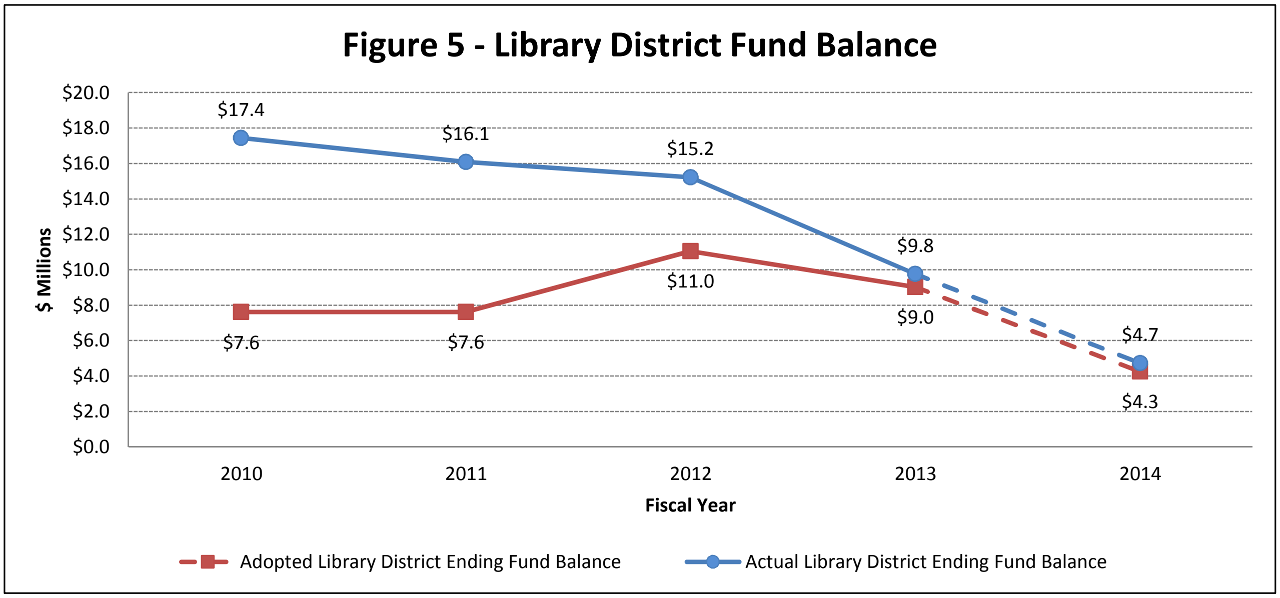
Figure 4 - Debt Service Secondary Net Assessed Value and Tax Levy

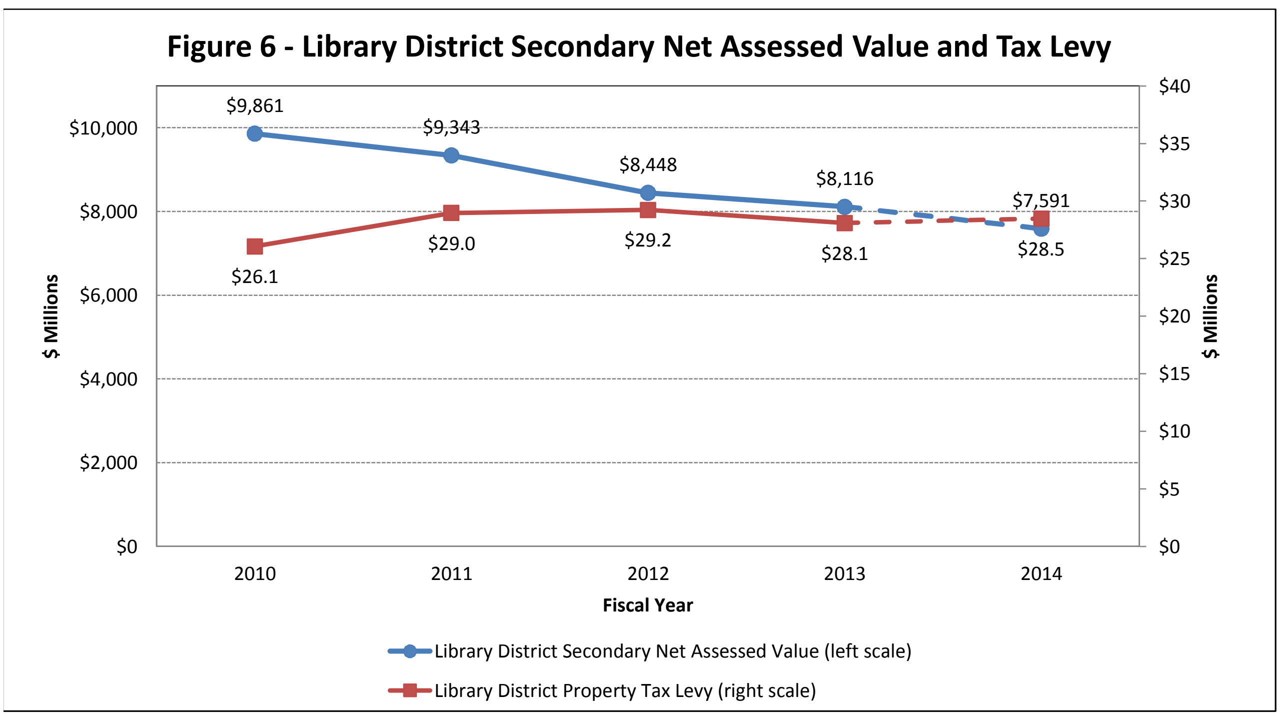


LIBRARY DISTRICT

PROPERTY TAX BASE, TAX LEVY AND FUND BALANCE

	Fiscal Year				
	2010	**2011**	**2012**	**2013**	**2014**
Adopted Library District Ending Fund Balance	$7,609,130	$7,614,079	$11,047,078	$9,027,487	$4,251,398
Actual Library District Ending Fund Balance	$17,438,701	$16,088,341	$15,216,724	$9,760,440	$4,722,636
Library District Secondary Net Assessed Value	$9,860,980,900	$9,342,561,193	$8,448,281,586	$8,116,015,231	$7,590,546,275
Library District Property Tax Levy	$26,062,573	$28,961,940	$29,231,054	$28,081,413	$28,487,320
Library District Property Tax Rate	$0.2643	$0.3100	$0.3460	$0.3460	$0.3753





FLOOD CONTROL DISTRICT

Fiscal Year

PROPERTY TAX BASE, TAX LEVY AND FUND BALANCE

	2010	2011	2012	2013	2014
Adopted Flood Control District Ending Fund Balance	$6,140,515	$9,349,360	$6,069,772	$5,945,967	$7,239,887
Actual Flood Control District Ending Fund Balance	$9,507,085	$13,850,684	$9,711,956	$8,191,220	$7,394,087
Flood Control District Secondary Net Assessed Value	$8,885,189,956	$8,529,149,549	$7,634,237,253	$7,244,629,122	$6,768,456,641
Flood Control District Property Tax Levy	$23,412,476	$22,474,309	$20,116,215	$19,089,598	$17,834,883
Flood Control District Property Tax Rate	$0.2635	$0.2635	$0.2635	$0.2635	$0.2635

Figure 7 - Flood Control District Fund Balance

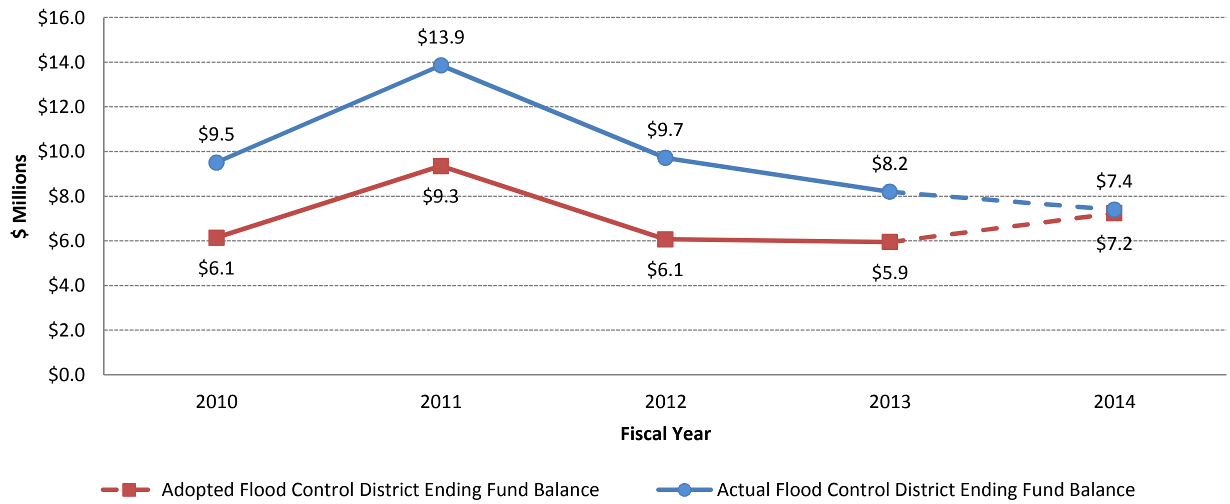


Figure 8 - Flood Control Secondary Net Assessed Value and Tax Levy