The taxpayer's watchdog for 75 years

ARIZONA TAX RESEARCH ASSOCIATION

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Governor Ducey Promises to Protect Taxpayers at ATRA Outlook

Arizona Governor Doug Ducey highlighted ATRA's 75th Annual Meeting and Outlook Conference program. Addressing a crowd of over 300 ATRA members and state and local policymakers, Governor Ducey congratulated ATRA on the great work the organization has done on behalf of taxpayers over the last 75 years.

The Governor reflected proudly on the successful special session which resulted in the Legislature referring to the ballot a proposed resolution to the long standing legal dispute between the state and the K-12 schools over inflation funding. The Governor extended his thanks

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Michael Preston Green Honored with Lifetime Achievement Award

At the 2015 ATRA Annual Meeting, the Outstanding Member award was presented to Michael Preston Green in the form of a Lifetime Achievement Award. An ATRA member since the 1970's, Green has been one of the organization's key contributors over the last 40 years.

Green has been a force at the Capitol and certainly one of Arizona's most accomplished and successful lobbyists. A policy development expert for over four decades, Green's influence in ATRA's Legislative Policy Committee and Executive Committee heavily contributed to the organization's success.

Michael has been an ATRA Board Member since 1983 and the organization is excited to continue to benefit from his wisdom and leadership as he winds down his extraordinary career.

Legislative Leaders Address 2016 Session

The 2015 ATRA Outlook conference concluded with commentary from legislative leadership from the Arizona House of Representatives and Senate. House Appropriations Chairman Justin Olson, Senate Finance Chairman Debbie Lesko, House Speaker David Gowan and Senate President Andy Biggs set the stage for the 2016 legislative session.

Representative Justin Olson emphasized caution on the spending front; warning that our cash position is hardly flush and the rainy day fund remains low. Olson wants to avoid creating another structural deficit by being conservative on spending and using one-time revenues on one-time projects. Olson committed to cleaning up the 1% homeowner property tax cap issue which began last year but requires revisiting. On Joint Technical Education Districts (JTEDs), Rep. Olson stressed that he is a supporter of them but their budget cut which begins in FY2017 was necessary as a cost savings and if there is new money available for restoration, it would need to be done with an eye towards reforming the JTED model.

Senator Debbie Lesko focused her speech on the various policy issues she has spent the offseason working on, particularly PSPRS reform, which she has championed. She was hopeful about the prospect of reaching a compromise with the various interested parties. Reformers are hoping to usher in significant changes to PSPRS, bringing stability to the fund and relief for the employers and taxpayers. Senator Lesko also committed to legislatively addressing school funding inequity issues, highlighting the policy problems of the nonvoter approved levies for desegregation and office of civil rights agreements. Senator Lesko argued the state needs to continue to push for spending equity in public schools and tax equity for taxpayers.

House of Representatives Speaker David Gowan spoke positively of the work the Legislature has done in recent years to negotiate tough budget cycles and the state should feel a sense of pride in their balanced budget. He thanked many of the people who made that possible and encouraged the business community to support legislative leaders who made the tough decisions to see the state through its past

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crises. Speaker Gowan suggested the 2016 session would be similarly efficient to last year's effort and would include positive reforms for taxpayers.

Senate President Andy Biggs regaled the group with a story of the Barbary Pirates, which is an allegory he uses to convey the message that policymakers need to show restraint during a crisis and wait out the storm before making hasty decisions. As Arizona rights its budget ship and finds calmer seas, Biggs wants Arizonans to feel proud that they managed the situation as best they could without resorting to more drastic measures. President Biggs suggested there would be room for tax reform this year and said his top concern is property taxes. He wants to find reforms in secondary property taxes, particularly related to bonds and overrides.

Gilroy Talks Public Safety Pension Reform

Leonard Gilroy of the Reason Foundation discussed the challenges facing the Public Safety Personnel Retirement System (PSPRS), beginning with the massive increase in unfunded liabilities over the last decade. He highlighted the skyrocketing employer costs impacting state and local governments in Arizona and used the cities of Bisbee and Prescott as examples of two cities where unfunded liabilities are negatively impacting budgets and threatening key municipal services. He explained the courts have struck down some of the previous reforms enacted by the Legislature which sought to improve the financial health of the system and remaining reforms are in threat of being struck down as well.

Gilroy continued by focusing on the two major problems impacting the funded status of PSPRS: Permanent Benefit Increases (PBI) and underperforming investment returns. He emphasized that by not reforming the system, employer contributions will continue to rise and crowd out other public services. Additionally, employers will continue to find it difficult to hire new public safety employees and provide pay raises. Additionally, he noted the actuarially valued returns have consistently performed below the expected rates of return since 2002. He warned there will be a continued push to impose new taxes to pay for the uncontrollable costs, as well as new debt financing proposals.

Gilroy emphasized the pension reform goal should be to create a retirement system that is affordable, sustainable and secure. He outlined the major reforms presently being discussed by various groups, including a constitutional amendment that revamps the PBI/COLA for retirees, current workers, and new hires, a sustainable COLA structure that is pre-funded and limited to inflation and reforms to prevent pension spiking. In closing, Gilroy noted that not only is the current system unsustainable, but taxpayers bear too much risk and strong markets cannot solve the problem.

Bob Robb Spins a Grand Compromise

Arizona Republic columnist Bob Robb wrapped up an informative ATRA Outlook Conference and Annual Meeting with a thought provoking luncheon address on the state of tax policy in Arizona. Robb, who has editorialized on politics and public policy for the Republic since 1999, provided his view of what he called a "grand bargain" that would provide stability in state finances.

ATRA Outlines 2016 Taxpayer Issues

ATRA Staff highlighted for Outlook Conference attendees the major public finance and taxation issues facing policymakers and taxpayers in the upcoming year.

President Kevin McCarthy kicked off the panel with a historical review of how the property tax system performed over the last decade. He noted that between 2005 and 2009, property levies grew at unprecedented levels as a result of most taxing jurisdictions' failure to adjust tax rates to offset the dramatic growth in values. During that time, property values grew 77% and statewide levies grew 33%. Over the five years that followed, property values dropped 38%; however, levies declined by less than 1%.

McCarthy referenced the volatility in property values over the last decade. However, in the first year that Prop 117 went into effect, the growth in levies was limited to a modest 2.1% despite the 13% growth in market values this year. McCarthy acknowledged that taxable values will continue to grow but at a much more predictable rate as a result of Prop 117.

Kevin continued by explaining the FY 2016 state budget provision that seeks to manage the 1% Homeowner Cap costs. In place since 1980, the 1% cap limits the total primary property taxes for all homeowners to 1% of the limited property value, a protection solely for homeowner property taxes and not for other classes of property like residential renters, ranchers, and businesses. Historically, the state general fund has covered all 1% cap costs and the FY 2016 budget ended that unlimited state subsidy by requiring local taxing authorities that levy above average tax rates to make up the gap in those costs. As the system was originally designed to minimize 1% cap violations, McCarthy emphasized the importance of managing the 1% cap issue

and urged state policymakers to focus on the issues that have been created over the years which contribute to the problem.

ATRA Vice President Jennifer Stielow continued the discussion with an overview of the policy changes the Legislature has enacted over the past several years effecting local taxing jurisdictions, some permanent and others temporary. Policy changes include the DOR local cost sharing, which requires DOR charge a fee to counties and cities to recover a portion of the costs associated with the administration and collection of Transaction Privilege Tax and the 1% cap overage payments, which requires local taxing authorities share in those costs above $1 million per county. In addition, the FY 2016 state budget required all counties share the burden of housing juveniles at the State Department of Juvenile Corrections based on population. Other policy changes include counties sharing the costs of housing Sexually Violent Persons at the state hospital and restoring individuals to competency in order to stand trial. In turn, many jurisdictions blamed their property tax increases this year on these policy changes with the 1% cap penalty being the most oft-cited.

Stielow continued by describing some of the larger tax increases imposed by local governments in tax year 2015, including the $28 million increase in Maricopa County, $12.7 million in Pima County, $9 million by Pinal Community College, and the $6 million increase in Pinal County. The reasons provided for the abovementioned tax increases varied, whether they were to offset the 1% cap costs or to just replenish cash reserves. Whatever the reason, Stielow reiterated that if the state does not address the root issues that cause tax rates to rise, we can expect more of the same.

ATRA's Senior Research Analyst Sean McCarthy anchored the presentations by drilling down into the issues that have exacerbated the 1% cap problems, such as Desegregation/Office of Civil Rights levies, levies for Adjacent Ways, the Small School Adjustment, and cash balance corrections, all of which result in major subsidies from the State General Fund. McCarthy continued by noting the lengthy list of 1% cap districts, the majority of which are in Maricopa, Pima and Pinal Counties and will likely be subject to the penalty.

Sean followed with a summary of the state budget trailer bill that failed to pass but that included important taxpayer protections, particularly the provision to cap the tax rates in the effected jurisdictions. McCarthy emphasized that the 1% cap fix shouldn't expose non-class 3 properties to even higher taxes as a result. He continued by explaining the complications that still exist such as how to calculate the state average, how to determine the "at fault" percentages, how to protect the non-class 3 property, and how to parcel out the $1 million per county penalties.

All ATRA Outlook Conference presentations can be found on the ATRA website under Event Presentations at http://www.arizonatax.org/events/presentations

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to Senate President Andy Biggs and House Speaker David Gowan for their leadership in helping pull together a final agreement.

Governor Ducey also proudly noted that Arizona's FY2016 budget is balanced and expressed confidence that Arizona's fiscal picture looks bright for the first time in several years. He pointed to several legislative successes during the 2015 session that will help put Arizona on more stable financial footing in the future. Specifically, he noted the success of his recommendation to reform how the constitutional 1% Cap for homeowners is financed at the state and local level. He explained that the state will no longer have unlimited liability for the taxing decisions in high property tax areas of the state.

Governor Ducey also congratulated House Appropriations Chair Justin Olson on his bill to protect income taxpayers by indexing personal income tax brackets to inflation. The Governor renewed his commitment to continue reducing income taxes through the remainder of his term in office.

Michael DiMaria Re-Elected ATRA Chairman

For the third year running, Michael DiMaria was elected Chairman of the Arizona Tax Research Association's Board of Directors. DiMaria is the Director of Legislative Affairs for CenturyLink,

The other officers elected with **Michael DiMaria** were **Steve Barela, *Arizona Public Service***, first vice-chair; **Keely Hitt, *Circle K***, second vice-chair; **Michael Stull, *Cox Communications*,** third vice-chair; and **Dave Minard, *Individual***, Secretary/Treasurer.

The following members were elected to seats on the ATRA Board of Directors for terms expiring in 2020: **Steve Barela, Arizona Public Service; Jim Brodnax, Individual; Jason Bagley, Intel Corp.; Michael DiMaria, CenturyLink; Joe Hughes, American Airlines; Russell Smoldon, B3 Strategies; Keely Hitt, Circle K; Michael Preston Green, Law Offices of MPG; Pat Irvine, Fennemore Craig; Britann O'Brien, Hudbay Minerals, Inc; Janna Day, AZ Policy Connect.**

Stavneak Relays Good & Bad News on Budget

Richard Stavneak, Director of the Joint Legislative Budget Committee (JLBC), began the 2015 ATRA Outlook conference with a far rosier outlook of the state budget than experienced in previous years with roughly 4% revenue growth expected for FY2016 through FY2019.

The projected one-time cash balance for FY2017 is $555 million with up to $218 million of that being available for permanent spending without creating structural deficits. Of the $378 million in revenue gain for FY2015, JLBC describes $240 million of it as ongoing. Revenue available to the state general fund is projected to approach $9.4 billion and is set to reach pre-recession levels by FY2018.

Stavneak cautioned the audience with a reminder that per historical trends, Arizona is due for a recession as the current period of expansion has lasted 75 months. The slow growth of the current expansion may translate to a longer expansion cycle but a 1% variance in revenue projections tips the scales by several hundred million dollars. Furthermore, income tax withholdings and sales tax revenues, which JLBC describes as "core" revenues, are growing slower than anticipated at 2.5% for sales and 1.2% for withholdings in the first trimester of FY2016. There continues to be significant volatility in collections of capital gains and corporate income taxes.

On the expenditure side, JLBC expects a 1.4% increase in state general fund spending in FY2017, which includes the special session increases for K-12 if approved by voters in May. Expenditure increases are projected for Arizona Health Care Cost Containment System (AHCCCS), the Department of Economic Security (DES), Corrections and Universities netting a total of $140 million in new spending.

Stavneak was pleased to report FY2017 could be the first structurally balanced budget for the state of Arizona since FY2006, though by a narrow $4 million margin.

The presence of new revenues has spurred supplemental funding requests for FY2016 and large budget requests for FY2017. The Department of Child Safety has requested $65 million this year and $106 million additional for FY2017. The Arizona Board of Regents has asked for a $24 million supplemental and a FY2017 increase of $170 million. DES is asking for $8 million this year and $56 million in the next. School Facilities Board is asking for a $15 million supplemental this year and $27 million more next year.

Stavneak cautioned lawmakers against using gains in corporate income tax and capital gains tax for ongoing expenditures but instead looking to examples of other states who set ceilings on those revenue collections and reserve the remainder for one-time spending.

Stavneak's presentation (as well as Len Gilroy's and ATRA Staff) can be found on the ATRA website under Event Presentations at http://www.arizonatax.org/events/presentations

Legislative leaders discuss the upcoming 2016 session

Below: ATRA board member Jeff Sandquist chats with Michael Preston Green

ATRA Legislative Policy Committee Chair Gretchen Kitchel with ATRA Chairman Michael DiMaria

Kevin McCarthy presents Michael Preston Green with the ATRA Lifetime Achievement Award

Former ATRA staff Chris Kelling and Dean Miller