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ARIZONA TAX RESEARCH ASSOCIATION

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Voters Approve Prop 117 by Wide Margin

With over 2.3 million ballots cast, Prop 117 passed at the ballot with 57% approval from Arizona voters. As a result, Prop 117 will be implemented effective for the 2014 valuation year/2015 tax year.

Prop 117 reforms Arizona's property tax system in two ways:

Limits the taxation of property to one value — the Limited Property Value (LPV). The LPV will be the only taxable value on property; however, the county assessor will continue to establish the Full Cash Value (FCV) at market value.

Caps the annual value growth on the LPV to 5%. The existing dual calculation to determine the LPV of up to 10% over the previous year or 25% of the difference between the current FCV and the previous year's LPV, whichever is greater, is eliminated. The calculation is simplified to a maximum of 5% growth per year, not to exceed the FCV. There is no limit on the amount the LPV can decrease each year.

ATRA's recommendation to eliminate the two-tiered assessed valuation system and cap the annual growth at 5% was sponsored by Senator Steve Yarbrough under SCR1025 during the 2012 legislative session. The measure received bi-partisan support and was subsequently referred as Prop 117 to the November ballot.

ATRA advocated for the reforms under Prop 117 in response to the flaws in Arizona's property tax system that were exposed as a result of the swift

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JLBC's Stavneak Provides Outlook Conference Update on State's Fiscal Picture

The state budget outlook was provided by Richard Stavneak, Director of the Joint Legislative Budget Committee. The budget outlook consisted of different budget scenarios, revenue projections, and the effect of federal legislation on the state budget among other issues. Mr. Stavneak began his presentation by laying out the two major factors that will affect the budget process, recovery rate of the economy and the federal health care legislation, and constructed two scenarios. The first scenario presented was the "baseline" scenario, which assumed revenue growth of 6% and no Medicaid expansion. Under this scenario, the $368 million balance in FY 2014 will transform into a $67 million shortfall in 2016. The alternate scenario, which assumes lower revenue growth and higher spending for health care, brings the state shortfalls in

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Richard Stavneak, JLBC Director

FY 2015 and FY 2016 of $411 million and $583 million, respectively. Despite JLBC's limited ability to predict the future, the Director stated that ongoing expenditures will exceed ongoing revenues through FY 2016. Another caveat of the budget process is that eventually state lawmakers will have to deal with temporary formula suspensions and more than $1 billion in rollovers.

The Director provided base revenue changes from FY 2014 to FY 2016 using consensus revenue forecasts which showed moderate growth through FY 2016. With the temporary one-cent sales tax expiring at the end of FY 2013, baseline revenue will drop $280 million in FY 2014. In FY 2015 and FY 2016, the growth in base revenue will offset enacted tax legislation and the decrease in the fund balance by $40 million and $145 million, respectively. Stavneak noted the fiscal impact of tax laws enacted at the state level, which is $67 million in FY 2014 and grows to $634 million in FY 2019. Unfortunately, the consensus revenue forecast still shows FY 2016 revenue below the FY 2007 level.

The presentation then turned to the state budget and the obligations of the general fund. The FY 2013 general fund budget is $8.6 billion, with 84% dedicated to the three main drivers of spending: education (49%), health care (23%), and prisons (12%). Only 31% of the total state budget is attributable to the general fund, Stavneak noted, down from 43% in FY 2002.

Even more so than baseline revenues, baseline spending estimates are projected to increase from FY 2014 through FY 2016. In FY 2014, the majority of the $149 million increase is the result of the K-12 funding formula. In FY 2015 and FY 2016, the increases are primarily the result of the Medicaid formula, although increases in the K-12 formula are significant in each year. Additionally, the federally mandated Medicaid expansion will add a considerable cost to spending over the next couple years. Coverage of children of families whose income is 133% of the federal poverty level (FPL) will cost the state $69 million in FY 2014 and enrollment expansion will cost $170 million in FY 2015. If the state chooses to cover childless adults, costs could range from $135 million to $478 million.

Stavneak wrapped up his presentation with budget projections for the next few fiscal years under the baseline and alternate scenarios. Regrettably, both scenarios reflect a budget shortfall in FY 2016 but he did offer that the $450 million in the rainy day fund will be available to offset the shortfall. The baseline budget, he explained, will have a minimal shortfall in FY 2016 and have a small fund balance. On the other hand, the alternate budget will run a growing shortfall in FY 2015 and in FY 2016, when the fund balance is completely wiped out.

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Jim Rounds Reports on Arizona's Economy & Its Impact on the State's Fiscal Challenges

The 2012 ATRA Outlook Conference kicked off with a presentation by Jim Rounds, Senior Vice-President of Elliott D. Pollack & Company, on the current economic picture. The presentation included economic indicators for the nation, Arizona, and the greater Phoenix area as well as comparisons of Arizona to other states in terms of competitiveness and real estate figures.

Rounds began his presentation by briefing the audience on the fiscal situation in Washington and how each political party is approaching the looming "fiscal cliff." He then moved on to national economic indicators and pointed out that although employment numbers are up, consumer confidence is well below normal as it has been for several years. Also, retail sales are mirroring disposable personal income, which is increasing at a decreasing rate.

Jim Rounds, Senior Vice President
Elliott D. Pollack & Company

Because of the relationship government has with the national economy, Rounds advised government on what role it could play to boost the weak economy. He suggested government should significantly reduce spending and match those cuts with modest tax increases. One of the greatest challenges of note will be increasing taxes without discouraging production. But according to Rounds, spending cuts and tax increases will hurt the economy in the next year, which means those measures will have to be phased in. He predicted that lawmakers will draft a multi-year plan with the "pain" to set in down the road in the latter years of the plan and ease the tension in the near future. Going forward, he does not believe that the nation is heading toward another recession but recovery will be slow and gradual.

Moving on to state economics, Rounds gladly informed members that Arizona's employment figures exceed the nation as a whole. The only caveat, however, is that the state's employment growth is dependent on population growth, which needs to hold for the employment trend to continue. The presentation showed how Arizona has compared to other states in terms of job growth. In 2006, arguably the peak of the state's economic activity, Arizona ranked second in job growth. Just three years later, after the housing bubble burst, Arizona was 49th in the nation in job growth followed by a subsequent 49th ranking in 2010. However, recent job growth figures provided by the US Bureau of Labor Statistics showed that Arizona ranked 23rd in 2011 and, as of September year-to-date, 6th in 2012. Net job growth is projected to increase 162,100 over the next two years, Rounds explained, but if mandated spending cuts are enacted, 45,000 to 50,000 jobs could be at stake for Arizona. Even if those jobs are lost, employment is still expected to grow but at a slower pace.

The presentation concluded with a reiteration that Arizona's economy will improve because many of the factors that businesses find attractive are found within the state. The strides lawmakers have taken at the Legislature and natural geographic features have increased the state's competitiveness and business-friendly atmosphere. Rounds predicted that Arizona will continue to have a top ten economy and make a full recovery by fiscal year 2016.

Michael DiMaria Named 2012 Outstanding Member

Michael DiMaria

On behalf of the ATRA Board of Directors, ATRA Chairman Lyn White presented Michael DiMaria with the 2012 Outstanding Member Award at the Outlook Conference Luncheon.

Since joining ATRA as a representative of CenturyLink, Michael has been a constant presence around ATRA. He currently serves on the ATRA Board of Directors, the ATRA Executive Committee, and the ATRA Legislative Policy Committee, where he plays a vital role in helping ATRA develop a sound tax and fiscal policy agenda for Arizona. At the 2012 ATRA Annual Meeting Michael was appointed Chairman of the ATRA Legislative Policy Committee.

Lyn White

In presenting the award, Ms. White said, "If you are around ATRA for any length of time, one of the first things you notice is the length of service that many members of the board have given to the organization. We are very proud of the fact that most people who join the organization not only maintain their support – they also participate and become a part of the 'ATRA family.' Michael DiMaria is a great example of the real dedication of an ATRA member that supports the ATRA mission and lends his personal expertise in state and local taxation and policy advocacy to make ATRA a better organization. As the Director of Legislative Affairs for CenturyLink, Michael DiMaria has built a strong background in numerous areas of public finance and taxation that greatly benefit ATRA".

Kitty Decker Recognized for Dedicated Service to Arizona

Former lawmaker and current ATRA Board Member Lori Daniels presented Kitty Decker with a Special Recognition Award on behalf of the ATRA Board of Directors at this year's ATRA Outlook Luncheon.

(left to right) Lori Daniels & Kitty Decker

Kitty Decker recently retired after many years of state service, most of which was spent staffing the House Ways & Means Committee.

In introducing the award, Lori explained that ATRA's role in advocating sound tax policy at the Capitol includes not only working with the Governor and the Legislature, but also legislative staff. She continued by saying that legislative staff is given tremendous responsibility to produce sound analyses on hundreds of bills that are annually considered at the Capitol and Kitty's knowledge of Arizona's tax system has been truly invaluable.

Kitty has been an incredible asset over the years in developing sound fiscal policy at the Legislature. Lori knows this first hand since Kitty staffed the House Ways & Means Committee when Lori chaired that Committee. In describing Kitty, Lori emphasized the fact that she was well-respected and liked by others "despite never being shy to call BS on a bad idea."

In presenting the award, Lori said, "Kitty, Arizona taxpayers are better off today as a result of your many years of service with the State of Arizona. This Special Recognition Award is a small token of ATRA's appreciation for your dedicated service to Arizona."

2012 ATRA OUTLOOK CONFERENCE SPEAKERS



Above: (left) Senate President-Elect Andy Biggs and (center) House Minority Leader Chad Campbell provided insights on budget, tax, health care, and education that lawmakers will wrestle with during the 2013 session. (right) Stepping up for Speaker of the House Andy Tobin, Lorenzo Romero provided an overview of the recent policy successes at the Capitol as well as a preview of the Speaker's objectives for the 2013 session.

Left: Michael Hunter, Governor Brewer's Director of Legislative Affairs, updated the conference attendees on the major tax issues from the Governor's perspective as well as providing an update on the progress of the TPT Task Force he is chairing.

Right: ATRA President Kevin McCarthy highlighted the major public finance and tax issues for 2013 as well as ATRA 2013 major legislative issues.

Scott Smith & Kathy Peckardt Receive 2012 ATRA Good Government Award

Rep. Justin Olson

For the last 21 years, ATRA has taken the occasion of the annual luncheon to recognize outstanding individuals whose work in the public sector is characterized by strong, continuing, and consistent efforts to spend taxpayer dollars wisely and to promote government that is efficient, open, and accountable. This year, State Representative Justin Olson presented the 2012 J. Elliott Hibbs ATRA Good Government Award to Arizona Department of Administration Director Scott Smith and Human Resources Director Kathy Peckardt.

Both Smith and Peckardt worked tirelessly with Representative Olson this past session to pass what was truly historic legislation to reform the state personnel system. In presenting the award, Representative Olson expressed what an honor it was, along with Representative Justin Pierce, to be asked by Governor Brewer to take a leadership role in guiding the important measure through the Legislature. The ultimate success of the reform was largely the result of countless hours of hard work, compromise and education that was done by Directors Smith and Peckardt, who collectively have over a half century of experience in state government. Together, over the course of 18 months, they developed a proposal based on the best practices of both the private sector and local governments in Arizona. They held countless stakeholder meetings to build support for the reform as well as avoid unintended consequences.

State Personnel Reform introduced a series of common sense human resource practices that have long been the standard in the private sector and eliminated a system of cumbersome rules that ultimately discouraged the State's best employees and protected its weakest performers. As a result, State managers will now be able to act more quickly when it comes to hiring the most talented applicants, rewarding the best workers, and disciplining underperforming employees without excessive bureaucracy and levels of unnecessary review.

Kathy Peckardt & Scott Smith

Under Smith's and Peckardt's leadership, the Human Resources Division of ADOA took on the task of implementing Personnel Reform upon its passage. In just four months, ADOA rewrote the State Personnel Rules to incorporate the new changes, held an Open Enrollment for employees choosing to become uncovered, and held mandatory training sessions throughout the State for the 6,200 State supervisors to help them better manage the workforce in the new system.

The personnel reform accomplished by Smith and Peckardt will increase productivity, improve accountability, and make state employment a more attractive option – all while saving taxpayers money.

2012 ATRA OUTLOOK CONFERENCE ATTENDEES

Left: Graham County Manager Terry Cooper (right) speaks with Munir Malek of Freeport-McMoran.

Right: Bas Aja of the Cattlemen's Association (left) and Michael Preston Green of Brownstein Hyatt Farber Schreck, LLP.

Below: Steve Barela of APS sits with Rep. Debbie Lesko (right).

Left: Joe Salkowski of UNS (left) with Pima County Supervisor Ray Carroll.

Right: Kathy Senseman of Policy Development Group, Inc. (left) and Allison Bell of APS.

Right: Gretchen Kitchel of SRP poses a question to the legislative panel during the conference.

Below: Jana Day of Brownstein Hyatt Farber Schreck, LLP.

Above: Jim Brodnax of B&G Property Tax.

Left: Dick Foreman of Southwest Gas Corp.

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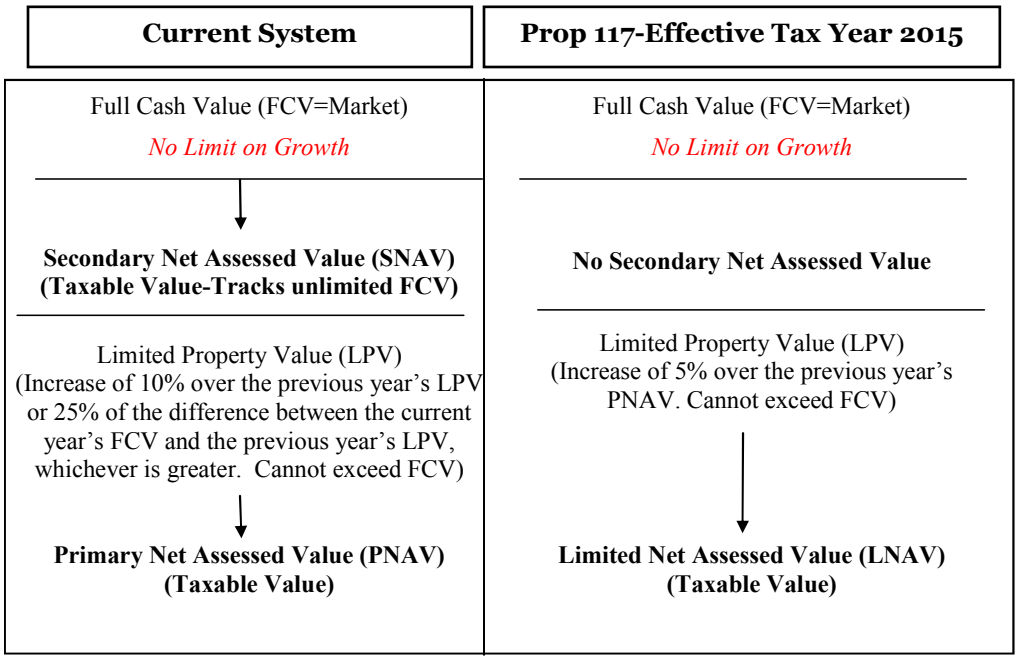
rise and ultimate collapse of the real estate market in Arizona over the last decade. The inactions of many jurisdictions to adjust tax rates in response to the inflated values during that time resulted in dramatic tax increases. That led ATRA to study and consider various proposals to limit the same dramatic fluctuations from occurring again in the future. ATRA determined that the best way to create greater stability in Arizona's property tax system would mean imposing a reasonable cap on the annual taxable valuation growth for all locally assessed property.

Additionally, Arizona is the only state that creates the unnecessary complication of using two taxable values. In an effort to simplify the system, ATRA observed that this was the perfect opportunity to reduce the taxation of property to just one value (LPV) since the statewide FCV and LPV are nearly identical. However, the assessor will continue to determine the FCV, which should reflect the market value, in order to provide taxpayers with the opportunity to appeal the FCV of their property if they believe the FCV exceeds market value. Although the FCV will no longer be taxed, it will be important for taxpayers to continue to monitor its accuracy since the LPV will continue to increase each year until it reaches the FCV.

ATRA will propose conforming legislation during the 2013 session to implement the constitutional reforms under Prop 117.



<u>Current Property Tax System exists through Valuation Year (VY) 2013/Tax Year (TY) 2014</u>

March 2013 (VY 2013) – County Assessor mails Notice of Valuations (NOV) to all property owners based on existing system. NOV includes the two taxable values, full cash value (FCV) and limited property value (LPV).

October 1, 2014 (TY 2014) - Taxes are due on values noticed in March 2013.

<u>Prop 117 Reforms Effective Beginning in VY 2014/TY 2015</u>

March 2014 (VY 2014) – County Assessor mails NOV to all property owners based on the reforms included under Prop 117. NOV includes the FCV (for appeal purposes only) and the new 5% limit on the LPV. VY 2014 LNAV cannot exceed VY 2013 PNAV by more than 5%.