Policymakers Should Finish 1% Cap Reform

Governor Ducey’s recommendations to balance the budget deficit he inherited for FY 2016 proposed a major change to how the state historically dealt with what is arguably the most complicated aspect of Arizona’s property tax system: the 1% Cap on homeowner property taxes. No tax or budget proposal caused more questions and confusion during the 2015 session than the 1% Cap debate.

In 1980, Arizona voters approved a series of tax and spending limit initiatives at a Special Election on June 3, 1980. Most of the key provisions of those initiatives remain intact 35 years later. One of the constitutional amendments approved in Prop 106 capped a portion of a homeowner’s annual property tax liability at 1% of property value. This provision, now commonly referred to as the 1% Cap, was a

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Where to Eat & Stay in Arizona
Pima College inflates Student Counts

Pinal Comm College District Raises Levy 48%

Largest College Tax Increase in State History

In front of a board room full of angry citizens, the Pinal Community College District (CCD) Board of Governors voted on May 19 to raise their primary property tax levy by 85 cents; an $18.4 million tax increase. Despite a number of Pinal County residents pleading with the board to reconsider and not a single civilian speaking in support, the 4-1 approval vote marked the largest tax increase for a college district in state history. Interestingly, Pinal CCD has experienced a 20% decline in students the last several years which led to their constitutional expenditure limit dropping 2.7% for FY 2016. Ergo, expenditures from “local revenue sources” like property taxes should be slimming, not exploding.

District officials described the tax increase as critical to addressing deferred maintenance, rising utility costs and other business costs. Maximizing their constitutional property tax levy, the district chose to raise their primary rate to the ceiling as provided by law, characterizing it as simply taking “their fair share.” In addition to capital spending, the district will add employees and enact a 4% salary schedule raise.

As was the case statewide, enrollment spiked at Pinal CCD during the recession and has normalized to pre-recession levels. Despite that normalization trend, the FY 2016 primary levy will now be 64.7% higher than pre-recession levels. District officials blame cuts in state aid, which spiked to $10 million in 2007 during peak economic years, but historically was roughly $6.5 million and for FY 2016 was cut 34% to $2 million. Levy

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Where to Eat & Stay in Arizona
The Taxpayers Guide

Before you set sail for an evening out or summer weekend trip, taxpayers should know which cities and towns in Arizona offer more bang for the buck. There are wide discrepancies in certain Transaction Privilege Tax rates (TPT or sales tax) around the state of Arizona. In particular, disparities in TPT rates are eye-opening for lodging and restaurants. On average, Arizona has the 11th highest sales tax rates in the country; a significant source of revenue for state and local government.

Smart Dining and Deep Sleeping

The base restaurant TPT rate for the state of Arizona is 5.6%. Beyond that, counties have a variety of additional rate options and cities apply their own TPT rate. All counties and cities in Arizona apply a TPT rate on restaurants to varying degrees. The base lodging TPT rate for the state of Arizona is 5.5% and local rates vary substantially. Tourist-based jurisdictions often have very high rates, justifying it as necessary to provide support for the industry. The municipality feels demand is inelastic enough to warrant higher rates on nonresidents, shielding residents from taxes.

Maricopa County

TPT restaurant rates for Maricopa County government total 0.70%, which is near the statewide average. The county lodging rate is 0.77% which is below average and there is also a county TSA rate of 1% for lodging.

The wallet-conscious diner would do well to frequent the East Valley. The cheapest restaurant TPT rates are Gilbert (7.80%), Mesa (8.05%), Scottsdale (7.95%) and Tempe (8.10%). The rates are a total amount, combining state and local rates. Phoenix is at 8.30%. Avoiding the West Valley altogether is the smart move where rates are much higher. In particular, you’ll get gouged in Glendale (10.20%) and Goodyear (10.30%).

Need to lodge in the West Valley? Avoid Glendale (15.17%) if you can and stay in Litchfield Park (11.07%), Tolleson (11.77%) or Phoenix (12.27%).

Feel free to visit the northern foothills for dinner and dancing but you’re better off taking an Uber back to town rather than staying overnight in Cave Creek (14.27%) or Carefree (13.27%).

You won’t be surprised to see vacationers pay more to stay in Paradise Valley (13.17%), Scottsdale (13.92%) or Fountain Hills (13.87%).

In the East Valley, the easy decision is to have the in-laws avoid Mesa (14.02%) and instead lodge in Chandler (11.67%) or Gilbert (11.77%).

Southern Arizona

Headed south on I-10? There’s no reason to pit stop for lunch in Eloy (12.70%) as you head to Tucson! Pinal
County government adds 1.10% to their restaurant rate and many of their cities also have high restaurant rates such as Coolidge (9.70%) and Superior (10.70%). The respite comes in Pima County, where they have low county and city rates except South Tucson (11.60%). Dine in Marana, Tucson, and Sahuarita (all 8.10%).

But if you want to stay in a swanky resort in Marana or Oro Valley, beware; you’re looking at a 14.05% and 14.55% tax rate. You’re better off in Sahuarita (10.05%) or unincorporated Tubac, paying just the state and Santa Cruz County rate (6.6%).

For those who cannot make the drive to San Diego in one day, Yuma (10.41%) isn’t gouging for lodging rates relative to others.

Headed to Cochise County? One should avoid staying in Tombstone (13.55%), Bisbee and Wilcox (both 13.05%) and instead stay in Benson (10.55%) or Sierra Vista (11.55%).

Northern Arizona

Escaping the heat and headed north? Payson isn’t a bad place to stop for lunch (8.72%) but don’t lodge in city limits (13.72%). Push on to Show Low in Navajo County, who sports some of the lowest sales taxes in the area at 8.10% for restaurant and 8.05% for lodging. Neighbor Pinetop-Lakeside has much higher TPT rates: 10.60% for restaurant and 11.55% for lodging. Snowflake is also more at 9.10% for restaurant and 12.05% for lodging.

Both Yavapai and Coconino County have relatively high rates. Retreat for the weekend to Prescott or Jerome, who both have below average rates respectively at 8.35% and 9.85% for restaurant and 11.33% and 9.83% for lodging- well below peers in Camp Verde, Chino Valley, Cottonwood, and Sedona.

Drivers on I-40 should break for food in Holbrook (9.10%) and pass on Winslow (11.10%), Flagstaff (10.951%) or Williams (11.40%).

Watch out for some of the highest TPT rates in the state in Page, near Lake Powell; 10.90% for restaurant and 14.16% for lodging.

Mohave County rates are particularly low, with a County rate of just 0.25% for restaurant and 0.275% for lodging which translates to some of the lowest rates in the state, making Bullhead City and Lake Havasu City economical places to both eat (7.85% and 8.85%) and stay (10.78% for both).

-Sean McCarthy
While all community college districts in Arizona face challenges amidst the changing landscape of higher education, Pima Community College District (CCD) arguably has the heaviest burden.

The FY2016 state budget cut all state aid to both Maricopa and Pima CCD. The $7.1 million cut to Pima CCD represents 4.2% of their proposed FY2016 General Fund budget; a substantial reduction in contrast to the less than 1% cut Maricopa CCD took with their $8.8 million state aid cut. Property taxes from new construction alone will make up for most of the cut to Maricopa CCD. Pima CCD has much bigger financial woes.

Following statewide trends, Pima CCD enrollment figures have decreased substantially since the recession from a high of 22,900 full time student equivalents (FTSE) in FY2011 to 17,963 in FY2014. Their accreditation issues also contributed to the decline, amongst other market issues. The constitutional expenditure limitations in Arizona were designed to limit the growth of government to a measure of population growth and an inflation adjustment. A smaller population corresponds to lower expenditure limitations. Tuition, fees, federal dollars, debt financing, and other exemptions such as workforce development are monies that may be expended outside of (or in addition to) the constitutional expenditure limitations.

The below chart, which is available on Pima CCD’s website, illustrates how they plan to manage their expenditure limit problem. Though ATRA has raised concerns over student count exaggerating, this chart reflects reality better than ATRA’s warnings. The green line is the Expenditure Limit (EL) as the constitution envisions, which grew due to a student surge in the recession. The red line, the college’s expenditures subject to the EL, grew through the green line and continued north. All the while the blue estimated EL line remained at higher levels because their FTSE count was intentionally over-estimated to the Economic Estimates Commission. The delta between the blue

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and the green line represents that over-estimation. The amount of money spent between the red line and the green line represents money the constitution does not envision the district has the right to spend.

Indeed, despite every indication they experienced a one-time surge during the recession and are contracting in size, Pima CCD continues to report 23,000 FTSE despite having at least 25% fewer FTSE than that high-water mark.

The refrain from CCDs is familiar: the cost of doing business has outstripped inflationary adjustments and the expenditure limits unfairly hinder operations. Certainly some costs such as health care benefits have risen faster than inflation and many of the colleges have built expansive plants they must maintain. Rarely mentioned are efficiencies gained from the operationally cheap and highly lucrative online environment which has exploded in growth. Disagreement with constitutional protections do not justify sidestepping them.

Including all positions, Pima CCD has increased staff 23% since 2000, when its FTSE was the same as today. While the constitution imagines a reduction in operational scope to match its student population, leadership has indicated it will manage the situation with a hiring freeze and elimination of a certain few vacant positions, including three college presidents. They also plan to raise property taxes as well as institute a $5 per credit hour tuition increase. Otherwise total staffing levels remain constant despite the dramatic drop in enrollment.

This exercise is a reminder of government resistance to contraction. Despite a significant reduction in services provided, district officials expect to spend at a consistent level and hope enrollment sees an unprecedented 35% growth over the next four years (see the green line).

In this case, constitutional checks have not had the intended effect, but their necessity is certainly visible.

-Sean McCarthy

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increases over that time outpaced state aid cuts on a 5:1 ratio. That does not include the significant increase in tuition; rising from $60 to $82 per credit hour over that time. The primary tax rate for the district will now be $1.22 higher than three short years ago. With this rate increase, Pinal CCD will have the highest CCD property tax rate in the state; roughly double the average.

Pinal County has historically been at or near the top of property tax rates in Arizona. In fact, most homeowners in the county are already at the constitutional 1% homeowner property tax rate cap (see the front page article for more on that topic). Homeowners in school districts such as Maricopa, Coolidge, Combs, Superior, Eloy, Mammoth, and Florence will not pay for the tax increase because of the cap. The rate increase puts Casa Grande and Toltec Unified homeowners into the 1% cap. With the Legislature indicating it will only subsidize the amount over the cap up to $1 million per county with state general fund monies, local jurisdictions will have to pay for the increased amount above the 1% cap. The total countywide increase in 1% cap “liability” resulting from this tax increase alone will be at least $3.1 million. All renters, ranchers, farmers and business owners will pay for the rate increase regardless of jurisdiction. Homeowners in Apache Junction and Oracle school districts will pay the full property tax increase because they are not in 1% cap districts.

For business owners, the rate increase comes at a particularly tough time for a county that has struggled to encourage business activity largely due to its high property taxes. Total tax levies for business property owners in Pinal County have risen 24% since 2009 because significant drops in home values shifted tax burdens. Numerous
consistent theme of property tax revolts that were being debated across the country at the time. The provision bore some similarity to the key provision of California’s Prop 13 passed in 1978. In addition, it also mirrored the key provision of a major property tax limitation initiative that Arizona voters would act on in November 1980. That initiative was dubbed the “Heuisler Initiative” after the author and chief advocate Bill Heuisler.

By the spring of 1980, state policymakers knew that the Heuisler Initiative would be on the November 1980 ballot. Concerned that Arizona voters would react favorably to the measure, the Arizona Legislature referred a series of measures to the voters in a June Special Election. Altogether, the Legislature referred a package of nine separate constitutional amendments to the voters. The volume of new laws proposed could explain why the 1% Cap proposal had so many policy shortcomings.

In order to secure support from the homeowner/voter, the 1% Cap provision in Prop 106 clearly attempted to mimic the key tax limit in the Heuisler Initiative. However, in reality, Prop 106 was dramatically different than Heuisler or Prop 13, both of which provided hard property tax caps for all property taxpayers – not just homeowners. More importantly, Heuisler and Prop 13 fundamentally changed the classic ad valorem property tax system where taxpayer’s obligations were subject to the myriad of budget and tax rate decisions of local governments to a capped obligation that was completely removed from that budgeting process.

The blending of these two dramatically different concepts for taxing property – local governments setting budgets and fixing tax rates versus a fixed property tax obligation at 1% of value – created a major problem for Arizona policymakers. Like Prop 13 and Heuisler, if Prop 106’s 1% Cap simply stopped the flow of more money into government coffers than the result would have been obvious: less government spending.

However, the 1% Cap proposal referred to voters in Prop 106 accomplished almost the reverse of what voters probably thought they were approving in 1980. Instead of a taxpayer-focused policy that limited government spending, the 1% Cap actually incentivized higher property tax rates. State policymakers in 1980 recognized some of the negative consequences of actually having homeowners reach the 1% Cap threshold. The FY1981 state budget significantly increased funding for a new homeowner rebate in an effort to keep the effective tax rates for homeowners below 1%.

The decision to “reward” high tax areas where homeowners eclipse the 1% Cap by making the state general fund
responsible for the taxes not paid by the homeowner was also a part of the conforming statutory framework passed in 1980 to support the constitutional amendments. That mechanism, which essentially makes up the shortfall through additional state aid to the school district, resulted in relatively modest state general fund burdens. However, the homeowner rebate, which cost the state $44 million in 1981 has ballooned to $360 million for FY2016.

In 1980, state policymakers undoubtedly limited the 1% Cap protection to homeowners in an effort to avoid a major tax cut for business property taxpayers. Because of Arizona’s classification system, business property taxpayers have effective tax rates well in excess of 1%. For years, tax reform studies have criticized the fact that low, subsidized homeowner property taxes undermine accountability for the spending decisions of locally elected officials. Those concerns are amplified dramatically in an environment where the homeowner/voter’s liability is actually capped while businesses, agricultural property, and rental property taxpayers are left fully exposed to higher taxes.

While the 1% Cap has been a non-issue in some Arizona counties, it has effected spending and tax decisions in counties with historically high property tax rates. Maybe the most notable examples of the perverse incentives associated with both the cap and the state subsidy were the local elections to create a primary property tax in two Pinal County towns. The Town of Superior (1995) and the Town of Maricopa (2006) both moved fire protection from existing fire districts funded through secondary property taxes (secondary taxes are not subject to the 1% cap) into town fire departments funded through a primary property tax.

In both instances, town officials were quite open about their strategy to leverage the 1% Cap on primary property taxes thereby shifting existing homeowner tax obligations to the state general fund. The Town of Maricopa took the bold step in the publicity pamphlet of precisely calculating for the homeowner/voter that they would be insulated from the entire cost for the new primary tax. It should come as no surprise that the primary tax rates for both towns have skyrocketed. Initially set at $2.00, the Town of Superior’s primary rate was $7.04 this year. Maricopa’s initial rate of $3.20 has climbed to $4.98.

The last major study of Arizona’s tax system, the Citizens Finance Review Commission (CFRC) in 2005, recommended the elimination of the 1% Cap. The CFRC correctly noted that the 1% Cap frustrated almost every reform the Commission considered. The CFRC stated that the Cap breaks the necessary link between the spending decisions of local governments and the residents’ willingness to fund that spending.

Regrettably, despite the widespread recognition that the 1% Cap was a flawed policy from the beginning, the likelihood for major change is remote. Regardless of its policy shortcomings, the repeal of a tax cap for homeowners wouldn’t receive a warm reception at the ballot box. For that reason, reforming the mechanics of how the Cap is administered is critically important. This year’s effort only addressed the state’s role in subsidizing these high tax areas. Left unaddressed was the exposure that the non-homeowner property taxpayers continue to face in these high tax areas. An effort to cap the high tax rates of the local governments driving the problem failed late in the session.

In the 2016 session, Governor Ducey and state policymakers need to pass comprehensive 1% Cap reform. In addition to eliminating the state subsidy for high spending and high tax local governments, non-residential property taxpayers have to be protected from the potential of ever-increasing property tax rates after the subsidy is eliminated.

-Kevin McCarthy