ATRA SPECIAL REPORT

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Action without information is dangerous. Information without action is futile.

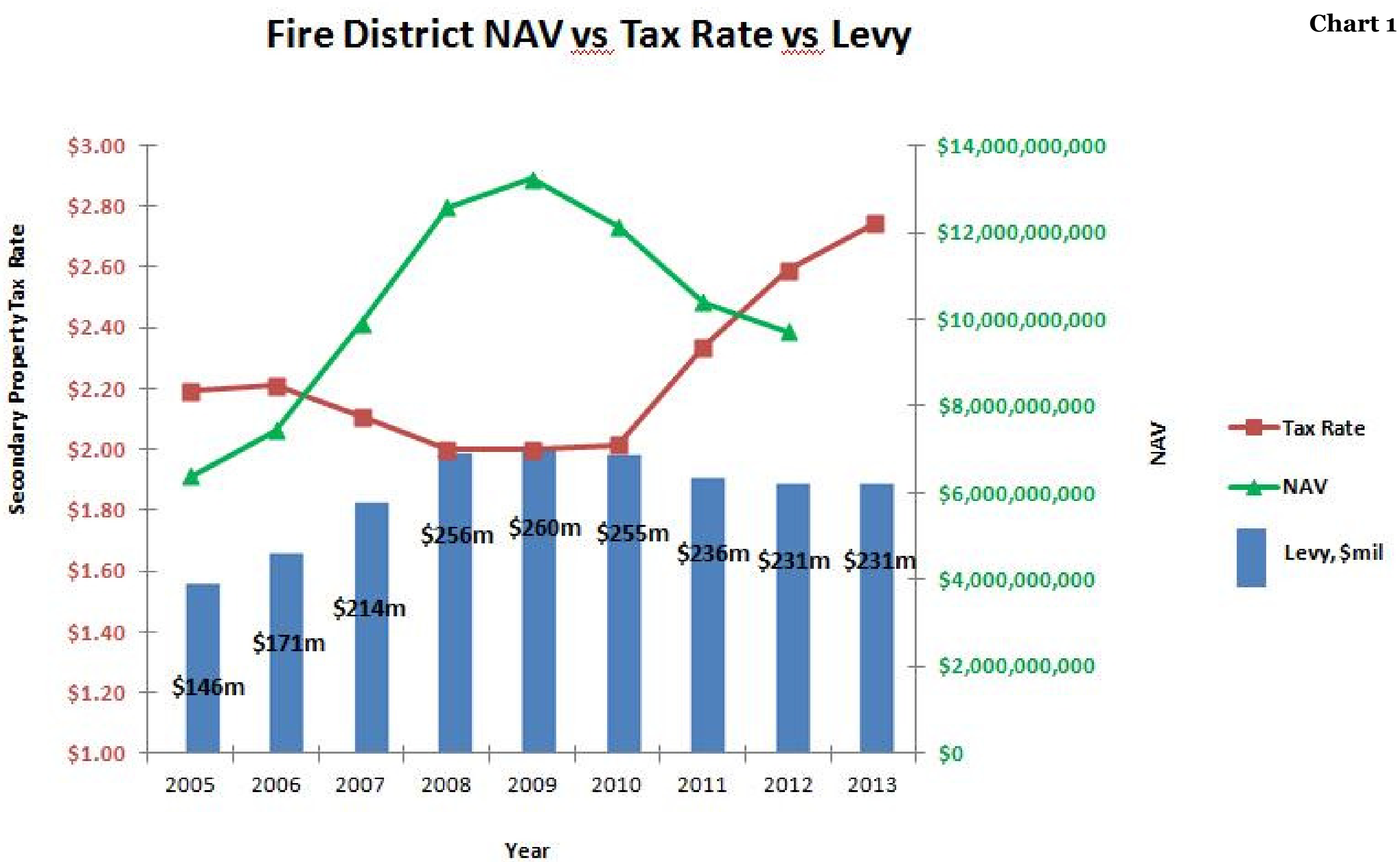
Pensions Anchor Fire District Budgets

Taxpayers Shoulder the Burden of Runaway Costs

Arizona Fire District tax rates have climbed dramatically over the last five years. Rapid declines in property Net Assessed Value (NAV) drove rates higher as most Fire Districts (FDs) have been forced to fund ever increasing retirement costs- regardless of the impact on taxpayers.

According to budget projections, taxpayers in FDs should expect their property taxes to continue to rise to pay for rapidly expanding employer contributions for pensions. In the past five years, median secondary property tax rates for FDs statewide have risen from $2.00 to $2.74 per $100 of assessed value. On average, tax rates increased in FDs 26% during this period.

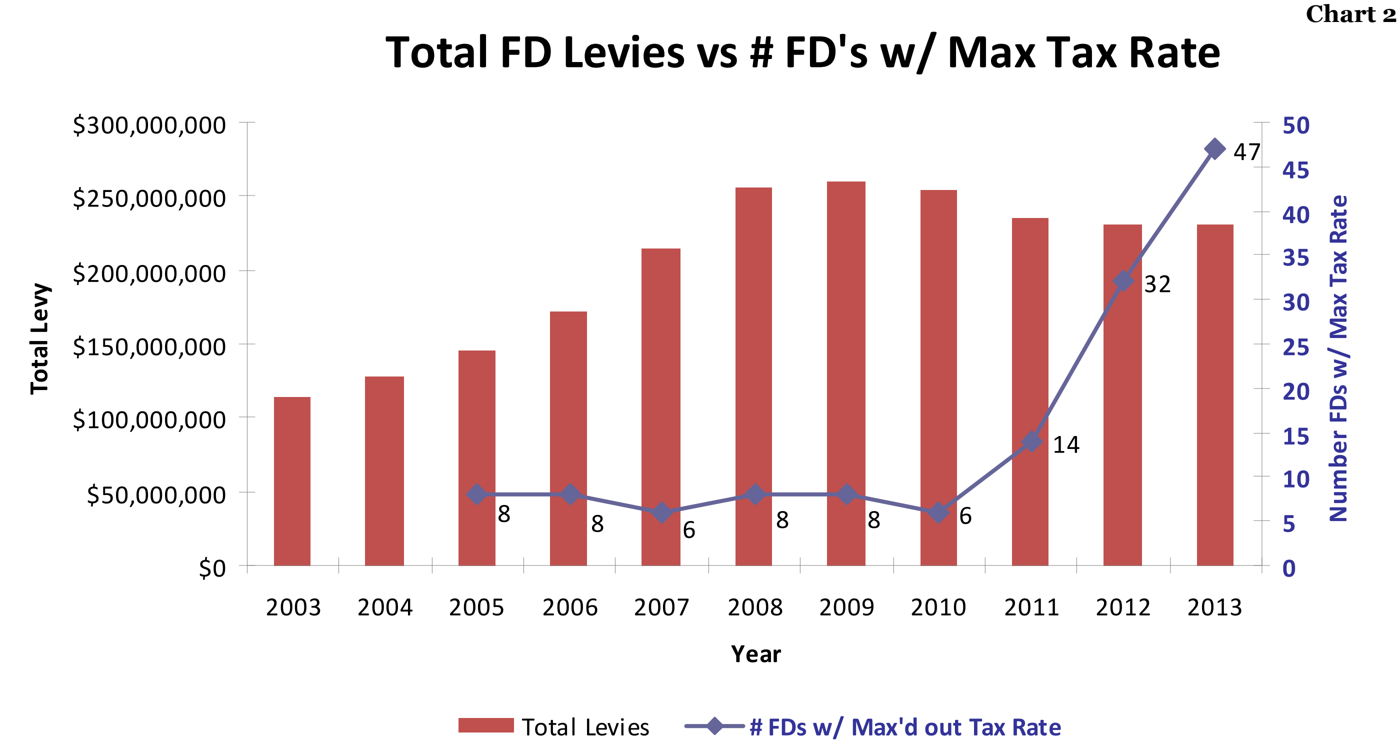
Chart 1



There are currently 156 Arizona Fire Districts, the majority of which provide fire and emergency services in rural areas. These special districts are funded primarily by secondary property taxes from the residents and businesses within the district boundaries.

The blue columns in chart 1 show total FD levies spiked before the recession and leveled off as NAVs plummeted. Beginning in 2010, property tax rates climbed in order to rescue budgets from lagging NAVs in an effort to maintain late 2000 budget levels. From Tax Year (TY) 2003 to TY08, total FD levies increased 125% from $114 million to $256 million; a tax increase resulting from skyrocketing property values and FDs leaving their tax rates mostly unchanged. As real estate values dropped, many FDs maximized their rates in order to maintain their levy amount but ran into the $3.25 statutory limit, sometimes resulting in a small tax decrease. FDs have a maximum statutory property tax limit of $3.25 per $100 of assessed value. As chart 2 indicates, in TY05 just eight districts levied at or above the statutory limit, but by 2013, 47 districts levied at $3.25 or more, via bonds.

Chart 2



Sixty-one of the largest FDs participate in the Public Safety Personnel Retirement System (PSPRS) and annually report their budgets and pension contributions.

Between FY09 and FY13, Arizona's PSPRS FDs increased property tax rates on average 55 cents per $100 of assessed value. The median tax rate for these FDs rose to $2.93 and 29 districts are at or within 5% of the maximum allowable rate. By contrast, non-PSPRS FDs have a far lower median tax rate at $2.01 and rose 38 cents in the past five years. Only 17 of 95 non-PSPRS districts are at their $3.25 limit. These FDs, while smaller, faced similar decreases in NAV as large districts.

The owner of a $150,000 home in a PSPRS participating district pays $83 more per year on average in property taxes than five years ago for this tax alone. If one presumes their property value dropped 18% in that time frame, their taxes raised $18.

As noted, taxpayers' contributions towards FD pensions have increased substantially, to the tune of 27% in the past five years. Not counting districts new to PSPRS, average district contributions raised to $361,000 per district per annum.

Fire Districts make up 69 of more than 400 member organizations in the PSPRS, a system plagued with unfunded liability. Prior to 2011 pension reform (SB1609), the member contribution was fixed at 7.65% and beginning in FY13 has risen to 11.05%, which is pending litigation. Taxpayer contributions remained stable at roughly 22% from FY09 to FY11 but have steadily risen to 27% in FY13 and are expected to be 32.5% in FY15. A staggering 60% of taxpayer contributions are simply covering the amortization of unfunded actuarial accrued liability for service performed in the past.

The bad news for taxpayers is that future budget and tax considerations for FDs are actually worse than current costs as unfunded liabilities continue to climb. In FY13, the PSPRS had a 10.64% rate of return and yet the funding ratio of the program still declined from 58.6% to 57.1%; a sobering data point that decries the long term viability of the PSPRS.

Given the Arizona Supreme Court ruling that cost-of-living-adjustments (COLA) must be honored, PSPRS projects employer contribution rates will certainly be higher than anticipated. If the court rules that the new member contribution rate of 11.05% is also unconstitutional, taxpayer contributions will increase substantially and must also refund past contributions made over the 7.65% mark.

In addition to pensions, property tax increases also funded salary increases in FDs that are PSPRS members. Over the past five years, FDs increased total payroll 33.4%. Salaries increased 9.73% or roughly $5,000, to an average salary of $59,967. Removing new districts brings the average salary of the 58 legacy districts to $61,000.

As property values slowly recapture lost value, most FDs are beginning to see growth in their NAV and levying capacity. Regrettably, the dramatic growth in retirement contributions along with salary increases will likely exceed NAV growth.

As employee benefits squeeze budgets, FD lobbyists have begun efforts to raise the $3.25 tax rate cap in statute. As introduced by Senator Driggs this year, SB1472 would have raised the FD tax rate cap to $3.50 and provided for a 2% increase each year thereafter. The annual rate increase was not specified as being adjusted to inflation or "cost-drivers"; it simply raised 2% each year in perpetuity. The FD maximum rate would have risen to $3.86 by FY20 and $4.27 by FY25. The proposed legislation also added a second override mechanism whereby voters could approve an override to the current tax rate cap provided the levy does not grow beyond the 8% limit. Current law only allows a voter approved FD override of the 8% levy increase limit provided the rate remains below $3.25. If successful, this legislation would have represented the second time in the last decade FD rates had risen. The maximum rate was increased from $3.00 to $3.25 in 2005. SB1472 failed to receive a hearing in the Senate Finance Committee.

-Sean McCarthy