MEMORANDUM

Date: April 28, 2009

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

From: C.H. Huckelberry
County Administrator

Re: **Five-Year Financial Forecast of Property Tax and State-Shared Revenues**

I. Introduction

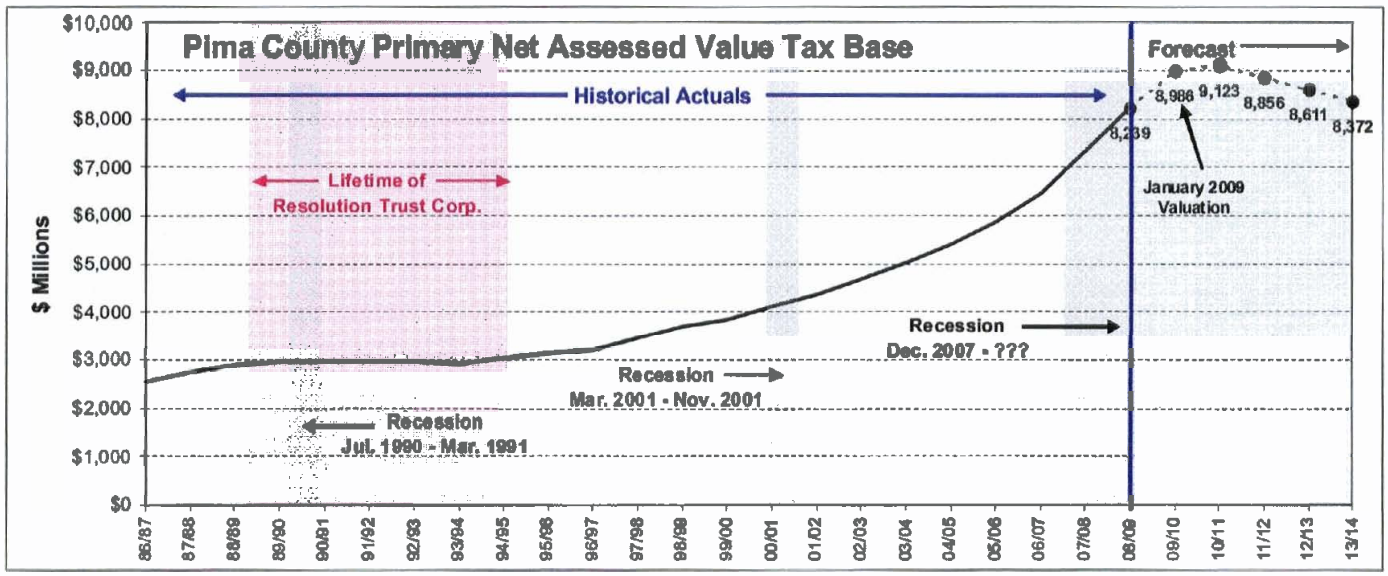
Given the continuing financial uncertainty that exists in the general economy, it is appropriate to critically review the primary revenue sources for the County General Fund, as well as secondary property tax special districts to determine how best to meet the possible fiscal challenge of declining revenues while it is likely service demands will increase due to general economic conditions. The unique services provided by the County in the area of criminal justice (jails, detention center, prosecution, indigent defense, and courts; as well as public health obligations and medical services; as well as central community services such as job training and workforce reinvestment) usually increase during general periods of economic decline. The five-year revenue generating capacity of the County is forecasted to show a potential decline beginning in fiscal year 2010/11 and more than likely continuing through 2013/14 (see Attachment 1). The revenue generating capacity as measured by the values of the primary and secondary property tax bases could decrease by as much as 6.8 percent and 14 percent respectively, something that has never happened before in Pima County. During the Savings and Loan collapse beginning in 1989 and through the Resolution Trust Corporation workout nearly five years later, the primary and secondary tax bases only declined by 1.4 percent and 4.2 percent during the five year period between 1989/90 and 1993/94. Hence, we may face unprecedented fiscal pressure in the years ahead.

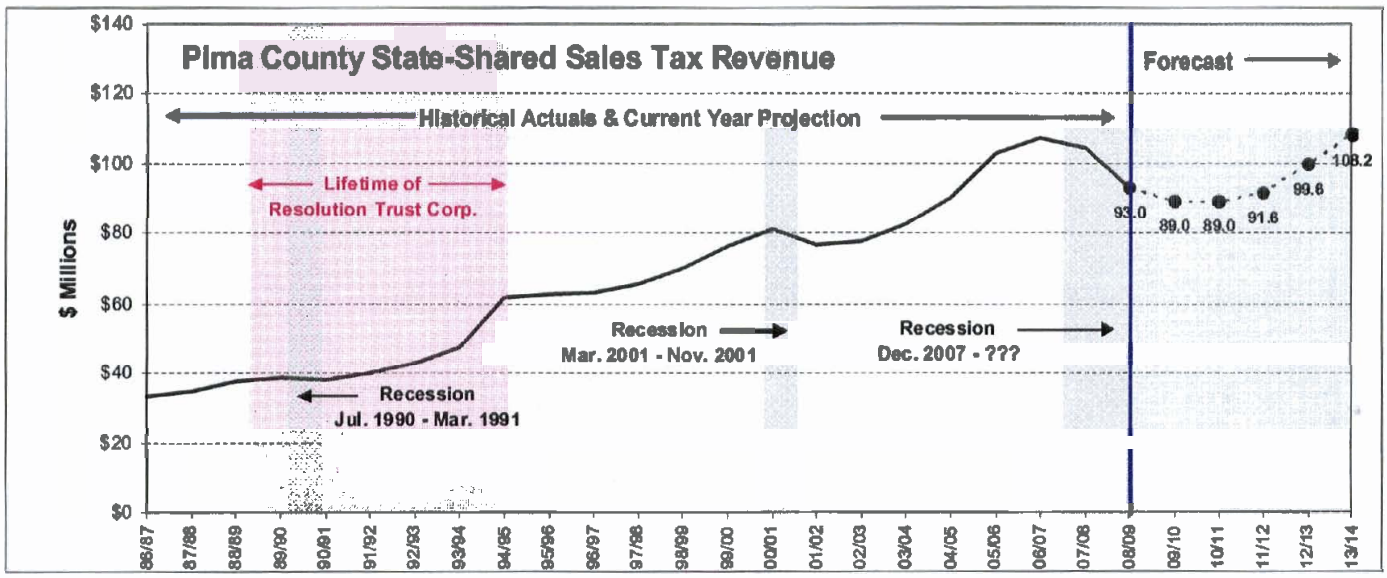
II. Major Revenue Sources of the County General Fund and Special Districts

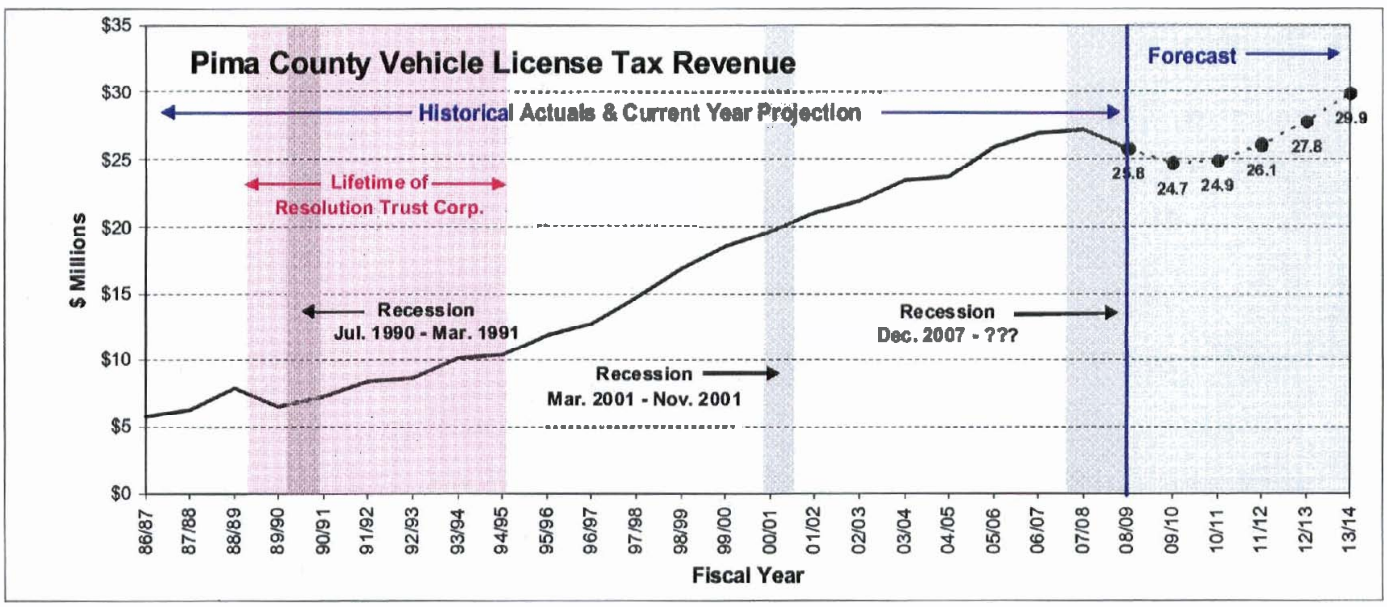
Unlike cities and towns in Pima County, the County has had to deal only with significant losses in state-shared revenues to date. Most cities and towns rely heavily on local sales taxes and state-shared revenues, both sales and income taxes. These revenue sources are linked and respond almost instantaneously to general economic conditions. The County has dealt with substantial declining state-shared revenues in both sales and vehicle license taxes of nearly $15 million this year alone. However, state-shared revenues of vehicle license taxes and sales taxes make up only 27.5 percent of the General Fund budget ($104.8 million in state-shared sales tax plus $27.8 million in vehicle license tax, compared to total General Fund revenues of $481,334,223 for fiscal year 2008/09).

Attachment 1

County Primary Property Tax Base & State-Shared Sales and General Fund Vehicle License Tax Revenues







Note: The Resolution Trust Corp. was established during 1989 to dispose of failed thrift institutions taken over by federal regulators after January 1, 1989. Recession dates as indicated by the National Bureau of Economic Research's Business Cycle Dating Committee.

Property tax revenues make up a majority of the County General Fund and they also exclusively fund two special districts, the Library District and Regional Flood Control District. In addition, County secondary property taxes also fund debt service to repay voter authorized general obligation bonds. Table 1 below shows the 2008/09 tax levy for County primary property taxes and the County levied secondary taxes of the Library District, Regional Flood Control District and the Debt Service Fund.

Table 1

Property Tax Revenues of the County

	Primary	Secondary		
		Library	Flood Control	Debt Service
FY 2008/09	$279,136,768	$32,555,365	$25,489,218	$58,048,912

Total Property Taxes - $395,230,263

Clearly the dominant County revenue source under the direct control of the Board is property taxes, and the largest single variable associated with the property tax levy is the assessed value or the value of the property tax base.

III. Ten-Year Historical Perspective of Property Taxes, State-Shared Sales and Vehicle License Taxes, County Assessed Value, and County Tax Rates

Table 2 shows the ten-year history of property taxes, assessed value and property tax rates. It should be noted that in the last three years the County has substantially restricted the growth in property taxes by being the only county in Arizona to meet statutory truth in taxation standards by limiting tax increases to only that representing new growth in the tax base, not appreciation. Pima County also became the first county to apply these same standards to the growth in secondary tax levies and rates.

Table 2

Assessed Value of the County Tax Base ($ Millions)

	Primary	Flood Control	Library District	Debt Service
FY 1999/2000	3,853.6	3,390.4	4,000.6	4,000.6
FY 2000/01	4,111.7	3,597.8	4,236.1	4,236.1
FY 2001/02	4,361.5	3,834.7	4,491.4	4,491.4
FY 2002/03	4,669.3	4,158.6	4,835.6	4,835.6
FY 2003/04	5,022.5	4,511.1	5,221.3	5,221.3
FY 2004/05	5,412.6	4,907.4	5,620.2	5,620.2
FY 2005/06	5,849.5	5,323.4	6,051.0	6,051.0
FY 2006/07	6,467.2	6,114.0	6,870.0	6,870.0
FY 2007/08	7,353.3	7,412.2	8,220.4	8,220.4
FY 2008/09	8,231.0	8,684.6	9,594.9	9,594.9

Tax Rates ($ per $100 of Net Assessed Value)

	Primary	Flood Control	Library District	Debt Service	Total
FY 1999/2000	4.0720	0.3046	0.2024	0.9350	5.5140
FY 2000/01	4.0720	0.3046	0.2024	0.9350	5.5140
FY 2001/02	4.0720	0.3546	0.2124	0.8950	5.5340
FY 2002/03	4.0720	0.3546	0.2124	0.8150	5.4540
FY 2003/04	4.0720	0.3546	0.2124	0.8150	5.4540
FY 2004/05	4.0720	0.3546	0.2124	0.8150	5.4540
FY 2005/06	4.0720	0.3746	0.2575	0.7150	5.4191
FY 2006/07	3.8420	0.3746	0.3675	0.7150	5.2991
FY 2007/08	3.6020	0.3446	0.3975	0.6850	5.0291
FY 2008/09	3.3913	0.2935	0.3393	0.6050	4.6291

Property Tax Levies ($ Millions)

	Primary	Flood Control	Library District	Debt Service	Total
FY 1999/2000	156.9	10.3	8.1	37.4	212.8
FY 2000/01	167.4	11.0	8.6	39.6	226.6
FY 2001/02	177.6	13.6	9.5	40.2	240.9
FY 2002/03	190.1	14.7	10.3	39.4	254.6
FY 2003/04	204.5	16.0	11.1	42.6	274.2
FY 2004/05	220.4	17.4	11.9	45.8	295.5
FY 2005/06	238.2	19.9	15.6	43.3	317.0
FY 2006/07	248.5	22.9	25.2	49.1	345.7
FY 2007/08	264.9	25.5	32.7	56.3	379.4
FY 2008/09	279.1	25.5	32.6	58.0	395.2

Table 3 shows the ten-year history of state-shared sales taxes and vehicle license taxes. Please note the substantial decline in these revenues for this year.

Table 3

State-Shared Sales Tax and Vehicle License Tax Revenue ($ Millions)

	State-Shared Sales Tax	Vehicle License Tax
FY 1999/2000	$76.271	$18.502
FY 2000/01	$80.925	$19.672
FY 2001/02	$76.759	$21.093
FY 2002/03	$77.729	$21.904
FY 2003/04	$82.652	$23.413
FY 2004/05	$90.285	$23.630
FY 2005/06	$102.619	$25.894
FY 2006/07	$106.932	$26.967
FY 2007/08	$103.895	$27.166
FY 2008/09	$93.000	$25.750

IV. Forecast of Property Tax Base Assessed Value Change 2009 to 2014

Property tax valuation notices for 2010 mailed earlier this year by the Assessor showed residential valuation declines for the first time in perhaps 20 years. Table 4 below shows the historic primary and secondary assessed value of the County from 1989/90 through 2009/10, a near 20-year period.

Table 4

History of Net Assessed Values ($ Millions)

	Secondary NAV	Primary NAV
FY 1989/90	$3,105.4	$2,984.1
FY 1990/91	3,045.0	2,983.2
FY 1991/92	2,998.2	2,969.7
FY 1992/93	2,993.0	2,951.2
FY 1993/94	2,974.1	2,941.4
FY 1994/95	3,150.1	3,049.3
FY 1995/96	3,218.9	3,130.8
FY 1996/97	3,247.5	3,247.5
FY 1997/98	3,700.3	3,700.3
FY 1998/99	3,852.6	3,852.6
FY 1999/2000	4,000.6	3,853.6
FY 2000/01	4,236.1	4,111.7
FY 2001/02	4,491.4	4,361.5
FY 2002/03	4,835.6	4,669.3
FY 2003/04	5,221.3	5,022.5
FY 2004/05	5,620.2	5,412.6
FY 2005/06	6,051.0	5,849.5
FY 2006/07	6,870.0	6,467.2
FY 2007/08	8,220.4	7,353.3
FY 2008/09	9,594.9	8,231.0
FY 2009/10	9,840.6	8,986.3

This valuation history begins with the national recession during 1990, which included and was caused partly by the Savings and Loan crisis and the necessary workout of failed financial property transactions through the Resolution Trust Corporation. As can be seen, the assessed values of Pima County during the period from 1989/90 to 1993/94 was relatively flat or even slightly declining as contrasted to the rapid runup in assessed values during the housing bubble in 2006/07 through 2008/09. The change in the primary tax base between 2005/06 and 2009/10 represented a 53.6 percent increase, while the secondary assessed value increased by 62.6 percent. Looking

forward to 2010/11 through 2013/14, it is likely that the County, for the very first time, will see a potential appreciable decline in aggregate assessed value, more so than during the economic correction for the Savings and Loan crisis followed by the Resolution Trust Corporation workout from 1989 through 1994.

The attached Chart 1 shows an index of the total full cash value of the County compared to a composite index of Countywide personal income, population and employment. Current values are an anomaly when measured against basic drivers in the market place. The full cash values (secondary values used to fund the Library District, Flood Control District, with personal property excluded, and Debt Service) follow the actual real estate market. Chart 1 demonstrates that values are substantially above the economic factors that create them, such as personal income, population, and employment.

This value anomaly has been caused by a large amount of investment going into real estate as well as documented loose lending practices which put even more money into real estate. This artificially drove up per parcel values in Pima County substantially. In 2007 the world financial system began to falter as it became apparent that the loans made under previous loose standards were failing. People purchased over priced properties that are now worth much less than when they first established their mortgage. Today, home building has essentially stopped. Commercial development has stopped as developers have become concerned with their ability to keep existing tenants or find new ones.

In the near future, it is believed that property values will begin to return to "normal." Normal is defined in the forecast methodology as "property values will change so they will closely follow the County's population growth and ability to pay for the real estate." In Chart 1 the projected value portion of this curve is an expression of the return to the normal conditions as they were between 1996 and 2005.

Limited values (primary values used to fund general government expenditures) are determined by formulas which include the prior year's limited value and the current year's full cash values. In times when full cash values increase rapidly, as they have in the recent past, the limited values fall behind. When the full cash values slow their rapid increases or decline, the limited values will continue to increase until they almost equal the full cash values. How long they will continue to increase depends on how much below the full cash values they are and how fast the full cash values are dropping. Limited values are difficult to forecast but they will eventually begin to decline as the full cash values return to "normal."

As confirmation that growth in the tax base has dropped dramatically, one need only examine the change in growth of property tax base parcels. The foreclosure market is so strong that home builders are not building new product, thus limiting new growth in the tax base. Between fiscal years 2009 and 2010 the number of residential parcels increased 0.44 percent. In the prior year the number of residential parcels increased 2.5 percent. The Secondary Net Assessed Value for residential properties dropped 1.5 percent between fiscal year 2009 and 2010. In the prior year it increased almost 21 percent. The projection for fiscal year 2011 is that the number of residential parcels will increase by only 0.5 percent and the Secondary Net Assessed Value for residential properties will decline three to five percent. Hence, property devaluation has arrived for the tax base.

The number of single family housing permits issued also confirms the drop in taxable parcel base growth. Table 5 below shows both a baseline and pessimistic forecast by the Economic and Business Research Center at the University of Arizona for the issuance of single family permits, as well as a history of permits since 2005.

Table 5

Single Family Housing Permits

Calendar Year	Baseline	% of 2005 Permits	Pessimistic	% of 2005 Permits
2005	11,166	100.0	---	100.0
2006	8,132	72.8	---	72.8
2007	4,698	42.1	---	42.1
2008	2,690	24.1	---	24.1
2009	1,937	17.3	855	7.7
2010	4,518	40.5	2,694	24.1

The number of permits for new residential single family home construction during 2009 could be only 8 to 17 percent of the peak number during 2005. This is a dramatic drop in creating growth in the tax base.

In conclusion, using the previously described methodology, the possible future primary and secondary total assessed values for Pima County are shown in Table 6 below.

Table 6

Forecast of Primary and Secondary Net Assessed Values ($ Millions)

	Secondary NAV	SNAV % Change from FY 2009/10	Primary NAV	PNAV % Change from FY 2009/10
FY 2009/10	9,840.6		8,986.3	
FY 2010/11	9,472.1	-3.74%	9,122.6	1.52%
FY 2011/12	8,997.3	-8.57%	8,855.9	-1.45%
FY 2012/13	8,701.1	-11.58%	8,610.8	-4.18%
FY 2013/14	8,460.6	-14.02%	8,372.3	-6.83%

V. Forecast of State-Shared Revenues 2009 to 2014

In examining the previous, it is obvious that the increase in primary property taxes of approximately $14,249,782 from fiscal year 2007/08 ($264,886,986) to 2008/09 ($279,136,768) has been completely offset by a loss of $13.8 million in state-shared sales tax revenues and vehicle license taxes. As has been indicated previously, state-shared sales taxes and vehicle license taxes, while not the majority of the County General Fund revenue base, do make up a sizeable component of General Fund revenues.

V.(A) State-Shared Sales Tax Revenues

County state-shared sales tax revenues depend on the magnitude and type of economic activity throughout Arizona as well as within Pima County. When a sale is taxed, the state keeps a portion of the tax revenue that depends on the type of sale and then deposits the remaining revenue into a "distribution base," from which monies are shared amongst the state, counties and incorporated cities and towns. Our share of statewide population in the statutory formula is currently 15.706 percent and will remain the same until June 2011, when each county's 2010 Census population will be used in the distribution formula for the following five-year period. Local and statewide population projections currently indicate Pima County's share of statewide population will decline to about 15.115 percent beginning in June 2011, for an immediate drop at that time of nearly 4 percent for that portion of the distribution formula.

A prolonged period of low interest rates and Arizona's mid-decade boom in residential construction produced extraordinarily high rates of growth in sales tax revenues throughout the state, with year-over-year changes of 15 percent to 20 percent during many months in fiscal year 2005/06. With expanding incomes, low interest rates and new types of mortgage financing, more households could afford home ownership. Purchases by first-time buyers and numerous investors led to increased spending on taxable new home construction. With greater demand for housing, home prices escalated rapidly, allowing homeowners and real estate investors to withdraw significant amounts of equity by refinancing mortgages on their properties. Equity withdrawals were used to buy taxable items such as home renovations and additions, construction of new second homes and rental housing, new cars and vehicle leases and numerous other retail purchases.

Prices for new and existing homes peaked during early 2006 and then began to decline, resulting in a rapid fall off in new home construction to present levels that are the lowest in absolute terms in more than 30 years and the lowest since World War II when measured on a per-capita, or population, basis. The housing recession quickly spread throughout the real estate and financial industries and then spilled over into other areas of the state's economy during the past two and one-half years, causing statewide personal income growth to fall sharply to a projected 1 percent decline for fiscal year 2009/10, likely the greatest statewide decline since the Great Depression. Even though Pima County did not experience the same level of overbuilding as was the case for Pinal, Maricopa and Mohave counties, personal income growth for Pima County is expected to be 1 percent or less for fiscal year 2009/10, the lowest rate of local income growth seen in many decades. The attached Chart 2 shows how such slowdowns in state or local personal income can have dramatic effects on Pima County state-shared sales tax revenues. County state-shared sales tax revenues reached a peak during fiscal year 2006/07 and have been steadily declining on a year-over-year basis since September 2007.

Projections for state-shared sales tax revenues from fiscal year 2009/10 through fiscal year 2013/14 are based on evaluating population and economic information contained in baseline and pessimistic forecasts for the national economy from *IHS Global Insight* (February 2009 forecasts) and similar forecasts for the local economy from the University of Arizona's Economic and Business Research Center (2008Q4 forecasts).

A number of factors are expected to result in a further decline in Pima County state-shared sales tax revenues of 4.4 percent for fiscal year 2009/10 and no growth in fiscal year 2010/11, as construction-related tax revenues, which lag current economic activity, continue to decline throughout the state. By fiscal year 2011/12, state-shared sales tax revenues are expected to grow again, but at a lower rate than that experienced statewide because the County's share in the population portion of the distribution formula will be lower when the 2010 Census population numbers become available, and the growth in local taxable sales will be somewhat less than overall statewide growth.

Pima County State-Shared Sales Tax Revenues by Fiscal Year ($ millions)

1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93
33.292	34.664	37.449	38.660	38.280	39.925	43.024
1993/94	**1994/95**	**1995/96**	**1996/97**	**1997/98**	**1998/99**	**1999/2000**
46.976	61.542	62.473	62.972	65.630	70.026	76.271
2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**
80.925	76.759	77.729	82.652	90.285	102.619	106.932
2007/08	**2008/09**	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14**
103.895	93.000	88.950	88.950	91.600	99.575	108.150

V.(B) General Fund Vehicle License Tax Revenues

County General Fund vehicle license tax revenues are highly sensitive to changes in new vehicle sales and the pattern of population in-migration, as new residents register vehicles that are typically newer than the average age of vehicles already in the local tax base. Between fiscal year 1998/99 and its peak in fiscal year 2007/08, General Fund vehicle license tax revenues grew by more than 60 percent, whereas the County's overall population grew by 22 percent. During the early years of this period (i.e., fiscal year 1998/99 through fiscal year 2000/01), the state reduced the overall vehicle license tax rate by nearly 28 percent, while holding "harmless" the County portion of vehicle license tax revenues. At the same time, the state increased the rate at which the tax base declines each year from 15 percent to 16.25 percent. Counties were not held "harmless" for this provision, however, which means the tax base for General Fund vehicle license tax revenues could decrease by up to 16 percent each year if no new vehicles are added to the existing tax base over time.

General Fund vehicle license tax revenues actually grew during the last recession (the period from March 2001 through November 2001) as both businesses and consumers took advantage of extraordinary low interest rates and financing incentives that manufacturers/dealers offered to maintain their new vehicle sales. Today, interest rates are again extraordinarily low, but loans with such favorable rates are available only for the most creditworthy borrowers, and domestic vehicle manufacturers/dealers, many near bankruptcy, are not financially able to

provide the same amount of incentives. The allure of incentives will not be enough in the current economic environment because consumers and businesses have dramatically reduced their purchases of long-lived, durable goods such as vehicles. Arizona motor vehicle dealer taxable sales decreased during January by 40 percent versus a year ago and by 50 percent since January 2007, while national vehicle sales have decreased by 37 percent and 40 percent during the same periods.

County General Fund vehicle license tax revenues for fiscal year 2009/10 through fiscal year 2013/14 are projections derived from information contained in baseline and pessimistic forecasts for the national economy (*IHS Global Insight* February 2009 forecast) and the local economy (University of Arizona's Economic and Business Research Center 2008Q4 forecast).

General Fund Vehicle License Tax Revenues by Fiscal Year ($ millions)

1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000
10.063	10.410	11.916	12.700	14.798	16.937	18.502
2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**
19.672	21.093	21.904	23.413	23.630	25.894	26.967
2007/08	**2008/09**	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14**
27.166	25.750	24.700	24.900	26.100	27.770	29.900

Slow rates of local population growth and no rebound in new vehicle purchases until fiscal year 2010/11 are the key factors affecting the outlook for County General Fund vehicle license tax revenues. Population growth is expected to slow to nearly one percent per year through fiscal year 2009/10, as net in-migration slows to near zero levels, before increasing to annual rates of 1.6 to 2.0 percent thereafter, which are still well below the historic average growth of 2.2 percent per year. Slow population growth, coupled with historically low levels for new vehicle purchases, means the tax base will not grow fast enough in the short-term to offset the 16.25 percent statutory decrease each year, thus causing a 4 percent decline in County General Fund vehicle license tax revenues during fiscal year 2009/10. Revenues are projected to increase only slightly during fiscal year 2010/11, as population growth and new vehicle sales are barely enough to offset the statutory decrease in the tax base. It is not until later years, when both population growth and new vehicle purchases return to more typical levels, that County General Fund vehicle license tax revenues are expected to grow again at 5 percent to 7 percent annual rates.

VI. Net Potential Change of Total County Property Tax and State-Shared Revenues

By comparing the five-year forecasts of future property valuations and state-shared revenues, it is evident that the potential loss in property taxes will be significantly greater than any possible increase in combined state-shared sales and vehicle license tax revenues.

It should be noted that during the only previous period of declining County assessed values following the 1990 recession and the Savings and Loan crisis workout, the primary assessed value of the County decreased by nearly $43 million, or 1.4 percent, during the five-year period from fiscal year 1989/90 through 1993/94, while secondary assessed value decreased by $131 million, or 4.2 percent. Potential decreases in primary and secondary assessed values between fiscal years 2009/10 and 2013/14 could be as much as 6.8 percent (primary) and 14 percent (secondary). The fiscal year 2009/10 to 2013/14 drop is nearly a fivefold greater loss in County primary assessed value. Fiscal year 2008/09 tax rates applied to the fiscal year 2009/10 valuations result in a primary levy of $304.8 million and $119.0 million in secondary levies, with combined levies totaling $423.8 million. Applying the fiscal year 2008/09 tax rates to the fiscal year 2013/14 estimated values results in the sum of the levies being $386.3 million, with $284.0 million for the primary levy, a drop of $20.8 million (6.8 percent) from fiscal year 2009/10, and $102.3 million for the secondary levies, a loss of $16.7 million (14 percent). This represents a cumulative property tax loss of $37.5 million to the County between fiscal years 2009/10 and 2013/14.

State-shared sales and vehicle license tax revenues attributed to the County General Fund during the previously mentioned period from 1989/90 to 1993/94 showed an increase of $8.3 million for state-shared sales tax revenues and an increase of nearly $3.5 million for vehicle license tax revenues, offsetting the loss of primary property tax revenues caused by the 1.4 percent decline in assessed value. We will not be so lucky this time.

For the forecasted period from 2009/10 to 2013/14, state-shared sales taxes are estimated to increase by $19.2 million. In addition, a $5.2 million increase in vehicle license taxes is forecasted for a total increase of $24.4 million in these General Fund state-shared revenues, only about two-thirds of the projected cumulative loss in property tax revenues assuming constant tax rates.

VII. Closer Examination of the Property Tax Base in New Growth Versus Appreciation or Depreciation of the Property Tax Base from 2004 to 2014

The tax base changes by growing (shrinking) and appreciating (depreciating). Growth is the actual, physical, change of the tax base. The construction of new houses, new stores, new offices, and factories is growth. Growth is indicative of increased population and employment.

The Assessor measures growth each year. He first determines the value of the property that was in existence last year using the current year's valuation standards. He then calculates the percent difference between that number and the total value for the current year.

The attached Chart 3 is a comparison of the Assessor's growth percentages with the number of single family residential permits issued. Both sets of data have been indexed to where their maximum values are 100. Single family residential permits are the largest value class of permits issued in the County. The Assessor data has been lagged about two years. The data the Assessor bases his valuations on takes approximately two years to show up in the actual property taxes of the County. The forecast of the growth rate is based on the economic indicators discussed previously. In the short run the engines of growth, i.e. population, increased employment, and reasonable financing, are going to be weak until the national economy begins to emerge from the present condition.

Appreciation or depreciation is driven by the rules of supply and demand. Supply is the ability to provide the product and demand is the number of people able and willing to purchase the product. If the supply is low and the demand is high, the price of the product will most likely rise. This was the real estate market in Pima County. The attached Chart 4 shows the average monthly median price of resale homes in Pima County over the last few years. Also shown is the average taxable value of owner-occupied residences over the same period. (They are again lagged two years to match taxable values to actual market values.) From 1999 to 2006 the market value of residential property increased over 100 percent.

The appreciation from 1999 to 2006 was driven by large amounts of money made available for the purchase of real estate. Some of the money was investment money coming from poorly performing equity markets, but most of it came in the form of high-risk mortgages which over time have proven to be bad. Without money to borrow and a large number of properties going into foreclosure, demand for real estate has dwindled significantly. Without demand the price of real estate will fall. Chart 4 indicates the current direction of the value of existing homes being sold and the possible direction of values in the future.

Neither growth nor appreciation will be at work to expand the property tax base of Pima County over the next few years. Simply stated, the value of the tax base will shrink. Chart 1 shows the overall impact of this scenario on the total tax base.

VIII. Fiscal Neutrality in Property Taxation for the Ten-Year Period of 2004 to 2014

Fiscal neutrality as defined by current statutory law is a term of art related to measuring property tax increases and determining whether or not those levy increases exceed certain parameters designed to define excessive property taxation. The Legislature, through these statutes, has defined property tax fiscal neutrality as the limitation of the property tax levy to no more than the growth in assessed value added to the tax base through new construction. This simply means that in a fiscally neutral tax environment the levy of property taxes and setting of the tax rate eliminates and/or reduces the allowable levy increase related to property appreciation as caused by market forces.

Pima County, for three years in a row, since 2006/07, has met this standard of limiting property taxation. Pima County is the only county in Arizona that has met this standard. In meeting this standard the County has received little recognition to acknowledge our efforts in limiting property taxation. The Legislature created this standard in 1996, and its creation apparently assumed or did not consider the distinct possibility of significant declines in overall assessed value or, simply stated, significant reductions in appreciation or the fact that appreciation could turn to depreciation, which now appears very likely. Simply reviewing the assessed value notices sent out by the County Assessor in February of this year confirms this fact wherein a significant number of these notices showed a decline in real value as reflected by, again, market conditions. While the County over the last several years has been reducing the property tax rate to meet definitions of fiscal neutrality, there is a very real possibility that in the next few years the property tax rate will actually have to be increased to meet the legislative definition of neutrality.

IX. Net Revenue Forecast for the Five-Year Period of 2009 to 2014 - Total Revenues Potentially Declining Significantly

Table 7 below demonstrates the five-year change in Primary and Secondary Assessed Value of the County and the percent change per year associated with this change, plus the total change from 2010 to 2014. In addition, the five-year forecasted change in sales tax and vehicle license tax revenues attributed to the General Fund are also shown in the same table. Assuming a constant aggregate tax rate as set in fiscal year 2008/09 for the total property tax levies from 2009/10 through 2013/14, Table 7 shows the potential loss in property tax revenues over the base year of 2008/09. These losses are not appreciably offset by increases forecasted in state-shared sales taxes or vehicle license taxes.

Table 7

Estimated Total Revenue Losses ($ Millions)

	NET ASSESSED VALUES				Total Prop. Tax Rev. @ 08/09 Rate*	STATE SHARED REVENUES		
	Secondary NAV	Secondary NAV % Change	Primary NAV	Primary NAV % Change		State Shared Sales Tax	Vehicle License Tax	Sum of State Shared Taxes
FY 09/10	$9,840.6	2.56%	$8,986.3	9.1%	**$423.816**	$88.950	$24.700	**$113.650**
FY 10/11	$9,472.1	-3.74%	$9,122.6	1.5%	**$423.979**	$88.950	$24.900	**$113.850**
FY 11/12	$8,997.3	-5.01%	$8,855.9	-2.9%	**$409.190**	$91.600	$26.100	**$117.700**
FY 12/13	$8,701.1	-3.29%	$8,610.8	-2.8%	**$397.294**	$99.575	$27.770	**$127.345**
FY 13/14	$8,460.6	-2.76%	$8,372.3	-2.8%	**$386.296**	$108.150	$29.900	**$138.050**

* A rough calculation of all County levies for illustration purposes only.

	Sum of Revenues	Change in Revenues	Cumulative Total
FY 2009/10	$537.466		
FY 2010/11	$537.829	$0.363	$0.36
FY 2011/12	$526.890	-$10.939	-$10.58
FY 2012/13	$524.639	-$2.251	-$12.83
FY 2013/14	$524.346	-$0.293	-$13.12

As can be seen, with a constant tax rate for all primary and secondary levies, the loss in assessed value, or value of the tax base, has adverse financial consequences on County revenues. These property tax revenue losses are only partially offset by increased state-shared sales and vehicle license taxes. Cumulatively, the revenue losses will exceed $13 million over the future five-year period. Without the forecasted $24.4 million increase in state-shared revenues, property tax losses over the forecast period would approach $38 million.

X. Summary

This forecast of property taxes and state-shared revenues is intended to allow the County to plan and adjust to a changing and potentially adverse revenue environment. This forecast predicts for the first time a possible measurable and significant drop in the value of the tax base. Unless tax rates are adjusted upward, losses in property tax revenues will be significant. Finally, losses in property tax revenues will only partially be offset by increases in state-shared revenues that more quickly respond to present day economic conditions. Cities and towns have been more dramatically impacted by the sharp reductions in sales and state-shared revenues, while the County's main revenue source, the property tax, has been largely unaffected until now. Because general economic conditions being experienced today are not reflected in the tax base for approximately 2 years, our budget, based on predicted revenue declines, will become increasingly difficult beginning in fiscal year 2010/11 and quite likely continuing to 2013/14.

CHH/jj

Attachments

c: Martin Willett, Chief Deputy County Administrator
Hank Atha, Deputy County Administrator for Community and Economic Development
John Bernal, Deputy County Administrator for Public Works
Dennis Douglas, Deputy County Administrator for Medical and Health Services
Tom Burke, Finance and Risk Management Director
Thomas House, Budget Manager, Finance and Risk Management

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Chart 1 - Index of Pima County Full-Cash Value Compared to a Composite Index of Personal Income, Population and Employment

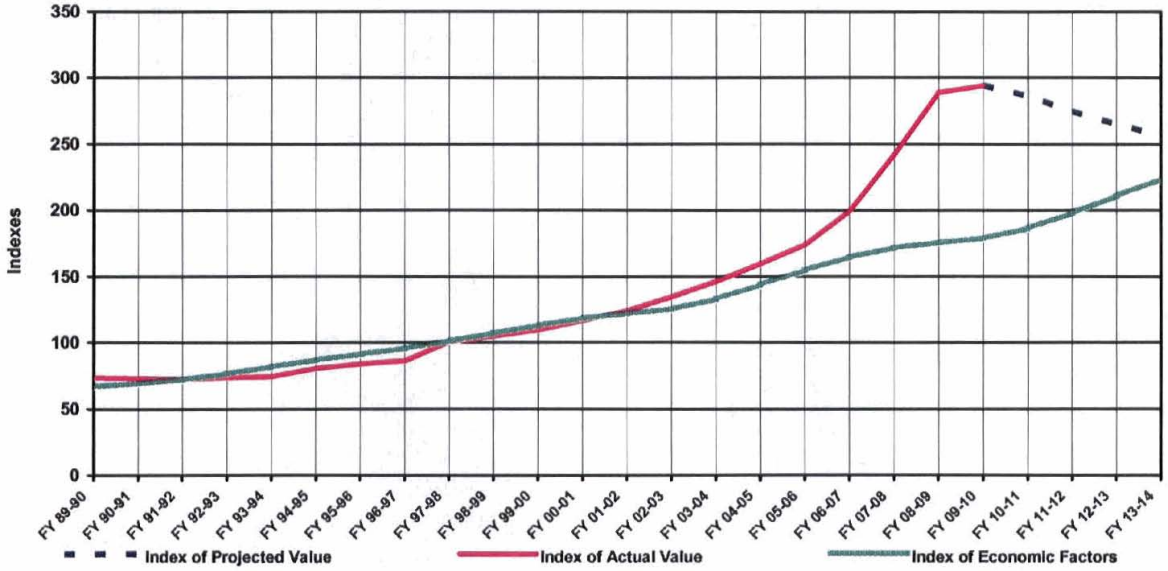
Chart 2 - State-Shared Sales Tax Revenue and Personal Income (Pima County and Arizona)

Chart 3 - Comparison of Assessor Growth Rates and Single Family Permits

Chart 4 - Average of the Median Monthly Price of Single Family Homes and the Average Taxable Value of Owner Occupied Residential Property

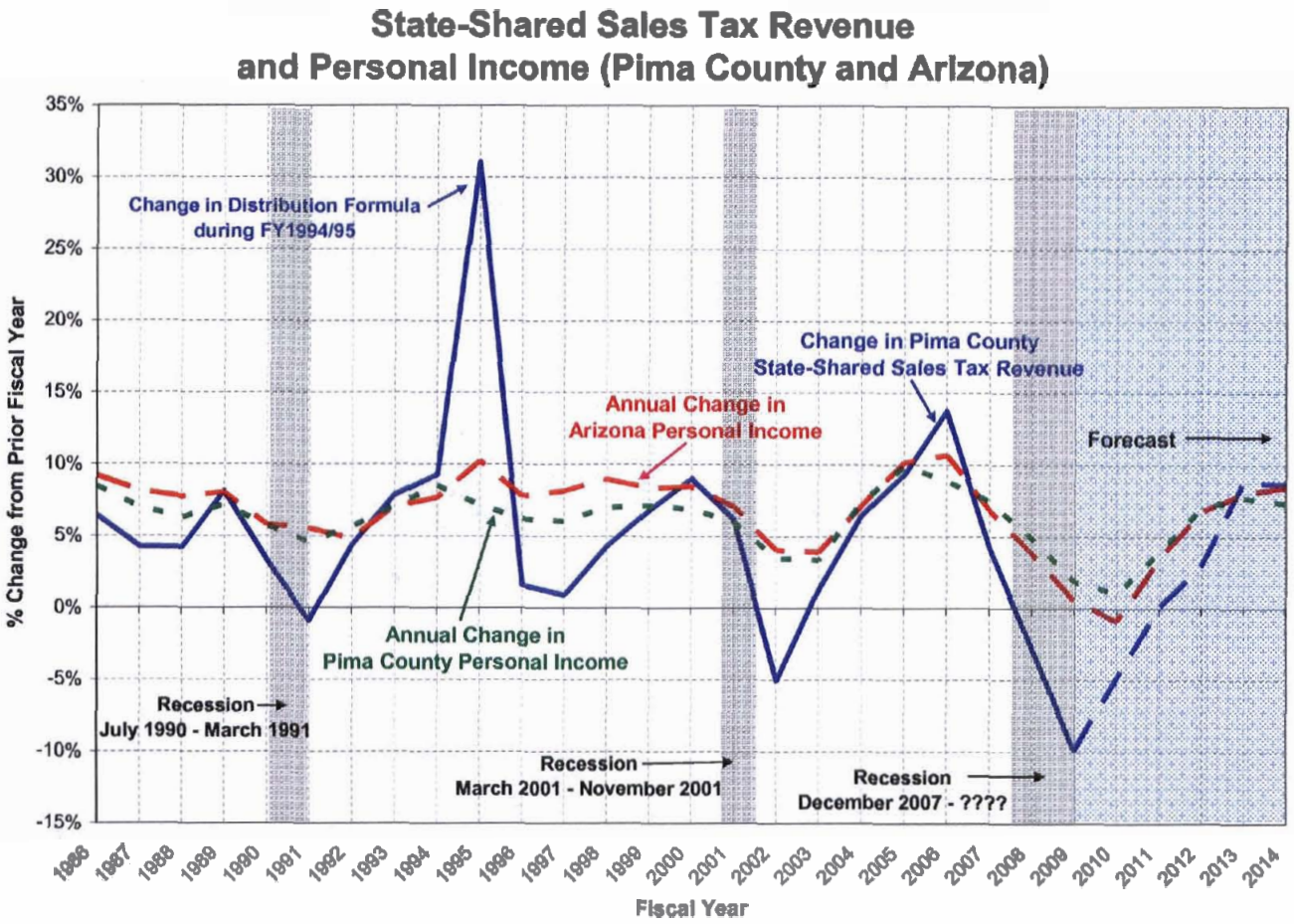
Chart 1

Index of Pima County Full-Cash Value compared to a Composite Index of Personal Income, Population & Employment



Sources: Index of Actual Value: Pima County Budget Division
Index of Projected Value: Pima County Budget Division
Index of Economic Factors: The University of Arizona, Economic & Business Forecasting Center, & Pima County Budget Division.

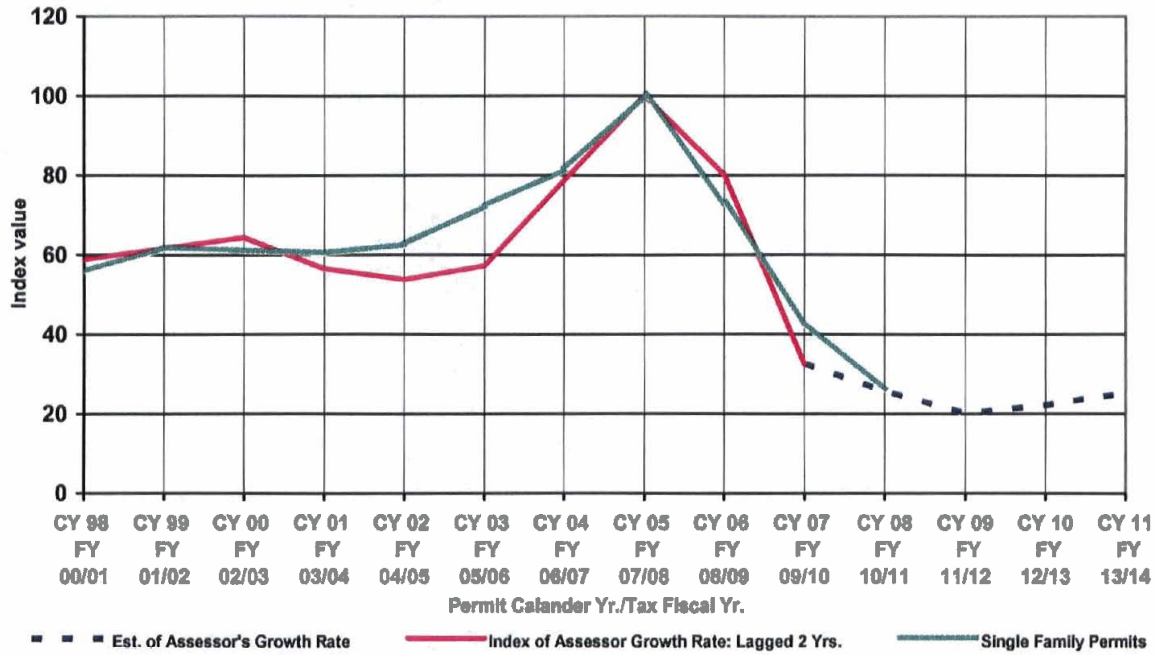
Chart 2



Sources: Pima County and Arizona Personal Income: Economic and Business Research Center, University of Arizona.
National Recession Dates: National Bureau of Economic Research, Business Cycle Dating Committee.
Pima County State-Shared Sales Tax Revenues: Arizona Department of Revenue and Pima County Budget Division.

Chart 3

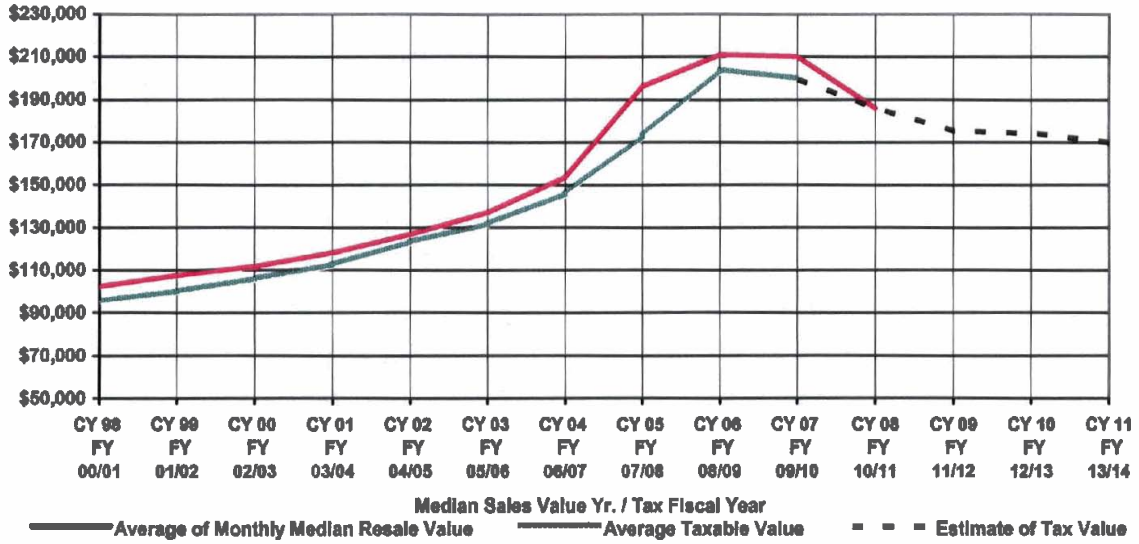
Comparison of Assessor Growth Rates and Single Family Permits



Sources: Assessor's Growth Rate: Pima County Assessor's Office, Truth in Taxation letters.
Single Family Permits: Bright Future's Consulting Services.
Estimate of Assessor's Growth Rate: Pima County Budget Division.

Chart 4

Average of the Median Monthly Price of Single Family Homes & the Average Taxable Value of Owner Occupied Residential property



Sources: Average of Monthly Median Resale Value: Bright Futures Consulting Services & Pima County Budget Division.
Average Taxable Value: Pima County Abstract of Values & Pima County Budget Division.
Estimate of Taxable Value: Pima County Budget Division.