City Council Report

Date: June 17, 2019

To: City Council

Through: Michael Kennington, Chief Financial Officer
Candace Cannistraro, Management and Budget Director

From: Ryan Wimmer, Treasurer

Subject: Fiscal Year 2019-20 Secondary Property Tax Rate and Levy

Purpose

This action approves the levy of a secondary property tax on taxable property in the City of Mesa for Fiscal Year (FY) 2019-20. The levy can only be used to pay principal and interest on debt service from general obligation bonds issued to finance capital infrastructure.

The proposed FY 2019-20 secondary property tax levy and tax rate are:

Levy = $41,740,629
Rate = $1.1870 per $100 of taxable value

Background

Property tax is calculated as follows:

property <u>value</u> * tax <u>rate</u> = tax <u>levy</u>

A property's <u>value</u> is determined annually by either the County Assessor or State Department of Revenue. The property tax <u>rate</u> is set by governing bodies as a dollar amount per $100 of taxable value. The property tax <u>levy</u> is the property <u>value</u> multiplied by the tax <u>rate</u> and is the dollar amount of property tax owed.

Since FY 2009-10, the City of Mesa has levied a secondary property tax to pay for debt service on general obligation bonds. Unless new general obligation bonds are authorized by voters, or the Council provides direction to alter the levy, the tax rate is adjusted to maintain the same levy from one fiscal year to the next. The City's practice is to fully adjust the levy in the fiscal year following a successful bond election.

The City uses the tax levy (not the tax rate) to manage secondary property tax. The amount of the levy is intended to fund the annual cost of debt service over the life of the authorized bonds. State law (A.R.S. §35-458(A)) limits the amount of a secondary property tax levy to the projected general obligation principal and interest due, plus a reasonable delinquency factor. Accumulated fund balance to pay general obligation debt service is limited to 10% of the current fiscal year debt service payment.

In general obligation bond authorizations approved by Mesa voters in the 2008, 2012, 2013, and 2018 elections, ballot language stated that the issuance of the bonds would result in a property tax increase sufficient to pay the annual debt service on the bonds.

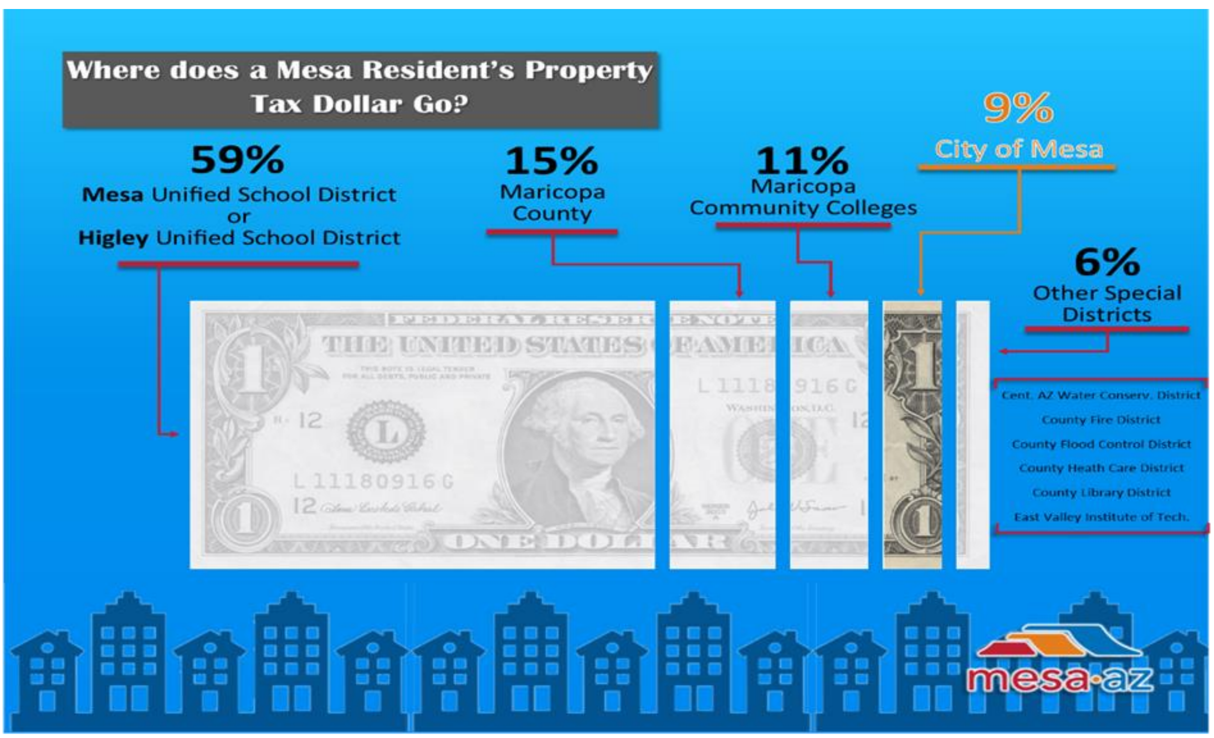
The City of Mesa does not currently levy a primary property tax.

Discussion

Relative Size of Mesa's Property Tax Levy

City property tax represents only 6% to 9% (depending on the area of the City) of a Mesa resident's total property tax bill. The largest portion of a resident's tax bill (from 40% to 60%) is paid to public school districts. Figure 1 below shows the proportion of a Mesa resident's property tax dollar in the Mesa Public School District received by various taxing jurisdictions. Mesa residents also live in the Gilbert, Higley, Queen Creek, and Tempe School Districts.

Figure 1: Property Tax Dollar of Mesa Resident (Mesa Public School District)



Property Value

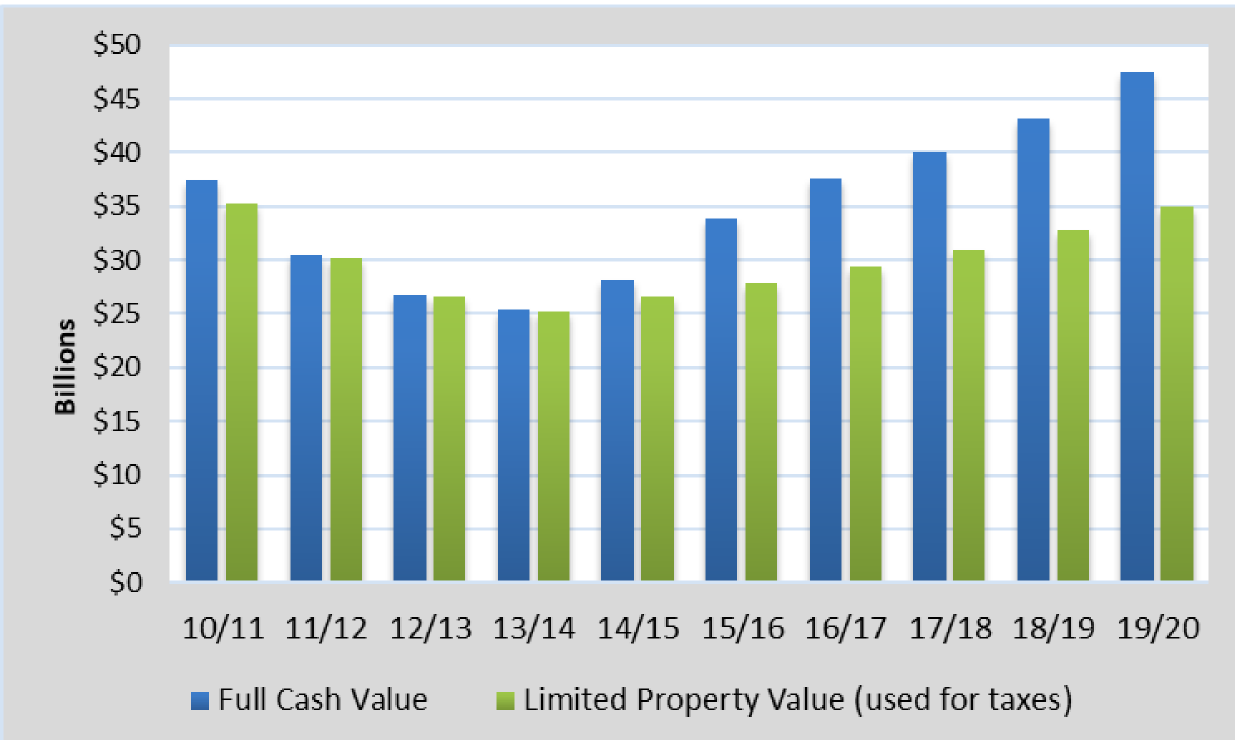
Arizona property owners pay property tax based on the value (ad valorem) of the property. The property value used for one fiscal year is based on market values from two to three years prior to allow time for review and appeals. The assessed value used in FY 2019-20 is based on property valuations from mid-2016 to mid-2017.

Each parcel of property in the State of Arizona is assigned a full cash value (FCV), which is based on market value, and a limited property value (LPV), which is used for property tax purposes.

For most property, the current limited property value is the lesser of full cash value or the prior year's limited property value increased by 5%. Full cash value does not have an annual increase restriction. A property's limited property value cannot exceed its full cash value.

The use of limited property value for property tax purposes moderates the short-term impact of rapid property value increases. Figure 2 below shows both the full cash value and limited property values in Mesa for the past decade.

Figure 2. City of Mesa – Property Value by Fiscal Year



The full cash value of property in the City of Mesa increased by 10% in FY 2019-20. Property valuation changes vary by classification of property (see Figure 3 below).

Figure 3. City of Mesa Full Cash Value by Property Class: FY18-19 to FY19-20

Class	Description	FY18-19	FY19-20	$ Change	% Change
1	Commercial	$ 7.3 B	$ 8.0 B	+$0.7 B	+9%
2	Land/Agriculture	$ 5.6 B	$ 5.9 B	+$0.3 B	+6%
3	Primary Residential	$20.0 B	$21.9 B	+$1.9 B	+9%
4	Rental	$10.1 B	$11.4 B	+$1.3 B	+13%
Other	Miscellaneous	$ 0.2 B	$ 0.4 B	+$0.2 B	+60%
TOTAL		**$43.2 B**	**$47.5 B**	**+$4.3 B**	**+10%**

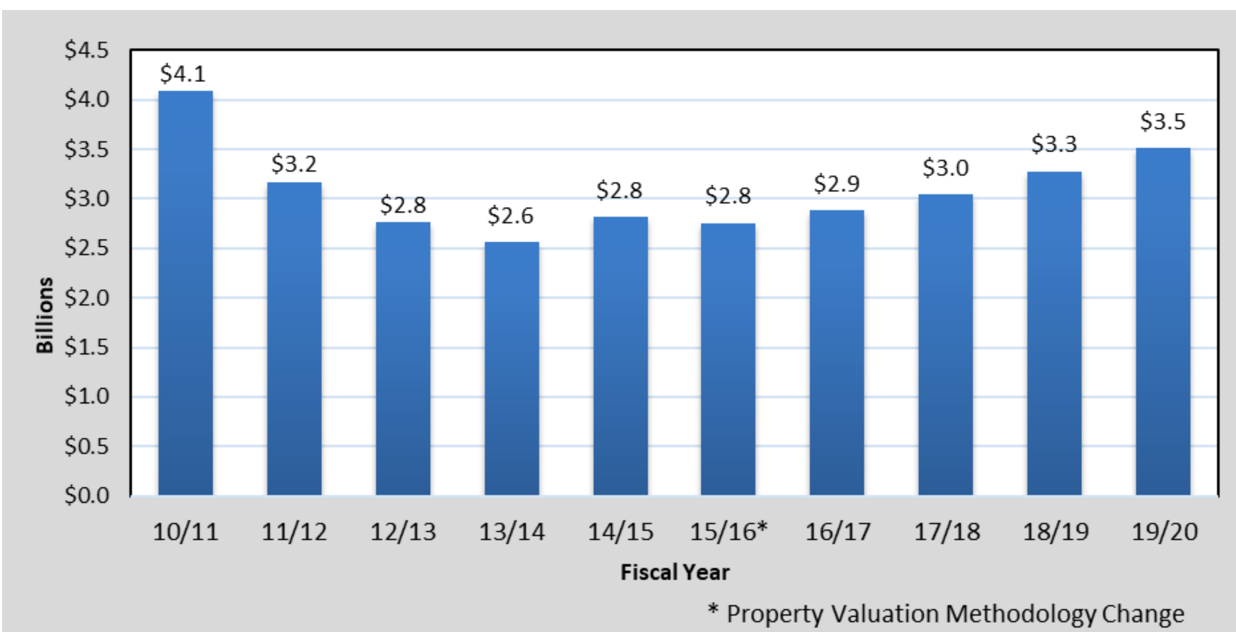
Taxable Property

The limited property value is used as a starting point to calculate the taxable value of a property, called net assessed value (NAV). An assessment ratio is applied to the limited property value based on property classification to determine a property's "assessed value". For example, the assessment ratio is 10% for residential property, 18% for commercial property, and 15% for vacant land.

Exempt property (not-for-profit, governmental, etc.) is netted (subtracted) out of the assessed value, resulting in a property's "net assessed value". Net assessed value is the value of the property that is subject to taxation.

City of Mesa secondary net assessed value for recent fiscal years is shown in Figure 4 below.

Figure 4. City of Mesa – Net Assessed Value by Fiscal Year



In FY 2019-20, the net assessed (taxable) value of property in the City of Mesa increased by 7% (4% due to appreciation of existing property, 3% from new construction).

Figure 5. City of Mesa Net Assessed Value (NAV): FY18-19 to FY19-20

	FY18-19	FY19-20	$ Change	% Change
Net Assessed Value (NAV) (taxable value)	$3.28 Billion	$3.52 Billion	+$238 Million	+7%
Appreciation of Existing Property			+$136 Million	+4%
New Property			+$102 Million	+3%

New property represents construction of homes, buildings, equipment, etc. that add to the base of property value in the City.

New Bond Authorizations

The proposed FY 2019-20 property tax rate and levy are adjusted from the prior year for the $196 million of public safety and parks and cultural general obligation bonds approved by voters in November 2018 (see Figure 6 below).

Figure 6: 2018 General Obligation Bond Authorizations by Purpose

Purpose	Authorization
Parks and Culture	$111 million
Public Safety	$ 85 million
Total	**$196 million**

Impact to Property Owners

The estimated impact of the proposed FY 2019-20 secondary property tax levy on the median homeowner was presented in the Council study session on May 30. The estimated impact included in the presentation was based on a preliminary median residential property value. In this report and the accompanying presentation, the estimated impact has been updated with a final median value that is slightly higher than the preliminary value. The median residential value is simply used as an example value, there is no change to the proposed tax levy or tax rate.

The FY 2018-19 annual impact of the City's secondary property tax rate to a median homeowner is $129. The 2018 general election publicity pamphlet included an annual cost estimate of $50 to the median homeowner for the new general obligation bonds.

The sum of the two amounts, $179, was anticipated as the impact to the median homeowner in FY 2019-20.

Median Homeowner Annual Impact

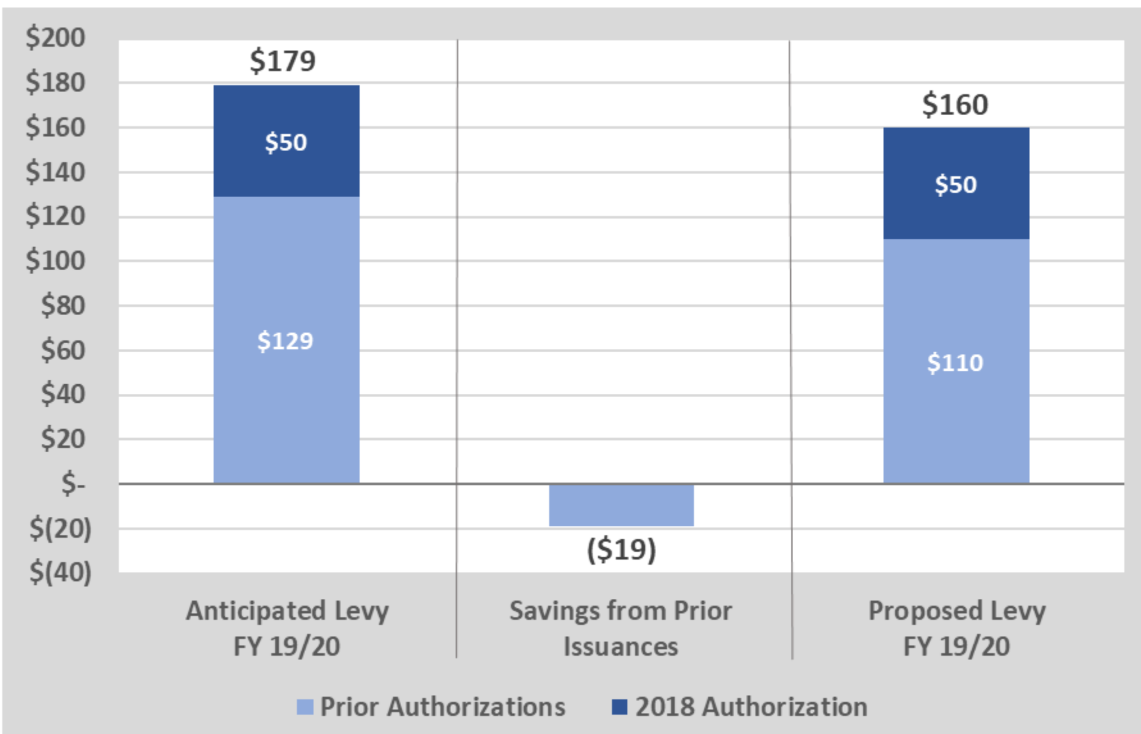
Current Levy (FY 18-19)	= $129
2018 Election Publicity Pamphlet Estimate	= $ 50
Anticipated Levy (FY19-20)	= $179

The impact of the 2018 general obligation bond authorizations on the median homeowner is $50, as anticipated. However, the impact from general obligation bonds authorized prior to 2018 is reduced from $129 to $110 in the proposed FY 2019-20 levy as a result of savings from prior issuances due to:

1. Borrowing costs (interest rates) being less than conservatively assumed
2. Property tax collection rates being higher than conservatively assumed
3. Savings from (a) and (b) above were used to structure new issuances with principal due in early years

The total impact of the proposed FY 2019-20 levy to the median homeowner is $160.

Figure 7: Property Tax Adjustment: Impact to Median Homeowner



The median values of a Mesa residential property in FY 2019-20 are:

Limited Property Value (LPV):	$135,206	(taxable value; limited to 5% annual growth)
Full Cash Value (FCV)	$190,000	(upper limit on taxable value; a percentage of sale value)
Sale Value (estimate):	$231,707	(estimated sale price)

Property Tax Levy and Rate

The anticipated FY 2019-20 property tax rate and levy are shown in Figure 8 below. These amounts include the existing FY 2018-19 levy and rate combined with the rate and levy assumed (in the election publicity pamphlet) to be the result of the general obligation bonds approved in November 2018. Because of savings from prior issuances (discussed above), the proposed FY 2019-20 levy and rate are substantially less than anticipated (see Figure 8 below).

Figure 8. City of Mesa Property Rate and Levy: FY18-19 to FY19-20

	FY18-19	FY 19-20 Anticipated	FY19-20 Proposed
Secondary Property Tax Levy (Taxable Value * Tax Rate)	$33.4 million	$46.9 million	**$41.7 million**
Secondary Property Tax Rate (per $100 of Taxable Value)	$1.0201	$1.4501	**$1.1870**
Annual Cost to Median Homeowner	$129	$179	$160

What is Funded by the Levy?

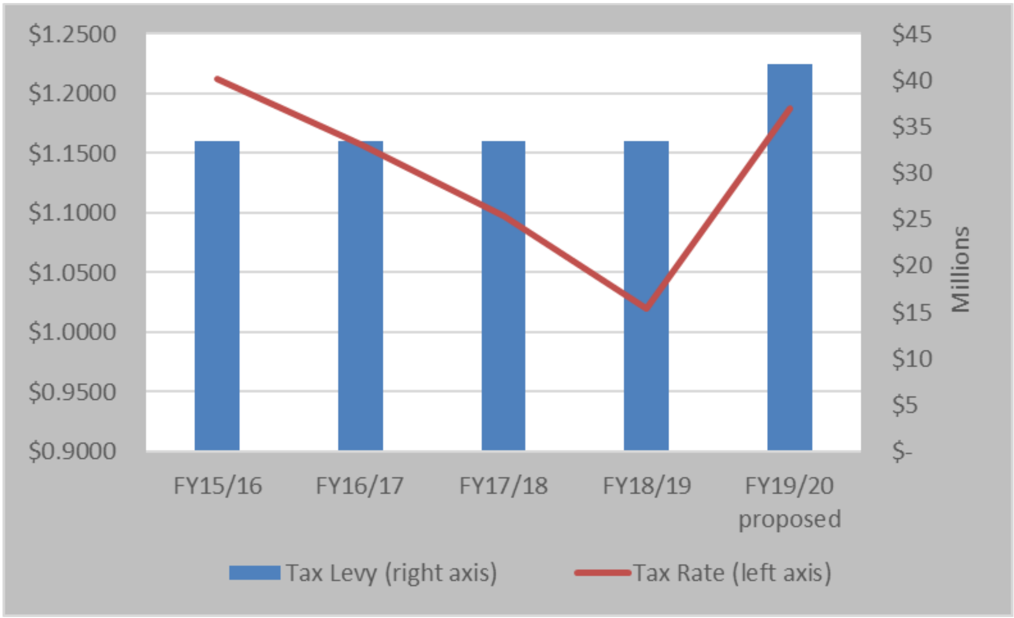
The proposed FY 2019-20 property tax is levied to pay debt service payments for:

- Streets and Public Safety bonds approved by Mesa voters in 2008 and 2013
- Parks bonds approved by Mesa voters in 2012
- Court, Public Safety, Library, Parks, and Streets bonds issued before 2008. By paying for this debt with secondary property tax, the City's General Fund is freed up to pay the operating costs for two new fire stations (which opened in FY 2009-10 and FY 2012-13) as well as other City operations.
- Public Safety and Parks and Culture bonds approved by Mesa voters in 2018

Historical Comparison

For the past several years the City's secondary property tax levy has been constant while the tax rate has declined. The addition of new property and the appreciation of existing property resulted in a lower rate being necessary to generate the same levy from one fiscal year to the next. The proposed adjustment to the City's FY 2019-20 secondary property tax rate and levy would fund the bonds authorized in the November 2018 election.

Figure 9. City of Mesa Property Rate and Levy: 5-Year Comparison



Alternatives

The Council may choose not to levy a secondary property tax or to levy any rate and amount less than proposed. A reduction to the proposed levy and rate would necessitate the payment of general obligation debt service with the General Fund, which would draw down General Fund reserves or require reductions to General Fund services provided by the City (police, fire/medical, library, parks, etc.).

The property tax levy cannot legally be greater than proposed because secondary property tax can only be used to pay for general obligation debt service and the proposed levy is sufficient to fully fund general obligation debt service due in FY 2019-20.

Fiscal Impact

Adopting the proposed secondary property tax levy and rate would allow the City to meet its general obligation debt service obligations as planned. The secondary property tax levy is a critical piece in maintaining the fiscal stability of the City.