



ABOR Tax Free Zones

A POLICY REVIEW

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The largest office development in Arizona history pays no property taxes and will not for 99 years. How this occurred is even more surprising. The massive State Farm facility overlooking Tempe Town Lake is actually a lease; it's technically owned by the Arizona Board of Regents and sits on university land. The State of Arizona is exempt from property taxes, meaning the \$928 million property with 2.2 million square feet of office space and the land underneath it are exempt as long as ABOR holds the deed to the property.¹

Businesses don't like paying property taxes. They are owed annually regardless of profitability and are notoriously high in Arizona. Low homeowner property taxes are no accident: Arizona makes up for it with high business property taxes. In the only national study to analyze effective property tax rates (ETRs), Phoenix and Tucson rank 19 and 22 of the 50 largest US cities for highest commercial property taxes.² Arizona has the highest ETRs on business property taxes in the region outside of Texas, who doesn't have a personal income tax.

The history of property tax avoidance in Arizona is storied and continuous. This report will examine tax-free zones on Arizona's universities.

Wait. How?

All property in Arizona is subject to tax unless it has an exemption in the Constitution. When Arizona cities began aggressively using their tax-exempt status for economic development purposes in the 1980's by shielding commercial development from tax,



the Arizona Legislature responded with a possessory interest tax. The state long had an Improvements on Possessory Rights (IPR) tax, which taxes private improvements (buildings) on government land, but it needed a possessory interest tax in order to "reach through" the government owned land *and* improvement in order to tax the private lessor. The IPR tax was avoided through a "lease back" where a private developer builds an improvement

¹ "State Farm campus in Tempe sold to investment groups in sale-leaseback deal" Arizona Republic, 15 Dec 2017.

<https://www.azcentral.com/story/news/local/tempe/2017/12/15/state-farm-campus-tempe-sold-investment-groups-sale-leaseback-deal/951647001/>

² "50 State Property Tax Comparison." Minnesota Center for Fiscal Excellence & Lincoln Land Institute

<http://www.lincolninst.edu/sites/default/files/pubfiles/50-state-property-tax-comparison-for-2016-full.pdf>

on government land and then transfers title back to the government upon completion in exchange for the property being “leased back” to the developer.

The 1985 Possessory Interest Tax (PIT) required an in-lieu property tax on any city owned improvement that was used commercially. However, its prospective application was deemed flawed by the courts following the *Scottsdale Princess* lawsuit in 1993. The PIT law provided exemptions to that tax for properties that had already entered lease-back deals with cities; the entire law was struck down because the exemptions violated the constitutional mandate that all property be taxed.³

The Legislature responded by creating the Government Property Lease Excise Tax (GPLET) in 1996. At that time, policymakers thought GPLET accomplished three goals: First, by shifting to an “excise” tax, the state would be able to maintain the exemptions in the 1985 law that were struck down by the court; Second, the Legislature thought it would continue to act as a check on the cities use of their tax exempt status for private development; Third, the new tax would also allow the cities to continue to use the eight-year tax abatement in a downtown central business district.

But state land was not included in the GPLET bill, meaning the state and thus, ABOR could shield a private concern from property tax if the deed was transferred to ABOR in a lease-back scenario.

Betting the Farm

The introduced version of SB1116, the 1996 law creating GPLET, applied the GPLET tax to all government improvements on city, county, special district and ABOR land. While the focus was on cities, there was some concern over the use of tax abatement in the ASU Research Park.

ASU acquired a large Tempe farm in 1956 and used it for research until the agricultural department was dissolved.⁴ In 1983 the State Legislature passed a law allowing ABOR to form a “Research Park”— a popular concept sweeping

the nation envisioning students working alongside industry to spring university ideas from the lab to market. Originally, the ABOR Research Parks were included in Class 11 (now Class 9) which meant they paid real property taxes but their assessment ratio was just 1%, meaning they paid the same rate as others but only on 1% of their value. By 1996, policymakers questioned the mission creep at the Research Park and included ABOR in the original GPLET bill.

As the bill advanced through the Legislature, ABOR convinced



Pursuant to ARS 15-1636, ad valorem real property taxes are abated for certain “Qualified Uses” constructed on land leased at the ASU Research Park. Qualified Uses are defined in the statute and summarized as follows: Regional or national headquarters of the lessee or its subsidiaries that are engaged in research or development or education activities. [...]

* Screen shot from ASU Research Park website

³ SCOTTSDALE PRINCESS v. MARICOPA COUNTY <https://www.legale.com/decision/1995553185ariz3681493>

⁴ ASU Research Park <https://asuresearchpark.com/#Our-History>

lawmakers they were not in the real estate development business and should not be included in GPLET, lest they have to manage this tax for small retail and housing serving students on campus. Lawmakers amended ABOR out of the GPLET statutes on the condition they strengthen the controls of the Research Park statutes to better align with legislative intent. Thusly, SB1116 was amended to reform the Research Park statute in Title 15 to demand that beginning with leases for improvements after July 20, 1996, the property would only be used for a series of academic, research, testing, training, or education purposes.⁵

There were some glaring problems with the 1996 reform relating to ABOR. There now was no mechanism to tax possessory interests on ABOR land *outside* of the Research Park, whereas before there would have been with the 1985 PIT law. Further, the 1996 Research Park “reform” was not reform at all. The list of uses allowed on a Research Park includes some restrictive concepts relevant to a university mission. However the fourth option is a “regional or national headquarters of the lessee or its subsidiaries that are engaged in research and development or education activities.” The only thing a company must do is



designate their facility a regional headquarters and conduct “education activities” somewhere (or anywhere?) within their company. Naturally the ASU Research Park lists this use option first on their website, highlighting the low legal hurdle (see image on previous page from ASU Research Park homepage).

Between the University of Arizona (UA) and ASU Research Park, there are roughly 50 companies in 4 million square feet. Instead of paying property taxes, they pay a tariff to the University and typically a separate payment to the City. The other jurisdictions dependent on the property tax are cut out. And they

THE MARINA HEIGHTS DEVELOPMENT AVOIDS \$12 MILLION IN ANNUAL PROPERTY TAXES WITH ITS “LEASE-BACK” STRUCTURE. THAT SHORTS LOCAL GOVERNMENTS AND THE STATE GENERAL FUND.

ASU Research Park

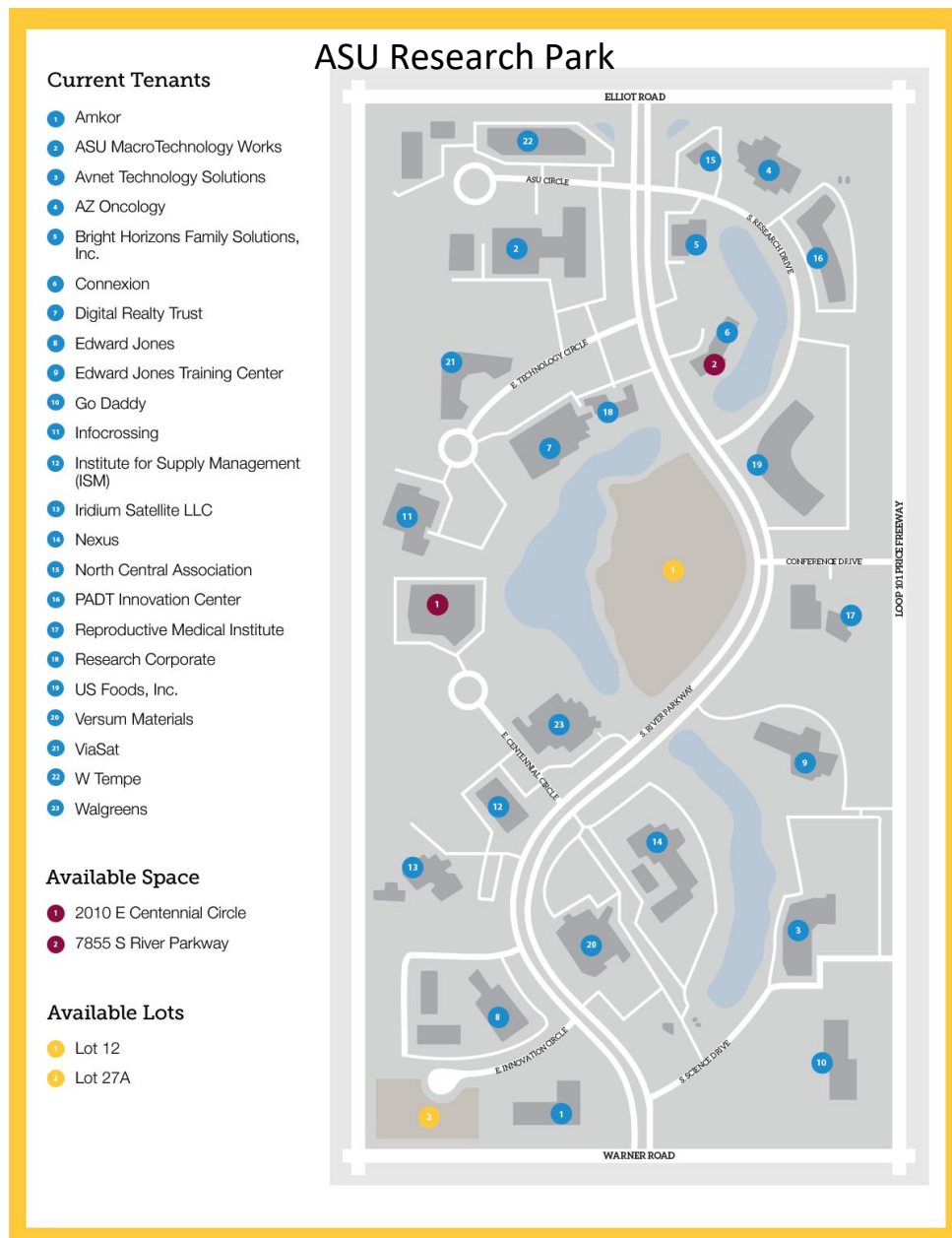
- South Tempe, 101 & Chandler
- Operated by nonprofit, authorized by ABOR
- Managed by Sunbelt Holdings
- 20+ Buildings
- 2 million square feet
- 49 companies
- 4,500 employees

UA Research Parks

- Managed by Tech Parks Arizona
- **UA Tech Park**
- 1,345 acres near I-10 & S. Rita
- 20+ Buildings
- 2 million square feet
- ~40 tenants
- Contains academic sites like UA South & Vail Academy High School
- **“The Bridges”**
- 65 acres acquired in 2009
- I-10 & Kino Parkway
- In development phase

⁵ A.R.S. §15-1636 “Lease of real property and improvements in research park; prohibited and permitted uses”
<https://www.azleg.gov/viewdocument/?docName=https://www.azleg.gov/ars/15/01636.htm>

appear to be growing. The UA expanded into a second Research Park in 2009 when it acquired new land dubbed “The Bridges” and is seeking new tenants at both of its parks.



The Ultimate Economic Development Tool

Folks in the economic development industry often speak of the “tools” they wish to use to attract or expand business or to reduce a company’s tax burden to influence their behavior. No one in the State of Arizona has a tool like ABOR. The ability to permanently evade the property tax is not something contemplated in state law... but ABOR and the Universities can. As often happens in policy, it doesn’t appear this concept was ever publicly considered.

While the Research Park statute in Title 15 attempts to match a University Research Park to the academic goals of the institution, there is nothing in law stopping ABOR from taking existing University land and using it for profit via private real estate development. Or from acquiring new land and leasing it for the same.⁶ ASU could

eliminate the Communications Major and lease their building to ACME Inc., creating a handsome revenue stream. The land that was a parking lot for students will certainly now provide more revenue to ASU as the State Farm facility. But what of State Farm’s competitors down the street who pay full property taxes, supporting the local public schools to their economic disadvantage?

⁶ Arizona Revised Statutes §15-1625 “General Powers of Board as Body Corporate”

<https://www.azleg.gov/viewdocument/?docName=https://www.azleg.gov/ars/15/01625.htm>

Harming Taxpayers and Local Governments

According to the Maricopa County Assessor's Office, the Marina Heights development is presently valued at \$608 million and, if assessed as class one commercial property, would pay taxes on about \$474 million in value. That translates to a \$12.1 million property tax bill. Of that total, \$6.6 million would go to Tempe Elementary and Tempe Union school districts. Maricopa Community College District would receive \$1.2 million. Those unpaid taxes mean higher taxes for all other taxpayers in the County who will make up most of the difference. The rates local governments must charge grow. The debt capacity for the K-12 school and community college districts are diminished.

Property taxes work differently than a sales or income tax, where a rate is set and revenues are estimated. Property taxes are set based on an expected levy; or how much revenue is demanded from local governments. Any amounts not paid by one taxpayer represent an additional cost to all others. In a state with a reputation for high business property taxes, with effective tax rates higher than nearly all Arizona's regional competitors, burden shifting to other taxpayers while a few get a big break is bad policy and awful messaging.

The Constitutionality of the ABOR tax-free zone is highly dubious. Article IX, Section 1 of Arizona's Constitution demands its property tax system "shall be uniform upon the same class of property," which is undermined when some taxpayers are allowed to evade tax. Section 2 makes clear that all property not exempt "shall be subject to taxation to be ascertained as provided by law." Section 7 prevents the state from gifting or loaning its credit in the aid of a subsidy to a private business. And though the reference in Section 2 was related to exemptions for disabled veterans, it says "No property shall be exempt which has been conveyed to evade taxation," which clearly shows the framers' intent that a lease-back which does nothing more than evade the IPR tax is counter to the Constitution.

Regardless of how policymakers feel about finding new revenue for universities, the ability to shield a business from property tax while harvesting that revenue for their budget is a public policy problem at a minimum and a constitutional threat at worst.

It's Not in the University Facilities District

When the Marina Heights/State Farm facility was built, many assumed it was the first building in Arizona State's new University Athletic Facilities District. When it became clear that it was not inside the district, policymakers should have immediately wondered what taxing framework it was operating under.

In 2009, ASU asked the Legislature to allow the creation of a new special taxing district for the purpose of financing improvements on existing intercollegiate athletic facilities. After failing, it finally passed in 2010. Per law the district was created by the county board of supervisors and is governed by a board of directors that is established through an intergovernmental agreement between the county board and ABOR.

Each state university is given the authority to establish a district within the contiguous exterior boundaries of property owned by ABOR. The Regents are also allowed to expand the district by acquiring additional property. The otherwise tax exempt university property is to be used for private development and the district will collect revenues from lessees. The tax is an in-lieu property tax that is calculated annually by the board of directors. The in-lieu property tax cannot exceed the total property taxes that the property would have been subject to in the jurisdictions where it is located.

In their advocacy for the district, ASU insisted taxpayer equity was a concern of theirs and that there would be no substantial tax benefit to be inside the district; in-lieu taxes would be owed equal to properties outside the district. The in-lieu revenues would fund facility needs instead of going to the traditional local governments who depend on the property tax. Some seven years later there is no lease generating money in the district despite substantial planning. Instead of financing hundreds of millions in stadium renovations as promised back in 2010, companies seem more interested in locating on ABOR property *outside* the district where they owe zero tax.⁷

The Marina Heights/State Farm and Research Park examples do raise the question why the Facilities District was needed at all, considering there is no law against housing corporate entities tax free on campus. For one, the District gives the university a certain amount of public relations cover as they begin to use university land for corporate functions. The State blessed the concept as a way to cover facilities expenses. Second, a governmental district has the opportunity to sell tax-free bonds, leveraging the revenue generated in the district for debt service payments. Presently the universities are limited in how much debt they can acquire, which is tied to university revenues.

While the Athletic Facilities District was not sound public policy, as it deprives the state of general fund dollars it now must use to offset the K-12 education formula, it is the law of the land and is not a tax-free zone.

More than Taxpayer Uniformity; State General Fund Impacts

Any property avoiding the property tax roll presents a cost to taxpayers across the state. The K-12 finance structure demands a “participatory” rate of property tax which funds the formula, called the Qualifying Tax Rate (QTR). The remainder of a school district’s formula budget is covered by state aid coming from the state general fund. Therefore the State Farm facility with a taxable value of \$474 million presents an annual cost to the state general fund of \$3.45 million. There is roughly \$350 million in assessed value in the Tempe Research Park, which means the state general fund impact is north of \$6 million before calculating the UA impact.

The \$4.8 million per year in rent State Farm will pay ASU beginning in year nine after eight years of no payments is far less than what it would pay in property taxes, which means it’s a great deal for both entities. While the schools and other jurisdictions were left out of the deal, the City of Tempe negotiates a special payment in the leases, which brings in roughly \$660,000 per year.

Clear Policy Going Forward

The expansion of Arizona’s public university mission into real estate development should concern policymakers. It pits taxpayers against each other creating unequal tax treatment, deprives the state and other local governments of necessary revenue, and diverts the focus of the university away from its core mission.

INSTEAD OF FINANCING HUNDREDS OF MILLIONS IN STADIUM RENOVATIONS AS PROMISED BACK IN 2010, COMPANIES SEEM MORE INTERESTED IN LOCATING ON ABOR PROPERTY OUTSIDE THE DISTRICT WHERE THEY OWE ZERO TAX.

It has yet to be addressed in state law primarily because it is a relatively new phenomenon. While the Research Park is old, its original intent did not alarm policymakers. Current trends should. ASU’s economic development office advertises “business opportunities” in six “Innovation Zones” including 300 acres at ASU East, 60 acres at ASU West,

⁷ For example, see the planned Mirabella retirement community and Omni Hotel projects <http://www.phoenixnewtimes.com/news/demand-soaring-for-seniors-only-high-rise-on-arizona-state-universitys-tempe-campus-9254237>

330 acres in the Athletic Facilities District, 150 acres at the Health Solutions Corridor adjacent to the Mayo Clinic, and space at the Research Park.⁸ Each of them offer a property tax-free setup with rent paid to ASU.

There may be a legitimate university mission in a joint corporate-academic venture, such as a biomedical company performing research alongside students. Such activity appears to be a tiny fraction. Advocates are quick to concede there is no research going on at the Research Park— this is simply a revenue generator for the University.

Policymakers should make clear in law that new businesses outside the University's core mission (such as food and housing) should prospectively pay property tax like any other taxpayer via the IPR law.⁹ ABOR should exercise significant control over the acquisition of land for such purposes. Research Parks and any land not connected to a core University's function should be limited in their ability to expand.

Taxpayers share the burden of funding government via the property tax. Policymakers must vigilantly protect its uniform application and disallow attempts to escape the tax roll. Arizona is a great place to do business because for the most part, the tax burden on businesses is considered broadly with fair treatment for all types, new and old. But there will always be attempts at carve outs. ABOR was not the first and will not be the last.

⁸ <http://innovationzones.asu.edu/portfolio>

⁹ A.R.S. §42-19003 "Improvements on unpatented land; mining claims or state land; exemption." Also see ADOR Property Tax Handbook <https://www.azdor.gov/Portals/0/Property/AZ-Personal-property-Manual.pdf>