

SPECIAL *investigation*

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Shifting The Burden: Cities Waive Property Taxes for Favored Businesses

by Mark Flatten, Investigative Reporter, Goldwater Institute

Mesa had turf to protect—turf owned by a private developer who promised to bring a \$1 billion resort and convention center to the eastern outskirts of the city.

To make the deal work, Mesa and the developer, Scottsdale-based DMB Associates Inc., needed to protect a special exemption in state law that allows the builders of such mega-projects to avoid paying property taxes, ever.

But reformers in the legislature were close to a deal in the waning days of the 2009 regular session. It would have limited the scope and unending life of the exemption, as well as raised payments that developers are charged to something more akin to what is being lost in property taxes.

Those lawmakers insist the proposed changes included an iron-clad guarantee that the planned resort would not be affected.

That wasn't good enough for Mesa or DMB, who wanted to protect the tax break for future deals.

At the last minute, city officials and the developer's lobbyists blew up the deal that had been two years in the making.

"They didn't want to work it out. They wanted to kill it," said Sen. Ken Chevront, D-Phoenix, the chief advocate for putting limits on the law that allows developers like DMB to avoid hundreds of millions of dollars in property taxes. "The whole purpose was to kill it at the last minute because if they had brought up those issues before and we had addressed them, it wouldn't have blown up the issue."

Now the backers of renewed reform talks say the prospects for change are grim.

Chevront has threatened to sue.

GOLDWATER
I N S T I T U T E



CityScape in downtown
Phoenix

*An official estimate says
Gaylord Entertainment will
avoid paying more than
\$776 million in property
taxes over 50 years for a
resort and convention center
in southeast Mesa.*

And the resort that will be built for Gaylord Entertainment is still on track to avoid paying more than \$776 million in property taxes over the 50-year life of the project near Phoenix-Mesa Gateway Airport.

Scott Butler, Mesa's lobbyist, acknowledged that the city's interests are intertwined with those of DMB through the Gaylord project. But he insists he was not trying to spike changes he agrees are needed in the law when he objected to the deal that had been worked out in June 2009.

"We have a billion-dollar common interest and that's Gaylord," Butler said when asked if he killed the reform talks at the behest of DMB. "It's important for DMB, but it's also important for the City of Mesa, and so we have a common interest that is vital for the Gateway area. Absolutely we have a common interest. But no, DMB is not calling the shots for the City of Mesa."

STRAW BUYERS

The special exemption that was targeted in the failed negotiations is the Government Property Lease Excise Tax, referred to as GPLET.

To its supporters, GPLET is a critical economic development tool, the last incentive available to lure high-end development to the state. To its detractors, the law is an unfair giveaway to a few hand-picked developers who would have come to Arizona anyway, or who are bringing risky projects that could not succeed on their own.

The heart of a GPLET deal is a straw transaction in which title to the land and buildings of a particular project are transferred to the city in which it is built. The project is then leased back to the developer or end user, typically for a few thousand dollars per year.

Since cities do not pay taxes, the development is exempt from property taxes that would normally be used to support local schools, community colleges and various other government jurisdictions.

More than \$2 billion worth of developments are exempt from property taxes throughout Arizona under GPLET deals. Most of them are in downtown Phoenix and Tempe. Those projects would otherwise generate about \$31 million annually in property taxes.

The number and value of exempt properties is expected to balloon in coming years as other big-dollar GPLET developments are finished.

Many properties that have yet to open or be valued by the county assessor were not included in \$2 billion total. They include the \$900 million CityScape being built at Central Avenue and Washington Street in Phoenix; Central Park East at 50 E. Van Buren Street in Phoenix, recently valued at \$46 million; and the Cancer Treatment Centers of America in Goodyear, built a cost of more than \$100 million. The billion-dollar DMB/Gaylord project in Mesa also is not in the total figures the Institute compiled. For-profit businesses that rent a small amount of space in buildings used primarily for government purposes also were excluded from the totals because there is no way to track the value of that incidental space in county tax records.



Tempe Marketplace

OTHER PEOPLE'S MONEY

It's easy for cities to hand out GPLET deals because cities themselves do not rely much on property taxes. Sales taxes are the main source of general fund income for cities, and they rake in millions from construction of mega-properties, as well as any retail sales and hotel room bookings the project ultimately generates.

School districts, however, rely largely on property taxes and state aid that is tied to property values. About 60 percent of the money raised through property taxes normally goes to local schools. The amount cities get varies by jurisdiction, but is typically in the 10 to 15 percent range.

"Most of the property tax given away by municipalities is, of course, not municipal property tax," said Tempe Mayor Hugh Hallman, a critic of GPLET deals. "So there is an incentive to use other people's money. I really would get rid of it all. I just see money going out the door and we don't need to give it away."

School officials have not shown much concern about GPLET until now, because the state has compensated for property taxes exempted under GPLET agreements. That is changing this year, when the state will stop paying the difference.

For the first time, school districts will have to pass the cost of GPLET exemptions directly to their taxpayers.

"Now there is an incentive for the districts to get involved," said Kevin McCarthy, president of the Arizona Tax Research Association. "They are going to start noticing that there is a pile of money missing in their budgets and they are going to start figuring out there are some consequences to this thing."

GPLET has been used to create property tax exemptions for everything from high rise buildings and a recently-closed dog racing track in Phoenix to a tattoo

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— Tempe Mayor Hugh Hallman*

studio in Clifton, according to the list of deals compiled by the Institute.

Virtually every tall building in downtown Phoenix erected since the law took effect in 1996 is exempted from property taxes under GPLET. So is Phoenix Greyhound Park near Sky Harbor International Airport.

Among the biggest projects already reaping GPLET benefits:

- One North Central in Phoenix. The 20-story office building is valued at almost \$223 million for tax purposes by the Maricopa County Assessor.
- Collier Center, 201 E. Washington St. in Phoenix. The 24-story complex has a taxable value of \$219 million.
- Renaissance Center at Central and Washington, valued at \$214.7 million.
- Arizona Center at Van Buren and Third streets in Phoenix, valued at \$162.5 million.
- Tempe Marketplace, located near the intersection of the Loop 101 and 202 freeways, valued at \$156.5 million.
- Hayden Ferry in Tempe, valued at \$141.5 million.

Virtually every tall building in downtown Phoenix erected since 1996 is exempted from property taxes under GPLET.

The beneficiaries of GPLET deals pay an alternative tax meant to offset the loss of revenue to schools and other governments that rely heavily on property taxes. However, it amounts to only a small portion—typically less than 10 percent depending on the terms of the deal—of what would be paid in property taxes over the life of the project, according to legislative studies and reports on individual projects.

The alternative tax varies based on several factors, including the location, size and height of a building. It also declines over time. The standard deal lasts 50 years. After that time, neither property taxes nor the alternative GPLET charge is paid.

SHIFTING THE BURDEN

The biggest gripe about the law is that it unfairly shifts the property tax burden onto surrounding landowners who did not get GPLET designations, said Tim Lawless, president of a trade organization that represents commercial developers.

Many of the builders in Lawless' group, the National Association of Industrial and Office Properties in Arizona (NAIOP), have benefitted from GPLET deals, he said. Many others have not, and they have borne the brunt of shifted property tax burdens that result when a few large properties are exempted.

The estimate that GPLET properties would generate more than \$31 million in property taxes annually may not sound like much, especially as governments

across Arizona are facing deficits totaling billions of dollars, Lawless said. But GPLET deals tend to be concentrated in a few areas, meaning their effects on surrounding property owners are magnified, he said. That puts property owners who do not have GPLET deals at a competitive disadvantage against those who do, Lawless said.

The value of a GPLET deal also must be weighed over the long term, since they normally last for decades, Lawless said.

An analysis done for the city on the DMB project in Mesa shows GPLET will allow the developers to avoid about \$776 million in property taxes for the two planned hotels over a 50-year time frame.

A similar analysis of the Cancer Treatment Centers of America in Goodyear shows GPLET will allow the medical center to avoid paying about \$89.8 million over 50 years. Both studies conclude that other taxes the projects will pay will make up for the property taxes over the same time frame.

But those taxes are expenses the new developments would have borne anyway, Lawless said.

“I don’t care if it’s \$10 or \$10 million. If it’s an inappropriate tax shift, it’s inappropriate,” Lawless said. “Basically what you are doing is Swiss-cheesing the tax code and shifting it to benefit a few at the expense of the many.”

Lawless was among those who met with legislators in a failed attempt to reform the GPLET law last year. NAIOP supports significantly scaling back the length of GPLET deals and raising the alternative tax rates to more closely reflect what would be paid in property taxes.

The organization wants to preserve, or “grandfather,” existing GPLET agreements, Lawless said. Developers who have invested hundreds of millions of dollars in projects should not have the terms of their deals suddenly and dramatically altered by the legislature, he said.

Lawless points out that Arizona’s commercial property taxes are among the highest in the nation. The problem with GPLET is it is used to remedy those high taxes by giving special deals to some developers, rather than dropping the rates for everyone, he said. Aside from putting cities in the position of picking winners and losers, GPLET artificially inflates everyone else’s taxes and ends up making Arizona less financially attractive to investors.

A better approach is to eliminate special deals and lower the tax rate for everyone, according to Lawless.



Tim Lawless

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– Tim Lawless*



Wells Fargo building in downtown Phoenix

A 2008 legislative study showed GPLET leases have raised property taxes for neighboring landowners.

“It makes no sense to rifle shot tax credits to 25 companies when we have more than 450,000 businesses in Arizona,” Lawless said. “It makes no sense whatsoever to be only trying to deal with a handful of companies when the vast, vast majority of other companies don’t share in that relief.”

In May 2008 studies, the Joint Legislative Budget Committee (JLBC) concluded GPLET deals create a substantial tax shift to surrounding properties in the downtown Phoenix area. Hans Olofsson, chief economist at JLBC, examined 14 properties in the area and concluded those properties would have paid an additional \$14.7 million annually without the GPLET exemption, or a total of about \$17.1 million in annual property taxes. Instead, they paid about \$2.38 million in alternative GPLET taxes, according to the study, which was based on the 2007 tax year.

That difference means that because of the GPLET deals, the owner of a \$200,000 home in the area paid between \$90 and \$183 in additional property taxes for local schools every year, depending on what district the house is in, according to JLBC.

The disparities described in the JLBC reports are illustrated in the tax bills for several high-rise buildings in downtown Phoenix. Last year, Wells Fargo & Co. paid about \$1.07 million in property taxes for its office tower at First Avenue and Washington Street in downtown Phoenix. That building is valued by the county assessor at \$48 million. A block to the east is One North Central, known as the Phelps Dodge tower because of its former tenant. The Dodge building is valued at \$222.9 million. Last year it generated \$59,223 in property assessments for a special downtown improvement district that all property owners, including the city, pay into for maintenance and security. The owners of the Dodge building paid an additional \$21,380 in GPLET taxes. Wells Fargo officials declined to comment on the tax disparity.

LURING PROSPERITY

Advocates of GPLET say that it is the last significant economic development tool available to cities in Arizona as they battle to attract companies looking to invest billions of dollars. Without the incentive, many of the premier projects that have been built in the last decade likely would not have come, they say.

Arizona is the only state that does not have Tax Increment Financing, an incentive to developers based on future increases in property values, said Jeff Kros, legislative director for the League of Arizona Cities and Towns, a lobbying group for municipalities.

Sales tax incentives once popular with retail developers are no longer available. The Goldwater Institute sued to block \$97.4 million in sales tax rebates to the developers of CityNorth in Phoenix, arguing the incentives on the \$1.8 billion shopping center violate the gift clause in the state's constitution. The Arizona Supreme Court kept the CityNorth deal intact, but ruled that cities in the future can't simply give away sales tax dollars to lure new retailers. The legislature has also restricted the ability of cities to use sales tax incentives to attract retail developers.

Kros said that leaves GPLET as the best incentive for cities to offer when investors are weighing whether to spend hundreds of millions of dollars for a new project in the state.

David Krietor, deputy Phoenix city manager, said GPLET has helped the city transform its downtown from an area in decline that was checker-boarded with empty lots. Vacant land and parking lots that used to generate only a few thousand dollars' worth of property taxes every year have been replaced by towering office buildings that create jobs, generate millions in other taxes, and increase the values of surrounding properties, Krietor said. Without GPLET or some other incentive, many of those projects would not have been built, he said.

"If you are a true believer in downtown redevelopment and in building a core to your community, and you understand the cost of doing this development, you do need to provide some support to make those projects happen," Krietor said. "If you don't believe that, then let downtown be characterized by having vacant lots and go out and build everything out in the suburbs."

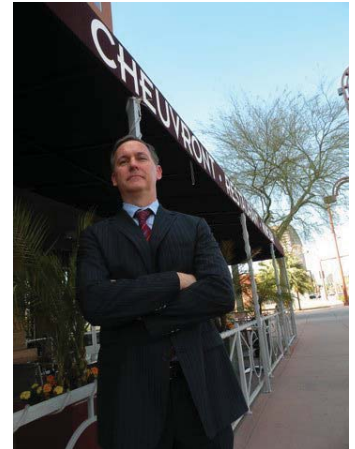
TAX GIVEAWAY

Reformers are skeptical of the argument that big developments would not come to Arizona without GPLET.

It wasn't GPLET that revitalized downtown Phoenix, said Cheuvront, the senator leading the efforts to curtail or eliminate the property tax exemption. A far bigger factor was the billions in taxpayer money spent to build sports arenas, refurbish and expand the Phoenix Convention Center, create a campus for Arizona State University and construct a light rail line, he said.

"What we are doing is just subsidizing the developer, and to me that's unfair because you are just letting a for-profit company make more money," Cheuvront said. "To those people who are not on GPLET, it's just inherently unfair that they are having to pay property taxes and their competitor across the street is not."

Beyond the fairness issue, GPLET is a subsidy that entices developers to build



Senator Ken Cheuvront

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— Senator Ken Cheuvront*



One North Central
building in Phoenix

more office and retail space in an already glutted market, Chevront said. That skews the market forces that should decide when a new high-rise office building or shopping center goes up, he said.

“Would some of them not have been built? Of course,” he said. “When you have buildings that are completely empty, they probably shouldn’t have been built.”

Office vacancy rates in the Phoenix metropolitan area are almost 25 percent, according to a quarterly trends report issued in January 2010 by Cassidy Turley BRE Commercial, which monitors lease rates and availability of commercial properties in metro-Phoenix. That amounts to about 17.7 million square feet of unused space, according to the report.

Of the nearly 12 million square feet of office space that has opened in the area since the last building boom began in 2005, about half is vacant, according to the report. A separate quarterly analysis of Valley retail by CB Richard Ellis shows the vacancy rate at the end of 2009 was 11.4 percent of available space.

REINING IN CITIES

GPLET was actually created to rein in cities that had been using their tax-exempt status to benefit private developers for decades, according to state legislative reports.

Initially, there was no mechanism to tax land or buildings on property that was titled to a city, even if it was used exclusively in a commercial venture by a for-profit company.

In 1985, the legislature passed a possessory interest law, creating a mechanism to tax commercial ventures on city land. A possessory interest is created when a private company gets the exclusive use of property on government land. The 1985 law treated that exclusive benefit as taxable property. Lawmakers exempted deals that had been cut before the law took effect. That proved to be its undoing.

The possessory interest tax was challenged, leading to a 1993 court ruling declaring it unconstitutional. The Arizona Constitution limits property tax exemptions that the legislature can create. The exemption for deals struck before the possessory interest law took effect violated that provision, the court held.

The legislature repealed the possessory interest tax and in 1996 replaced it with GPLET. The difference is that GPLET is not a property tax. It is an excise tax based on the size of a building, not its value. Therefore, exemptions to preserve

*Read: Scottsdale's SkySong
avoids property taxes
without GPLET lease*

pre-existing deals through “grandfathering” were deemed permissible by lawmakers who crafted the bill.

When a GPLET deal is reached, the land and all improvements are titled to the city. That exempts the development from property taxes. It is then leased back to the real owner, typically the developer who built the project or the company that occupies it, for a minimal fee. A standard GPLET agreement lasts 50 years. Some last longer. There is no time limit in state law.

State statutes set the rate for the alternative tax. It varies depending on the size and height of the buildings. In theory, the full rate applies for the first 10 years of a GPLET agreement.

However, no one really pays that rate because of exceptions in the law.

A property located within a city-designated “central business district” can have the alternative tax eliminated through an abatement for up to eight years. Most GPLET projects are located in a “central business district.”

After 10 years, the GPLET rates drop by 20 percent. They continue to drop by 20 percent every decade, eventually reaching zero after 50 years. That means after 50 years, the development’s true owner does not pay property taxes or the alternative tax for as long as the lease remains in place.

Another exception is for properties in a city-designated “slum and blighted area,” which pay 80 percent of what the normal GPLET rates would be. There are few limits on where cities can declare a slum and blighted area, and that designation is a standard term of a GPLET agreement.

Cities collect the alternative taxes. They are distributed through a formula also set in statute. Elementary and high schools get 73 percent of the money. The county receives 13 percent, and cities and community colleges each get 7 percent.

SPREADING THE BURDEN FOR SCHOOLS

Although schools rely heavily on property taxes, school officials rarely object to GPLET deals because the state has been making up the difference, said Chuck Essigs, director of government relations for the Arizona Association of School Business Officials, which lobbies for districts on issues affecting school financing.

In simple terms, state aid to local school districts is based on the number of students and the amount of money the district can raise from local property taxes by applying a flat rate set by the legislature.



Arizona Center

The value of all property in a school district is tallied. Government-owned properties, including those covered under GPLET, are deducted from the total to determine the district's tax base.

To equalize funding between rich and poor districts, the Legislature sets the statewide levy, known as the qualifying tax rate or QTR. The QTR is multiplied against the total value of properties in a district to determine how much it can raise through local property taxes. If the total falls short of the per-pupil formula, the state pays the difference.

That funding mechanism applies to the primary taxes levied in a school district, which are used for day-to-day operations. School construction costs are paid through secondary taxes. But because the state pays to build new schools, GPLET's impact on secondary tax rates is minimal, Essigs said.

"Who gets ripped off is the state because we have this equalization formula," Essigs said. "When that property is not there to be taxed, it just means the state has to pay the school district more money than they would have paid otherwise."

But this year the rules are changing.

The state has stopped replacing property tax funds for school districts waived by GLPET leases.

GPLET properties will no longer be deducted from the total tax base of a district like other municipal properties, under a revision to the law passed last year. That means districts will have to come up with that money themselves by raising their own tax rates.

Clyde Dangerfield, assistant superintendent of the Gilbert Unified School District where the DMB/Gaylord project will be located, said exempting properties under GPLET does not change how much a school district can spend, even under the new law. That is the main reason school officials do not complain when large developments are exempted from property taxes.

GPLET deals may mean property owners within a school district have to pay more, but that amount is minimal and likely offset because projects like the Gaylord resort will enhance the value of surrounding land that is on the tax rolls, he said.

"It doesn't really change the amount of money that comes in and out of Gilbert schools," Dangerfield said of the Gaylord project. "What it does impact is the property tax base. The fact that the Gaylord project would be an exemption would mean that as a homeowner I will pay a bit more on my property taxes because Gaylord isn't picking up a piece of the Gilbert public schools. But there is no direct impact on the revenue that Gilbert schools receive as a result."

Sara Bresnahan, spokeswoman for the Phoenix Elementary School District, which encompasses the downtown area, said officials there support the way that city has used GPLET.

“We understand the short-term shortfall in tax dollars that the tax exemptions can produce, and the fact that there is an impact on other taxpayers,” Bresnahan said. “The bottom line is the district believes the short-term challenges are worth the effort in terms of the fact that it produces stronger tax structures for the district as more businesses and residents are brought to the downtown area.”

That optimism is not shared by Antonio Sanchez, superintendent of the Wilson Elementary School District, which encompasses the area around Sky Harbor airport in Phoenix. He is concerned about shifting the property tax burden onto local home and business owners, and the resulting difficulty in convincing voters to approve bond issues or overrides.

“It’s a great concern,” Sanchez said. “It shifts the tax onto our property owners, our homeowners, and it’s a huge shift.”

Tracey Benson of the Arizona School Boards Association said the group that advocates for school districts has not taken a position on the GPLET law.

DOWNTOWN DRAW

Phoenix has been the most aggressive in using GPLET to lure development since the law was passed. Of the \$2 billion in GPLET properties exempted from property taxes, about \$1.2 billion worth are in Phoenix, according to the Goldwater Institute’s analysis.

Most of that is downtown.

Phoenix has restricted the use of GPLET to the downtown area and to land near Sky Harbor International Airport, said Krietor, the deputy city manager who oversees economic development.

Last December, the Phoenix City Council took the unprecedented step of approving plans to pursue a GPLET agreement for the existing Wyndham Hotel at 50 E. Adams St. Phoenix Hotel Ventures LLC, the Wyndham’s owner, has been paying about \$700,000 annually in property taxes. Under the proposed GPLET lease, which is tied to a \$10 million renovation, the company would save about \$400,000 annually, according to city estimates.

Krietor said the deal is a good one for the city. The Wyndham will be rebranded



David Krietor

Property within Phoenix makes up more than half of the \$2 billion in land exempted from property taxes with GPLET leases.



Phoenix Greyhound Park

to the more prestigious Renaissance Hotel by Marriott and nearly double the number of people employed there, he said.

The hotel also will generate about \$96 million in total tax revenues to the city, county and state over 20 years, according to city estimates. The remodeled and rebranded Wyndham also is important in making Phoenix a top-tier convention destination, Krietor said. The Phoenix Convention Center was recently expanded at a cost to taxpayers of \$600 million. What is lacking is a sufficient number of premier hotel rooms in the area to support the largest conventions, he said.

The city-owned Sheraton Hotel was built with taxpayer funds to help fill that gap, Krietor said.

The Wyndham deal will leave the adjacent Hyatt Regency as the only major hotel in downtown Phoenix still paying property taxes. Last year, the tab for that hotel's owners was \$1.66 million.

Krietor said the Hyatt's owners are getting other benefits from the city. It is next door to the convention center, and the city recently renewed a 10-year deal to lease space in a city parking garage across the street, he said.

Hyatt officials declined to comment.

Most of the Phoenix GPLET properties outside of the downtown are on land that will eventually be used for airport expansion, Krietor said. That includes Phoenix Greyhound Park at 40th and Washington streets, acquired by the city in 2007 under a 15-year GPLET lease, he said.

GPLET allows the city to acquire land and hold it until it's needed for airport expansion, while keeping existing businesses operating and paying taxes there, Krietor said. The dog racing track was bought because it's one of the last large blocks of land near the airport owned by a single, private entity, he said.

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SUBURBAN EXPANSION

There is no sign that the use of GPLET is winding down in Phoenix. GPLET deals also are becoming more popular in the suburbs and other parts of the state, as cities battle each other to lure the next big project.

Flagstaff used GPLET in 2003 to land a Purina pet food plant, valued at \$26.7 million. In 2005, Glendale gave the tax break to the Cabela's retail store, assessed at \$22.5 million.

In Clifton, GPLET is being used for a tattoo studio. The reason is the town recently acquired and rehabilitated two historic buildings that had been damaged by flooding, said Alan Baker, town manager. When the buildings were leased to private businesses, including the tattoo studio, GPLET was the only mechanism available to tax them, Baker said.

More grandiose office and retail buildings have gone up on the south shore of Tempe Town Lake with tax breaks under GPLET, including Hayden Ferry and Tempe Marketplace. Tempe trails only Phoenix in the use of GPLET, with more than \$500 million in properties covered under government leases.

But Tempe structures its deals differently than most other cities. The standard deal in Tempe is for the eight-year abatement only, according to city records. After that, the development loses its property tax exemption. Some agreements have been limited to an abatement period of less than eight years. Tempe also charges a separate fee on developers when land is exempted to replace the revenue it had been generating for local schools. That money is split evenly between the Tempe elementary and high school districts.

Last year that account raised \$50,523 for local schools, in addition to the \$184,487 that was generated through GPLET payments, according to city records.

Mayor Hallman said he also pushes for some public benefit when a GPLET deal is agreed to. In downtown Tempe, that usually means the developer will have to build public parking spaces to qualify, he said.

“My approach has always been if someone asks me for something, I ask for something back that we need,” Hallman said. “I don’t give them money.”

A similar approach is used in Queen Creek, where developer Vestar QCM LLC got an eight-year property tax abatement in 2008 to build Queen Creek Marketplace at Ellsworth and Rittehouse roads. As part of that deal, Vestar will contribute about \$26 million to upgrade Ellsworth, said Patrick Flynn, assistant town manager.

Queen Creek Marketplace is the only GPLET development in the town, said Flynn, who used to work in Tempe where he structured similar deals. The agreement shows GPLET is still an effective economic development tool when it is limited to the abatement period, Flynn said.

“Granted, the value to the developer is much greater if you extend it out,” Flynn said. “But philosophically, management here as well as our council believes these properties need to be back on the tax rolls.”



Hayden Ferry in Tempe

*Tempe and Queen Creek
have limited GPLET
property tax exemptions to
eight years or less.*



Cancer Treatment Centers
of America in Goodyear

“Cancer Treatment Centers of America was going to come to the Valley. They were going to Phoenix. The only reason they are in Goodyear is suddenly at the last minute somebody gave them \$50 million of incentives.”
— Jim Miller

Flynn said he does not buy the notion that property tax exemptions are warranted by promises of job growth and enhanced sales tax collections alone.

“It’s got to be a hard asset, something we are buying, something we can see,” he said.

LAST-MINUTE MOVE

The most controversial GPLET deal in recent years happened in 2007, as two Valley cities were battling to lure the Cancer Treatment Centers of America (CTCA). CTCA was considered a prize catch for any city. It was seen as a catalyst that would anchor a premier health-care core and bring hundreds of high-paying jobs wherever it wound up.

The potential sites for CTCA were a few miles apart, one in west Phoenix and the other in Goodyear. Neither city was offering GPLET initially.

Phoenix officials offered a three-way land deal in which the city would buy 15 acres from the John F. Long Foundation, then sell it to CTCA. Phoenix appeared to be the winner in March 2007, when CTCA issued a letter of intent to locate in Long’s Algodon Medical campus.

But after that letter was issued, CTCA officials asked both Phoenix and Goodyear for GPLET as an additional incentive. Phoenix refused. Goodyear agreed.

Despite the letter of intent, CTCA backed out of the Phoenix location and announced in July 2007 that it would build its western regional facility on a cotton field near Interstate 10 and Litchfield Road in Goodyear.

“When we found out they wanted the property tax abatement, we said no,” said Jim Miller, director of real estate for John F. Long Properties. “And the City of Phoenix, our partner, said no for a different reason. We did it on principle. We’re not going to give away other people’s money.”

“Cancer Treatment Centers of America was going to come to the Valley. They were going to be in Phoenix. The only reason they are in Goodyear is suddenly at the last minute somebody gave them \$50 million worth of incentives. That’s government at its worst.”

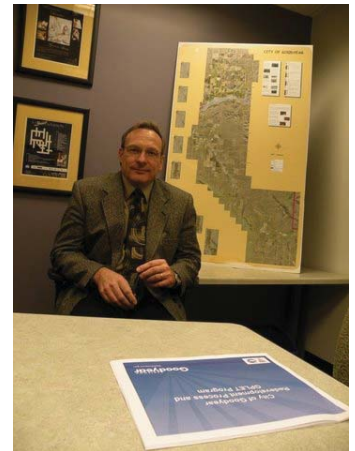
Miller also blasted Goodyear for designating an agricultural field “slum and blighted,” a critical label needed to make the GPLET deal more valuable to the developer.

Harry Paxton, manager of economic development in Goodyear, said the council declared a swath that covers roughly six square miles as a “slum and blighted” redevelopment area in 2005, long before CTCA began looking for a site in the Valley.

Paxton acknowledged the GPLET designation was a critical factor in bringing the facility to Goodyear. But he said Goodyear followed the rules in making the tax break available. The 50-year lease, which includes the eight-year abatement, will save CTCA about \$89.8 million in property taxes, according to city projections. Over that same period, CTCA will pay about \$80.7 million through a combination of taxes on equipment and GPLET payments, city estimates show.

“That’s the kind of thing you use GPLET for,” Paxton said.

CTCA officials did not return phone calls seeking comment.



Harry Paxton

MESA’S MEGA-RESORT

Mesa became the biggest player in GPLET in September 2008, when officials announced plans to bring a \$1 billion resort and conference center to land owned by DMB at Elliott and Ellsworth roads.

DMB acquired the property as part of a 3,200-acre purchase of the General Motors Proving Grounds in 2006.

Under the three-way agreement, Gaylord will build a 1,500 room hotel and a convention center which it will operate. A second 500-room hotel and golf course will also be built on the site. Its operator will be determined later.

All of the property will be titled to the city under a GPLET lease, exempting the entire project from property taxes for 50 years, according to a three-way agreement among Mesa, DMB and Gaylord. Both hotels also will retain all or part of the city-imposed bed tax for self-promotion as an added incentive.

When the deal was announced, city officials claimed the property tax benefit would amount to about \$85 million over the 50-year life of the deal. The bed-tax incentive would be capped at \$51 million.

However, those figures are based on an accounting method called “net present value,” which estimates the present value of future tax benefits. In real dollars, the GPLET agreement will save DMB and Gaylord about \$776 million in property taxes that will not have to be paid, according to an analysis done for the city in October 2008 by an outside accounting firm. The bed tax incentive will save the



An artist's concept of the planned Gaylord Entertainment resort in Mesa

hotel operators another \$413 million over 50 years, raising the total value of city incentives to about \$1.2 billion, according to the projections. The deal is expected to generate about \$844.7 million in new revenues, mostly through sales and bed taxes, according to the 2008 report.

The Gaylord property is not in a “central business district,” so the eight-year abatement is not available, said Karrin Kunasek Taylor, executive vice president of DMB. DMB officials tried to change the law to allow the abatement several months before the Gaylord deal was announced. The company’s lobbyist, Chuck Coughlin, pushed a bill by then-Rep. John Nelson, R-Litchfield Park, to allow the abatement in military reuse zones. The Gaylord project would have qualified because of its proximity to Phoenix-Mesa Gateway Airport, formerly Williams Air Force Base. Nelson’s bill failed.

In December 2008, the city designated the resort property as “slum and blighted” so it could qualify for the reduced GPLET rate. Taylor, the chief entitlement officer at DMB, said the tax incentives under GPLET were warranted to lure a premier resort like the Gaylord project to Mesa. The convention center will be built with private money, not taxpayer funds like those in Phoenix and virtually every other major city in the country, she said.

If it were not for GPLET, Gaylord would not have come, she said.

The agreement between Mesa, DMB and Gaylord took effect November 3, 2008. That date would be critical in reform negotiations that began in the legislature two months later.

So would DMB and Coughlin.

REFORM TALKS

Talk of reforming GPLET has gone on for years. To date, nothing has come of it. In 2004, a special task force appointed by then-Governor Janet Napolitano recommended a series of reforms to the law. They included raising the rates to more closely reflect what is lost in property taxes, increasing disclosure requirements and maintaining the eight-year abatement. Bills were introduced to make some of those changes, but none passed.

Renewed efforts to revamp the law began in the wake of the squabbles that erupted after the Cancer Treatment Centers of America backed out of its deal with Phoenix and went to Goodyear.

Jim Miller, the director of real estate at John F. Long Properties, contacted

Nelson to complain that the law needed to be fixed. Nelson, the sponsor of the DMB-backed bill in 2008, is a former Phoenix councilman and came to be seen as the advocate for cities in subsequent negotiations.

Senator Cheuvront started his efforts to curtail or eliminate GPLET in 2008. He got involved in the issue after trying to figure out why property taxes on his restaurant in downtown Phoenix were so high, he said. With all the high-rise buildings that had been going up, he believed his taxes should be much lower.

Cheuvront found out that those new office towers were not paying property taxes because of GPLET. In the 2008 legislative session, as Nelson was pushing a bill to expand GPLET, Cheuvront sponsored legislation to curtail the deals. Both bills failed.

When the legislative session began in January 2009, Nelson and Cheuvront put together a group of stakeholders to hammer out a compromise. On one side was Nelson, the cities and DMB, who wanted only minor changes largely related to disclosure requirements. On the other side was Cheuvront and the Arizona Tax Research Association, who wanted to eliminate GPLET or substantially increase the rates so they more closely aligned with property taxes.

Scattered in between were a variety of interest groups, including NAIOP, the National Federation of Independent Business and Miller of John F. Long Properties. All sides interviewed by the Goldwater Institute say they believe the law is broken and needs to be reformed. There are varying degrees of agreement on issues that include preserving the abatement period, protecting existing agreements through “grandfathering,” shortening the 50-year term of the leases and requiring enhanced disclosure when cities make pacts with developers. No one interviewed defended the current structure that has rates declining, rather than increasing, over time and being eliminated after 50 years.

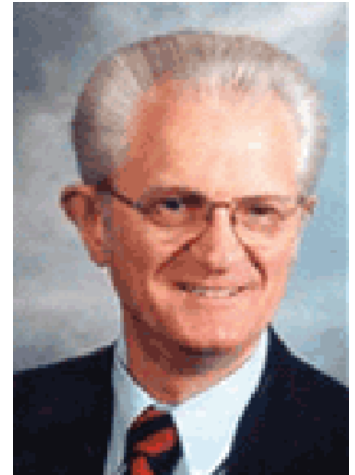
Most also agree the alternative tax rates are too low, and need to more closely reflect what is being lost in property taxes.

“The way the thing works is not fair,” said Nelson.

But finding the middle ground proved troublesome.

Cheuvront agreed to grandfather existing agreements, to maintain the abatement period and to allow the leases to continue for 30 years before the property is returned to the tax rolls. He also gave ground on the rates.

“We pretty much gave away everything we believed in just to get something going,” Cheuvront said.



Senator John Nelson

*“The way the thing works
is not fair.”
– Senator John Nelson*

Nelson agreed to raise the rates, but wanted to keep them low enough so GPLET would still be a viable tax break for major developers looking to invest in Arizona. After six months of negotiations, an agreement was all but reached. The final detail to be resolved was the rates that would apply to GPLET leases, and it was left to Chevron and Nelson to reach an agreement so the bill could move to the senate floor for a final vote.

To that point, neither Mesa nor DMB officials had objected to the proposed legislation. They had made it known that the Gaylord deal would have to be protected, but had not participated in the negotiations to any significant extent, according to several people who were in the meetings, including Nelson and Chevron.

Time was running short by mid-June. The legislative session was drawing to a close, and everyone in the negotiations knew that if a bill was not finalized within days there would not be enough time to get it through the legislature.

After two years of negotiations, the final details were to be adopted at the June 17 stakeholders' meeting. That's when the deal blew up.

State legislators were close to a deal in 2009 to reform the law on GPLET leases, until the City of Mesa and DMB Associates objected.

Eric Carlson of DMB produced a financial analysis that, he says, showed the increased rates would put Mesa at a disadvantage in future deals. Because property taxes are higher in Phoenix than they are in Mesa, the value of a GPLET deal would be greater in Phoenix, Carlson argued. Developers in Mesa would actually end up paying more under GPLET than they would in property taxes, he said.

Butler, Mesa's lobbyist, also said the grandfathering language in the final draft was unacceptable because it would not protect the Gaylord deal with enough certainty. Karrin Taylor of DMB said the company had submitted its own language for grandfathering, but it was not included in the final version of the bill. The grandfathering language that was included was unacceptable, she said in an interview with the Institute. The objections came so late in the process because that's when the final rates and grandfathering language were released, she said.

Both she and Butler say it is unfair to blame either DMB or Mesa for spiking the reform efforts.

"I think it's unfair to say that Mesa killed the deal because the language the proponents of the bill said they were going to hold true to did not appear in the language that was presented," Butler said. "So the people that killed the deal were those that didn't stick to the commitments as far as what the bill would do. So that's what killed the bill. If people want to say that Mesa killed the bill because we pointed out the inaccuracies of what they said the bill did, then so be it."

Others see it differently.

LOBBYING TACTICS

Nelson, who had been the cities' point man during the negotiations, said the deal fell apart when Mesa and DMB raised last-minute objections and insisted the current rates be maintained.

Lawless, whose group represents developers, agreed.

"It's no secret the City of Mesa came in and blew up the deal in the 11th hour," he said. "There were reasons why the City of Mesa came forward and I think it's very clear that it's on behalf of the interests of the GM Proving Grounds (DMB) as far as future considerations dealing with GPLET expansion. They didn't make any bones about it."

McCarthy of ATRA said the objections Mesa and DMB raised were bogus. The Gaylord project would not have been affected because of the grandfathering language in the final bill, he said.

As to the rates, McCarthy said he doesn't buy the numbers that DMB produced showing developments in Mesa would pay more under the compromise language than they would under property taxes. The argument that the relative value of GPLET in Phoenix is higher than in Mesa because of the difference in property tax rates is true under the current scheme, he said.

Cheuvront said he believes DMB officials had a deliberate strategy to ensure no reform bill was passed because they have plans to seek other GPLET deals for the balance of their 3,200-acre proving grounds property. Raising last-minute objections to kill a bill in the waning days of the legislative session is an old tactic, Cheuvront said.

And the master of that tactic, he added, is Coughlin, DMB's lobbyist.

"It was typical Chuck," Cheuvront said. "Chuck's fingerprints were all over the blowup."

Coughlin and his firm, HighGround Public Affairs Consultants, have extensive ties to Mesa and to other developers benefitting from GPLET. In addition to DMB, HighGround's clients include the owners of the Wyndham hotel, which the Phoenix City Council has agreed to put under a GPLET deal retroactively, and RED Development, builders of the GPLET-subsidized CityScape currently under construction in downtown Phoenix. HighGround used to represent Vestar, the developer of Tempe Marketplace and Queen Creek Marketplace, but was not part of their GPLET deals, Coughlin said.



Kevin McCarthy



Chuck Coughlin

Coughlin also ran Mesa Mayor Scott Smith's 2008 campaign, as well as a variety of campaigns for city ballot initiatives, including the proposed ratification of the Gaylord deal.

Smith's son also works for HighGround.

HighGround was Nelson's political consultant in his 2008 senate campaign.

Coughlin said Cheuvront's charge that he sabotaged the reform agreement is "crazy."

"Ken Cheuvront killed this bill by putting in rate structures which were not agreed to in prior negotiations and neglecting to include grandfathering language that was acceptable to all parties," Coughlin said. "He intentionally killed his own bill."

Coughlin said he never talked to Mayor Smith about the GPLET reform efforts, nor did he seek any favors for DMB from city officials.

Smith would not agree to an interview. Other officials in Mesa's economic development department also would not agree to discuss the Gaylord project. As to whether DMB will seek future GPLET deals on the proving grounds site, Taylor said there are no immediate plans. But if an appropriate proposal surfaces, it would not be ruled out, she said.

HighGround Public Affairs has significant ties to Mesa Mayor Scott Smith and several projects with GPLET leases.

"KILL THE BILL"

E-mail exchanges between Butler and Anne Hamilton of HighGround show that by mid-June the main concern of city officials was no longer whether the Gaylord development would be protected through the grandfathering language. Rather it was how the new rates would affect future GPLET developments in the Gateway airport area, according to documents obtained by the Institute under the state's public records law.

"As much as I would like to think that we can kill the compromise GPLET bill, the only things that are REALLY bad in the bill are the rate and term," Butler said in a June 23 e-mail to Hamilton.

Hamilton responded that she would continue to fight the bill.

Butler agreed.

"I also agree that our primary goal should be to kill the bill, because it would

destroy GPLET as a tool in Mesa,” he wrote.

Butler and Hamilton also discussed seeking expansion of GPLET to allow the 8-year abatement in military reuse zones, including the Gateway airport area.

Nelson and Cheuvront were still trying to salvage their compromise in hopes of getting the bill to the senate floor before the legislative session ended. The final hurdles before reaching the full senate for debate were the Republican and Democratic caucuses, where bills are explained and discussed.

At the Republican caucus meeting June 26, Sen. Thayer Verschoor, R-Gilbert, who represents the area that encompasses the DMB site, objected to the compromise bill. He cited the financial projections produced by DMB and said the proposal would unfairly penalize Mesa, the same arguments that had been made in the stakeholders’ meetings.

At that point, there was no hope of salvaging the compromise, said Nelson, who acknowledged he probably should have done more to defend the bill. Nelson said he still wanted to push the compromise at that point, but McCarthy told him ATRA would file a lawsuit seeking to have the law declared unconstitutional under the state’s prohibition against giving taxpayer gifts to private companies.

The bill never reached the senate floor for a final vote.

ILLEGAL GIFT

Shortly after the reform talks in the legislature collapsed, Cheuvront approached Clint Bolick, the Goldwater Institute’s litigation director, about filing a lawsuit challenging GPLET as unconstitutional.

Cheuvront is one of the plaintiffs in a 2007 lawsuit brought by the Institute challenging \$97.4 million in sales tax rebates to the developer of the CityNorth shopping center in Phoenix. That suit charged the subsidy is an unconstitutional gift to the developer, the Klutznick Company, another client of Coughlin’s lobbying firm.

The Arizona Supreme Court agreed in a unanimous ruling issued in January 2010. The court rejected arguments by Phoenix officials that the CityNorth deal is justified because of the jobs that will be created and the other taxes that will be paid by the developers, the same arguments that are made to justify GPLET deals. However, because prior court rulings had been routinely misinterpreted, the justices opted not to undo the CityNorth agreement. The tighter restrictions in its ruling will be applied to all future deals, the court held.



Clint Bolick

“Indirect benefits such as the promise of jobs or tax benefits are not sufficient consideration. GPLETs trade real taxpayer dollars for indirect economic benefits.”
– Clint Bolick

Now that the Supreme Court has clarified the rules for when tax incentives violate the state's prohibition on gifts, a new lawsuit challenging GPLET is the logical next step, Bolick said.

"It is highly likely that we will file a test case challenging GPLET," said Bolick, adding no final decision has been made. "Indirect benefits such as the promise of jobs or tax benefits are not sufficient consideration. GPLETs trade real taxpayer dollars for indirect economic benefits."

Beyond the issue of the gift clause, the justices directed the Arizona Court of Appeals to determine whether special tax deals with developers violate the state's constitutional ban on special laws that benefit a select few.

"To the extent that not everyone can get or even apply for a GPLET, that suggests the process is ad-hoc rather than an expression of broad public policy," Bolick said. "That's problematic under the special law provision."

A new GPLET reform bill has been introduced this year. Its sponsor, Rep. Rick Murphy, R-Peoria, said he anticipates a tough fight getting it passed. Murphy's proposal incorporates the language that had been agreed to last June, just before Mesa and DMB raised their objections that spiked the deal. It puts a 30-year limit on GPLET leases, grandfathers existing projects and requires enhanced disclosure. Murphy's bill also raises rates to the levels that Nelson had proposed.

*Read: Avoiding
Constitutional Flaws in
GPLET Leases*

The CityNorth decision increases pressure to reach a legislative compromise, said Murphy, chairman of the tax-writing House Ways and Means Committee. He also hopes that officials from Mesa and DMB will realize it is in their best interest not to block the bill.

"With all the turmoil that's happened, I don't know that I would say that the prospects are great," Murphy said. "The way Mesa and DMB forced an end to things last year, I think that didn't sit well with a lot of folks. And I think that they've got some work to do to mend some relationships. And if they don't do that, I think in the long run it's going to come back and bite them. I hope they're smart enough to realize that."

About the Author

Mark Flatten has spent 28 years covering government as a political and investigative reporter, earning a variety of national and statewide journalism awards.

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