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DISTRICT 11

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November 30, 2017

Mayor Mark Mitchell and the Tempe City Council:

I have been made aware that recent city council action is in conflict with Arizona state law in at least three specific areas. First, the property tax incentives offered for the Graduate Hotel and the Bank of the West/FountainHead are disallowed by Arizona Revised Statutes (A.R.S.). Second, the attempts to use such Government Property Lease Excise Tax (GPLET) rates were not vetted by the Arizona Department of Revenue (DOR) as required by state law. Finally, there is no legal basis for beginning a new GPLET lease for the Graduate Hotel in year 47 of the statutorily-allowed 50 years. The following will explain in greater detail why I believe the City is in violation of state law and a recommended recourse.

No Specified Conditions

According to City Ordinance 2017.39 and 2017.48, the City of Tempe has agreed to enter into a lease with the Graduate Tempe Owner, LLC and the KBSII FountainHead, LLC using GPLET rates established in A.R.S. § 42-6203(A) – rates that were eliminated for use beginning June 1, 2010 unless a city had a “grandfathered” project. A.R.S. § 42-6203(A) states:

“Except as otherwise provided in this section, if a lease of a government property improvement was entered into before June 1, 2010, or if a development agreement, ordinance or resolution was approved by the governing body of the government lessor before June 1, 2010 that authorized a lease on the occurrence of specified conditions and the lease was entered into within ten years after the date the development agreement was entered into or the ordinance or resolution was approved by the governing body and the lease was determined by the department of revenue to be in compliance with this subsection:”

Lease agreements subject to City Ordinances 2017.39 and 2017.48 do not qualify for “grandfathered” A.R.S. § 42-6203(A) rates because there was not a development agreement, ordinance, or resolution approved before June 1, 2010 authorizing a lease on “specified conditions.” The “grandfathering” ordinance referenced in both projects, City Ordinance 2010.76, is nothing more than a generic reference to using GPLET and has no “specified conditions” related to either project. Such an interpretation of a grandfathering provision renders the statute meaningless as any project within the city could qualify. The use of City Ordinance

2010.76 is patently against the law. Further, the City knows well the legislative intent of the grandfathering clause was to only allow specific projects already approved by a governing body to continue as originally designed.

Failure to Consult DOR

In 2017, the Arizona State Legislature passed HB2213, which among other changes added a provision to A.R.S. § 42-6203(A) that requires DOR to determine compliance with the section in order to access the “grandfathered” rates. For this law to have any meaning, this review must occur before the lease rates are accessed. This law became effective August 9, 2017, well before both lease agreements were signed. To my knowledge no review occurred, which means both lease agreements are also in conflict with this provision of state law.

No Legal Basis to Begin a 50 Year Lease Agreement in Year 47

Finally, City Ordinance 2017.39 and subsequent lease agreement(s) are in violation of state law because they purport to begin a new GPLET lease agreement in year 47, allowing for a significantly reduced rate of tax remittance.

The rates of tax for “grandfathered” GPLET rates are outlined in A.R.S. § 42-6203(A)(2). These rates decline every ten years from the beginning of the GPLET lease until year 50 when the rate becomes zero. The statute does not allow a new GPLET agreement to “back-date” the lease agreement to the original construction date of the building. The property in question was built in 1970 and as a commercial hotel has been remitting ad-valorem property taxes. It will not become a government property subject to GPLET until the government receives the deed following the certificate of occupancy. A.R.S. § 42-6203(A)(2) reads:

“The tax rate for government property improvements for which the original certificate of occupancy was issued:

- (a) At least ten years but less than twenty years before the date the tax is due is eighty percent of the rate provided in paragraph 1 of this subsection.
- (b) At least twenty years but less than thirty years before the date the tax is due is sixty percent of the rate provided in paragraph 1 of this subsection.
- (c) At least thirty but less than forty years before the date the tax is due is forty percent of the rate provided in paragraph 1 of this subsection.
- (d) At least forty but less than fifty years before the date the tax is due is twenty percent of the rate provided in paragraph 1 of this subsection.
- (e) Fifty or more years before the date the tax is due is zero.”

Although the property was originally built in 1970, it did not become government property until 2017, and therefore the original certificate of occupancy (C/O) would be in 2017, not 1970. Despite there being a significant and obvious financial incentive for the City and the lessee to pretend this incentive began 47 years ago, such an interpretation is a peculiar and likely illegal stretch of the law.

Thankfully, the recourse for both GPLET deals is relatively simple. Both leases must be canceled and re-signed using the “post-2010” GPLET rates of A.R.S. § 42-6203(B). This solves all three illegal actions taken by the council and will not further necessitate an Attorney General SB 1487

investigation brought pursuant to A.R.S. § 41-194.01. I expect your response on these matters by Thursday, December 21st.

Thank you in advance for your prompt response and attention to this letter.

Respectfully,

A handwritten signature in cursive script that reads "Vince Leach".

Vince Leach
State Representative, District 11
Arizona House of Representatives

cc: Vice Mayor Robin Arredondo-Savage
Councilmember Kolby Granville
Councilmember Randy Keating
Councilmember Lauren Kuby
Councilmember Joel Navarro
Councilmember David Shapira

VL: JK/sa