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REVISED

November 18, 2016

The Honorable Doug Ducey
Governor
Office of the Governor
West Wing, State Capitol
1700 W. Washington, 9th Floor
Phoenix, AZ 85007

The Honorable Michele Reagan
Secretary of State
Secretary of State-Department of State
West Wing, State Capitol
1700 W. Washington, 7th Floor
Phoenix, AZ 85007

The Honorable Andy Biggs
President of the Senate
Senate Wing, Room 205
State Capitol
1700 W. Washington
Phoenix, AZ 85007

The Honorable David Gowan
Speaker of the House of Representatives
House Wing, Room 223
State Capitol
1700 W. Washington
Phoenix, AZ 85007

The Honorable Debbie Lesko
Chairwoman, Senate Finance Committee
Senate Wing, Room 302
State Capitol
1700 W. Washington
Phoenix, AZ 85007

The Honorable Darin Mitchell
Chairman, House Ways and Means Committee
House Wing, Room 313
State Capitol
1700 W. Washington
Phoenix, AZ 85007

Dear Governor Ducey, Secretary Reagan, President Biggs, Speaker Gowan, Senator Lesko, and Representative Mitchell:

Laws 2010, Chapter 321, Section 11 requires the Joint Legislative Budget Committee Staff to report to you by December 15, 2016 on the impact of the Government Property Lease Excise Tax (GPLET) rates in effect for government property improvement leases entered into on or after June 1, 2010. Among other provisions, Chapter 321 provided new and higher tax rates, as well as new abatement and reporting requirements for leases entered into on or after June 1, 2010.

We have attached a copy of our report. If you have any questions, please let us know.

Sincerely,

Richard Stavneak

Richard Stavneak
Director

RS:lm
Attachment
xc: Lorenzo Romero, Director, OSPB
Reed Spangler, Senior Policy Advisor, Senate
John Fetherston, Policy Advisor, Senate
Bill Ritz, Analyst, Senate Finance Committee
Travis Swallow, Policy Advisor, House
Cynthia Aragon, Senior Policy Advisor, House
Michael Madden, Analyst, House Ways and Means Committee

Government Property Lease Excise Tax (GPLET) Report

This report responds to the requirement in Laws 2010, Chapter 321 for a Joint Legislative Budget Committee (JLBC) Staff analysis of the Government Property Lease Excise Tax (GPLET) rates in effect for leases entered into on or after June 1, 2010.

Below is a summary of the key findings under the Chapter 321 GPLET analysis.

- GPLET payments for 5 of the 6 government property improvement leases included in the sample study were calculated based on the incorrect tax rate.
- Under the actual but incorrect GPLET rates, 5 of the 6 lessees paid less under GPLET than what they would have paid under the ad valorem property tax.
- However, if the correct GPLET rates had been used, 5 of the 6 lessees would have paid more under GPLET than under the ad valorem property tax.
- For the 6 leases combined, actual tax payments were an estimated 37.8% lower under GPLET than under the property tax.
- If the correct GPLET rates had been applied, GPLET payments would have been an estimated 28.4% lower under GPLET than under the property tax.

Brief Description of GPLET

The Government Property Lease Excise Tax (GPLET) was enacted in 1996 (Laws 1996, Chapter 349) to allow cities, towns, counties and county stadium districts (hereafter referred to as "government lessors") to lease property that they own to private parties ("prime lessees") for commercial, residential rental, or industrial purposes for at least 30 days.

Because the Arizona Constitution exempts federal, state, county, and municipal property from taxation, government lessors do not have to pay any property taxes. Instead, the prime lessees are required to pay a GPLET on the building ("government property improvement") that they lease from the government lessor. Unlike the property tax, GPLET is based on factors other than a property's assessed value, such as a building's square footage and usage.

Changes to GPLET Enacted in 2010

Laws 2010, Chapter 321 provided new requirements for all leases subject to GPLET that were entered into on or after June 1, 2010. The act provided new and higher tax rates, as well as new abatement and reporting requirements. Additionally, the act grandfathered all leases that were entered into before June 1, 2010, or that resulted from a development agreement, ordinance, or resolution approved before this date and entered into within 10 years of such approval.

A grandfathered lease that is amended after June 1, 2010 continues to be subject to the provisions in effect prior to Laws 2010, Chapter 321, if all of the following conditions are met:

(1) the amendment furthers the purpose of the original lease, (2) any land added under the amendment is contiguous to the land under the original lease and does not increase the land area by more than 50%, and (3) any government property improvement added under the amendment does not increase the area of gross building space by more than 100%.

Table 1 below shows the GPLET rates for leases entered into prior to June 1, 2010 (or otherwise grandfathered under the pre-June 1, 2010 rates) and for leases entered into on or after June 1, 2010. These rates are hereafter referred to as the "pre-June 2010" and "post-June 2010" rates, respectively.

Table 1

GPLET Rates for Pre-June 2010 and Post-June 2010 Government Property Improvement Leases

Property	Pre-June 2010 Base Tax Rate 1/	Post-June 2010 Base Tax Rate 1/, 2/
Office Building: 1 Story	\$1.00 per square foot	\$2.25 per square foot
Office Building: 2 to 7 Stories	\$1.25 per square foot	\$2.59 per square foot
Office Building: 8 or more Stories	\$1.75 per square foot	\$3.49 per square foot
Retail Building	\$1.50 per square foot	\$2.82 per square foot
Hotel/Motel	\$1.50 per square foot	\$2.25 per square foot
Warehouse/Industrial Building	\$0.75 per square foot	\$1.52 per square foot
Residential Rental Building	\$0.50 per square foot	\$0.85 per square foot
Other Building	\$1.00 per square foot	\$2.25 per square foot
Parking Space	\$100.00 per parking space	\$224.99 per parking space

1/ The base rate may be further adjusted (increased or decreased) depending on the location of the property and the date of issuance of the original Certificate of Occupancy for the building. In addition, the post-June 2010 base rate may be reduced further depending on the combined property tax rate in the area where the building is located.

2/ Post-June 2010 rates are adjusted for inflation each year. The rates in this column are the TY 2015 (FY 2016) GPLET rates.

Besides the start date of the lease and property type, the GPLET rate also depends on where the property is located and when the original Certificate of Occupancy for the government property improvement was issued. For this reason, the base tax rates shown in *Table 1* above can be either higher or lower. As an example, retail space under a pre-June 2010 lease that is located outside of a "slum" or "blighted" area and for which the Certificate of Occupancy was issued 25 years ago is subject to a GPLET rate of \$1.35 per square foot, which is 10% below the pre-June 2010 base rate of \$1.50 per square foot. However, the exact same retail space leased under a post-June 2010 lease would be subject to a GPLET rate of \$4.23 per square foot, which is 150% above the post-June 2010 base rate of \$2.82 per square foot.

GPLET Analysis

The Chapter 321 GPLET analysis is required to include the following information: (1) the amount of tax revenue generated by GPLET under the post-June 2010 rates by taxing jurisdiction, (2) the amount of tax revenue that would have been produced by the same properties if they had been subject to ad valorem property tax by the taxing jurisdiction, and (3) the amount of property tax revenue previously received from vacant or underutilized properties that have since been redeveloped and are now subject to the post-June 2010 GPLET rates. Laws 2010, Chapter 321, as amended by Laws 2015, Chapter 10 provides that the JLBC Staff analysis be based on a representative sample of properties subject to the post-June 2010 GPLET rates.

Laws 2010, Chapter 321 required the Office of the Auditor General to conduct a special audit of the changes to GPLET enacted in 2010. According to the report released by the Auditor General in December 2015, there were a total of 268 government property improvement leases in effect in 2014. However, only 16 of the 268 leases were subject to the post-June 2010 GPLET rates. The other 252 leases were either exempted or subject to the pre-June 2010 rates.

The JLBC Staff analysis, which is described in more detail below, is based on a sample of 6 government property improvement leases out of the 16 post-June 2010 leases identified by the Auditor General. The other 10 post-June 2010 leases were excluded from our study for one of the following reasons: (1) the lease is no longer active, (2) the lease was not included in the Department of Revenue's GPLET database, (3) the lease was not included in the county treasurer's 2015 GPLET report, or (4) the valuation data from the county assessor's website was not sufficiently detailed to estimate what tax payments would have been under the ad valorem property tax. The JLBC Staff analysis is based on the most recently available data, which is for Tax Year 2015, or for budgetary purposes, FY 2016.

To prepare the analysis, the JLBC Staff used GPLET data received from the county treasurers and property tax rate and valuation data from the county assessors. After further examining the GPLET payments for the sample leases, the JLBC Staff determined that 5 of the 6 prime lessees used the incorrect GPLET rate. This finding was consistent with the Auditor General's 2015 special audit report, which reported that 11 of the 12 sample leases included in their analysis were based on incorrect GPLET rates.

Table 2 below provides basic information on each of the leases included in the JLBC Staff analysis, including property type, square footage, the actual rate used, as well as the rate that likely should have been used.

Table 2

Basic Information of Sample Leases Included in GPLET Analysis

Sample Lease	Property Type	Square Footage	Actual GPLET Rate	Correct GPLET Rate
1	Warehouse/Industrial	269,598	$1.10 per sqft.	$1.22 per sqft.
2	Retail Building	5,609	$2.82 per sqft.	$2.82 per sqft.
3	Retail Building	1,300	$1.35 per sqft.	$4.23 per sqft.
4	Retail Building	2,600	$1.35 per sqft.	$4.23 per sqft.
5	Retail Building	1,105	$1.35 per sqft.	$4.23 per sqft.
6	Retail Building	450	$0.90 per sqft.	$4.23 per sqft.

As indicated in the table above, only Lessee #2 used the correct rate to calculate their FY 2016 GPLET liability. Lessees #3 through #6 incorrectly applied the pre-June 2010 GPLET rates, which were less than one-third of the correct post-June 2010 rates. While Lessee #1 correctly applied the post-June 2010 rate, they incorrectly based their tax calculation on the TY 2012 rate, which was 10% lower than the correct TY 2015 rate.

Table 3 shows the amount of actual GPLET payments made by the 6 sample lessees in FY 2016 and compares those amounts to what they would have paid under the ad valorem property tax. As indicated in the table, 5 of the 6 lessees paid less under GPLET than what they would have paid under the property tax. These 5 lessees paid an estimated 39.1% to 57.8% less in taxes under GPLET. The only exception was Lessee #2, which paid an estimated 7.3% more under GPLET than under the property tax. As noted above, Lessee #2 was the only lessee that applied the correct GPLET rate among the 6 sample lessees included in the analysis. For all 6 sample leases combined, the total FY 2016 GPLET payment was $319,537, which was $(194,187), or 37.8%, below the amounts that would have been generated under the property tax.

As shown in *Table 3* most of the $(194,187) revenue loss under GPLET relative to the property tax was incurred by school districts ($67,042), followed by special districts ($49,152), community college districts ($37,670), municipalities ($27,175), and counties ($13,149). Under current statute, GPLET is distributed as follows: 73% to school districts, 13% to counties, 7% to community college districts, 7% to cities and towns and 0% to special districts. This means that special districts, which include taxing jurisdictions such as flood control, library, health care, and fire districts, lose all their tax revenue under GPLET.

Table 4 shows what GPLET payments for the 6 lessees would have been if they had applied the correct GPLET rate for FY 2016. These payments are then compared to the estimated amount of tax revenue that would have been generated under the ad valorem property tax. As shown in the table, Lessees #3, #4, and #5 would have paid an estimated 89.7% more under GPLET than under property tax if the correct rates had been used, whereas Lessee #6 would have paid almost twice as much. While GPLET payments for Lessee #1 would have increased from $296,558 to $328,910 if the correct rate had been used, they would still have paid 32.4% less under GPLET than under the property tax. If all 6 sample lessees had applied the correct GPLET rate, their combined FY 2016 GPLET payments would have been an estimated $48,265, or 15%, higher in FY 2016. Relative to the ad valorem property tax, the 6 lessees combined would have paid 28.4% less under GPLET if the correct rates had been used.

The results reported in *Table 3* and *Table 4* should be interpreted with caution. While the analysis is based on actual GPLET and property tax rate information, the property valuation data is estimated based on limited information obtained from the county assessors. The property assessment prepared and reported by the county assessors is based on the entire land plus the buildings and structures erected on that land. In almost all instances, however, a private entity (prime lessee) is leasing and occupying only part of a building, for which no assessment data exists.

As an example, a shopping center that is owned by a city and leased to several private businesses receives one single assessed value for the whole parcel as opposed to separate assessed valuations for the space occupied by each lessee. For the purpose of this analysis, the JLBC Staff estimated each of the 6 lessees' assessed valuation by calculating the space that they occupied (in terms of square feet) relative to the total space of the entire parcel of real estate owned by the government lessor, as reported by the county assessor.

Finally, since the JLBC Staff was not able to determine from available data the amount of property taxes paid for the 6 sample properties when they were vacant or underutilized, we were not able to estimate the potential gain or loss under the post-June 2010 GPLET rates.

Table 3

Actual But Incorrect GPLET Rates

Sample Lease #1

Jurisdiction	GPLET	Property Tax	$ (Loss)/Gain	% (Loss)/Gain
County	$ 38,553	$ 52,353	$ (13,800)	-26.4%
City	20,759	46,644	(25,885)	-55.5%
Comm. College	20,759	57,473	(36,714)	-63.9%
School District	216,487	283,310	(66,823)	-23.6%
Special Districts	-	47,082	(47,082)	-100.0%
TOTAL	**$ 296,558**	**$ 486,862**	**$ (190,304)**	**-39.1%**

Sample Lease #2

Jurisdiction	GPLET	Property Tax	$ (Loss)/Gain	% (Loss)/Gain
County	$ 2,056	$ 1,277	$ 779	61.0%
City	1,107	1,642	(535)	-32.6%
Comm. College	1,107	1,402	(294)	-21.0%
School District	11,547	9,317	2,230	23.9%
Special Districts	-	1,101	(1,101)	-100.0%
TOTAL	**$ 15,817**	**$ 14,738**	**$ 1,079**	**7.3%**

Sample Lease #3

Jurisdiction	GPLET	Property Tax	$ (Loss)/Gain	% (Loss)/Gain
County	$ 228	$ 244	$ (16)	-6.6%
City	123	327	(204)	-62.4%
Comm. College	123	268	(145)	-54.2%
School District	1,281	1,838	(557)	-30.3%
Special Districts	-	223	(223)	-100.0%
TOTAL	**$ 1,755**	**$ 2,899**	**$ (1,144)**	**-39.5%**

Sample Lease #4

Jurisdiction	GPLET	Property Tax	$ (Loss)/Gain	% (Loss)/Gain
County	$ 456	$ 488	$ (32)	-6.5%
City	246	653	(407)	-62.4%
Comm. College	246	536	(290)	-54.2%
School District	2,562	3,675	(1,113)	-30.3%
Special Districts	-	446	(446)	-100.0%
TOTAL	**$ 3,510**	**$ 5,799**	**$ (2,289)**	**-39.5%**

Sample Lease #5

Jurisdiction	GPLET	Property Tax	$ (Loss)/Gain	% (Loss)/Gain
County	$ 194	$ 208	$ (14)	-6.5%
City	104	278	(173)	-62.4%
Comm. College	104	228	(123)	-54.2%
School District	1,089	1,562	(473)	-30.3%
Special Districts	-	190	(190)	-100.0%
TOTAL	**$ 1,492**	**$ 2,465**	**$ (973)**	**-39.5%**

Sample Lease #6

Jurisdiction	GPLET	Property Tax	$ (Loss)/Gain	% (Loss)/Gain
County	$ 53	$ 119	$ (66)	-55.8%
City	28	-	28	N/A
Comm. College	28	131	(102)	-78.3%
School District	296	602	(306)	-50.9%
Special Districts	-	109	(109)	-100.0%
TOTAL	**$ 405**	**$ 960**	**$ (555)**	**-57.8%**

Total - All Sample Leases

Jurisdiction	GPLET	Property Tax	$ (Loss)/Gain	% (Loss)/Gain
County	$ 41,540	$ 54,688	$ (13,149)	-24.0%
City	22,368	49,543	(27,175)	-54.9%
Comm. College	22,368	60,037	(37,670)	-62.7%
School District	233,262	300,304	(67,042)	-22.3%
Special Districts	-	49,152	(49,152)	-100.0%
TOTAL	**$ 319,537**	**$ 513,724**	**$ (194,187)**	**-37.8%**

Table 4

Correct GPLET Rates

Jurisdiction	Sample Lease #1 GPLET	Sample Lease #1 Property Tax	Sample Lease #1 $ (Loss)/Gain	Sample Lease #1 % (Loss)/Gain	Sample Lease #2 GPLET	Sample Lease #2 Property Tax	Sample Lease #2 $ (Loss)/Gain	Sample Lease #2 % (Loss)/Gain	Sample Lease #3 GPLET	Sample Lease #3 Property Tax	Sample Lease #3 $ (Loss)/Gain	Sample Lease #3 % (Loss)/Gain
County	$ 42,758	$ 52,353	$ (9,594)	-18.3%	$ 2,056	$ 1,277	$ 779	61.0%	$ 715	$ 244	$ 471	192.8%
City	23,024	46,644	(23,620)	-50.6%	1,107	1,642	(535)	-32.6%	385	327	58	17.9%
Comm. College	23,024	57,473	(34,449)	-59.9%	1,107	1,402	(294)	-21.0%	385	268	117	43.6%
School District	240,104	283,310	(43,206)	-15.3%	11,547	9,317	2,230	23.9%	4,014	1,838	2,177	118.4%
Special Districts	-	47,082	(47,082)	-100.0%	-	1,101	(1,101)	-100.0%	-	223	(223)	-100.0%
TOTAL	**$ 328,910**	**$ 486,862**	**$ (157,952)**	**-32.4%**	**$ 15,817**	**$ 14,738**	**$ 1,079**	**7.3%**	**$ 5,499**	**$ 2,899**	**$ 2,600**	**89.7%**

Jurisdiction	Sample Lease #4 GPLET	Sample Lease #4 Property Tax	Sample Lease #4 $ (Loss)/Gain	Sample Lease #4 % (Loss)/Gain	Sample Lease #5 GPLET	Sample Lease #5 Property Tax	Sample Lease #5 $ (Loss)/Gain	Sample Lease #5 % (Loss)/Gain	Sample Lease #6 GPLET	Sample Lease #6 Property Tax	Sample Lease #6 $ (Loss)/Gain	Sample Lease #6 % (Loss)/Gain
County	$ 1,430	$ 488	$ 941	192.8%	$ 608	$ 208	$ 400	192.8%	$ 247	$ 119	$ 128	107.9%
City	770	653	117	17.9%	327	278	50	17.9%	133	-	133	N/A
Comm. College	770	536	234	43.6%	327	228	99	43.6%	133	131	3	2.0%
School District	8,029	3,675	4,353	118.4%	3,412	1,562	1,850	118.4%	1,390	602	788	130.8%
Special Districts	-	446	(446)	-100.0%	-	190	(190)	-100.0%	-	109	(109)	-100.0%
TOTAL	**$ 10,998**	**$ 5,799**	**$ 5,199**	**89.7%**	**$ 4,674**	**$ 2,465**	**$ 2,210**	**89.7%**	**$ 1,904**	**$ 960**	**$ 943**	**98.2%**

Jurisdiction	Total - All Sample Leases GPLET	Property Tax	$ (Loss)/Gain	% (Loss)/Gain
County	$ 47,814	$ 54,688	$ (6,874)	-12.6%
City	25,746	49,543	(23,797)	-48.0%
Comm. College	25,746	60,037	(34,291)	-57.1%
School District	268,495	300,304	(31,808)	-10.6%
Special Districts	-	49,152	(49,152)	-100.0%
TOTAL	**$ 367,802**	**$ 513,724**	**$ (145,922)**	**-28.4%**