MEMORANDUM

Date: December 13, 2016

To: The Honorable Chair and Members
Pima County Board of Supervisors

From: C.H. Huckelberry
County Administrator

Re: **Cost/Benefit Analysis of Economic Development Incentives**

Recently, there has been discussion about whether economic development incentives are cost effective from the perspective of public fund cash flow; which means is the loss or deferral of tax revenues in the short term recaptured from expanded economic activities that generate excess tax revenues in the future?

In most, if not all, cases where economic development incentives are offered, a financial analysis is performed to project increased employment payroll and various taxes paid by a specific activity. These analyses are always forward looking. I asked my Executive Assistant, Nicole Fyffe, to examine the local Government Property Lease Excise Tax (GPLET) abatement projects in the City of Tucson, downtown/Gateway redevelopment area and central business district to determine the actual outcomes of a number of projects that have received the tax abatement. The examination was to determine if the increase in property values, as a result of the incentive in the investment and/or redevelopment, have been realized.

The attached memorandum shows that Tucson's Mayor and Council have approved 14 City GPLET tax abatement agreements. Of those, four have completed construction and the constructed improvements have been valued by the Pima County Assessor. Of these four, three have resulted in an increase in property value (Full Cash Value) sufficient to meet the State's requirements. State law requires that, in order to approve a GPLET tax abatement agreement, there must be an expectation that the improvements will result in at least a 100 percent increase in property value; as increased property values over time would result in increased tax revenues after the GPLET and tax abatement period have ended. One property, however, is of concern, as its Limited Value (the value assigned by the Assessor for the purposes of levying taxes), was not increased by the Assessor to reflect the improvements due to the timing of a property valuation appeal prior to entering into the GLPLET agreement. This was discovered as a result of this examination, and we have requested that the Assessor correct the Limited Value.

Through this examination, it was also discovered that the methodology used by the City's consultant as part of the State-required economic impact analysis was consistently overestimating post-construction property value. The City was made aware of this, shared this with their consultant, and the consultant has already revised their methodology to address this issue. This revised methodology has been shared with the Assessor to determine if, in fact it is improved.

What could not be assessed as part of the examination, was whether the post-construction sales tax revenues and indirect revenues have achieved expectations. Regardless, it is noted that during the period these properties are not paying property taxes, it is the City, State and Regional Transportation Authority that benefit the most from increased sales tax revenues; while the County and school districts experience the bulk of lost revenues during this period, as we rely most heavily on property taxes. The recent Rio Nuevo proposal for a GPLET agreement is Rio Nuevo's first direct experience with such an agreement. They are proposing a 25-year term, as opposed to the City that has thus far limited the agreements to 8-year terms.

In summary, the examination was worthwhile in that we were able to catch an issue with one particular property that will need to be addressed by the Assessor and have hopefully improved the methodology used in estimating post-construction property values. We were also able to verify that the City is cautiously entering into these agreements; requiring in one case an escrow payment by the property owner in the event post-property tax benefits are not realized. This exercise should be repeated next year when more of these properties have completed construction and have been captured by the Assessor's valuation process.

CHH/anc

Attachment

c: The Honorable Bill Staples, Pima County Assessor
Tom Burke, Deputy County Administrator for Administration
Keith Dommer, Director, Finance and Risk Management
Dr. John Moffatt, Director, Economic Development Office
Patrick Cavanaugh, Deputy Director, Economic Development Office
Craig Horn, Finance Analyst Supervisor, Finance and Risk Management
Nicole Fyffe, Executive Assistant to County Administrator

MEMORANDUM

Date: December 8, 2016

To: C.H. Huckelberry
County Administrator

From: Nicole Fyffe
Executive Assistant to the
County Administrator

NF

Re: **City of Tucson GPLET Tax Abatement Projects, Property Value Increases & Tax Revenue Projections**

You asked whether the City of Tucson's Government Property Lease Excise Tax (GPLET) agreements and tax abatement projects were resulting in the anticipated property value increases. This memorandum includes background on the City's GPLET agreements, the State requirements for approval, comparisons of pre and post property valuation data publically available on the Pima County Assessor's website, and a review of reports provided by the City estimating the economic and revenue impacts for the projects associated with these agreements.

On September 13, 2016 I met with Pima County Assessor Bill Staples, Deputy Director for Economic Development Patrick Cavanaugh, Finance Analyst Supervisor Craig Horn, and City of Tucson Economic Development Manager Camila Bekat. The purpose of the meeting was to discuss a draft of this memorandum. Their comments, as well as changes that occurred after the meeting, are now incorporated.

Background

On April 17, 2012 the City of Tucson adopted boundaries for the Downtown/Gateway Redevelopment Area and Central Business District, which provided the legal means for the City to enter into GPLET agreements and tax abatements as a redevelopment incentive within this geographic area. These agreements commence after significant improvements have been made to the property, and reduce costs for private developers/property owners by transferring title of the improved private property to the City for an 8-year period, who then leases the property back to the private entity making the property exempt from real property taxes during the term of the lease. Normally there would be a lease excise tax levied in lieu of property taxes, but since the properties are within the Central Business District and improvements are expected to increase the property value by at least 100 percent, the lease excise tax is also abated for the 8-year term. The tangible benefit to the developer/private lessee during that period is not having to pay real property taxes to the City, County, school districts and any other entities that would otherwise levy real property taxes.

The Mayor and Council has approved 14 City of Tucson GPLET tax abatement agreements and nine of them have completed construction (see Table 1).

Table 1
City of Tucson Approved GPLET Agreements

Project	City of Tucson Approval	Construction Complete
1 E. Broadway	4/23/2013	Yes
Herbert Apartments	9/10/2013	Yes
Cadence/Plaza Centro	9/10/13 & 10/22/13	Yes Yes
Fifth and Congress Hotel	11/5/2014	No
Mister Car Wash	12/9/2014	Yes
Congress Rialto Block	5/19/2015	Partially complete, partially picked up by Assessor
Congress Annex	10/20/2015	yes, but not yet picked up by Assessor
One West Broadway	3/22/2016	No
Gibson Family LLC	4/5/2016	yes, but not yet picked up by Assessor
Wildcat House	4/5/2016	Yes
Riverpark Inn	6/21/16	No
Arizona Hotel/Dabdoub	8/9/2016	No
Cirrus Visual	8/9/2016	yes, but not yet picked up by Assessor

Per State law[1], Mayor and Council cannot approve a GPLET tax abatement agreement in the designated Central Business District area unless (1) the proposed construction project will increase the property value by at least 100 percent; (2) the economic and fiscal benefits to the state, county, city or town exceed the benefits to the private lessee, and that this is determined by an analysis conducted by a third party[2]; and (3) the city or town notify the governing bodies of the county and school district at least 60 days before the Mayor and Council considers the item for approval. The City contracts with Applied Economics for the economic and fiscal benefits analysis.

1. Did the construction project increase the property value by at least 100 percent?

For the purposes of this evaluation, the "property value" is defined as the "full cash value" of the property as determined by the Pima County Assessor. However, the term is undefined in the State's GPLET statute. It could be argued that it could be defined as just the improvements portion of the full cash value (i.e. property improvement value and not the land value). It could also be argued that it could be defined as the market value resulting from an appraisal, which would likely be a bit higher than the full cash value assigned by the Assessor.

[1] ARS 42-6209

[2] State law exempts residential rental housing from this analysis, but it appears the City conducts them anyway.

For each of the GPLET projects for which construction is complete, and for which the Assessor's data is reflecting completion, the full cash values before and after construction are listed in the attachments and summarized below. This eliminated several properties where construction is complete, but not recognized by the Assessor. Repeating this evaluation next year will likely pick up at least another three projects. The Cadence/Plaza Centro project is not included in this analysis due to the complexity associated with parcel splits and number of resulting parcels.

Also included are the before and after "limited values" which are determined by State statute for the purposes of taxation. The limited values are the basis for levying property taxes. The limited values are included in this evaluation because part of the justification for entering into these GPLET agreements is that these construction projects will increase the property taxes paid to the various taxing entities after the tax abatement period ends.

It should be noted that State statute does not specify "when" the property value should have increased by at least 100 percent. The analysis above assumes the intention was that the property value would have increased by at least 100 percent by the year after construction.

Table 2
Did Property Values Increase by at least 100% Post Construction?

Project	Yes	Full Cash Value Increase	Limited Value Increase
1 E. Broadway	Yes	1183%	1155%
Herbert Apartments	No	76%	5%
Mister Car Wash	Yes	115%	101%
Wildcat House	Yes	107%	92%

Regarding the Herbert Apartments (former MLK low income housing), the full cash value increased by 76 percent from Tax Year 2014 to Tax Year 2016, reflecting the time period before and after construction. But more concerning is that the limited value has only increased five percent. This means that the limited value has not been increased to capture the value of the construction, which could result in much lower property tax revenues than anticipated when the 8-year tax abatement ends. Mr. Staples provided the following explanation: The prior owner's successful 2014 appeal lowered the value. Per ARS 42-16002 the 2014 value rolls to 2015. So although the construction/remodel took place during 2013/2014, the Assessor couldn't reflect it in the full cash value until 2016. ARS 42-13302 lists circumstances where the limited value can be increased to reflect a percent of the full cash value, including a change in use or modification by construction that occurred since the "proceeding valuation year". But since the construction/remodel took place prior to the preceding year, the Assessor did not increase the limited value. While Mr. Staples stated that there is a way to correct this, he was reluctant to do so without fully understanding the possible ramifications. I will continue to request that Mr. Staples pursue the correction.

Initially the Riverpark Inn was determined by the City of Tucson to be ineligible for a GPLET tax abatement agreement as an initial analysis found the benefits to the taxing jurisdictions would not exceed the tax abatement benefit to the applicant. An additional marketing and operating revenue projection study was then conducted that found the project would generate a sufficient increase in revenues to exceed the value of the property tax abatement by a margin of less than $100,000. As a result of the tight revenue benefit margin, City staff recommended, and Mayor and Council approved, the applicant depositing $200,000 in a City account, an audit schedule to determine whether the benefit ratio was being achieved, and the opportunity for the City to cancel the GPLET and retain the $200,000. During our September meeting, City of Tucson Economic Development Management Camila Bekat mentioned that the Riverpark Inn owners had also appealed Assessor's determination of value prior to the GLPET agreement approval. Although they were unsuccessful, renovations to the Riverpark Inn are not yet completed and it is unknown whether the owners will file another appeal next year. It is also unknown whether these are two isolated cases and whether these appeals were attempts to increase the opportunity for being eligible for the GPLET program.

2. **Do the economic and fiscal benefits to the state, county, city or town exceed the benefits to the private lessee during the 8-year tax abatement period?**

This is difficult to answer as the majority of the benefits listed in the "Economic and Revenue Impacts" reports to the City are indirect benefits associated with property taxes generated by new housing for employees, and sales taxes generated by employees supporting local businesses, as well as new state income tax revenues. But there appears to be no reason to question many of the estimates of direct and indirect benefits to City, County, schools and State included in these reports for the 8-year tax abatement period. It is interesting to note that the majority of the direct benefits during these 8-year periods are received by the City, State and RTA since they levy sales taxes on the resulting businesses, while the majority of the costs or lost revenues are to the County and school districts as they most heavily rely upon property taxes that are abated during these leases.

The one concerning issue with these reports is that they consistently overestimate the resulting property value increase which, in turn, leads to an overestimation of the property tax savings to the private lessee and the expected property tax revenues to local governments after the 8-year tax abatement period ends. This appears to be caused by the methods that Applied Economics uses to calculate the post-construction property value. To estimate the post-construction property value, they typically use 85 percent of the construction costs or 85 percent of the land acquisition plus construction costs. In three of the four cases this resulted in an estimation of property tax savings to the lessee that are double what would have actually been levied if not for the exemption.

Table 3
Differing Property Tax Estimates

Project	Applied Economics Estimate of Property Tax Savings to Lessee	Property Taxes Post Construction Based on Assessor's Limited Value*
1 E. Broadway		
2015	$ 358,824	$ 186,964
2016	$ 349,126	$ 188,510
Herbert Apts		
2015	$ 187,359	$ 53,412
2016	$ 182,296	$ 55,116
Mister Car Wash		
2015	$ 136,180	$ 59,201
2016	$ 132,500	$ 59,438
Wildcat House		
2017	$ 35,778	$ 30,670

*And applicable tax rate and assessment ratio

This issue was discussed with Mr. Staples and Ms. Bekat at the September meeting and it was determined that a meeting with Applied Economics would be pursued with the goal of better understanding how Applied Economics calculates the post construction property value and tax revenues and what improvements could be made. Applied Economics was willing to meet but we were unable to schedule a meeting with Mr. Staples. However, Ms. Bekat did forward a draft of this memorandum and the attached spreadsheets to Applied Economics and their latest report (October 2016 City Park) includes a revised methodology that is intended to improve the post construction property valuation estimate. I've forwarded the report to Mr. Staples for his review.

Rio Nuevo's Proposed City Park GPLET Agreement

Rio Nuevo has provided notice that it intends to enter into a 25-year GPLET agreement for the 45,000 square foot restaurant and entertainment "City Park" project, to be built on the vacant lots at 40 E. Congress, east of the Chase Bank building. Ms. Bekat confirmed that all of the City of Tucson's GPLET agreements have been limited to 8-years such that the agreement ends at the same time the lease excise tax abatement period ends. Rio Nuevo's would continue on for another 17 years after the 8-year abatement ends – meaning the lease excise tax would be paid in lieu of property taxes for year 9-25.

Based on the Applied Economics report provided with the notice, the estimated lease excise tax of $34,447 is about 30 percent of estimated post construction property taxes without the GPLET agreement. After the 17 years of paying the lease excise tax, the property owner will have paid an estimated $600,000, which is about equivalent to what the property owner would have paid in property taxes on the vacant land over 25 years if the project was not built. The lease excise tax would be higher if not for a provision in the State statute that provides for an exemption for entertainment related uses. Therefore, the lease excise tax for City Park applies only to the space allocated to office use, which is about 27 percent of the total project. Similar to the findings in the City GPLET Applied Economics reports, the estimated increase in sales tax revenue is what drives the more significant revenue impacts from the project, as sales taxes are not abated or exempted during the term of the GPLET agreement.

Summary and Continued Follow Up

Ms. Bekat's cautious approach with Riverpark Inn, as well as her follow up with Applied Economics that resulted in a change in methodology for estimating post construction property valuation, shows that that City of Tucson is taking a responsible approach to managing this GPLET abatement program. I will continue to pursue correction of the Herbert Apartments property valuation with Mr. Staples. I will also seek confirmation from Mr. Staples with regard to his opinion on the Applied Economics revised methodology. Finally, I do think it is worth repeating this pre and post valuation comparison in a year or so, if only to verify whether other situations like the Herbert Apartments occur and need addressing.

Please let me know if you need anything else on this.

Attachments

C: Bill Staples, Pima County Assessor
Camila Bekat, City of Tucson Economic Development Manager
Tom Burke, Deputy County Administrator
Keith Dommer, Finance Director
Patrick Cavanaugh, Deputy Director for Economic Development
Craig Horn, Finance Analyst Supervisor

1 E. Broadway

Property Values Pre and Post construction

	FCV 2013	FCV 2015	% increase	LV 2013	LV 2015	% increase
117-12-087C	$ 558,612	$ 7,165,000	1183%	$ 536,268	$ 6,729,726	1155%

Property Taxes Pre and Post Construction

Parcel	Before Construction (TY2013)	After Construction (TY2015)*	TY2016**
117-12-087C	$ 19,561	$ 186,964	$ 188,510

*Based on Assessor's Limited Assessed Value/100*combined tax rates of 16.966. Assessment ratio of 16.4%

**Based on Assessor's Limited Assessed Value/100*combined tax rates of 16.6735. Assessment ratio of 16.4%

Applied Economics Estimated Property Tax Savings During Exempt Years

2015	$ 358,824
2016	$ 349,126
Total over 8-years	$ 2,822,104
After GPLET expires	$ 349,000
Construction cost	$ 14,600,000
Land Acquisition	$ 890,000

Notes: Applied Economics report uses a tax rate of 15.23 and an assessment ratio of 18%

Applied Economics report uses (construction cost+acquisition cost)*85%*18%*15.23 tax rate/100 to estimate property tax savings.

Herbert Apts

Property Values Pre and Post construction

Parcels	FCV 2014	FCV 2015	FCV 2016	% increase	LV 2014	LV 2015	LV 2016	% increase
117-06-245C	$ 3,096,000	$ 3,096,000	$ 5,489,136		$ 3,096,000	$ 3,096,000	$3,250,800	
117-06-245B	$ 7,224	$ 7,774	$ 7,774		7224	$ 7,401	$ 7,771	
117-06-249A	$ 46,523	$ 47,073	$ 47,073		$ 46,523	$ 44,813	$ 47,054	
Totals	$ 3,149,747	$ 3,150,847	$ 5,543,983	76%	$ 3,149,747	$ 3,148,214	$3,305,625	5%

Property Taxes Pre and Post Construction

Parcels	Before Construction on Tax Rolls (TY2014)	After Construction on Tax Rolls (TY2015)*	2016**
117-06-245C	0	$ 52,526	$ 54,202
117-06-245B	0	$ 126	$ 130
117-06-249A	0	$ 760	$ 784
Totals	0	$ 53,412	$ 55,116

*Based on Assessor's Limited Assessed Value/100*combined tax rates of 16.966. Assessment ratio of 10%

**Based on Assessor's Limited Assessed Value/100*combined tax rates of 16.6735. Assessment ratio of 10%

Applied Economics Estimated Property Tax Savings During Exempt Years

2015	$ 187,359
2016	$ 182,296
Total over 8-years	$1,473,556
After GPLET expires	$182,000
Construction cost	$5,400,000
Acquisition	$3,500,000

Notes: Applied Economics report uses a tax rate of 15.23% and an assessment ratio of 18%

Applied Economics report uses (construction cost+acquisition cost)*85%*18%*15.23 tax rate/100 to estimate property tax savings.

Mister Car Wash

Property Values Pre and Post construction

Parcels	FCV 2014	FCV 2015	% increase	LV 2014	LV 2015	% increase
117-04-2630	$ 763,165	$ 1,844,085		$ 763,165	$1,724,219	
117-04-2640	$ 86,294	$ 86,051		$ 86,294	$ 80,458	
117-04-2670	$ 43,418	$ 43,297		$ 43,418	$ 40,483	
117-04-2680	$ 14,468	$ 14,430		$ 14,468	$ 13,492	
117-04-2690	$ 29,499	$ 29,417		$ 29,499	$ 27,505	
Totals	$ 936,844	$ 2,017,280	115%	$ 936,844	$1,886,157	101%

Property Taxes Pre and Post Construction

Parcels	Before Construction (TY2014)	After Construction (TY2015)*	TY2016**
117-04-2630	$ 12,796	$ 54,119	$54,335
117-04-2640	$ 1,447	$ 2,525	$2,536
117-04-2670	$ 728	$ 1,270	$1,276
117-04-2680	$ 243	$ 423	$425
117-04-2690	$ 495	$ 864	$867
Total	$ 15,709	$ 59,201	$ 59,438

*Based on Assessor's Limited Assessed Value/100*combined tax rates of 16.966. Assessment ratio of 18%

**Based on Assessor's Limited Assessed Value/100*combined tax rates of 16.6735. Assessment ratio of 18%

Applied Economics Estimated Property Tax Savings During Exempt Years

2015	$ 136,180
2016	$ 132,500
Total over 8-years	$1,063,678
After GPLET expires	$133,000
Construction Cost	$4,000,000
Acquisition	$1,500,000

Notes: Applied Economics report uses a tax rate of 15.9888 and assessment ratio of 18%

Applied Economics report uses (construction cost+acquisition cost-full cash value)*85%*18%*15.9888 tax rate/100 to estimate property tax savings.

Wildcat House/Brother Johns BBQ

Property Values Pre and Post construction

	FCV 2016	FCV 2017	% increase	LV 2016	LV 2017	% increase
115-06-207B	$ 531,200	$ 1,100,000	107%	$ 531,200	$ 1,021,900	92%

Property Taxes Pre and Post Construction

Parcel	Before Construction (TY2016)*	After Construction (TY2017)*
115-06-207B	$ 15,943	$ 30,670

*Based on Assessor's Limited Assessed Value/100*combined tax rates of 16.6735. Assessment ratio of 18%

Applied Economics Estimated Property Tax Savings During Exempt Years

2016	$ 35,778
2017	$ 35,778
Total over 8-years	$ 286,228
After GPLET expires	$ 36,000
Construction cost	$ 1,000,000
Land value at 66%	$ 364,597

Notes: Applied Economics report uses a tax rate of 15.3066 and an assessment ratio of 18%

Applied Economics report uses (construction cost*85%+66%*assessed value of existing property since 33% is not part of this lease)*18%*15.3066 tax rate/100 to estimate property tax savings.