

SUBSTANTIVE POLICY STATEMENT
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THIS SUBSTANTIVE POLICY STATEMENT IS ADVISORY ONLY. A SUBSTANTIVE POLICY STATEMENT DOES NOT INCLUDE INTERNAL PROCEDURAL DOCUMENTS THAT ONLY AFFECT THE INTERNAL PROCEDURES OF THE AGENCY AND DOES NOT IMPOSE ADDITIONAL REQUIREMENTS OR PENALTIES ON REGULATED PARTIES OR INCLUDE CONFIDENTIAL INFORMATION OR RULES MADE IN ACCORDANCE WITH THE ARIZONA ADMINISTRATIVE PROCEDURE ACT. IF YOU BELIEVE THAT THIS SUBSTANTIVE POLICY STATEMENT DOES IMPOSE ADDITIONAL REQUIREMENTS OR PENALTIES ON REGULATED PARTIES YOU MAY PETITION THE AGENCY UNDER SECTION 41-1033, ARIZONA REVISED STATUTES, FOR A REVIEW OF THE STATEMENT.

Short Title: Statutory Shopping Center Appeals.

Appeals before the State Board of Equalization ("SBOE") for statutory shopping centers are reviewed as required by A.R.S. § 42-13205. Following is the SBOE policy for appeals of statutory shopping centers.

1. Verify that the property appealed qualifies as a statutory shopping center. A.R.S. § 42-13201 (defining a shopping center).
2. Accept and review market-value evidence to compare against the results of the statutory valuation methodologies. A.R.S. § 42-13205 (determining full cash value by whichever statutory valuation method "most closely approximates fair market value").
3. Review the cost approach valuation evidence submitted by the petitioner and the assessor for compliance with the statutory method. A.R.S. § 42-13203.
4. Review the income approach valuation evidence submitted by the petitioner and the assessor for compliance with the statutory method. A.R.S. § 42-13203. This review will consider the development of the building capitalization rate and the development of the land capitalization rate.
5. Accept and apply evidence provided by either party to supplement the original income information submitted by the petitioner to the assessor, so long as such evidence is credible and appropriate for the valuation of the fee simple interest in the subject property by the statutory income method. A.R.S. § 42-13205(1).
6. Accept and apply evidence of a sale of the subject property that occurred within two years prior to the date of value so long as there has been "no material change to the

property, its lease terms, tenants or occupancy rates." A.R.S. § 42-13205(3). Accept and apply evidence of sales of other properties that occurred within two years prior to the date of value, providing that they are "comparable to the subject property by clear and convincing evidence." *Id.*

7. Determine the value of the subject property using the statutory valuation methodology that "most closely approximates . . . market value." A.R.S. § 42-13205.

While the valuation decision by the SBOE must be supported by a preponderance of the evidence, the SBOE's use of evidence submitted by either party regarding sales of similar shopping centers must be supported by clear and convincing evidence.

A summary of the reasoning and analysis used by the SBOE to create this policy is contained in the memorandum to board members dated July 30, 2024.

MEMORANDUM

To: All Board Members
CC: All Hearing Officers and Staff
From: George R. Shook, Interim Chair
Date: July 30, 2024
RE: Statutory Shopping Center Appeals.

BACKGROUND

Unlike appeals of other types of property subject to statutory valuation methods, the valuation methods that the State Board of Equalization may use is expanded over the methodology the assessor is required to use in the initial valuation. Statutory procedures provided to the SBOE for use with statutory shopping center appeals are reviewed below.

DISCUSSION

The primary objective in interpreting a statute is to determine the legislative intent. *Mail Boxes, Etc., U.S.A. v. Indus. Comm'n of Arizona*, 181 Ariz. 119, 121, 888 P.2d 777, 779 (1995). The plain language of the statute is the best indicator of legislative intent. *Id.* When the language opens the statute to more than one plausible meaning, the statute must be interpreted based upon its "context, subject matter, and historical background." *Hayes v. Cont'l Ins. Co.*, 178 Ariz. 264, 268, 872 P.2d 668, 672 (1994). In order to assist in the understanding of the statutes regarding shopping centers, the legislative history of the statutes is reviewed next. The SBOE's use of this information in its analysis of the shopping-center statutes follows the legislative history.

A. History of the Statutory Shopping Center Statute.

Full cash value is equivalent to market value, unless there is a statutory valuation methodology. A.R.S. § 42-11001(6) (defining "full cash value"). For certain retail properties, the legislature enacted a statutory method for the valuation and review of shopping centers. Title 42, Chapter 13, Article 5 of the Arizona Revised Statutes. The statutory valuation method to be used by the assessor is the "replacement cost less depreciation method," also known as the cost approach to value. A.R.S. § 42-13203(A). Subsections B and C of this statute modifies the standard cost approach by specifying sources of cost data and depreciation schedules the assessor is required to use. The taxpayer is permitted to elect a straight-line building residual method of valuation for a statutory shopping center either on review or for the initial valuation by the assessor. A.R.S. §§ 42-13203(D) and -13204. For the purpose of reviewing the noticed value in an appeal, the legislature created procedures to be used by the reviewing body. A.R.S. § 42-13205. A review of the history of these statutes, along with the legislative findings, will

help to understand how they are to be used in an administrative appeal of a statutory shopping center valuation before the SBOE.

The legislature first passed the statute providing the procedure for county assessors to value a statutory shopping center in 1982. A.R.S. § 42-125 (1982); *See* 1982 Ariz. Session Laws, ch. 232, § 2. In its finding, the legislature determined that two problems existed: (1) there were too few sales of shopping centers and (2) that prescribing uniform factors for the cost and income methods would provide stability and equality in shopping center valuations. 1982 Ariz. Session Laws, ch. 232, § 1. This statute included a subsection permitting the taxpayer to elect to have the property valued by the income-approach method known as the Straight Line Building Residual (the "SLBR") method either initially or on appeal. A.R.S. § 42-125(B), (C) (1982).

This new statute also provided a process for reviewing the value of the property in an administrative appeal or before the tax court.

Upon appeal of a valuation determined by the income method or an appeal where the taxpayer has elected the income method pursuant to subsection B, if after computing the value by the income method the reviewing body finds that other valuation factors must be applied to determine the value of the property it may utilize such other factors as it finds necessary; provided that it shall specify in its written order what other factors were considered, the manner in which they were applied, and the change in the final value, if any, resulting from the use of such other factors. A.R.S. § 42-125(D) (1982); *See* 1982 Ariz. Session Laws, ch. 232, § 2.

On April 4, 1995, the Arizona Supreme Court decided that while the shopping-center statute provided a procedure for determining full cash value, the intent of the legislature was that this value be equivalent to market value. *Business Realty of Arizona v. Maricopa County*, 181 Ariz. 551, 561, 892 P.2d 1340, 1350 (1995) (reviewing the legislative finding as well as the statutory language to clarify the legislative intent). In *Business Realty*, the assessor argued that upon appeal, the statute "gives the reviewing body the power to use any and all relevant information" to determine value and the taxpayer argued that the reviewing body must use the cost approach or, at the taxpayer's election, the SLBR method for the income approach. *Id.* at 555-56, 892 P.2d at 1344-45. At issue was the assessor's use of market sales in the valuation. The court determined that the phrase "other valuation factors" could include market sales and that the legislature did not intend for the valuation of shopping centers to be other than market value, as is the case for other commercially-classed properties. *Id.*

In 1996, the legislature amended the shopping center statute. In its finding, the legislature stated that the conditions it identified in 1982 continued and that the "limited use, on appeal only, of the market comparison method of valuation[,] would "prevent unstable and unfair taxation of shopping centers." 1996 Ariz. Session Laws, ch. 366, § 1. The changes in the statute that affect the SBOE were made regarding the taxpayer's election for use of the SLBR method of the income capitalization approach for appeals

and the use of the sales-comparison approach. The amendment required that, if the taxpayer elects the income approach, "the valuation of a shopping center shall be determined" by the SLBR method so long as the taxpayer provides "reasonably necessary income and expense information for the . . . three most recent fiscal years." A.R.S. § 42-147(D) (1996). For appeals, the new language provided three methods of valuation, including the use of market sales; however, restricting the types of sales that may be used and requiring a higher level of proof of comparability. A.R.S. § 42-147(E) (1996) (requiring that any market sales used to value the property in an appeal must be proven to be comparable by clear and convincing evidence). (Note: the legislature renumbered the shopping center statute in 1985 from Section 125 to Section 147 and no other changes were made until 1996.)

The result of these changes to the section creating the review procedures in an appeal is shown below.

E. Upon appeal of a valuation determined by the income method or an appeal where the taxpayer has elected the income method pursuant to subsection C of this section, the valuation of a shopping center shall be determined by whichever one of the following valuation methods most closely approximates fair market value:

- 1. The income method commonly known as the straight line building residual method pursuant to subsection C of this section. If the reviewing body finds that other information that is customarily analyzed under the income method must be used to properly apply the income method to the property, it may utilize such other information to supplement information provided by the taxpayer, provided that:
 - (a) The credible and accurate information provided by the taxpayer remains the primary basis for the valuation under the income method.*
 - (b) The information is credible, is derived from properties or circumstances that are substantially comparable to the property and is valid under the income method.*
 - (c) The reviewing body shall specify in its written order what other information was considered, the manner in which it was applied, and the change in the valuation under the income method, if any, resulting from the use of such other information.**
- 2. The replacement cost less depreciation method pursuant to subsection B of this section.*
- 3. The market comparison method, if a comparable sale of the subject property occurred within two years before the date of valuation and no material change to the property, its lease terms, tenants, occupancy rates or other material fact has occurred since the sale. If the market comparison method is applicable, the reviewing body may consider information on sales of other properties that occurred within two years before the date of valuation and that are determined to be comparable to the subject property by clear and convincing evidence. A.R.S. § 42-147(E) (1996); See 1996 Ariz. 7th Special Session, Laws ch. 4, § 6.*

While the legislative objective in the valuation is still "fair market value," some additional restrictions were made on the valuation methods and market data that the reviewing body is permitted to use. For instance, the legislature permitted the reviewing body to use "other valuation factors" to determine the full cash value in the original version. A.R.S. § 42-125(D) (1982). In the 1996 version, the factors to be used are specifically described. A.R.S. § 42-147(E) (1996). This appears to be a response by the legislature to the *Business Realty* decision.

In 1997, the legislature split the shopping center statute into separate statutes and made some technical corrections to the language of the statute. *See* 1997 Ariz. Session Laws, ch. 150, § 172. The most recent change was made by the legislature in 2000. In the statute regarding the procedure for reviewing the valuation in an appeal, the legislature made a technical correction by removing the unnecessary word "comparable" from the market-comparison method. *See* 2000 Ariz. Session Laws, ch. 390, § 11; A.R.S. § 42-13205(D)(3). No other changes were made to the shopping center statutes.

In summary, the legislature first promulgated the statutory valuation methods for shopping centers in 1982 to address a lack of shopping-center, market-value sales and to provide more consistency in shopping-center valuations. This consistency was provided by establishing a baseline for cost and depreciation data developed by county assessors and by establishing the procedure for determining the building capitalization rate under the SLBR method for the income approach. The statutes give the taxpayer the option to elect the income approach as the method for valuation by the assessor. Importantly, if the valuation made by the assessor is appealed, the statute provides additional options for the reviewing body to use to value the shopping center with the ultimate aim to employ the method that "most closely approximates fair market value[.]" A.R.S. § 42-13205 (providing the methods to be employed to review statutory shopping center valuations in appeals to boards of equalization or tax court).

B. SBOE policies for the appeal of the valuation of statutory shopping centers.

Following are SBOE policies regarding the statutory procedures for use by the Board for review of statutory shopping center valuations. These policies incorporate the SBOE's interpretation of relevant statutes, relevant case law, applicable standards used in the appraisal industry, and relevant and manuals published by the Arizona Department of Revenue. A.R.S. § 42-11054(A)(1) (directing the department to develop guidelines for assessors to use in determining the full cash values for locally-assessed properties).

1. Verify that the property appealed qualifies as a statutory shopping center.
A.R.S. § 42-13201 (defining a shopping center).

The term "shopping center" is defined by statute as follows:

In this article, unless the context otherwise requires, "shopping center" means an area that is comprised of three or more commercial

establishments, the purpose of which is primarily retail sales, that has a combined gross leasable area of at least twenty-seven thousand square feet, that is owned or managed as a unit with at least one of the establishments having a gross leasable area of at least ten thousand square feet and that is either owner-occupied or subject to a lease that has a term of at least fifteen years. A.R.S. § 42-13201.

There are several tests within this statute to determine if the appealed property qualifies as a statutory shopping center. These tests will be discussed as follows:

- (a) three or more commercial establishments owned or managed as a unit;
- (b) primarily used for retail sales;
- (c) totaling at least 27,000 square feet of gross leasable area;
- (d) at least one of the establishments having a gross leasable area of at least 10,000 square feet and that is either owner occupied or subject to a lease of at least 15 years.

a. three or more commercial establishments owned or managed as a unit.

In order to satisfy first part of this test, the property must include at least three "commercial establishments." *Id.* The term "commercial establishment" means "[a] place where commodities are exchanged, bought or sold." *Black's Law Dictionary* 270 (6th ed. 1998). Instructions issued by the Department of Revenue to assessor personnel include "Commercial Establishment . . . refers to a commercial enterprise for profit in an identifiable location with some degree of permanency." Ariz. Dep't. of Revenue, *Shopping Center Manual* p. 8 (2002). While this directive provides general guidance on determining whether a property contains at least three commercial establishments, it falls short in the case of a charitable or religious organization that engages in commerce at the subject property. An establishment that is operated by a charity is not automatically excluded as a commercial establishment. Such an establishment that engages in a business that serves "the general public in competition with ordinary commercial enterprises" would qualify as a commercial establishment. *Tony and Susan Alamo Foundation v. Secretary of Labor*, 471 U.S. 290, 299 (1985). Even if the organization operating the establishment is a non-profit organization operating for a charitable or religious purpose, the activity within the space, as proven by objective facts, may be determined to be a commercial business if it engages in a business activity. *Id.* It is SBOE policy to determine whether or not a use is a commercial establishment based upon evidence of the business activity occurring within the establishment and not the income-tax status of the operator.

Additionally, this test sets the minimum requirement for establishments included in a shopping center for property tax purposes given that the statute requires "three or more commercial establishments." A.R.S. § 42-13201. The use of the word "unit" in the statute is significant in that the relevant definition

is "a single thing of any kind." *Black's Law Dictionary* 1533 (6th ed. 1998). From this, the shopping center definition is meant to include the entire shopping center and not a fraction of it. *Scottsdale 101 Assocs. LLC v. Maricopa Cnty.*, TX 2008-000518 (Ariz. Tax 2013) (interpreting the definition of "shopping center" to be "single, indivisible entity for the purposes of taxation"); *see also* *Nordstrom, Inc. v. Maricopa County*, 207 Ariz. 553, ¶¶ 11-15, 88 P.3d 1165, 1169 (App. 2004) (finding that the parcel or parcels appealed must, by themselves, qualify as the shopping center). Thus, the appeal must include all parcels that are "owned or managed as a unit" and comprise the shopping center.

b. primarily used for retail sales.

The term "primarily" indicates that more than half of the shopping center must be used for retail sales. Ariz. Dep't. of Revenue, *Shopping Center Manual* p. 7 (2002). While the term "retail sales" is not specifically defined in the statutes relating to shopping-center valuation, it is defined for tax purposes as the sale of tangible personal property by a business that is not intended for resale. A.R.S. § 42-5061(A) (establishing the type of business activity subject to the transaction privilege tax).

c. totaling at least 27,000 square feet of gross leasable area ("GLA").

The property under appeal must contain at least 27,000 square feet of GLA. Gross leasable area is defined as "[t]he total floor area designed for the occupancy and exclusive use of tenants, including basements and mezzanines" Appraisal Institute, *The Dictionary of Real Estate Appraisal* 164 (3rd ed. 1993).

d. at least one of the establishments having a gross leasable area of at least 10,000 square feet and that is either owner occupied or subject to a lease of at least 15 years.

This final test sets the qualifications for a large establishment that is often referred to as an anchor. Generally, A.R.S. § 42-13201 provides a list of qualifications that, given the language of the statute, the first qualifications modify subsequent ones. *Phoenix Control Systems, Inc. v. Ins. Co. of North America*, 165 Ariz. 31, 34, 796 P.2d 463, 466 (1990) (using the "last antecedent" rule to interpret a contract). Because the qualifying establishments must be commercial, the establishment that would qualify as the anchor establishment must also be commercial. The anchor tenant must be a commercial establishment primarily engaged in retail sales.

A further requirement for the anchor establishment is that it is either "owner occupied or subject to a lease of at least 15 years." A.R.S. § 42-13201. It is the policy of the SBOE that a space subject to a lease of 15 or more years requires that the original lease term be at least 15 years. A tenant whose lease

was extended by mutual agreement or through the exercise of an option may still qualify so long as the original lease term was at least 15 years. This is the factor the legislature determined to test the permanency for the qualifying anchor tenant. Ariz. Dep't. of Revenue, *Shopping Center Manual* pp. 7 - 8 (2002).

It is SBOE policy that a property under appeal that satisfies each of these statutory requirements and constitutes the entire shopping center must be valued as required under Title 42, Chapter 13, Article 5 of the Arizona Revised Statutes as a statutory shopping center.

2. Accept and review market evidence to compare against the results of the statutory valuation methodologies.

The administrative or judicial review of a statutory shopping center valuation must be made using specific valuation methods. A.R.S. § 42-13205. The statutory objective for the review is that the method that "most closely approximates fair market value" shall be used to determine the full cash value. *Id.* The use of the word "shall" in the first sentence of the statute makes it mandatory for the SBOE to determine the market value of the property in order to determine which statutory method results in a value that is closest to market value. *HCZ Construction, Inc. v. First Franklin Financial Corp.*, 199 Ariz. 361, 364, n. 1, ¶ 9, 18 P.3d 155, 158 (App. 2001); *Arizona Downs v. Arizona Horsemen's Foundation*, 130 Ariz. 550, 554-55, 637 P.2d 1053, 1057-58 (1981).

Evidence of market value using standard appraisal methods and techniques must be supplied by the parties in order for the SBOE to follow the mandate in the first sentence of A.R.S. § 42-13205. *See* A.R.S. § 42-16161(E) (restricting the SBOE review to the consideration of evidence provided at the hearing only). It is SBOE policy that if a noticed value for a statutory shopping center is appealed and insufficient evidence of market value is provided by the parties, the SBOE may not adjust the full cash value using the statutory valuation methods provided in A.R.S. § 42-13205. The SBOE will accept relevant evidence indicating market value from either party.

3. Review the cost approach valuation evidence submitted by the petitioner and the assessor for compliance with the statutory method.

The full cash value for a statutory shopping center using the cost method must comply with the standard appraisal techniques for a cost approach to value, except that depreciation, "including any adjustment for obsolescence, shall be the schedule in existence on January 1, 1982 and used by the county assessor." A.R.S. § 42-13203(C). The schedule of depreciation and obsolescence to be used is the one created by the Arizona Department of Revenue. A.R.S. § 42-13203(E). The statute also requires that the cost data reflect the "base rates in

existence on January 1, 1982" that were adjusted to reflect changes in the cost of construction that occurred since. This appears to require cost data that are adjusted to reflect local costs as of the date of valuation. A.R.S. § 42-13203(B). An important step in the review of the full cash value determined by the statutory cost approach is that it must not exceed market value. A.R.S. § 42-11001(6) ("Full cash value shall not be greater than market value regardless of the method prescribed to determine value for property tax purposes"). Because the method for determining land value is not established in the procedure for the cost method, the SBOE will accept relevant evidence for the market value of the land consistent with "standard appraisal methods and techniques." A.R.S. § 42-11001(6).

4. Review the income approach valuation evidence submitted by the petitioner and the assessor for compliance with the statutory method, including the development of both the building and land capitalization rates.

The statutory income approach for shopping centers is the straight-line building residual technique. A.R.S. § 42-13203(D). The purpose of residual techniques is to allow the appraiser to value separate components of the property by income capitalization. Appraisal Institute, *The Appraisal of Real Estate* 473 (10th ed. 1992). For the building residual technique, the appraiser will determine the net operating income for the property, create separate building and land capitalization rates, and estimate the market value of the land. *Id.* at 473-74. Using the estimated total net operating income, the appraiser will determine the amount attributable to the land by multiplying the land capitalization rate and the market land value. *Id.* The result will be the income attributable to the land. This income will be subtracted from the total net operating income to derive the net income attributable to the building. *Id.* The appraiser will then estimate the value of the building component of the property by dividing the income attributable to the building by the building capitalization rate. *Id.* The value of the entire property based upon the building residual technique is the building value plus the land value. *Id.* Because the method for determining land value is not established in the statutory procedure for the income method, the SBOE will accept relevant evidence for the market value of the land consistent with "standard appraisal methods and techniques." A.R.S. § 42-11001(6).

For SBOE hearings, the review of the income valuation evidence will focus on four steps. The final step of the review of this method is discussed separately in Section 5 below. The first three steps of review for the straight-line building residual method to estimate full cash value are summarized below and will be reviewed in more detail:

- (a) Review the estimate of the building capitalization rate for compliance with the statute. A.R.S. § 42-13203(D) (defining the recapture rate to use a 35-year economic life).

- (b) Review the estimate of the land capitalization rate for compliance with standard appraisal methods and techniques for the building residual method.
- (c) Verify the accuracy and completeness of the source for income and expense information used to estimate the net income.
 - a. review the estimate of the building capitalization rate for compliance with the statute.

The building capitalization rate is a built-up rate comprised of the combination of the discount rate, the recapture rate, and the effective tax rate. A.R.S. § 42-13203(D); *see* International Association of Assessing Officers, *Property Assessment Valuation* 388 (3rd ed. 2010). The recapture rate utilizes a 35-year economic life. A.R.S. § 42-13203(D)(2). This is computed by dividing the **effective age** of the building by 35. *Property Assessment Valuation* at 354-55. The SBOE will review evidence as to the economic age of the improvements as of the date of valuation to determine if the recapture-rate portion of the building capitalization rate was estimated correctly.

- b. review the estimate of the land capitalization rate for compliance with standard appraisal methods and techniques for the straight line building residual method.

The land capitalization rate is not defined in the statutes for valuation of shopping centers. Title 42, Chapter 13, Article 5 of the Arizona Revised Statutes. Therefore, the land capitalization rate must be estimated using standard appraisal techniques and methods. A.R.S. § 42-11001(6). The development of the land capitalization rate may be similar to that of the building capitalization rate, except no recapture rate is used since land does not depreciate. *Property Assessment Valuation* at 388. Thus, the land capitalization rate may be a built-up rate comprised of a discount rate plus the effective tax rate. *Id.* Because the method for determining the land capitalization rate is not established in the procedure for the income method, the SBOE will accept relevant market evidence for the development of a land capitalization rate for the subject property consistent with "standard appraisal methods and techniques." A.R.S. § 42-11001(6). It is SBOE policy to permit the use of land capitalization rates extracted from market sales or determined using the built-up method described above.

- c. verify the accuracy and completeness of the source for income and expense information used to derive estimated net income.

This verification will analyze the income and expense evidence supplied by the petitioner and the assessor derived from operations of the subject property. A clear understanding of how the subject property operates is

essential to the valuation of the property using an income approach. This will include discovering if income from all leased spaces is included, determining what space is not leased, and verifying that all sources of non-lease income are included. This analysis is essential for the final analysis required by law and discussed in Section 5 below.

5. Accept and apply evidence provided by either party to supplement the original income information submitted by the petitioner to the assessor, so long as such evidence is credible and appropriate for the valuation of the fee simple interest in the subject property by the statutory income method

The straight line building residual method of valuation may require additional market data as a supplement if data supplied by the taxpayer in the petition is insufficient to complete the analysis. A.R.S. § 42-13205(1). The supplementary data may be supplied by either party or both parties. This supplementary data must be credible as defined in the statute. *Id.* at (1)(b). Full cash value for property-tax purposes must include all interests in the property, including any leasehold value created by a below-market lease. *Caldwell v. Department of Revenue*, 122 Ariz. 519, 521, 596 P.2d 45, 47 (App. 1979) (concluding that the "combined value of both the lessor's and lessee's interests under a long-term lease is subject to taxation") ; *see also*, *Recreation Centers of Sun City, Inc. v. Maricopa County*, 162 Ariz. 281, 285-86, 782 P.2d 1174, 1178-79 (1989) (finding that the tax is against the property and not against value of only the owner's interest in the property).

The statutory scheme seems consistent for a valuation of the fee-simple estate. The cost approach consists of replacement costs new, less all accrued depreciation, plus land value which results "in an indication of the value of the fee simple interest in the property." Appraisal Institute, *The Appraisal of Real Estate* 313 (10th ed. 1992); A.R.S. § 42-13203 (A) – (C). The use of the market comparison method is not permitted to be used in the initial valuation of the property. Title 42, Chapter 13, Article 5, Arizona Revised Statutes. When the legislature modified the statute in 1996, it specifically stated that its intent was to limit the use of market sales for valuation purposes to appeals only and with restrictions. 1996 Ariz. Session Laws, ch. 366, § 1. This was to protect against "unstable and unfair taxation of shopping centers" by the market comparison method. *Id.* It was intended to "minimize the inherent problems of applying the method to shopping centers." *Id.* A concern is that sale prices of shopping centers will be affected by long-term leases at below-market rates. This is reasonable since the purchaser is buying the shopping center subject to its existing leases. While the legislature did not specifically outline its concerns, it is reasonable to conclude that the legislature was concerned by the effect of above- and below-market leases on the sale prices of shopping centers. It seems as if the legislature wanted to create a means of estimating a fee-simple value without the interference of market sales encumbered with long-term leases.

For the statutory income approach, it seems reasonable that the legislature intended market rents to be used to adjust contract rents for the subject property that were either above or below market levels. While not expressly stated, the definition of "shopping center" includes an owner-occupied or long-term leased anchor space. A.R.S. § 42-13201. It would not be reasonable to solely rely upon actual rents for a space that is owner-occupied and generates no rents. Given the concerns of the legislature to protect against "unstable and unfair taxation of shopping centers," the adjustment of actual income information for the subject property with market rents seems reasonable and consistent with relevant statutes. 1996 Ariz. Session Laws, ch. 366, § 1 (legislative finding); *Kent K. v. Bobby M.*, 210 Ariz. 279, ¶ 14, 110 P.3d 1013, 1017 (2005) (stating, ". . . we determine legislative intent by looking first to the text and context of the statute and then considering its historical background, effects and consequences, and its spirit and purpose"). Thus, the rents shown for each space must be analyzed to determine if they are at market, below market, or above market rents.

The income information supplied by the owner must be reviewed as the primary basis of the valuation by the income approach. A.R.S. § 42-13205(1)(a) (stating that "[t]he credible and accurate information provided by the owner remains the primary basis for the valuation under the income method"). This subsection of the statute must be read using the plain meaning of the words used by the legislature and in context with related statutes. *Baker v. Univ. Physicians Healthcare*, 231 Ariz. 379, 384, ¶ 15, 296 P.3d 42 47 (2013) (using a dictionary to determine the intended meaning of undefined terms in a statute); *State ex rel. Larson v. Farley*, 106 Ariz. 119, 122, 471 P.2d 731, 734 (1970) (stating that statutes "should be read in connection with, or should be construed with other related statutes, as though they constituted one law"). The word "primary" used in the statute above is an adjective that means "first" and, logically, could not be interpreted to mean sole or only. *Black's Law Dictionary* 1190 (6th ed. 1998). The word "basis" means "the foundation or groundwork of anything." *Id.* at 151. As the foundation of the analysis, the income information provides objective evidence of the operation of the subject property in clear relief. This is essential to produce an income approach that reflects the value of the fee simple interest in the property in its current use. A.R.S. § 42-11001(4) (defining "current usage"). This is consistent with the procedure for income valuation that states, "[t]he reviewing body shall use the information submitted by the owner and may also use any other information customarily analyzed under this method". A.R.S. § 42-13203(D). Further, there is a presumption that the statute is constitutional and if there are ambiguities, they *must be resolved in keeping with constitutional mandates*. *State v. Gilfillan*, 196 Ariz. 396, 405, 998 P.2d 1069, 1074 (2000); *State v. Thompson*, 204 Ariz. 471, 478, ¶ 27, 65 P.3d 420, 427 (2003) (stating courts have a duty to construe statutes in a way that "not only gives effect to the legislature's intent, . . . but also in a way that maintains

its constitutionality"). It is important to test the interpretation of A.R.S. § 42-13205(1)(a) against the requirement that ". . . all taxes shall be uniform upon the same class of property[.]" Ariz. Const. art. 9, § 1. Valuing the fee-simple interest in shopping centers that do not meet the statutory criteria and not valuing the fee-simple interest for statutory shopping centers offends the uniformity clause of the constitution as well as the legislative findings that the statutory procedures for shopping center valuation is intended to promote "stability and equality" in their valuation. *Id.*; 1982 Ariz. Session Laws, ch. 232, § 1. It is SBOE policy that the net income used in the statutory shopping center income approach will be adjusted to reflect the market in order to value the fee-simple interest in the subject property as is consistent with other properties in this class.

Contract rents that are below market levels require adjustment to market rent. Contract rents that are above market must be adjusted downward to market levels. *See* A.R.S. § 42-11001(6). Contract rents that are at market levels require no adjustment. The same type of analysis may be required when credible market data is supplied for operating expenses. A review of the operating expenses is necessary to insure that they do not include amounts used for other properties that are not under review, include capital expenditures not normally included in net income for valuation purposes, or the property tax expense. However, "[t]he credible and accurate information provided by the owner remains the primary basis for the valuation under the income method." A.R.S. § 42-13205(1)(a).

It is SBOE policy to review the straight-line building residual valuation to insure that it is complete, accurate, and fairly indicates the market value of the fee-simple estate in the subject property.

6. Accept and apply evidence of a sale of the subject property or evidence of sales of other properties, so long as such evidence meets the statutory requirements.

Statutory restrictions on the sales comparison approach to value require that if evidence of a sale of the subject property is provided by either party, the evidence may only be applied as a value indicator if the sale occurred within two years before the valuation date and that there were no material changes to the physical property or operation of the property. A.R.S. § 42-13205(3). Additionally, evidence of sales of other properties must have occurred within two years before the valuation date and must be comparable to the subject property. *Id.* The standard of proof for the use of market-sales evidence in this method is "clear and convincing." *Id.* Clear and convincing evidence is sufficient to prove that it is highly probable that the sales are comparable. *Colorado v. New Mexico*, 467 U.S. 310, 316 (1984) (holding in a civil case regarding water rights). This is a very difficult standard to meet given the complexities of an operating shopping center. For this reason, while the

SBOE may apply market sales of other shopping centers as indicators of market value as described in Section 2 above, these market sales may not meet the standard of proof necessary to be used as a statutory valuation method.

7. Determine the value of the subject property using the statutory valuation methodology that "most closely approximates . . . market value."

There may be up to three indications of value under the statutory procedures for a shopping center appeal. A.R.S. § 42-13205. The reviewing body must use evidence of market value to determine which of these "valuation methods most closely approximates fair market value." *Id.* If the evidence provided by the parties is insufficient to either determine market value using standard appraisal methods and techniques or to determine full cash value using at least one of the statutory methods of value, the SBOE is unable to change the noticed full cash value. A.R.S. § 42-16162 (requiring reductions in full cash value to be based on competent evidence presented at the hearing). In such a case, it is SBOE policy that a value reduction will not be made if there is insufficient evidence to fully complete at least one of the statutory valuation methods or to determine market value using a standard appraisal method or technique in order to make the statutorily-required, market-value comparison.