Shopping Centers

Effective January 1, 2002

Arizona Revised Statutes (A.R.S.) 42-13201 through 42-13206 direct the valuation of shopping centers:

"42-13201. Definition of shopping center

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."

"42-13202. Exclusive method and procedure for valuing shopping centers; confidentiality

A. A shopping center that is subject to valuation for purposes of property tax shall be valued pursuant to this article. This article establishes the exclusive valuation methods and procedure for determining the valuation of a shopping center.
B. All information that a taxpayer submits pursuant to this article is confidential pursuant to chapter 2, article 1 of this title."

"42-13203. Replacement cost less depreciation method of valuing shopping centers; election to use income method on appeal

A. Except as provided by section 42-13204, the county assessor shall determine the valuation of a shopping center by using the replacement cost less depreciation method.
B. This method shall use base rates in existence on January 1, 1982 subject to any changes that are necessary to reflect changes in costs of construction. The base rates shall be based on average costs that relate to this state as reported in professional cost manuals and publications that are approved by the department.

C. The depreciation schedule used under the replacement cost less depreciation method, including any adjustment for obsolescence, shall be the schedule in existence on January 1, 1982 and used by the county assessor.

D. On review or appeal of a valuation determined under this section, the owner of a shopping center may elect to have the valuation of the shopping center determined by the income method commonly known as the straight line building residual method if the owner submits all reasonably necessary income and expense information. The reviewing body shall use the information submitted by the owner and may also use any other information customarily analyzed under this method. The capitalization rate used for purposes of this subsection shall be comprised of:

1. For the 1983 tax year a discount rate of 10.5 per cent, adjusted each year thereafter according to the percentage change in the weighted average cost of monies derived from interest paid on savings accounts, federal home loan bank advances and other borrowed money as reported by the federal home loan bank of San Francisco for this state for the most recent twelve month period ending June 30. The discount rate shall not be less than ten per cent.
2. A recapture rate based on a thirty-five year economic life.
3. The effective tax rate for the property for the most recent tax year.

E. The department shall:

1. Determine the average differences in valuations for similar size and age shopping centers that result from the two valuation methods prescribed by this section and section 42-13204 and from which the department shall develop a schedule of obsolescence factors that can be added to the depreciation schedule used in the replacement cost less depreciation method. County assessors shall incorporate the obsolescence factors into the depreciation schedule.
2. Develop obsolescence factors prescribed by paragraph 1 of this subsection based on statistical research in order to, on average, equalize the valuations

that result from the two valuation methods prescribed in this section and section 42-13204. The department may use data from state sources, nationally recognized publications and journals and other related research."

"42-13204. Election to use income method of valuation initially

In lieu of valuation under section 42-13203, the owner of a shopping center may elect to have the valuation of the shopping center determined by the income method commonly known as the straight line building residual method if the owner submits all reasonably necessary income and expense information for the owner's three most recent fiscal years to the county assessor before September 1 of the year immediately preceding the year for which the property will be valued."

"42-13205. Valuation method applied on appeal

On appeal of a valuation determined by the income method pursuant to section 42-13204 or an appeal in which the owner has elected the income method pursuant to section 42-13203, subsection D, 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 section 42-13203, subsection D. 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 use the other information to supplement information provided by the owner if:
   (a) The credible and accurate information provided by the owner remains the primary basis for the valuation under the income method.
   (b) The supplementary 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 specifies 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 the supplementary information.

2. The replacement cost less depreciation method pursuant to section 42-13203.
3. The market comparison method, if a 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 or occupancy rates or any 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."

"42-13206. Valuation of dedicated parking or common areas

For the purposes of this article any part of the land of a shopping center that is limited by a zoning requirement or contractual covenant to parking or common area use shall be valued on the assumption that no other use is possible."

Background

Since the inception of shopping centers as a new form of marketing, they have undergone constant change. The shopping center emerged as a group of rental and service establishments built around a supermarket which were designed to serve a relatively small trade area. Today they range from that small beginning, to centers with three or more major full-line department stores as the core, around which there may be more than one hundred various retail, service, banking and office establishments.

With the rapid growth in number of all types of shopping centers (neighborhood, community, regional, super regional, and power centers) and with varying age groups, shopping centers can become dated and lose clientele unless they continually renovate. Changing market conditions affect shopping center values and should be monitored.

A special obsolescence schedule was created by statute for those structures that qualify as a shopping center. Pursuant to A.R.S. 42-13203(E), the Department is given the responsibility of calculating shopping center obsolescence factors. The currently effective “Shopping Center Economic Obsolescence and Depreciation Tables Using the Construction Cost System” is shown at the end of this subsection as Appendix A.

Definitions

Shopping Centers. A shopping center complex must meet specific standards to qualify for shopping center designation and valuation under the provisions of A.R.S. 42-13201. Qualifying standards are concerned with ownership, management, structure size, lease terms, and current and predominant use, as discussed below. Those properties that do not qualify as shopping centers under the statute will be valued by the same procedures and using the same standard methods and techniques (i.e., the three recognized approaches to value) that are used for other general commercial use properties.

Neighborhood Shopping Center. In a neighborhood shopping center the primary tenant is generally a supermarket, drug or variety store. If the shopping complex meets the minimum structure size and management requirements and there are three or more stores in the center including service establishments and retail sales outlets, the complex constitutes a shopping center.

Community Shopping Center. In a community shopping center the primary tenant is typically a junior department store, a discount department store, or a variety store, in addition to a supermarket. A community shopping center will normally include between ten and forty retail stores or service establishments.

Regional Shopping Center. In a regional shopping center the primary tenant(s) will be one or two full line department stores ranging between 50,000–100,000 square feet. Its typical size may range between 250,000 to more than 900,000 square feet. Emphasis is on apparel stores, although there may be banks, theaters, service establishments, medical, dental and business offices. NOTE: The distinguishing factor between a community and regional shopping center is the primary (anchor) tenant.

Super Regional Shopping Center. Essentially the same as a regional center, except that there will be three or more major full line department stores. Typical size of a super regional shopping center is about 1,000,000 square feet of gross leasable area. The size may range from 500,000 to more than 1,500,000 square feet.

Power Retail Center or Super Community Center. With the exception of mall conversions, a power center/super community center generally has an open-air configuration containing 250,000 or more square feet of gross leasable area. This area is anchored by at least three or more tenants that occupy 60 to 90 percent of the space; the number of specialty stores is typically kept to a minimum.

Qualifying Characteristics

Ownership. A qualifying shopping center may be individually owned and operated as a unit, or it may be owned by several owners but must still be managed and operated as a unit. To qualify under the ownership provisions of the statute and this guideline, one of the following conditions must be met:

A. The land and buildings are formed as a unit, and title is recorded under a single ownership. The property under a single ownership may qualify for the shopping center designation as long as it meets the criteria defining a shopping center in A.R.S. 42-13201.
B. The land and buildings are owned by two or more owners. The individual ownership interests and the total physical complex may be considered as one unit for shopping center designation. The aggregate holdings of several separate owners may qualify for shopping center designation as long as these are

managed and operated as a unit; two or more separate owners bound together by the qualifying management agreement(s).

Whether the shopping center is individually owned, or is jointly owned by several owners, as long as it is operated as a unit, and meets the qualifications for current and predominant use, structure size, and has common property management, it qualifies for shopping center designation.

Management. Management must be evidenced by contractual agreement(s) to qualify under the unit management concept. The contractual agreement(s) should address some, if not all, of the following: common advertising, operating hours, building maintenance, parking lot maintenance, common insurance, and central facilities management. Unit management need not address every item listed above, but it must extend beyond the common use of parking facilities and common parking lot sweeping contracts. The agreement must support the management of the entire property as an individual economic unit.

Size – Leased Area and Lease Terms. A qualifying shopping center must include a gross leasable area under roof of at least 27,000 square feet, and be comprised of three or more commercial establishments. The leasable area must be devoted primarily to retail sales. At least one tenant or establishment must occupy 10,000 or more square feet of the 27,000 or more total square feet. The 10,000 or more square feet may be owner occupied, or may be leased to a tenant for a term of not less than 15 years.

Use. To qualify for shopping center designation, the predominant use (over 50 percent) of the total gross leasable area must be retail sales.

Gross Leasable Area (GLA). The gross leasable area is the total floor area designed for tenants' occupancy and exclusive use, including any basements, mezzanines, or upper floors, expressed in square feet and measured from the centerline of joint partitions and from outside wall faces.

Net Leasable Area (NLA). The net leasable area is the area that includes only the floor area occupied by the tenant.

Ingress and Egress. The majority of parcels and improvements located within the perimeter of the qualifying shopping center property will be valued as part of the shopping center. The exceptions are those improvements and associated land which are isolated from the balance of the shopping center area by walls, fences, plants, planters, curbing or other physical restrictions to restrict use of parking facilities to the improvements. These improvements will be valued using nonstatutory valuation methods.

Pad or Satellite Commercial Establishments. A “pad” or “satellite” commercial establishment shall be included as part of the shopping center if any of the following criteria are met:

A. Ownership of the land is the same as that of the center, is within reasonable proximity to and logically located with respect to the rest of the center.
B. Ownership of the improvements is the same as that of the center (entire center possessory rights) and the commercial establishment is within reasonable proximity to and logically located with respect to the rest of the center.
C. Management of the commercial establishment is contractually aligned with that of the center as evidenced by written agreement(s) concerning:
    1. Joint (contributory) maintenance of common areas; for example, parking lot and mall.
    2. Joint (contributory) promotional activities; for example, advertising.
    3. Participation as member of merchants association if one exists.

Commercial Establishment. This refers to a commercial enterprise for profit in an identifiable location with some degree of permanency.

Approaches to Value

Cost Approach. Properties meeting the preceding qualifications will be valued in accordance with the provisions of A.R.S. 42-13203 (A), (B), (C) and (E), and Appendix A, "Shopping Center Economic Obsolescence and Depreciation Tables Using the Construction Cost System" of this subsection.

Qualifying shopping centers will be valued using the cost approach to value through application of the Arizona Department of Revenue Construction Cost Manual. Applying the appropriate shopping center property use code results in the use of the Shopping Center Economic Obsolescence and Depreciation Table in Appendix A. The DOR Construction Cost System utilizes the factors in the "System Depreciation" column of the table. Due to the statutory valuation methods used in the valuation of qualifying shopping centers, and unlike other commercial properties valued under a market standard, market adjustment factors are not applied when calculating replacement cost values of shopping centers. Those counties providing their own data processing service will use the guidelines appropriate for entry of depreciation/obsolescence in their system.

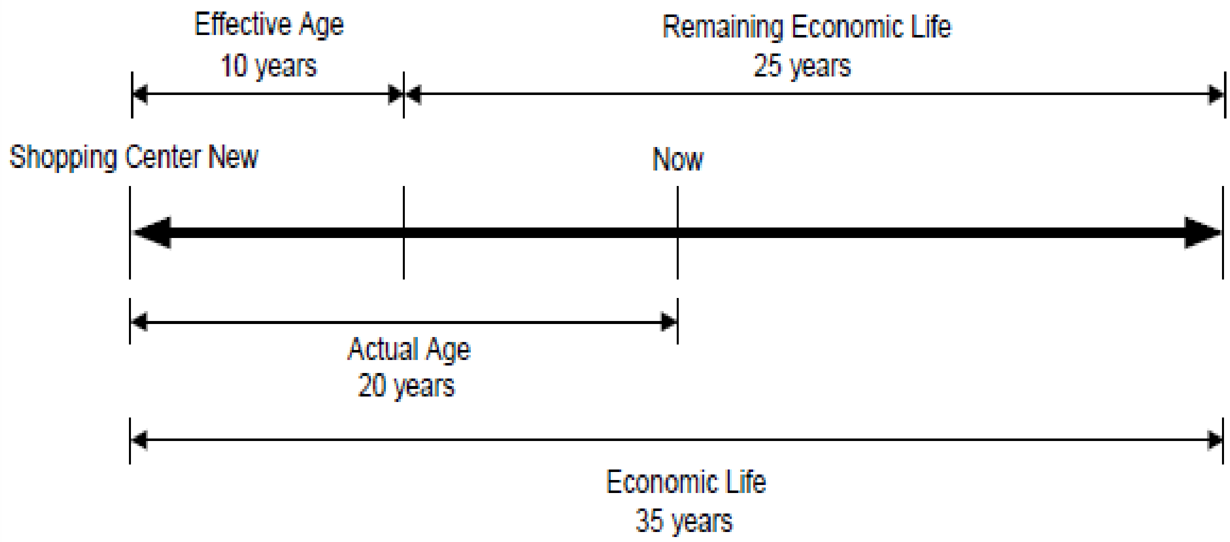
The Income Approach. A.R.S. 42-13204 (Appendix B) establishes that upon election by the owner, a shopping center property may be valued using the straight line building residual method of income property valuation. If the taxpayer so elects, all reasonably necessary income and expense information must be submitted to the County Assessor prior to September 1 of the year immediately preceding the year for which the property will be valued.

Additionally, A.R.S. 42-13203(D), establishes that **"On review or appeal of a valuation..., the owner of a shopping center may elect to have the valuation of the shopping center determined by the income method commonly known as the straight line building residual method…."**

If the shopping center owner elects income capitalization, all necessary income and expense information must be submitted to the County Assessor with a "Petition for Review of Real Property Valuation" (DOR Form 82130). Petitions must be submitted within 60 days of the mailing date of the notice of valuation. 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, the reviewing body may utilize such other factors as it finds necessary. In such cases, however, the reviewing body must specify in its written order the other factors which were considered, the manner in which they were applied and any change in the final value resulting from their use.

The discount rate to be used in the capitalization of shopping center income data will be issued by the Department on an annual basis. A.R.S. 42-13203(D)(1) states, **"...The discount rate shall not be less than ten percent."** The annual calculation is shown in Appendix B.

A.R.S. 42-13203(D)(2) mandates that the recapture rate to be used for shopping centers will be based on a thirty-five year economic life. For example: a qualified shopping center constructed twenty years ago, but with an effective age of 10 years due to rehabilitation and modernization has a remaining economic life of twenty-five years. As shown by the following diagram, the remaining economic life may be estimated by subtracting the effective age from the thirty-five year economic life. The recapture rate is derived by dividing one (1) by the remaining economic life.



Careful consideration must be given in determining the remaining economic life using the thirty-five year economic life and effective age. It may be helpful to review the remaining terms on the leases to see what remaining economic life is indicated by those documents.

The effective tax rate will be that rate for the property for the most recent tax year, and can be calculated using the procedure outlined previously in Chapter 1 "Approaches to Values," in Part 2 of this manual.

All income attributed to the real estate including overage rent, common area income, utilities income, and all legitimate expenses must be considered when the income approach is considered in the valuation process of qualified shopping centers.

The Market Approach. Pursuant to A.R.S. 42-13205(3), the Market Sales Comparison approach to value can **only** be considered during an administrative appeal proceeding, and then only if (1) a valid sale of the subject property has occurred within two years of the valuation date, and (2) there has been "no material change to the property, its lease terms, tenants or occupancy rates or any other material fact" relevant to the property since the date of that sale. If, based on these criteria, the reviewing body (the County Assessor, the County or State Boards of Equalization, or the Courts) considers the market approach applicable, they may consider the sales of comparable properties from "within two years before the date of valuation," if the comparability of those sold properties can be determined by "clear and convincing evidence."

Most qualified shopping center properties have unique characteristics in terms of serving their locations and market areas, as well as in terms of their variations by type, size, age, and the available amenities. "Clear and convincing" comparability can be difficult to establish. Due to these factors, the market sales comparison approach is, by statute, not utilized in the Assessor's initial valuation of qualified shopping center properties, and the approach has only limited application in the administrative appeals process or in the judicial system appeal process.

APPENDIX A

Shopping Center Economic Obsolescence and Depreciation Tables Using the Construction Cost System

Age in Years	Normal Depreciation	Actual Obsolescence	System Depreciation
1	0.00%	0.00%	**0%**
2	0.50%	0.00%	**1%**
3	1.00%	4.00%	**5%**
4	1.50%	8.50%	**10%**
5	2.50%	11.50%	**14%**
6	3.00%	16.00%	**19%**
7	4.00%	19.00%	**23%**
8	5.00%	21.00%	**26%**
9	7.00%	22.00%	**29%**
10	8.00%	24.00%	**32%**
11	9.00%	26.00%	**35%**
12	10.00%	27.00%	**37%**
13	11.00%	28.00%	**39%**
14	12.00%	29.00%	**41%**
15	12.50%	29.50%	**42%**
16	13.50%	29.50%	**43%**
17	14.50%	29.50%	**44%**
18	16.00%	29.00%	**45%**
19	17.50%	27.50%	**45%**
20	18.50%	26.50%	**45%**
21	19.50%	25.50%	**45%**
22	20.00%	25.00%	**45%**
23	21.50%	23.50%	**45%**
24	22.50%	22.50%	**45%**
25	23.50%	20.50%	**44%**
26	25.00%	19.00%	**44%**
27	26.50%	17.00%	**43%**
28	27.50%	14.50%	**42%**
29	28.50%	12.50%	**41%**
30	30.00%	10.00%	**40%**
31	30.50%	8.50%	**39%**
32	31.50%	7.50%	**39%**
33	32.50%	5.50%	**38%**
34	33.50%	3.50%	**37%**
Age 35 and older	34.50%	1.50%	**36%**

Note: Pursuant to A.R.S. 42-13203(E), the Department shall develop obsolescence factors for shopping centers.

Calculation of Shopping Center Discount Rate, Pursuant to A.R.S. 42-13203(D)(1)

"For the 1983 tax year a discount rate of 10.5 per cent, adjusted each year thereafter according to the percentage change in the weighted average cost of monies derived from interest paid on savings accounts, federal home loan bank advances and other borrowed money as reported by the federal home loan bank of San Francisco for this state for the most recent twelve month period ending June 30. The discount rate shall not be less than ten per cent."

The discount rate for each subsequent tax year is calculated by factoring the discount rate by the change in the actual or market interest rate from the preceding year. As shown in the Shopping Center Discount Rate Table, the 1984 weighted average cost was 10.143. This rate was then divided by the 1983 weighted average cost of 10.977 which equaled a change factor of 0.9240. This factor times the preceding period's discount rate, or in this case 10.50% which was the statutory rate applied in 1983 for the 1984 tax year, equaled 9.702%. Since 9.702% is less than the statutory minimum of 10.00%, the statutory minimum of 10.00% was used. This same methodology must be used each year as long as this statute is in effect.

APPENDIX B

Shopping Center Discount Rate Table

Period Ending June 30	Weighted Avg. Cost	Change Factor	Valuation Year	Tax Year	Discount Rate
1983	10.977%	N/A	1984	1984	10.500%
1984	10.143%	0.9240	1985	1985	9.702% use 10.00%
1985	10.180%	1.0036	1986	1986	9.737% use 10.00%
1986	8.929%	0.8771	1987	1987	8.540% use 10.00%
1987	7.458%	0.8353	1988	1988	7.133% use 10.00%
1988	7.553%	1.0127	1989	1989	7.224% use 10.00%
1989	8.178%	1.0827	1990	1990	7.821% use 10.00%
1990	8.678%	1.0611	1991	1991	8.299% use 10.00%
1991	8.004%	0.9223	1992	1992	7.654% use 10.00%
1992	6.105%	0.7627	1993	1993	5.838% use 10.00%
1993	4.233%	0.6934	1994	1994	4.048% use 10.00%
1994	3.848%	0.9090	1995	1995/1996	3.680% use 10.00%
1995	4.654%	1.2094	1996	1997	4.451% use 10.00%
1996	5.352%	1.1500	1997	1998	5.119% use 10.00%
1997	5.199%	0.9714	1998	1999	4.972% use 10.00%
1998	5.275%	1.0146	1999	2000	5.047% use 10.00%
1999	4.808%	0.911	2000	2001	4.598% use 10.00%
2000	4.786%	0.995	2001	2002	4.575% use 10.00%
2001	5.079%	1.061	2002	2003	4.854% use 10.00%
2002	*				

*June 30, 2002 Cost of Funds Index to be announced in mid-August, 2002.