

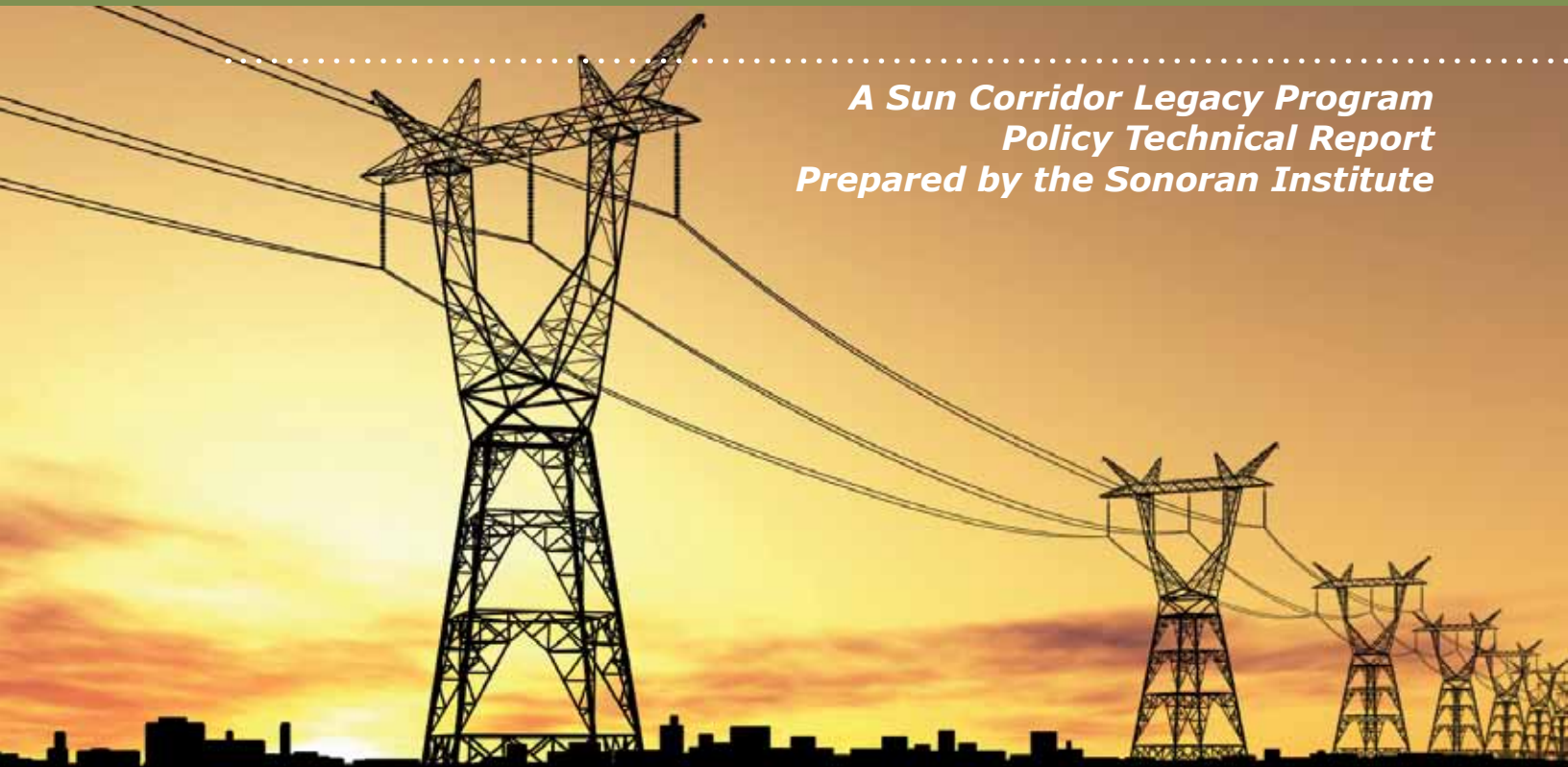


*Shaping the Future of the West*



# ***Wires, Roads, and Water: Developing Sustainable Infrastructure on State Trust Land***

***A Sun Corridor Legacy Program  
Policy Technical Report  
Prepared by the Sonoran Institute***



# Sonoran Institute

## Mission

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The Sonoran Institute inspires and enables community decisions and public policies that respect the land and people of western North America.

## Vision

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The Sonoran Institute contributes to a vision of a West with:

- Healthy landscapes—including native plants and wildlife, diverse habitat, open spaces, clean air and water—from northern Mexico to western Canada.
- Vibrant communities where people embrace conservation to protect quality of life today and in the future.
- Resilient economies that support prosperous communities, diverse opportunities for residents, productive working landscapes, and stewardship of the natural world.

## A Collaborative, Community-based Approach

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The nonprofit Sonoran Institute, founded in 1990, works across the rapidly changing West to conserve and restore natural and cultural assets and to promote better management of growth and change. The Institute's community-based approach emphasizes collaboration, civil dialogue, sound information, local knowledge, practical solutions and big-picture thinking.

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## Acknowledgements

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The Superstition Vistas in northern Pinal County, Arizona – approximately 275 square miles of contiguous state trust land – offers an incredible opportunity for sustainable master planning at a large scale. In order to reach optimal potential and value for this parcel, the sole property owner, Arizona State Land Department (ASLD), needs the ability to perform siting and investment of primary infrastructure in advance of development. This includes regionally connected transportation infrastructure, energy corridors and, open space amenities.

A private landowner does not have the same constitutional and statutory regulations which the ASLD faces regarding advance infrastructure. This report, the third in a series from the Sun Corridor Legacy Program, examines the current methods and limitations ASLD encounters in siting critical infrastructure and offers various alternatives to increase the department's flexibility to incentivize infrastructure investment, which adds value to the trust beneficiaries as well as contributes to a more sustainable development pattern in the Sun Corridor region.

I wish to thank Sonoran Institute authors Susan Culp and Dan Hunting for their excellent research and writing, as well as Peter Culp, an attorney and partner with Squire, Sanders & Dempsey L.L.P., whose expertise on state trust land law was essential to this report. Additionally, Dave Richins, Director of the Sun Corridor Legacy Program, was instrumental in coordinating the project.

Most importantly, I offer sincere thanks to the Thomas R. Brown Family Foundation and the Lincoln Institute of Land Policy. I am very grateful for the generosity of both organizations whose support makes this work possible.

A handwritten signature in black ink that reads "Luther Propst".

Luther Propst  
*Executive Director*  
Sonoran Institute  
February 2011

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# Contents

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## **1 Executive Summary**

## **2 Background**

Superstition Vistas: The Need for a New Approach to Infrastructure Planning  
The Broader Role of State Trust Land in Large Scale Infrastructure Siting  
The Real Estate Context for State Trust Land in Arizona  
The Trust Responsibility for the Arizona State Land Department

## **9 Financing Options for State Trust Land Infrastructure**

Municipal Improvement Districts  
County Improvement Districts  
Community Park Maintenance Districts  
Special Road Districts  
Sanitary Districts  
Limitations of Financing Options for State Trust Land

## **12 Infrastructure Siting Under Arizona Statutes**

Land Sales  
Commercial Leases  
Sale or Lease of Right-of-Way  
Special Use Permits  
Urban Lands Provisions  
Improvement Plans  
Infrastructure Agreements  
Arizona Preserve Initiative  
Participation Agreements

## **24 Potential Approches to Improving Infrastructure Siting**

Long-Term Infrastructure Planning  
Constitutional Lien Authority  
Expansion of Participation Contract Authority  
The Master Developer Lease

## **29 Conclusion**

## **30 Appendix I**

## **33 Appendix II**

## **37 Appendix III**

## **41 End Notes**



## Executive Summary

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The Arizona State Land Department (ASLD), unlike a traditional private landowner, is limited in its options for infrastructure siting and development on its land. This working paper evaluates the current constitutional and statutory authorities of the ASLD in siting key infrastructure. It recommends specific statutory changes that would provide the ASLD additional flexibility to incentivize infrastructure investment. These improvements would add value for the trust beneficiaries and contribute to a more sustainable development pattern in the Sun Corridor megaregion.

The Superstition Vistas state trust land parcel in northern Pinal County, Arizona presents an incomparable opportunity for sustainable master planning at a large scale. A significant factor to fully realize the potential and value of this property is ASLD's capacity to build infrastructure in advance of development. This includes a regionally connected transportation infrastructure, energy corridors, and open space amenities.

This report presents four recommendations to improve the ability to locate infrastructure on state trust land:

- 1 Begin long-range infrastructure planning to identify areas with the most urgent need for transportation, energy, and open space infrastructure.
- 2 Facilitate special taxing districts through amendment of the state constitution to allow lien authority on trust land.
- 3 Expand the ability of the ASLD to enter into participation contracts, which allow the state to partner with private firms to develop infrastructure on state land.
- 3 Allow for master developer leases to provide the state more flexibility in developing trust land.



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### **Superstition Vistas: The Need for a New Approach to Infrastructure Planning**

At the edge of one of the fastest growing metro areas in the nation is a vast tract of open land known as the Superstition Vistas. It is 275-square miles in size – over 170,000 acres in total – and in single ownership. Superstition Vistas is composed of state trust land, which is managed by the Arizona State Land Department (ASLD) to generate revenue for the trust beneficiaries, primarily public school children.

At statehood, Arizona was granted a little over 10 million acres of land to be held in trust to support a variety of public institutions.<sup>1</sup> Like New Mexico, Arizona was granted sections 2, 16, 32, and 36 of each township.<sup>2</sup> While many other Western states received the majority of their holdings in a scattered pattern corresponding to the actual township grants, Arizona's case was different. Since Arizona was among the last states to join the Union, many of these designated sections were unavailable, having already been granted as tribal lands, railroad land grants, national forests, parks, and other federal reservations, or they had been homesteaded or otherwise passed into private ownership.

As a result, wherever a designated section occurred within an existing federal reservation or private land grant, Arizona was allowed to select "in lieu" land sections to include in the trust portfolio. These "in lieu" selections, coupled with a series of extensive land exchanges in the decades prior to the 1990's, allowed the ASLD to acquire large, contiguous parcels of land, many of which are now located near growing urban areas. Today, nearly 9.3 million acres remain in the state land trust; Superstition Vistas is the largest of the consolidated parcels that is located at the urban edge.

The nature and location of Superstition Vistas presents an incomparable opportunity for sustainable planning at a large scale as well as the chance to create a new model of development in one of the fastest-growing megaregions in the nation, the Sun Corridor. If developed effectively, this area is estimated to become home to an additional one million residents. The anticipated revenue generating capacity of the parcel to the trust beneficiaries is therefore incredibly high, and efforts to achieve the parcel's fullest potential for value creation through development has become a priority. To maximize the potential of this area and ensure that piecemeal development doesn't undermine the opportunity presented by a parcel of this size and character, an ad hoc steering committee comprised of the ASLD, local jurisdictions within and neighboring the Superstition Vistas parcel, business leaders, and non-governmental organizations convened to engage in a long-term scenario planning and visioning process.

Over the past two years, a consulting team of planning experts was commissioned to assist the steering committee in exploring scenarios for the development of Superstition Vistas. These scenarios, developed by Fregonese Associates, were used to highlight trade-offs and opportunities among economic development, environmental sustainability, and social equity – a triple-bottom-line approach.

Ultimately, five scenarios were produced including a range of indicators and measures assessing each scenario's performance: jobs/housing mix, energy and water consumption, vehicle miles traveled (VMT), household demographics and income, and carbon footprint. However, each scenario used the same core

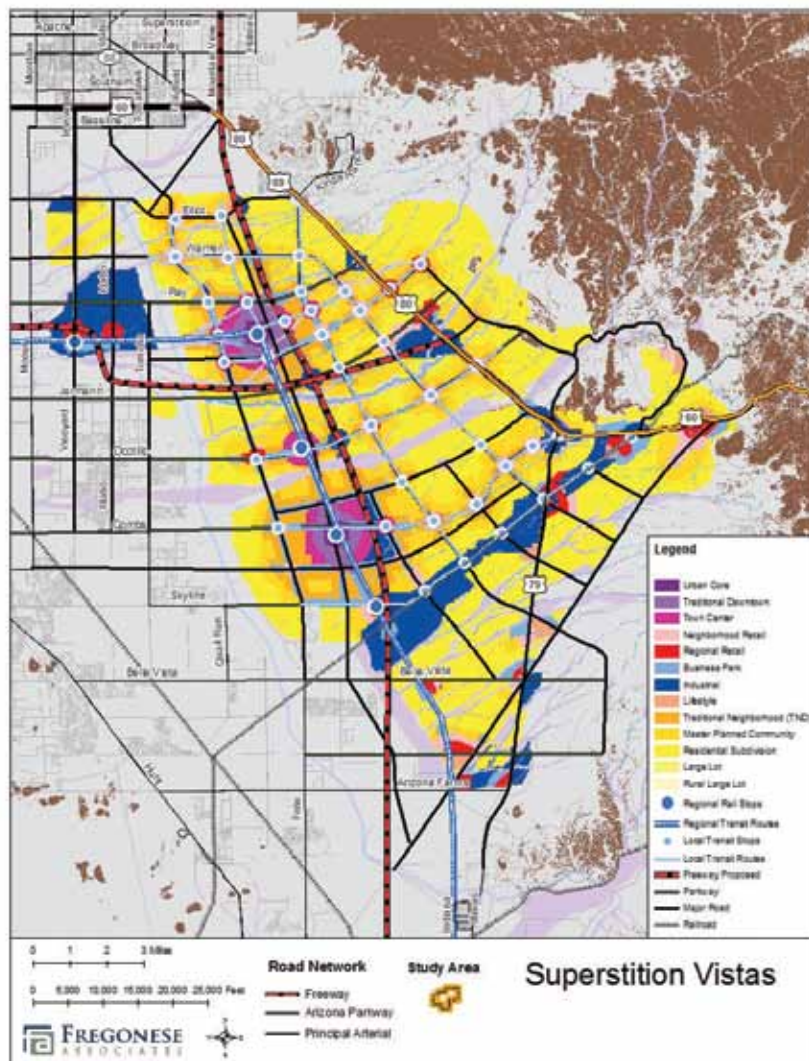




infrastructure design to optimize a compact, transit-friendly development pattern, open space preservation, and an efficient, multi-modal transportation system (Figure 1). Figure 2 represents the essential transportation corridors that the consulting team identified in collaboration with Arizona Department of Transportation (ADOT) and their transportation corridor planning process for the region, discussions with the steering committee members, and other stakeholder conversations.

### Superstition Vistas Scenario Map Outlining Transportation Network and Higher Density Transit-Oriented Development Nodes

1



One of the core lessons from the scenario planning exercise is that a well-positioned, multi-modal transportation network would create a backbone around which a more sustainable, mixed-use, transit-oriented development can be organized. Efficient siting of the transportation infrastructure supporting development would yield significant positive outcomes in terms of lowered VMT; connectivity to the larger

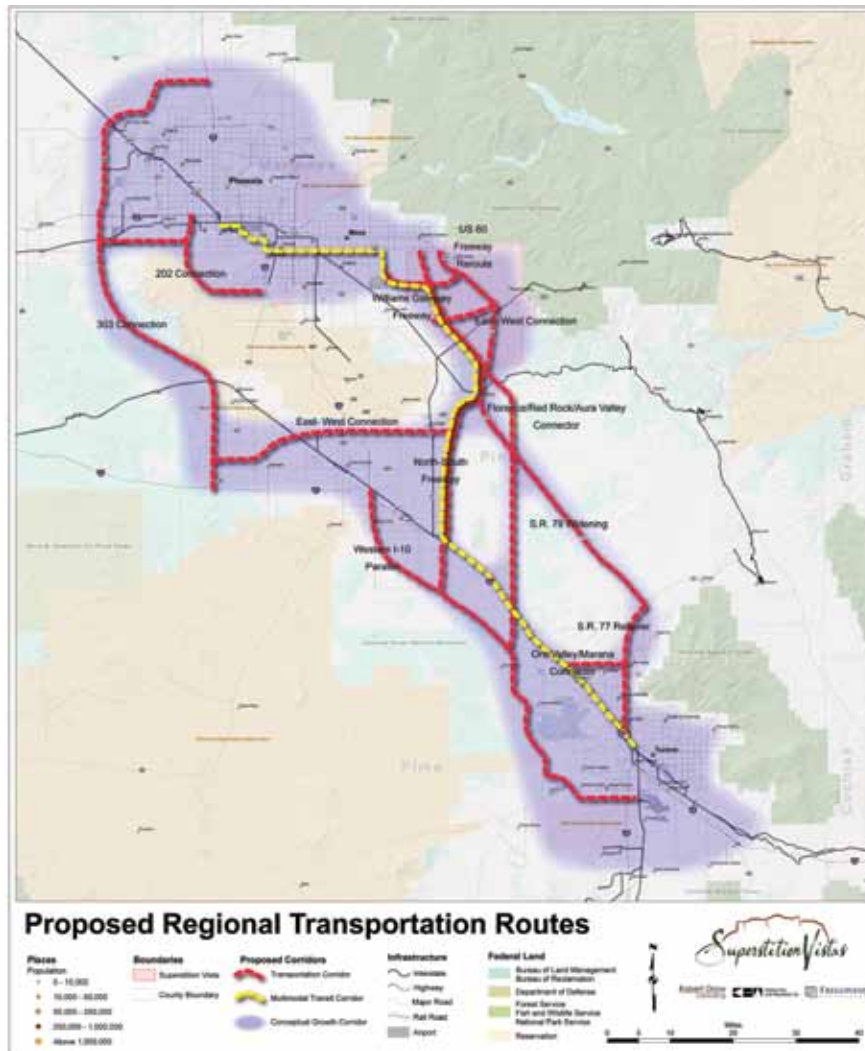




megaregion through the transportation design would contribute to Superstition Vistas economic prosperity and value.

### Sun Corridor Region Overlaid with Preferred Transportation Infrastructure Corridors

2



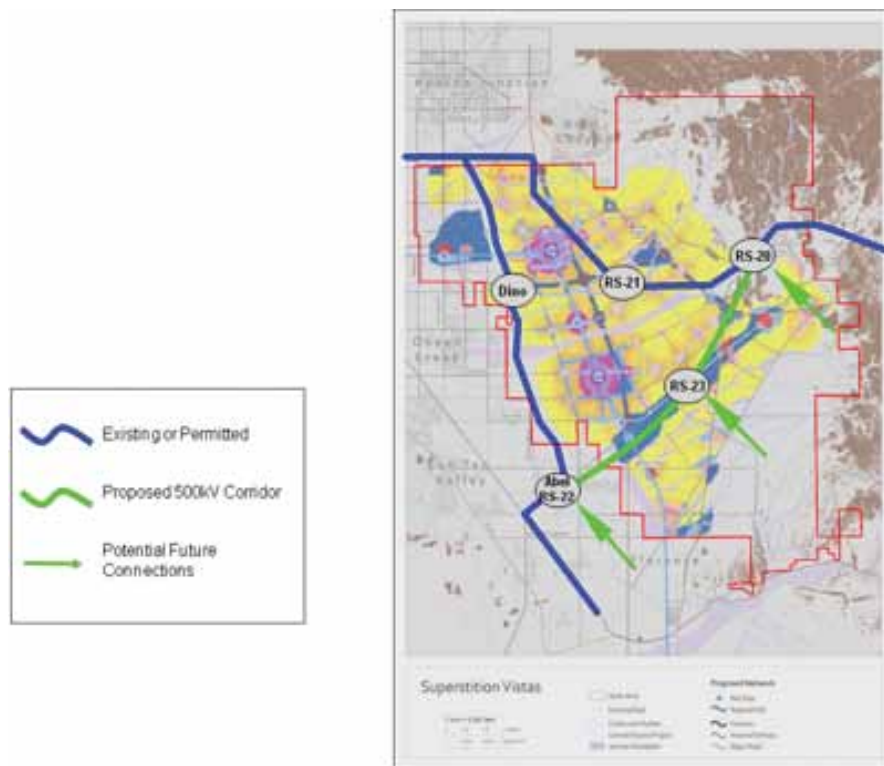
Likewise, a well-planned energy generation and transmission network, including incorporation of “smart grid” technology, could also yield sustainability benefits and added value, such as increased energy efficiency, reduced consumption and lowered energy costs, and reduced greenhouse gas emissions.<sup>3</sup> The consulting team’s recommendations to the steering committee include identifying areas in the southeastern portion of the Superstition Vistas parcel for utility or district-scale renewable energy generation and implementing smart grid technologies that support distributed generation. Figure 3 represents planned and potential power corridors identified for Superstition Vistas.



Part of the Superstition Vistas vision also includes the dedication of significant areas for open space. This type of “green infrastructure” will create considerable quality of life benefits and amenities for the neighboring community as it grows, as well as value enhancements to the lands adjacent to the protected natural areas. The scenarios developed for Superstition Vistas include significant, inter-connected open space set-asides throughout the development, particularly rugged areas of the parcel near the Superstition Wilderness and areas located through the wash corridors.

### Superstition Vistas Scenario Map Overlaid with Energy Transmission Corridors

3



In order to realize the many benefits, including increased land values for the trust, created by planned roads and rail lines, energy generation and transmission, open space, and other infrastructure investments, ASLD would need improved tools and mechanisms to ensure the siting for these infrastructure corridors before development even begins. This is currently a challenge for the ASLD, whose constitutional and statutory authorities around rights-of-way dedications and infrastructure planning are constrained.

The inability of ASLD to plan for these infrastructure corridors in advance of development could ultimately undermine the larger vision for Superstition Vistas and other state trust land holdings that could benefit from infrastructure investment. Moreover, the limitations reduce the economic value potentially available to the beneficiaries through development of the parcel in the coming decades.



## The Broader Role of State Trust Land in Large Scale Infrastructure Siting

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ASLD's land portfolio includes a large quantity of lands suitable for the siting of public infrastructure, the majority of which are currently used for agricultural purposes or grazing that produce comparatively low returns. In fact, ASLD has historically generated less than one percent of its annual revenues from grazing and agricultural leases, although the vast majority of trust land, more than 8.5 million acres, is currently dedicated to these uses.

### Shaping Development

While the majority of Arizona's trust land is located in rural areas of the state, more than one million acres of Arizona's trust land are located adjacent to or within rapidly urbanizing areas, including Maricopa, Pinal, and Pima Counties. In many areas, trust land is held in large, contiguous blocks, which, when held back from disposal have effectively blockaded growth at the edges of urban areas. This causes development to pile up against trust boundaries and drives development to areas with more plentiful private land. In many cases, development has simply jumped over miles of trust land to pursue more easily developed private land in areas beyond. Examples of this phenomenon are visible on any map of trust-rich areas such as north Phoenix, the I-17 corridor, the Superstition Vistas area, and large portions of Pinal and Pima counties. The outcome has been increased infrastructure and transportation costs for local communities, development of far-flung, environmentally sensitive or agricultural lands, and generally poor urban form that trends towards sprawl and distracts from smart growth.

By contrast, decisions to bring these lands to market may substantially shift development patterns, attracting development towards open lands near urban cores. The type of development selected for trust land may also have important consequences. For example, construction of a regional mall and/or employment centers, like ASLD's Desert Ridge projects, may create new development nodes that strongly influence the disposition of private lands around them. On a larger scale, these decisions may ultimately influence the direction of development in the larger metropolitan area. Planning efforts around ASLD's Superstition Vistas property have the potential to shift the balance of development within the Phoenix metropolitan area as a whole.<sup>4</sup> Similarly, the ASLD's nearly exclusive ownership of major areas to the south of Tucson means that the types and locations of development on these lands, or the lack of development on these lands, if the ASLD is unable to accommodate it, will substantially shape the urban character of that city for decades to come.

### Transportation Infrastructure

Given the extent of trust holdings in rapidly growing regions of Maricopa, Pima, and Pinal counties, trust land managers are in a position to significantly influence the location of transportation corridors by simply offering or withholding land needed for the siting of these corridors. This influence will be particularly significant if proposed trust reform efforts are successful, as the ASLD would be in a position to grant the costly rights-of-way needed for highways, rail, and other major infrastructure. The grants would save infrastructure projects millions of dollars in exchange for locating that infrastructure in areas that would be advantageous to the trust or that would be otherwise desirable in shaping the path of development. In many areas, such grants could cover nearly the entire alignment of a major highway project.



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### Utility Corridors

Similar benefits could accrue to the siting of other critical public infrastructure, including utility corridors. The ASLD could potentially provide grants of rights-of-way or discounted rights-of-way where infrastructure would generate benefits to trust land.

### Conservation

Trust land planning could also be influential with regard to conservation-related activities. The simple act of defining trust land in which the ASLD has a development interest would provide incentives for the near-term acquisition of sensitive land to rescue important habitat areas or scenic values from development. At the same time, the identification of land on which development is unlikely would shape land-use decisions on adjacent private and federal land by placing increased emphasis on achieving conservation of surrounding land in areas where development is less likely to occur.

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## The Real Estate Context for State Trust Land in Arizona

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Despite the recent recession, Arizona is expected to face continuing, rapid growth for at least the next few decades. Maricopa County recently ranked as the fastest growing county in the U.S., while Phoenix is the nation's fifth largest city. This growth will stretch Arizona's resources to the limit, bringing with it significant transportation, water resource, public service, and environmental protection challenges.

As noted above, the ASLD controls an enormous amount of the land base on which this future development is anticipated to occur. Approximately 38 percent of the land in Pinal County, which encompasses the majority of the Phoenix-Tucson growth corridor, is state trust land. Once federal land is subtracted, state trust land represents more than two-thirds of the available land base for future development.<sup>5</sup> In rapidly-expanding north Phoenix, more than 70 percent of the remaining undeveloped land is state trust land.<sup>6</sup> Similarly, trust land comprises the vast majority of the land in the growth corridor located to the south of the City of Tucson in Pima County. Although precise estimates of the total developable land base in Central Arizona vary, the Maricopa Association of Governments has estimated that only around one-third of the total land base of Maricopa, Pinal, Pima, and Yavapai counties may ultimately be available for development. Of this available land base, state trust land comprises more than 50 percent.<sup>7</sup>

Because of the unique restrictions governing the disposal of state trust land, in particular the requirement that trust land be sold at public auction (discussed in detail later in this report), trust land has historically operated at a comparative disadvantage for purposes of development when compared to private land. ASLD also currently lacks the administrative or technical expertise to review and prioritize a high volume of applications for infrastructure siting and/or successfully negotiate complex arrangements for infrastructure development. Significant budget cuts have reduced staff and depleted resources that were once available to contract for consulting expertise and assistance on technical matters outside the ASLD's scope of regular activities. Recent attempts to allow the ASLD to retain a portion of the revenues they generate to fund operations have come under fire through a constitutional challenge by public school advocates.<sup>8</sup>

Nevertheless, given the enormous resource base controlled by Arizona's trust managers, the policies and planning that govern trust land management and disposal



will have tremendous significance not only for the future of the state land trust, but also for the future of the state as a whole. Trust managers' decisions will determine which trust land will be developed, and as importantly where development will be focused within and among urban areas, the availability of urban open space, and other major planning outcomes.

The policies and rules governing trust management still lag far behind where they need to be to meet either this challenge or this opportunity. Over the past decade, the State of Arizona has considered a series of state trust land reform proposals that have sought to modernize the management of state trust land and address strict limitations on trust land disposal contained in Arizona's Enabling Act and Constitution. These efforts include a ballot-box showdown rejected by voters in 2000; a broad-based stakeholder reform proposal submitted to the state legislature for consideration in 2004 and again in 2005, both rejected by the legislature; a ballot measure based on the 2004-2005 reform proposals was narrowly defeated in 2006; a third, highly simplified ballot measure failed to qualify for the ballot in 2008; and in 2010 another ballot proposition, this time focused on preserving land around military installations, was defeated at the polls.

Each of these reform efforts included provisions that would enable Arizona trust managers to use a number of modern real estate disposition tools that are unavailable under current constitutional and Enabling Act-related restrictions. These tools make disposals of rights-of-way without auction possible and allow consideration of value increases to the benefited trust land in setting the price for disposal. Those mechanisms include development agreements, participation agreements, infrastructure financing mechanisms that maximize returns from the sales of trust land, entitlement "trades" between the ASLD and local communities, and other forms of non-monetary consideration to pay for open space trust land

Among the most crucial of these reform provisions, however, have been efforts to address the critical challenges associated with the development and financing of public infrastructure on trust land. With trust reform continuing to prove to be elusive, there are two central questions with regard to improving the capability to more effectively address infrastructure needs on state trust land: (1) if comprehensive reform can be accomplished, what would be the preferred approach; (2) if such reform cannot be accomplished, is there an alternative approach to addressing these issues?

## **The Trust Responsibility for the Arizona State Land Department**

All actions regarding Arizona's trust land must be taken in consideration of the state's trust responsibilities. This legal obligation has been defined very strictly through a series of court decisions, which have directed the state to manage the trust to ensure long-term benefits at the expense of flexibility. For a detailed look at the legal background of this responsibility, refer to Appendix III.





## Financing Options for State Trust Land Infrastructure

Municipal infrastructure requires a substantial initial capital investment, but once in place it returns benefits to the community for many years. Bonding has been the traditional way of paying for such infrastructure. The issued bonds provide the municipality the immediate funding required to proceed with construction. Bond purchasers are then repaid with interest over a period of years. Investments of this nature are considered safe as government defaults on bonds are extremely rare in the United States, and their tax-exempt status makes them attractive despite modest rates of return.

Financing of the infrastructure options considered in this report is restricted by the legal environment in which the ASLD operates, as well as by the trustee status of the ASLD. The ASLD functions as the land owner when selling or leasing state trust land, while bearing specific legal responsibilities in its role as trustee. These obligations restrict the ways in which the state can finance infrastructure on trust land. In addition, a series of statutory requirements and judicial rulings further impair the state's flexibility in developing trust land and maximizing returns to the trust beneficiaries.

### **Low Carrying Costs for Trust Land**

Although ASLD is greatly constrained in financing infrastructure improvements on trust land, it does have one advantage over most private landowners. Private landowners have carrying costs in the form of mortgage payments, maintenance, and property taxes on their land. Since the State of Arizona doesn't tax itself, and was given the land at statehood, the carrying costs on trust land are very low, approaching zero in the case of remote rural land.

The ASLD has additional tools available for trust land considered urban land; parcels located within or near existing cities or towns. The development plans created for these lands articulate the location of infrastructure. The value of the parcels and easements required for the necessary infrastructure is then transferred to the parcels to be developed. Despite usage restrictions, this mechanism has the potential to facilitate the financing of infrastructure improvements on trust land offered for sale or lease.

Statute also allows cities, towns, counties, and improvement districts to levy assessments for the implementation of improvement plans to potentially finance infrastructure. Private landowners may vote to form a special taxation district, such as a community facilities district (CFD). Title 48 of the Arizona Revised Statutes defines dozens of special taxing districts available to the citizens of the state. These districts allow municipalities and citizens to create taxes to pay for services ranging from the control of insects in cotton crops to the construction of amusement parks. Typically, the taxing district generates cash through the sale of bonds and then pays off the bonds over time with revenue from a property tax levied on its members. These taxing districts are designed to raise funds to build civic infrastructure, such as roads and sewers, and provide other needed services. Although many of these districts are specifically directed toward agricultural properties, or used in large cities, some may be applied in the development of state trust land. In addition to the district types listed below, it may be possible to extend infrastructure onto state trust land through existing special taxing districts such as the Regional Public Transportation district. The existing districts that show the most promise for trust land infrastructure development are municipal and county improvement districts, community park maintenance districts, special road districts, and sanitary districts.





## Municipal Improvement Districts

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Municipal improvement districts can be employed to finance a wide variety of public infrastructure, including water mains, sewers, streetlights, and roads.<sup>9</sup> Water and sewage treatment plants may also be funded via these districts. The district is operated by the governing body of a municipality, such as a city or town council. Additionally, a subset of property owners within the municipality may petition to form their own improvement district for enhanced municipal services.<sup>10</sup>

A CFD is a special type of municipal improvement district authorized to sell either general obligation bonds or revenue bonds.<sup>11</sup> The general obligation bonds are to be repaid via a property tax assessment. There are provisions in the statute for the district to negotiate with the state to pay the assessment due on state-owned lands.<sup>12</sup> Revenue bonds are repaid by fees generated from the project; for example, bonds used to construct a parking garage might be repaid via charges to use the facility.

## County Improvement Districts

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County improvement districts are similar to municipal improvement districts, but are designed for areas unincorporated into a city or town.<sup>13</sup> Although the primary purpose of these districts is to construct wastewater treatment facilities, they may also make other improvements such as streets, water mains, and street lights.<sup>14</sup> The district is authorized to issue bonds to pay for these improvements and to set water and sewer fees or property taxes to repay the bondholders.<sup>15</sup> As with municipal improvement districts, the county improvement district would need to contract with the state to capture assessments made against state trust land. However, A.R.S. §48-984 indicates that these assessments constitute a first lien against the property, rendering the use of this mechanism doubtful since liens are not permitted on state property.

## Community Park Maintenance Districts

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These districts are for the maintenance and operation of parcels less than 160 acres in size dedicated to "unrestricted public use."<sup>16</sup> These services are paid for by a property tax assessment of lands within the district. Capital improvements are explicitly excluded from funding under this statute. Although these districts are limited in their capacity to fund actual infrastructure, they do provide a means to identify and earmark open space and to fund land upkeep.

## Special Road Districts

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Special road districts may be created to construct and maintain roads and highways, and are funded by a property tax not exceeding 75 cents per 100 dollars in assessed valuation.<sup>17</sup> The board of trustees for the district may elect to issue bonds if the annual property tax assessment is insufficient to cover the immediate need.

## Sanitary Districts

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Sanitary districts may be established in non-urban unincorporated areas to provide sewage treatment and landfill services.<sup>18</sup> The district's board of directors is authorized to issue bonds and to repay those bonds through property tax assessment or user fees. These districts are also allowed to finance and construct sewer collection systems.



## Limitations on Financing Options for State Trust Land

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These mechanisms, though commonly used by local governments to assure infrastructure provision in an orderly and low-cost manner, cannot be used in the context of state trust land. The charges levied through special taxation districts cannot be collected until the trust land has been sold or leased, so the state is effectively precluded from constructing infrastructure in advance of development. Since state trust land is not taxed, it cannot be subjected to lien. Furthermore, it is impossible to issue bonds for state trust land at this time. The bonds issued under the improvement plan would use the underlying land as collateral in the event of a default. However, liens against state land are illegal, resulting in a lack of collateral on state land.

ASLD is allowed to enter into infrastructure agreements for the provision of infrastructure on trust land. The builder of these improvements is authorized to be reimbursed by later purchasers or lessees of the property. This mechanism requires significant up-front capital. Due to the restrictions detailed above, this financing is likely to be considerably more expensive than if it were done on privately held land.

To highlight the ASLD's limitations when financing infrastructure, the options for trust land disposition are shown below.



ASLD's current authorities provide for a variety of strategies for accomplishing infrastructure development on state trust land:

- 1 **Land Sales**
- 2 **Commercial Leases**
- 3 **Sale or Lease of Rights-of-Way**
- 4 **Special Use Permits**
- 5 **Urban Lands Provisions**
- 6 **Infrastructure Agreements**
- 7 **Arizona Preserve Initiative**
- 8 **Participation Agreements**

## Land Sales

The land sale mechanism is often used in connection with regular development sales to dispose of sites for major urban and rural infrastructure items. Pursuant to a land sale, ASLD is also able to offer a limited financing mechanism, whereby the buyer makes a required down payment but is able to make installment payments to ASLD pursuant to a reasonable commercial interest rate (described later in this report).

ASLD has broad authority to sell trust land upon application or on its own initiative.<sup>19</sup> With the exception of urban lands (which are subject to additional requirements under the Urban Lands Act), timber lands (which require timber values to be sold separately from the land), and mineral lands (which are restricted from sale), essentially all state land is open to sale.<sup>20, 21, 22, 23</sup> There are, however, acreage limitations on the amount of land classified for grazing (640 acres) and agricultural purposes (160 acres) that can be sold to any one person.<sup>24</sup>

Land identified for sale by ASLD, or with an approved application for sale, is appraised.<sup>25</sup> If ASLD determines that the sale is in the best interest of the trust, and has provided appropriate public notice, it can order the sale of land "to the highest and best bidder therefore at public auction held at the county seat."<sup>26</sup> Under the Arizona Constitution and the Enabling Act, trust land may not be sold or leased, in whole or in part, except to the highest and best bidder at a public auction, and no "contract for the sale of any timber or other natural product of such lands [shall] be made, save at the place, in the manner, and after the notice by publication provided for sales and leases of the lands themselves."<sup>27</sup> Furthermore, "all lands, leaseholds, timber and other products of land, before being offered shall be appraised at their true value, and no sale or other disposal thereof shall be made for a consideration less than the value so ascertained."<sup>28</sup>



Pursuant to A.R.S. §37-132(A)(5), ASLD is permitted to impose “such conditions and covenants and make such reservations in the sale of state lands as the commissioner deems to be in the best interest of the state trust.” ASLD may impose terms of sale that are in the best interest of the trust, and discourage certain bidders, provided that it does not unreasonably limit the pool of potential bidders.<sup>29</sup> Additionally, ASLD can require a permittee, lessee, or grantee to post a surety bond or other collateral to guarantee performance.<sup>30</sup> Pursuant to A.R.S. §37-261, ASLD is also allowed to auction its reversionary rights in a trust parcel held for more than 10 years.

A purchaser of state land at auction is required to pay a minimum of 10 percent of the appraised value of the land at the time of sale;<sup>31</sup> if the land is sold for more than the appraised value, the difference between 10 percent of the appraised value and 10 percent of the sale price must be paid within 30 days.<sup>32</sup> The remainder of the purchase price may be financed through ASLD on terms of up to 25 years, at either a fixed or variable interest rate determined by the State Treasurer.<sup>33</sup>

Upon the sale of the land at auction for less than the full cash value of the land, the purchaser receives a certificate of purchase that establishes the terms for payment of the remaining purchase price.<sup>34</sup> The certificate of purchase essentially functions as a deed to the property, subject to discretionary forfeiture and reversion of the land to ASLD if the terms of the certificate are not met, and can be recorded and assigned.<sup>35</sup> In addition, to the extent that a holder of a certificate of purchase sells any “sand, gravel, stone or other natural product” from the land subject to the certificate, the money derived from the sale is paid to ASLD and applied against remaining interest and principal.<sup>36</sup>

The holder of a certificate of purchase is entitled to pay off the remaining debt on the property at any time; upon full payment, ASLD issues a final patent for the land.<sup>37</sup> ASLD may also issue a patent for less than the entire property where it finds that doing so would be in the best interest of the trust, that the remaining value of the property is greater than the amount owed under the certificate of purchase, and that the value already paid for the acreage subject to the partial patent exceeds the per-acre purchase price for the entire property.<sup>38</sup> However, a partial patent cannot be issued for less than 10 acres or less than  $\frac{1}{4}$  of the total land (whichever is smaller), although if the original land tract is less than 40 acres in size, partial patents may be issued for as little as five acres.<sup>39</sup>

This partial patent mechanism is frequently used in large, multi-phase development projects, including the disposal of public sites and other infrastructure-related land parcels. By allowing a developer to “take down” a portion of a larger site as the timing of development dictates, this mechanism can facilitate the construction and dedication of public infrastructure during various phases of a development project. Thus, it minimizes the developer’s up-front capital expenditures by having ASLD effectively “finance” the capital costs of land acquisition for the remaining unpatented land.

It is critical to note a key drawback: while the partial patent mechanism provides some flexibility in the timing of when capital expenditures must be made, it nonetheless requires the developer to advance the full market value of infrastructure sites as part of infrastructure construction, adding to the associated capital burden. This burden can be particularly significant in the context of large, interconnected development projects. Such projects may necessitate construction and dedication of certain major elements of infrastructure prior to the time that residential or commercial development, and their associated cash flows, begin.



For example, a developer may be required to build all, or at least portions, of major roads, sewer and water infrastructure, and dedicate school sites prior to construction of residential housing, which under the existing statutory regime requires the developer to advance the capital costs of this infrastructure, as well as the full value of the trust land during a period in which little or no cash flow can be expected. This in turn can substantially increase the cost of the overall development project, and limit the value available to the trust.

A private landowner, however, has much wider discretion and flexibility in selling land. Terms and conditions may be arranged to suit both the buyer and seller. The seller is free to select any buyer's offer, regardless of its price, and to offer financing terms that are agreeable to both. Repayment schedules may be negotiated so that payments to the seller coincide with the buyer's expected income. For example, during early stages of a project, a developer incurs significant costs, well before any lots are sold to generate revenue. Private landowners are able to set aside portions of the land for infrastructure purposes such as road construction. Doing so may increase the value of the rest of the parcels for future development.

## Commercial Leases

Infrastructure can also be developed on trust land under commercial leases. Commercial leases in Arizona are generally issued for terms of between 10 and 99 years, and are sold at public auction to the "highest and best bidder."<sup>40</sup>

Lease rates are generally required to be the fair market rental value of the land, subject to annual, or for long-term leases, periodic, adjustment. Pursuant to A.R.S. §37-132(A)(7) and 37-214(B), commercial leases are subject to the approval of the board of appeals. If land is leased for more than 10 years, the board must determine that the benefit to the trust would be greater than if the land was sold.<sup>41</sup> The "commercial" designation is essentially a catch-all category that includes "business, institutional, religious, charitable, governmental or recreational purposes, or any general purpose other than agricultural, grazing, mining, oil, homesite, or rights-of-way."<sup>42</sup>

Under A.R.S. § 37-281.02, state trust land can be leased for commercial purposes to the highest and best bidder at public auction if ASLD determines that leasing of the land is in the best interest of the state.<sup>43</sup> The lease granted under this authority must be for more than 10 years but no more than 99 years, and it must provide for an annual rental of not less than the appraised fair market rental value of the land.<sup>44</sup>

ASLD's regulations provide that all state land classified as suitable for commercial purposes is subject to a commercial lease.<sup>45</sup> Applications to lease land not classified as commercial must be accompanied by a petition for reclassification.<sup>46</sup> Unless it is in the best interest of the state, it is not the policy of ASLD to issue commercial leases which will seriously interfere with, damage, or break up operations of an established ranch or farm unit.<sup>47</sup> There is no limit to the amount of commercial land that may be leased to any one individual or association.<sup>48</sup>

The lease auction must be conducted in the same manner as required for sales of state trust land, with some adjustment.<sup>49</sup> For certain rural land that is a given distance from incorporated cities and towns, ASLD must cooperate with the county in which the land is located in considering the intended uses of the land.<sup>50</sup> The lease must include a rental adjustment formula under which the rental is subject to adjustment every five years or more frequently, and both the rental for the first five-



year period and the rental adjustment formula must be established by ASLD prior to auction and published in the call for bids.<sup>51</sup> In addition, the annual rental must not be less than the appraised fair market rental value of the land.<sup>52</sup> The lease *may* include an amortization schedule to determine the value of improvements when the lease is terminated.<sup>53</sup> Each offer for lease must reserve the right of ASLD to reject all bids and re-offer the land for lease if the bids are not acceptable to ASLD.<sup>54</sup>

In most cases an application to lease state trust land must be accompanied by a deposit based on the approximate first-year rental plus administrative expenses. After each commercial lease auction deposits are returned if the applicant is not the successful bidder, applied to the rental price if the applicant is the successful bidder, or transferred to the trust if there are no bidders at auction.<sup>55</sup> Before acceptance of a bid, ASLD is required to establish to its satisfaction the responsibility of a bidder.<sup>56</sup> Upon announcement of the successful bidder, the first year's annual rental must be paid by cashier's check; if the successful bid exceeds the minimum bid, the difference is due five business days after the auction. Failure to meet these deadlines results in forfeiture of the lease and money already paid. The successful bidder must also pay the cost of the publication and reasonable expenses of the lease.<sup>57</sup>

For private landowners, leasing allows the landowner to retain control over the land, while freeing the tenant from the large financial commitments, such as down payments, that come with ownership. With a traditional commercial leasing situation, the landowner has an incentive to construct infrastructure that will make the property more valuable to a potential tenant, thus increasing the value of the property. Alternatively, the lessee may offer the tenant reduced rent in exchange for infrastructure improvements installed by the tenant. Neither of these options are currently available to ASLD.

### **Sale or Lease of Rights-of-Way**

One of the most common means of providing for the development of common infrastructure is through the sale of rights-of-way. Pursuant to Arizona statute, ASLD is permitted to grant rights-of-way on or across trust land "for any purpose it deems necessary."<sup>58</sup> In addition, ASLD has special authority to grant rights-of-way for transportation purposes to federal and state agencies and political subdivisions (such as cities and towns) without public auction.<sup>59</sup> Rights-of-way can be applied for and granted on any parcel of state trust land absent an insurmountable conflict with existing rights, and irrespective of the consent of surface or subsurface lessees.<sup>60</sup> ASLD is permitted to require a bond or other assurance to ensure restoration of the surface after closure of a right-of-way.<sup>61</sup>

Rights-of-way for a term of 50 years or less can be granted without a public auction; although in no event can a right-of-way be conveyed for less than appraised value. However, aside from grants to public agencies as noted above, any right-of-way that "amounts to the disposition of or conveys a perpetual right to use the surface of the land" must be sold at public auction. These sales are conducted in the same manner as land sales as described above.<sup>62</sup> Also, regardless of the process of sale, rights-of-way must always be conveyed for no less than their appraised value.<sup>63</sup> ASLD is also permitted to dispose of sites for reservoirs, dams, power plants, irrigation plants, and other purposes under the same rules governing the disposal of rights-of-way.





The constitutional requirement that rights-of-way be disposed at auction and for their “true value” has frequently had unfortunate consequences in practical application. In many cases, rights-of-way have little actual value to the trust, such that the time, cost, and effort required to conduct an auction for a right-of-way cancels out or even exceeds the revenues to the trust from the sale. Nevertheless, ASLD cannot refuse to process these applications as a practical matter, since (given the size of the trust portfolio) trust land would otherwise constitute an insurmountable barrier to necessary infrastructure.

Worse, in many cases the high cost of siting rights-of-way across trust land has led public infrastructure to be routed around trust land. This bypassing occurs despite the fact that placing infrastructure on trust land would substantially increase its value and, from a financial standpoint, the trust would benefit from granting the right-of-way for free. There are numerous instances where the trust has ended up actually losing money as a result of charging for infrastructure. For example, many cities assess development fees against trust land that incorporate the costs of acquiring the rights-of-way, plus an administrative fee. In essence, the trust is charged more for the right-of-way than the trust can expect to receive.

## Special Use Permits

In some cases, infrastructure development may occur pursuant to ASLD’s special use permitting mechanism, particularly short-term activities such as detailed site investigations, surveys, weather analysis, and so forth. Pursuant to A.R.S. §37-132(B)(6), ASLD is authorized to issue permits for the “short-term use of state land for specific purposes as prescribed by rule.” Under ASLD’s current implementing regulations pursuant to A.A.C. R12-5-1101, these permits may be issued for “special purposes not specifically provided for by existing law or the rules and regulations of the Land Department,” provided that the contemplated use does not conflict with any federal or state laws.

A special use permit can be issued for a term of up to 10 years without a public auction, although an application for an initial special use permit is currently limited to a period of no longer than two years.<sup>64</sup> ASLD is required to charge no less than the appraised rental value of the land for the purposes provided in the permit, and a minimum of five cents per acre or \$10.00 per year.<sup>65</sup> ASLD can craft a form of permit appropriate for the use contemplated, and permits are subject to forfeiture for non-compliance of the permit’s conditions. Moreover, ASLD can require a permittee or lessee to post a bond or other collateral to guarantee performance or restoration.<sup>66</sup>

## Urban Lands Provisions

In addition to the ASLD’s general authorities for the disposal of land, leases, and rights-of-way, it retains a series of special authorities related to the disposal of urban land. “Urban lands,” in this context, are defined as trust land that adjoins existing developed land and that is located within or adjacent to the boundaries of a city or town.<sup>67</sup> At the request of a local governing body, ASLD may designate as urban land any trust land located within one mile (for population less than 250,000) or three miles (for population of 250,000 or more) of a city or town boundary.<sup>68</sup> Urban land designation brings several other tools into play for trust land.



## Growing Smarter

Urban state trust land planning generally occurs under the framework of Arizona's 1998 Growing Smarter legislation. This legislation created a statewide framework for the planning of land in Arizona's cities and towns that requires the adoption and periodic update of general plans in each city and town and comprehensive plans in each county. A corresponding framework was also created for the planning of state trust land, requiring the ASLD to prepare and periodically update "conceptual plans" for urban trust land that will be integrated into local general and comprehensive plans. These conceptual plans define the various land uses and major constraints. As part of this conceptual planning process, ASLD is authorized to designate infrastructure corridors, public sites, and other primary infrastructure components.

The legislation also requires the ASLD, in consultation with city, town, and county planning authorities, to prepare five-year disposition plans that identify trust land that will be master-planned, zoned, sold, leased, or classified for conservation purposes.<sup>69</sup> Finally, the statutes provide for a process by which urban trust land can be planned in greater detail for development, receive entitlements, and ultimately be brought to auction for lease or sale.

## Development Plans

Once a conceptual plan for state land is in place, ASLD can designate land as suitable for a development plan. The development plan, which must be consistent with the existing conceptual plan, can be prepared by ASLD using its own resources or pursuant to a planning contract issued to the lowest and best bidder.<sup>70</sup> ASLD may issue a planning permit to a bidder at auction; the planning permittee is then responsible for planning and entitling the property and submitting the plan to ASLD for approval.<sup>71</sup> If necessary, ASLD can also develop or contract/permit for the development of a secondary plan to enhance an approved development plan.

The development or secondary plan defines specific land uses, densities, development timing, provisions for assured water supply, zoning and land use controls, and other development planning elements. The development plan also defines infrastructure components, including public facilities, water and wastewater infrastructure, transportation, parks and recreation, school sites, and other infrastructure components.<sup>72</sup> If existing infrastructure is inadequate to serve trust land, a development plan located within a city or town may also include provisions for a master plan area of 160 acres or larger. In this case, the plan can instead identify a set of design guidelines, conditions, and restrictions, as well as provisions for infrastructure planning, phasing, and funding.<sup>73</sup>

When the plan is approved, ASLD can then reclassify the land included in the plan in preparation for sale.<sup>74</sup> Classification is required to be based on a determination that "reclassification is in the best interest of the trust and of the State."<sup>75</sup> The reclassification may be appealed by any person adversely affected.<sup>76,77</sup> If no appeal is taken, or the decision of the Commissioner is upheld, any lease on the reclassified land is automatically cancelled, with a limited preferred right to lease the reclassified land given to the former lessee.<sup>78</sup>

Upon reclassification, the land can be sold for development.<sup>79</sup> As a condition of sale and when a certificate of purchase is issued to the buyer (or as the terms of any commercial lease), ASLD can impose enforceable covenants and conditions on the buyer/lessee to implement the elements of the development or secondary plan. A breach of these conditions can lead to reversion of the parcel to ASLD.<sup>80</sup>



To accomplish the development of planned infrastructure in the development or secondary plan, ASLD can attach the value of the various easements and infrastructure sites (such as those for parks, schools, open space, and other public facilities) to parcels that will be sold or leased for development as a means of obtaining the required appraised value for these parcels. ASLD has substantial flexibility in establishing the value of the infrastructure components in the development plan, provided that the total revenues derived from all parcels within the development plan are not less than the aggregate appraised value of the land located within the plan.<sup>81,82</sup>

A recent ruling from the Arizona Court of Appeals in *Northeast Phoenix Holdings, LLC v. Winkleman* suggests that this statutory tool may be of significant importance in navigating around the strictures of the *Lassen* decision (holding that the ASLD must receive true value for any right-of-way across trust land). In *Northeast Phoenix Holdings*, the court found that it was constitutional for the Commissioner to bundle a parcel of land together with associated rights-of-way for purposes of appraisal and auction, and to then assign a total value to the combined property. Because the successful bidder was required to expend significant amounts of money to construct infrastructure on these rights-of-way as a condition of the 99-year commercial lease, the practical effect of this action was that the resulting appraisal applied a significant “discount” to the value of the rights-of-way, since the costs that would be incurred by the bidder were quite substantial in comparison to the value of the interests granted in the trust land.<sup>83</sup>

The court found that there was no harm to the trust associated with this approach to the appraisal and auction process. This holding relied, at least in part, on the Commissioner’s statutory authority to assess the value of rights-of-ways or parcels to be used for public purposes and assign those values to particular parcels “within the scope of an approved development or secondary plan” for urban land.<sup>84</sup> It is also critical to note that in this case the court specifically found that it was not a violation of the Arizona constitution, Enabling Act, or the trust responsibility to approach the appraisal and disposal of property in this manner. This decision confirmed that ASLD has substantial flexibility to bundle infrastructure, rights-of-way, financing, and land development together into a single package for purposes of land sales and leases.

This mechanism has allowed ASLD to put together complex, large scale development plans in which the purchasers or lessees of each parcel agree to build a portion of the infrastructure required for the development as a whole. In ASLD’s massive Desert Ridge development project in northern Phoenix, the owner of each certificate of purchase was responsible for constructing both the infrastructure required for the development of their particular parcel, as well as the common infrastructure required to access and provide utility service to neighboring parcels. For example, the developer of Parcel A would construct the interchanges and roads necessary to access both Parcel A and neighboring Parcels B and C, along with oversize sewer and water lines that would serve all three parcels. The developer of Parcel B would then extend that infrastructure throughout Parcel B and also to Parcel C. In turn, the developers of Parcel A and B would receive development fee credits for the construction of this “excess” infrastructure, and the developer of Parcel C would then reimburse both through the payment of development fees to underwrite the infrastructure construction.



Although workable in theory, this strategy has proved to be unreliable in practice. In the aforementioned Desert Ridge project, the recent downturn resulted in several major developers either defaulting or threatening to default on their certificates of purchase and/or commercial leases. Other developers experienced significant construction delays due to lack of housing demand, and sought corresponding delays in their infrastructure construction obligations. Given the overlapping and interdependent nature of the infrastructure construction agreements that held the project together, the resulting combination of delays and defaults left ASLD with a literal patchwork of half-constructed infrastructure, which in turn left many surviving developers without the completed roads, water, and sewer lines necessary to connect their own projects to existing public infrastructure.

## Improvement Plans

Arizona law allows a city, town, county improvement district, or community facilities district to submit an “improvement plan” to ASLD for approval that provides for the levy of assessments against state trust land for the construction of on or off-site improvements that benefit the state land.<sup>85</sup> The improvement plan is required to identify the nature of the improvements, estimated costs, and a proposed method and schedule for imposing costs on lessees and the holders of any certificate(s) of purchase for the affected land. An assessment of the benefit to state land demonstrating that the benefits are at least equal to the assessments that will be imposed is also required.<sup>86</sup> Because this mechanism permits assessments for both on and off-site improvements, it allows for trust land to potentially be included in larger public infrastructure projects financed by local jurisdictions and/or special taxing districts.

Assessment charges levied against state land pursuant to improvement plans and other special assessments are reported to ASLD, which includes payment of such charges as a condition of each lease and certificate of purchase. Where charges are held in abatement, payment of accumulated back charges are assessed against a purchaser or lessee as a condition of sale or lease.<sup>87</sup> Failure to pay assessment charges is a basis for default under a lease or certificate of purchase.<sup>88</sup>

This mechanism is a critical element in enabling the use of local impact fee programs to finance infrastructure on trust land, whereby impact fees are assessed against both developers and commercial lessees. Impact fee programs are discussed in greater detail later in this report. The use of improvement plans is subject to two key limitations, however. First, the assessment can be imposed only against the interest held by the lessee of commercial leases and/or the owner of a certificate of purchase on the affected land; it cannot be imposed against the state lands themselves. As such, until lands are sold or leased, any costs associated with such an assessment must be held in abeyance.<sup>89</sup> Similarly, in the event of default, the only recourse available to the city or special district is against the interest held in the state land; the state lands themselves cannot be subject to lien and cannot be foreclosed upon as a result of any default.<sup>90</sup> Second, the assessment cannot be imposed against any existing lessee or certificate of purchase holder unless they consent to the inclusion.<sup>91</sup> Absent such consent, an improvement plan must generally be put in place prior to development sales and leases, since financing must be generally rely on prospective purchases and leases.



The significance of these limitations is difficult to understate, as they fundamentally undermine the ability of local jurisdictions and special taxing districts to effectively provide bond financing for public infrastructure. Under normal conditions, infrastructure bonds can be secured and repaid from assessments levied against the lands benefited by them; in the event of default, these assessments function as a lien on the land and can, worst case, be foreclosed upon. However, in the case of trust land, because only a lessee or purchaser's interests in trust land can be subject to lien, in the event of default there is no opportunity to foreclose on the underlying land. This effectively prevents the use of bond financing to construct infrastructure on trust land, foreclosing access to the most common and cheapest forms of public infrastructure financing.

## Infrastructure Agreements

Pursuant to Arizona statute, ASLD is authorized to enter into agreements with both public and private parties to construct, operate, and maintain infrastructure located on trust land. This infrastructure agreement identifies the specific infrastructure to be constructed, schedules for installation, repair and maintenance obligations, and other relevant provisions. Additionally, it provides a methodology for establishing reimbursable costs, which can include costs associated with land acquisition, construction costs, and a reasonable rate of interest. Under the agreement, the party funding these costs can then seek reimbursement from subsequent purchasers or lessees of these costs and interest.<sup>92</sup> The agreement can be ensured by appropriate security, such as a performance bond, to guarantee that the party meets its obligations under the agreement. These types of agreements are frequently utilized in connection with city impact fee programs, which provide for reimbursement of infrastructure capital costs that are advanced by one developer from impact fees collected from future developers.

## Development Fees

Development fees have played a critical role in Arizona as a means of financing public infrastructure on trust land, as they provide a known source of revenue from trust land development. This revenue source frequently materializes in advance of the development of a local tax base on former trust land, as it is patented, passed into private ownership, and subject to local taxes and fees. Many local municipalities assess fees for a broad range of public infrastructure, ranging from roads and water/wastewater systems to public libraries, open space, and trails.

As land use regulations, development fees are subject not only to the requirements of the enabling statutes that empower local governments to collect these fees, but also to constitutional requirements which prohibit taking private property for public use without just compensation. In essence, the courts have found that development fees must satisfy a "rational nexus test" consisting of three basic elements. First, a rational nexus between the demands generated by a particular type of development and the infrastructure to be funded by the development fee charged against that type of development must be established. Second, the fees charged must be proportionate to the extent of the infrastructure demand imposed by development. Third, the payor of the development fee must ultimately receive a benefit from the payment of the fee in the form of access to or availability of the infrastructure or capital improvements funded by the fee. Although these constitutional requirements are incorporated into Arizona's development fee statute, these "rational nexus test"



elements continue to underlie the requirements of the statute and can be used to guide an interpretation of the express statutory requirements.

Pursuant to A.R.S. §9-463.05, an Arizona municipality is authorized to assess development fees “to offset costs to the municipality associated with providing necessary public services to a development.” Necessary public services are defined broadly to include “the costs of infrastructure, improvements, real property, engineering and architectural services, financing, other capital costs and associated appurtenances, equipment, vehicles, furnishings and other personalty.”<sup>93</sup> The relevant requirements of the statute are reviewed briefly below.

Under the statute, collected fees must be accounted for separately and expended on the “same category of necessary public service for which the development fee was assessed.”<sup>94</sup> Consistent with the prevailing case law, the statute also requires development fees to result in beneficial use to the development and bear a reasonable relationship to the burden imposed upon the municipality to provide the additional infrastructure necessary to service new development.<sup>95</sup> The statute further requires that fees must be assessed in a “nondiscriminatory” manner.<sup>96</sup>

To ensure this reasonable relationship, the statute mandates that municipalities “provide a credit toward the payment of a development fee for the required dedication of public sites, improvements and other necessary public services included in the infrastructure improvement plan (IIP) and for which a development fee is assessed” to the extent that these dedications are provided by a developer.<sup>97</sup> The statute also separately provides for an “offsets” provision, which requires that the municipality must “consider, among other things, the contribution made or to be made in the future in cash or by taxes, fees or assessments by the property owner towards the capital costs of the necessary public service covered by the development fee.”<sup>98</sup>

The statute finally includes a number of “transparency” requirements intended to ensure that the basis of municipal development fees is explained sufficiently and can be reviewed by the public during the required public notice, review, and hearing process. There are essentially three requirements associated with these “transparency” provisions. The first step is preparation of an IIP that estimates the need for future necessary public services, forecasts the capital costs of those services for which a fee will be charged, and forecasts the time required to finance and provide the services. The second requirement is the preparation of a development fee study that identifies the relationship between the fee and IIP, the methodology used to calculate the fee, and any index that will be used for automatic adjustment based on changes in materials costs.<sup>99</sup> Third is the stipulation for periodic reporting on development fee charges, infrastructure financing, and fee usage.<sup>100</sup>

It should be noted that the statute permits the IIP and development fee study to be united in a single document, which is the preferred practice among most Arizona municipalities. Although the IIP and development fee study are not expressly required to include all supporting documentation, the statute nevertheless requires the development fee study to include “documentation that supports the assessment of [any] new or modified development fee.”<sup>101</sup> Statute also requires the municipality to “make available to the public the documents used to prepare the [IIP]” as part of the public review process.<sup>102</sup>





The development fee is normally assessed when a building permit or site plan is issued. In the case of development projects on trust land, this means that the majority of development fee collections will occur only after the issuance of a patent. Because the usual strategy for residential development projects involves obtaining at least a partial patent covering the appropriate phase of the development prior to pulling building permits, only commercial lease projects can be expected to pay development fees while they remain in trust ownership. However, the availability of development fee credits can provide a significant means of financing infrastructure on residential projects, as a developer of one project can be required to undertake the development of common infrastructure serving a broader area, while expecting to recover those costs from the development of the other land.

### **Arizona Preserve Initiative**

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In addition to the mechanisms described above, open space and conservation infrastructure can be addressed via the Arizona Preserve Initiative (API) program. The API was created by the Arizona legislature in 1996 “to encourage the preservation of select parcels of state trust land in and around urban areas for open space to benefit future generations.” Under this program, a state or local government, business, state land lessee, or a citizen group can petition the State Land Commissioner to reclassify state trust land as “suitable for conservation purposes.” The Commissioner can also reclassify land on his/her own initiative. If the land is reclassified, the Commissioner may adopt a coordination plan to protect the property’s conservation values and allow the land to be withdrawn from sale or lease for three to five years to enable prospective lessees or purchasers time to raise funds; the trust land may then be leased or sold for conservation purposes at auction.<sup>103</sup> To date, the Commissioner has reclassified nearly 40,000 acres of urban land as “suitable for conservation purposes” and has sold approximately 3,000 acres under the program. A 1998 amendment also provided for a \$220 million public-private matching grant program to assist the purchase or lease of trust land for conservation.

However, Arizona’s API program is in serious trouble due to recent challenges from program opponents who believe the program to be unconstitutional, since it does not guarantee that trust land is sold to the “highest and best bidder” as required by the Arizona Constitution.<sup>104</sup> Although there has been no definitive ruling on this issue, the program is now on indefinite hold. As noted elsewhere in this report, creating more flexible and functional programs and approaches to land conservation has been a central feature of recent reform efforts.

### **Participation Agreements**

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A final mechanism available to ASLD in promoting infrastructure development and financing is the use of a participation contract. Pursuant to A.R.S. §37-101, a “participation contract” is defined as “a contract arising out of a sale together with other rights and obligations in trust land whereby ASLD receives a share of the revenues generated by subsequent sales or leases.” A participation contract involves a transaction in which land is auctioned at a lesser current price in exchange for a “participation” in the revenues generated when the land is subsequently sold or leased by the purchaser.



Pursuant to state law, joint ventures between Arizona state agencies and political subdivisions and private parties are expressly prohibited. Article IX, Section 7 of the Arizona constitution provides that “neither the state, nor any county, city, town, municipality, or other subdivision of the state shall ever...become a subscriber to, or a shareholder in, any company or corporation, or become a joint owner with any person, company, or corporation, except as to such ownerships as may accrue to the state by operation or provision of law or as authorized by law solely for investment of the monies in the various funds of the state.”<sup>105</sup> This legal restriction on direct agency participation in joint ventures requires a careful separation of interests in any participation contract to ensure that state resources are not being used in a joint venture.

Pursuant to A.R.S. §37-239, ASLD is authorized to enter into participation contracts on state land and to retain consultants in negotiating or preparing these contracts based on a fee charged to the applicant for a participation contract. Like land sales and commercial leases, participation contracts are subject to the approval of the board of appeals.<sup>106</sup> Prior to the approval of a participation contract, ASLD is required to consider and report on anticipated revenues from the contract, trends in land values for similar land uses, financial feasibility, economic risks and benefits to the trust, and alternative uses for the land.<sup>107</sup>

State land participation contracts are required to provide specific criteria and plans for phasing and disposition of subsequent sales or leases of the participation land, a formula for determining the amount of revenue to the trust as a result of subsequent sales and leases, and specific rights and remedies in the case of a default on the participation contract, including forfeiture of the land.<sup>108</sup>

The participation contract mechanism thus allows a private party to obtain legal control over trust land in such a manner that the party is able to develop infrastructure and make other critical investments in the property in advance of actual land sales. It should be noted that via its commercial leasing authority, ASLD can additionally include similar types of participation terms in commercial leases; the inclusion of such terms in a commercial lease does not subject the lease to approval as a participation agreement.

### **Infrastructure Financing under Participation Contracts**

A participation contract is similar to a joint partnership between a landowner and a developer. The landowner supplies land, the developer improves and perhaps builds on it, and the two share revenue from the project. This can be a very advantageous arrangement to a landowner with low carrying costs, such as the state with regard to trust land. The state is not allowed to enter into *full* partnership with a developer, as a private party is, and terms of the participation agreement must be carefully spelled out to avoid mingling state and private funds.



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### Long-Term Infrastructure Planning

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At present it is difficult to accurately evaluate the potential impact of infrastructure development on the trust. Many major infrastructure projects, such as large-scale transmission lines, freeway projects, and flood control structures, can effectively foreclose future development opportunities on trust land, frequently on a significant scale. As such, ASLD is normally inclined to avoid siting large-scale infrastructure on trust land.

However, given the size of the ASLD portfolio, it is extremely unlikely that more than a tiny fraction of its trust assets will ever be developed. Arizona has approximately 9.28 million surface acres of trust land.<sup>109</sup> Of these, more than one million acres are located adjacent to or within rapidly urbanizing areas where development may be the most valuable future use. In addition, much of Arizona trust land is held in large, contiguous parcels that approach hundreds of square miles in size, like the Superstition Vistas project.

In recent years, over 90 percent of the annual revenue generated from the trust portfolio has been generated by land sales and commercial uses of trust land, primarily for commercial and residential development in Arizona's urban areas. However, these uses currently occur on an extremely small subset of lands. ASLD has recently averaged sales of only around 2,000 to 3,000 acres of land for development each year out of the nearly one million acres currently located within or adjacent to urban areas.

Despite the high value of land for development, given the rate of land absorption in Arizona's urban areas, constraints on transportation, water and other natural resources, and various political considerations, it is highly unlikely that ASLD will ever sell more than a small percentage of its overall portfolio for development use over the next few hundred years. As such, at recent rates of land disposal, in most cases infrastructure development is unlikely to interfere with development opportunities.

As discussed in a recent Sonoran Institute/Nature Conservancy report, *The Next Million Acres*, a large scale, statewide planning effort to identify trust land suitable for development could have enormous benefits. The decisions that the ASLD will make in the future with regard to trust land dispositions will have a profound influence on growth. This potential is particularly significant with regard to three key, interlinked issues: the location and type of development, the location of transportation corridors, and planning for open space and conservation.

Trust land dispositions have the potential to have a similar influence on the location and timing of public infrastructure, particularly transportation corridors. As of 2006, Arizona's transportation infrastructure included more than 57,000 miles of federal, state, county, and local roads.<sup>110</sup> This infrastructure lies at the heart of Arizona's economy, providing the means to move both people and commerce between and within commercial and industrial centers. The relationship of major transportation infrastructure, such as freeways, arterial highways, rail, and airports (including flight corridors) likely influences the path and timing of development, as well as the relative value of undeveloped land, more than any other single factor. Freeways and arterial highways, for example, make up approximately 11 percent of the 57,000



miles of Arizona roads; yet they carry nearly 75 percent of all traffic on Arizona roads.<sup>111</sup> These major transit routes are also becoming increasingly important as the state grows. Recent studies show that in Arizona vehicle miles continue to rise much faster than the national average as our cities proceed to spread out and commuters travel further and further to connect home and work.<sup>112</sup>

Pursuant to A.R.S. §37-211, the Commissioner is authorized to “conduct investigations and experiments on the lands of the state” to obtain “information and data which will aid in the leasing, sale and administration of lands belonging to the state.” Based on these investigations, the Commissioner can classify and reclassify state land into a series of potential use categories, including commercial uses.<sup>113</sup> Upon reclassification, existing leases can be noticed and cancelled to allow for a changed use.<sup>114</sup>

Similar investigative functions are also expressly provided for under the statutes authorizing ASLD’s Resource Analysis Division. The statutes authorize the division to maintain a central repository for various types of land resource information, engage in remote sensing and survey work, produce maps, and engage in similar activities.<sup>115</sup> The Division is additionally permitted to contract for any services it requires to the extent that they cannot provide services in-house, as well as utilize the advice and services of other federal, state, local, and regional agencies.<sup>116</sup>

Under A.R.S. §37-132(A)(3) ASLD’s existing authority to “make long-range plans for the future use of state lands in cooperation with other state agencies, local planning authorities and political subdivisions” would provide similar authority to engage in cooperative, state and local planning efforts for long-term infrastructure planning. Notably, pursuant to A.R.S. 37-132(A)(11), ASLD is also authorized to expressly withdraw state land from surface or subsurface sales or lease application “if the commissioner deems it to be in the best interest of the trust.” This would allow ASLD to specifically limit the use of land identified for infrastructure corridors, encouraging the development of infrastructure in these planned areas.

### **Constitutional Lien Authority**

One approach to providing for public infrastructure financing that has been examined as part of previous reform discussions is to create an exception to the constitutional restrictions against liens on state land that otherwise apply by virtue of Article IX of the Arizona constitution. This proposed constitutional exception would allow, pursuant to further legislative authorization, trust land to be included in a special taxing district, such as a community facility district (CFD), provided that certain criteria are met, including a provision of security adequate to prevent foreclosure of the lien.

Although this provision has appeared in at least two different versions of recent trust reform measures, it remains unclear how this change could be practically implemented as this proposed reform raises both substantial practical and legal issues. From a practical standpoint, the issue is that in order for a potential CFD on trust land to be able to accomplish anything from a financing perspective, the CFD will require identified methods of both creating a revenue stream and securing the trust land such that the bonds issued by the CFD would be marketable.



Both of these complex issues will require a substantial supporting statutory and/or administrative rulemaking framework in order to succeed. For purposes of the former, it will be necessary to develop a methodology and approach to the formation and implementation of a CFD that could occur early enough in the development cycle for a large project to provide a viable alternative for financing public infrastructure, while still having enough of an identified, known, and certain revenue stream that it could support a marketable bond issue. The latter will require identifying methods of securing the trust land against the liens created by a CFD obligation such that trust land will not be forfeited if things go badly.

In light of recent credit market conditions, identifying a means of meeting both needs will likely require substantial discussion among the ASLD and local development interests. Previous reform efforts assumed that a variety of credit forms would be readily available to developers for purposes of securing a trust land lien; however, more recent experience suggests that credit may be extraordinarily difficult to arrange. In this new context, a stakeholder discussion to evaluate and define an acceptable financing structure and approval process will be essential.

### **Expansion of Participation Contract Authority**

In light of the substantial concerns associated with the development of constitutional lien authority, an alternative approach would be to expand the ASLD's current participation authority. As discussed above, the participation statute framework permits the formation of something akin to a limited joint venture, in which the developer can obtain access to state land at a substantially lower cost, in exchange for providing the ASLD a percentage of back-end revenues.

While the participation contract statute already allows the ASLD to participate in this type of transaction, this process has not been widely viewed as a desirable approach, and there are well documented reasons as to why it has not been frequently employed. The most significant reason is that a participation contract requires a relatively high down payment of 2.5 percent. For a large project the developer is required to cover a substantial amount of additional financing costs up front - costs that could probably be better employed improving the value of the land in preparation for sale. This requirement has the effect of limiting the potential size of projects, since the larger the project, the greater the financing burden placed on the developer therefore making the investment less likely.

Similarly, and perhaps more importantly, related requirements of the participation statute oblige the developer to provide even more up-front costs, at least 10 percent, prior to reaching critical entitlement stages of planning and zoning.<sup>117</sup> This requirement limits the potential size of projects and creates incentives to delay entitlements for as long as possible to avoid incurring costs, both of which are contrary to the interests of the trust. Worse, the statute imposes a similar 10 percent requirement before the developer can begin making physical improvements to the property, including grading activities as well as the construction of required infrastructure.<sup>118</sup>

These requirements are only complicated by the partial patent rules discussed earlier which are applied to a participation project. Under those rules, ASLD can only issue



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a patent for less than the entire property where the remaining value of the property is greater than the amount owed under the certificate of purchase, and that the value already paid for the acreage subject to the partial patent exceeds the per-acre purchase price for the entire property.<sup>119</sup> Partial patents cannot be issued for less than 10 acres or less than  $\frac{1}{4}$  of the total land (whichever is smaller), although if the original land tract is less than 40 acres in size, partial patents may be issued for as little as five acres.<sup>120</sup> These requirements substantially limit flexibility in project design and disposal, and are only made more restrictive by an additional statutory requirement that no partial patent disposals can occur under a participation contract until the 10 percent requirement has been met.<sup>121</sup> Taken together, these rules require developers to cover an enormous additional amount of financing costs and risks, creating substantial disincentives for use of this mechanism that likely make use of the participation mechanism uneconomical in many circumstances.

Appendix II provides a series of suggested amendments to the existing participation statutes that would address at least some of these concerns by relaxing a few of the most problematic requirements. It is critical to recognize that the closer the statute gets to authorizing something that looks like a joint venture, the more risk it entails to the state land trust. Many, if not most of these risks can be addressed through the inclusion of appropriate contractual protections on a case-by-case basis, but mitigating risk in this manner will require a high degree of vigilance and sophistication on the part of the ASLD; capabilities that will be a challenge to maintain in light of current budgetary limitations.

### **The Master Developer Lease**

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A final, and perhaps the most promising approach, would be the development of a master developer lease framework similar to that employed in certain other Western states, notably Utah. The master developer lease concept is an attempt to provide for an entirely different approach, in which the ASLD can follow something closer to a true joint venture, but with far more limited exposure than in a true joint venture.

In a typical private joint venture, the landowner/investor puts up the land, the developer puts up the development costs, and they share in the proceeds. The master developer lease is an effort to provide something similar, avoiding the partial patent problems, down payment issues, and other restrictions by allowing the ASLD to continue to own the land throughout the primary process of development, therefore letting the developer take advantage of the ASLD's low carrying costs.

Appendix I contains a proposed version of a master developer lease statute. Under the statute, developers bid on a "master developer lease" through a multiple-phase auction process that would allow the ASLD to properly qualify bidders. The lease can then provide for varying levels of detail requirements related to planning, entitlement, development of infrastructure, and other requirements, mirroring the ASLD's existing authorities to delegate such tasks, while providing the developer with a far more reliable means of cost recovery and reasonable expectations of profit. The lease effectively provides a master developer with a deliberately low-cost approach to obtaining access to state trust land for development and disposal, compensating the developer with a participation mechanism, while ensuring higher revenues to the ASLD by allowing them to participate in land sales and leases after substantial entitlement and/or development has occurred.





The lease also preserves the opportunity for multiple strategies for ultimate land disposal, by specifying that land subject to the lease can be sold by the master developer subject to participation by the ASLD, but also permitting land developed under the lease to be sold by ASLD at auction, subject to a similar participation element. This would allow for a flexible disposal plan that would combine the potential benefits of state land auctions for the disposal of large parcels and sections of a master plan (requiring the private developer to undertake the complex planning and permitting that is generally beyond the capacity of the ASLD), while allowing smaller parcels and rights-of-way to be disposed of by the developer for the sake of efficiency and/or profitability (again, while taking advantage of ASLD's low carrying costs).

While recognizing the somewhat higher legal risk with this approach, the master developer lease concept should in fact pass constitutional muster provided that the terms of the lease are clearly defined, the lease is appraised properly, and it is sold competitively at auction. It is important to note that the proposed master developer lease notice and auction requirements are intended to follow the same requirements as those of a sale. These requirements are necessary because this process, to the extent that it includes a lessee's participation, could be viewed effectively as either a lease or as a two-stage sale, whereby the master developer lease represents the sale of the future lessee's participation subject to the risks undertaken by the developer, and the eventual sale/lease of the land itself by the ASLD (or by the developer) represents the sale of the remainder interest.

Previous case law evaluating the legality of "holding leases" suggests that this type of structure should be permissible. In *Havasu Heights Ranch and Development Corporation v. State Land Department of Arizona*, the court was asked to evaluate the validity of "holding leases" issued by the ASLD to Havasu Heights.<sup>122</sup> The leases, labeled "commercial," were issued "for the purpose of holding for future commercial uses as may be approved by lessor" and prohibited any actual current use of the land.<sup>123</sup>

The ASLD was in the practice of issuing such leases essentially for speculative purposes based on the value of the preferred right of renewal granted by statute in the instance that the land was subsequently reclassified for urban land development.<sup>124</sup> The leases were challenged on a number of grounds, including that "holding for speculation" is not a valid commercial "use" within the version of A.R.S. § 37-101 that was then applicable.

The court denied this challenge, finding that "use" can mean "purpose," which is an "end, objective, plan or project" and does not require "actual use."<sup>125</sup> Furthermore, the definition of "commercial" land included (and still does under the present statute) "business" purposes and "any general purpose other than agricultural, grazing, mining, oil, homesite or rights-of-way."<sup>126</sup> The court found that holding for potential future profit could fit into either of these categories.<sup>127</sup> The court observed that its statutory interpretation was supported by the requirements that the ASLD make the "best use" of trust land and maximize the financial benefits flowing from the trust. Keeping options open, the court observed, may in some circumstances be the "best use" of trust land and consistent with the duty to maximize the value of the trust.<sup>128</sup>



The vision held by the Superstition Vistas Steering Committee is a grand one that would create a new paradigm for large-scale comprehensive planning on state trust land, for Arizona, and throughout the West. Success in realizing this vision depends on a host of factors, but clearly the ability to provide a well-planned and appropriate infrastructure framework consisting of roads, rail, energy, and natural open space will have a significant impact. That impact will be made on the future development pattern, the quality of life, the sustainability, and ultimately the ability of Superstition Vistas to attract future residents and compete at the megaregional scale in the Sun Corridor.

As demonstrated through this analysis of ASLD's legal authorities, there is a limited range of options available to create infrastructure investments in advance of development. They include the sale, lease, and disposal of rights-of way, as well as other permitting and land use planning mechanisms created through the Growing Smart Act of 1998. However, the ASLD has a need for more flexible and effective tools for incentivizing infrastructure investment. Currently, the ASLD is constrained in terms of its resources and planning practices, which could diminish the immense value, in terms of financial return, promoting orderly development, and quality of life and amenity value, for parcels such as Superstition Vistas and other similarly planned state trust land in the state.

This paper has explored a range of options for expanding the authority of ASLD to encourage the planning and investment of transportation networks, energy corridors, and conservation land prior to the first shovel being turned on a parcel. The gains to the beneficiaries of the trust could be significant, as land already connected to the larger region with roads, power and water lines, and committed open space generate a higher dollar sale price than raw land with no such advantages.

The most promising approach evaluated in this analysis is the development of a master developer lease that would provide the ASLD with a flexible range of opportunities for infrastructure investment and ultimate disposal of state trust land. It is similar in approach to that of a true joint venture, but limits the risk to the trust. It is also a more financially feasible method and more appealing to the developer than the other strategies explored. Therefore, it is more likely to result in on-the-ground success in siting value-added infrastructure with the potential to produce sustainability gains while increasing revenue to the trust beneficiaries.

Comprehensive state trust land reform efforts continue in Arizona, and many of the additional tools and statutory changes explored in this analysis have been proposed for inclusion in these reform packages over the years. Future efforts could be well served in considering the master developer lease provisions as a part of a comprehensive package of reforms. If such provisions were included, and passed by the voters, ASLD would gain a great deal of new flexibility in infrastructure planning on state trust land. If the authorities paved the way for more orderly disposal of state trust land appropriate for development and created a more sustainable development pattern in the process, it would be a boon not just to the beneficiaries of the trust, but to all Arizona residents.



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**Proposed Statutory Language to Create a Master Developer Lease Provision**  
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37-281.05 (ALT. 37-335.05). LEASING URBAN LANDS FOR MASTER DEVELOPER PURPOSES

A. URBAN LANDS MAY BE LEASED FOR MASTER DEVELOPER PURPOSES FOR A TERM OF UP TO FIFTY YEARS IN ACCORDANCE WITH THE CONSTITUTION OF ARIZONA, STATE LAW AND THE RULES OF THE DEPARTMENT. A MASTER DEVELOPER LEASE SHALL BE TREATED AS A COMMERCIAL LEASE AND SHALL BE SUBJECT TO THE REQUIREMENTS OF A.R.S. §37-281.02, WHERE NOT IN CONFLICT WITH THE PROVISIONS OF THIS SECTION.

B. THE DEPARTMENT MAY RETAIN ONE OR MORE CONSULTANTS TO ASSIST IN NEGOTIATING OR PREPARING A MASTER DEVELOPER LEASE, AND MAY CHARGE A FEE TO ANY APPLICANT TO DO SO. IF THE APPLICANT IS NOT THE SUCCESSFUL BIDDER, THE DEPARTMENT SHALL REFUND THE FEE.

C. IF THE COMMISSIONER DETERMINES THAT LEASING OF THE LAND UNDER THE MASTER DEVELOPER LEASE IS IN THE BEST INTEREST OF THE STATE, THE TRACT OR TRACTS SHALL BE OFFERED FOR LEASE TO THE HIGHEST AND BEST BIDDER AT A PUBLIC AUCTION. THE AUCTION SHALL BE CONDUCTED AT THE PLACE, IN THE MANNER, AND AFTER THE NOTICE BY PUBLICATION PROVIDED FOR SALES OF SUCH LANDS, EXCEPT AS OTHERWISE PROVIDED IN THIS SECTION. EACH OFFER FOR LEASE SHALL RESERVE THE RIGHT IN THE DEPARTMENT TO REJECT ANY AND ALL BIDS AND TO AGAIN OFFER THE TRACT OR TRACTS FOR LEASE IF THE BIDS RECEIVED ARE NOT ACCEPTABLE TO THE DEPARTMENT.

D. A MASTER DEVELOPER LEASE SHALL PROVIDE FOR THE USE AND POSSESSION OF TRUST LANDS BY A PARTY SERVING AS A MASTER DEVELOPER FOR THE PURPOSES OF ONE OR MORE OF THE FOLLOWING:

1. PLANNING AND ZONING URBAN LANDS;
2. MAKING IMPROVEMENTS TO URBAN LANDS TO FACILITATE THEIR SUBSEQUENT LEASE OR SALE FOR DEVELOPMENT;
3. PROVIDING FOR THE SUBSEQUENT SALE OR COMMERCIAL LEASE OF URBAN LANDS FOR DEVELOPMENT, RIGHTS-OF-WAY, CONSERVATION, OR PURPOSES ANCILLARY TO THE SAME BY THE LESSEE OR THE DEPARTMENT;
4. PROVIDING FOR THE SUBSEQUENT SALE OR LEASE OF URBAN LANDS FOR DEVELOPMENT, RIGHTS-OF-WAY, CONSERVATION, OR PURPOSES ANCILLARY TO THE SAME UNDER A PARTICIPATION CONTRACT.

E. THE MASTER DEVELOPER LEASE MAY REQUIRE THE LESSEE TO UNDERTAKE ONE OR MORE OF THE ACTIVITIES LISTED IN SUBSECTION D ON SUCH TERMS AS THE COMMISSIONER MAY DEEM APPROPRIATE, SUBJECT TO THE REQUIREMENTS OF THIS SECTION. THE RENTAL FOR A MASTER DEVELOPER LEASE SHALL BE DETERMINED BASED ON THE APPRAISED VALUE OF THE LEASE, WHICH SHALL BE REDUCED IN ACCORDANCE WITH THE IMPROVEMENTS, COSTS, AND EFFORTS TO BE UNDERTAKEN AND INCURRED BY THE LESSEE UNDER THE TERMS OF THE LEASE AND SHALL CONSIDER THE INCREASED VALUE TO THE TRUST ANTICIPATED TO



RESULT FROM THE SUBSEQUENT SALE OR LEASE OF LANDS AS A RESULT OF THE SAME.

F. A MASTER DEVELOPER LEASE THAT REQUIRES THE LESSEE TO UNDERTAKE PLANNING AND ZONING OF PROPERTY SUBJECT TO LEASE SHALL REQUIRE THE APPROVAL OF THE COMMISSIONER FOR ANY PLANNING AND ZONING ACTIONS, AND MAY INCLUDE PROVISIONS FOR REIMBURSEMENT OF PLANNING COSTS AS PROVIDED IN 37-388.

G. A MASTER DEVELOPER LEASE MAY REQUIRE THE LESSEE TO IMPROVE LANDS SUBJECT TO LEASE VIA THE INSTALLATION OF IMPROVEMENTS ON STATE LANDS, AND IF THE LESSEE WILL NOT RECEIVE FULL COMPENSATION FOR SUCH IMPROVEMENTS VIA A PARTICIPATION ELEMENT PURSUANT TO SUBSECTION H OF THIS SECTION, MAY PROVIDE FOR THE REIMBURSEMENT OF THE COSTS OF SUCH IMPROVEMENTS AT A COMMERCIALY REASONABLE RATE OF INTEREST, ON SUCH TERMS AS THE COMMISSIONER MAY DEEM APPROPRIATE. THE LEASE MAY INCORPORATE OR PROVIDE FOR AGREEMENTS FOR OFF-SITE IMPROVEMENT OF

URBAN LANDS PURSUANT TO A.R.S. §37-335.02 OR AGREEMENTS TO FUND, INSTALL, AND REIMBURSE COSTS OF INFRASTRUCTURE ON URBAN LANDS PURSUANT TO THE REQUIREMENTS OF A.R.S. 37-335.06. NOTWITHSTANDING ARTICLE 5 OF THIS TITLE AND THE PROVISIONS OF A.R.S. §37-335.01, A MASTER DEVELOPER LESSEE SHALL NOT BE ENTITLED TO COMPENSATION FOR IMPROVEMENTS MADE UNDER A MASTER DEVELOPER LEASE EXCEPT AS PROVIDED IN SUCH AGREEMENT OR AS OTHERWISE SPECIFICALLY PROVIDED IN THE TERMS OF THE LEASE.

H. A MASTER DEVELOPER LEASE MAY INCLUDE PROVISIONS FOR THE SUBSEQUENT SALE, LEASE, OR SUBLEASE OF LANDS BY THE DEPARTMENT OR THE LESSEE, AS THE COMMISSIONER MAY DEEM APPROPRIATE, AS FOLLOWS:

1. IF ANY LANDS SUBJECT TO THE LEASE WILL BE SUBSEQUENTLY LEASED OR SOLD BY THE DEPARTMENT, PROVISIONS FOR COMPENSATION TO THE LESSEE FOR THE LESSEE'S INVESTMENTS IN PLANNING AND IMPROVEMENTS TO THE LANDS SHALL BE CLEARLY STATED AND DEFINED IN THE MASTER DEVELOPER LEASE. A MASTER DEVELOPER LEASE WHICH INCLUDES SUCH PROVISIONS MAY INCLUDE A PARTICIPATION ELEMENT WHEREBY THE LESSEE MAY RECEIVE A PERCENTAGE OF THE REVENUES GENERATED BY SUBSEQUENT SALES OR LEASES OF THE LANDS BY THE DEPARTMENT IN FULL OR PARTIAL COMPENSATION OF THE LESSEE'S INVESTMENTS IN PLANNING AND IMPROVEMENTS TO THE LANDS. ANY LEASE CONTAINING SUCH A PARTICIPATION ELEMENT SHALL BE TREATED AS A PARTICIPATION CONTRACT AND SHALL BE SUBJECT TO THE PRIOR APPROVAL OF THE BOARD OF APPEALS UNDER A.R.S. §37-239, PROVIDED THAT THE REQUIREMENTS OF A.R.S. § 37-239, SUBSECTION E SHALL NOT APPLY TO A MASTER DEVELOPER LEASE.

2. A MASTER DEVELOPER LEASE MAY ALTERNATIVELY INCLUDE PROVISIONS FOR THE SUBSEQUENT SALE OR COMMERCIAL LEASE OF LANDS BY THE LESSEE PURSUANT TO A PARTICIPATION ELEMENT WHEREBY THE DEPARTMENT WILL RECEIVE A SHARE OF THE REVENUES GENERATED BY SUBSEQUENT SALES OR LEASES UNDERTAKEN BY THE LESSEE. ANY SUCH LEASE SHALL BE TREATED AS A PARTICIPATION CONTRACT AND SHALL BE SUBJECT TO THE PRIOR APPROVAL OF THE BOARD OF APPEALS UNDER A.R.S. §37-239, PROVIDED THAT THE



REQUIREMENTS OF A.R.S. § 37-239, SUBSECTION E SHALL NOT APPLY TO A MASTER DEVELOPER LEASE.

I. PRIOR TO ISSUING A MASTER DEVELOPER LEASE FOR AUCTION, THE COMMISSIONER MAY SOLICIT PROPOSALS FOR THE MASTER DEVELOPER LEASE THROUGH ADVERTISEMENT FOR AT LEAST FIVE CONSECUTIVE DAYS IN A NEWSPAPER OF GENERAL CIRCULATION IN THE COUNTY IN WHICH THE LANDS ARE LOCATED, OR IF THERE IS NO DAILY NEWSPAPER OF GENERAL CIRCULATION IN THAT COUNTY, THE ADVERTISEMENT SHALL BE PUBLISHED AS MANY TIMES WITHIN A THIRTY-DAY PERIOD AS THE NEWSPAPER IS PUBLISHED BUT NOT MORE THAN FIVE TIMES. THE COMMISSIONER MAY REQUIRE INFORMATION REGARDING PROPOSED PLANNING AND ZONING, PROPOSED INFRASTRUCTURE INSTALLATION AND OTHER IMPROVEMENTS, ESTIMATED COSTS AND MEANS OF FINANCING, AND ANY OTHER INFORMATION THE COMMISSIONER DEEMS APPROPRIATE. THE RESPONDENTS MAY ALSO BE REQUIRED TO PROPOSE A COMPLETE COMPENSATION PACKAGE FOR THE MASTER DEVELOPER LESSEE, INCLUDING PROPOSED MEANS OF REIMBURSING THE LESSEE FOR TIME AND COSTS, INTEREST ON TIME AND COSTS, STRUCTURED FEES, AND ANY PARTICIPATION

ELEMENTS. THE COMMISSIONER MAY PROVIDE THAT SOME OF THE INFORMATION THAT IS CONTAINED IN THE PROPOSALS WILL REMAIN CONFIDENTIAL, IF THE INFORMATION IS PROPRIETARY, UNTIL THE COMMISSIONER SELECTS A FINAL FORM FOR THE MASTER DEVELOPER LEASE. AFTER THE PROPOSALS ARE RECEIVED, THE COMMISSIONER MAY CONDUCT PREAUCTION CONFERENCES REGARDING THE PROPOSALS. THE COMMISSIONER MAY THEN AUCTION A MASTER DEVELOPER LEASE THAT, AT THE COMMISSIONER'S OPTION, INCORPORATES INFORMATION THAT WAS ACQUIRED THROUGH THE PROPOSAL PROCESS.

J. IN CONDUCTING AN AUCTION FOR A MASTER DEVELOPER LEASE, THE COMMISSIONER MAY REQUIRE BIDDERS TO BID ON MULTIPLE LEASE TERMS, INCLUDING THE AMOUNT OF LEASE PAYMENTS, PARTICIPATION TERMS, AND/OR PROVISIONS FOR LESSEE COMPENSATION.

K. IN SELECTING THE HIGHEST AND BEST BIDDER FOR A MASTER DEVELOPER LEASE, THE COMMISSIONER MAY REQUIRE THAT EACH BIDDER DEMONSTRATE THE NECESSARY EXPERIENCE, EXPERTISE AND FINANCIAL CAPABILITY TO SERVE AS A MASTER DEVELOPER FOR THE LANDS SUBJECT TO LEASE AND TO PLAN, IMPROVE, AND DISPOSE OF THE LANDS SUBJECT TO LEASE IN THE BEST INTEREST OF THE TRUST, INCLUDING THE QUALIFICATIONS OF ANY CONSULTANTS. THE COMMISSIONER MAY RETAIN ONE OR MORE INDEPENDENT EXPERTS TO ASSIST IN ASSESSING THE QUALIFICATIONS OF THE BIDDERS AND THEIR CONSULTANTS AND MAY CHARGE A FEE TO ANY APPLICANT TO DO SO. IF THE APPLICANT IS NOT THE SUCCESSFUL BIDDER, THE COMMISSIONER SHALL REFUND THE FEE.



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**Proposed Statutory Language Changes to Improve Participation Agreement Structure and to Improve Patent Issuance Process for the Arizona State Land Department**

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37-239. Participation contracts; planning and disposition proposals

A. The commissioner may enter into participation contracts and may charge a fee to an applicant to retain one or more consultants to assist in negotiating or preparing a participation contract. If the applicant is not the successful bidder, the commissioner shall refund the fee.

B. Before recommending any participation contract to the board of appeals, the commissioner shall consider and report on:

1. The methodology for determining any reimbursable infrastructure costs.
2. An analysis of the state trust revenue to be derived from the proposed participation contract.
3. The historical trends in land values in the area by types of proposed land uses.
4. An analysis of the financial feasibility of the planned development's proposed build-out schedule.
5. An evaluation of the potential economic risks and benefits to the trust arising from the participation contract.
6. An analysis of the economic and financial impact, and other factors determined by the commissioner, regarding alternative dispositions or no disposition of the lands.

C. Each participation contract shall:

1. Provide that subsequent sales or leases of state land that are subject to a participation contract shall be based on the criteria and the phasing and disposition plan included in the participation contract and the formula for determining the amount of revenue to the trust as a result of the subsequent sale or lease.
2. Prescribe rights and remedies in the case of default including rights to cure, forfeiture and other appropriate remedies.

D. This state's share of the revenues from the sale of land under a participation contract shall be deposited, pursuant to sections 35-146 and 35-147, in the appropriate perpetual fund.

E. A participation contract may be offered on lands that do not have a development plan approved by the commissioner or on land that may require the successful bidder to further plan and zone property after the auction. Before auctioning a contract requiring planning and zoning, the commissioner may solicit planning and disposition proposals, through advertisement for at least five consecutive days in a newspaper of general circulation in the county in which the lands are located, or if

there is no daily newspaper of general circulation in that county, the advertisement shall be published as many times within a thirty-day period as the newspaper is





published but not more than five times. The commissioner may require information regarding the projected planning and zoning, the estimated costs of the planning and zoning and the financial feasibility of the proposal. The proposals shall also contain proposed participation payments. The commissioner may provide that some of the information that is contained in the proposals will remain confidential, if the information is proprietary, until the commissioner recommends a contract to the board of appeals. After the proposals are received, the commissioner may conduct preauction conferences regarding the proposals. The commissioner may then auction a participation contract that, at the commissioner's option, may incorporate information that was acquired through the proposal process. A participation contract that is entered into pursuant to this subsection shall:

1. Require the successful bidder to pay a nonrefundable down payment of at least two and one-half per cent of the minimum bid for the property, **UNLESS THE COMMISSIONER DETERMINES THAT A LOWER AMOUNT WILL IMPROVE THE MARKETABILITY OF THE PARTICIPATION CONTRACT. IN ADDITION TO THE REQUIRED DOWN PAYMENT, THE SUCCESSFUL BIDDER SHALL BE REQUIRED TO PAY** ~~plus~~ the required fees prescribed in section 37-108 and, if the successful bidder did not pay the consultant fee pursuant to subsection A of this section, any fee charged pursuant to subsection A of this section, by cashier's check at the time of the auction. The down payment does not include participation payments.
2. Require an additional payment to be made within thirty days if the amount bid for the land exceeds the minimum bid, so that the total down payment, including the down payment paid on the date of the sale, will equal the required percentage down payment of the total amount bid. The additional payment does not include participation payments.
3. Require the successful bidder to post within thirty days after the auction a surety bond or another form of collateral that the commissioner considers to be sufficient to cover the costs of the required planning and zoning.
4. Provide for the forfeiture of the contract and any accompanying certificate of purchase or lease if the successful bidder fails to provide the required collateral.
5. Describe the land to be planned and zoned, which may include land that is retained by the department and not auctioned with the contract.
6. Contain guidelines for expected planning and zoning and time frames for the planning and zoning consistent with the guidelines.
7. Provide for the forfeiture of the contract and any accompanying certificate of purchase or lease if the successful bidder fails to accomplish the planning and zoning within the prescribed time, unless extended in writing by the commissioner based on good cause shown.
8. ~~Require at least ten per cent of the total purchase price to be paid by the time the planning and zoning are completed, unless extended in writing by the commissioner based on good cause shown.~~
9. Provide for absolute approval authority by the commissioner of any planning and zoning actions.



~~10. Deny the successful bidder the right to physically develop the property, including grading or leveling, until at least ten per cent of the purchase price has been paid.~~

~~11. Deny the issuance of partial patents for the property until at least ten per cent of the purchase price has been paid and the requirements of section 37-251 have been met.~~

~~10~~<sup>12</sup>. Contain such other terms that the commissioner considers to be necessary or appropriate.

F. After it is accepted by the commissioner, a planning and zoning proposal submitted to the local governing body by the successful bidder shall be administered as a state general plan or development plan as appropriate, according to the procedures described in article 5.1 of this chapter.

#### 37-251. Issuance of patents for state lands

A. Upon filing the certificate of purchase, together with evidence of full payment of principal and interest, for the entire tract of land sold, and evidence that all terms and conditions of the certificate of purchase have been satisfied, the department shall issue to the purchaser a patent under the seal of the state, signed by the governor and countersigned by the secretary of state.

B. On application by the purchaser a patent for less than the entire tract may be issued to the purchaser if the commissioner finds that it is in the best interest of the applicable trust, subject to the following:

1. The parcel to be patented may consist of one or more pieces of land, described either by metes and bounds or by legal subdivision.

2. A patent shall not be issued for less than one-fourth of the tract sold or less than ten acres, whichever is smaller, except that:

(a) If the original tract is less than forty acres, a patent may be issued for parcels of not less than five acres each.

(b) In the case of a right-of-way the actual parcel needed for the right-of-way may be patented.

3. Before any parcel less than the entire tract is patented the department shall determine that the remaining lands are of greater value than the unpaid balance of the certificate of purchase and that the remaining lands have development potential independent of the acreage that is being patented. Before patenting, the commissioner shall require to be paid an amount, on the lands to be patented, in excess of the purchase price per acre of the entire tract until the total price of the entire tract has been paid. In establishing the amount to be paid for the partial patent the commissioner shall take into account the amount of the down payment made on the entire tract. Nothing in this paragraph affects certificates of purchase issued before September 30, 1988.

4. When paid, the partial purchase price shall be credited on the total purchase price stated in the certificate of purchase. The department may issue a supplement to the certificate of purchase deleting the land patented and reducing the amount of each of the remaining annual installments to that amount which, when all installments are



paid in full, will discharge the entire unpaid balance due on the original certificate of purchase.

**5. IN THE CASE OF LANDS SOLD PURSUANT TO A PARTICIPATION CONTRACT, PATENTS MAY BE ISSUED CONSISTENT WITH THE TERMS OF THE PARTICIPATION CONTRACT.**

C. Any land patented under this section is subject to existing valid rights-of-way.

D. If the purchaser has died, and the land described has been sold and confirmed by order of court, the patent shall be issued to the purchaser to whom confirmation of sale was made. If the estate of the deceased person is distributed by order of the court, the patent shall be issued to the heirs of the deceased person, or to the person to whom the lands are distributed. Patents issued to a deceased person shall inure to the benefit of the heirs or assigns of the deceased person.

E. If an assignment of the certificate of purchase has been filed with and approved by the department, the patent shall be issued to the assignee, and if proper evidence of a transfer of the certificate by operation of law is filed with the department, the patent shall be issued to the transferee.

F. A record of all patents issued shall be kept in the records of the department.



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## Details of Arizona's Trust Responsibility

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ASLD is charged with administering all laws relating to land owned by, belonging to, and under control of the state.<sup>129</sup> ASLD is specifically authorized to make long-range plans for the future use of state land in cooperation with other state agencies, local planning authorities, and political subdivisions, and to classify and appraise all state land, together with improvements on state land, for the purpose of sale, lease, or grant of rights-of-way.<sup>130</sup>

A fundamental requirement of any decision undertaken by ASLD with regard to the disposition of trust land is whether that disposition is consistent with the "trust responsibility" that attaches to trust land management. Pursuant to two decisions of the United States Supreme Court, *Ervien v. United States* and *Lassen v. Arizona*, the Congressional land grants to the State of Arizona under the Arizona-New Mexico Enabling Act created a trust relationship.<sup>131</sup>

<sup>132</sup> The Enabling Act provides that any disposition of trust land or the monies and resources derived from said disposition in a manner contrary to the provisions of the Enabling Act "shall be deemed a breach of trust."<sup>133</sup>

Decisions interpreting the requirements of state trusts have applied a variety of the common-law fiduciary principles that govern trust administration to state trust land managers.<sup>134</sup> Under the common law, the trustee is charged with a series of fiduciary duties, either express or implied, to the beneficiary of the trust.<sup>135</sup> The most important of these are (1) to manage the trust in accordance with the instructions of the settlor; (2) a duty of loyalty or good faith, which requires the trustee to elevate the interests of the trust beneficiaries over other considerations; (3) a duty of prudence, which requires the trustee to manage the trust property with the same degree of skill that a prudent person would exercise in her own affairs; and (4) a duty to preserve and protect the trust assets, or trust corpus, to satisfy both present and future claims against the trust.<sup>136</sup>

Although the fiduciary rules governing the responsibilities of the state trustee are similar to those governing a private trustee, they differ in two critical respects. First, the obligations are owed to some extent to the broader public because the trust does not benefit a discrete individual or group of individuals that are effectively separated from the larger public in the manner of a private trust. Second, the trust exists in perpetuity, since it embraces a purpose that will continue from generation to generation without a foreseeable end.<sup>137</sup> In addition, because the "trust" is established in federal law and by state constitution, and the parties are government entities whose objectives (and budgets) are defined by legislative and executive prerogatives, the obligations and considerations that apply to the trustee are much broader and necessarily embrace, to some extent, the political and economic concerns of the public at large.

With regard to the first requirement, a trustee generally is required to honor the purposes for which a trust is established when administering the assets of a trust.<sup>138</sup> However, absent specific instructions for how the trust is to be managed, the trustee otherwise has broad discretion in the trust's administration and may enjoy great flexibility in the management of trust assets.<sup>139</sup> Since the purpose of the state land trust was established in the state's Enabling Act, in the context of the Arizona state land trust, this equates to a requirement to honor the conditions of the New Mexico-Arizona Enabling Act for the administration of Arizona's trust land. However, the actual administration of state land is additionally governed by the provisions of the Arizona Constitution and Arizona statutes, such that the requirements for management of state land are more constrained than would otherwise be required by the trust.<sup>140</sup>



The trustee's duty of good faith requires that the trustee act honestly and with undivided loyalty to the interests of the trust and its beneficiaries, ensuring that the interests of third parties are not placed ahead of the interests of the trust.<sup>141</sup> In the context of the state trustee, the trustee is nonetheless bound to function under the laws that govern the behavior of government agencies, even where this benefits third parties, or even the general public, in derogation of the interests of the trust.<sup>142</sup> This can include both procedural requirements like public notice, public records, administrative and judicial appeal, and substantive requirements, such as special requirements to consider, avoid, or mitigate environmental or economic impacts associated with state lands.

The trustee's duty of prudence descends in part from the duty of good faith, requiring that the trustee act with due care, diligence, and skill in managing the trust. In the context of the management of a large trust portfolio such as the state land trust, this duty requires the trustee to function as a "prudent investor," balancing risks and returns, anticipating future needs and reevaluating and adjusting investments across the overall portfolio over time, and disposing of assets in appropriate ways and at appropriate times.<sup>143</sup> Under the modern, evolving version of the trust doctrine, this standard should be "applied to investments not in isolation but in the context of the trust portfolio," requiring the trustee to construct a balanced portfolio of diversified investments that meet the trust's long-term management objectives.<sup>144</sup> This allows the trustee to make decisions that involve greater risks, long-term investments, or lower overall returns than would be permissible in isolation, so long as the investments are prudent in the context of the strategy for the overall portfolio.<sup>145</sup>

The duty to preserve and protect the assets of the trust is closely related to the duty of prudence. It requires the trustee to manage the corpus of the trust in a manner that ensures that the trust can satisfy both the present and future needs of the trust beneficiaries. In the context of a perpetual trust, this generally obliges the trustee to manage the trust corpus in a manner that will ensure that the trust will remain undiminished to serve the needs of future beneficiaries in perpetuity.<sup>146</sup> This requires a trustee to look past simple notions of achieving "maximum financial return" on every transaction, and instead look at ways to manage trust assets in a sustainable, preservation-oriented fashion that will maintain a healthy trust corpus for future generations.

In addition to the general conditions of the trust responsibility, Arizona trust managers face a relatively unique set of restrictions on their management activities that stem from the original limitations imposed by Congress in the New Mexico-Arizona Enabling Act. As a general matter, the discretion of the Commissioner in structuring and planning the sale, lease, and use of state land is closely related to the three key requirements of the Enabling Act: (1) that trust land and the natural products of trust land may only be sold or leased "to the highest and best bidder at a public action," that (2) all land and leases must be appraised at their "true value," and (3) that land cannot be disposed for less than this appraised true value.<sup>147</sup> These provisions are replicated in Arizona's Constitution as well, along with additional restrictions.<sup>148</sup> These requirements have imposed particularly significant limitations on Arizona trust land dispositions due to the strict interpretation of them that was adopted in *Lassen v. Arizona ex rel. Ariz. Highway Dep't*.<sup>149</sup>

The infamous *Lassen* case invalidated Arizona's long-standing practice of granting rights-of-way to the State Highway Department free of charge despite the Enabling Act requirement that lands could only be sold or leased at public auction, to the highest and best bidder, for not less than their true value.<sup>150</sup> These grants were justified by the theory that highways built on trust land would always enhance the value of the surrounding trust land.<sup>151</sup> In *Lassen*, the U.S. Supreme Court found that these activities impermissibly resulted in the disposition of lands for less than their true value.<sup>152</sup> Because a discount for "enhanced value" would require the state to make an inherently uncertain estimate of the value of the enhancement, the Court found that

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this would risk diverting a portion of the benefits derived from the trust land to the Highway Department and away from trust beneficiaries.<sup>153</sup>

The rationale provided in *Lassen* has resulted in a series of cases that have overturned numerous strategies employed by ASLD or the legislature to circumvent competitive bidding. For example, courts determined that trust land cannot be acquired by condemnation because the trust would not benefit from any additional profit that might come from competitive bidding at advertised public auction.<sup>154</sup> Courts ruled that public auctions and competitive bidding are required for all sales of land, even when the purchaser is a governmental entity such as a city or a state agency.<sup>155, 156</sup> Additionally, lease provisions cannot provide for future decreases in rental rates if real estate conditions render the lease “uneconomic,” and land exchanges are unconstitutional insofar as they constitute “sales” without public auction.<sup>157, 158</sup> Furthermore, courts found that the ASLD cannot reject competitive bids by conservation organizations for grazing leases, or be required to automatically renew leases, and that leases or sales of mineral resources cannot be disposed for less than their true value as determined by appraisal and the maximum value of these resources cannot be established by statute.<sup>159, 160, 161, 162</sup>

Nevertheless, as Arizona case law has evolved, insofar as competitive bidding can be maintained as part of the disposal process, the courts have found that ASLD has “great discretion” in deciding which lands are to be disposed, structuring the actual terms under which land is sold or leased, and establishing the conditions under which competitive bidding occurs. As a general rule, ASLD’s determinations under its “authority to devise detailed plans for the sale, lease, and use of state trust land ... will not be overturned absent illegal action, an abuse of discretion, or unfair bidding.”<sup>163</sup> The courts have found that “[a]s long as the proposed sale terms are justified by the best interest of the state trust, do not include conditions that would exclude eligible bidders, are not intended to favor a particular bidder, and are not otherwise contrary to law, the Commissioner has discretionary authority to determine the structure of a proposed sale.”<sup>164</sup> This standard effectively allows ASLD to structure a sale or lease of state lands however it deems fit, even if this substantially limits the pool of interested bidders, so long as the terms do not “improperly limit the universe of potential bidders to one.”<sup>165</sup>

Several recent cases highlight the degree of flexibility available to ASLD in its management and disposition decision-making. In *Campana v. Arizona State Land Department*, the court found:

[T]he Commissioner is obligated to manage trust land for the benefit of the trust and its beneficiaries. He has the duty to maximize revenue to the trust. However, immediate revenue is not the sole consideration in determining the best interests of the trust. The Commissioner has great discretion concerning the disposition of trust land and has authority to devise detailed plans for the sale, lease, and use of state land. These decisions will not be overturned absent illegal action, an abuse of discretion, or an unfair bidding.<sup>166</sup>

In *Campana*, the court upheld the legality of an auction structure where two related auctions were scheduled in relation to a planned community, one for three commercial leases for a set of parcels and another for the sale of nearby residential land and 58 acres of associated public roadway and utilities. The Department structured the auction so that the successful bidder for the leases would become the master developer of the entire community, and requires the successful bidder of the sale to post a bond for the installation of infrastructure.<sup>167</sup> The auctions were protested on the grounds that the bidding was chilled by the relationship of the commercial leases to the land sale, which purportedly resulted in a preference to the lessee as master developer over a residential developer.<sup>168</sup> The court found that there was no evidence in the record that the bidding was chilled, citing the broad discretion of the Commissioner in planning for the disposition of land as quoted above.<sup>169</sup>



It should be noted, however, that although the Commissioner's discretion is broad, conditions placed on the disposition of state trust land have been invalidated by the courts for violating a lessee's rights and for failure to consider the best interest of the trust. In *Havasu Heights v. State Land Department of Arizona*, the court invalidated two "special conditions" imposed on commercial holding leases because they waived rights granted lessees by the Arizona Constitution and statutes.<sup>170</sup> One such condition waived claims to damages otherwise granted by statute, and the other waived the lessee's rights to compensation for improvements at the end of the lease term.<sup>171</sup> The court noted that although the department has a great deal of discretion concerning the terms of the lease, the department may not act contrary to the statutory or constitutional scheme.<sup>172</sup>

In *Forest Guardians v. Wells*, the ASLD denied the award of a grazing lease to an environmental group as a matter of law because the environmental group did not intend to actually use the land for grazing.<sup>173</sup> The Supreme Court held that the Commissioner's fiduciary duty required him to at least *consider* whether the rejected bids would have been best for the corpus of the trust and its beneficiaries, noting that although the Constitution permitted property classification as an aid to proper administration of the trust, "administrative concern and practice must conform to the core fiduciary trust duties imposed by our law."<sup>174</sup>

The standards under which ASLD's interpretation of its trust responsibility are ultimately judged are also influenced by the judicial doctrines governing deference to state agencies in their interpretation of federal laws, state constitutional provisions, state statutes, and in their findings of fact. Assuming that a person who is seeking to challenge a given decision of ASLD can meet the requirements for standing (that they have suffered an "injury-in-fact," causality, judicial redressability, and that they are within the category of persons intended to be protected by a given constitutional or statutory requirement), the standard applicable will depend on whether the decision at issue involves an interpretation of law or a finding of fact.<sup>175, 176, 177</sup>

Where ASLD's decision involves an interpretation of law, such as whether or not a given action is authorized by a state statute, it will generally be subject to de novo review – the least deferential standard of review.<sup>178</sup> By contrast, where ASLD's decision involves a conclusion of fact, such as whether or not a given action is consistent with the interests of the trust, ASLD is entitled to significant levels of deference.<sup>179</sup> As a state agency, as long as the agency complies with the letter of the law, the agency's actual decisions are normally entitled to significant deference and can only be overturned if the decisions are "arbitrary" or "capricious," or are unsupported by substantial evidence in the record.<sup>180</sup> Similarly, where a discretionary decision of an agency is implicated, like a decision with regard to whether or not to grant a lease or to sell land, courts will apply a similar "abuse of discretion" standard that upholds the decision unless the agency has disregarded evidence, committed clear error, or acted against reason.<sup>181, 182</sup>

Ultimately, despite the often unreasonable constraints associated with the Enabling Act and Arizona constitution, in keeping with the broader view of the trust responsibility that has developed through interpretation of the portfolio standard described above, Arizona trust law allows ASLD with relatively broad discretion in determining what is and is not in the best interests of the trust. Arizona caselaw provides that the determination of the trust's best interest is "made in light of all of the circumstances."<sup>183</sup> Under this broad mandate, although ASLD must work to maximize trust revenue, "immediate revenue is not the sole consideration in determining the best interest of the Trust. The Commissioner may forego immediate revenue to obtain "public benefits flowing from employing state land in uses of higher value."<sup>184</sup>

This broader, modern view of both the duty of prudence and the duty of preservation has important ramifications in evaluating both the potential and the approach to infrastructure siting on state trust land.



<sup>1</sup>Cite PFR.

<sup>2</sup>*Id.*

<sup>3</sup>A "smart grid" delivers electricity from suppliers to consumers using two-way digital technology to control appliances at the consumers' homes to save energy, reduce cost and increase reliability and transparency. It overlays the electricity distribution grid with an information and net metering system. (Definition taken from Wikipedia.org).

<sup>4</sup>A recent report by the Morrison Institute of Public Policy, prepared in cooperation with the Arizona State Land Department and a number of surrounding cities, utilities, non-profit groups, and Arizona State University, discusses the immense potential of this massive parcel of trust land and how its development could shape the future of the Phoenix metropolitan area. See *The Treasure of the Superstitions: Scenarios for the Future of Superstition Vistas, Arizona's Premier State Trust Land in the Southeast Valley*, Morrison Institute of Public Policy Report (April 2006).

<sup>5</sup>Maricopa Association of Governments, *Building a Quality Arizona*, Working Paper #2, Economic Development (September 2007).

<sup>6</sup>Maricopa Association of Governments, *Land Use and Urban Development Issue Paper*, Regional Transportation Plan Update (June 2001).

<sup>7</sup>D. Smith, Executive Director's Report to the Regional Council, Maricopa Association of Governments (February 2007).

<sup>8</sup>J. Duda, "Arizona Land Department Will Be Self-Funded," Arizona Capitol Times. (August 24, 2009).

<sup>9</sup>A.R.S. § 48-501.

<sup>10</sup>A.R.S. § 48-501.

<sup>11</sup>A.R.S. § 48-701.

<sup>12</sup>A.R.S. § 48-920.

<sup>13</sup>A.R.S. §48-901.

<sup>14</sup>A.R.S. § 48-909.

<sup>15</sup>A.R.S. §48-910.

<sup>16</sup>A.R.S. §48-1201.

<sup>17</sup>A.R.S. §48-1401.

<sup>18</sup>A.R.S. § 48-2001.

<sup>19</sup>See A.R.S. §37-233.

<sup>20</sup>See A.R.S. 37-331 et seq.

<sup>21</sup>See A.R.S. 37-233(B).

<sup>22</sup>See A.R.S. §37-231(D).

<sup>23</sup>A.R.S. §37-231(A).

<sup>24</sup>A.R.S. §37-240.

<sup>25</sup>See A.R.S. §37-132(A)(5)

<sup>26</sup>A.R.S. §37-236(A).

<sup>27</sup>Ariz. Const. art. X, § 3; see also *State Land Dep't. v. Tucson Rock & Sand Co.*, 481 P.2d 867 (Ariz. 1971).

<sup>28</sup>Ariz. Const. art. X, § 4. See also *New Mexico-Arizona Enabling Act*.

<sup>29</sup>*Campana v. Arizona State Land Dep't.*, 860 P.2d 1341 (Ariz. App. 1993).

<sup>30</sup>See A.R.S. §37-132(B)(3).

<sup>31</sup>See A.R.S. §37-241(B).

<sup>32</sup>See A.R.S. §37-241(B).

<sup>33</sup>See A.R.S. §37-241(D)&(E).

<sup>34</sup>See A.R.S. §37-244.

<sup>35</sup>See A.R.S. §37-245; see also A.R.S. §37-247.

<sup>36</sup>A.R.S. §37-246.

<sup>37</sup>A.R.S. §37-251.

<sup>38</sup>A.R.S. §37-251(B); see also A.A.C. R14-5-408.

<sup>39</sup>*Id.*

<sup>40</sup>Commercial leases in Arizona function as a "catch-all" category for uses that do not fall within the specified land-use categories (agriculture, grazing, home-site, minerals, etc.).

<sup>41</sup>A.R.S. §37-214(B).

<sup>42</sup>A.R.S. §37-101(3).

<sup>43</sup>A.R.S. §§ 37-281.02(A), 37-281.02(B).

<sup>44</sup>A.R.S. § 37-281.02(A).

<sup>45</sup>A.A.C. § R12-5-703(B).

<sup>46</sup>A.A.C. § R12-5-703(D).

<sup>47</sup>A.A.C. § R12-5-703(B).

<sup>48</sup>*Id.*

<sup>49</sup>A.R.S. § 37-281.02(A).

<sup>50</sup>See A.R.S. § 37-281.02(A) (If the state land is more than three miles outside the boundaries of incorporated cities and towns with a population of 10,000 or fewer people, or more than five miles outside the boundaries of incorporated cities and towns having a population of more than ten thousand people, ASLD shall cooperate with the county or counties in which the land to be leased is located in considering the intended uses).



<sup>51</sup>A.R.S. § 37-281.02(F).

<sup>52</sup>*Id.*

<sup>53</sup>A.R.S. § 37-281.02(G).

<sup>54</sup>A.R.S. § 37-281.02(C).

<sup>55</sup>A.R.S. § 37-281.02(I).

<sup>56</sup>A.R.S. § 37-281.02(E).

<sup>57</sup>A.R.S. § 37-281.02(D).

<sup>58</sup>A.R.S. 37-461(A).

<sup>59</sup>A.R.S. 37-461(B).

<sup>60</sup>See AAC R12-5-801(B)(2),(4).

<sup>61</sup>AAC R12-5-801(B)(7).

<sup>62</sup>A.R.S. 37-461(B), AAC R12-5-801(B)(5)(c)(ii).

<sup>63</sup>AAC R12-5-801(B)(5)(c)(iii).

<sup>64</sup>See A.A.C. R12-5-1101(4).

<sup>65</sup>A.A.C. R12-5-1101(5).

<sup>66</sup>See A.R.S. 37-132(B)(3).

<sup>67</sup>see ARS 37-101(19).

<sup>68</sup>ARS 37-331.01.

<sup>69</sup>ARS 37-331.03(D).

<sup>70</sup>A.R.S. § 37-334.

<sup>71</sup>A.R.S. § 37-338.

<sup>72</sup>A.R.S. § 37-334(D).

<sup>73</sup>A.R.S. § 37-334.01.

<sup>74</sup>A.R.S. § 37-335.

<sup>75</sup>A.R.S. § 37-212(C); also *Koepnick v. Arizona State Land Department*, 1 CA-CV 07- 0271 P.9 (Ariz. Ct. App. 2009).

<sup>76</sup>A.R.S. § 37-215 (“An appeal from a final decision of the State Land Commissioner relating to classification or appraisal of lands or improvements may be taken to the board of appeals by any person adversely affected by the decision.”).

<sup>77</sup>It should be noted that all Trust land within Maricopa County proposed for inclusion in the Project are leased by Project participants, which should minimize the potential for any adverse appeal of a reclassification.

<sup>78</sup>A.R.S. § 37-290.

<sup>79</sup>Although ASLD is permitted to recover the costs of planning from the buyer, the recovered costs are paid to the state general fund; as such, ASLD’s planning costs are essentially non-recoverable from a budgetary perspective.

<sup>80</sup>A.R.S. § 37-335(G).

<sup>81</sup>A.R.S. § 37-335(N).

<sup>82</sup>Although a lessee is permitted to secure obligations related to a lease on the lessee’s interest, it is important to note that the state’s interest in a commercial lease cannot be encumbered for purposes of financing infrastructure or other requirements related to the lease. A.R.S. § 37-335(M).

<sup>83</sup>193 P.3d 776 (Ariz. Ct. App. 2008).

<sup>84</sup>*Id.* at 17.

<sup>85</sup>ARS 37-335.02.

<sup>86</sup>ARS 37-335.02(A).

<sup>87</sup>ARS 37-335.03.

<sup>88</sup>ARS 37-335.03(C).

<sup>89</sup>ARS 37-335.02(A)(5).

<sup>90</sup>ARS 37-335.04.

<sup>91</sup>ARS 37-335.02(B).

<sup>92</sup>ARS 37-335.06.

<sup>93</sup>A.R.S. §9-463.05(A).

<sup>94</sup>A.R.S. §9-463.05(B)(2).

<sup>95</sup>A.R.S. § 9-463.05(B)(2) &(B)(4).

<sup>96</sup>A.R.S. §9-463.05(B)(5).

<sup>97</sup>A.R.S. §9-463.05(B)(3).

<sup>98</sup>A.R.S. §9-463.05(B)(4).

<sup>99</sup>A.R.S. §9-463.05(C).

<sup>100</sup>A.R.S. §9-463.05(F) .

<sup>101</sup>A.R.S. §9-463.05(C).

<sup>102</sup>A.R.S. §9-463.05(D).

<sup>103</sup>Conservation is defined as “protection of the natural assets of state trust land for the long-term benefit of the land, the beneficiaries, lessees, the public, and unique resources such as open space, scenic beauty, protected plants, wildlife, archaeology, and multiple use values.” *Id.* at § 37-311.

<sup>104</sup>As discussed in section IV, although the U.S. Supreme Court held in *Lassen* that the Arizona Enabling Act did not require lands to be sold at auction when they were transferred to public bodies, the Arizona Supreme Court later



interpreted identical language in the Arizona Constitution to require auctions to occur even where lands are transferred to public bodies.

<sup>105</sup>Ariz. Const. art. IX, sect. 7.

<sup>106</sup>A.R.S. §37-214.

<sup>107</sup>A.R.S. §37-239(B).

<sup>108</sup>A.R.S. §37-239(C)(1).

<sup>109</sup>ARIZONA STATE LAND DEPARTMENT 2005 ANNUAL REPORT (2005).

<sup>110</sup>D.A. DeKok & M.A. Worden, *Transportation Systems – Connecting Rapidly Growing Places; Arizona’s Rapid Growth and Development: Natural Resources and Infrastructure*, 88th Arizona Town Hall Report, Table 3.2 (April 2006).

<sup>111</sup>*Id.* at p. 58.

<sup>112</sup>*Id.* at 63-64.

<sup>113</sup>See A.R.S. §§37-211(D) and 37-212.

<sup>114</sup>See A.R.S. §37-290.

<sup>115</sup>See A.R.S. §37-173.

<sup>116</sup>See A.R.S. 37-174.

<sup>117</sup>A.R.S. § 37-239(E)(8).

<sup>118</sup>A.R.S. § 37-239(E)(10).

<sup>119</sup>A.R.S. § 37-251(B); also A.A.C. R14-5-408.

<sup>120</sup>*Id.*

<sup>121</sup>A.R.S. § 37-239(E)(12).

<sup>122</sup>764 P.2d 37, 39 (Ariz. App. 1988).

<sup>123</sup>*Id.*

<sup>124</sup>*Id.* at 41.

<sup>125</sup>*Id.* at 42.

<sup>126</sup>*Id.*; A.R.S. § 37-101(3).

<sup>127</sup>*Havasu Heights*, 764 P.2d at 42.

<sup>128</sup>Although the court held that the Department thus had the authority to enter into holding leases, it also found that the specific lease at issue included conditions that were invalid, *id.* at 44, and that the Department had entered into a “holding lease program” without a rulemaking, which would be required to implement such a program, *id.* at 46.

<sup>129</sup>A.R.S. § 37-102.

<sup>130</sup>A.R.S. § 37-132.

<sup>131</sup>251 U.S. 41 (1919).

<sup>132</sup>385 U.S. 458 (1967).

<sup>133</sup>Enabling Act § 28.

<sup>134</sup>*C.f. Oklahoma Ed. Ass’n, Inc. v. Nigh*, 642 P.2d 230, 236 (Okla. 1982); see also *State ex rel. Ebke v. Board of Educ. Lands and Funds*, 47 N.W.2d 520 (Neb. 1951)(describing general fiduciary principles associated with trust management that are applicable to state trust land managers).

<sup>135</sup>RESTATEMENT 2D, TRUSTS § 3.

<sup>136</sup>*Id.* at § 170.

<sup>137</sup>76 AM. JUR. 2D *Trusts* § 93; RESTATEMENT 2D, TRUSTS § 379 (1959); RESTATEMENT 3D, TRUSTS § 379 (1992).

<sup>138</sup>*Id.* at § 125.

<sup>139</sup>76 AM. JUR. 2D *Trusts* § 58. *C.f. In re Trust of Brooke*, 697 N.E. 2d 191 (Ohio 1998).

<sup>140</sup>For example, despite the U.S. Supreme Court’s more liberal interpretations of Enabling Act provisions to permit condemnations and land exchanges, the Arizona Supreme Court interpreted identical provisions in the Arizona Constitution to prohibit condemnations and exchanges. See *Deer Valley Unified School District v. Superior Court*, 760 P.2d 537, 541 (Ariz. 1988); see also *Fain Land & Cattle Co. v. Hassell*, 790 P.2d 242 (Ariz. 1990).

<sup>141</sup>GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, *THE LAW OF TRUSTS AND TRUSTEES*, 235-241 (2nd ed. 1978).

<sup>142</sup>See *Colorado State Board of Land Commissioners v. Colorado Mined Land Reclamation Board*, 809 P.2d 974 (Colo. 1991) (allowing mining permits on state lands to be denied where inconsistent with county zoning, even though this worked to the disadvantage of the trust); see also *Noel v. Coel*, 655 P.2d 245 (Wash. 1982) (requiring trust managers to follow requirements of state Environmental Policy Act even though this placed the trust at a significant disadvantage); and see also *Ravalli County Fish and Game Association v. Montana Department of State Lands*, 903 P.2d 1362 (Mont. 1995) (same).

<sup>143</sup>RESTATEMENT 3D, TRUSTS § 227.

<sup>144</sup>*Id.*

<sup>145</sup>See Haskell, *The Prudent Person Rule For Trustee Investment and Modern Portfolio Theory*, 69 N.C. L. Rev. 87 (1990).

<sup>146</sup>76 AM. JUR. 2D, TRUSTS § 404; *Branson School District. RE-82 v. Romer*, 161 F.3d 619, 637 (10th Cir. 1998) (common law trust doctrines require that a trustee must take steps to preserve the trust property from loss, damage, or diminution in value).

<sup>147</sup>New Mexico-Arizona Enabling Act 36 Stat. 557, § 28 (1910).

<sup>148</sup>*C.f. ARIZ. CONST. Art. X § 3* (interpreted to prohibit exchanges without public auction in *Fain Land & Cattle Co. v.*

*Hassell*, 790 P.2d 242 (Ariz. 1990).

<sup>149</sup>385 U.S. 458 (1967).

<sup>150</sup>*Id.* at 465.

<sup>151</sup>*Id.* at 459-460.

<sup>152</sup>*Id.* at 469-470.

<sup>153</sup>*Id.* at 469.

<sup>154</sup>*Deer Valley Unified School Dist. No. 97 of Maricopa County v. Superior Court*, 760 P.2d 537 (Ariz. 1988).

<sup>155</sup>*Arizona State Land Dept. v. Superior Court In and For Cochise*, 633 P.2d 330 (Ariz. 1981); *City of Sierra Vista v. Babbitt*, 633 P.2d 333 (Ariz. 1981).

<sup>156</sup>*Gladden Farms, Inc. v. State*, 633 P.2d 325 (Ariz. 1981).

<sup>157</sup>*Campana v. Arizona State Land Dept.*, 860 P.2d 1341 (Ariz. 1993).

<sup>158</sup>*Fain Land & Cattle Co. v. Hassell*, 790 P.2d 242 (Ariz. 1990).

<sup>159</sup>*Forest Guardians v. Wells*, 34 P.3d 364 (Ariz. 2001).

<sup>160</sup>*Havasus Heights Ranch and Development Corp. v. Desert Valley Wood*, 807 P.2d 1119 (Ariz. 1990); see also *State ex rel. McElroy v. Vesely*, 52 P.2d 1090 (N.M. 1935); see also *Ellison v. Ellison*, 146 P.2d 173 (N.M. 1944) (interpreting provisions of the Enabling Act to determine that lease renewal was not absolute right under New Mexico's trust system).

<sup>161</sup>*Kadish v. Arizona State Land Dept.*, 747 P.2d 1183 (Ariz. 1988).

<sup>162</sup>*State Land Dept. v. Tucson Rock & Sand Co.*, 469 P.2d 85 (Ariz. App. 1970).

<sup>163</sup>*Campana v. Arizona State Land Dept.*, 176 Ariz. 288, 291, 860 P.2d 1341, 1344 (App. 1993); see also *Foster v. State Land Dept.*, 199 Ariz. 489, 19 P.3d 630 (App. 2001).

<sup>164</sup>*Id.* at 291. The *Campana* case is quoting *Martori v. Ariz. State Land Dept.*, 176 Ariz. 420 (App. 1993), which was subsequently vacated by the Arizona Supreme Court, explaining only that "a majority of the court entertained substantial reservations about the resolution of the issues by the court of appeals." See *Martori v. Ariz. State Land Dept.*, 178 Ariz. 478 (1994). The *Campana* case has never been cited nor overturned by the Supreme Court, and remains valid law.

<sup>165</sup>*Id.*

<sup>166</sup>186 P.2d 1341, 1344 (Ariz. App. 1993) (internal citations omitted).

<sup>167</sup>*Id.* at 1343.

<sup>168</sup>*Id.* at 1344.

<sup>169</sup>*Id.* at 1344-45.

<sup>170</sup>764 P.2d 37, 44, 46 (Ariz. App. 1988).

<sup>171</sup>*Id.* at 43.

<sup>172</sup>*Id.* (In the same case, the court upheld the general concept of a "holding lease," including a condition requiring that the land not be put to any immediate use).

<sup>173</sup>34 P.3d 364, 369 (Ariz. 2001).

<sup>174</sup>*Id.* at 371.

<sup>175</sup>An "injury-in-fact" exists where a plaintiff shows "an invasion of a judicially cognizable interest which is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical." *Bennett v. Spear*, 520 U.S. 154, 167 (1997).

<sup>176</sup>See *Steel Co. v. Citizens for a Better Environment*, 523 U.S. 83, 102-103(1998).

<sup>177</sup>2 AM. JUR. 2D Administrative Law §430.

<sup>178</sup>2 AM. JUR. 2D Administrative Law § 489. See *Forest Guardians v. Wells*, 201 Ariz. 255 (2001) (Arizona Supreme Court found that the failure to consider a competitive bid application based on ASLD's interpretation of law was subject to de novo review), *Id.* at 262.

<sup>179</sup>*Forest Guardians v. Wells*, 34 P.3d 364, 367-368 (Ariz. 2001) (state land commissioner has considerable discretion with regard to trust administration decisions that involve questions of fact).

<sup>180</sup>2 AM. JUR. 2D Administrative Law § 488. This question is well-settled with regard to federal agency actions, but state courts are also in general agreement on this point. See *id.* at § 489. Where questions of law and fact are mixed, courts will generally interpret the law independently of the agency's determination, but then apply this to the facts as found by the agency. See *id.* at § 496.

<sup>181</sup>*C.f. Foster v. Anable*, 19 P.3d 630, 633 (Ariz. App. Div. 1 2001) (Land Commissioner had broad discretion in dispositions of trust land, and would not be overturned absent abuse of discretion or illegal action). See also *Campana v. Arizona State Lands Dept*, 860 P.2d 1341 (Ariz. App. Div 1 1993); *Thompson v. Conwell*, 363 P.2d 927 (Wyo. 1961).

<sup>182</sup>*Jeppeson v. State, Dept. of State Lands*, 667 P.2d 428 (Mont. 1983), quoting *Taylor v. County Comm'rs* 270 P.2d 994, 999 (Mont. 1954), quoting *Grant v. Michaels*, 23 P.2d 266, 269 (Mont. 1933).

<sup>183</sup>A.R.S. § 37-290.

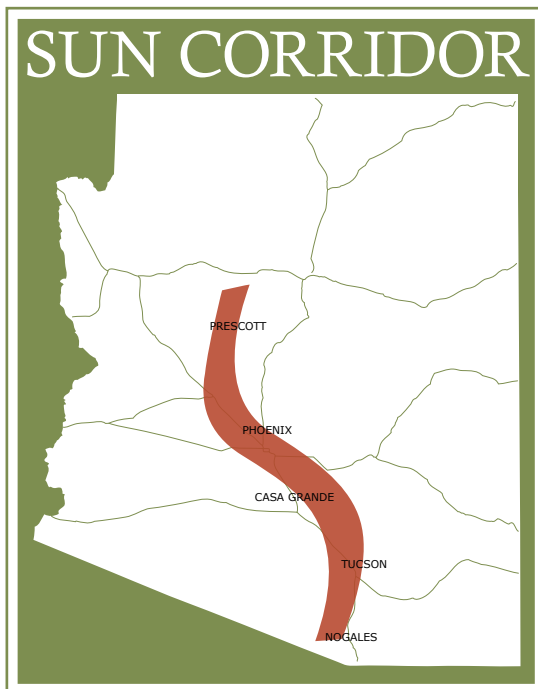
<sup>184</sup>*Koepnick*, 1 CA-CV 07-0271 at P.19, quoting *Havasus Heights*, 807 P.2d at 1128.

## About the Sun Corridor Legacy Program

The "Sun Corridor" refers to Arizona's megapolitan area stretching from Nogales in the south to Prescott in the north, with Phoenix and Tucson at its core. The megapolitan is growing at a tremendous rate, and that rapid growth comes with the challenge of conserving natural desert and open space while improving urban quality of life. As one of the four keystone initiatives of the Sonoran Institute, the Sun Corridor Legacy Program addresses growth and change as models for sustainable development. Our five goals include:

- 1 ***Promote a rail system linking the entire Sun Corridor***
- 2 ***Create a world-class model for sustainable desert cities***
- 3 ***Advance the availability of clean and secure energy for the Sun Corridor***
- 4 ***Conserve more than one million acres in Arizona for future generations***
- 5 ***Encourage state policies that protect and restore free flowing rivers in Arizona***

The Sun Corridor's desirable climate, housing options, and relatively low cost of living are reasons why this area continues to attract new residents. The area's future quality of life, environmental quality, and economic prosperity will be determined largely by how well growth is managed. Going forward, regional solutions that comprehensively address conservation, development, transportation, water, and energy issues will be critical to a sustainable future.



Arizonans must make better decisions about how to develop communities, preserve cherished open spaces, ensure an adequate high-quality water supply, protect our quality of life, and enhance economic prosperity. New approaches to leadership are needed to make this happen and Sonoran Institute finds them through work with federal, state, and local governments, and stakeholder groups to determine the best mix of use and conservation for lands in this region. To find out more about the program's work, visit [www.sonoraninstitute.org](http://www.sonoraninstitute.org).





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