

## B. Trust Land Management in Arizona

Arizona has approximately 9.28 million surface acres and 9 million subsurface acres of trust lands.<sup>1</sup> These lands are enormously diverse in character, ranging from arid scrubland, desert grasslands, and riparian areas in the southern half of the state, to the mountains, forests, and meadows of Northern Arizona. While the majority of these lands are located in rural areas of the state, more than one million acres of Arizona's trust lands are located adjacent to or within rapidly urbanizing areas. In addition, although some 2.3 million acres of Arizona's trust lands are held in a checkerboard pattern, the majority of these lands are held in larger, contiguous parcels, some approaching hundreds of square miles in size.<sup>2</sup>

### 1. Arizona's Land Grant

At statehood, Arizona received sections two, sixteen, thirty-two, and thirty-six in every township "for the support of common schools."<sup>3</sup> In addition to this common school grant, the state also received specific grants for a variety of other public institutions, including: 200,000 acres for university purposes; 100,000 acres for legislative, executive, and judicial public buildings; 100,000 acres for penitentiaries; 100,000 acres for insane asylums; 100,000 acres for schools and asylums for the deaf, dumb and blind; 50,000 acres for miners' hospitals; 200,000 acres for "normal schools," 100,000 acres for charitable, penal, and reformatory institutions; 150,000 acres for agricultural and mechanical colleges; 150,000 acres for a school of mines; 100,000 acres for military institutes; and 1,000,000 acres for the payment of county bonds (after these bonds were repaid, the majority of this latter grant passed to the Arizona common schools trust).<sup>4</sup> Arizona currently retains approximately 87 percent of its original land grant of 10.5 million acres.

### 2. Enabling Act and Constitutional Requirements

As discussed in section II(C)(3), due to their late entry into the Union, Arizona and New Mexico have the most restrictive Enabling Acts of the Western states with regard to the administration of trust lands. Most importantly, Arizona and New Mexico were the first states in which Congress expressly indicated that the granted lands were to be held "in trust," to be "disposed of in whole or in part only in the manner as herein provided," and providing that any disposition of trust lands or the monies and resources derived therefrom in a manner contrary to the provisions of the Enabling Act "shall be deemed a breach of trust."<sup>5</sup>

Arizona's Enabling Act (and the subsequent amendments to the Act in 1936 and 1951) identifies a series of detailed restrictions on trust land dispositions. Most significantly, the Enabling Act prohibits any mortgage or encumbrance of trust lands, and requires that trust lands and the natural products of trust lands may only be sold or leased "to the highest and best bidder at a public action," with a few enumerated exceptions for leases of ten years or less and mineral/hydrocarbon leases. The Act also specifies that before being offered, all lands and leases must be appraised at their "true value," and cannot be disposed for less than the appraised value. Finally, the Act establishes minimum standards for the conduct of auctions, including minimum notice, advertising, and locational

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<sup>1</sup> ARIZONA STATE LAND DEPARTMENT 2003 ANNUAL REPORT, 20 (2004).

<sup>2</sup> The reason for the relatively contiguous nature of Arizona trust ownership is related to the predominance of federal land ownership in the state and the relatively late entry of Arizona into the Union. As noted elsewhere above, where identified sections in the trust land grant were previously occupied or reserved, the federal government generally provided states with *in lieu* lands that were to be selected out of the unreserved sections of the public domain. Nearly 69% of Arizona's total land area is held in one or another type of federal ownership, with the substantial majority in reserved ownership categories such as national forests, national parks, military reservations, and federal Indian reservations. In addition, by the time that Arizona achieved statehood, an enormous quantity of public domain land had been granted to the Southern Pacific Railroad, largely as a checkerboard pattern across the northern half of the state. As a result, Arizona took only a small amount of its overall grant in the form of reserved sections; the majority was taken as *in lieu* selections that allowed the state to aggregate its holdings in larger, contiguous parcels.

<sup>3</sup> New Mexico-Arizona Enabling Act, 36 Stat. 557, § 24 (1910).

<sup>4</sup> *Id.* at § 25.

<sup>5</sup> *Id.* at § 28.

requirements.<sup>6</sup> Arizona's Constitution contains even more detailed provisions, reiterating the requirements of the Enabling Act but also imposing additional restrictions, such as a prohibition against land exchanges.<sup>7</sup>

### 3. Arizona's Trust Responsibility

The specificity of Arizona's Enabling Act and Constitutional requirements has been interpreted by the courts to impose a strict trust responsibility that is the most restrictive among all the Western states. Based on this trust responsibility, the courts have held, among other things, that:

- An Arizona school district could not acquire a parcel of school trust land for its fair market value (by condemnation) because the trust would not benefit from any additional profit that might come from competitive bidding at advertised public auction.<sup>8</sup>
- Public auctions and competitive bidding are required for all sales of land, even when the purchaser is a governmental entity such as a city<sup>9</sup> or a state agency.<sup>10</sup>
- Lease provisions allowing for future decreases in rental rates if real estate conditions rendered the lease "uneconomic" violated requirements that the state land department must sell or lease state trust land to "highest" bidder.<sup>11</sup>
- Exchanges of trust lands, although permitted in Arizona's Enabling Act and Arizona statutes, constituted "sales" without public auction for purposes of Arizona's Constitution and were therefore unconstitutional.<sup>12</sup>
- The State Land Commissioner cannot reject a conservation group's application to lease grazing lands for conservation and restoration purposes without considering whether the offer is in the best interests of the trust;<sup>13</sup> in addition, the "best interest of the trust" does not require blind adherence to the goal of maximizing revenue at the expense of stewardship or the cost of contracting with an irresponsible lessee.<sup>14</sup>
- The state is under no obligation to renew any existing lease of trust lands, as the state is required to grant leases in accordance with the best interest of the trust.<sup>15</sup>
- Leases or sales of mineral resources, however incidental, cannot be disposed for less than their true value as determined by appraisal,<sup>16</sup> and the maximum value of these resources cannot be established by statute.<sup>17</sup>
- The state land department must receive the true value for any right-of-way across trust lands, and the actual monetary compensation for the right-of-way cannot be diminished by the amount of any enhancement in value that the right-of-way may bring to the remaining trust lands.<sup>18</sup>

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<sup>6</sup> *Id.* at § 28.

<sup>7</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>8</sup> *Deer Valley Unified School Dist. No. 97 of Maricopa County v. Superior Court*, 760 P.2d 537 (Ariz. 1988).

<sup>9</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>10</sup> *Gladden Farms, Inc. v. State*, 633 P.2d 325 (Ariz. 1981).

<sup>11</sup> *Campana v. Arizona State Land Dept.*, 860 P.2d 1341 (Ariz. 1993).

<sup>12</sup> *Fain Land & Cattle Co. v. Hassell*, 790 P.2d 242 (Ariz. 1990).

<sup>13</sup> *Forest Guardians v. Wells*, 34 P.3d 364 (Ariz. 2001).

<sup>14</sup> *Jeffries v. Hassell*, 3 P.3d 1071 (Ariz. 1999).

<sup>15</sup> *Havasu Heights Ranch and Development Corp. v. Desert Valley Wood*, 807 P.2d 1119 (Ariz. 1990).

<sup>16</sup> *Kadish v. Arizona State Land Dept.*, 747 P.2d 1183 (Ariz. 1988).

<sup>17</sup> *State Land Dept. v. Tucson Rock & Sand Co.*, 469 P.2d 85 (Ariz. App. 1970).

<sup>18</sup> *Lassen v. Arizona ex rel. Arizona Highway Dept.*, 385 U.S. 458 (1967).

#### 4. Governance of Trust Lands in Arizona

Arizona's trust lands are managed by the Arizona State Land Department, under the direction of the State Land Commissioner (Commissioner). The Commissioner is appointed by and serves at the pleasure of the Governor.

The Land Department has the administration of state trust lands as its central focus, although it also manages state sovereign lands, state forestry programs and wildfire programs, in addition to other ancillary responsibilities. The Department is organized into six major divisions: Natural Resources, Real Estate, Assets Management, Land Information Title and Transfer, Forestry, and Administrative and Resource Analysis. Nearly 75 percent of the Land Department budget, which is appropriated by the legislature from general funds, is dedicated to the administration of trust lands.

The Commissioner has essentially complete authority over the administration of trust lands. The only exceptions are with regard to (1) *in lieu* land selection, which is governed by a state Selection Board comprised of the State Treasurer, Governor, and Attorney General; and (2) land sales and commercial leases, which must be approved by the Board of Appeals (which also hears appeals from certain Land Department decisions). The five members of the Board of Appeals are selected by the Governor and confirmed by the Senate for six-year terms. Three members represent the state's fifteen counties, which are divided into three districts, with two members holding at large positions. Additionally, in administering urban trust lands, the Commissioner cooperates with two advisory committees that provide advice on urban planning and conservation matters under Arizona's general and comprehensive planning scheme and an urban open space program.

#### 5. Trust Land Management in Arizona

The Land Department identifies its mission as follows:

To manage State Trust lands and resources to enhance value and optimize economic return for the Trust beneficiaries, consistent with sound stewardship, conservation, and business management principles supporting socioeconomic goals for citizens here today and generations to come. To manage and provide support for resource conservation programs for the well-being of the public and the State's natural environment.

Arizona's trust management activities can be roughly divided into three types of activities: (a) surface uses, (b) subsurface uses, and (c) trust land sales and other uses. Unlike many states, Arizona currently receives a majority of its total trust income from permanent trust land dispositions, including sales of trust lands, rights-of-ways, commercial payments, and interest payments.

##### a. Surface Uses

The vast majority of Arizona's surface use acreage and revenues are associated with grazing, agricultural, commercial, and right-of-way uses; Arizona also administers a special use permit system for certain activities on trust lands. Pursuant to the state's Enabling Act, trust lands can generally only be leased to the "highest and best bidder" at a public auction.<sup>19</sup> However, most leases that are issued in Arizona take advantage of several enumerated exceptions to these strict public auction requirements, allowing leases of ten years or less for grazing, agricultural, commercial, and domestic purposes without public auction; leases of twenty years or less for mineral purposes without public auction; and leases of twenty years or less for oil, gas, and hydrocarbon development without public auction, bidding, or appraisalment.

Grazing and agricultural leases in Arizona are almost universally administered under a short term, ten-year lease program. Short-term leases are available from the land department upon application, and can be granted without a public auction. Only expiring grazing leases are

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<sup>19</sup> New Mexico-Arizona Enabling Act 36 Stat. 557, § 28 (1910).

advertised.<sup>20</sup> Within a specified time frame prior to the expiration of a short term lease, an applicant may conflict the renewal of a lease. After considering any and all applications for a short term lease, the department awards the lease to the party that the department deems to have the “best right and equity to the lease.” Existing lessees who are in good standing with their leases are also eligible for a “preference right,” which allows them to secure a new short-term lease by matching the highest bid. Another exception in the Enabling Act allows for provisions that protect lessees’ rights to improvements that require payments by purchasers or subsequent lessees for those improvements. As a result of these protections and a number of other practical considerations, these short-term leases have typically not been awarded on a competitive basis. Some commercial leases are also administered under a similar short-term leasing program.

Commercial leases<sup>21</sup> are also issued for ten to ninety-nine year terms; however, these leases must be issued at public auction to the “highest and best bidder.” 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; however, for grazing leases, the market value of the lease is established by the state’s Grazing Land Valuation Commission, which develops a lease value based on a set formula.

Grazing leases generate the least revenue per acre of all trust activities, returning an average of \$0.25 per acre on the nearly 8.4 million trust acres utilized for that purpose – Arizona also has the lowest returns from grazing uses of any Western state. This compares with an average of \$7.31 per acre for use permits, an average of \$18.46 per acre for agricultural uses, and an average of \$170.20 per acre for commercial leases.

#### *b. Subsurface Uses*

The State Land Department issues leases for three general types of mineral commodities: leaseable minerals (primarily base and precious metals, but includes industrial minerals that are unique and distinct); common variety minerals (also referred to as “salable minerals” or “mineral materials,” which include construction materials, landscaping materials, and other minerals commonly used as aggregate or fill); and energy minerals (primarily oil, gas, and geothermal resources).<sup>22</sup> The agency also issues prospecting permits designed to encourage exploration; however, where the resource is discovered by the lessee, the lessee is entitled to a non-competitive lease.<sup>23</sup>

State land mineral leases (except energy resources) and exploration permits are awarded at public auction for terms up to twenty years, and generally require the payment of royalties to the department.<sup>24</sup> Common variety mineral leases are awarded for terms of ten to twenty years.

Leases for energy resources differ depending on the type of potential resource. For lands within an area with known oil and gas fields, leases are awarded based on a noticed, competitive sealed bid process for a primary term of five years.<sup>25</sup> For leases in areas that are not known to contain oil and gas resources, leases are awarded on a noncompetitive basis by application and are subject to a royalty payment of 12.5 percent.<sup>26</sup> Geothermal leases, by contrast, are awarded to the highest and best bidder, based on the highest bonus that will be paid to the department.<sup>27</sup>

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<sup>20</sup> ARIZ. REV. STAT. § 37-281.01.

<sup>21</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>22</sup> Arizona Department of State Lands, Mineral Leasing Program, *available at*: [http://www.land.state.az.us/programs/natural/mineral\\_leasing.htm](http://www.land.state.az.us/programs/natural/mineral_leasing.htm) (as of November 30, 2004).

<sup>23</sup> ARIZ. REV. STAT. § 37-272.

<sup>24</sup> *Id.* at § 37-235.

<sup>25</sup> *Id.* at § 37-556.

<sup>26</sup> *Id.* at § 37-555.

<sup>27</sup> *Id.* at § 37-760.

### *c. Land Sales and Other*

As noted elsewhere, Arizona's Enabling Act imposes a series of strict requirements on sales of trust lands, requiring that trust lands and the products of trust lands be sold "to the highest and best bidder at a public auction." These restrictions are replicated in Arizona's Constitution and statutes, requiring that these auctions be held at the county seat where the lands are located, and that public notice be provided for not less than ten weeks in a newspaper of general circulation at the state capitol and in whatever newspaper is published nearest the lands that are the subject of the auction. The Arizona Enabling Act also provides that no sale or disposal of trust lands can be made for less than the "true value" of those lands as determined by appraisal, and provides that legal title cannot pass until this consideration is paid. The Act also requires "ample security" for any sales on credit. Similar requirements apply to sales of rights-of-way, easements, participation agreements, sales of natural products, and other permanent dispositions of trust resources.

When trust lands are sold for development, trust lands are typically disposed under more complex disposition rules provided in Arizona's Urban Lands Act and its Growing Smarter legislation. These guidelines provide for a land planning process, administered by the Land Department, in which trust lands can be "conceptually planned" – a plan that corresponds roughly to the local general and comprehensive planning process administered by cities and counties – and can later be planned in greater detail for development, obtain zoning, and be brought to auction for lease or sale. The identification of lands as suitable for development prior to the development planning process requires the Land Department to consider a series of factors relevant to the planning of urban trust lands, such as water and infrastructure availability, proximity to existing development, and so forth. The Department is also required to consult with an advisory committee when planning trust lands for urban development.

Arizona currently generates the majority of trust revenues from land sales and other permanent dispositions. Due to the rapid growth of Arizona's urban areas, more than one million acres of undeveloped trust lands are now contained within or adjacent to urban areas. In fiscal year 2003, revenues from land sales and other permanent land dispositions accounted for nearly \$120 million of the \$145 million in revenues generated by trust activities, more than 82 percent of the total.

Arizona's State Land Department is currently constitutionally prohibited from engaging in land exchanges – a management tool that is available to many other states. In addition, as discussed below, the Land Department is currently significantly constrained in its ability to dispose of trust lands for conservation purposes. Both of these issues may potentially be addressed as a part of Arizona's ongoing trust land reform efforts.

Table V(B): FY 2004 Revenues – Arizona State Land Department

Source	% of Revenue	Receipts
<b>Surface</b>		
Agriculture	1.7%	\$3,630,218
Commercial	7.0%	\$14,932,591
Grazing	1.2%	\$2,168,628
Homesite	0.0%	\$23,213
Other	0.2%	\$398,865
Rights-of-way	0.9%	\$2,005,762
School Leases	2.8%	\$5,993,468
Use Permits	0.9%	\$1,955,194
<b>Total Surface</b>	<b>14.8%</b>	<b>\$31,107,939</b>
<b>Subsurface</b>		
Coal		
Oil and gas	0.2%	\$482,648
Other	0.2%	\$335,272
<b>Total Subsurface</b>	<b>0.0%</b>	<b>\$817,920</b>
<b>Sales and Other</b>		
Land Sales*	65.0%	\$138,319,546
Sales interest	11.8%	\$25,042,150
Penalty and interest	0.1%	\$126,414
Commercial prepayments	0.9%	\$1,988,978
Royalty	2.0%	\$4,162,779
Rights of way	3.2%	\$6,823,523
Other	2.0%	\$4,344,614
<b>Total Sales and Other</b>	<b>85.0%</b>	<b>\$180,808,004</b>
<b>Grand Total</b>	<b>100%</b>	<b>\$212,733,863</b>
<b>Agency Budget</b>		<b>\$13,544,300</b>

\* Arizona sold 1,875 acres of trust land in FY 2004, for a total sales price of \$310,647,731 (a 245% increase over the previous fiscal year). However, some principal payments are deferred; this figure reflects payments actually received in FY 2004 from sales and deferred principal payments arising from sales in previous fiscal years.

Source: Arizona Land Department FY 2004 Annual Report

## 6. Trust Revenue Distribution in Arizona

There are fourteen beneficiaries who receive revenues from trust activities in Arizona. These beneficiaries include: (1) the state's common schools; (2) Legislative, Executive, and Judicial Buildings; (3) the Arizona State Hospital; (4,5) two Miners' Hospitals; (6) State Charitable, Penal, and Reformatory Institutions; (7) the State Penitentiaries; (8) the state Normal Schools; (9) the state Agricultural and Mechanical Colleges; (10) the state Military Institutes; (11) the School of Mines; (12) the University Land Code; (13) the University of Arizona; (14) and the School for the Deaf and Blind. Although these trusts are administered separately, the revenues from multiple trusts may go to single institutional beneficiaries. For example, the Arizona Board of Regents receives the revenues from the Normal Schools, Agricultural and Mechanical Colleges, Military Institutes, School of Mines, University Land Code, and University of Arizona trusts, for distribution to Arizona's various universities; similarly, the revenues from the Miners' Hospitals trusts and half of the Charitable, Penal, and Reformatory Institutions trust go to support the Arizona Pioneer's Home. Of these beneficiaries, the common schools are by far the largest, credited with approximately 8.1 million acres of the 9.28 million acres in the trust.

The revenues generated from Arizona's trust lands are classified as either "permanent" or "expendable." Revenues derived from the sale of trust land, the sale of most natural products (such as sand, gravel, water, and fuel wood), and royalties earned from mining and other mineral extraction activities are classified as "permanent" and are deposited into a "permanent fund" for the appropriate beneficiary for long-term investment. Revenues from lease rentals, interest earned on deferred sale payments, and other "renewable" types of uses are classified as "expendable" and are immediately available for use by the trust beneficiaries.

Arizona's Constitution establishes a separate permanent fund for each trust beneficiary to manage these revenues. The State Board of Investment serves as the trustee of the permanent funds and is responsible for managing the assets of each fund; however, for investment purposes these individual funds are aggregated into a single permanent fund, with investment earnings, interest, dividends, and other realized gains and losses credited proportionately to each beneficiary. The State Treasurer, under the guidance of the State Board of Investment, invests the permanent fund in stocks, bonds, annuities, and other interest-bearing securities. At the end of each year, the Board of Investment determines the distribution from the permanent fund to each beneficiary based on a formula that provides a return equivalent to the average rate of return over the past five years on the average fund balance over that same period. Since statehood, the various beneficiaries have received distributions totaling approximately \$1 billion (over \$900 million of which went to the common schools). Arizona's permanent fund (aggregating the investment assets associated with each beneficiary) was valued around \$1.2 billion at the end of fiscal year 2004.

Arizona recently changed its funding formula for the state's common schools – a change that has significantly influenced the state's trust management system. Beginning in 1975, Arizona had followed a relatively simple funding formula for public school operations, establishing a minimum level of funding per student, as well as an expenditure limit based on the number of students. Property taxes in each school district were levied based on a minimum tax rate, and the difference between local tax revenues and the expenditure limit was to be supplied from the state general fund. This latter arrangement was intended to ensure that the majority of state aid would go to poorer districts providing a semblance of "equity" in the funding of public schools. Under this funding formula, state trust revenues were utilized to underwrite the general fund obligations for state aid, supplanting general fund revenues on a dollar-for-dollar basis (and thus freeing up general fund monies for other purposes).

In November of 2000, Arizona voters approved Proposition 201, which changed the distribution of the trust expendable revenue. Proposition 201 capped the amount of expendable revenues that could be used for state aid at \$72 million, and required that all revenues above this amount go into a new "Classroom Site Fund," which would combine any additional trust revenues with the proceeds from a sales tax increase. These combined revenues are distributed to school districts and charter schools on a pro-rata, per-student basis, to supplement basic teacher salaries (20

percent), fund teacher performance pay (40 percent), and fund classroom-based programs (40 percent). The legislature is prohibited from using these funds to supplant general fund dollars, such that the funds serve to supplement the monies derived from the state's basic school funding formula. In fiscal year 2003, total trust revenues amounted to around \$71 million, including approximately \$19 million from permanent fund investment and \$52 million from lease and interest payments. Due to unusually poor investment returns from the permanent fund investment in fiscal year 2004 (down almost 70 percent from fiscal year 2003), the trust made no contribution to the Classroom Site Fund in 2004.

Although these contributions continue to represent only a small fraction of Arizona's total education budget – less than 1 percent of the state funding supplied to public schools by the Department of Education – the targeting of trust revenues to provide supplemental funding for the specific purposes outlined in the Classroom Site Fund has significantly increased the level of attention paid to these funds by major education stakeholders. As noted above, prior to Proposition 201, trust revenues were simply used to supplant existing general fund obligations to education; as such, the source of these funds was of little consequence to education stakeholders, since an increase in trust revenue would simply result in a corresponding decrease in general fund appropriations. Now that trust revenues are supplemental funds, increased trust revenues correspond directly to increases in the revenues available for education – and education stakeholders have taken a direct interest in improving revenue generation from trust management. This has led to the direct involvement of education interests in the ongoing efforts to reform Arizona's trust land management system.

## *7. Recent Developments and Emerging Issues in Arizona*

### *a. The Arizona Preserve Initiative*

As noted elsewhere, there are now more than one million acres of state trust lands located in and around Arizona's urban areas; overall, trust lands comprise more than 30 percent of the available urban development land in Maricopa County, the fastest-growing area of the state. Although these lands clearly represent a major asset for the trust due to their potential value for development, in many cases these lands also have important value for urban open space. In 1996, the Arizona Legislature passed the Arizona Preserve Initiative (API) in an attempt "to encourage the preservation of select parcels of state trust land in and around urban areas for open space to benefit future generations."

Under the API program, a state or local government, business, state land lessee, or a citizen group can petition the State Land Commissioner to reclassify state trust lands as "suitable for conservation purposes." If the land is reclassified, the Commissioner may adopt a coordination plan protecting the property's conservation values that allows 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 lands may then be leased or sold for conservation purposes at auction.<sup>28</sup> To date, the Commissioner has reclassified nearly forty thousand acres of urban land as "suitable for conservation purposes," and has sold approximately three thousand 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 lands 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 lands are sold to the "highest and best bidder" as required by the Arizona Constitution.<sup>29</sup> Although there has been no definitive ruling on this issue, the program is now on indefinite hold.

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<sup>28</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>29</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.

*b. Growing Smarter: Five-Year Disposition Planning*

Arizona's 1998 Growing Smarter legislation created a statewide framework for the planning of lands in Arizona's cities and towns that requires the adoption and periodic update of general plans in each city and town and the comprehensive plans in each county. This legislation also created a corresponding framework for the planning of state trust lands, requiring the land department to prepare and periodically update "conceptual plans" for urban trust land that will be integrated into the general and comprehensive plans of cities, towns, and counties. The legislation also required the State Land Department, in consultation with city, town, and county planning authorities, to prepare five-year disposition plans that identify trust lands that will be master-planned, zoned, sold, leased, or classified for conservation purposes over the next five years.

The legislation requires the Commissioner to make a series of determinations before considering trust lands for planning and disposition, including that:

- The lands adjoin existing developed lands within or adjacent to the corporate boundaries of a city or town;
- The lands are located in areas where development is appropriate, development will be beneficial to the trust, and development of the lands will not promote urban sprawl or leapfrog development;
- The department has considered the development's proximity to and compatibility with existing developments, land uses, and local jurisdictions;
- The lands have the quality and quantity of water needed for urban development;
- The department has fully cooperated with the local planning authorities with jurisdiction over the area or areas in which the lands are located, the classification for development is consistent with local development policies, and local development policies have been taken into consideration;
- The department has considered the proximity of lands to public facilities and the impact of development on those facilities;
- The department has considered the natural and artificial features of the land, including floodplains, geologic instabilities, natural areas, wildlife habitat, airport influence zones, potentially hazardous conditions, and historic and archaeological sites and structures;
- The department has considered the timing of development, impacts to existing leases, and the available resources for planning.

With regard to disposition plans, the Commissioner is additionally required to consider, at a minimum, the market demand for the lands, anticipated transportation needs, and the availability of development infrastructure.

To meet the demands of the legislation, the State Land Department has been developing a new process to prepare disposition plans for trust lands that integrate these considerations while focusing the Department's limited staff resources for development planning on the highest-value, most suitable parcels for development. To this end, the Department has created an integrated Geographic Information Systems (GIS) database that contains a wealth of information about relative land valuation, transportation, and infrastructure availability, the physical suitability of lands for development, and other factors. This information is used to measure the relative suitability of trust land parcels for development, the regulatory and legal limitations such as endangered species presence and permitting limitations, the physical attributes such as high slopes and one hundred-year floodplains, the locational attributes such as proximity to existing transportation, water, sewer, and electric infrastructure, and the financial information related to the relative valuation of the land. Based on this information, each trust parcel receives a "ranking" based on a weighted point system that assigns different values to each attribute of the parcel based on its estimated impact on development suitability.

From this ranking, the highest-suitability parcels are re-evaluated based on market analyses and more detailed evaluations of development suitability. From this second tier, the highest-scoring

parcels are then targeted for proactive planning and disposition by the Department, with detailed master-plans for the targeted parcels prepared by the Department or by planning permittees selected through a request for proposals (RFP) process. This proactive planning and disposition approach has proved to have significant potential as a method to maximize revenues from trust dispositions. For example, the Department's Desert Ridge development, which is the product of many years of Department planning, is expected to net nearly \$40 billion for the Department in commercial leases and land sale proceeds over the next one hundred years on less than twenty thousand acres of trust lands.

This approach has also created a highly defensible system for the selection of development parcels that has focused the Department's limited resources for real estate dispositions on the most valuable and most easily accomplished development opportunities in the state, rather than simply responding to development proposals from outside parties whose interests may not align with those of the trust. Under the new disposition planning system, proposals that are identified by outside parties are first screened through the Department's disposition ranking system. If the parcel identified does not rank as high as the parcels that are the focus of the Department's efforts, it will not be considered unless the outside parties can somehow increase the objective ranking high enough for it to be considered (for example, by agreeing to bring infrastructure to the parcel, or by resolving a major regulatory constraint that had lowered the ranking, etc.).

### *c. Challenges to Grazing Lease Preferences*

Like other Western states, Arizona has recently been faced with challenges to its grazing lease program, which has traditionally incorporated a series of "preferences" for grazing lessees and has not been administered on a completely competitive basis. In 2001, the Arizona Supreme Court decided *Forest Guardians v. Wells*,<sup>30</sup> which upheld a challenge by an environmental group whose application for a grazing lease had been rejected.

Forest Guardians had applied to acquire an expiring grazing lease, with the stated intention of resting the property to improve the conditions of the soil and vegetation. The Department rejected the application on the basis that the group had no intention of grazing the land but instead wanted to lease the land for conservation. Since conservation leases are considered commercial leases under Department regulations, the Department argued that the group should instead seek to reclassify the land as suitable for commercial use, and then seek a commercial lease at a substantially increased rent.

The Arizona Supreme Court disagreed, finding that the use of lands for conservation was a legitimate use of grazing lands, particularly in light of the fact that many grazing lessees would fallow lands to allow soils and vegetation to regenerate. The Court found that "restoration and preservation are already and must continue to be considered legitimate uses for land that, according to the Commissioner's classification, has no higher and better use than grazing. Otherwise, grazing lessees could continue to graze stock until the land is damaged and its value destroyed."<sup>31</sup> Since the group had offered to pay more and increase the value of the land for grazing, the court found that the Department was required to consider whether the proposed use was in the best interests of the trust. The classification system could not provide a legitimate basis to reject an application to use lands for restorative purposes. The court thus ordered the Department to consider the Forest Guardians application to determine whether the proposed lease was in the best interests of the trust.

The Forest Guardians decision has been widely heralded as a major victory for environmental groups, and is equally disparaged by the ranching community as a threat to the continuity of land management and the interests of ranchers statewide. Although to date, the vast majority of conflicting applications have been filed by ranchers against other ranchers, and environmental groups have successfully acquired only one lease in the state (which remains in dispute), the decision has

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<sup>30</sup> 201 Ariz. 255 (2001).

<sup>31</sup> *Id.* at 262.

nevertheless engendered a great deal of controversy within the ranching community, and led to pressures to limit competition in grazing leases as a part of Arizona's proposed trust land reform.

#### *d. Exchange Authority*

Of Arizona's 9.3 million acres of trust land, some 2.3 million acres are interspersed with private lands in a "checkerboard" with the trust owning every other section of land. In addition, around five hundred thousand acres of trust lands are "landlocked" within federal land holdings, including national forests, national parks, and national monuments. These ownership configurations have complicated the management of these lands as a result of access issues. Federally-landlocked parcels are unlikely to have any productive use because of limited access or because of the applicable restrictions on the surrounding lands; at the same time, the checkerboard lands are extremely difficult to manage effectively. The majority of the checkerboard lands are located within large grazing units, and as a result, the owner of the surrounding private lands may be the only viable lessee.

Historically, the Department exchanged approximately two million acres with the federal government to preserve lands for important state and federal parks, national wildlife refuges, and wilderness areas and to secure federal lands in the vicinity of Arizona cities and towns and along the Colorado River with potential for revenue generation, as well as securing land for the University of Arizona's experimental range. Although Arizona's Enabling Act and its statutes provide authority for the State Land Department to engage in land exchanges, a 1990 Arizona Supreme Court decision declared land exchanges unconstitutional (despite the fact that they are permitted by the state's Enabling Act) on the basis that they constituted a "sale" without public auction for purposes of Arizona's Constitution.<sup>32</sup>

Over the past decade, at least six land exchange measures have been referred to the Arizona voters and have been rejected. These measures have included limited provisions that would have allowed exchanges to occur only between public entities. Opposition to these measures has generally focused on the somewhat checkered history of federal land exchange programs throughout the West, arguing that public lands have frequently been exchanged in less-than-equitable deals that have benefited private land developers. Another land exchange measure, disguised as a "military airport preservation measure," appeared on the Arizona ballot in the fall of 2004 but once again failed to win the support of the Arizona voters.

#### *e. Trust Land Reform*

The Arizona legislature is currently in the process of considering a comprehensive reform proposal that seeks to modernize the management of state trust lands by addressing many of the limitations in Arizona's Enabling Act and Constitution. After a ballot-box showdown in 2000 in which a modest reform initiative failed due to opposition from conservationists, a group of diverse stakeholders representing educators, developers, city, town, and county representatives, ranchers, and conservation organizations explored the development of a consensus proposal for trust land reform.

After approximately three years of negotiations, the stakeholder group reached agreement on a consensus proposal that was supported by most of the participants in the process. This proposal was developed into legislation that would have amended Arizona's Constitution and many of the statutes governing the Land Department; it would also have required a subsequent amendment to Arizona's Enabling Act. In brief, the original reform proposal was intended to:

- Change the administration of trust lands by creating a Board of Trustees, composed of a majority of beneficiary representatives, who would exercise oversight over certain trust-related activities of the state land department, and improve Land Department resources by establishing market-competitive salaries for key personnel and directing a percentage of proceeds from trust land dispositions to fund trust management activities.

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<sup>32</sup> Fain Land & Cattle Co. v. Hassell, 163 Ariz. 587 (1990).

- Require collaborative planning of trust lands in urban areas by the Land Department and local jurisdictions in a framework that allows for the disposal of lands for open space without auction if value is provided through monetary payments, density transfers, and other forms of non-monetary compensation.
- Enable modern real estate disposition tools, such as development agreements, participation agreements, and infrastructure financing mechanisms to maximize returns from the sales of trust lands, allow entitlement “trades” between the Land Department and local communities, and enable land exchanges for conservation purposes, dispositions for environmental mitigation, and sales of conservation easements without auction to protect ranch units in checkerboard ownership areas.
- Enable disposals of rights-of-way without auction and allow consideration of value increases to the benefited trust lands in setting the price for disposal.
- Reform rural land management provisions to allow for non-competitive grazing lease renewals and long-term leases where lessees follow improved range management practices, and improve reporting and inspection of range conditions.
- Permanently set aside approximately three hundred thousand acres of identified “conservation lands” to protect critical urban open space, educational and research reserves, and ecologically significant rural landscapes and state landmarks, and temporarily set aside approximately four hundred thousand acres of “conservation option lands” to allow time for public agencies and entities to compensate the trust.

The original reform proposal was submitted to the Arizona legislature by the stakeholder coalition for consideration in May of 2004. Despite several months of hearings under a special joint select legislative committee formed to consider the proposal, the reform package failed to move forward in the legislature. Further negotiations among the stakeholder coalition in an attempt to produce a package that would garner support from key legislators ultimately fell apart, and although two separate trust land reform bills were introduced into the spring 2005 legislative session, both failed. Nevertheless, trust land reform remains a priority for many of the stakeholders, and elements of the proposal will likely be pursued via legislative referendum or a ballot initiative in the 2006 elections.