



**STATE OF ARIZONA**

**OFFICE OF THE ATTORNEY GENERAL**

<p>INVESTIGATIVE REPORT</p> <p>By</p> <p>MARK BRNOVICH ATTORNEY GENERAL</p> <p>May 4, 2018</p>	<p>No. 18-003</p> <p>Re: City of Sedona Ordinances 2016-06 and 2018-02, amending City Code Chapter 5.25, related to regulation of Short-Term Rentals</p>
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To: The Honorable Doug Ducey, Governor of Arizona  
The Honorable Steve Yarbrough, President of the Arizona Senate  
The Honorable J.D. Mesnard, Speaker of the Arizona House of Representatives  
The Honorable Darin Mitchell, Requesting Member of the Arizona Legislature  
The Honorable Michele Reagan, Secretary of State of Arizona

**I. Summary**

Pursuant to Arizona Revised Statutes (“A.R.S.”) § 41-194.01, the Attorney General’s Office (“Office”) has investigated City of Sedona (“City”) Ordinance 2016-06 and Ordinance 2018-02 (collectively, “Ordinances”) and, as amended by the Ordinances, Sedona City Code Chapter 5.25 (“Chapter 5.25,” and together with the Ordinances, “City’s Regulation”), which presently regulates short-term rentals and vacation rentals (“Short-Term Rentals”). Based on a review of relevant authorities and materials during the limited 30-day period in § 41-194.01(B), the Attorney General has determined that the City’s Regulation requiring Short-Term Rentals to obtain a City business license **violates** state law.

## **II. Background**

### **A. The Office's Investigation**

On April 4, 2018, the Office received a request for legal review of the Ordinances pursuant to A.R.S. § 41-194.01 from Representative Darin Mitchell ("Request"). The Office asked the City to provide a voluntary response. The City fully cooperated with the Office's review, including by providing a voluntary response and supporting materials. In performing the required investigation during the limited 30-day period, the Office reviewed relevant materials and authorities.

The Office's legal conclusions are set forth below. The facts recited in this report serve as a basis for those conclusions, but they are not administrative findings of fact and are not made for purposes other than those set forth in A.R.S. § 41-194.01.

### **B. Relevant State Laws**

The Request questions whether the City's Regulation comports with A.R.S. § 9-500.39, which limits how municipalities may regulate Short-Term Rentals, and also notes A.R.S. § 9-1304, which prohibits municipalities from adopting a "residential rental licensing requirement for residential rental properties or property owners."

Section 9-500.39 forbids municipalities from prohibiting Short-Term Rentals (subpart A) and limits how municipalities may regulate Short-Term Rentals (subpart B). The statute defines a Short-Term Rental as a residential house or "dwelling unit" that either "is also a transient public lodging establishment" or a non-commercial, owner-occupied residential home used to house "transients." A.R.S. § 9-500.39(D)(2). Section 9-500.39(D)(1) incorporates the meaning of "transient" found in A.R.S. § 42-5070, which defines the term as a person who, in exchange for payment, "obtains lodging space or the use of lodging space on a daily or weekly basis, or on

any other basis for less than thirty consecutive days.” A.R.S. § 42-5070(F). Section 42-5070 further explains that the “transient lodging classification” is comprised of “the business of operating, for occupancy by transients, a hotel or motel[.]” A.R.S. § 42-5070(A). Accordingly, a Short-Term Rental in A.R.S. § 9-500.39(D)(2) is a residential house or dwelling unit used for the business of lodging persons for less than thirty consecutive days.

Municipalities possess some limited authority to regulate Short-Term Rentals. In particular, municipalities “may not restrict the use of or regulate [Short-Term Rentals] based on their classification, use or occupancy” unless the regulation falls under one of three noted categories. A.R.S. § 9-500.39(B). First, municipalities can regulate for the “[p]rotection of the public’s health and safety.” A.R.S. § 9-500.39(B)(1). This category includes “rules and regulations related to fire and building codes, health and sanitation, transportation or traffic control, solid or hazardous waste and pollution control, and designation of an emergency point of contact[.]” *Id.* Second, Short-Term Rentals may be made subject to “residential use and zoning ordinances . . . if the ordinance is applied in the same manner as other property classified under sections 42-12003 and 42-12004.” A.R.S. § 9-500.39(B)(2).<sup>1</sup> Third, Short-Term Rentals may be limited or prohibited from certain specified uses, such as housing sex offenders, selling illegal drugs, or operating adult-oriented businesses. *See* A.R.S. § 9-500.39(B)(3).

Section 9-1304 further establishes the contours of allowable municipal regulation for residential rental property. As relevant here, it prohibits municipalities from imposing a “residential rental licensing requirement for residential rental properties or property owners.” A.R.S. § 9-1304(B). A “residential rental licensing requirement” is a requirement “that property

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<sup>1</sup> Broadly, sections 42-12003 and 42-12004 are tax classifications for residential property.

owners or property managers obtain a license or permit from the city or town . . . before they can legally engage in the rental of dwelling units in the city or town.” A.R.S. § 9-1301(11).

### **C. The City’s Regulation**

In response to the enactment of A.R.S. § 9-500.39 in 2016, the City Council adopted Ordinance 2016-06, which amended Chapter 5.25 of the City Code to permit Short-Term Rentals in the City.<sup>2</sup> The amended Chapter 5.25 included a business license requirement for “[e]very Short-Term Rental, Vacation Rental, or Transient Lodging establishment.” In 2018, the City Council passed Ordinance 2018-02, which again amended Chapter 5.25, this time by removing the terms “Short-Term Rental” and “Vacation Rental.”

As it currently reads, Chapter 5.25 requires “[e]very transient lodging establishment . . . [to] obtain a city of Sedona business license as required pursuant to [Sedona City Code] Chapter 5.05.” Sedona City Code Chapter 5.25.040. City Code Chapter 5.05 establishes the City’s generally applicable business license requirement, making it unlawful for a business to operate without a business license if the business is “(1) physically located within the city limits, or (2) if it has an obligation to pay transaction privilege taxes (TPT) to the city of Sedona for the business it is conducting.” Sedona City Code Chapter 5.05.020(A). Obtaining a business license requires submission of an application and payment of a \$50 fee.

### **III. Analysis**

Working together, A.R.S. §§ 9-500.39 and 9-1304 establish to what extent municipalities may regulate Short-Term Rentals. First, municipalities may not prohibit Short-Term Rentals. A.R.S. § 9-500.39(A). Second, municipalities may not require Short-Term Rentals to obtain a license or permit before renting the property. A.R.S. § 9-1304(B). Lastly, municipalities may

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<sup>2</sup> Before A.R.S. § 9-500.39 was enacted (forbidding municipalities from prohibiting Short-Term Rentals), Chapter 5.25 outright prohibited renting residential properties for less than 30 days.

not adopt targeted regulations of Short-Term Rentals unless those regulations fall within limited categories. A.R.S. § 9-500.39(B). Chapter 5.25 violates state law because Chapter 5.25's business license requirement forces Short-Term Rentals to obtain a license before operating.

**A. Chapter 5.25 Violates State Law By Contravening A.R.S. § 9-1304**

Chapter 5.25's licensing requirement is an unlawful pre-requisite to operating a Short-Term Rental in the City. Section 9-1304(B) broadly prohibits municipalities from adopting "a residential rental licensing requirement for residential rental properties or property owners." A "residential rental licensing requirement," as stated in § 9-1304(B), is a "requirement established by a city or town that property owners or property managers obtain a license or permit . . . before they can legally engage in the rental of dwelling units in the city or town." A.R.S. § 9-1301(11).<sup>3</sup> Chapter 5.25 imposes just such a prohibited licensure requirement on those wishing to operate a Short-Term Rental.

The plain language of A.R.S. § 9-1304(B), as informed by the definition of "residential rental licensing requirement" in A.R.S. § 9-1301(11), alone establishes that the City's business license requirement as applied to Short-Term Rentals under Chapter 5.25 violates state law. *See Premier Physicians Grp., PLLC v. Navarro*, 240 Ariz. 193, 195 ¶9 (2016) (when statute's plain language is clear, it is applied). Chapter 5.25, by its terms, imposes a requirement that property owners wishing to operate Short-Term Rentals must obtain a City business license before doing so. Neither A.R.S. § 9-1304(B) nor the corresponding definitions in A.R.S. § 9-1301 have a rental-length exception or exclusion. And nothing about how Short-Term Rentals are defined in

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<sup>3</sup> Section 9-1304(B) allows a municipality "that imposes a sales tax on rent" to require "a transaction privilege tax license for residential rental property owners." However, Chapter 5.05 specifically notes that the business license at issue here "is in addition to the privilege tax license required by Section 8-300 of the Sedona City Tax Code." Sedona City Code Chapter 5.05.020(A).

A.R.S. § 9-500.39(D)(2) suggests that such rentals are not subject to the broad prohibition imposed by A.R.S. § 9-1304(B) on municipal licensure of those owning or managing residential dwelling unit rentals—a Short-Term Rental is a residential rental property all the same.

The contextual interaction of A.R.S. §§ 9-1304 and 9-500.39 likewise confirms that the City’s business license requirement violates A.R.S. § 9-1304(B). Sections 9-1304 and 9-500.39 impose separate requirements that work in harmony; municipalities must allow Short-Term Rentals to operate without some form of official pre-approval, and A.R.S. § 9-500.39 articulates exactly when municipalities may adopt regulations targeted at Short-Term Rentals (*i.e.* regulations based on classification, use, or occupancy as a Short-Term Rental). *See City of Mesa v. Salt River Project Agric. Improvement and Power Dist.*, 92 Ariz. 91, 98 (1962) (“[C]ourts will not render an interpretation of statutes which makes them contradictory to each other but must, if sound reason and good conscience allow, construe statutes in harmony.”).

Indeed, the defined terms in A.R.S. §§ 9-1304(B) and 9-500.39 share key textual aspects that confirm their harmonious relationship and further validate A.R.S. § 9-1304(B)’s overarching application to residential houses and “dwelling units”—the key terms in understanding what properties are Short-Term Rentals pursuant to A.R.S. § 9-500.39(D)(2). Again, A.R.S. § 9-1304(B) prohibits municipalities from requiring a license for “residential rental properties.” Although “residential rental properties” in § 9-1304(B) is not defined, the definition of “residential rental licensing requirement,” which is what cannot be imposed on “residential rental properties,” specifically incorporates “the rental of dwelling units.” *See* A.R.S. § 9-1301(11) (“a requirement . . . [to] obtain a license or permit . . . before . . . legally engag[ing] in the rental of dwelling units”). “Dwelling unit” is not itself defined, but “residential dwelling unit” and “residential rental dwelling unit” are defined in A.R.S. § 9-1301(9)-(10), respectively. And these

definitions make plain that a “dwelling unit” is, at a minimum, a “building or structure or part of a building or structure that is used for a home or residence,” A.R.S. § 9-1301(9), which is precisely the type of property defined as a Short-Term Rental in A.R.S. § 9-500.39(D)(2). As the interaction of these terms demonstrates, the statutory context supports applying A.R.S. § 9-1304(B) to Short-Term Rentals.<sup>4</sup>

Furthermore, to conclude that A.R.S. § 9-1304(B) precludes the City from applying a business license requirement to Short-Term Rentals does not limit the City’s authority to adopt health and safety regulations targeted at Short-Term Rentals pursuant to A.R.S. § 9-500.39(B)(1). Pre-approval to operate within City limits by obtaining a license plainly is not the same type of requirement as the health and safety measures contemplated by A.R.S. § 9-500.39(B)(1), which specifically lists, among others, measures related to fire codes, health and sanitation, and emergency points of contact. These types of measures can be adopted independently of a licensure requirement, which is an altogether different type of burden on property owners wishing to operate a Short-Term Rental. As a result, interpreting A.R.S. § 1304(B) as applying to Short-Term Rentals is wholly consistent with the regulatory authority granted to municipalities under A.R.S. § 9-500.39.

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<sup>4</sup> The City points to the legislative history for H.B. 2221, which enacted what is currently A.R.S. § 9-1304 in 2006, *see* 2006 Ariz. Sess. Laws, ch. 285, § 1 (2d Reg. Sess.) (codified at A.R.S. § 9-1304), as demonstrating that A.R.S. § 9-1304 does not apply to Short-Term Rentals. Although the legislative history noted that “[t]he act does not apply to commercial or industrial properties . . . or hotel and motel occupancies,” Amended Senate Fact Sheet, H.B. 2221, 47th Leg., 2d Reg. Sess. (May 3, 2006), section 9-500.39 specifically provides that Short-Term Rentals are both residential and commercial in nature. *See* A.R.S. § 9-500.39(D)(2) (Short-Term Rental is residential house or dwelling unit “*that is also* a transient public lodging establishment” (emphasis added)). To interpret A.R.S. § 9-1304 as excluding Short-Term Rentals based on this single statement from the legislative history would effectively nullify the residential nature of these properties as specifically set forth in A.R.S. § 9-500.39(D)(2). Moreover, it would fail to account for the above-detailed interaction between the later, specific definition of Short-Term Rentals in A.R.S. § 9-500.39(D)(2) and the definitions in A.R.S. § 9-1301.

**B. Chapter 5.25 Does Not Independently Violate A.R.S. § 9-500.39**

Whether Chapter 5.25 violates A.R.S. § 9-500.39(B) independent from the violation of A.R.S. § 9-1304 ultimately depends on whether the business license requirement imposed by the City's Regulation is specifically targeted at Short-Term Rentals. As previously noted, a municipality "may not restrict the use of or regulate [Short-Term Rentals] based on their classification, use or occupancy" unless the regulation falls under one of three express categories. A.R.S. § 9-500.39(B). Accordingly, generally applicable regulations that do not target Short-Term Rentals are permitted by A.R.S. § 9-500.39.<sup>5</sup>

The City's business license requirement cannot be understood as regulating Short-Term Rentals based on classification, use, or occupancy, and it therefore falls outside the purview of A.R.S. § 9-500.39(B). Rather than imposing its own specific requirement on Short-Term Rentals, Chapter 5.25 instead confirms that Short-Term Rentals "shall obtain a city of Sedona business license as required pursuant to Chapter 5.05." Sedona City Code Chapter 5.25.040.

And Chapter 5.05 states:

"[i]t is unlawful for *any business* to operate if it is (1) physically located within the city limits, or (2) if it has an obligation to pay transaction privilege taxes (TPT) to the city of Sedona for the business it is conducting, without first having procured a current business license from the city and complying with any and all regulations of such business.

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<sup>5</sup> Indeed, no language in the statute indicates otherwise. Interpreting A.R.S. § 9-500.39(B) as limiting municipal regulatory authority over Short-Term Rentals to *only* measures not targeted at Short-Term Rentals based on their classification, use, or occupancy would render superfluous (B)(2)'s provision that residential use and zoning ordinances may apply to Short-Term Rentals "if the ordinance is applied in the same manner as [to] other [similarly classified] property." See *City of Tucson v. Clear Channel Outdoor, Inc.*, 209 Ariz. 544, 552 ¶31 (2005) (avoiding rendering statutory provisions superfluous). Such an interpretation also could produce absurd results (e.g. ordinance generally banning sex offenders from renting in residentially-zoned areas). See *State ex rel. Montgomery v. Harris*, 237 Ariz. 98, 101 ¶13 (2014) (avoiding absurd results).



Sedona City Code Chapter 5.05.020(A) (emphasis added). By its terms, the requirement placed on Short-Term Rentals in Chapter 5.25 is not a special provision for Short-Term Rentals but instead a duplicative imposition of a generally applicable requirement that is no different than the one applying to all businesses in the City. *See Havasu Heights Ranch and Dev. Corp. v. State Land Dep't of Ariz.*, 158 Ariz. 552, 560 (App. 1988) (a rule is “generally applicable” when it “applies to a class, which is ‘open’ in the sense that the class is described in general terms and new members which fit that description can be added”).<sup>6</sup> As a result, the City’s business license requirement does not independently violate A.R.S. § 9-500.39.

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State law, as reflected in A.R.S. § 9-500.39 and A.R.S. § 9-1304, does not bar all regulation of Short-Term Rentals, but it does conclusively provide that (1) Short-Term Rentals must be allowed by municipalities, and (2) municipalities cannot force Short-Term Rentals to obtain a license to operate any more than municipalities can require other residential rental units to obtain such a license. The City’s Regulation violates this combined state statutory scheme for Short-Term Rentals by mandating an improper business license requirement for Short-Term Rentals. As such, the City’s Regulation violates state law.

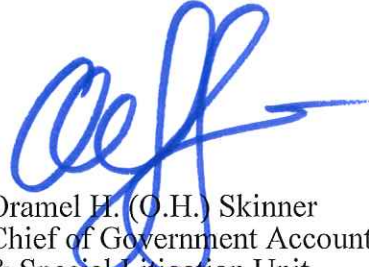
#### **IV. Conclusion**

The Office concludes under A.R.S. § 41-194.01(B) that the City’s Regulation requiring a business license for Short-Term Rentals violates state law. Pursuant to A.R.S. § 41-194.01(B)(1), the City has thirty days from the issuance of this written report to resolve the violation. If the City fails to resolve the violation within thirty days, the Attorney General will, pursuant to

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<sup>6</sup> To the extent the City may use Chapter 5.05 to impose a licensure requirement on Short-Term Rentals independent of Chapter 5.25, Chapter 5.05 would be subject to the same analysis set forth in Section III.A.

A.R.S. § 41-194.01(B)(1), “[n]otify the state treasurer who shall withhold and redistribute state shared monies from the county, city or town as provided by section 42-5029, subsection L and from the city or town as provided by section 43-206, subsection F.”



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