MEMORANDUM

To: Jason Rogers and John Bourjaily, City of Commerce City

From: Dan Guimond and Andrew Knudtsen, Economic & Planning Systems

Subject: Metro District Draft Model Service Plan Financial Impacts; EPS #223089

Date: September 6, 2022

The City of Commerce City requested Economic & Planning Systems (EPS) provide an analysis of the financial impacts of proposed policy changes to its metro district policies and its Model Metro District Service Plan. The proposed regulations are intended to provide greater protection for future district residents regarding the maximum allowable mill levy and length of time for bond issuances, as well as district residents' control over any future debt financings.

EPS provided a memo with preliminary comments that was presented by City staff to City Council at its July 25th meeting. EPS was not able to attend the meeting but listened to the session recording. This memorandum provides EPS' response to the questions raised by Council members, as well as additional input received from discussions with Denver area investment banking firms on the potential impacts of the policy modifications under consideration.

Based on the discussion at the July 25th meeting, the Council has requested input from EPS on six proposed policy issues with financial implications as listed below:

- Mill levy cap Gallagher provision
- Mill levy cap
- Debt limit cap
- Developer reimbursement limits
- Maximum mill levy imposition term
- Maximum interest rate and maximum underwriting discount

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Mill Levy Rate Gallagher Provision

The proposed Model Service Plan does not provide a provision authorizing the adjustment of any mill levy to account for changes in the method of calculating assessed valuation (including any change in the ratio of actual valuation) or any constitutionally mandated tax credit, cut or abatement.

> *This is a potentially unreasonable restriction. The District should allow for the mill levy to be "Gallagherized". This would mean if the State lowers property assessment rates, the mill rate can go up correspondingly so that the amount of revenue collected by the district remains the same. This protection is necessary to ensure that the district can continue to make its debt service requirements.*

A Council member also raised the question of restricting the district from revenue increases above current levels.

> *The district's revenue growth is limited by TABOR which caps revenue increases to the prior year's spending by inflation plus population growth (unless the district debruces at the time of the initial TABOR election). The City may want to state that it will not allow the district to debruce without City Council approval.*

Mill Levy Cap

The City proposes a total mill levy cap of fifty (50) mills for both debt service and operations and maintenance, with no more than ten (10) mills being used for operations and maintenance even if the debt service mill levy becomes unlimited.

> *A combined cap of 50 mills for both debt service and operations is uncommon along the Front Range, but not unprecedented. It is much more common to see a 50 mill cap for debt service and an additional 10 mills for operations.*

An exception is allowed for as follows; provided that the service plan allows for unlimited mill levy for the payment of debt if the total amount of the district's debt is equal to or less than fifty percent (50%) of the district's assessed valuation.

> *This exception is also found in other model service plans. Although the language is hard to understand, the intended purpose is to allow the mill levy cap to roll off once the district reaches a level of assessed value that means it no longer needs the cap in place. Once the cap has rolled off, the district has a much easier time accessing the investment grade end of the capital markets, which lowers interest rates significantly.*

Debt Limit Cap

The City is proposing a restriction of the total debt authorization to no more than the lesser of one hundred percent (100%) of the maximum projected debt capacity or one hundred percent (100%) of the estimated costs of the public improvements, as shown in the district's financial plan.

This is a reasonable provision. To eliminate any confusion as to the definition of debt capacity, the Service District Financial Plan (as further detailed below) should include debt issuance and service schedules and calculations establishing the District's projected maximum debt capacity (total debt limitation) based on assumptions of: 1) the projected interest rate on debt to be issued; 2) projected assessed valuation on property within the district; and 3) the projected rate of absorption of assessed valuation within the district; further calibrated by 100 percent of the maximum costs of public improvements plus 10 percent for contingency.

Maximum Mill Levy Imposition Term

A metro district has a maximum amount of time to impose a mill levy on a particular property for debt repayment. The City is proposing a limit not to exceed 35 years unless a majority of the district board are residents of the district and have voted in favor of a refunding that will result in a net present value savings as set forth in C.R.S. 11-56-101 *et seq.*

EPS reviewed the debt limit requirements of other city policies including Denver, Aurora, and Fort Collins, and found that 40 years is a more common time horizon. When the mill levy imposition term is longer, it allows districts to fund more infrastructure at lower interest rates because there is more cushion for investors in the event that things go wrong. EPS therefore recommends the City also adopt a 40-year maximum time limit. It should be noted that the term for a mill levy for operations and maintenance of district assets has no similar time limitation.

Developer Reimbursement Limits

A prohibition on the reimbursement of any developer of property in the district more than eighty percent (80%) of the actual costs of public improvements, more than $25,000 of the costs of organizing the district; or any development security expenses.

We are not sure why this restriction is beneficial or necessary. The district's eligible public improvements ((listed under (b) Contents (5) Description of Public Improvements)) should specify the eligible public improvements that are proposed to be developed and financed. Reimbursing the developer for up to 100 percent of costs is essentially the purpose of metropolitan districts and the limitation to an 80 percent ceiling appears onerous, particularly when there are other issues more directly linked to future residents' interests.

Maximum Interest Rate and Maximum Underwriting Discount

A limitation of the maximum voted interest rate on any debt to twelve percent (12%) and of the maximum underwriting discount for any debt to three percent (3%).

These limitations are common and not very restrictive in today's environment.

Section 13-2101 – Regional Improvement Mill Levy

The Service Plan includes a provision for requiring a regional improvement mill levy of five (5) mills for a residential district, one and a half (1.5) mills for a commercial district, and ten (10) mills for an industrial district with the following requirements.

(a) All service plans approved after January 1, 2022 shall provide for the authorization of and require the imposition, collection, and remittance of a regional improvement mill levy applicable to all properties within the district to ensure that properties benefiting from improvements funded through such mill levy pay a reasonable share of costs associated with such improvements.

(b) The service plan shall require that, as part of the district's initial TABOR election, the district seeking authority to impose the regional improvement mill levy and the authority under TABOR to enter into an intergovernmental agreement with the city obligating the district to pay as a multiple-fiscal year obligation the proceeds from the regional improvement mill levy to the city. The district shall not issue debt or impose any mill levy or fee for the repayment of debt until the district has complied with this subsection.

(c) The regional improvement mill levy shall be in addition to and not subject to any limitation on the mill levy for debt service or operations and maintenance.

(d) When imposed by a district, a regional improvement mill levy shall not exceed a term of forty (40) years from December 31 of the tax collection year after which the regional improvement mill levy is first imposed.

> *A number of cities provide for the implementation of a regional improvement mill levy as part of a Metro District Service Plan or as a separate district that metro districts are required to participate in. With respect to the draft language above, some additional specificity is recommended. The City cannot require a mill levy without specifying what improvements are being paid for and the benefits to the property owners of the district. It seems to us that there may be districts where a contribution to regional improvements is not warranted. The Fort Collins policy indicates that the Service Plan* ***may*** *include a section addressing regional improvements, stating that the intent is to ensure that privately owned properties to be developed within a district that benefit from regional improvements pay for a reasonable share of the costs*

We also have concerns about the proposed rate structure. The rationale for the differing rates for commercial and industrial districts is not clear.

> *We understand the City is proposing a lower rate on commercial properties because of concerns about the sensitivity of commercial leases to high total mill rates. However, developers typically address these concerns by imposing a lower metro district mill rate on commercial properties compared to residential properties so the impetus for these adjustments is for the district to adjust its mill levies and not the city. What about office uses; are they also considered a commercial use? And what is the rationale for the higher industrial rate? At 10*

mills, it is 6.7 times higher than the commercial rate of 1.5 mills and effectively 8 times higher than the residential rate (10 mills x .29% assessment rates vs. 5 mills x 7.15% assessment rate).

Other Service Plan Contents

In addition to the contents required by the Special District Act as listed above, the Draft Model District Plan is recommended to include the following items:

Financial Plan

The Draft Model Service Plan proposes a requirement for inclusion of a Financial Plan that:

1. Reflects the district's anticipated schedule for issuing such Debt as the District can reasonably pay within the Maximum Debt Mill Levy Imposition Term from revenues derived from the Maximum Debt Mill Levy, Fees and other legally available revenues, subject to the limitations of this Service Plan. The Financial Plan is based on economic, political, and industry conditions as they presently exist and reasonable projections and estimates of future conditions. These projections and estimates are not to be interpreted as the only method of implementation of the district's goals and objectives but rather a representation of one feasible alternative. Other financial structures may be used so long as they are in compliance with this Service Plan. Based upon the assumptions contained in the Financial Plan, the Financial Plan projects the issuance of Debt to fund the Public Improvements and anticipated Debt repayment based on the development assumptions and absorptions of the property within the District Boundaries by End Users. The Financial Plan anticipates that the district will acquire, construct, and complete all Public Improvements.

2. The Financial Plan demonstrates that the district will have the financial ability to discharge all Debt to be issued as part of the Financial Plan on a reasonable basis. Furthermore, the District will secure the certification of an External Financial Advisor who will provide an opinion as to whether such Debt issuances are in the best interest of the district at the time of issuance.

    Based on our experience reviewing metro district applications, we recommend the City be more specific regarding what is required in the Financial Plan in order to have sufficient information for evaluation. The Financial Plan should include data on development market values and absorption levels that support the projections of debt and operating financial projections prepared by an investment banking or financial advisory firm; the debt issuance and service schedules, total debt limitation, and estimated operations and maintenance costs. The plan should include a summary that captures total sources of funds and total uses of funds, with the uses of funds broken down by infrastructure category and by subarea (if the size of proposed district is sufficiently large to have multiple subareas).

Description of Public Improvements

The Draft Model District Service Plan requires a description of the public improvements that will be built, acquired, or financed by the district, including at a minimum a map or maps and preliminary construction drawings of such improvements, a written narrative and description of the public improvements, and a general description of the district's role with regard to the public improvements.

> *Additional specificity is recommended including the estimated cost of public improvements to be financed and how the improvements are to be financed including district revenues and other external sources.*

Conclusions

The City's proposed restrictions and controls on metro districts is intended to protect the interests of the future residents as well as to prevent overly burdensome financial practices by developers. These provisions can be appropriate and reasonable as long as they are not so onerous as to eliminate the ability of the districts to issue debt to finance the eligible improvements. It would otherwise be more appropriate for the City to decide it does not want to allow for metro districts to exist at all.

The intended purpose of metro districts is to finance the cost of public improvements in newly developing areas within the city. This long-term financing is paid for by the development's future homeowners over time. If, alternatively, the cost of these improvements was to be included in the price of each home, many residents would be priced out of the market.

Commerce City has relied on metro districts to pay for a large portion of the costs of capital improvements in newly developing areas so that new development is "paying its own way" and not part of the tax burden on existing residents. If it were to decide to eliminate the ability to form metro districts, it would need to either identify another way to build and fund the needed improvements or be willing to accept that the only development that could feasibly be built would be luxury housing affordable to only a small segment of the market.