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Memorandum To : Mayor Jacki Marsh and Loveland City Council

From: Brian Matise

Date: April 10, 2018

Subject: LOVELAND CITY COUNCIL STUDY SESSION ON PROPOSED METRO DISTRICT SERVICE PLAN REQUIREMENTS

Dear Mayor Marsh and City Council,

Thank you for inviting me to this study session to discuss proposed requirements for a model service plan for metropolitan districts in the City of Loveland. I fully support the creation of a model service plan for the City. Model service plans provide developers with guidance as to parameters for what the City views as acceptable in a service plan, while also protecting future taxpayers from unreasonable and onerous taxes and fees. It also can help promote financially sound districts and avoid the inevitable "race to the bottom" where each new district financial plan is slightly more risky than the prior district.

I have reviewed the 12 proposed requirements in your February 20, 2018 City of Loveland Metropolitan District Review document. These are my comments on these requirements. These comments are my personal opinions based on my 12 years of experience serving on Metro District Boards, representing property owners and homeowners associations in dealing with districts, and representing districts as general counsel. These comments do not reflect the views of any organization or District that I represent.

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1	Limit Inactive Districts	A district must issue debt within 5 years of the original date of City Council's approval of the Service Plan.	If the district issues no debt within the period, the district must commence dissolution proceedings unless City Council grants an extension.

I support the purpose of this requirement to limit inactive districts. If a district is inactive for more than five years, it is likely that the District's original financial plan no longer represents the existing conditions when the district was formed. For example, cost of infrastructure, financing costs (interest rates), and the surrounding development very likely have changed.

The Special District Act already provides for a quinquennial review of reasonable diligence for authorized debt (CRS 32-1-1101.5) by the authorizing municipality. This allows the City to require and review authorized debt every five years. CRS 32-1-1101(2) provides that electoral authorization for debt exceeding 1.5% of the assessed value of the District expires 20 years after authorization, unless bonds are issued within that time period.

The model service plan should clarify the definition of "debt" for the purpose of this requirement. Generally, "debt" may be incurred to developers under contractual agreements (such as developer advance and reimbursement agreements) even though bonds may not be issued. For the purpose of this requirement, "debt" should include any multiple fiscal year obligation of the District requiring TABOR authorization. There may be good reason why general obligation bonds are not issued for five years (such as adverse market conditions), but there may be TABOR contractual debt.

Council should consider a separate requirement for inactive districts which would require dissolution after 5 years. A district that is inactive pursuant to CRS 32-1-104(3) should be subject to dissolution after a period of time (perhaps 5 years of inactive status), but a district that is active but has not issued debt should be subject to a thorough quinquennial review requiring City Council certification.

Note that state law prohibits dissolution if there are outstanding financial obligations. The model service plan or a separate developer agreement should provide for responsibility for debts in the event of dissolution.

2	Public Improvement Limits	The City can identify specific improvements that will not constitute public improvements.	The district cannot design, acquire, install, construct, finance, operate, maintain or otherwise use the district's funds or debt for such improvements.

I support this requirement. Areas such as private landscaping or recreational facilities that are to be turned over to homeowner associations, tree lawns in the City street right of way that typically are maintained by individual homeowners, and necessary work to develop the property for private profit should be excluded.

3	Maximum Debt Limit	The City can specify this amount.	This ensures the amount reasonably relates to the improvements, does not overburden residents and is consistent with past City authorizations.

I support this requirement. The City should include a formula for determining maximum debt limit based on the financial plan that is submitted. Generally, a maximum debt limit not more than 50-75% of the fully "built out" assessed value would be appropriate for most districts. A district whose debt to assessed value ratio is 50% or less is generally considered very healthy, while debt ratios up to 100% may be justified depending on interest rates. Note that a 5% interest rate on debt would require 50 mills to be levied for 30 years to service debt at a 75% debt-to-assessed value ratio. At a 100% debt to assessed value ratio, a 5% interest rate on debt would require 30 years at 65 mills to service.

4	Maximum Debt Term	No debt can have a term of more than 40 years from the date of issuance.	40 years after the date of debt issuance, any remaining balance is discharged. This provides homeowners with an end date for the debt mill levy.

I support a maximum debt term. 40 years is the maximum allowed for debt under the Supplemental Public Securities Act. However, the City should consider how this affects refinancing of debt. If 30-year bonds are refinanced in the 15th year at a lower interest rate, does that mean subsequent debt may be issued for only a 25 year term?

Similarly, the District may wish to issue debt in the future to finance additional improvements. The City should make it clear that the 40-year limit on the mill levy does not apply to subsequently issued debt.

The City should also consider requiring that all debt must be self-amortizing. This would prevent a District from issuing debt requiring a balloon payment after 20-30 years.

The City may wish to consider modifying these provisions as follows: 1) No single debt issue can have a term of more than 30 years from date of issuance; 2) The term of the INITIAL debt service mill levy, including any refinancing, expires not more than 40 years after the original issuance UNLESS refinancing is authorized by a Board consisting of members not affiliated with the developers.

5	Debt Repayment Deadline	The district must repay all debt within 45 years from approval of the service plan.	Any debt that exists after 45 years from the service plan approval is extinguished. This coincides with the 5-year deadline to issue debt above. This also provides homeowners with an end date for the debt mill levy.

This is closely related to #1 and #4 above. As set forth above, I would suggest the City consider limiting this provision to give more flexibility to the District and the City: 1) this provision would not apply to debt issued by the District to finance subsequent improvements authorized by a Board consisting of members not affiliated with the developers; 2) this would not apply to

refinancing of debt authorized by a Board consisting of members not affiliated with the developers; 3) in the even the City extends the date for issuance of debt (see #1 above) to more than 5 years after approval of the service plan, this date would be extended as well.

6	Extensions of Debt Term or Repayment Deadline	If a majority of a board approving an extension is comprised of residents, the debt term and/or repayment deadline extensions may occur.	This provision is to encourage the transfer of power from the initial creator of the district to the residents.

I support the general idea of this provision, but it may be too rigid. For example, a developer-controlled Board may have an opportunity to take advantage of favorable refinancing opportunities to refinance shorter-term obligations (5-15 years) to more permanent 30-year financing. I would modify the provision (see comments to #4 above) that no refinancing of debt may extend the term of the term of the debt to more than 30 years (or 40 years) after original issuance unless refinancing is authorized by a Board consisting of members not affiliated with the developers.

7	Last Debt Issuance	The district can issue no debt 10 years after the original date of City Council's approval of the service plan.	No new debt may be issued 10 years after approval of the service plan to encourage timely construction of the improvements and the project.

I support the general idea, but the City may wish to consider revising this to allow the District to refinance the debt or to issue new debt for later-constructed improvements (such as a new recreation center, etc.). See #4 and #6 above.

8	Disclosure Policy	The district can issue no debt until the owner of the property in the district executes a disclosure agreement with the City and records it with the County.	The disclosure agreement requires the owner to provide specific disclosures to initial home purchasers about the district.

There are already provisions in state law requiring disclosure of special district debt. For example, CRS 32-1-104.8, 32-1-809, and 32-1-209. The problem is that this is usually disclosed in a manner that is not reasonably calculated to inform purchasers and residents. For example, 32-1-809 allows the District to satisfy the transparency notice requirement by posting on the Special District Administration (SDA) website. Only very sophisticated purchasers know about the SDA. Filing with the County Clerk and Recorder also does not put most purchasers on notice, because it is often only picked up in a title commitment report.

I suggest adding into the Service Plan: 1) requirement of disclosure to the initial homeowner/residents (i.e., non-developer, non-builder) of the disclosure statement including the MAXIMUM mill levy, estimated property taxes to be levied by the District, and estimated average debt per home that is to be repaid; and 2) requirement of ANNUAL mailing of transparency notice to homeowners.

9	Metropolitan District Notice	The district can issue no debt until the owner records a specific notice regarding the district with the County.	The 2-page disclosure generally identifies the existence of the district, contact information for the district, and the effect of the district on a homeowner's property taxes.

See the comments to No. 8 above. I support this requirement. This should be provided to initial homeowners/residents as well as annually to all homeowners.

10	Debt Mill Levy Cap	The City can specify this amount.	This ensures that the debt mill levy on the property does not overburden residents, and is consistent with past City authorizations.

I support a mill levy cap consistent with state law. Under state law, debt service mill levy may be unlimited if the debt-to-assessed value ratio is less than 50%. I recommend that the City consider allowing the mill levy cap to "roll off" once this ratio is met. That is because a district with debt-to-assessed value ratio below 50% is generally in a healthy condition.

Also, I would suggest the City consider allowing a future District Board to allow issuance of unlimited mill levy debt under certain conditions such as refinancing the District's debt at a lower interest rate and term not to exceed current duration of debt such that the District would pay less in total debt service costs.

The City should consider setting a debt service mill levy cap that may be Gallagherized for changes in the residential assessment ratio. For example, 50 mills at 7.2% of actual value equates to 0.36% of a home's actual value ($1,440 per year for a $400,000 home). If the Gallagher Amendment requires the assessment rate to change, the mill levy cap should change as well so that the maximum tax rate remains 0.36% of the home's actual value.

11	O&M Mill Levy Cap	A separate operations and maintenance mill levy maximum is specified.	The O&M mill levy cap prevents a district from maintaining a high Total Mill Levy by increasing the O&M budget once the Debt Mill Levy is paid.

I support an O&M Mill Levy Cap. Again, I propose this be Gallagherized to account for changes in the residential assessment ratio. The financial plan submitted by each district should indicate whether property taxes will be the major source of O&M funding, or fees, or enterprise revenues (such as water/sewer charges). The O&M mill levy cap should be sensitive to whether the District will receive other sources of financing, such as fees, and be sufficiently large to provide for the District's anticipated financial needs. For example, 20-35 mills is typically adequate to provide for most residential metro district operation and maintenance requirements.

Using tax revenues to finance a district has significant advantages, including: 1) a share in the county Specific Ownership Tax revenues (typically 7.5% of property taxes); 2) reduced collections cost; 3) virtually no delinquencies; 4) less administration cost (mailings, etc.). For a

district with 500-1,000 homes and a budget of $1,000,000 a year, this could benefit the District by more than $100,000 a year.

12	Material Modification Definition	The service plan identifies a number of actions as material modification to the service plan, such as increasing or decreasing the district size, increasing the Debt Mill Levy Cap, O&M Mill Levy Cap or the debt limit, or extending the debt term, debt repayment date or last debt issuance date.	Any material modification requires notice to residents, an opportunity to be heard before City Council, and City Council approval. This is intended to provide more transparency to district action and oversight by City Council.

I support a clear definition of material modifications to the service plan. Clear parameters need to be set for how much of an increase/decrease to the District's size (+/- 5% of projected assessed value at build out might be a guide), extending the debt term more than 10 years from the financial plan or at a mill levy/annual debt service level greater than projected in the financial plan would be a good definition to use. Issuance of debt that is not fully amortized and requires refinancing would be an additional criteria.

In consolidated multiple-district service plans, the City should also consider material modifications to include changing the anticipated ownership or control of the District's facilities or transferring any assets to a different district. This removes the incentive for developers facing an election in which non-affiliates are likely to take control of the Board to transfer the infrastructure or control of the infrastructure to another district that they will continue to control.

Thank you for the opportunity to address the Council on these issues. I look forward to our study session on Tuesday, April 10, 2018.

Very truly yours,
BURG SIMPSON
ELDREDGE HERSH & JARDINE, P.C.

Brian Matise