Planning & Community Development Department Overview of C.R.S. Title 32 Metropolitan Districts

a. General Background

Title 32 Special Districts derive their name from the relevant State statute under which they are organized. Districts organized under Title 32 include several different general options and some specialized types. As further articulated beginning in Section c below, the most common type of Title 32 district used in the State and in Colorado Springs are metropolitan districts.

Of all the allowable types of special districts in the State, they arguably have the most potential independence and largest potential range of powers. In Colorado, well over half of the over 4,000 local governmental entities are Title 32 districts. The majority of Title 32 districts are now metropolitan districts. These districts operate as "special purpose quasi municipal governments." Their general functions are to provide public financing for various public improvements and/or to operate and maintain public facilities over time. They can only be created with the concurrence of a general purpose local government. However, once formed, these quasi-municipal governments have independently elected boards of directors that are responsible to the property owners and/or ratepayers within the district.

b. Types of Title 32 Districts

Title 32 authorizes a variety of different types of special districts based on their individual purposes. These include but are not limited to water districts, sanitation districts, water and sanitation districts, fire protection districts, ambulance districts and park and recreation districts. With the exception of water and sanitation districts, any district that is intended to serve (or finance the infrastructure for) two or more purposes is organized as a **metropolitan district**. As a practical matter, almost all Title 32 Special Districts in the City are organized as metropolitan districts because their intended purpose is to provide public financing for multiple categories of facilities, such as roads, drainage and parks. Therefore, organization as a metropolitan district provides the most flexibility for developers and the City at both the front and the back ends.

In Title 32 "Metropolitan district" is defined to mean a special district that provides for the inhabitants thereof any two or more of the following services:

(a) Fire protection;
(b) Mosquito control;
(c) Parks and recreation;
(d) Safety protection;
(e) Sanitation;
(f) Solid waste disposal facilities or collection and transportation of solid waste;
(g) Street improvement;
(h) Television relay and translation;
(i) Transportation;
(j) Water.

c. Metropolitan District Service Plans

Title 32 districts may be further limited with conditions applied by the "approving authority" in conjunction with their required approval of the **service plan** for the district. The service plan is essentially the charter that limits and governs the operation of the special district. These must be approved prior to the election and District Court processes that must be completed before any Title 32 district is organized. At the service plan stage, the City has approval authority and the option of veto power for any district that is to be located wholly within City limits. In the case of districts with split jurisdiction in incorporated and unincorporated territory, the approving authority is the County, and the County may approve the service plan over the objections of the municipality, after consultation. There are a total of four statutory findings that must be considered in the City's decision to either approve, deny or conditionally approve a service plan, and five more that may be considered. These are found in an attachment. In practice, these findings are sufficiently general so as to allow Council very broad discretion.

With certain exceptions, once the service plan is approved, the district essentially moves to an equal and independent governmental standing with the City, and with other local governments. Following approval, the City no longer has an opportunity to limit or influence the actions of the district, absent a subsequent intergovernmental agreement or a request by the district for a "material modification" that triggers a requirement or need to amend the original service plan. Once a Title 32 Special District is created, it can only be dissolved via a district-initiated process or by the State, and then only if any outstanding financial obligations have been addressed.[1]

For metropolitan districts, Colorado Springs has applied a **model service plan** approach as a means of standardizing the content to the service plans, streamlining the review and approval process and assuring that all of the legal limiting language is included in each plan. These model plans were incorporated as part of the 2006 Policy update. The City has adopted separate model plans for single and multiple districts. A copy of the single district model service plan is provided as an attachment It differs from the multiple district plan only in areas where additional information is needed to address multiple district arrangements. The model plans are intended to include a complete and comprehensive description of all Policy components.

d. Powers

Unless otherwise limited by the Service Plan, Title 32 Special Districts (and metropolitan district in particular) have a broad range of powers, including but not limited to:

- Providing a range of services in accordance with statute

[1] The City's Model Service Plans do include a provision whereby the districts must agree to petition for dissolution upon a determination by City Council that their purposes have been accomplished.

- Certifying a property tax mill levy, and imposing tolls rates and charges (but not a direct sales tax)
- Using the proceeds of a Public Improvements Fee (PIF), which is imposed indirectly through a Public Improvements Corporation (PIC).
- Issuing tax-exempt bonded indebtedness subject to statutory limitations
- Condemning property for legitimate public purposes related to the district
- Entering into contracts including Intergovernmental Agreements (IGAs)
- To sue or be sued
- To include or exclude future properties
- Acquiring and/or constructing facilities, and operating them
- Enforcing Covenants (see additional discussion below)

Title 32 Districts cannot directly provide most law enforcement services.

The City's Model Service Plans specifically prohibit any use of condemnation authority except as authorized by City Council. They also limit the inclusion of property unless these areas are identified in the service plan, and they only allow for ongoing services to be provided if these are explicitly listed in the plan.

e) Proliferation of Districts and Evolution from Services to Facilities Financing

As of mid-2019, 2,436 Title 32 special districts were operating in the State of Colorado, with more being organized regularly. The majority of these are metropolitan districts which have been organized within the last 20 years. Within El Paso County alone, the Colorado Department of Local Affairs lists over 300 separate units of local government, most of which are special districts.

There has been both a proliferation and an evolution of these districts in response to several broad trends. Traditionally, Title 32 Special Districts were used primarily in unincorporated areas to provide municipal services such as water, sewer and structural fire protection because counties are typically not authorized to provide these services. Fire districts were most often organized to transition volunteer fire departments to taxing districts in areas with at least some existing population. Water and/or sanitation districts were created either to transition existing private systems to public systems or to allow for the operation of new central systems in raw ground unincorporated developments. In either case, a low emphasis was typically placed on using the district initially as a major development financing mechanism. Over time, the use of these districts has evolved more toward function as a means of shifting a share of the burden of required or desired public improvements costs from developer to the property owners within their developments, both in unincorporated areas and in municipalities. This trend is likely a response to a combination of factors including, but not necessarily limited to:

- The increase of requirements placed upon development to pay for and construct its fair share of on and off-site infrastructure.
- The impact of the Taxpayer Bill of Rights (TABOR), which effectively limits the ability of general purpose local governments to bond for public improvements and/or raise additional revenues through new or increased taxes.
- The increasing trend for cities, towns and counties to implement multi-party approaches and public/private solutions to regional infrastructure needs.
- The incremental impact of the "level playing field" argument. Essentially, once a jurisdiction allows one developer to use a special district to obtain tax exempt financing for public infrastructure costs and to shift these costs to the future property owners, it is difficult to tell other developers they should not have the same competitive advantage in the marketplace.

The overall impact and result is that the use of development-specific districts has now become an integral part of the financial proforma of much of the development in the City. Developers have become strategic in taking actions to assure that key financial decisions are made prior to relinquishment of their control.

e) Trend Toward Smaller Districts

When a district is created by developers with the primary purpose of facility financing, rather than providing ongoing services, there is often very little incentive for another adjoining developer or property to include their property in that district. Conversely, there is limited incentive for the new developer to share in the financial responsibility for another developer's project costs. With financing districts, developers are typically inclined to "create and control their own deal". At the same time, there is an incentive within larger developments to create multiple districts within the same project in order to assure financial obligations are in place prior to resident control. Other factors, such as option of using metropolitan districts to perform traditional HOA functions, and the need for robust entities to manage on-site storm water facilities, may also contribute to small district proliferation. Finally, as noted above, the financial benefits of districts are significant enough to that developers of very small projects view the creation of districts as worth the cost and trouble to them.

As a result, a majority of the individual metropolitan districts created in Colorado Springs from 2008-2019 contain less than 100 acres each. Most of these will have very little potential for enlargement over time. All these factors lead to a trend of proliferation of more and smaller districts which becomes largely self-perpetuating.

A positive aspect of the trend toward smaller districts is that this can result in the most localized and customized control of financial responsibility and representation. The potential downsides are the creation of more layers of government along with their overhead costs, and the potential for increased financial inefficiency due to the lack of economies of scale. A number of relatively fixed costs are associated with simply maintaining districts once they are formed. The smaller the base of property owners, the higher the per capita share of this overhead is likely to be.

Because property taxes paid to districts may deductible from State and federal income taxes, and because interest paid on district-issued bonds is typically double tax exempt, the shift of what were traditionally private developer functions to district functions has a major impact on State and federal tax revenues. This impact will grow over time as districts expand and grow their tax base.

From the property owner's perspective, the increases in the standard deductions that occurred in conjunction with the 2017 Federal Tax Act, have resulted in a significantly higher proportion of households no longer being eligible to claim tax deductions for mortgage interest and property taxes. Various national sources have reported a 60% reduction in the national number of households who itemizing deductions. City staff are unaware of figures specific to Colorado homeowners who reside in districts.

f) Developer Districts

In order to create and operate a new Title 32 Special District in Colorado, election questions must be approved in which 50 percent or more of the qualified electors agree to be included in the district, and to authorize (but not necessarily issue) any debt or impose any new or additional taxes. Generally, qualified electors consist of residents of the district, or property owners, or the spouses of property owners. Where a district is being proposed by a developer for the primary purpose of financing required development infrastructure, an unrelated property owner within the proposed boundaries has limited incentive to favorably approve the election question. This situation leads to a typical scenario whereby raw ground districts are created by developers and their associates prior to any residents or other property owners moving in. Maximum amounts of debt, and future options to issue debt and/or increase mill levies are authorized and "deTABORed" to the extent they can be, at this initial election, thereby largely avoiding the need to conduct subsequent TABOR elections for these purposes. In the initial stages of the project, a developer will commonly enter into reimbursement agreements with the district, with issuance of formal debt delayed unit higher levels of assessed value available to service debt. However, formal debt is typically issued while the initial five-person board of directors is still in control of the board.

This desire to create districts and make key financial commitments while the board is still controlled by the original developers, sometimes results in pressure to speed up the creation process. Debt authorization elections can occur only three times every two years (May and November elections in even numbered years and only in November elections in even numbered years).

Because of these timing-related concerns, there have been and will be cases where the developer may desire to have the district or districts created prior to putting the underlying land use approvals in place. This timing sequence, in turn, creates two potential issues. First, if the basic development entitlements do not yet exist for a project, it may be difficult to make the statutorily required findings that there is a present need for the district(s). If the district is allowed to be created in advance of development approvals and then allowed to make financing or other commitments prior to land use approvals, this may create undue pressure on City Council or its delegates to later approve the requested development plans. Contingency language can be added to City a Council service plan approval resolution to clarify that Council expects to retain its full land use approval discretion.

g. Multiple, Sequential or Control Districts

Over the past decade or so, real estate developers have increasingly begun to create multiple numbers and sometimes layers of interrelated metropolitan districts for the same project. There are three main reasons to do this, although they are sometimes interrelated:

1. First, these multiple district arrangements allow the developer to control the key financing decisions throughout the active phases of land development for a project that is expected to develop over phases and take time to build out. Without this control, a developer could be at risk of losing the opportunity to use district financing for the latter, and often more financially rewarding phases of the project. For example, a developer could invest a lot of money and the district's resources in a four-phase 1,000-acre project. However, when the first 250-acre phase is built out, and the residential or commercial property owners have the potential to take over the district's board of directors, they might be inclined to look askance at the costs associated with bonding for future phases. Proponents of multi-district arrangements also make the related argument that, without them, a developer-controlled board may be more inclined to prematurely issue bonds or build infrastructure before it is needed.[2]

2. A second reason for multiple districts has to do with a response to the 1982 Gallagher Amendment ("Gallagher") to the State Constitution. Gallagher equalizes the State-wide ratio of residential and non-residential property taxes such that non-residential properties are now assessed at more than three times the rate of residential properties based on market value. Multiple district arrangements allow a developer to address this fundamental lack of property tax equity by creating separate districts for commercial and residential areas, and then possibly imposing different mill levies. The City Special District Policy creates a further incentive for district stratification because it allows higher debt service mill levies for districts that only contain commercial property.

3. The third reason for multiple districts is to allow the type and nature of financing and possibly services to be more uniquely tailored to different areas within a development. For example, a multifamily area might have need for substantial funding and maintenance of common areas and community facilities, whereas a single-family area might not have as many of these needs. At the same time, both

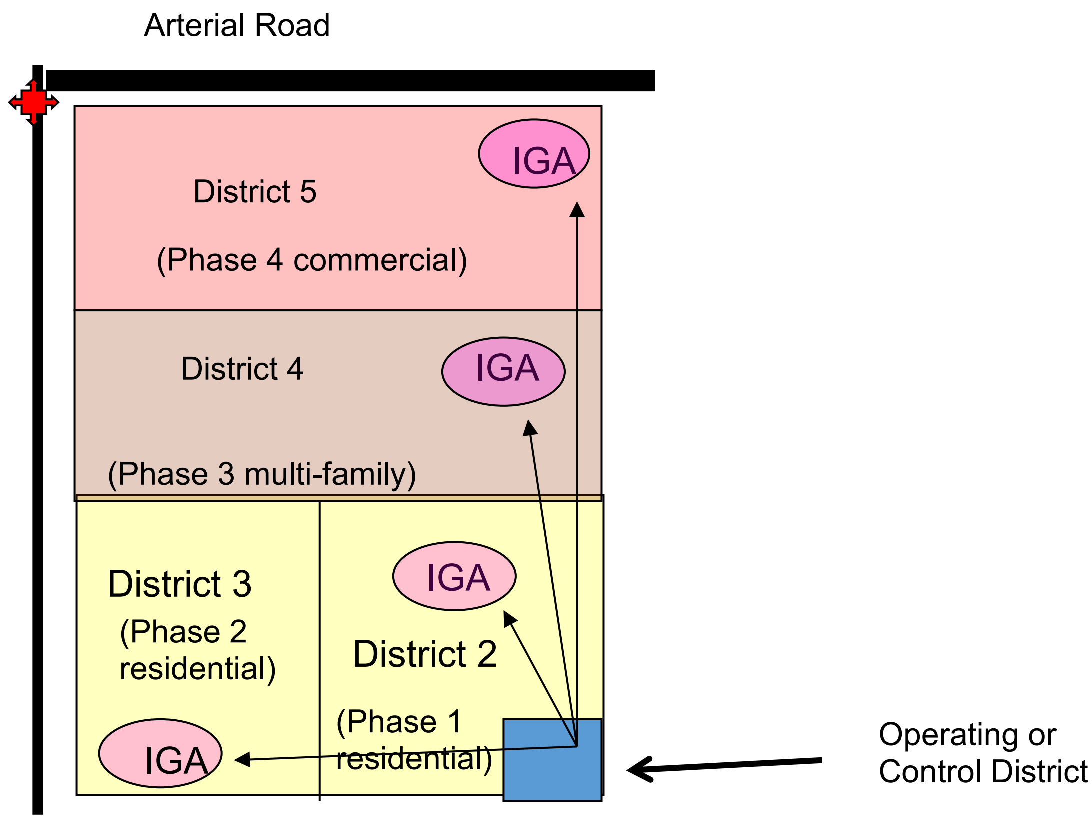
[2] Although some potentially risky and higher cost financing may well be avoided with this strategy, this benefit may end up being somewhat offset because there are often reimbursement contracts in place from the outset with sometimes higher rates of interest accruing on them.

areas have a common need for roadway infrastructure. A multi-district arrangement allows for tailoring individual districts to these more specific needs, while at the same time allowing for coordination of common financing needs and management through intergovernmental agreements (IGAs). A very recent trend in district geography is for the developer to seek approval of a “portfolio” of multiple districts with flexible geography. These can then be deployed with boundaries modified as needed, in response to how phasing and land use choices in a large master planned project evolve and are refined over time.

Multiple district structures can be set up so that each district could transition to broader property owner control relatively early in the development process, or structured so that the original developer maintains control throughout the entire project. In the former case, the multiple districts are typically sequenced such that developer control is maintained long enough that the key financial decisions and commitments are made for that phase. In the latter case, a small master or control district is set up under the ownership of the developer and related parties, with one or more additional districts set up for the balance of the property. Through an IGA among the districts, essential control of key financing decisions is in effect ceded from the other districts to the operating or control district. As described below, the City currently allows multiple district structures with or without a separate operating district.

City-wide, since the late 1980’s most property annexed into the City in the form of large master planned developments, is now included in metropolitan districts with a multiple district structure.

Figure 2- Conceptual Depiction of a Master District Arrangement



h. <u>Conversion of Property Owners Association (POA) Functions to District Functions</u>

State statutes now allow Title 32 special districts to perform the covenant enforcement function traditionally undertaken by homeowners associations (HOAs), business owners associations or related property owners associations (POAs), all collectively described as POAs for the purposes of this Paper. Before this, districts could finance and maintain most of the common area improvements that might be taken care of by a POA. However, because the districts could not legally enforce covenants, there was ordinarily no way to dispense entirely with the POA. The current City Special District Policy is silent on this topic.

One key advantage of allowing this arrangement is it provides an opportunity to dispense altogether with the need to have a POA, thereby allowing for efficiencies in the costs of overhead and administration. From a representation perspective, districts should generally afford the same level of access and empowerment to residents and businesses, as an owners association would, at such time as resident seats open up on the board.

Another stated advantage of using a district in lieu of a POA is that the POA fees (which can be very significant) can be at least in part converted to a mill levy which, unlike the POA fee, could be tax deductible (subject to the higher itemized deduction limits that are part of the 2017 Federal Tax Act. With a conversion to property tax, the process of tax revenue collection becomes automated and simplified compared with the separate billing for POA fees. Because the tax advantage is primarily due to an income tax deduction, the primary governmental fiscal impact will be felt by state and federal government.

Under the City's current operational mill levy cap of no more than 10.0 mills (Gallagher adjusted), a primarily residential district might be able to absorb the added costs of covenant enforcement, but would not be able to rely on tax revenues to replace more substantial monthly assessments if needed for common area maintenance. Therefore, the district would need to impose a substantial fee or assessment of its own. This is currently allowable in the Model Service Plans provided that common area maintenance is an authorized function in the service plan.

Imagine a residential development that has a $100 per month ($1,200 per year) POA fee that is used for such purposes as administration, insurance, operating a swimming pool, grounds maintenance, outdoor lighting, maintenance of drive aisles and parking lots, trash service and creating a small capital replacement reserve. Assuming the average value of a residential dwelling unit in the project is $350,000, the annual revenues from 10 mills with the current assessed valuation rate of 7.2 percent of market value would be about $250 per year**,** or only about one fifth of the amount necessary to replace the POA. Under this scenario, an operational property tax levy of about 50 mills would be needed to fully replace the POA with a district reliant only on a mill levy.

Finally, as noted in the sales tax discussion below, POA purchases are not tax exempt, whereas direct district purchases typically are. This creates the potential for some additional tax revenue loss as further discussed in Section j. below.

j. <u>Potential Fiscal Impacts</u>

The overall positive impact of the use of special districts in the City is that they presumably allow developers to afford to finance more public infrastructure associated with their projects. This provides the City with a higher level of public facilities at limited or no cost to the general taxpayer. In some cases, such as with neighborhood parks in newer developments, the districts allow not only a financing option, but also a structure within which to allow ongoing ownership and operations of facilities that would otherwise need to be maintained with general City revenues. With districts as an option, the City is presumably in a better position to negotiate higher public facility requirements through both the annexation and land use planning processes. With this overall benefit as context, the following sub-sections address some of the potentially negative fiscal impacts which may be associated with districts.

1. Overlapping Debt and Tax Obligations

Of concern to general purpose local governments such as the City is the fact that special districts often impose much higher property tax levies as compared with the City and County, with rates which are often at or near the levels of the overlying school districts. Additionally, because most districts have “de-TABORed” at the front end in a developer-controlled election, the general purpose local governments, school districts[3] and the Pikes Peak Library District are at a comparative disadvantage under TABOR. This disadvantage may become exacerbated as non-deTABORed mill levies ratchet down under TABOR, and because Gallagher adjustments are not typically available to entities such as the City.

Under current Policy a residential metropolitan district may impose up to 40 mills (no more than 30 for debt service and no more than 10 for operations) and a commercial district is limited to 60 total mills with no more than 50 mills devoted to debt service. By Policy, these maximum mill levies are intended to be cumulative, at least with respect to aggregate totals for all directly related districts. However, the maximum levies may be adjusted upward to account for any further disparity in the Gallagher assessment ratios. Additionally, the current Policy does not explicitly prohibit the potential overlapping levies from other special purpose districts not organized under Title 32 (see Policy #6). Therefore, it is possible for a given property to be in a primary metropolitan district with the maximum mill levy and also be located in some combination of other districts which may include specialized metropolitan districts, a BID, a GID and/or a SIMD, all of which has their own levies. As one example, the Woodmen Heights Metropolitan Districts currently certify the maximum residential debt service and operational mill levies. These same properties are located in the Woodmen Road Metropolitan District, which has its own separate levy (now 11.599 mills) specific to the financing of Woodmen Road. Some properties in Woodmen Heights are also required to remain in the Black Forest Fire Protection District for a significant period of time following annexation.

As another example, a redeveloping commercial property could be proposed for a new metropolitan district with a maximum mill levy cap of 50.0 and at the same time is located in the Downtown Development Authority and in the Downtown Business Improvement District, each with an additional 5.0 mills.

By comparison, the current Colorado Springs General Fund property tax mill levy is only 4.279.

[3] Although the majority of all school districts in the State have de-TABORed on the revenue side, some in El Paso County have not.