Special District Financing for Infrastructure—Sharing the Credit With Local Government

Special districts are a means of financing the costs of public infrastructure through the imposition of dedicated taxes and assessments on the benefited properties. Lending institutions providing financing to projects which utilize this type of financing need to be aware of the legal structure as well as the financial impacts of these districts.

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Lending institutions providing construction financing for real estate projects are familiar with the need for developers of residential and commercial projects to provide contributions of public infrastructure as part of the conditions imposed by local governments for approval of the development projects. Whether couched as a development condition, proffer, or by other nomenclature, local governments increasingly look to the development community to finance new road construction, water and sewer systems, schools, parks and recreation facilities, and other public amenities as a condition to approving new developments.

More often than not, these public facilities must be built up-front, before the developer can sell finished lots or pad sites, and therefore recognize an economic return from the project. Further, these public facilities must be dedicated to a governmental agency upon completion free and clear of all liens and encumbrances. Financing the construction of these public improvements creates financial pressure on lending institutions under conventional acquisition, development, and construction (ADC) financing arrangements which typically require repayment to the lender as property is developed and either sold or put into active use. Most ADC loans provide for a blanket lien on the property, which is released in stages as developed property is sold or leased. The financing of the construction of the public infrastructure requires the lender to advance funds at the early stages of the project, when its economic success is most speculative, and oftentimes to release its lien prior to the sale or ultimate disposition of the developed properties, thereby increasing the risk to the lending institution.

A technique that has developed in many growth areas which lessens the financial risk on the lending institution while encouraging the up-front development of public infrastructure is special district financing. This financing involves the formation of a public-private partnership whereby the local governmental agency agrees to the creation of a specially designated tax district in advance of the development of the project. Revenues derived from the taxes levied in the special tax district, whether they be additional special taxes or assessments over and above the normal real property taxes, or an increment of the normal *ad valorem* real property taxes, are used to finance the construction of the public infrastructure, generally through the issuance of municipal bonds by the local governmental authority. Oftentimes the debt service for the bonds during the initial years of the project is funded out of the bond proceeds pending the development of the project and the realization of the inherent increased property values.

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Local governments can use special districts as a means to encourage development in growth areas. Unlike impact fees and proffers, which are largely dependent on the financial health of the developer, special districts derive revenues from the property owners who benefit from the development activity, which may include the developer initially, but which is ultimately a more diversified base. Special districts can provide a means to finance infrastructure at an earlier time in the development process than developer payments, and thereby help insure that the needed infrastructure is in place when needed.

In a typical special taxing district, special taxes or special assessments, over and above the usual and customary taxes, are imposed on properties located within a defined geographic area for a specified period of time.

Lending institutions are an indirect beneficiary of these special taxing districts, yet there are issues for the lending institution to be aware of in their implementation. For example, tax liens in almost all cases have priority over contractual liens imposed on real property through mortgages and deeds of trusts used to secure ADC credit facilities, and accordingly, if a property owner fails to pay these taxes, the properties can go to tax sale. Lenders which have extended secured financing would thereby be required to bid on the properties at a tax sale in order to preserve their liens. Further, as a condition to agreeing to the creation of special taxing districts and the financing of infrastructure through municipal bonds, the local governmental authority can require the developer to provide additional public benefit through the real estate project, whether that be additional public infrastructure, the acceleration of the construction of required public infrastructure, or other public rights to utilization of the privately constructed facilities, which can affect the overall *pro forma* for the development project. Lenders therefore need to understand the legal structure of the special district financing, as well as the financial impacts that such financing has on the overall project.

This article provides a general overview of the various types of special districts in use throughout the country and summarizes the laws of some of the jurisdictions where this financing has been utilized more frequently. Since the creation of special districts is primarily a matter of local law, it is impossible to generalize the process for all localities. The jurisdictions the authors have examined tend to be the jurisdictions where special districts are more common. There is no implication by the omission of any jurisdiction that special districts are not used in such jurisdiction, however.

OVERVIEW OF SPECIAL TAXING DISTRICTS

Special taxing districts are creatures authorized by state and local law. They are referred to under different names, including community facilities districts, community development authorities, development districts, improvement districts, and others. These special taxing districts originated in the early 1980s in California (where they are referred to as "Mello-Roos" community facilities districts) in response to legislation which enacted curbs on the permissible annual increases in real property taxes in that state.[1]

While in some jurisdictions, special tax districts may be used to fund ongoing public services, such as security and other public safety, garbage collection, water or sewer supply, street cleaning and maintenance, or cultural activities, the focus of this article is on taxing districts which finance the construction of infrastructure improvements needed to support general real estate development. The various state enabling statutes list the specific types of eligible infrastructure improvements that can be financed through special taxing districts. These range from streets, interchanges, roads and other transportation improvements, to water and sewer systems, to schools, libraries and civic or governmental facilities, to parks and other recreational facilities.

Further, jurisdictions may authorize the use of various types of taxes and assessments to support special tax district financing. Most jurisdictions utilize assessments or taxes on real property; however, sales taxes and various types of excise taxes may also be authorized.

In a typical special taxing district, special taxes or special assessments, over and above the usual and customary taxes, are imposed on properties located within a defined geographic area for a specified period of time. These taxes and assessments are deposited into a special fund administered by the governmental entity issuing municipal bonds, or applied directly to fund the construction of eligible infrastructure improvements. Municipal bonds issued by a governmental authority on behalf of special taxing districts are generally considered special revenue bonds, secured by the special taxes and assessments, but not supported by the full faith and credit of the

[1] Cal. Constitution Art XIIIA ("Proposition 13").

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governmental agency. In some jurisdictions, general obligation bonds which are supported by the full faith and credit of the governmental authority can be issued on behalf of special districts, and in some cases the bonds are considered "double-barreled" supported by both the special taxes and assessments and the general governmental revenues of the jurisdiction.

Tax Increment Financing. A form of special district known as a "tax increment financing" or "TIF" district involves the use of a portion of the general real property taxes assessed within a defined district to fund the costs of infrastructure. Under a TIF scenario, the assessed value of the property in the district for a base year is established and any incremental increase in the amount of the property taxes attributable to an increase in the assessed value of the property over and above the existing base year assessed value is diverted into a special account where it may be used to pay for the necessary infrastructure. TIF districts are generally utilized where local governmental authority are seeking to spur economic development and where the loss of general tax revenues is expected to be made up by the increase in other forms of economic benefit to the governmental authority. Traditionally TIF districts are utilized in situations where "but for" the real estate development financed by the TIF, the increased assessment of the real property would not occur, therefore meaning that the local governmental authority would not be surrendering tax revenues it would otherwise be able to realize.[2]

Oftentimes, TIF districts are established with a back-up special taxing district serving as a credit enhancement to secure the necessary revenues. In such instances, the local governmental authority creates separate TIF districts and special taxing districts over a common geographic boundary. In these situations, the requirements of both the special taxing district and the TIF district enabling legislation need to be complied with.

Generally, special taxing districts are formed at the behest of private property owners, or developers representing their interests. In virtually all state enabling statutes, the creation of a special district requires that a designated percentage (ranging from 51% to 100%, by value and by number) of the owners of the benefited properties petition for, or ultimately consent to, the creation of the district. The local governmental authority must adopt by ordinance or resolution the boundaries of the district and the legal framework to enable the collection of the special taxes and assessments. In cases where the governmental authority issues municipal bonds on behalf of the district, a separate resolution or ordinance of the governmental authority is needed to authorize the issuance of the municipal bonds which are to be supported by tax revenues. The local enabling statutes for special districts often include requirements for public hearings and other legal procedures to be followed as a precondition to the establishment of the districts.

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In certain jurisdictions, the local governmental entity itself issues the debt and administers the special district, while in other jurisdictions a separate legal entity, which will be administered by the property owners or their agents, is established to fulfill this function. In a case where a separate legal entity is formed, there are additional legal issues surrounding the governance of the district, including the authority of the board or commissioners to establish or change tax rates and the potential avoidance of conflicts of interest surrounding the selection of members to administer the district.

Requirements for Special Taxes and Assessments. The state enabling statutes for special districts generally provide that the special taxes and assessments bear the same priority as general real property taxes, and may be enforced in the case of delinquency or non-payment in the same manner as the collection of delinquent general real property taxes. Generally, in the event that a property owner defaults in the payment of special taxes or assessments after a given due date including any grace period, the property owner will be assessed a delinquency charge, and failing the payment of tax and penalties by a date certain, the property will be subject to the jurisdiction's tax sale procedures. Since real property taxes are senior to any private liens, including the liens of mortgage lenders, the local government is assured that it will have the ability to ultimately collect the delinquent special taxes

[2] While many of the legal and other considerations described in this article apply to TIF districts, we have not attempted to survey the enabling statutes of local jurisdictions with regard to the establishment of TIF districts, and therefore readers are encouraged to consult local counsel in this regard.

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and assessments through a tax sale of the property or the redemption of the right to enforce a tax sale by a private property owner. Lenders who have taken back mortgages and/or deeds of trust on properties located in special tax districts will generally bid at such tax sales in order to protect their liens on the affected properties.

Depending on the terms of the enabling statute and the ordinance or resolution establishing the special district, the taxes may be assessed on an *ad valorem* basis against the properties by class or in the form of special assessments. The rate and method established at the time of issuance of the bonds will provide whether the overall taxes or assessments increase each year, or remain level, which is tied to the level of debt service on the bonds. In some cases, the property owners are given the express right to prepay the special taxes or assessments imposed against their properties based upon a present value calculation of the total amount of special taxes or special assessments which can be imposed under the authorizing resolution or ordinance.

There are a couple of universal legal principles in the formation of special taxing districts. In order to be enforceable, the amount of the special taxes and assessments imposed on properties located within special taxing districts must generally bear a reasonable relationship to the value of the benefits accruing to the affected property.[3] The Supreme Court has indicated that the method of determining the amount of the benefit is within the legislative discretion of the taxing authority, and unless arbitrary or a flagrant abuse of taxing power, must be presumed to be within the jurisdiction's taxing authority.[4] The improvements to be financed by the special taxes and assessments must be public in nature and which the public, acting through the government, has the right to construct without the individual consent of each of the particular individuals affected thereby.[5]

The enabling laws of some jurisdictions require public hearings in order to establish special districts and/or advance disclosure in real estate sales contracts, deeds, or marketing literature to purchasers of properties located in special taxing districts as a precautionary measure. In order to assess the special taxes or assessments, a declaration is generally filed in the land records, which will provide notice to title companies and the general public of the existence of the district. As communities increasingly rely on special taxing districts to finance infrastructure, the knowledge of the community and the sophistication of real estate developers in marketing these districts tends to increase. While there are many market forces which affect the price of real property, the existence of a special taxing district may have a dampening effect on the price of the property given the requirement that the owner bear an increased tax load. On the other hand, the owner will only bear this load while owning the property, and oftentimes the level of the special taxes and assessments is not so high as to meaningfully depress the value of the property below comparable properties of similar type and location.

In addition to the particular provisions of the individual state enabling statutes, certain of which are summarized later in this article, other legal and financial requirements generally apply to the issuance of municipal bonds on behalf of special taxing districts. These are summarized briefly below.

FEDERAL INCOME TAX CONSIDERATIONS INHERENT IN ISSUANCE OF MUNICIPAL BONDS

One of the primary benefits sought by purchasers of municipal bonds is the tax exemption provided under Section 103 of the Internal Revenue Code for interest paid on such bonds. Municipal bonds can be issued on a taxable basis, as well; however, the market for taxable municipal bonds is fairly shallow, and the interest paid on such taxable bonds will generally be comparable to interest paid in a conventional bank financing, thereby making this type of financing less attractive for property owners. Therefore, in most instances, the offering will be structured to insure that interest on the bonds is exempt from federal (as well as in many cases, state and local) income taxes. The following is an overview of some of the relevant federal income tax considerations in connection with municipal bonds issued on behalf of special districts.

Private Activity Bonds. In order to achieve tax exemption under the Code, the bonds must not be deemed to be "private activity bonds" unless the bonds meet certain other tests which are generally not applicable to special district financing.[6] Section 141 of the Code defines the conditions under which

[3] See, Village of Norwood v. Baker, 172 U.S. 269 (1898); Louisville & Nashville R.R. Co. v. Barber Asphalt Paving Company, 197 U.S. 430 (1905); Kansas City S. Ry. v. Road Improvement Dist. No. 3, 266 U.S. 379 (1924); Montgomery County, Maryland v. Schultze, 489 A. 2d 16 (Md. 1985); Serkin v. Township of Ocean, 493 A.2d 531 (N.J. 1985).

[4] Houck v. Little River Drainage District, 239 U.S. 254 (1915).

[5] W.Page and P. Jones, *Taxation by Local and Special Assessments*, sec. 283, p. 439 (1909).

[6] Section 103(b)(1).

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a municipal bond will be treated as a private activity bond. There are two alternative tests for determining if a bond is deemed a private activity bond:

- the bond must meet the "private business use" test *and* the "private security or payment" test of Section 141(b), *or*
- the bond must meet the "private loan financing test" of Section 141(c).[7]

Section 141(b)(6) and the regulations thereunder define "private business use" where more than 10% of the proceeds of the bonds are used for the trade or business of any nongovernmental party. The "private security or payment" test is satisfied where more than 10% of the proceeds of the bonds are secured by an interest in property to be used for a private business use or derived from payments in respect of property or money borrowed which is used or to be used for private business use.[8] The "private loan financing test" of Section 141(c) is satisfied where more than the lesser of $5 million or 5% of the bond proceeds are used to make or finance loans to other than governmental parties.[9]

In order to avoid satisfying the private business use test, the infrastructure financed by such bonds ultimately must be owned and maintained, in substantial part, by a governmental entity. The regulations issued under Section 141 state that the use during an initial development period by a developer of an improvement that carries out an "essential governmental function" such as a road, water system or recreational facility, is not considered private business use if the issuer and the developer reasonably expect as of the issue date for the bonds to proceed with all reasonable speed to develop the improvements and the property benefited by the improvements, and to subsequently transfer the improvements to a governmental person promptly after the property benefited by the improvement is developed.[10]

Since the "private business test" is framed in conjunction with the "private security and payment test," a bond offering must satisfy both tests in order to meet the first private activity bond test. For purposes of the "private security and payment test" taxes of general applicability are not taken into account. A tax of "general applicability" is a tax which is a governmentally enforced tax imposed at a uniform rate on all persons of the same classification.[11] Accordingly, general real property taxes, such as would secure an issuance of tax increment financing bonds, are taxes of general applicability. On the other hand, special taxes and assessments are not taxes of general applicability, and accordingly would fall within the parameters of this test if used to finance private business use property.[12]

With regard to the second alternative private activity bond test, an important exception to the "private loan financing test" is that loans which qualify as "tax assessment loans" are not treated as private loans for purposes of the private activity bond test.[13] Tax assessment loans are defined as loans secured by taxes or assessments which are either mandatory taxes or assessments of general applicability which are used for one or more essential governmental functions.[14] Generally, bonds secured by special assessments and tax increment revenues which are used to finance improvements serving an essential government function each would fall within the tax assessment loan exception, so this alternative test for finding a private activity bond would not be satisfied.

The net result of the applicability of these alternative tests is that for special taxing district bonds, the infrastructure financed must generally be available for use by members of the general public and must be owned and subject to the control of a governmental entity. Accordingly, privately owned improvements, such as community recreational facilities and private roads and streets which are generally are owned by the community home owners association, are not eligible for tax exempt financing through municipal bonds, even if the facilities are made available to the public.

Additional Federal Income Tax Requirements Affecting Bond Structuring. Other federal income tax requirements applicable to the issuance of municipal debt may impact the structuring of bonds issued on behalf of special taxing districts. For example, Treasury regulations generally require that the proceeds of municipal bonds be disbursed by the issuer within a defined period of time, generally ranging from three to five years from the date of issuance.[15] These restrictions will limit the ability to finance projects with long construction periods through a single bond issuance, and may

[7] Section 141(a)(1).

[8] Section 141(b)(2).

[9] Section 141(c)(1).

[10] Reg. 1.141-3(d)(4).

[11] Reg. 1.141-4(e)(2).

[12] Reg. 1.141-4(e)(3).

[13] Reg. 1.141-5(d)(1).

[14] Reg. 1.141-5(d)(2).

[15] Reg. 1.150-2(d)

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mandate the use of two or more series of bonds to complete the financing of infrastructure for a given project. Restrictions on arbitrage, or the reinvestment of bond proceeds, will generally require that bond proceeds be held in yield-restricted accounts pending disposition through construction draws or the purchase of completed infrastructure in order that the interest earned on these bond proceeds not exceed the tax-exempt rate paid by the issuer.[16] These arbitrage restrictions may also restrict the ability of a developer to finance infrastructure which is not constructed or completed in close proximity to the date of issuance of the bonds.

In order to issue municipal bonds in the market, the governmental authority will hire bond counsel to opine as to the legality of the bond issuance and the qualification of the bonds as tax-exempt bonds under the Code. Many jurisdictions which regularly issue municipal debt have existing relationships with bond counsel who can provide these opinions, but for smaller jurisdictions and jurisdictions which do not rely on municipal debt, the complexity of hiring bond counsel can add to the cost of the financing.

MUNICIPAL BOND UNDERWRITING CRITERIA

Where the taxes imposed on properties located within a special district secure special revenue bonds, additional restrictions are often imposed on the structuring of the district in order to satisfy municipal bond underwriting criteria. Some municipal bonds are rated by the national rating agencies, including S&P, Moody's and Fitch,[17] which publish their bond rating criteria, but even in the case of unrated bonds, there are recognized underwriting criteria for special revenue bonds secured by taxes and assessments.

Debt Service Reserve Funds. In most cases, a debt service reserve fund of up to 10% of the principal amount of the bonds will be established at the inception of the financing, which reserve fund will contain funds available to pay debt service on the bonds during a period of default or delinquency in the payment of the underlying tax revenues. The funds in the debt service reserve fund may be used to pay down bond debt service during the life of the financing, or may be applied at the end of the financing to reduce the property owners' funding requirements for the bonds. This can be an important consideration for the financing transaction since the principal amount of the bonds, and the corresponding interest payments, will be based on the total amount of the infrastructure financed plus the amount of a reserve fund, in addition to costs of issuance and, in some cases, capitalized interest payments.

Capitalized Interest. In addition, under certain circumstances during the construction phase of a project the bond proceeds may be used to pay bond interest costs during the early years of the project, and therefore avoid the need to utilize tax revenues during this period. Generally, IRS guidelines limit the maximum period of time for utilizing so-called "capitalized interest" in a bond offering to the construction period prior to the date the property is placed in service.[18]

Value-to-Lien Ratios. Another criteria examined by underwriters is the value-to-lien ratio of the underlying properties located in a district to the principal amount of the bond issuance. For unrated debt, the minimum fair market value of the land subject to the tax must generally be at least two or three times the principal amount of the bonds at the time the bonds are issued. If this ratio cannot be supported, which may be the case in the early years of a project, a portion of the bond proceeds may be escrowed and not made immediately available to the project. Rated bonds will require a much higher value-to-lien ratio, generally at least seven or eight times the principal amount of the bonds.[19]

Debt Service Coverage and Other Criteria. Other criteria applicable to special district financing are the ratio of the debt service to expected tax revenues or "debt service coverage" and the ratio of the special taxes and assessments to the value of the individual properties within the district. The amount of excess debt coverage

[16] See Section 148.

[17] Standard & Poor's (www.standardandpoors.com), Moody's Investors Service (www.moodys.com), and Fitch Ratings Ltd. (www.fitchratings.com), are independent rating agencies that evaluate the credit quality of debt instruments worldwide and, in some cases, assign a rating based upon the perceived degree of credit quality of the issue. Debt instruments which do not meet the minimum rating requirements are considered unrated debt and typically bear a higher interest rate, as well as being sold in a much thinner market than rated debt. Each of the rating agencies periodically publish reports, available to paid subscribers, setting forth the minimum criteria for debt issuance to achieve each of the designated ratings of that firm.

[18] Reg. 1.266-1(b); Rev. Rul. 81-23, 1981-1 CB 50.

[19] See, for example, Standard and Poor's Public Finance Criteria: *Special Purpose Districts* (October 16, 2006), which contains the following statement: "High property value-to-debt ratios, preferably above 7:1 for investment grade ratings, increase the likelihood of making assessment payments on a timely basis."

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permissible in any given offering will depend to a large extent on the facts and circumstances surrounding the district, including the ability to raise assessments or tax rates on an annual basis, the existence of diversity among taxpayers within a district, the size of the district, the value-to-lien ratio of the underlying property, and the general risks associated with the underlying project. The primary concern regarding the level of the special taxes in relation to the value of the properties is that the taxes be affordable to the underlying property owner. As a rule of thumb, underwriters prefer that the total level of special taxes not exceed more than 2% of the value of the underlying properties, although again, the facts and circumstances surrounding the district properties, the level of general *ad valorem* real property taxes in relation to property values, the delinquency rates historically experienced, and other factors will have a bearing on the total level of special taxes.

The ownership of the properties located within the district will be evaluated to see what entities will ultimately be responsible for paying the taxes on the properties. Generally, the larger the size of the district and the greater the number of taxpayer property owners, the safer the district is considered from an underwriting perspective. Further, the more developed property which exists in the district, as opposed to undeveloped land, the greater the perceived safety of the district from an underwriting standpoint. The presence of small number of primary taxpayers is also viewed as more risky than a greater number of taxpayers sharing the load. To bolster the assurance that taxes will be paid in undeveloped districts, bond underwriters might seek additional credit enhancements, including letters of credit from developers and other financial covenants to safeguard the issuance of bonds, as well as demanding appraisals of the underlying real property and third party marketing and feasibility studies for the project.

Bond underwriters will assess the overall financial requirements of the development, including whether existing commitments for lending institutions or loan agreements are in place to finance the underlying project, whether sufficient equity has been invested into the project by the developers, whether construction contracts for the improvements have been entered into, and whether external engineering, feasibility and market studies have been conducted on the underlying project.

State Law Restrictions on Bond Issuances. Some enabling statutes authorize jurisdictions to issue general obligation bonds on behalf of special taxing districts. In these cases the security of the bonds is obviously enhanced by the full faith and credit of the local governmental authority. Due to concerns about the underlying credit rating of the local governmental authority, jurisdictions may impose constitutional or other legal restrictions on the issuance of municipal debt which need to be considered. Even if not subject to a government's legal debt limit, special revenue bonds fall into the category of "overlapping debt" which is examined by credit rating authorities as part of the overall analysis of a local jurisdiction's bond rating.

The more developed property which exists in the district, as opposed to undeveloped land, the greater the perceived safety of the district from an underwriting standpoint.

Oftentimes bonds which are sold initially as unrated debt can be refinanced by the issuing jurisdiction's sale of rated debt once the project has been built out and diversified ownership base has been established. This enables the local jurisdiction to lower the overall level of special taxes and assessments on the property owners and enhances the risk profile of the bonds to the local jurisdiction.

POLITICAL AND OTHER CONSIDERATIONS

Due to the requirement that the local governmental authority must establish by ordinance or resolution a special district, the process for the formation of such districts is an inherently political process. The determination of whether a given project is truly "in the public interest" when competing for scarce public resources against competing private interests involves a delicate political balancing act by the elected officials in considering the formation of such districts. Developers and property owners seeking to establish special districts need to consider the pros and cons of requesting public participation in their project, which will often mandate the public disclosure of sensitive financial information and the airing of community concerns which may or may not directly relate to the merits of the proposed financing.

In some jurisdictions, the approval of special districts may carry additional benefits beyond the financing, including the vesting of development rights, which are tied to the approval of these districts. Further, the approval of a special district may have ancillary positive benefits from a governmental standpoint, serving as a galvanizing force towards obtaining the approval of the local governmental agencies for development rights and entitlements.

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Financing Documents. The creation of special districts and the issuance of municipal bonds to finance such districts will generally take more time than conventional financing due to the requirements of the political process, as well as the need to prepare the financing documents and to market the bonds to investors. With respect to the latter, the following financing documents are generally required in order to issue municipal bonds:

- a trust indenture between the issuing governmental authority and a banking institution to provide for the payment of monies owed to the bondholders;
- a bond purchase agreement between the governmental issuer and the ultimate purchaser of the bonds;
- a disclosure document (referred to as a "Official Statement" or "Limited Offering Memorandum") which describes the terms of the bonds and the status of the project,[20] and continuing disclosure agreements whereby the developer and the local governmental issuer provide periodic updates to the disclosure to the bond purchasers concerning the bond structure and the project during the life of the bonds;[21] and
- a development agreement or acquisition agreement between the developer and the local governmental issuer which provides for the disbursement of bond proceeds to finance the construction of the public infrastructure.

The creation of special districts and the issuance of municipal bonds to finance such districts will generally take more time than conventional financing due to the requirements of the political process, as well as the need to prepare the financing documents and to market the bonds to investors.

Lending institutions which finance projects that are the beneficiaries of special district financing should pay particular attention to the development agreement entered into with the local governmental authority. Typically, a development agreement will provide certain rights to the local governmental authority in the event of a developer default to remove the developer and to utilize proceeds of the municipal bonds issued on behalf of the special district to complete the construction of public infrastructure on its own. Lending institutions may negotiate to be included as third-party beneficiaries of such development agreements, to be given notice and cure rights in the event that a local governmental authority is asserting a developer default and to be provided with certain forbearance rights by the local governmental authority, among other possible remedies, as part of the development agreement.

The complexity of the financing documentation involved and the extended time period needed to create a special district and to market the bonds generally mandates a lead time of at least four to six months before bond proceeds can be disbursed and makes the process generally impracticable for developments with public infrastructure requirements of less than $5 to $10 million. The actual time and cost to create and finance such districts will vary extensively from jurisdiction to jurisdiction.

STATE-SPECIFIC LAWS

Figure 1 summarizes certain of the legal requirements under state enabling laws for special district financing in eleven states: Arizona, California, Colorado, Delaware, Florida, Illinois, Maryland, New York, Pennsylvania, Texas, and Virginia. For further analysis of these states, see Appendix: Infrastructure-Related Special District Laws in Select Jurisdictions at the end of the article.

CONCLUSION

Special districts can provide a win-win-win situation for the local jurisdiction, the developer, and the ultimate owners of the benefited properties. Lending institutions which advance credit to borrowers on properties located in these districts stand to benefit as well.

The local jurisdiction is able to ensure that infrastructure necessary to sustain growth in the

[20] Sales of municipal bonds are exempt from the registration requirements of the Securities and Exchange Commission; however, the Municipal Securities Rulemaking Board has adopted Rule G-32 which requires broker-dealers involved in the sale of municipal securities to deliver a disclosure document to the bond purchasers on or before the date of settlement.

[21] Under Rule 15c2-12 promulgated by the Securities and Exchange Commission, broker-dealers are barred from buying municipal securities sold on and after July 3, 1995 unless the issuer has agreed, in writing, to provide ongoing disclosure. Although the SEC cannot regulate municipalities, it effectively did so indirectly by the rules imposed on broker-dealers. With certain exceptions, the rule requires bond issuers to prepare and disseminate to Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs") "Annual Financial Information" and notices of material events. A list of the NRMSIRs is posted on the website of the SEC at http://www.sec.gov/info/municipal/nrmsir.htm. Bond issuers typically impose a similar undertaking on the developers of properties using special district financing.

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Figure 1: Financial Issues of Special District Financing in Selected States

Jurisdiction// Statutory Reference	Name	Types of Projects Financed	Security for Issuance of Bonds	Issuance of General Obligation Bonds	Lien Priority	Disclosure Required to Residents
Arizona Section 48-701, et. seq. of Arizona Revised Statutes	Community Facilities District	Construction and/or acquisition of sanitary sewage systems, drainage and flood control systems, water systems, highways, streets and roadways, pedestrian walkways, roadways and malls, parks and recreation facilities, landscaping and lakes, public buildings, public safety facilities and fire protection, lighting systems, or traffic control systems.	Ad valorem tax; special tax assessment levied based upon benefit received by the land; or other sources of revenue from the county or municipality contributing to the District.	Yes; secured by a pledge of ad valorem tax. In addition, District may issue revenue bonds which are secured by a pledge of revenues of District, county or municipality.	First lien priority, subject only to general property taxes and prior special assessments.	An order forming district, a general plan, a canvass of the general obligation bond election and any special assessments levied within the district are filed with the County records office and the State Real Estate Department.
California Section 53311, et. seq., California Code, Gov't. Code Title 5, Division 2, Part 1, Chapter 2.5	Mello-Roos Community Facilities District	Real or other tangible property with an estimated useful life of 5 years or longer located within or outside of the facilities area (e.g., parks, pathways, schools, libraries, child care facilities, water distribution facilities, flood and storm protection facilities, utilities distribution facilities).	Special tax assessment which is based upon mathematical formula which takes into account property characteristics such as use of the property, square footage of the structure and lot size.	No.	On par with lien priority of ad valorem property taxes, unless agreed to otherwise.	Yes. Sellers required to provide disclosures to purchasers.
Colorado Title 32 of Colorado Revised Statutes	Metropolitan District	Construction and/or acquisition of two (2) or more of the following: fire protection services, mosquito control, parks and recreation, safety protection, sanitation, solid waste disposal facilities or collection and transport of waste solids, street improvement, TV relay translation, transportation, or water.	Ad valorem tax levied upon every dollar of valuation for assessment of taxable property within the district.	Yes; secured by pledge of full faith and credit of District and covenant to impose mill levies w/o limit to retire bonds.	On par with lien priority of other general taxes.	Notice of creation of district recorded among land records. Title companies give notice of existence based on title review.
Delaware Section 1801, et. seq., Title 22 of Delaware Code	Special Development District	Construction and/or acquisition of storm drainage systems, sewers, water systems, roads, bridges, tunnels, sidewalks, lighting, parking, park and recreational facilities, libraries and schools, transit facilities, solid waste facilities.	Ad valorem tax or special tax assessment on all property within the district. If special tax assessment, the amount is calculated based upon methodology set forth in the statute.	No.	On par with lien priority of general ad valorem real property taxes.	Not required in statute. Localities may make additional requirements for disclosure.

(Continued)

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Figure 1: Financial Issues of Special District Financing in Selected States (continued)

Jurisdiction// Statutory Reference	Name	Types of Projects Financed	Security for Issuance of Bonds	Issuance of General Obligation Bonds	Lien Priority	Disclosure Required to Residents
Florida Chapter 190 of Florida Statutes	Community Develop-ment District	Construction and/or acquisition of water management and control facilities, water supply, sewer and waste water management facilities, bridges, canals, floodways, holding basins for drainage, roads, street lights, alleys, landscaping, parking improvements, environmental clean up costs benefiting land in district, construction areas. In addition, with prior consent of local general-purpose government, the following types of projects may be financed through creation of a district: construction of parks and recreational facilities, fire prevent and control facilities, schools, security systems, mosquito control facilities, waste collection and disposal.	Ad valorem tax or benefits or maintenance special tax assessment which is calculated based upon the benefit received.	Yes; secured by a pledge of full faith and credit and taxing power of District and for payment of which recourse may be had against the general fund of District. In addition, District may issue revenue bonds which are secured by a pledge of revenues of District, other than ad valorem tax revenues.	On par with lien priority of state and county taxes.	Yes. County-provided. Contracts for initial sale of property also include public disclosure statement.
Illinois 35 ILCS 200/Section 27-5, et. seq.	Special Service Area Tax District	All forms of services pertaining to the government and affairs of the municipality or county. The term "services" includes public infrastructure improvements such as waste water facilities, water supply, storage and distribution facilities, roadways, utilities, flood plain/ wetlands management systems, and schools.	Ad valorem tax or special tax assessments may be levied. Special tax assessments may be made on any other basis which provides a rational relationship between the amount of the tax levied against each lot, block, tract and parcel of land and the benefit rendered.	Yes; secured by the full faith and credit of the District. In addition, special obligation bonds are issued and secured by special tax assessments.	Statute does not expressly address. Special taxes shall be enforced and collected independently of any other provision of the statutes.	Statute does not expressly address. Localities may make additional requirements for disclosure.
Maryland Article 24, Section 9-1301 of the Code of Maryland and Article 23A, Section 44A of the Code of Maryland	Special Taxing District	Construction and/or acquisition of storm drainage systems, sewers, water systems, roads, bridges, streets, sidewalks, lighting, parking parks and recreation facilities, libraries, schools, transit facilities, and solid waste facilities.	Ad valorem taxes and special tax assessment calculated based upon methodology set forth in the statute.	No.	On par with lien priority of general ad valorem taxes.	No. Varies by county.
New York McKinney's Town Law Section 190, et. seq.	Improve-ment District	Construction and/or acquisition of sewer, water drainage, water quality treatment, water supply, parks, public parking, lighting, snow removal, sidewalks, fallout shelter district, refuse or garbage district, aquatic	Ad valorem tax or special tax assessment. Special tax assessment shall be apportioned upon lots according to the benefit received.	Yes. No indebtedness shall be contracted for by a District unless it is secured by District's pledge of its faith and. credit for payment of	On par with lien priority of unpaid town taxes.	No. However, an order establishing district is recorded among county land records.

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		plant grown control district, ambulance district, harbor improvement district, public dock district, beach erosion control district.		principal thereof and interest thereon.		
Pennsylvania Section 5601, et. seq., Title 53 of Pennsylvania Statutes and Section 832, et. seq. of Title 73 of Pennsylvania Statutes	Neighborhood Improvement District	Construction and/or acquisition of capital improvements, traditional streetscape and building renovations, retaining walls, street paving, street lighting, parking lots, parking garages, trees and shrubbery, pedestrian walks, sewers, water lines, rest areas, blighted buildings and structures, as well as the provision of additional services to supplement, not replace, existing municipal services provided with the district.	Special tax assessment calculated based upon methodology set forth in statute and may be weighted heavier for businesses than residents, provided there is a rational basis.	Yes; secured by a pledge of full faith, credit and taxing power of District or local government unit. In addition, District may issue guaranteed revenue bonds which are secured by a pledge of revenues of District and guaranteed by taxes or other general revenues of District or local government unit.	Statute does not address. Special tax assessments are collected at the same time and in the same manner as municipal tax claims.	No. However, locality may require additional disclosure to residents.
Texas Texas Water Code, Chapters 49, 54 (Municipal Utility District); and Texas Local Government Code, Chapter 372, Subchapter A (Public Improvement Districts)	Municipal Utility District (“MUD”) or Public Improvement District (“PID”)	**MUD** Construction or acquisition of storm-water and floodwater, irrigation, drainage, sewer and sanitary, navigation, and conservation facilities. **PID** Construction or acquisition of landscaping, erection of fountains, distinctive lighting and signs, acquiring, constructing, improving, sidewalks, streets or any other roadways.	**MUD** 1. Ad Valorem Tax. 2. Pledging designated revenues resulting from a portion of facilities. 3. Pledging revenues available to district. 4. Combination of above **PID** Special tax assessment based upon the special benefits accruing to the property because of the improvement.	**MUD** Yes; secured by a pledge of full faith and credit of the State. **PID** Yes; secured by a pledge of full faith and credit of the State.	**MUD** Statute does not address. **PID** On par with state, county, school district or municipality ad valorem taxes.	**MUD** Yes. Notice to Purchasers is given upon resale and signed by Seller and Purchaser. **PID** No.
Virginia Section 15.2–5152, et. seq. of the Code of Virginia	Community Development Authorities	Construction and/or acquisition of roads, bridges, parking facilities, sidewalks, traffic signals, storm-water management and retention systems, gas and electric lines, street lights, parks and recreational facilities, cultural and educational facilities, security, landscaping, fencing, fire protection, school-related structures, and infrastructures for age restricted communities.	Special tax assessment levied upon the assessed fair market value of the property within the authority, which amount shall not exceed the rate of $0.25/$100.	No.	Statute does not address. Special taxes are collected at the time and in the same manner as locality taxes.	No. However, locality may require additional disclosure to residents.

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community will be built in a timely basis and not tied to the development schedule or financial conditions of the developer. The infrastructure delivery can be accelerated from the timetable used under the typical proffer arrangement whereby the developer is required to build certain public infrastructure based upon the progress of the development. Further, the local governmental authority can utilize special district financing as a carrot to attract development to a desired growth area.

For the developer of properties located within such districts, a huge advantage is that the cost of constructing the public infrastructure is removed from the developer's balance sheet, which in turn reduces development costs and frees up capital resources. The developer is able to pass along the debt service obligation for such infrastructure to the ultimate property owners as the property is sold or improved. Further, the interest coupon on tax-exempt municipal debt is often lower than the cost of capital provided through private institutional lenders and private equity, although given the requirements for debt service reserve funds and other municipal debt underwriting criteria discussed in this article, the overall cost of the financing may or may not be less expensive than conventional financing. Special districts afford the developer a separate source of funding for public infrastructure which, as noted, oftentimes must be constructed prior to the construction of the ultimate development which funds the repayment of the project financing.

For the ultimate property owner, benefits of special districts include the assurance that the public infrastructure will be provided on a more certain basis without regard to the financial condition of the developer and the fact that the property owner is bearing the cost of the infrastructure for a limited time while actually occupying or using the property. Depending upon market conditions, the property owner may be able to purchase the property at a lower price by virtue of the special district, and depending upon the structure of the taxes, may enjoy deductions for at least a portion of the taxes on their federal and state income tax returns.

Lending institutions also benefit from special district financing due to the additional source of external financing and the additional credit enhancement inherent in a governmental authority underwriting the special district financing. Complexities in the mechanics of such financing, however, may lengthen the time period for the development process, increase the overall public infrastructure improvement requirements on the developer, and complicate the lender's foreclosure process in the event the project financing goes into default.

To date, special district financing has been typically used for greenfield developments where large infrastructure requirements are necessary in order to proceed with development. Increasingly, however, these special districts will be needed for redevelopment purposes, as well. At the current time, there is an unmistakable trend towards increasing reliance on the use of special districts as the resources of local government to provide public infrastructure are restrained and increasing public infrastructure demands are placed on the developers of real estate projects.

APPENDIX: INFRASTRUCTURE-RELATED SPECIAL DISTRICT LAWS IN SELECT JURISDICTIONS

This appendix surveys special district laws in eleven select states, with a particular focus on certain financing issues related to the formation of these districts. Each state discussed below has adopted enabling legislation authorizing some or all of its localities (i.e., counties, municipalities, towns, etc.) to establish special districts for the purpose of financing public infrastructure improvements. While other states have adopted similar enabling laws, the authors have focused on these select jurisdictions because special districts seem to be especially prevalent in these states and/or the enabling legislation adopted within each of these states is unique and, therefore, provides readers with an opportunity to compare and contrast how a particular issue has been treated in a variety of jurisdictions.

For a synthesis of information discussed below regarding specific states, see Figure 1: Financial Issues of Special District Financing in Selected States, above. The issues discussed are by no means comprehensive and simply are intended to give the reader a broad overview of certain discrete financing issues to be considered in connection with the formation of a special district within a particular state. For additional information about a particular state, readers are encouraged to review the enabling legislation, with the applicable regulatory interpretations, to obtain a more complete understanding of these laws. Oftentimes, local counties and municipalities will also adopt their own enabling legislation, which may expand upon or limit the provisions of state enabling law, and these local laws need to be consulted as well.

Arizona. The Arizona Legislature has authorized any municipality or county within Arizona to establish a "Community Facilities District" ("CFD") within its boundaries in order to finance

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certain public infrastructure improvements.[22] These improvements include the construction of sanitary sewage systems, drainage and flood control systems, water systems, highways, streets and roadways, pedestrian walkways, roadways and malls, parks and recreation facilities, landscaping and lakes, public buildings, public safety facilities, lighting and traffic control systems.

If a petition to form a CFD is signed by at least 25% of the owners within a proposed CFD and filed with the appropriate governing body, the governing body may pass a resolution stating its intent to establish the CFD. In addition, interested parties must be given an opportunity to submit testimony at a hearing. If an interested party fails to object at the hearing, he/she/it will lose his/her/its right to appeal. If, after the hearing, the governing body approves of the CFD, a resolution ordering the formation of the CFD will be adopted and the governing body will hold an election of the owners within the CFD. At the election, each owner will receive a proportionate number of votes equal to the number of acres or portions of acres rounded upward to the nearest one-fifth of an acre owned by that owner within the submitted CFD. Assuming that the resolution is approved at the election, the governing body will order the formation of the CFD and record the notice of formation among the land records.

Bonds are issued by the locality and are payable through and secured by:

1. *Ad valorem* real property taxes assessed against the property located within the CFD,
2. Special tax assessments levied against and calculated according to the benefit received by each parcel of land within the CFD, or
3. Other sources of revenue received by the locality contributing to the CFD.

Localities are authorized, but not required, to pledge general obligation indebtedness in connection with the issuance of CFD bonds. Such a pledge is made when CFD bonds are payable through *ad valorem* real property taxes. Otherwise, the obligation on the indebtedness will be limited to the revenue generated from the special assessments levied in connection with the CFD. Special assessments are considered to be liens of first priority on property within the CFD, subject only to general property taxes and prior special assessments.

The statute enabling the formation of CFDs does not provide purchasers with a right to receive certain disclosures about the CFD. However, the statute does provide that certain information—specifically, an order forming the CFD, a general plan, a canvass of the general obligation bond election and any special assessments levied within the CFD—must be recorded in the land records of the locality establishing the CFD.

California. The California state Legislature has authorized the formation of "Mello-Roos Community Facilities Districts" (each, a "Mello-Roos District"), named after the authors of the legislation, the late former state Senator Henry Mello and former Assemblyman Mike Roos.[23] Mello-Roos Districts are very flexible and are used to finance real or tangible property with an estimated useful life of five years or longer located within or outside of the facilities area, including parks, pathways, schools, libraries, child care facilities, water distribution facilities, flood and storm protection facilities, and utilities distribution facilities.

Bonds are issued exclusively on the basis of special tax assessments which are based upon a mathematical formula which takes into account property characteristics such as the projected use of the property within the Mello-Roos District, the square footage of the particular structure and lot size. Mello-Roos Districts may not pledge general obligation indebtedness but, rather, are limited to the revenue generated from the special assessments levied in connection with the Mello-Roos District. Otherwise, the special tax assessments levied in connection with a Mello-Roos District are considered to be on par with the lien priority of *ad valorem* property taxes, unless agreed to otherwise by the local agency administering the Mello-Roos District and the landowners within the district.

The California statute contains a detailed process for formation of Mello-Roos Districts. In general, the process can be initiated by petition of 10% of the landowners or 10% of the registered voters within the proposed district, or by action of the legislature itself, but ultimately a two-thirds majority of the "qualified electors" must be achieved in order to form the district. Qualified electors are defined as the landowners of the property proposed to be located within the district, voting by size of

[22] Section 48-701, et. seq. of Arizona Revised Statutes.

[23] Section 53311, et seq., California Code, Gov't. Code Title 5, Division 2, Part 1, Chapter 2.5.

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property owned, unless there are at least 12 registered voters living within the district during specified periods of time, in which case the registered voters serve as the qualified electors.

California law requires that public hearings on the creation of Mello-Roos Districts be held at specified times, and also requires sellers of property to provide purchasers with certain disclosures about the establishment of a Mello-Roos District.

Colorado. The Colorado General Assembly has authorized the formation of certain special tax districts known as "Metropolitan Districts" (each, an "MD").[24] Each MD is located within a particular county and is used to finance the construction of two (2) or more of the following types of projects: fire protection services, mosquito control, parks and recreation, safety protection systems, sanitation systems, solid waste disposal facilities or collection and transport of waste solids, street improvement, TV relay translation systems, transportation systems, or water systems.

Colorado's statute provides a detailed procedure for establishing an MD, which includes:

1. The petitioners (i.e., at least 30% or 200 of the taxpaying electors within a proposed MD) must file a "service plan" with the board of county commissioners of each county that has territory included within the boundaries of the proposed MD;
2. The board of county commissioners must hold a hearing to consider the service plan;
3. Upon approval of the service plan, the petitioners will file a petition in district court;
4. The district court will also hold a hearing to consider the petition, and, if the district court determines that the appropriate procedures have been followed, the district court will order that the question be presented to voters within the proposed MD; and
5. If a majority of voters approve of the MD, the district court will declare that the MD is formed. The district court's declaration is final and may not be appealed.

Bonds are issued by the county and are payable through and secured by *ad valorem* taxes levied upon every dollar of valuation for assessment of taxable property within the MD. Bonds may be secured by a pledge of the full faith and credit of the MD, together with a covenant to impose mill levies without limit to retire the bonds. The *ad valorem* taxes imposed within an MD are on par with the lien priority of other general taxes.

While there is no statutory right of disclosure for purchasers, each purchaser should receive notice of the existence of an MD from its title company because an order forming the MD is recorded among the land records of the county in which the MD lies.

Delaware. The Delaware General Assembly has authorized municipalities to establish "Special Development Districts" (each, an "SDD") to finance certain public infrastructure improvements.[25] SDDs may be used to construct storm drainage systems, sewers, water systems, roads, bridges, tunnels, sidewalks, lighting, parking, park and recreational facilities, libraries and schools, transit facilities, and solid waste facilities.

Bonds issued in connection with the formation of an SDD are secured by either *ad valorem* taxes or special tax assessments on all of the property within a particular SDD, which special taxes are calculated based upon a specific methodology set forth in the statute. The Delaware SDD statute expressly prohibits municipalities from pledging general obligation indebtedness in connection with the issuance of SDD bonds. The *ad valorem* taxes imposed within an SDD are on par with the lien priority of general *ad valorem* real property taxes.

While there is no statutory right of disclosure, each municipality may adopt requirements for disclosing the existence of an SDD to purchasers.

Florida. The Florida Legislature has authorized counties and municipalities to establish "Community Development Districts" (each, a "CDD") as a vehicle for financing certain public infrastructure improvements.[26] CDDs are popular financing tools in Florida and are used to finance the construction of the following types of projects: water management and control facilities, water supply, sewer and waste water management facilities, bridges, canals, floodways, holding basins for drainage, roads, street lights, alleys, landscaping, parking improvements, environmental clean-up costs benefiting land in the district, and construction areas. In addition, with the prior consent of the local-general purpose government, CDDs can be used for the construction of parks

[24] Title 32 of Colorado Revised Statutes.

[25] Section 1801, et seq., Title 22 of Delaware Code.

[26] Chapter 190 of Florida Statutes.

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and recreation facilities, fire prevention and control facilities, schools, security systems, mosquito control facilities, as well as waste collection and disposal facilities.

In order to form a CDD, all of the landowners within a proposed CDD must consent, in writing, to the filing of a petition. If the land within the CDD is more than 1,000 acres in size, the petition will be filed with the Florida Land and Water Adjudicatory Commission. Otherwise, the petition should be filed with the county commission of the county having jurisdiction over the majority of land within the CDD. Moreover, Florida requires that the governing body responsible for forming the CDD must hold a hearing so that the general public is given an opportunity to appear and present oral or written comments on the petition.

The CDD functions as a unit of local government with its own popularly elected board of supervisors in accordance with the provisions of the Florida statute. CDDs may be classified as "dependent" where the board of supervisors consists of members appointed by the local county or municipality or "independent" where the board is not subject to local governmental control.

Bonds issued in connection with the establishment of a CDD are secured by (1) *ad valorem* taxes, (2) benefits special assessments, or (3) maintenance special assessments. CDDs are also authorized to issue revenue bonds, which are secured by a pledge of the revenues of the CDD, other than *ad valorem* tax revenue. CDD bonds may be secured by a pledge of the full faith and credit and taxing power of the CDD and for payment of which recourse may be had against the general fund of the CDD. Assessments levied within a CDD are on par with the lien priority of state and county real property taxes.

The statute enabling the formation of CDDs does provide that contracts for the initial sale of property must include a public disclosure statement. In addition, some counties may require additional disclosures to purchasers.

Illinois. The Illinois General Assembly has authorized municipalities or counties to form "Special Service Area Tax Districts" (each, a "Service Area District") to finance public infrastructure projects.[27] The Illinois statute is extremely broad, and Service Area Districts may be used to finance all forms of services pertaining to the government and affairs of the municipality or county, including public infrastructure improvements such as waste water facilities, water supply facilities, storage and distribution facilities, roadways, utilities, flood plain/wetlands management systems, and schools.

In Illinois, only one owner of property must sign a petition to form a Service Area District. Once a petition is filed with the appropriate municipality or county, a hearing of all interested parties will be held and the municipality or county will determine whether to form the Service Area District. However, even after a Service Area District is formed, Illinois permits owners, in essence, to veto the formation of the district by permitting at least 51% of the electors within the Service Area District and at least 51% of the owners of record to file an objection petition, which prohibits the municipality or county from taking any further action with respect to the formation of the district.

Service Area Districts are financed through the issuance of bonds which are secured by either *ad valorem* taxes or special tax assessments on all of the property within a particular district, which special taxes are calculated based upon any basis which provides a rational relationship between the amount of the tax levied against each lot, block, tract and parcel of land and the benefit rendered. Bonds may be secured by a pledge of the full faith and credit of the Service Area District. Otherwise, special obligation bonds will be issued and secured by the special tax assessments. The Illinois statute does not address the lien priority of taxes/ assessments, however, it is clear that taxes/ assessments shall be enforced and collected independently of any other provision of the statute.

While there is no statutory right of disclosure, each municipality may adopt requirements for disclosing the existence of a Service Area District to purchasers.

Maryland. The Maryland General Assembly has authorized certain counties and municipal corporations to form "Special Taxing Districts" as a tool for financing public infrastructure projects, including storm drainage systems, sewers, water systems, roads, bridges, streets, sidewalks, lighting, parking, parks and recreation facilities, libraries, schools, transit facilities, and solid waste facilities.[28] In addition, some counties within Maryland have adopted separate ordinances authorizing Special Taxing Districts.

[27] 35 ILCS 200 / Section 27-5, et seq.

[28] Article 24, Section 9-1301 of the Code of Maryland and Article 23A, Section 44A of the Code of Maryland.

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Under Maryland law, a petition signed by two-thirds of the property owners in the proposed district by assessed value and by number must be filed with the county or municipality in order to commence the process to establish a Special Taxing District. Once such a petition is received, the county or municipality may establish the Special Taxing District and authorize the issuance of municipal bonds secured by the special taxes or assessments by ordinance or resolution.

Bonds issued in connection with the establishment of a Special Taxing District are secured by *ad valorem* real property taxes, as well as special tax assessments, which special taxes are calculated based upon a specific methodology set forth in the statute. Counties may not pledge general obligation indebtedness in connection with the issuance of bonds. The *ad valorem* taxes imposed within a Special Taxing District are on par with the lien priority of general *ad valorem* real property taxes.

Under Maryland law, prior to the adoption of the resolution or ordinance establishing the district, the county or municipality must hold a public hearing after giving not less than ten days' notice in a newspaper of general circulation. While except in the case of certain designated counties, there is no statutory right of disclosure, each county/ municipal corporation may adopt requirements for disclosing the existence of the district to purchasers.

New York. The New York State Assembly has authorized towns to establish "Improvement Districts" to finance certain public infrastructure improvements, including sewers, water drainage, water quality treatment, water supply, parks, public parking, lighting, snow removal, sidewalks, fallout shelter districts, refuse or garbage districts, aquatic plant grown control districts, ambulance districts, harbor improvement districts, public dock districts, and beach erosion control districts.[29]

Improvement Districts are financed by bonds which are secured by *ad valorem* taxes or special tax assessments, which are apportioned upon lots according to the benefit received. The New York State Constitution requires an Improvement District to pledge its faith and credit for the payment of principal and interest on bonds issued in connection with the formation of a district. The *ad valorem* taxes imposed within an Improvement District are on par with the lien priority of unpaid town taxes.

While there is no statutory right of disclosure for purchasers, each purchaser should receive notice of the existence of an Improvement District from its title company because an order forming the district is recorded among the land records of the county in which the district lies.

Pennsylvania. The Pennsylvania General Assembly has authorized the formation of "Neighborhood Improvement Districts" ("NIDs") in order to finance certain public projects.[30] NIDs are used to finance the construction of capital improvements, traditional streetscapes and building renovations, retaining walls, street paving, street lighting, parking lots, parking garages, trees and shrubbery, pedestrian walks, sewers, water lines, rest areas, blighted buildings and structures, as well as the provision of additional services to supplement, not replace, existing municipal services provided within the NID.

A NID may be formed upon the petition of residents within the NID. Owners of property within the proposed NID are entitled to object to the formation of the NID at a public hearing if at least 40% of the ownership, in numbers, of the benefited properties within the NID file written objections. Unless at least 40% of the owners register their disapproval of the final plan for the NID, the municipality may, following a 45-day period, enact a municipal ordinance establishing the NID.

Each NID is managed by a management association, which is governed by an administrative board. The administrative board will include property owner representatives, as well as representatives from businesses and other institutions located within the NID. The NID management association's responsibilities include issuing special tax assessments against properties within the NID and imposing liens on property for the nonpayment of such assessments.

NIDs are financed through the issuance of bonds, which are secured by special tax assessments. The special taxes are calculated based upon a methodology set forth in the statute and may be weighted heavier for businesses than for residents, provided that there is a rational basis for the discrepancy. Special taxes may be secured by a pledge of the full faith, credit and taxing power of the NID or the local government unit. In addition, a NID may issue guaranteed revenue bonds which are secured

[29] McKinney's Town Law Section 190, et seq.

[30] Section 5601, et seq., Title 53 of Pennsylvania Statutes and Section 832, et seq. of Title 73 of Pennsylvania Statutes.

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by a pledge of the revenues received by the NID and guaranteed by taxes or other revenues of the NID or local government unit. The Pennsylvania statute does not address the lien priority of special assessments, however, it is clear that assessments shall be collected at the same time and in the same manner as municipal tax claims.

While there is no statutory right of disclosure, each locality may adopt requirements for disclosing the existence of a NID to purchasers.

Texas. The Texas Legislature has authorized the formation of two (2) types of special tax districts: a "Municipal Utility District" ("MUD") and a "Public Improvement District" ("PID").[31] MUDs are used to finance public infrastructure improvements such as stormwater and floodwater systems, irrigation facilities, drainage, sewer and sanitary systems, navigation, and conservation facilities. PIDs, on the other hand, are used more frequently to stimulate economic development by financing projects such as landscaping, erection of fountains, distinctive lighting and signs, and acquiring, constructing, and/or improving sidewalks, streets, and roadways.

MUDs finance improvements through the issuance of bonds secured by any, or all, of the following:

1. *Ad valorem* taxes,
2. Pledging designated revenues resulting from a portion of the improvements, or
3. Pledging revenues available to the MUD.

PIDS, however, rely solely on special tax assessments, which are calculated based upon the special benefits accruing to the property as a result of the improvement.

MUDs and PIDs are separate political subdivisions of the State with their own elected board of directors and possessing the power and authority to issue municipal bonds, as well as certain other governmental powers, including the authority to obtain easements, to enter into contracts and to condemn property.

MUDs and PIDs each are authorized to pledge general obligation indebtedness through the Texas State Constitution. However, the statutory authority establishing MUDs and PIDs, respectively, offer differing approaches to addressing the lien priority of assessments. That is, the MUD statute does not address whether assessments have any lien priority, while the PID statute expressly provides that assessments are on par with state, county, school district or municipality *ad valorem* taxes.

The MUD statute also requires that purchasers must receive notice of a MUD, which notice is acknowledged by the seller's signature. The PID statute, however, does not expressly require any types of disclosure to purchasers.

Virginia. The Virginia General Assembly has authorized localities to establish "Community Development Authorities" ("CDAs") as a tool for financing public infrastructure improvements.[32] CDAs are used to finance projects such as roads, bridges, parking facilities, sidewalks, traffic signals, stormwater management and retention systems, gas and electric lines, street lights, parks and recreational facilities, cultural and educational facilities, security, landscaping, fencing, fire protection, school-related structures, and infrastructures for age restricted communities.

To establish a CDA, the Virginia statute requires that the landowners owning at least 51% of the land area or assessed value of the land must petition the locality where the CDA is to be established to create same. The CDA once established is a separate political subdivision with its own authority board and is authorized to issue revenue bonds to finance the improvements authorized by the implementing resolution or ordinance.

Bonds issued in order to finance CDAs are secured by special tax assessments. These special taxes are levied upon the assessed fair market value of the property within the CDA, which amount shall not exceed the rate of $0.25/ $1.00. CDAs may not pledge general obligation indebtedness in connection with the issuance of bonds. The Virginia CDA statute does not address the lien priority of special assessments, however, it is clear that assessments shall be collected at the same time and in the same manner as a locality's taxes.

The Virginia statute requires that the local governmental entity creating the CDA to hold a public hearing prior to adopting the resolution or ordinance establishing the CDA. While there is no statutory right of disclosure, each locality may adopt requirements for disclosing the existence of a CDA to purchasers. ■

[31] Texas Water Code, Chapters 49, 54 (Municipal Utiity District) and Texas Local Government Code, Chapter 372, Subchapter A (Public Improvement Districts).

[32] Section 15.2 – 5152, et seq. of the Code of Virginia.

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