Festus, Missouri

FINANCING NEIGHBORHOOD "CREATION" THROUGH THE NEIGHBORHOOD IMPROVEMENT DISTRICT (NID) ACT

by Thomas A. Cunningham and Gary Edwards

In the last decade, numerous Missouri communities have used the Neighborhood Improvement District (NID) Act to improve the infrastructure and amenities of existing neighborhood areas. More recently, the City of Festus and other growing municipalities have realized the NID Act also provides a vehicle to "create" neighborhood areas. Properly applied, the NID Act can provide a powerful incentive to encourage new residential development in selected areas that are underserved by public facilities and amenities. Subsequently, the same mechanism can provide the funds to maintain these new facilities.

The NID Act

Enacted pursuant to a constitutional amendment in 1990, the Neighborhood Improvement District Act authorizes issuance of general obligation NID bonds to finance public improvements within designated "neighborhood improvement districts." NID financing is expressly authorized in Article III, §38(c) of the Missouri Constitution and in §§67.453-475 of the Revised Statutes of Missouri, as amended. Improvements can range from streets and sewers to park areas and open space and may include land acquisition.

The NID bonds are secured by special assessments on the properties located within the districts and benefited by the financed improvements. NID bonds require neither a pledge of taxing power nor, if created by petition, voter approval. The special assessments are collected along with the City's regular property taxes and may be paid in installments over 20 years.

The Bailey Subdivision began constructing homes about two years ago. This NID project will result in 272 new homes in Festus.

Public improvements for which special assessments may be levied include maintenance and renovation of existing public facilities as well as new construction. In addition to labor and material expenses, eligible costs include planning and design fees, underwriters' costs, attorney fees and interest. The City also may include its own administrative expenses and project supervision costs.

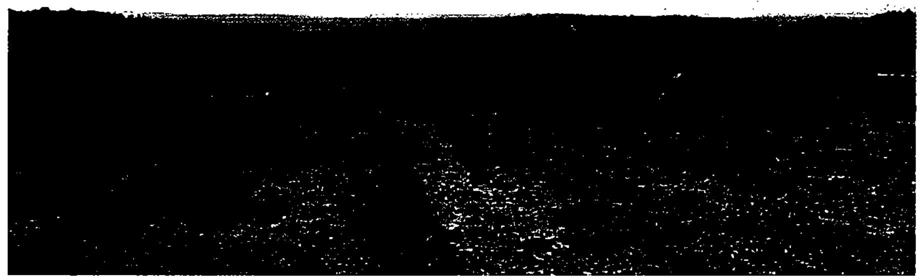
Festus' NID Policy and Resulting Developments

Located in the heart of developing Jefferson County, the City of Festus has experienced rapid growth typically located along interstate highway corridors and other areas already well served by public infrastructure. Other areas of the City lacking the same levels of infrastructure have lagged behind, however. In response, the Festus city council in 2001 adopted a policy of using NID financing to selectively promote housing development in targeted areas. Unlike other communities, the council's policy now limits NID assistance to "off-site" amenities that are demonstrated to be necessary to neighborhood development.

So far, the program has produced more than 400 new homes to be constructed in two large "upscale" developments. Hanover Holdings, L.C., has proposed a 272-unit, single-family development along Bailey Station Road on the City's west side. The City has authorized temporary NID financing for an estimated $280,000 in road and entry improvements to serve the development. More recently, Lawless Homes initiated work on Tanglewood Estates, a 150-unit, single-family development. The City's NID program will finance up to

$400,000 in off-site sanitary sewerage improvements serving the Tanglewood development. Future tie-ins to these amenities are planned.

These residential NID developments are additionally supported by two independent public infrastructure NID projects. The City plans to combine these projects in "piggy-back" fashion with the developers' NID improvements and to issue a single series of permanent NID bonds, a unique feature of NID financing. In addition to providing low-cost, "up-front" funds for the projects, the City's approach will spread the costs of issuing the bonds among the projects, reducing the cost from that which would result from independent financings.


The Lawless Homes development currently is beginning site prep on a 72-acre site in Festus. This NID project will result in about 150 new homes with infrastructure.

Creating The Districts

The NID Act provides two independent procedures for establishing neighborhood improvement districts. A district may be established by approval of the qualified voters residing in the proposed district. The required percentage of voter approval equals that required for the issuance of general obligation bonds. Alternatively, a district may be established upon petition signed by at least two-thirds of the property owners located within the proposed district.

Because of the absence of qualified voters in targeted areas, cities "creating" neighborhoods typically use the petition process. The developer/land owner initiates the petition and sponsors the development. Festus also requires the petitioning developer to provide "start-up" funds to defray the City's administrative and legal costs. The "district" simply is an assessment area, not a separate political subdivision. Thus, the City retains control of NID implementation and administration.

The petition process is relatively straightforward. The simplified process is outlined below:

Step 1. The owners of record of two-thirds of the affected properties by area file a Petition to Create a Neighborhood Improvement District with the city clerk. This requirement typically is satisfied when the developer acquires or obtains control of the land to be developed.

Step 2. On receiving the petition, the City's governing body adopts an ordinance or resolution determining advisability of the improvements identified in the petition, ordering establishment of the District and ordering preparation of preliminary plans and specifications for the improvements. The petitioning developer's improvement plans typically satisfy this requirement.

Step 3. The City receives the preliminary plans and specifications and adopts an ordinance or resolution ordering assessments to be made based on estimated costs of the improvements and ordering preparation of a proposed assessment roll.

Step 4. The City then files plans and specifications and proposed assessment roll with the city clerk, and the governing body conducts a public hearing to consider proposed improvements and proposed assessments.

Step 5. After the hearing, the governing body adopts an ordinance ordering the improvements to be made and directing the obtaining of financing including, as applicable, the issuance of Temporary NID Notes. For example, temporary notes may be required if improvement costs are not previously agreed upon.

Step 6. Upon completion of construction of improvements, the City's governing body computes final costs and apportionment and adopts an ordinance assessing costs against properties described on the assessment roll and authorizing issuance of NID Bonds. As an alternative, the City and the developer may agree on a fixed final improvement cost. As soon as this final amount is determined, permanent NID bonds may be issued. Because "up-front" project funds may be obtained from bond proceeds, developers typically prefer this alternative approach.

Step 7. Bond documents are prepared, NID bond purchase arrangements are negotiated and concluded and the bonds are issued. Bond proceeds also may be used to pay any temporary notes and accrued interest.

Key Advantages To The City's NID Approach

Key features and advantages to the City's use of NID to "create" neighborhoods include:

Availability of low-interest, tax-exempt financing. Bonds require neither a pledge of taxing power nor, if created by petition, voter approval. NID bonds are well accepted in the public finance marketplace and bond insurance can be obtained. Resulting interest savings currently are estimated at $180,000 for each $1 million financed.

Broad categories of eligible improvements. Any "public" improvement may be financed. Examples include but are not limited to streets,

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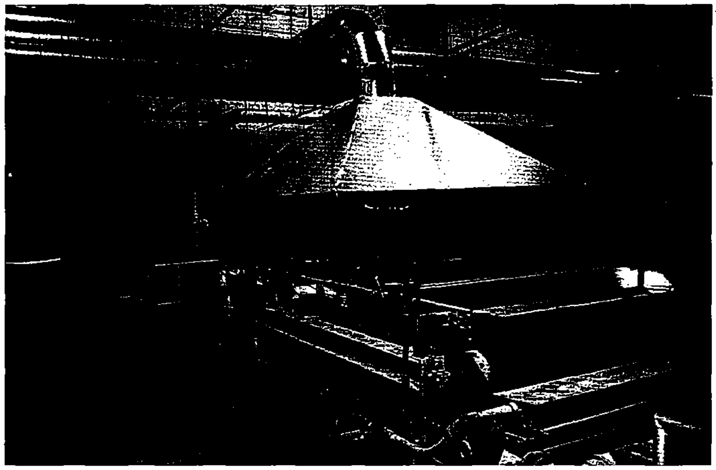

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water, storm/sanitary sewerage, landscaping, parks and parking facilities. The "public" requirement may be variously satisfied by grant to the City of fee ownership, easement or any possessory/access interest in the improvements financed.

Flexibility of assessment plans. Any "reasonable assessment plan" is acceptable. For example, assessments may be based upon lot frontage, total area, per lot or any other basis by which a substantially equal share of the total costs are assessed against all property receiving similar resulting benefits. Assessments may be varied if different benefits are derived.

"Grace" period for levy of assessments. The flexibility of NID assessments also permits a delay of actual levies, allowing time for development/market absorption. This allows for a substantial "ramp-up" period, which is attractive to private developers. Interest accruing in the interim may be capitalized.

Availability of funds at project initiation. If a developer wishes to capitalize accrued interest during the "ramp-up" period (or is willing to begin paying assessments earlier and to forego the "ramp-up"), NID bonds may be issued immediately based upon an agreed fixed amount of improvement costs. In this way, bond proceeds may be used at the beginning of the project and initial capital obtained at tax exempt rates.

Cost overrun protection. The NID Act expressly provides protection for construction cost overruns. If the actual improvement costs to be assessed exceed 125 percent of the approved estimates, the NID approval process must be repeated. This issue is avoided, however, if the City and developer mutually establish a fixed limit on the amount of improvement costs to be financed.

These advantages notwithstanding, some cautions attend the NID approach. Because the NID bonds are "general obligations" of the issuing city, the amount of the obligations issued is counted in determining that city's constitutional debt limitation. Thus, cities with significant existing general obligation debt may wish to limit involvement and associated exposure.

The combined project approach undertaken by Festus also entails some increased administrative burden. Depending upon individual assessment schedules for the Districts and associated improvements, separate assessment ordinances may be required. Additionally, the City will be required to establish separate funds or accounts for each identified improvement.

Finally, because the NID assessment is levied on property rather than individuals, the use of a long "ramp-up" period invites the possibility that ultimate home buyers will incur the future obligation to pay assessments without prior knowledge. To avoid this problem, the City of Festus' NID policy expressly requires a written development agreement with each participating developer that obligates the developer to affirmatively disclose the special assessment obligation to each potential buyer and to local realtors.

Conclusion

Several Missouri municipalities (including most recently Wentzville, Crystal City and Pevely) have undertaken "neighborhood creating" projects using NID. Many of these projects, however, are admittedly developer-driven and designed to "stand alone." The City of Festus approach is distinguished by providing an established overall policy framework for neighborhood creation, targeted to specific areas of need. Further, inclusion of the City's public facility projects in a combined "piggy-back" NID financing provides both an efficient and cost-effective means of financing needed community infrastructure improvements.□

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