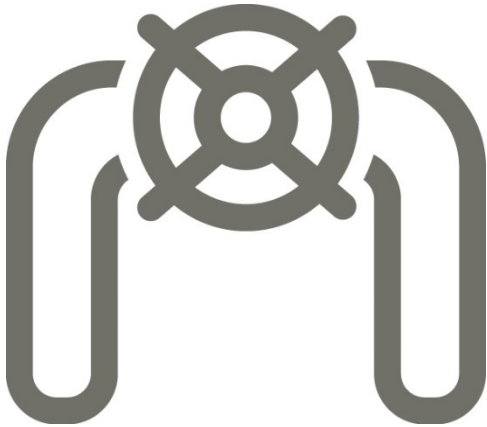


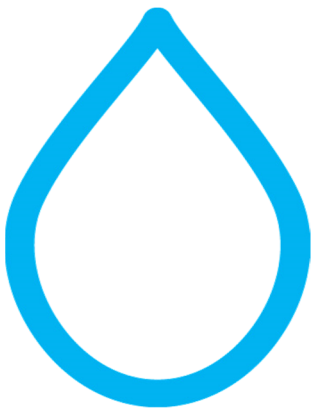
**City of Merced
Assessment District Formation**

Draft Memorandum



*Prepared for:
City of Merced*

*Prepared by:
Stantec Consulting Services Inc.*



February 8, 2017

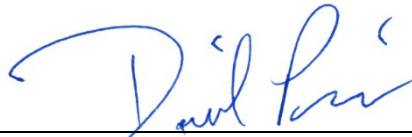
Sign-off Sheet

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Prepared by **Mark Hildebrand**

Reviewed by **Jason Mumm**

Approved by _____



(signature)

Dave Price, Project Manger

**CITY OF MERCED
ASSESSMENT DISTRICT FORMATION**

Introduction
February 8, 2017

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CITY OF MERCED
ASSESSMENT DISTRICT FORMATION

Introduction
February 8, 2017

1.0 INTRODUCTION

The purpose of this memorandum is to detail the proposed strategy of forming an Assessment District in order to pay for the expansion of the City of Merced's (City) sewer collection system in order to serve growth. This memorandum will describe the need for the project, the reasoning for forming an Assessment District, and a detailed implementation roadmap and schedule.

1.1 MERCED SEWER SYSTEM

The City owns and operates a sewer system consisting of over 400 miles of gravity sewers. The system is commonly described as having two geographical regions – North Merced and South Merced – delineated by Bear Creek running approximately east to west through the City. The City's customer base includes residential, commercial, industrial, and public users, with a majority of the wastewater being generated by the residential customers. The City's wastewater is treated at a wastewater treatment facility (WWTF) located southwest of the City.

1.2 PROBLEM STATEMENT: UNFUNDED GROWTH REQUIREMENTS

Growth estimates for the City were developed as part of the Merced Vision 2030 General Plan. In addition, the City has assessed expected infrastructure needs to accommodate growth with a Sewer Master Plan. Growth in North Merced - specifically the Bellevue Ranch development and growth of the UC Merced Campus - has spurred the expansion of the City's wastewater conveyance system and treatment capacity.

The Final Draft Sewer Master Plan (October 2016, Stantec) provides details on new collection system infrastructure to satisfy the interim and long-term system needs by both increasing capacity and extending infrastructure to previously undeveloped areas. The Sewer Master Plan discusses specific projects and cost estimates.

This memorandum addresses the funding of (the large, new trunk sewers recommended in the Final Draft Sewer Master Plan. Claiming that there is a 1% vacancy rate in local housing and that expansion of the University of California-Merced (UCM) will increase housing demand, developers in the community have made numerous requests to the City to fund and commence construction of new trunk sewers. While the City is in general agreement that new housing is necessary, there are insufficient reserves in the City's Sewer Enterprise Fund to pay for the new trunk sewers in the near-term.

CITY OF MERCED
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Introduction
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1.3 ASSESSMENT DISTRICT PROPOSAL

The costs of sewer system expansion are typically funded with developer fees (Capacity Charges) such that “growth pays for growth.” A common problem with this funding mechanism, however, is that the future customers that are driving the need for increased system capacity will pay their Capacity Charges at some time after the project is already built – in some cases, much later in the future. As such, unless the Capacity Charge fund has adequate reserves, utilities are often required (a) to borrow from another fund (such as the Sewer Enterprise Fund) or (b) issue debt to provide near-term funding for the expansion projects. Future Capacity Charge revenue provides reimbursement for these short-term obligations (assuming that the growth indeed occurs).

In this particular case, the Sewer's Growth Fund has already borrowed approximately \$15M from the Sewer Enterprise Fund to pay for the recent WWTF expansion. That debt is still outstanding partly because growth did not materialize in Merced as quickly as developers had estimated in the past. In order to avoid further indebtedness between funds or directly burdening the City with still more external debt (e.g. issue a General Obligation bond), the City is seeking an alternative financing mechanism for the construction of the new trunk sewers.

This memorandum explores the creation an Assessment District to fund the trunk sewers because this approach provides:

1. Near-term funding that is otherwise not available through the City;
2. A means to address the urgent need for the trunk sewers;
3. An equitable approach that will cause growth to pay for growth and will not expose the City to undue financing risks;

As is detailed in Section 2.0, the formation of a new Assessment District is subject to property owner approval through a ballot process. Votes are weighted based on the property owner's financial obligation. Approval requires a simple majority. Once the Assessment District is formed, a Special Tax Lien is placed against each property thereby generating a revenue stream that would support the issuance of municipal bonds for the purpose of funding the trunk sewers.

This memorandum also explores the potential use of private developer bridge loan prior to the formation of the Assessment District in order to accelerate the commencement of the sewer trunk expansion project.

CITY OF MERCED
ASSESSMENT DISTRICT FORMATION

Special Assessment Districts
February 8, 2017

2.0 SPECIAL ASSESSMENT DISTRICTS

2.1 LEGAL HISTORY

Two key laws set forth the procedures required to establish Assessment Districts in California – the Municipal Improvement Act of 1913 and Proposition 218.

2.1.1 Improvement Act of 1911 and Municipal Improvement Act of 1913

The Improvement Act of 1911 (1911 Act) and Municipal Improvement Act of 1913 (1913 Act) allowed communities to assess themselves for the construction of public infrastructure and utilize public financing mechanisms to address at least a portion of project costs. Among other things, the 1911 Act and 1913 Act allow for the levy of assessments to pay for capital costs and operating and maintenance costs for public improvements, including sanitary sewers.

Also, included in the 1911 Act are provisions governing access to bond financing for Assessment Districts for public improvements. Access to bond financing is further governed by the Improvement Bond Act of 1915.

2.1.2 Proposition 218

Proposition 218 (now Article XIII C and D of the California Constitution), known as the “Right to Vote on Taxes Act,” was passed in November 1996. A key feature in Article XIID, Section 4 was the implementation of stricter rules governing special assessments. Included in these rules was a definition of a special benefit as a “particular and distinct benefit over and above general benefits conferred on real property located in the District or to the public at large. General enhancement of property value does not constitute a special benefit.” These rules require assessments be calculated based on the direct, special benefit to individual parcels resulting from completion of a project, and provide a mandatory process for defining and approving the proposed special assessment.

2.1.3 Community Facilities Districts

“Mello-Roos Community Facilities Districts” (CFD) are a similar mechanism that are used to finance public improvements and services. The primary difference in this case is that a CFD is formed by obtaining a two-thirds majority vote of residents living within the proposed boundaries. Because the voting requirements are so much higher for CFD’s, we have not considered them for the purposes of this memorandum and have instead focused on creation of Assessment Districts.

CITY OF MERCED
ASSESSMENT DISTRICT FORMATION

Special Assessment Districts
February 8, 2017

2.2 PROCEDURAL REQUIREMENTS

The legal requirements for creating an Assessment District and imposing an assessment on specific properties are described below. 3.0 details the practical steps that need to be followed to form an Assessment District.

1. Write a detailed Engineer's Report (prepared by a registered professional engineer certified by the State of California) wherein the special benefit conferred on each identified parcel is calculated. It is important that the assessment not exceed the reasonable cost of the proportional share of the special¹ benefit conferred on each individual parcel.
2. Send a ballot to the record owner of each parcel whereby the owner may indicate his or her support or opposition to the proposed assessment. The "record owner" is defined as the owner of a parcel whose name and address appears on the last equalized secured property tax assessment roll.
3. The ballot must be accompanied by a written notice with the following information:
 - a. The reason for the assessment;
 - b. The proposed assessment for owner's particular parcel (including details of payments and duration) and the total amount chargeable to the entire Assessment District;
 - c. Basis used in calculating the proposed assessment;
 - d. The date, time, and location of the public hearing for the proposed assessment;
 - e. A summary of the procedures applicable to the completion, return, and tabulation of the ballots; and
 - f. A disclosure statement indicating majority protest will result the in assessment not being imposed.
4. Conduct a public hearing (no less than 45 days after mailing the notice) to consider protests against the proposed assessment.
5. Tabulate the submitted ballots by weighting each vote by the proportional financial obligation of the affected property. A majority protest exists if the weighted total of opposition ballots exceeds the weighted total of ballots submitted in favor of the assessment.

¹ This "special" benefit needs to be a particular and distinct benefit over and above general benefits conferred on real property located in the district or to the public at large.

CITY OF MERCED
ASSESSMENT DISTRICT FORMATION

Implementation Road Map
February 8, 2017

3.0 IMPLEMENTATION ROAD MAP

The following provides a practical road map to forming an Assessment District, including (1) the steps required to meet the procedural requirements of Proposition 218; (2) additional steps designed to improve the likelihood of success; and (3) practical implementation details.

3.1.1 Project Delineation

The boundaries of the proposed District will be identified based on the improvements recommended in the Sewer Master Plan and any modifications thereafter. All parcels receiving a special benefit from the construction of the trunk sewers and upon which an assessment will be imposed should be identified and listed in a database. The database should include key information regarding each parcel, including parcel size, zoning information, and location relative to any phase of the trunk sewer construction. A preliminary depiction of anticipated Assessment District boundaries, as well as the recommended trunk sewer improvements is provided in **Figure 1**.

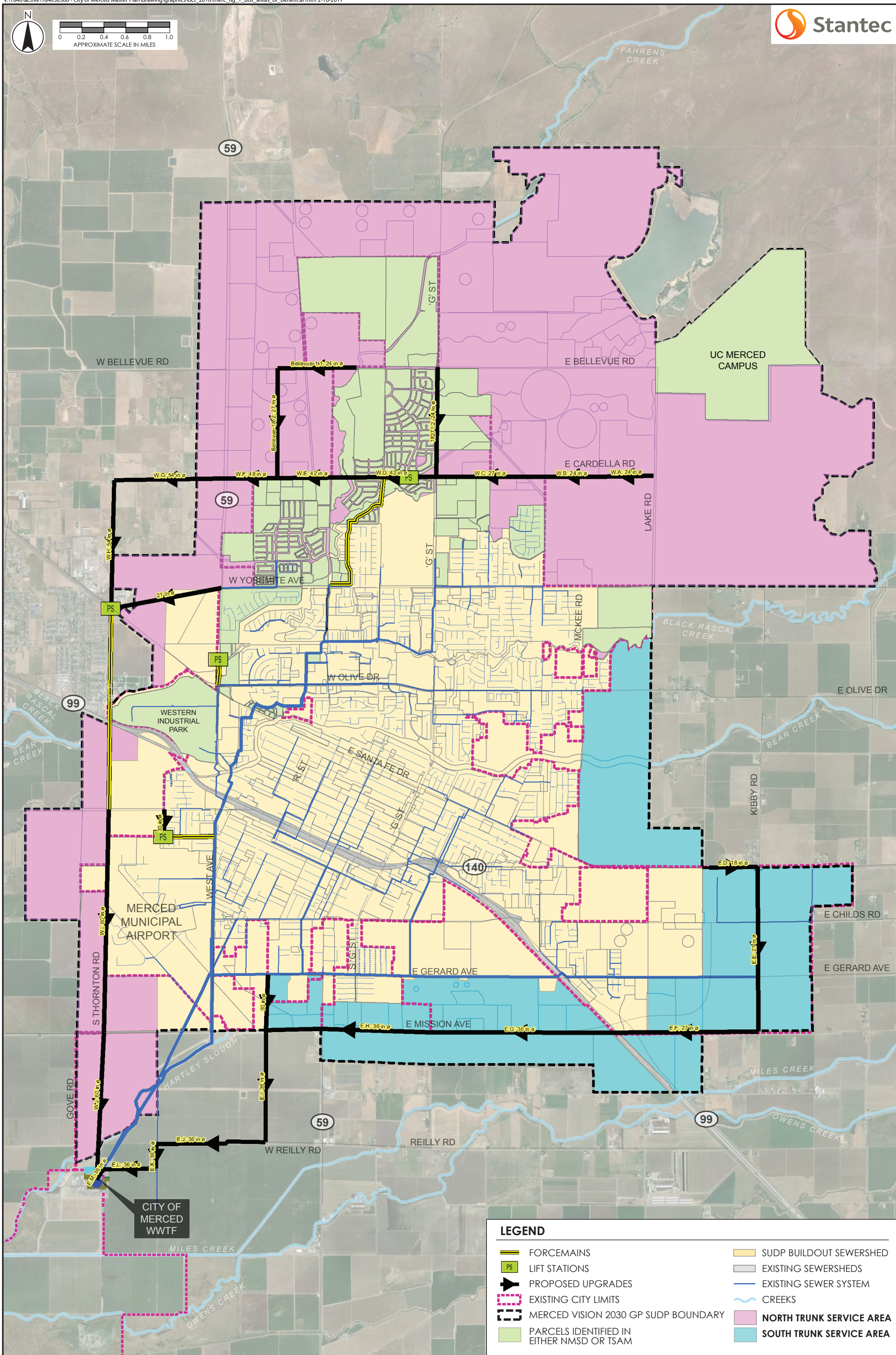
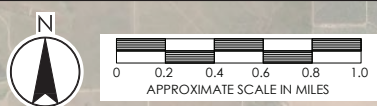
3.1.2 Cost Estimate

Based on project information from the Sewer Master Plan including the digital model of the collection system, a detailed estimate of capital costs will be developed in accordance with American Association of Cost Estimators (AACE) Class 4 estimating criteria. This cost estimate will serve as the basis for determining the maximum costs to be recovered through the assessment on parcels within the Assessment District. While the actual costs of the trunk sewer construction may vary from these cost estimates, the assessment shall not exceed the cost stated on the ballot (although the assessment can, and should, be lower in the event that costs are less than those stated on the ballot).

3.1.3 Petitioning

As an outreach step, and to gauge support of the project, petition forms will be prepared and distributed to the property owners within the Assessment District boundaries. The petitions will include basic information regarding the project, including the scope of the work, project delineation, general methodology for assigning cost responsibilities, and preliminary cost ranges for properties. In order to confirm support for the project (and therefore justify the expense of the ballot process), the City should seek to secure support from approximately two-thirds (2/3) of the polled votes (weighted).

In the event that property owners are split in their support of the project, the City may elect to redraw the boundaries of the Assessment District or redefine the project in order to be responsive to the expressed desires of property owners.



LEGEND

- FORCEMAINS
- LIFT STATIONS
- PROPOSED UPGRADES
- EXISTING CITY LIMITS
- MERCED VISION 2030 GP SUDP BOUNDARY
- PARCELS IDENTIFIED IN EITHER NMSD OR TSAM
- SUDP BUILDOUT SEWERSHED
- EXISTING SEWERSHEDS
- EXISTING SEWER SYSTEM
- CREEKS
- NORTH TRUNK SERVICE AREA
- SOUTH TRUNK SERVICE AREA

CITY OF MERCED
ASSESSMENT DISTRICT FORMATION

Implementation Road Map
February 8, 2017

Once sufficient support is expressed by property owner, the petition results will be presented to the City Council, seeking approval to move forward with the Engineer's Report (see Section 3.1.4) and hiring bond counsel (see Section 3.1.6), if applicable.

3.1.4 Engineer's Report

An Engineer's Report will be completed by a professional engineer as a means of documenting the assessment methodology in support of a ballot measure to approve funding of the trunk sewers. The engineer's report is the key to measuring and reflecting the special benefits that will accrue to each particular parcel within the Assessment District and ensuring that the proposed special assessments comply with the special benefit and proportionality requirements of Proposition 218. Clearly documented and well-defined methodologies for completing these tasks are crucial to successful adoption of the assessment.

The Engineer's Report will, at a minimum, include the following sections:

1. Definition of proposed sewer improvements;
2. Location of proposed improvements;
3. Cost estimate for completion of proposed improvements;
4. Description of general and special benefits provided by proposed improvements;
5. Methodology used to allocate the *special* benefits to each parcel; and
6. Assessment diagram showing locations of the benefitting parcels.

The methodology must link the benefits of public improvements to individual parcels in a quantifiable manner. No property owner pays more than his or her proportional share of the total cost. This may require the assessment rates to be set on a parcel-by-parcel basis.

In addition to meeting compliance with Proposition 218, the Engineer's Report should be used as an outreach tool to demonstrate that the basis of the assessment is equitable, transparent, and appropriate. An effective outreach strategy that clearly explains the methodology applied in determining the special assessment will improve public perception of the process and increase the likelihood of successful adoption.

**CITY OF MERCED
ASSESSMENT DISTRICT FORMATION**

Implementation Road Map
February 8, 2017

A Note on Special Benefits

It is important to understand the distinction between a general benefit versus a special benefit, since the law doesn't allow general benefits to be included as part of the cost of the special assessment. A special benefit confers a particular benefit to land and buildings, as opposed to a general benefit to the public or a general increase in property values. Any general benefits that are shared by the public at large must be proportionately subtracted from the calculation of special benefits. General benefits are not solely benefits to parcels outside the assessment district, but may include benefits to parcels within the assessment district that also benefit the public at large. That is, if special benefits represent 50 percent of total benefits, local government may use assessments to recoup half the project or service's costs.

It is critical to explain each element of the Engineer's Report clearly and support them with strong evidence and irrefutable logic. Since the adoption of Proposition 218, California courts have shifted the burden of demonstrating special benefit and proportionality to the agency establishing the special assessment.

While it is beyond the scope of this memorandum to develop the methodology by which the special benefits will be measured, it is worth noting that an obvious special benefit to the properties will be value of being credited for all, or a portion, of the sewer collection system Capacity Charge that would otherwise be charged in order to develop an unimproved parcel.

CITY OF MERCED ASSESSMENT DISTRICT FORMATION

Implementation Road Map
February 8, 2017

3.1.5 Resolution of Intent

The Engineer's Report will be presented to the City Council, with a motion to approve the mailing of the ballots and schedule the required public hearing.

The City may elect to adopt a "resolution of intention" prior to mailing the hearing notice. The typical resolution of intention (i) proposes (and sets forth the details of) the assessment, (ii) sets the date and time for the public hearing, (iii) directs staff to mail notice of the public hearing, and (iv) adopts procedures for the tabulation of votes. While the City is not legally obligated to have the City Council adopt a Resolution of Intent (rather than have staff proceed on its own authority), the extra step gives the elected officials a chance to consider the assessment before notice of the proposal is mailed to their constituents. Adopting the resolution reduces the possibility that Councilmembers are surprised when constituents start receiving notices and ensures that the City Council have explicitly approved the notices.

3.1.6 Additional Services

At this phase, the City may wish to procure additional services (if needed) to accomplish the Assessment District formation and financing, such as bond counsel, bond underwriter, printing services, or any other services as needed.

3.1.7 Outreach

After conducting the petition (see Section 3.1.3) and prior to mailing the ballots, there are several outreach activities that could increase the chances of successfully obtaining a majority vote. Perhaps the most impactful activity are property owner information meetings to explain the proposed District; provide information about the work to be accomplished; discuss the anticipated time schedule; clarify the assessment amount and the financial options available to property owners; and to answer any questions.

3.1.8 Ballot mailing

Ballots and written notices are mailed to the record owner of each parcel inclusive of a ballot to vote in favor or opposition of the assessment. See Section 2.2 for the requirements tied to these written notifications.

3.1.9 Public hearing

A public hearing will be held no less than 45 days after transmittal of the ballots to property owners. The City will use the public hearing to consider protests against the assessment and to accept any ballots that weren't previously received.

CITY OF MERCED
ASSESSMENT DISTRICT FORMATION

Implementation Road Map
February 8, 2017

3.1.10 Tally Votes

The tabulation of ballots involves calculating votes weighted based on the financial obligation of each parcel. This means parcels that will pay more as a result of the proposed assessment will have a larger share of the vote, and the vote equates to a one dollar: one vote, as opposed to one person: one vote.

3.1.11 District Formation and Finance Implementation

If the ballots support the formation of the Assessment District, City Council may resolve to form the Assessment District and order the levy of assessments based on the Engineer's Report.

3.1.12 Debt Issuance

Once the Assessment District has been approved, the City can proceed with securing a municipal bond. Section 4.0 discusses options for obtaining a near-term bridge loan while going through the process of obtaining a municipal bond.

3.1.13 Design and Construction Contracts

The design contract (and then construction contract) may be awarded once the debt financing has been secured (see Section 4.0).

CITY OF MERCED
ASSESSMENT DISTRICT FORMATION

Financial Strategies
February 8, 2017

4.0 FINANCIAL STRATEGIES

The following addresses a variety of financial options available to the City while forming the Assessment District.

4.1 PROPERTY OWNER PAYMENT OPTIONS

As was previously detailed in Section 2.0, once the Assessment District is formed a Special Tax Lien is placed against each property. Property owners then have the option to pay the entire assessment all at once, or in annual installments (as a Special Tax through their property tax bill). Once the Assessment District has been approved by the City Council, property owners have a period of time (say 30 days) to pay their entire assessment in cash if they choose. If the property owner elects to finance the costs, annual installments of principal, interest, and administrative fees will be collected with the property tax bill. The principal repayments will also include the cost of bond issuance. If a property owner pays the assessment in cash, he/she will save the bond financing costs. Cash payment also saves the cost of interest payments.

After the 30-day cash payment period any unpaid portion of the assessment will be financed through bond sales. Since it is unlikely that all property owners will pay their full assessment straightaway, municipal bonds will likely be sold by the Assessment District.

4.2 MUNICIPAL BONDS

The portion of the trunk sewers not funded with cash will be funded through the issuance of Improvement Bonds pursuant to the "Improvement Bond Act of 1915". The payment of the debt service on the Improvement Bonds shall be secured by the annual assessments within the District. The bonds are usually financed over a 15-year term.

4.3 BRIDGE LOAN

Even after the formation of the Assessment District, the issuance of a Municipal Bond for a newly-formed Assessment District may take several months or longer. Given the development community's expressed desire to commence construction of additional housing units within the anticipated District boundaries as soon as possible, it may be desirable to accelerate the financing and construction of the trunk sewers ahead of the formation of the Assessment District.

One potential option for accelerating the financing and construction of the trunk sewers is for the developers within the District (or perhaps elsewhere as well) to provide short-term bridge funding. Under this approach, the developers would secure private financing – either debt or equity – to pay for construction of the trunk sewers. Once the Assessment District is formed, the City would issue Improvement Bonds as described above with a portion of the proceeds going to refund the developers (for the bridge financing provided). The property owners would then

**CITY OF MERCED
ASSESSMENT DISTRICT FORMATION**

Financial Strategies
February 8, 2017

be faced with the options, as described above, to either pay their individual assessments in full or by annual assessment. The bridge financing option is not required. The Assessment Districts can be formed with or without this optional approach. However, the bridge financing is a means that would allow developers to commence their own housing projects a number of months sooner than otherwise while waiting for the Assessment District process to unfold. Of course, if the developers are unwilling to provide the private bridge funding, they can always wait until the Assessment District process is complete. Importantly, the City need not provide any advanced funding of the trunk sewers under this approach.

4.4 HARDSHIP

Property owners who are unable to pay the assessment should consult with a tax attorney to determine if their situation qualifies for deferred tax payments under the California Revenue and Tax Code. If their situation qualifies, the assessment MAY also qualify for deferment until the property is sold or the estate is settled.

4.5 CAPACITY CHARGE STUDY

As discussed in Section 3.0, one of the significant special benefits conferred by the Assessment District will be the credit that the assessed parcels will have towards future sewer capacity charges. The City may find that a Capacity Charge study will be needed in order to update the Capacity Charge fee schedule to be consistent with the assessments.

**CITY OF MERCED
ASSESSMENT DISTRICT FORMATION**

Approximate Schedule (assuming no Bridge Loan)
February 8, 2017

5.0 APPROXIMATE SCHEDULE (ASSUMING NO BRIDGE LOAN)

