EVOLUTION OF THE NID ACT AND NEIGHBORHOOD IMPROVEMENT DISTRICT PRINCIPLES AND PRACTICES: AN ILLUSTRATED HISTORY

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First authorized in the early 1990s, Neighborhood Improvement Districts (NIDs) provide Missouri local governments with a powerful and highly flexible tool to encourage economic development and real property improvements. However this was not always the case. The very act of establishing NIDs required overcoming constitutional limitations on the use of public monies and public credit for private purposes by way of an amendment to the Missouri Constitution. Mo. Const. art III, §38(c). This step paved the way for initial enactment in 1991 of the Neighborhood Improvement District Act (NID Act).

The utility and flexibility that the NID Act now affords is the result of an evolution. This evolution has affected ways in which the NID Act is interpreted and applied, as well as techniques and practices through which NIDs are established and administered. This article will explore, through an examination of several case studies of NID approaches employed by Missouri cities over the years, the directions in which the NID Act has evolved and illustrate ways cities have used NIDs creatively over the years to achieve real results that had not previously been considered.

First Steps – *Spradlin v. City Of Fulton*: Is A Golf Course A "Neighborhood"?

As enacted, the NID Act authorizes designation of contiguous areas within which assessments are levied, securing general obligation bonds to fund public improvements that benefit the area designated. The availability of general obligation bonds provides a type of financing not accessible to other special assessment and benefit mechanisms, typically at very favorable rates of interest.

The first uses of NIDs tended to be small and limited. In 1995 however, at the behest of a golf course developer, the city of Fulton established a NID to finance construction of a public golf course on a 188-acre tract of land. The NID consisted of a single parcel purchased and owned by the developer, who would build and operate the golf course as a public recreational facility under a lease to the City. The tract contained no residences or residents. The City authorized issuance of $3,110,000 in general obligation bonds to finance golf course improvements and imposed an assessment against the property in the NID to pay off the bonds. The City made no provision for prior voter approval. James Spradlin, a resident taxpayer of the city of Fulton, filed suit challenging the City's actions.

In resolving the lawsuit in the City's favor, the Missouri Supreme Court determined as an initial matter that a valid NID could exist where the land comprising the district was owned by a single entity and contained neither dwellings nor residents. The *Spradlin* Court also held that general obligation NID bonds could be issued without prior voter approval, and without requiring imposition of an annual tax on all of the taxable property in the City. In approving these new, "limited" general obligation bonds, the Court noted that if special assessment revenues proved inadequate, a valid "full faith and credit" pledge, albeit one limited to current city revenue streams or surpluses, supported NID bond payments.

Although the Court in *Spradlin* expressed doubt as to whether such "limited" general obligation NID bonds would be marketable, experience to date has demonstrated that underwriters and investors afford NID bonds much the same treatment as traditional, tax-backed general obligation bonds. With this recognition (and the *Spradlin* Court's broad favorable treatment), the stage was set for more "creative" approaches to NID financings.

City Of Olivette – Streamlining Toward Single-Step Financing To Improve Private Streets

On its creation in 1997, the city of Olivette's NID was the largest ever attempted and included hundreds of residential properties. Although the large scope of the NID avoided questions of single entity ownership already resolved in *Spradlin*, the Olivette NID raised other evolutionary issues.

The NID was intended to remedy widespread effects of deferred maintenance on private subdivision streets by financing street reconstruction and improvements to a degree that permitted ongoing city maintenance. In initial discussions, subdivision trustees were quite willing to accept NID assessments and public maintenance but expressed concerns over city ownership of street rights of way and potential future changes to the character of their "country lanes." In turn, these concerns required exploration of the NID Act's definition of the term "improvement" to resolve the degree of public ownership or interest required to invoke NID financing.

In prior NID undertakings, reference to "public facilities or improvements" within the language of the definition gave rise to a perception that outright public ownership of NID-financed improvements was essential. Looking to the facts in *Spradlin*, however, where the City held only a leasehold interest, the City reasoned that subdivision trustees need only grant easements for public use and maintenance over the improved rights of way. This and subsequent NID financings have firmly established that the "public improvement" requirement for purposes of the NID Act is satisfied where the municipality obtains some cognizable property interest in the financed improvement, and does not require that fee simple title to the improved property to be obtained.

Another innovation resulting from the Olivette NID experience was the application of single-step NID bond financing to projects where final improvement costs are determinable. Strict reading of the NID Act had suggested an awkward two-step financing mechanism in which a municipality must first issue a

temporary NID note to fund planning and construction phases. Only later, after project completion when actual costs were determined, could the City issue permanent NID bonds to redeem the temporary note and fund any differences. Although this was the practice at the time, Olivette saw a different approach.

The City reasoned that where a maximum funding amount could be established, improvements and associated costs could be tailored to available funds. Thus, with improvement costs readily ascertainable at the beginning of a project, cities should be able to eliminate temporary notes and move directly to the permanent financing afforded by NID bonds. Subsequent consultations with the Missouri State Auditor's Office affirmed this view.

This single-step approach so fundamentally altered the practitioner's view of NID financing that an immediate resort to permanent NID bonds has become the dominant approach applied in NID financings. Already at this relatively early stage, initial rigid views of the NID Act were yielding to more flexible approaches. As experience grew, more practical innovations followed.

City Of Wentzville – Coping With New Stakeholders Benefitting From New Drainage System Improvements

The trend of individual developer-owners of a single parcels seeking NID financing for various subdivision improvements continued through the 1990s. At the inception of these projects, NID assessments were typically levied on the single development parcel and paid by the single developer. However, as development proceeded and lots were sold off, and, of necessity, assessments became more complicated, new issues of NID administration arose involving realtors and new property owners.

In 1997, the city of Wentzville had formed a NID to fund construction of storm drainage and retention systems serving newly created residential lots surrounding the Bear Creek Golf Course. As development proceeded, shifting from temporary developer-paid financing to permanent NID bond financing, the City discovered that ultimate purchasers of residential lots had not been informed prior to sale and were not necessarily aware of NID assessments imposed on their newly purchased properties.

The City's response involved immediate outreach and notification to realtors active in the Bear Creek area including notification of NID assessments applicable to the area and requests that this information be passed along as a matter of course to prospective purchasers of lots within the development. Moreover, Wentzville and other cities now require as part of agreements to provide NID financing that developers include in sale contracts a written notification of NID assessment obligations applicable to the property to be purchased. Indeed, many cities now require inclusion in sale contracts for lot purchases a separate paragraph apprising the purchasers of NID assessment obligations and requiring purchasers' written acknowledgment of the notification.[1]

City Of Festus – "Piggybacking" City Improvements On Prior NID Projects

A particularly useful feature of the NID Act is ability of a municipality to issue a single series of NID bonds for multiple NID improvements, thus realizing significant savings in costs of issuance. Section 67.455 of the NID Act expressly provides that "[a]n improvement may be combined with one or more other improvements for the purpose of issuing a single series of general obligation bonds to pay all or part of the cost of such improvements ...". Although the NID Act uses the term "improvements," the city of Festus reasoned that this language also could be read to permit combinations of improvements located in separate neighborhood improvement districts.

The City had previously approved two prior private subdivision NIDs supported by temporary NID notes issued to the respective developers. However, neither project standing alone (or even put together) provided sufficient critical mass to justify ancillary costs of NID bond financing. Within a year of the issuance of the temporary notes, the City identified a need for new water storage and delivery facilities to accommodate growth within the City. Moreover, costs of the water facilities combined with the costs of the NID improvements would justify costs of NID bond financing.

Reasoning that under Missouri law a municipality, though immune from taxation, may be subject to special assessment, the City formed its own NID over city property and levied annual NID assessments sufficient to pay the costs of the water system improvements. The City then issued NID limited general obligation bonds to pay the costs of the combined private subdivision and city water system improvements. In so doing, the City allocated costs of issuance among the improvements pro rata in proportion to the costs of each improvement, thus sharing the aggregate issuance costs for additional savings.

City of St. Charles – "Turnkey" NID Improvements For New Urbanist Neighborhoods

New Town at St. Charles was envisioned as a multi-phased "New Urbanist," high-density residential development in the city of St. Charles. Planned improvements ranged from lakes, plazas and fountains, to vehicular and pedestrian bridges, to decorative street lights and furnishings, to extensive storm and flood-control devices and sanitary sewerage. In approving more than $30 million of NID financing for the New Town development over a 10-year build-out period, the St. Charles City Council realized that a unique partnership would be required.

Rather than a pay-as-you-go approach typical of municipal finance projects, the City imposed a "turnkey" requirement where the City would pay the developer from NID bond proceeds deposited in a city-held project fund, only for completed and installed improvements. The accepted improvements would then be turned over to the City for public maintenance. To assure the completeness of improvements to be accepted, financing agreements between the City and the developer specified a strict verification regime to which applications for payment would be subjected.

Moreover, in addition to providing a greater degree of certainty and control over the process, this "turnkey" approach to NID financing allowed the City to avoid burdens of construction and project management typically associated with NID improvements. The "turnkey" approach also reduced requirements for payment and performance security, thus providing additional savings.

Streets Of St. Charles At Noah's Ark – NID Provides "Bridge" Financing For New, Large- Scale, Mixed-Use Development In The City Of St. Charles

The crash of real estate and development markets in 2008 spelled the end of various planned projects throughout Missouri and the nation. In 2007, for example, the city of St. Charles had approved tax increment allocation financing (TIF) for a mixed-used project containing approximately 300,000 square feet of commercial office space built on a high density, New Urbanist theme on the Missouri river, adjacent to Interstate 70, near the City's casino entertainment district. In the wake of the 2008 crash, however, TIF financing was simply unavailable. Facing the collapse of the project, the City turned to the NID Act.

Unlike TIF, the full faith and credit pledge that supports NID bond payments made NID financing viable, even in a post-2008 environment. The City's agreement to establish a NID for the project area and to provide NID bond financing on an interim basis also contained an express requirement that, in any event all NID Bonds issued would be redeemed by TIF or similar obligations not later than 2016, presumably when the project had been built out. Even with this requirement, the City's NID bonds found a ready market. Four separate offerings were made totaling more than $35 million in project funds.

As of this writing, the "Streets of St. Charles at Noah's Ark" mixed-used project is well on its way to completion. The Noah's Ark project demonstrated the utility and flexibility of NID financing as "bridge financing" to rescue a critical, but endangered, project.

City Of Pacific – City Becomes Sole "Developer" Of NID-Financed City Hall Upgrades

In 2011, the city of Pacific sought low-cost financing for a proposed renovation and expansion of City Hall. After considering various traditional options, the City elected to utilize the NID Act. This choice was informed by evolving principles established in prior NID financed projects: that a NID may be composed of a single parcel, owned by a single owner; that a City, although tax exempt, may be subject to special assessments; and that a strong market exists for NID obligations.

City of Pacific City Hall

In Pacific, the sole parcel of property included in the proposed NID was owned by the City itself. Further, only the City would be subject to NID assessment. The City reasoned, however, that so long as the City enjoyed adequate cash flow, assessment obligations could continue to be satisfied. In a competitive solicitation, the City secured underwriting for the NID bonds that were offered and sold publically, and obtained at the same time, a State Auditor's certification that the NID bonds complied with all laws of the state of Missouri.

Conclusion: NID Lessons Learned

The NID Act has come a long way since its creation in the 1990s. Today, NID bonds are issued directly without the necessity of a prior temporary note; cities may satisfy public improvement requirements by obtaining any cognizable property interest in an improvement; NIDs may be established solely for city-owned properties; and cities may assure that new property owners are apprised of NID assessment obligations by developers as a condition of NID financing, and requiring that new purchasers similarly acknowledge the notification. NID bonds have been used as primary, temporary and bridge financing. Each of these aspects as well as other, now-common attributes of the NID Act, were once considered novel. All of this serves to underscore the flexibility of the Neighborhood Improvement District Act as perhaps the state's most powerful development tool, one that will likely continue to be applied to solve new problems in creative ways.❑

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Footnote

[1] In apparent recognition of the notice issue, Senate Bill 248, effective on August 28, 2013, revised the NID Act by adding a new requirement that, as a condition of levying any future NID assessment, the clerk of the governing body establishing a NID must record with the county recorder's office an instrument which sets forth: (i) the owners of record of the property within the NID as grantors; (ii) the name of the governing body establishing the NID and the title of the official or agency responsible for collecting and enforcing the NID assessments, as grantees; (iii) the legal description of the NID property; and (iv) the identifying number or a copy of the resolution or ordinance creating the NID. As a result of such an inclusion in county land records, subsequent title searches typically performed in connection with the sale of property would likely reveal this notification, thus providing notice to prospective purchasers that a NID assessment applies to the subject property. This is but one example of how NID practice has preceded (in this case by some 15 years) formalization in the NID Act itself of practical solutions to problems arising in the context of day-to-day NID administration. (In another such example, section 67.456.3 enacted in 2004, acknowledged and formalized the then-established practice of proportional reallocation of assessment amounts on parcels that are subdivided after final NID improvement costs have been levied and assessed on such parcels.)