OTTEN JOHNSON ALERT

Recent Shakeups for Public Infrastructure Financing Through Metropolitan Districts

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In Colorado, much of the public infrastructure installed in connection with development projects is financed by metropolitan districts. Metropolitan districts are governmental entities, authorized by Colorado statute, and controlled by an elected board of directors. They have taxing authority and can impose a mill levy on property within the boundaries of the district. Among other potential sources of revenue, this mill levy revenue can support the issuance of bonds to fund things like streets, curbs, gutters, drainage facilities, and other public improvements.

Only human beings, not corporate entities, can be eligible "electors" for purposes of serving on metropolitan district boards and voting in district elections. Qualification as an elector requires that an individual have an interest in property within the district. Metropolitan districts are typically established at the very early stages of a development project, at a point at which the developer is often the only property owner. Accordingly, there are statutory processes that enable entity property owners to qualify individuals as eligible electors to serve as board members and vote in metropolitan district elections, such as TABOR elections to authorize debt.

Until this year, one very common way for metropolitan district electors to be qualified was for the developer property owner to enter into option agreements with individuals, granting the individuals the right to purchase an interest in land, and obligating the option purchaser to pay taxes on the land pending closing. Literally hundreds, if not thousands, of electors had been qualified in this manner, and the qualified electors then proceeded to vote to authorize their districts to issue debt, and served on metropolitan district boards, approving bonds, etc.

Billions of dollars of public infrastructure has been financed in Colorado through this kind of system. Generally speaking, this kind of arrangement benefits both developers and property purchasers. Instead of including all of the costs of public improvements in the price developers charge to buyers for land, the buyers can pay for the costs of the public infrastructure over time through a portion of their property tax bill. This helps keep up front land costs lower.

However, Colorado's system for the financing of public improvements through metropolitan districts suffered quite a shock in April of this year as a result of the Colorado Court of Appeals' decision in *Landmark Towers Association, Inc., et al. v. UMB Bank, N.A., et al. Landmark Towers*, involved a challenge to the validity of certain metropolitan district debt, where the taxpayers were seeking to eliminate their obligation to pay district taxes that were pledged to pay bonds. In the face of the challenge, the Court of Appeals held that the option contracts qualifying eligible electors for the district were a "sham," highlighting several factors that purportedly supported this conclusion: (1) the individual parcels at issue were small, representing only an undivided 1/20th interest in a 100-square foot parcel, and too small to allow any beneficial use of the property; (2) the obligation to pay the property taxes was "illusory," since there was no right for the option seller to seek specific performance or damages for failure to pay the tax; (3) there was testimony that the individuals who had been qualified as electors had agreed amongst themselves that none of them would have to pay taxes on the parcels subject to the option contracts; (4) none of the individuals actually paid the down payment required by the option contracts; (5) none of the individuals, in fact, paid any property taxes; (6) none of the individuals exercised their options to purchase; and (7) none of the option contracts was ever recorded in the public records. Based on the "sham" contracts, the Court of Appeals invalidated the qualifications of the electors, thereby invalidating their TABOR votes to authorize the district's debt, and requiring a refunding of the taxes.

The facts concerning the qualification of electors are not the same for all metropolitan districts. Additionally, one could take issue with a number of aspects of the Court of Appeals' reasoning as it relates to the actual text of the statutes at issue. Indeed, a petition for certiorari to the Colorado Supreme Court is now pending, seeking to overturn the lower court ruling. Regardless, the impact of *Landmark Towers* was swift and widespread. The decision immediately called into question the validity of billions of dollars of debt issued by metropolitan district's with electors qualified through option contracts. It also halted the closings of hundreds of millions of dollars in loan and bond funding scheduled for the weeks following the ruling.

If left unresolved, this could have had an extremely negative effect on development projects throughout the state. A solution was needed immediately, and given the lengthy process for an appeal to the Supreme Court, a legislative fix was the only option. There were only weeks remaining in the legislative session, but a coalition of interests quickly coalesced behind SB-211. The bill was introduced on May 2, 2016, passed the legislature on May 10, 2016, and was signed into law by the Governor on May 12.

SB-211 attempts to address the problems created in *Landmark Towers*, but does so on a backward-looking basis. That is, it prohibits challenges to special district elections on the grounds that a person who voted was not an eligible elector unless the challenge was initiated prior to the April 21, 2016 date of the *Landmark Towers* decision. It also validated the qualifications of all electors who voted in such elections and all actions taken by board members. There are certain carve-outs for constitutional challenges. The bill did not, however, address the statutory interpretation that *Landmark Towers* created with respect to the qualification of new eligible electors.

While SB-211 is new and untested, its passage restored a measure of certainty to the metropolitan district public finance market in Colorado, and lenders and bond issuers began providing funds to previously-existing metropolitan districts again after its passage. However, because SB-211 does not address the process for qualifying new electors, *Landmark Towers* problems persist for new districts or districts seeking to hold new TABOR elections. Thus, following advice of their legal counsel, many metropolitan districts are changing the ways that they qualify electors, attempting to be sure that they comply with both the letter of the statutes concerning qualifications, and also the traps enumerated in *Landmark Towers*.

For now, the immediate crisis has been averted. However, the public financing component of a development project can be critical to its success. Accordingly, it will be important to watch this process play out over the next year or two as the Supreme Court takes the case. There is also the possibility of additional legislative changes to address the qualification of electors on a going-forward basis.

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