



# A Valuable New Development Resource: Kansas Enacts the Community Improvement District Act

By Matthew S. Gough

## I. Introduction and Background

On April 23, 2009, Gov. Kathleen Sebelius approved and enacted H.B. 2324, known as the Community Improvement District Act (CID Act).<sup>1</sup> The CID Act permits the establishment of community improvement districts (CIDs and individually a CID) that create new revenue sources to finance real estate development, similar to the legislation passed in numerous other states.<sup>2</sup> It confers powers for economic development purposes and any other purpose for which public money may be expended.<sup>3</sup> The CID Act enables a municipality's governing body to form a CID to finance the cost of a broad range of development, including operating expenses that are incurred post-construction.<sup>4</sup> A CID is broader and can generate greater revenue than under the Transportation Development District Act (TDD Act).<sup>5</sup> Furthermore, the CID Act has advantages over tax increment-based incentives (e.g., Tax Increment Financing (TIF) and Sales Tax Anticipated Revenue (STAR) bonds) and tax abatements because a CID does not affect the amount of sales or ad valorem property tax that taxing jurisdictions collect. Because the CID Act has the potential to positively impact real estate development projects both large and small, counsel who are conversant with the CID process can provide a meaningful benefit to their developer, lender, and municipal clients.

## II. Scope of CID Projects

A CID can be used to finance any "cost" of a "project."<sup>6</sup> Under the CID Act, a "cost" means the cost of land, materials, labor, and other lawful expenses incurred in planning and doing any project, as well as costs to create the CID and employ "consultants" (including attorneys, financial advisors, engineers, and architects), and other administrative and preliminary expenses.<sup>7</sup> The definition of "project" is likewise broad and nearly all-encompassing and includes land acquisition, horizontal and vertical construction costs, public infrastructure costs, and ongoing maintenance costs.<sup>8</sup> Neither the TDD Act nor any tax increment-based incentive has such a broad definition of eligible projects. The only advantage a TDD district has over a CID project is that TDD revenues can potentially be used to finance project costs incurred outside the boundary of the TDD, while all CID revenues must be used for improvements made inside the CID.<sup>9</sup>

## III. Methods of CID Financing

Subject to the requirements of the CID Act and the approval of the municipality's governing body, a CID can use up to five different revenue sources to finance project costs: (a) prepaid special assessments; (b) special assessments paid in installments; (c) a CID sales tax; (d) the municipality's full faith and credit to use its ad valorem taxing authority; and (e) any other funds appropriated by the municipality for the purpose of paying project costs, including the principal and interest of bonds issued pursuant to the CID Act.<sup>10</sup> Every CID must have a separate fund (a CID fund) that holds any CID sales taxes the district collects, special assessments paid to the municipality, CID bond proceeds, or any other revenues the CID generates.<sup>11</sup> The CID fund must be used to pay the cost of the project, through either the use of CID bonds or pay-as-you-

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go financing.<sup>12</sup> If moneys remain in the CID fund after the expiration of the CID sales tax, such moneys shall continue to be used solely to pay the cost of the project.<sup>13</sup> After CID revenues pay all eligible project costs or CID bonds, the municipality can spend any remaining funds as though they were local sales tax receipts.<sup>14</sup>

### A. Types of Financing

Unlike the TDD Act, which does not permit the use of full faith and credit bonds,<sup>15</sup> the CID Act permits the use of either special or general obligation bonds. In the context of the CID Act, special obligation bonds are payable solely from CID-generated sources and not from the municipality's general credit and taxing powers. CID special obligation bonds do not affect a municipality's bonded debt limitations.<sup>16</sup> By contrast, general obligation bonds are repayable not only from CID revenue sources, but also from a pledge of the general credit and taxing powers of the municipality.<sup>17</sup> General obligation CID bonds are within the bonded debt limit of the municipality to the extent they exceed 3 percent of the municipality's assessed valuation.<sup>18</sup> In general, when a municipality uses bonds to finance project costs, the municipality will sell bonds in an amount necessary to cover estimated project costs and any capitalized interest, administrative fees, issuance costs, and other expenses. Regardless of the type of bond issued, federal tax issues should be closely analyzed to confirm the bond's tax-exempt status. The bond proceeds are immediately available to reimburse project costs, frequently by reimbursing the developer for eligible out of pocket costs, and the municipality uses CID revenues (and the municipality's own taxing power, in the case of full faith and credit bonds) to repay the bonds. No CID bonds (of any type) can have a maturity date greater than 22 years.<sup>19</sup>

The alternative to CID bonds is to use "pay-as-you-go" financing, which means that the developer advances the costs of the project up front, without notes or bonds, and the CID fund reimburses the developer over the life of the CID.<sup>20</sup> Pay-as-you-go financing usually reduces administration costs, is easier to approve, and could result in more gross revenue (over time) than CID bonds. However, pay-as-you-go financing requires most developers to secure private lending, and to wait up to 22 years for maximum reimbursement (which may raise time-value of money concerns). To avoid a severe diminution in CID benefits, the developer should be certain that all or most of the developer's private interest expenses are reimbursable.

### B. CID Revenue Sources

The CID Act provides three primary revenues sources to finance CID projects, regardless of the type of financing: (1) special assessments on real estate, (2) additional sales taxes, and (3) the full faith and credit of the governmental entity forming the CID.

#### 1. Special assessments

A municipality has the power to levy and collect special assessments upon property in a CID and provide for the payment of all or any part of the cost of a project out of the proceeds thereof.<sup>21</sup> Special assessments can either be prepaid or paid in installments.<sup>22</sup> If special assessments are levied, the municipality must follow the procedures in K.S.A. 12-6a01 *et*

*seq.*, and amendments thereto, except that unlike traditional benefit improvement districts, no part of the assessments may be levied against the municipality at large.<sup>23</sup> Another distinction between CID special assessments and traditional special benefit districts is that annual CID sales tax income (or other municipally appropriated funds) can potentially reduce the annual special assessment installments property owners in a CID pay.<sup>24</sup> This potential reduction, however, may not apply to prepaid special assessments, which might not be reimbursed.<sup>25</sup>

## 2. Sales taxes

As an additional or alternative financing source, a municipality may impose a CID sales tax on sales within the CID.<sup>26</sup> The amount of the CID sales tax may be in any increment of 0.10 percent or 0.25 percent, not to exceed 2 percent.<sup>27</sup> By contrast, the TDD Act only permits TDD sales tax of up to one percent.<sup>28</sup> The duration of the CID sales tax is coterminous with the maturity date of CID Bonds or, if pay-as-you-go financing is used, no longer than 22 years from the date the state director of taxation begins collecting such tax.<sup>29</sup> The term of the CID sales tax may be shortened if the CID bonds or pay-as-you-go costs are paid in full.<sup>30</sup> The CID sales tax is collected at the same time and in the same manner as all other moneys collected by a state agency pursuant to K.S.A. 75-4215.<sup>31</sup> To defray the Kansas Department of Revenue's CID administrative and enforcement expenses, 2 percent of all CID sales taxes remitted to the state treasurer are withheld and deposited in a CID sales tax administration fund, except that no more than \$60,000 in the aggregate can be collected from all state CIDs in any state fiscal year.<sup>32</sup> The remainder of the CID sales taxes is remitted at least quarterly to the municipalities from which the CID sales taxes were collected.

## 3. General obligation bonds

Although CID sales tax and special assessments will often constitute all or the majority of revenue sources in a CID, highly motivated municipalities have the authority to also pledge its full faith and credit to use its ad valorem taxing authority for the repayment of general obligation bonds under the CID Act, and also to appropriate funds for the purpose

of paying project costs.<sup>33</sup> By backing a CID project with the municipality's full faith and credit, the municipality enables the issuance of general obligation bonds that greatly increase the marketability of CID bonds, and thereby enables a more immediate source of project funds and lower interest rates.

## IV. Formation of Community Improvement Districts

The statutory requirements to form a CID depend upon the type of revenue sources requested and the level of property owner support within the proposed district. Fewer procedural requirements exist for CIDs that generate revenue solely from special assessments, which do not seek the use of full faith and credit bonds, and which have 100 percent support of the property owners within the district.<sup>34</sup> In such instances, the formation process commences when such owners file a petition to the municipality that contains the following information:

- (A) The general nature of the proposed project,
- (B) the estimated cost of the project,
- (C) the proposed method of financing the project,
- (D) the proposed amount and method of assessment,
- (E) a map of the proposed district, and
- (F) a legal description of the boundaries of the proposed district.<sup>35</sup>

Once the petition is filed, the governing body may proceed *without notice or a hearing* to make findings by resolution or ordinance as to the nature, advisability and estimated cost of the project, the boundaries of the district, and the amount and method of assessment.<sup>36</sup> Upon making such findings by resolution or ordinance, the governing body may by simple majority authorize the project, effective upon publication of such resolution or ordinance.<sup>37</sup> The resolution or ordinance must also be recorded with the office of the register of deeds in the county in which the district is located.<sup>38</sup>

When a proposed CID does not have 100 percent support from property owners, or when a CID sales tax or full

faith and credit bonds are proposed, the CID Act requires more procedural steps to form the district.<sup>39</sup> At least 55 percent of the owners within the proposed district, both in terms of land area and assessed value, must file a petition with the governing body.<sup>40</sup> The petition must contain the following information:

- (1) The general nature of the proposed project;
- (2) the estimated cost of the project;
- (3) the proposed method of financing the project including, if applicable, the issuance of full faith and credit bonds;
- (4) the proposed amount and method of assessment, if any;
- (5) the proposed amount of community improvement district sales tax, if any;
- (6) a map of the proposed district; and
- (7) a legal description of the proposed district.<sup>41</sup>

After the petition is filed, the governing body must adopt a resolution to give notice of a public hearing on the advisability of creating or modifying a CID.<sup>42</sup> The resolution must also be published at least once each week for two consecutive weeks in the official newspaper of the municipality and sent by certified mail to all owners within the proposed district.<sup>43</sup> The second publication must occur no less than seven days prior to the date of the hearing and the certified mailed notice must be sent at least 10 days prior to the date of the hearing.<sup>44</sup> The resolution must contain the same seven enumerated items identified above.<sup>45</sup> Following the public hearing or any continuation thereof, the governing body may by simple majority create the district by adopting, publishing, and recording an ordinance or resolution.<sup>46</sup>

Regardless of the type of petition submitted, the petitioners may not withdraw their signatures after the governing body commences consideration of the petition, or more than seven days after the filing of such petition with the clerk of municipality, whichever occurs first.<sup>47</sup> The petition itself must include an acknowledgment of that fact, as well as the petitioners' consent to any assessments to the extent described in the petition without regard to benefits the project may confer.<sup>48</sup> Although the CID Act does not require the district to include all benefitted property or to subject all such property to an assessment,<sup>49</sup> the failure to include and assess all benefitted property may affect the tax exempt nature of the bonds issued for the project, or have other state or federal tax consequences.<sup>50</sup>

The Legislature wisely established a short statute of limitations for CID protests. No lawsuit to set aside the assessments, CID sales tax, or otherwise question the validity of the proceedings creating a CID or authorizing the project may be brought after the expiration of 30 days from the publication of the appropriate resolution or ordinance.<sup>51</sup> When a municipality approves the use of full faith and credit bonds, the voting public can file a protest petition no later than 60 days following the public hearing discussed above.<sup>52</sup> A valid protest petition requires the signature of at least 5 percent of the qualified voters of the municipality and must be filed with the municipality's clerk.<sup>53</sup> If a valid protest petition is timely filed,

the municipality may not issue full faith and credit bonds until a majority of the voters voting at an election thereon approve the bond issue.<sup>54</sup> If the voters do not approve the use of full faith and credit bonds, the municipality may use special obligation bonds instead.<sup>55</sup>

## V. Practice Tips

When forming a community improvement district, counsel for an applicant should work closely with the city's staff and bond counsel. In communities that do not regularly consider the formation of TDDs or CIDs, counsel should make certain that the staff and members of the governing body understand that the CID will not decrease the city's existing tax revenues. To the contrary, the CID project will probably create new tax revenue. Frequently there is confusion about the scope of the CID sales tax – the sales tax applies only within the CID, not to the city at-large. Most of the urban cities have adopted economic development policies that could affect a CID application. If a city's policy requires more information or findings than the CID Act requires, the client should be made aware of such requirements. Ideally, the submittal of a CID petition occurs only after having discussed the proposed development with city staff and bond counsel. The creation of a CID involves both legal and political decisions, and the CID petition stands the best chance of approval if both have been addressed prior to submittal.

In addition to the legal and political concerns that are, perhaps, the most important to an attorney, counsel should also

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remember that to the client, economics is the most important consideration in any CID project. The potential CID revenue is, after all, the primary benefit to the client (and the purpose for retaining legal counsel). In most instances, the developer will carry the risk of having a CID generate lower than expected revenues – local governments will probably only approve pay-as-you-go financing or special obligation bonds that are not backed by the city's full faith and credit. Consequently, counsel should inquire whether a client has conducted reasonable due diligence regarding the amount and timing of anticipated revenues. Establishing realistic revenue expectations is critically important to the success of a project. Although the CID Act and the municipality may not require a feasibility study, spending time and money to obtain a good feasibility study will pay dividends in financial planning. This information is also valuable to the client's commercial lender, because the lender will almost certainly take CID proceeds as collateral for the development loan.

Because a CID imposes additional taxes or assessments on real estate, a well-advised client interested in forming a CID should weigh revenue expectations with the impact such additional taxes will have on the project's customers. For example, if an additional sales tax would prevent a retail establishment from competing against nearby stores, a CID may not be the appropriate development incentive. If the project relies upon local business and if the CID sales tax would be unpopular in the community, a CID could negatively impact the project's business. On the other hand, retail businesses that derive a large portion of business from tourism and other transient clientele may not experience the same negative consequences from an additional sales tax.

Contemporaneously with or promptly following the municipality's approval of a CID petition, the developer and the municipality will enter into a formal agreement to codify each party's rights and obligations. This agreement will state with specificity any caps on and the payment priority of CID proceeds, any construction deadlines, the method for certifying eligible project costs, and the manner of reimbursement or repayment. The agreement determines and controls an applicant's right to receive CID revenue. As such, banks and other lenders will collateralize CID proceeds by requiring the borrower-developer to assign all right, title, and interest in the agreement to the lender. Because of the agreement's importance, lender's counsel will frequently ask to be involved in the negotiation of the CID agreement, to ensure the lender's interests are adequately addressed, and to confirm the municipality's consent to the collateralization of CID proceeds.

## VI. Comparison of Kansas and Missouri CID Acts

The state of Missouri adopted a Community Improvement District Act in 1998 (Missouri CID Act).<sup>56</sup> Although the influence of the Missouri CID Act is evident in the Kansas CID Act, the Kansas CID Act has several philosophical, procedural, and economic distinctions that benefit development. Most notably, the Missouri CID Act has a lower maximum sales tax – the Kansas CID Act permits up to two percent of additional sales tax, while the Missouri CID Act caps the maximum sales tax at 1 percent.<sup>57</sup> In Missouri, the term “district” is not only the geographic boundary of the project, but also an entity that is either a political subdivision of the state or a not-for-profit corporation.<sup>58</sup> In Kansas, a CID means only the geographic boundary of the district and the improvements constructed therein. A Missouri CID, when a political subdivision, has a board of directors that must prepare an annual budget and manage the CID.<sup>59</sup> From the perspective of a private developer, this additional red tape could require the developer's continuing involvement in the management of the district, via ongoing participation in the CID board of directors, or could result in higher administration costs because of the board of directors' duties and obligations.

The Kansas CID Act has more flexible eligibility requirements. The Kansas CID Act requires the support of at least 55 percent of the owners in the district – as determined by assessed value and *land area*.<sup>60</sup> By contrast, the Missouri CID Act requires the consent of more than 50 percent of the owners in the proposed district, both in terms of assessed value and *per capita*.<sup>61</sup> The per capita approach adopted in Missouri can be quite problematic to a developer, versus the land area approach used in Kansas. For example, in a proposed district where Owner A owns 99 acres and 99 percent of the appraised value and Owner B owns one acre and one percent of the appraised value, the Missouri CID Act requires Owner B's support to file a CID petition (to obtain at least 50 percent per capita approval), while the Kansas CID Act does not (because Owner A owns more than 55 percent of land area and valuation). This distinction greatly reduces the likelihood of one or several holdout landowners causing delay in Kansas.

## VII. Conclusion

In the present economic climate, in which credit markets have tightened considerably and commercial lenders are requiring more collateral for development loans, community improvement districts may become a routinely used tool to help finance development projects. An attorney with a basic understanding of the mechanics of the CID Act will be able to advise developer-clients to pursue such benefits, advise lender-clients to collateralize such benefits, and in each instance enhance the client's economic position. ■

### ENDNOTES

1. 2009 Kan. Sess. Laws 122, codified as K.S.A. 12-6a26 *et seq.*
2. *See, e.g.*, MO. REV. STAT. § 67.1401 *et seq.* (the Missouri Community Improvement District Act, adopted in 1998).
3. K.S.A. 2009 Supp. 12-6a26(b).
4. K.S.A. 2009 Supp. 12-6a27(h) (defining “governing body” as any

governing body of a city or the board of county commissioners of a county).

5. K.S.A. 12-17,140 *et seq.*
6. K.S.A. 2009 Supp. 12-6a33.
7. K.S.A. 2009 Supp. 12-6a27(e) and (f).
8. K.S.A. 2009 Supp. 12-6a27(m), defining “project” as follows:

**About the Author**

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- (1) Any project within the district to acquire, improve, construct, demolish, remove, renovate, reconstruct, rehabilitate, maintain, restore, replace, renew, repair, install, relocate, furnish, equip, or extend:
  - (A) Buildings, structures, and facilities;
  - (B) sidewalks, streets, roads, interchanges, highway access roads, intersections, alleys, parking lots, bridges, ramps, tunnels, overpasses and underpasses, traffic signs and signals, utilities, pedestrian amenities, abandoned cemeteries, drainage systems, water systems, storm systems, sewer systems, lift stations, underground gas, heating and electrical services and connections located within or without the public right-of-way, water mains and extensions, and other site improvements;
  - (C) parking garages;
  - (D) streetscape, lighting, street light fixtures, street light connections, street light facilities, benches or other seating furniture, trash receptacles, marquees, awnings, canopies, walls, and barriers;
  - (E) parks, lawns, trees, and other landscape;
  - (F) communication and information booths, bus stops, and other shelters, stations, terminals, hangers, restrooms, and kiosks;
  - (G) paintings, murals, display cases, sculptures, fountains, and other cultural amenities;
  - (H) airports, railroads, light rail, and other mass transit facilities; and
    - (I) lakes, dams, docks, wharfs, lakes or river ports, channels and levies, waterways, and drainage conduits.
- (2) Within the district, to operate or to contract for the provision of music, news, child care, or parking lots or garages, and buses, minibuses, or other modes of transportation;
- (3) Within the district, to provide or contract for the provision of security personnel, equipment, or facilities for the protection of property and persons;
- (4) Within the district, to provide or contract for cleaning, maintenance, and other services to public or private property;
- (5) Within the district, to produce and promote any tourism, recreational, or cultural activity or special event, including, but not limited to, advertising, decoration of any public place in the district, promotion of such activity and special events, and furnishing music in any public place;
- (6) Within the district, to support business activity and economic development, including, but not limited to, the promotion of business activity, development and retention, and the recruitment of developers and business;
- (7) Within the district, to provide or support training programs for employees of businesses; and
- (8) To contract for or conduct economic impact, planning, marketing, or other studies.
  9. *Id.* (stating that all types of "projects" must be "within a district").
  10. K.S.A. 2009 Supp. 12-6a33.
  11. K.S.A. 2009 Supp. 12-6a34.
  12. *Id.*
  13. *Id.*
  14. *Id.*
  15. K.S.A. 12-17,149.
  16. K.S.A. 2009 Supp. 12-6a35(a).
  17. K.S.A. 2009 Supp. 12-6a36(a).
  18. K.S.A. 2009 Supp. 12-6a36(c).
  19. K.S.A. 2009 Supp. 12-6a35(c) and 12-6a36(b).
  20. K.S.A. 2009 Supp. 12-6a27(l).
  21. K.S.A. 2009 Supp. 12-6a30(a).
  22. K.S.A. 2009 Supp. 12-6a33(a) and (b).
  23. K.S.A. 2009 Supp. 12-6a30(a).
  24. K.S.A. 2009 Supp. 12-6a30(b).
  25. *Id.*
  26. K.S.A. 2009 Supp. 12-6a31(a).
  27. *Id.*
  28. K.S.A. 2009 Supp. 12-17,145(a).
  29. K.S.A. 2009 Supp. 12-6a31(a).
  30. *Id.*
  31. K.S.A. 2009 Supp. 12-6a31(b).
  32. *Id.*
  33. K.S.A. 2009 Supp. 12-6a33(d) and (e).
  34. K.S.A. 2009 Supp. 12-6a28(a).
  35. *Id.*
  36. K.S.A. 2009 Supp. 12-6a28(c).
  37. *Id.*
  38. K.S.A. 2009 Supp. 12-6a28(e).
  39. K.S.A. 2009 Supp. 12-6a29.
  40. K.S.A. 2009 Supp. 12-6a29(a). By contrast, the TDD Act requires 100 percent support within the TDD district regardless of the type of project. K.S.A. 12-17,142.
  41. *Id.*
  42. K.S.A. 2009 Supp. 12-6a29(c).
  43. *Id.*
  44. *Id.*
  45. K.S.A. 2009 Supp. 12-6a29(c)(1) through (7).
  46. K.S.A. 2009 Supp. 12-6a29(c) and (f).
  47. K.S.A. 2009 Supp. 12-6a28(b) and 12-6a29(b).
  48. *Id.*
  49. K.S.A. 2009 Supp. 12-6a28(d) and 12-6a29(e).
  50. KANSAS REAL ESTATE PRACTICE & PROCEDURE § 18.14.1 (Lewis A. Heaven Jr. *et al.*, eds.) (5th ed. 2009).
  51. K.S.A. 2009 Supp. 12-6a32.
  52. K.S.A. 2009 Supp. 12-6a36(d).
  53. K.S.A. 2009 Supp. 12-6a32 and 12-6a36(d).
  54. K.S.A. 2009 Supp. 12-6a36(d).
  55. *Id.*
  56. MO. REV. STAT. §§ 67.1401- 67.1571 (2008). See also Joseph G. Lauber, *Public-Private Partnership in Community Development: Applying Constitutional Standards for Implementing the Missouri Community Improvement District Act*, 59 J. Mo. B. 80 (2003).
  57. MO. REV. STAT. § 67.1545(2008).
  58. MO. REV. STAT. § 67.1411(3) (2008).
  59. MO. REV. STAT. §§ 67.1451 and 67.1471(2008).
  60. K.S.A. 2009 Supp. 12-6a29(a).
  61. MO. REV. STAT. § 67.1421(2008).