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Special district: Due diligence is a must prior to acquisition

Special district due diligence is an important, and sometimes overlooked, step in real estate acquisitions. According to the Department of Local Affairs, more than 1,600 special districts are active in Colorado – almost five times the number of counties, cities and towns combined. Special districts play a critical role in financing the development and maintenance of public infrastructure. Property served by a special district may be the beneficiary of an existing or planned public infrastructure system. Special district due diligence also provides the buyer with information about the financial burdens that may be associated with financing such improvements. Prudent developers, homebuilders and real estate investors have come to appreciate the value of engaging professionals with expertise in special districts to perform special district due diligence before purchasing real property.

Special districts have the statutory authority to issue debt and impose a debt service mill levy to generate property tax revenue to repay such debt. Districts also may impose a separate mill levy to pay operations and maintenance costs. Additionally, special districts can impose fees, rates, tolls and charges, such as one-time capital development fees and ongoing service charges. Fee revenue can be utilized to supplement property taxes for repaying debt or for operating public improvements such as recreation centers or nonpotable irrigation water systems.

District taxes, until paid, constitute a perpetual lien on the taxed property and if not paid will be collected by the county treasurer pursuant to state statute. Nonpayment of district fees also encumbers the affected property and constitutes a perpetual lien on which the district can foreclose.

Darlene Sisneros
Shareholder, McGeady Sisneros PC, Denver

If a district issues debt secured by a property tax pledge, all property within its boundaries at the time of and after the issuance will continue to be burdened by the debt service mill levy, even if it is later excluded from the district.

The first step in special district due diligence is examining title work and tax certificates to determine whether the subject property is or has been in one or more special districts. Upon organization of a special district, a court order is recorded. Likewise, inclusions of property into and exclusions of property out of a special district are evidenced by recorded court orders. Because special districts sometimes are authorized to provide services outside their boundaries, a property that is outside the jurisdictional boundaries of a district might nonetheless be subject to the district's service connection and/or service charges as evidenced by a resolution recorded against the property. Tax certificates will indicate whether a special district has been imposing a mill levy on the property.

A review of the district's governing documents, including its service plan, is imperative. The district's governing documents not only set forth the original plan for financing and construction of public improvements, but also establish important limitations. The service plan will specify which of the statutory powers the district is authorized to provide (street, water, sanitation, public safety, parks and recreation, transportation, mosquito control, and television relay and translation improvements and services). Typically, it will establish the maximum amount of general obligation debt the district may issue and other financial constraints, such as the maximum mill levy the district can impose for repaying debt.

Kathy Kanda
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A complete picture of the district's current financial health and the burdens on the property to be acquired also requires close scrutiny of the district's financial documents, including its current budget, financial statements, audits and, if bonds have been issued, bond documents. District managers, attorneys and accountants should also be consulted for the most up-to-date information.

In-depth analysis of financial documents can yield information that a less rigorous investigation might not reveal. For example, an increase in a district's mill levy might be necessary to satisfy a future balloon payment to service district debt. The impending expiration of a letter of credit securing the district's bonds or delinquencies in capital fee payments could foreshadow an increase in financial burdens on district property owners.

Financial documents can provide information about the status of infrastructure development and any outstanding obligations for the district to construct additional public improvements. They indicate whether commercial and/or residential build-out has proceeded as projected, the current assessed value and property tax revenues generated from such development.

The district might have contractual obligations – financial and other – requiring a review of agreements with other governmental and private entities. Examples include agreements to share the costs of constructing regional improvements or of ongoing operations and maintenance activities. Many districts rely on developer advances to pay construction and operational costs until development is sufficient to support such activities through tax revenues and may have contractual obligations to reimburse such advances.

In addition to burdens on the property, special district due diligence can uncover benefits that run with the land and/or accrue to the district. Revenue-sharing arrangements between a district and a city or urban renewal authority are one example. Obligations of other governmental entities and/or developers to reimburse the district for constructing regional improvements is another example.

A recent trend in developing communities is to allocate the responsibilities that have been provided in the past by owners' associations to a special district. Evaluation of the district's funding reserves for recreation amenities and landscaping improvements will be an important part of the due diligence of a district that provides more traditional owners association maintenance responsibilities.

Like all due diligence, special district information allows for informed business decisions.▲