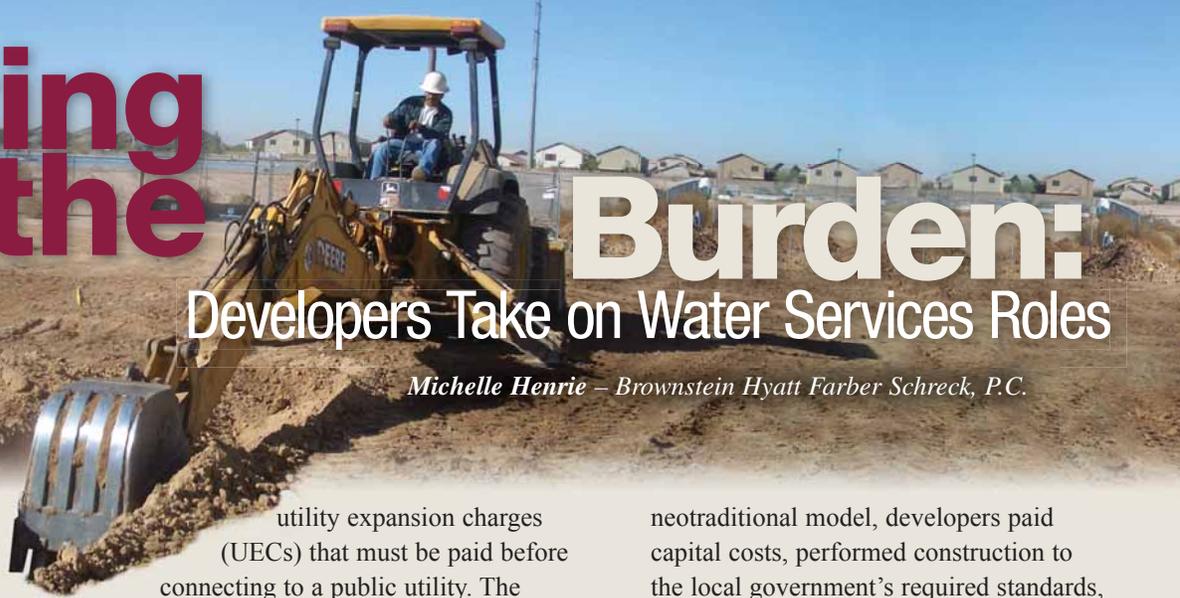


Shifting the

Burden: Developers Take on Water Services Roles

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Local governments are increasingly shifting the burden of costs relating to new development from public to private shoulders. It is now common for developers, homeowner associations, and special districts to pay capital costs as well as those for ongoing operations and maintenance. By taking on these roles previously filled by local government, developers are acting as municipalities. How did developers move into this role and what are the current trends?

History of Exactions

Local governments traditionally bore the up-front cost of infrastructure development, such as extension of water lines or street paving, and recouped this cost by distributing it among the citizenry in the form of taxes. By the 1930s, municipalities began to shift the task of recovering costs to private developers, requiring them to dedicate land within the subdivision for roadways, schools, parks, etc. By the 1950s, it was common for local governments to require developers to not only provide land, but also to install needed infrastructure on that land. Now, infrastructure installation and improvements often extend beyond a project's boundaries. For water and wastewater issues, off-site improvements might include upgrading treatment plants, expanding the capacity of plants or pipelines, providing new pump stations, and drilling new wells. We also now see required cash payments for use by a local government for a specific purpose, such as "in lieu fees" or "impact fees." In addition, other compensating payments are often required, such as "tap fees" or

utility expansion charges (UECs) that must be paid before connecting to a public utility. The actions, donations, and costs that are required of developers as a condition of developing are known as "exactions."

What Is The Trend?

Local governments are becoming more creative about identifying costs that can be shifted. Developers, too, are finding

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new ways to work with government to identify, budget for, and offer appropriate exactions early in the process—and thereby minimize their own risks.

Shifting Operations and Maintenance Costs: Homeowner associations typically own, insure, provide security for, manage, and maintain common areas. Common areas might include open space, streets and sidewalks, recreational facilities, and infrastructure such as water lines, shared wells, or community wastewater treatment facilities.

Under the traditional model, local governments provided capital, performed work, and supplied ongoing operations and maintenance in areas that are now typically "common areas." Under the

neotraditional model, developers paid capital costs, performed construction to the local government's required standards, and dedicated completed infrastructure and facilities to local government. Local governments then provided ongoing operations and maintenance costs for the infrastructure and facilities, and paid capital replacement costs. Now, many community associations are performing ongoing operations and maintenance and budgeting reserves for capital replacement costs, thus relieving local government of this responsibility, too.

Acknowledging Water Acquisition as a Capital Cost:

Local governments commonly include projected long-term capital costs of acquiring new water rights in impact fees, tap fees, and UECs. Active strategies for acquiring new water rights are less common. In the past, a word-of-mouth standing offer to buy water rights might have been a sufficient way to slowly grow a municipal portfolio, and slow growth had to be accepted because municipal attempts to actively purchase and move agricultural water rights were viewed as aggressive, resulting in public relations problems.

New Mexico municipalities are now pushing the burden of acquiring new water rights to developers. In Santa Fe, developers of certain types of projects must: 1) locate and purchase transferable water rights acceptable to the city in an amount that offsets the project's use; 2) donate these water rights to the city; and 3) supplement the water rights if the state engineer declines to transfer the entire donated amount.

Santa Fe and the applicant equally share all transaction costs, including the transfer proceedings before the state engineer. It is now developers who are proactively reaching out to water rights holders with offers to buy, not a municipality waiting passively for a seller to come to it with an offer to sell.

Developers have found willing sellers in downstream agricultural communities. So far, the water rights transfers have not impacted Rio Grande flows because downstream surface use is transferred to upstream city wells and the state engineer requires offsets (nonuse of surface water rights) for any wells that are hydrologically connected to the river. However, the transfers are subject to protest and hearing at the state engineer level, which typically takes up to two years. Santa Fe now allows developers to post a bond and pull a building permit after the city accepts the tendered water rights rather than waiting for the state engineer to complete the transfer process.

In other settings, developers have found long-term lease rights. Tribes, local governments, and water districts lease imported San Juan-Chama water flowing through the Rio Grande system. The Jicarilla Apache Nation leased water rights to Santa Fe, and it may decide to make more lease rights available to developers. Similarly, the Interstate Stream Commission has made Ute Lake reservoir water available by lease to local governments, some of whom subleased reservoir water to developers for use in lakeside subdivisions. The developers will build the infrastructure and a treatment plant needed to serve their projects.

Requiring Water Savings: The City of Santa Fe encouraged toilet retrofitting by requiring developers of new projects to retrofit a certain number of existing non-low-flush toilets within the city's water utility service area in order to free up water. The retrofits were intended to implement a policy of not allowing new demands on the municipal water system while allowing new development to occur. Here, too, the developers became proactive and created a market

for retrofits, which, many believe, has resulted in a faster phase-out of low-flush toilets than could be accomplished by incentives such as rebates.

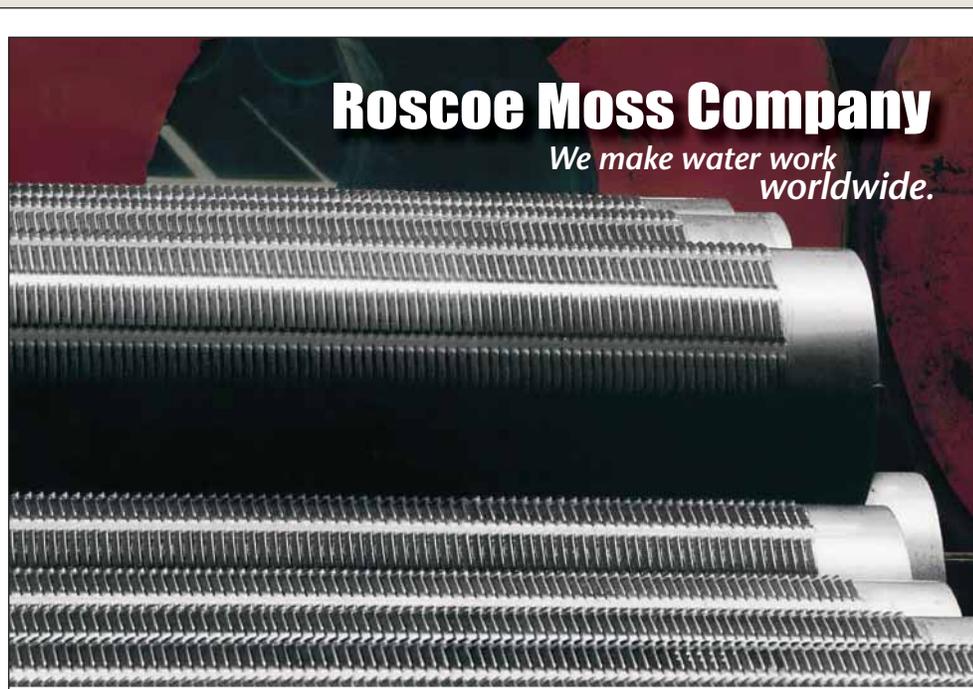
Partnering via Special Districts: In some states, another trend involves a developer and local government partnering to create special districts such as public improvement districts (PIDs). This partnering allows local governments to oversee and comment on the master planning of infrastructure projects without bearing any costs or risks of the project—which will be borne by the special district. The developer provides the footwork and expertise for the project. The local government forms the special district, which is a quasi-governmental entity that raises capital by issuing and selling bonds. This capital can be used to fund major projects such as water and wastewater treatment and distribution facilities or to reimburse the developer who has fronted these costs. Meanwhile, the bonds are paid off over time by homeowners living within the district boundaries.

Everybody Wins

For many developers, exactions are a part of doing business. However, developers should be able to know in advance what is required of them. Exactions should be clearly stated in an ordinance. Additional exactions should not be imposed as a condition of project approval. Added exactions increase the costs of a project, which may require the developer to renegotiate financing, cut costs elsewhere, or increase the costs of home prices or per square foot rental rates.

From the perspective of local government, there is no downside to shifting all costs of development from general taxpayers to developers, including hard costs (such as land acquisition, easements, paving, steel, and water rights), soft costs (such as staff costs involved in project review and attorneys fees for transferring water rights), and ongoing costs. This shift seems to be meeting public approval. Furthermore, local government benefits from an increased tax base from new projects without having to increase its budget for providing services.

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