

Infrastructure investment and the impact of special assessments under shifting population demographics

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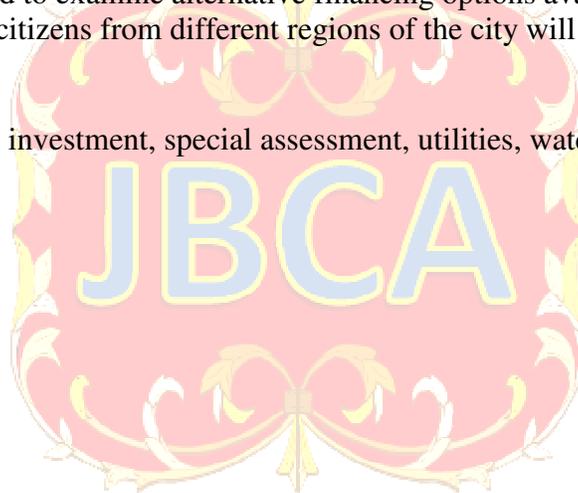
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ABSTRACT

This case examines the issues surrounding the expansion of utility services for a Florida city. Students are required to examine alternative financing options available and the economic impact and hardship that citizens from different regions of the city will potentially bear under alternative solutions.

Keywords: infrastructure, investment, special assessment, utilities, water



INTRODUCTION

This case places students into one of three groups, the citizens in favor of special assessment, the citizens opposed to special assessment, and the city council members listening to both sides and trying to weigh the issues. Case analysis requires examination of the alternative financing options available and the economic impact and hardship that citizens from different regions of the city will potentially bear under alternative solutions.

LEARNING OUTCOMES

By participating in the various roles of the respective stakeholders in this case, students will become familiar with utilities financing alternatives, tax burdens associated with respective taxing options, impact on property value from infrastructure development, and shifting demographic influences on utility supply and demand. The teaching notes include a discussion of the actual decision reached by the city council and its economic implications, along with an alternative strategy to teaching the case that involves a fourth group of stakeholders in the decision.

BACKGROUND

This case involves a city's alternative financing options for new utility production facilities. Florida law mandates that when water usage exceeds 75% of existing production capacity, a municipality must initiate new production facilities (Libaretore, 2009a). The key issue here involves how the new production facilities are financed.

The city of Cape Coral, in Southwest Florida, encompasses approximately 110 square miles (Wikipedia 2010). Originally conceived in the 1960's as a snowbird and retirement community, some critics have said that the city has suffered through the years from a lack of a comprehensive development plan. The "Cape," as it is known locally, was originally plotted around a system of man-made canals designed to provide residential access to the Caloosahatchee River and the Gulf of Mexico. The vast majority of land is residential, and the original development centered in the southwest region, which borders the river. Through the years, additional development has been haphazard and often ill-conceived.

In 2000, Cape Coral's population was around 100,000. The next six years saw tremendous growth, primarily residential; swell the city to over 150,000 residents. New construction extended to the north and east, areas that lacked access to city water and sewer utilities. During 2006, the city was cited by the state of Florida for insufficient production capacity to meet projected water demand (Libaretore, 2009a). At the time, the city's population was projected to reach over 190,000 by 2010. In anticipation of the expected increased demand, and as required by law, the city began expanding water and sewer production facilities. With nearly half of the city not connected to city utilities, the plan was to expand access to city utilities to help pay for the new production facilities. The cost of the expansion of city access was estimated to be \$281 million (Libaretore, 2009b). The question facing city officials was how to pay for the utilities expansion program.

FINANCING ALTERNATIVES

Impact fees and special assessments have become an increasingly important source of revenue since the local tax revolt of the late 1970's. (For a discussion of impact fees, see Brueckner, 1997, and Ihlandfeldt and Shaughnessy, 2004.) These revenue sources often can provide a way of circumventing the restrictions of the tax and expenditure limitations (TELs) imposed by voters in many areas. (Jung et al., 2009) However, the imposition of special assessments often creates a cash-flow problem for property owners. The financial benefits the property owners receive from the improvements that the assessments finance are not fully captured until the property is sold, yet the payment of the assessment is due before then. Shoup (1980) proposes "deferred special assessments" as a way to avoid that cash flow problem. Under such a plan, residents would have the option of deferring payment of the special assessments (along with accumulated interest) until the property was resold. However, this would make it more difficult (or at least more time consuming) for local government to raise the revenue needed to pay for the new infrastructure.

The primary alternatives that the Cape Coral city council considered were unilateral assessments and/or rate increases for all citizens across the city and targeted special assessments and/or rate increases for those citizens in the northern portion of the city (only) who would benefit directly from the new plant (Liberatore, 2009c). In the months leading up to the vote on the issue the city council heard numerous arguments from citizens with respect to these various alternative approaches for financing the utilities expansion. The community was essentially divided into two groups: 1) those in favor of a special assessment only for property owners in the northern portion of the city who owned lots that were directly impacted by the expansion of utility services, and 2) those who favored covering the expenses by increasing rates across all property owners in the city (including those who already had access to city utilities). Not surprisingly, property owners facing the prospect of a special assessment favored paying for the expansion with higher rates across the community. In contrast, the owners of properties that fell outside the special assessment region felt that the burden of paying for the expansion should be borne exclusively by those who would benefit directly.

DECLINING ECONOMIC CLIMATE

The situation was greatly complicated by the state of the local economy. Cape Coral had been experiencing dramatic population growth and appreciation in property values, and was often listed among the most overpriced markets by the popular press based on metrics that examined the relationship between the median priced home and median family income (Christie 2006). However, at the time of the vote the local economy, which was based largely on real estate construction, had stalled and property values were declining rapidly (Goodman 2010). The city was experiencing record levels of foreclosure activity as many property owners simply walked away from homes they had purchased during the recent market boom.

DISCUSSION QUESTIONS

1. To pay for the new utility production facilities, should the city council impose a unilateral rate increase on all city properties, or a special assessment only on those properties impacted by the new capacity?
2. Will the new utilities production facilities enhance market value for all city properties, or only those which will be directly impacted?
3. How will the political careers of sitting city council members be affected by their decision regarding how to finance the new utility production facilities?

APPENDIX

Group 1 (owners of properties subject to special assessment)

This group includes many property investors as well as end users. The investors are both seasoned real estate veterans and novices who were drawn to the market as a result of the dramatic property escalation over recent years. While they vary in expertise and willingness to accept the recent change in market conditions, they share a common problem. They hold real estate investments that have declined dramatically in value and liquidity. During the boom, many participants in this market segment were flippers who not only profited from buying properties and reselling them in a relatively short period but also used their profits to take increasing large positions in the market. The following arguments have been put forth by this group in opposition to the proposed special assessment.

1. The special assessment will place an undue burden on the owners of impacted properties.
2. The values of these properties have declined so much that it does not make sense to pay the special assessment.
3. The special assessment is unfair since the property owners will not be able to recover the expense when they sell their properties.
4. While more acceptable than the full special assessment, a deferred special assessment will still place serious cash flow constraints on existing property owners.
5. A special assessment will force many property owners to default on their obligations.
6. Rather than use a special assessment, the city should implement across the board rate increases to cover the cost of the infrastructure.
7. This was a bad idea and the project should have never been undertaken.

Group 2 (owners of properties not subject to special assessment)

While this group also includes some investors, it is dominated by end users. Like the members of group 1, these property owners have seen their property values decline dramatically as a result of the changing economic conditions. The following arguments have been put forth by this group in favor of the proposed special assessment.

1. The owners of the properties where utility services are being extended will benefit from the project. They should pay for the expansion.

2. The property owners facing the special assessments knew that the assessments had not been paid when they purchased the properties. Therefore, they should stop complaining and pay the assessment.
3. Raising utility rates across the board is unfair since we have already paid for the infrastructure that serves our properties.
4. Like the owners of the properties facing the special assessment, many other property owners are encountering cash flow problems. Thus, raising utility rates across the board will increase the risk of these property owners being unable to meet their obligations.

Group 3 (the city council)

This group is the city council of Cape Coral, which is made up of members who are elected at large, rather than from single-member districts. However, their members include representatives of both the special assessment region and the rest of the city. As governing officials, it is their job to decide between the one-time special assessments for property owners in the northern region versus a general across the board rate increase for all city residents.

This group will hear presentations on the pros and cons of the respective financing alternatives from Groups 1 and 2, and render a decision. The decision must consider the fact that 1) a special assessment may dramatically increase the number of property foreclosures in the northern part of the city, and 2) once regional growth resumes, the demand for the added capacity will resume (and likely increase). Finally, because city council members are elected on an at-large basis (rather than by individual districts), significant political impacts may result from any decision they make.

TEACHING NOTE

Case Outcome

The city council voted against using the special assessment to cover the cost of the utilities expansion. An across the board increase in utility rates was imposed instead. The result was an 85% increase in utility rates. Despite the fact that the special assessment was defeated, the number of property owners defaulting on their obligations continued to increase as the decline in the local economy intensified. By the spring of 2010 the City of Cape Coral had experienced property value declines to the point that it was listed as one of the most undervalued residential areas in the country (Goodman 2010).

Alternative Teaching Strategy

Group 4 (class research group): This group can be used in an alternate treatment of the case. Their role would be to research other situations where utility expansion took place, and the methods used to pay for the expansion. In addition to instructing the group to do a web-based search for such situations, the instructor may assign one or more readings from the case references to the research group. The use of this group provides an avenue to bring the most recent developments in this area into the classroom discussion. If the instructor elects to incorporate Group 4, it is suggested this group presents after groups 1 and 2, but before Group 3 deliberates and renders a decision.

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