Commentary

Fee Credits – Hidden Value

When new or expanded subdivisions are being approved, the city (or county) agency charged with the vetting of such projects also calculates the impact of the new housing on existing public facilities such as roads, bikeways and trails, parks, public safety facilities, sewers, storm drains, water systems and the like. The effect of the new housing on all these services is quantified and codified by the city under the heading of "impact fees."

Impact fees are an important source of funding for the city's capital improvements. However, impact fees can only be used for system level improvements that support new growth and development. In almost all cases, they cannot be used to fund small-scale local projects, maintenance, or rehabilitation of existing infrastructure. Project level improvements (on-site improvements) are generally made by developers at the subdivision level and dedicated to the city under subdivision improvement agreements.

In the case of a master planned community or a particularly large subdivision, the funding requirement of the system level (off-site) improvements that must be constructed may be beyond the financial capacity of the city. The city will execute development agreements with the developer(s) whereby the financial responsibility for the off-site improvements rests with the developer, thus creating "fee credits" and "reimbursables" for use later on.

For example, a development agreement encompassing Wonderful Master Planned Community ("Wonderful") is executed between Developer Don and The City. The agreement covers a multitude of on-site and off-site improvements, including the widening of a main arterial leading to the entrance of Wonderful and the expansion of The City's sewer treatment plant to accommodate some 3000 additional households. With respect to the street widening, this improvement will benefit not only Wonderful, but also future subdivisions in that part of The City. The City would calculate how much of the improvement is allocable to Wonderful and how much would benefit other future subdivisions, using their General Plan as a guide. The portion not allocable to Wonderful would qualify for reimbursement once the improvements were completed and accepted by The City. In most cases, The City will not have sufficient funds to reimburse Developer Don until the future subdivisions are approved and road fees collected from those developers are paid to The City who, in turn, reimburses Developer Don for the street widening.

As for the sewer plant, The City would already have a per-unit sewer hook-up fee established. Such fee is normally paid at the time a building permit is issued. But since Wonderful's map has been conditioned to pay for the sewer plant expansion up front, The City allows Developer Don "fee credits" totaling the cost of the sewer expansion to be utilized at the time of building permit issuance. These impact fee credits are based on the value of the system level improvements dedicated to the City in lieu of fees.

In the current economic environment we see that many times the off-site improvements have been completed but the project is foreclosed upon before building permits are issued or reimbursements are made. It is important that the foreclosing lender review their documents prior to foreclosure to ascertain the ownership of those valuable reimbursables and fee credits. First, the Deed of Trust and

Security Agreement must provide that the lender has a valid interest in the fee credits and reimbursables. Second, the Development Agreement should establish the lender's rights to those fee credits and reimbursables as a result of a unified foreclosure. It is possible that the city will have to acknowledge the lender's interest in the fee credits and reimbursables. If that is the case, the lender must move quickly to gain that acknowldgement before the foreclosure.

Once the foreclosure has been completed and the asset is being marketed, the fee credits and reimbursables should be shown on a schedule and provided to potential buyers. There can be significant value in those fee credits and reimbursables that can serve to lessen the ultimate charge-off.

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