SUMMARY OF COST OF GROWTH ISSUES AND RECOMMENDED IMPLEMENTATION STEPS

Prepared for

City of Bloomington, Illinois

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TischlerBise
Fiscal, Economic & Planning Consultants

BETHESDA, MD
TEMECULA, CA

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TischlerBise
Fiscal, Economic & Planning Consultants

4701 SANGAMORE ROAD | SUITE S240 | BETHESDA, MD 20816
T: 800.424.4318 | F: 301.320.4860

43460 RIDGE PARK DRIVE | SUITE 200W | TEMECULA, CA 92590
T: 951.719.8478 | F: 301.320.4860

WWW.TISCHLERBISE.COM

Executive Summary

OVERVIEW

The City of Bloomington is concerned about several issues related to the cost of growth and development. In particular, the City is interested in exploring the following issues/questions:

- What type of land uses should be incentivized?
- How has the City fared in the sharing of risk in development/annexation agreements?
- What are the costs associated with annexations?
- What is an appropriate return on investment period?

Before undertaking a consulting effort to address these issues, TischlerBise was retained to conduct a feasibility study. This feasibility study is intended to provide direction and recommendations as to what type of analysis should be conducted given Bloomington's situation and desired outcomes. This analysis and the recommendations presented herein are based on onsite interviews with key City personnel and feedback from City Council members. The report concludes with a summary of findings from our onsite interviews. These conclusions are based on our national experience, having conducted over 600 fiscal impact analyses around the country, more than any firm.

A fiscal impact analysis can be defined as the cash flow to the public sector. The fiscal impact equation consists of all revenue sources impacted by new growth on one side of the equation, and all capital costs and operating expenses on the other side. A fiscal impact analysis, in various forms, can be used to answer many of the questions/issues raised by City staff and elected officials during our discussion in Bloomington.

SUMMARY OF FINDINGS

A summary of findings from our evaluation and meetings with City staff and officials are listed below:

- The City of Bloomington has seen substantial residential and nonresidential growth over the last two decades. According to projections contained in the City of Bloomington Comprehensive Plan, the 2025 population is projected to reach 92,500. The Plan estimates this future growth will require nearly 6,000 acres of land for development, with the majority of acreage in residential land use. Our experience with Illinois jurisdictions indicate that unless the price points for residential are substantial, most jurisdictions need the revenue from nonresidential development to offset the costs of residential units. Therefore, it is in the City's best interest to ascertain whether the anticipated nonresidential development is enough to offset the impact of the residential component.

- The City of Bloomington has a fairly diverse revenue structure, as it receives property tax, sales tax and an income tax distribution from the state. It is important to note that local governments in some states have only one growth-related revenue source. Sales tax is by far the City's largest General Fund revenue source. Unfortunately for the City, sales tax is an elastic source of revenue (as is income tax) because consumer sales and personal income are affected more by economic shifts than property tax.
- The City has chosen to keep the property tax rate relatively low so that the School District will have an easier time going to the public on referendums for school construction. While this is admirable, this stance has placed stress on the City's ability to maintain levels of service in the face growth pressures and increasing capital maintenance needs, especially in light of the fact that approximately 45% of the City's Truth in Taxation levy goes directly to funding retirement benefits, social security contributions, and the fire and police pension funds. The percentage of property tax that will go to fund pensions, and social security will likely increase over time given the rate these costs are escalating relative to other City costs.
- Related to the bullet point above, there are signs of fiscal stress related to maintaining levels of service. The City has had trouble meeting road maintenance needs (like most cities) and has, at a minimum, approximately $11 million in unfunded capital needs as a result of annexations (City staff is in the process of inventorying these needs based on a review of past agreements).
- The City of Bloomington has had a somewhat aggressive annexation policy over time. Many of the City's annexations have involved non-contiguous parcels (known as "leapfrog" annexation), typically at the request of a developer. While contiguous annexation may allow for urban efficiencies of operation, leap frog annexation will create the disadvantage of stretching City services because of time and distance factors. Our discussions with City staff indicate this has certainly been the case in Bloomington.
- The City has assumed most of the risk associated with funding infrastructure related to recent annexation agreements. The City has essentially acted as the "banker" to the development community by "front-ending" roads and utility infrastructure in hopes of being reimbursed by the new growth at a later date.
- Because of the fiscal implications of annexation, the costs of providing municipal services must to be estimated and weighed against the anticipated revenues of areas proposed for annexation. This type of analysis is not something the City has utilized prior to entering into annexation agreements.

RECOMMENDATIONS

A summary of recommendations from our evaluation are listed below in order of priority:

- It is important for a community to understand the risks involved with approving a specific development proposal. It is also important for the City to understand the return on investment period for an annexation. Therefore, **TischlerBise feels the City's number one priority should be the development and implementation of fiscal impact model for use in evaluating the impact of annexations and other development proposals**. Understanding the fiscal impacts associated with various absorption schedules, or scenarios, will enable the City to negotiate an annexation agreement that involves a sharing of the risks between the local government and the developer.

- **TischlerBise feels strongly that the City should consider revising the methodology and structure of its sewer and water tap-on fees**. These fees are determined for each development on an ad hoc basis and are assessed per acre. The City should also include within the calculations the costs for system improvements such as water supply/treatment, storage and major lines that benefit new development. Currently, existing rate payers are subsidizing this cost for new development. A properly designed fee methodology would ensure the City captures its full share of growth-related capital costs. It would also take into account the likelihood of potential annexation areas and would separate out facilities that benefit the entire City versus those that strictly benefit new growth related to annexations, resulting in a tiered fee schedule. The City can use the fees as a revenue stream to reimburse the developer for their cost of oversizing sewer and water lines in exchange for development permission.
- Rather than assume the financial risk associated with the current practice of exacting a substandard road fee, **TischlerBise recommends the City revisit its policies related to site-specific infrastructure improvements associated with development projects**. The City's substandard road fee is meant to upgrade the roadway leading up to the proposed development, a cost that is typically borne by the developer as part of the exaction process for site-specific improvements.
- **On a somewhat related topic, TischlerBise recommends the City give strong consideration to the implementation of a citywide road impact fee structure through which the City assess the cost of providing systemwide capacity, including annexation-specific costs.** A portion of this impact fee or annexation fee could then be used as a revenue stream to reimburse developers for the cost of front-ending infrastructure as condition of development approval.
- As stated above, future growth will require nearly 6,000 acres of land for development, with the majority of acreage in residential land use. **The City should give serious consideration to preparing a fiscal impact analysis of future growth in the City to determine whether the proposed mix of uses is at a minimum, "fiscally neutral."**
- The currently has no dedicated capital funding sources other than park dedication fees and utility-related charges. **The City may want to consider having a long-term capital facilities funding**

strategy prepared that that evaluates capital needs (growth and non-growth), identifies alternative financing sources, and identifies potential funding scenarios.

Cost of Growth Analyses Defined

FISCAL IMPACT ANALYSIS

A fiscal impact analysis projects the net cash flow to the public sector (the local government and, in many cases, the school district) resulting from new development – residential, commercial, industrial, or other. A fiscal impact analysis is similar to the cash flow analysis a developer conducts in order to project costs and revenues likely to result from a proposed development. Just as a household benefits by forecasting its long-term cash flow needs (incorporating anticipated expenses for higher education and other large cost items) and setting money aside to pay for future outlays, local governments are better prepared for changing financial circumstances if they anticipate future costs and revenues.

Fiscal analysis enables local governments to estimate the difference between the costs of providing services for new development and the taxes, user fees, and other revenues that will be collected as a result of new development. Fiscal impact analysis can be used to evaluate the fiscal effect of an individual project (such as a request for rezoning), of a change in land-use policies (such as increasing allowable densities for development), or of a proposed annexation.

Fiscal impact analysis is one of many tools that can be used by local governments to make informed decisions about changes to land use regulations, proposed development projects or annexations. The combination of increasing service costs and resistance to tax increases is leading communities to ask more questions about the relationship of local budgets to land uses. An increasing number of local governments are requiring a fiscal impact analysis as part of the review of development proposals. Some local governments have even gone so far to established policies that new development be "fiscally neutral," or should result in a net positive impact on the local government's budget.

It is important to keep in mind that the fiscal impact of development policies, programs, and activities is only one of the issues that local government officials should consider when evaluating policy or program changes relating to land use and development. Land uses that are a financial drain or are less beneficial financially than other alternatives should not necessarily be excluded, since they may be necessary to the community's goals related to affordable housing, economic diversity, quality of life, etc. Moreover, localities have a responsibility to consider other impacts, too. Court cases have suggested that, in addition to fiscal impacts, local governments need to evaluate environmental impacts, regional needs for housing and employment, and other concerns. Nevertheless, fiscal impact data can be used as part of a larger cost-benefit analysis to craft a land use plan that incorporates the appropriate mix of land uses necessary to achieve fiscal sustainability.

How is a fiscal impact analysis different from what a budget or finance department does as part of its long-term financial planning or annual budgeting process? This is an excellent question and the differences are quite significant. First, local government budgets are fiscally constrained. That is, most local government budget/finance personnel look to past trends in order to project revenue going forward. As a result, operating and capital expenditures are constrained by the amount of revenue available. A fiscal impact analysis does just the opposite. It projects operating and capital costs without consideration of whether revenue is sufficient. The analysis then compares the revenue to costs to determine the fiscal impact. Second, TischlerBise projects operating and capital costs based on maintaining the jurisdiction's current levels of service for all facilities and services. This is an important assumption, as most local governments are not maintaining current levels of service across the board. Most local governments walk an annual budget tightrope that requires a substantial amount of compromise in order to balance the budget. For example, in order to increase the level of service for one program area, levels are reduced in another. Another common occurrence is the delay of growth-related capital facility projects or continued deferral of capital maintenance items (e.g. street resurfacing). As the above discussion indicates, projecting the cost of maintaining current levels of service can be a huge assumption.

Given the fact that each jurisdiction is unique in terms of demographics, budgetary structure, levels of service as well as growth pressures, TischlerBise recommends utilizing a case study-marginal approach in any fiscal impact analyses prepared for the City. This approach represents the true cash flow to the public sector since it considers what will be developed, along with service requirements that may vary by location.

In contrast to the average cost approach, which focuses on determining an average cost per capita multiplier, is the case study-marginal approach. This approach has greater accuracy in forecasting short to mid-term impacts of growth and policy decisions. Utilizing the Fire Department as an example, the average cost approach would divide the expenditure for fire services by population and possibly employment to arrive at a figure, say $21 per person. This cost would occur regardless of any spatial distribution. In contrast, the case study-marginal approach would reflect whether the Fire Department required additional space and apparatus to meet level of service times and responses. If new growth were primarily infill versus leap-frog development, the cost differential could be significant since in the former case there would be no additional cost for capital and associated personnel while in the latter case there might be a need for a new station with associated apparatus and personnel. A series of sensitivity evaluations would allow the client to understand whether any or all of proposed plans make sense from the perspective of timing and phasing. In addition to analyzing specific development proposals, TischlerBise could evaluate one or more growth scenarios for their fiscal impact on the community.

IMPACT FEES

Impact fees (sometimes referred to system development charges and capacity for utilities) are one-time payments that must be used solely to fund system improvements needed to accommodate new development. In contrast to project-level improvements, impact fees fund growth-related infrastructure that will benefit multiple development projects, or even the entire service area.

Impact fees have been utilized by local governments in various forms for at least fifty years. Impact fees do have limitations, and should not be regarded as the total solution for infrastructure financing needs. Rather, they should be considered one component of a comprehensive revenue portfolio to ensure adequate provision of public facilities and maintenance of current levels of service in a community. Any community considering impact fees should note the following limitations:

- Impact fees can only be used to finance capital infrastructure and cannot be used to finance ongoing operations and/or maintenance and rehabilitation costs;

- Impact fees cannot be deposited in the local government's General Fund. The funds must be accounted for separately in individual accounts and earmarked for the capital expenses for which they were collected; and

- Impact fees cannot be used to correct existing infrastructure deficiencies unless there is a funding plan in place to correct the deficiency for all current residents and businesses in the community.

There are three reasonable relationship requirements for impact fees that are closely related to "rational nexus" or "reasonable relationship" requirements enunciated by a number of state courts. Although the term "dual rational nexus" is often used to characterize the standard by which courts evaluate the validity of impact fees under the U. S. Constitution, we prefer a more rigorous formulation that recognizes three elements: "impact or need" "benefit," and "proportionality." The dual rational nexus test explicitly addresses only the first two, although proportionality is reasonably implied, and was specifically mentioned by the U.S. Supreme Court in the *Dolan* case.

The reasonable relationship language of the statute is considered less strict than the rational nexus standard used by many courts. We will use the nexus terminology in this feasibility report because it is more concise and descriptive. Individual elements of the nexus standard are discussed further in the following paragraphs.

Demonstrating an Impact. All new development in a community creates additional demands on some, or all, public facilities provided by local government. If the supply of facilities is not increased to satisfy that additional demand, the quality or availability of public services for the entire community will deteriorate. Impact fees may be used to recover the cost of development-related facilities, but only to the extent that the need for facilities is a consequence of development that is subject to the fees. The *Nollan* decision reinforced the principle that development exactions may be used only to mitigate conditions created by the developments upon which they are imposed. That principle clearly applies to impact fees. In this study, the impact of development on improvement needs is analyzed in terms of quantifiable relationships between various types of development and the demand for specific facilities, based on applicable level-of-service standards.

Demonstrating a Benefit. A sufficient benefit relationship requires that impact fee revenues be segregated from other funds and expended only on the facilities for which the fees were charged. Fees must be expended in a timely manner and the facilities funded by the fees must serve the development paying the fees. However, nothing in the U.S. Constitution or Illinois law requires that facilities funded with impact fee revenues be available *exclusively* to development paying the fees. In other words, existing development may benefit from these improvements as well.

Procedures for the earmarking and expenditure of fee revenues are typically mandated by the State enabling act, as are procedures to ensure that the fees are expended expeditiously or refunded. All of these requirements are intended to ensure that developments benefit from the impact fees they are required to pay. Thus, an adequate showing of benefit must address procedural as well as substantive issues.

Demonstrating Proportionality. The requirement that exactions be proportional to the impacts of development was clearly stated by the U.S. Supreme Court in the *Dolan* case (although the relevance of that decision to impact fees has been debated) and is logically necessary to establish a proper nexus. Proportionality is established through the procedures used to identify development-related facility costs, and in the methods used to calculate impact fees for various types of facilities and categories of development. The demand for facilities is measured in terms of relevant and measurable attributes of development. For example, the need for road improvements is measured by the number of vehicle trips generated by development.

Any one of several legitimate methods may be used to calculate impact fees. The choice of a particular method depends primarily on the service characteristics and planning requirements for the facility type being addressed. Each method has advantages and disadvantages in a particular situation, and to some extent can be interchangeable, because each allocates facility costs in proportion to the needs created by development.

Reduced to its simplest terms, the process of calculating impact fees involves two main steps: (1) determining the cost of development-related capital improvements, and (2) allocating those costs equitably to various types of development. In practice, though, the calculation of impact fees can become quite complicated because of the many variables involved in defining the relationship between development and the need for facilities. The following paragraphs discuss three basic methods for calculating impact fees and how those methods can be applied.

> **Plan-Based Impact Fee Calculation.** The plan-based method allocates costs for a specified set of improvements to a specified amount of development. The improvements are identified by a facility plan and development is identified by a land use plan. In this method, the total cost of relevant facilities is divided by total demand to calculate a cost per unit of demand. Then, the cost per unit of demand is multiplied by the amount of demand per unit of development (e.g. housing units or square feet of building area) in each category to arrive at a cost per specific unit of development (e.g., single family).
>
> The plan-based method is often the most workable approach where actual service usage is difficult to measure (as is the case with administrative facilities) or does not directly drive the need for added facilities (as is the case with fire stations). It is also useful for facilities, such as

streets, where capacity cannot always be matched closely to demand. The plan-based method is relatively inflexible in the sense that it is based on the relationship between a particular facility plan and a particular land use plan. If either plan changes significantly, the fees should be recalculated.

Cost Recovery Impact Fee Calculation. The rationale for the cost recovery approach is that new development is paying for its share of the useful life and remaining capacity of facilities from which new growth will benefit. This methodology is often used for systems that were oversized such as sewer and water facilities. To calculate an impact fee using the cost recovery approach, facility cost is divided by ultimate number of demand units the facility will serve.

Incremental Expansion Impact Fee Calculation. The incremental expansion method documents the current level-of-service (LOS) for each type of public facility in both quantitative and qualitative measures, based on an existing service standard (such as library square feet per capita or park acres per capita). The level-of-service standards are determined in a manner similar to the current replacement cost approach used by property insurance companies. However, in contrast to insurance practices, the impact fee funds would not be for renewal and/or replacement of existing facilities. Rather, the City will use the revenue to expand or provide additional facilities, as needed, to accommodate new development. An incremental expansion cost method is best suited for public facilities that will be expanded in regular increments, with LOS standards based on current conditions in the community.

Regardless of the methodology, a consideration of “credits” is integral to the development of a legally valid impact fee methodology. There is considerable confusion among those who are not immersed in impact fee law about the definition of a credit and why it may be required.

There are, in fact, two (2) types of “credits” each with specific, distinct characteristics, but both of which should be addressed in the development of impact fees. The first is a credit due to possible double payment situations. This could occur when contributions are made by the property owner toward the capital costs of the public facility covered by the impact fee. This type of credit is integrated into the impact fee calculation. The second is a credit toward the payment of an impact fee for dedication of public sites or improvements provided by the developer and for which the impact fee is imposed. This type of credit is addressed in the administration and implementation of an impact fee program.

Impact Fees in Illinois. Impact fees regulation in Illinois, while influenced by the *Dolan* U.S. Supreme Court case, is founded more squarely on a 1977 Illinois Supreme Court ruling. In *O.L. Krughoff et al. v. City of Naperville*, the state court held that impact fees could recover only those costs that are “specifically and uniquely attributable” to new development. A determination of “reasonableness” of the conditions imposed on developers will be based on the extent to which the need for improvement is specifically and uniquely attributable to the activity so as to justify casting the financial burden on the developer.

Overview of Bloomington Situation

BACKGROUND AND SETTING

The City of Bloomington is located in the heart of Central Illinois, approximately 125 miles southwest of Chicago, 155 miles northeast of St. Louis, and 64 miles northeast of Springfield, the State Capital. A 2006 special census indicated that Bloomington's population was 74,975. The City of Bloomington is one of the fastest growing metropolitan areas in Illinois with an estimated 20.25% increase in population between 1986 and 1995. Until the recent economic downturn, there was steady residential, industrial and commercial construction.

Although Bloomington is located in one of the most productive agricultural areas in the nation, the economy is diverse and well-balanced. A primary reason is that Interstates 39, 55 and 74 intersect at Bloomington, making the city a substantial transportation hub. US highways 51 and 150 and Illinois state route 9 also run through Bloomington. Bloomington is also serviced by two major railroad lines and Amtrak, as well as air transportation at the Central Illinois Regional Airport, one of the fastest growing airports in the country, which services commuter, corporate, and private aircraft.

DEVELOPMENT ACTIVITY

The City of Bloomington has seen substantial residential and nonresidential growth over the last two decades. As stated above, the 2006 population from the special census was 74,975. According to projections contained in the City of Bloomington Comprehensive Plan, the 2025 population is projected to reach 92,500. This represents an increase of more than 40 percent over the 2000 population of 64,808. Although quite robust, this projection reflects a declining growth rate from the peak that occurred during the 1990’s. The projections reflect an annual population increase of 1.75 percent from 2000 to 2010 and 1.25 percent from 2010 to 2025, as compared to an annual increase of 2.75 percent from 1990 to 2000. Given that these projections were developed prior to the nation’s current economic crisis, it is likely that these projections may still be a little aggressive.

According the City’s Comprehensive Plan, the City’s future growth is expected to require nearly 6,000 acres of land for development. The largest acreage requirement will be for residential development to meet the projected housing demand. The vast majority of this will likely be new low density, suburban development, with a relatively small, though significant, amount of infill and redevelopment. Significant amounts of commercial and industrial development are also projected, although proportionately less than residential growth. Our experience with Illinois jurisdictions indicate that unless the price points for residential are substantial, most jurisdictions need the revenue from nonresidential development to offset the costs of residential units. Therefore, it is in the City’s best interest to ascertain whether the anticipated nonresidential development is enough to offset the impact of the residential component.

OPERATING BUDGET OVERVIEW

The City of Bloomington has a fairly diverse revenue structure compared to many cities, as it receives property tax, sales tax and an income tax distribution from the state. It is important to note that local governments in some states have only one growth-related revenue source. Sales tax is by far the City's largest General Fund revenue source, totaling approximately $23.5 million (sales tax and home rule sales tax combined) in FY2010. Unfortunately for the City, sales tax is an elastic source of revenue (as is income tax) because consumer sales and personal income are affected more by economic shifts than property tax. As is the case with most jurisdictions, the City's sales tax receipts are projected to be lower than in previous years.

The City has also chosen to keep the property tax rate relatively low so that the School District will have an easier time going to the public on referendums for school construction. While this is admirable, this stance has placed stress on the City's ability to maintain levels of service due to growth pressures and increasing capital maintenance needs. Conversations with City staff indicate that property tax is decreasing over time as a percentage of the overall revenue. It is important to point out that approximately 45% ($8,917,187) of the City's Truth in Taxation levy ($19,541,834) goes directly to funding retirement benefits, social security contributions, and the fire and police pension funds. In contrast, only 30% ($5,791,114) of the City's Truth in Taxation levy actually goes to funding General Fund operations, which increases the burden on the City's sales taxes. The percentage of property tax that will go to fund pensions, and social security will likely increase over time, given the rate these costs are escalating relative to other City costs, which means less revenue for general city services.

CAPITAL BUDGET OVERVIEW

Discussions with staff indicate the City does not have a true Capital Improvement Plan (CIP). Rather, the City has what is known as a Capital Improvement Budget. The Capital Improvement Budget is prepared each year in conjunction with the annual Operating Budget. It generally includes only those projects from the first year of the Capital Improvement Plan that will be funded that year.

A Capital Improvement Plan usually covers a five to six-year period and identifies the needs of the community and includes the acquisition or construction of new infrastructure (fire stations, traffic signals, roundabouts, etc.) and projects that involve needed repairs or improvements to existing infrastructure (streets, parks, city facilities, sewers, etc.). A well-prepared CIP also identifies potential funding sources for each project. The current management team recognizes the need for preparing a Capital Improvements Plan and is taking steps to do so.

It is also worth noting that the City does not have a dedicated funding source for capital improvements other than park dedication fees and utility-related charges. Therefore, the City is in a position of funding only what it can afford with excess revenue on a year-to-year basis. The City may want to consider preparing a long-term funding strategy (including an evaluation of alternative financing sources) to meet those needs, as well as preparing a long-range Public Facilities Plan. A Public Facilities Plan provides facility recommendations based on an objective and equitable assessment of current and future needs throughout the City, including possible annexation areas. The Public Facilities Plan is long-term in nature, and fosters planning and programming of capital facilities in support of the Comprehensive Plan. The Public Facilities Plan is designed to function as a needs assessment for the annual CIP. A comprehensive approach integrates facility needs, siting criteria, and design issues with adopted land use plans and other planning concerns.

In summary, a Public Facilities Plan can be a valuable decision-making tool that:

- Uses growth projections to objectively identify the number and general location of public facilities needed over a 20-year period;
- Assesses the need for public facilities citywide, in developed and newly developing areas;
- Provides guidance for the Capital Improvements Program (CIP) and exactions;
- Provides a link between all city facilities plans (i.e. road plan) and the Comprehensive Plan;
- Identifies opportunities for land acquisition for facilities in advance of construction.

LEVEL OF SERVICE ISSUES

The majority of cities across the country are finding it harder and harder to fund city services and facilities at desirable levels. This is especially true for communities with revenue structures heavily reliant on sales taxes that have fallen during the nation's recent economic downturn. In addition, some states (Illinois included) impose limitations on the real growth of the value of the existing property base.

Interviews with City staff and our review of budget materials indicate there are signs of fiscal stress related to maintaining service levels. For example, conversations indicate that the City's General Fund unrestricted reserve fell below $3 million and the Sewer Enterprise Fund currently has an unrestricted fund balance deficit. In another example, the City recently constructed a fire station on the southwest fringe of the City and chose not to open it given the anticipated operating impacts as well as increasing response time needs in the northeast portion of the City. And like many communities, the City is struggling to keep up with street maintenance needs.

Another topic worth noting is the structure of the City's sewer and water tap-on fees, which are intended to cover the cost of extending distribution and collection trunk lines. Our understanding is that these fees are determined for each development on an ad hoc basis rather than the standard practice of having a set schedule by equivalent residential unit or by size of meter like is done with traditional connection/capacity charges or impact fees. The tap-on fees do not contain a cost factor for system capacity such as treatment, storage or supply. This results in a situation where the existing utility customers are subsidizing the capacity needs generated by new growth. A similar situation exists with the substandard road fee, which does not contain a cost component for system capacity.

Like most cities in the country, Bloomington hasn't been keeping pace with its street maintenance needs. Staff estimates it will take $46 million to bring the system needs up to a high quality standard.

ANNEXATION AGREEMENTS

The City of Bloomington has had a somewhat aggressive annexation policy over time. The major advantages of annexation include the ability of the City to control growth in close proximity. This not only includes the use and density of the new development but also the building standards. The onsite improvements required for housing in the City are likely to be significantly higher than standards in the unincorporated county. Finally, another advantage is that annexation could allow for urban efficiencies of operation. However, this is dependent on the pattern of annexation. Many of the City's annexations have involved non-contiguous parcels, typically at the request of a developer, and can be classified as "leapfrog" annexations. While contiguous annexation may allow for urban efficiencies of operation, leap frog annexation will create the disadvantage of stretching the City services because of time and distance. This inefficiency of cost can manifest itself in the provision of capital facilities, particularly utilities and roads, as well as operations, particularly public safety. Our discussions with City staff indicate this has certainly been the case.

Because of the fiscal implications of annexation, the costs of providing municipal services must be estimated and weighed against the anticipated revenues of areas proposed for annexation. This type of analysis is not something the City has utilized prior to entering into annexation agreements. By way of example, a review of the City's unfunded capital liabilities related to annexations totals a little over $11 million.

Another issue related to annexation is the annexation agreements themselves. The use of formal agreements between landowners and local governments regarding the use of land has increased dramatically in the last forty years. An annexation agreement is similar to a development agreement with the exception of the fact that the land in question resides outside of the incorporated municipal boundary. Otherwise, the theory and principal reason for negotiating such agreements are essentially the same. The landowner generally wishes to guarantee that a local government's land use regulations, conditions and exactions remain fixed during the life of a prospective land development on the subject parcel. The local government seeks as many concessions and land development conditions as possible beyond what it could reasonably require through subdivision exactions, impact fees and other conditions through the normal exercise of its regulatory authority or police power.

Cost sharing on infrastructure provision is an essential aspect of the negotiations, and provisions for cost sharing must be explicitly set forth in the annexation agreement. The agreement must include a description of any new public facilities that will serve the development, who will pay, and a schedule of when facilities will be provided. The goal is to ensure infrastructure will be available concurrently with the impacts of development. Our understanding is that the City has taken on most of the risk associated with funding infrastructure related to recent annexation agreements. The City has traditionally "front-ended" and oversized roads and utilities for annexation agreements versus the developer. The following are some of the issues associated with these annexation agreements noted during our onsite visit:

- The City waived all development-related fees (approximately $900,000) for the Cedar Ridge subdivision in the name of affordable housing;

- Because of an insufficient traffic analysis during the review and approval of The Grove development, the City is on the hook for the turn lane required for the proposed school site;

- Because the City's substandard road fee is based on linear feet of road frontage abutting the subject property, the same developer was able to circumvent the requirements by strategically placing park land and a school site along the perimeter of the property, resulting in no fee requirement.

As mentioned above, the City assumes most of the risk in previous annexation agreements and in many ways can be viewed as the "banker" in these agreements. For example, the City's substandard road fee only provides for the upgrade of one side of the affected road. Interestingly, the type of improvement this fee is intended for is typically part of the site-specific improvements a developer is required to make in most communities. More importantly, the City does not collect the fee in advance. The fee is owed to the City only after the City has made the upgrade. In many cases, the developer does not have to pay the fee if the City does not provide the upgrade within a certain time frame. A somewhat similar situation exists with sewer and water where the City oversizes the water or sewer main and the collects tap-on fees from future development.

In both situations described above, the City assumes most or all of the risk. This is somewhat unusual when compared to what TischlerBise sees in most communities around the country, particularly in situations where the developer is coming to the City and requesting annexation on parcels that are not contiguous to the City's municipal boundaries. In these situations cities usually require the developer to upfront the cost of infrastructure (both site specific and system improvements), with reimbursement for the system improvements (capacity or oversizing) through future tap-on fees and road impact fees.

Suggested Next Steps

As part of this cost of growth feasibility analysis, TischlerBise met with City staff as well as the City Council to talk about growth and budgetary issues facing the City. These meetings were intended to provide TischlerBise with the background information for this analysis, but also solicit input to determine exactly what types of questions the City would like to have answered as part of any consulting activities. Below are several work efforts TischlerBise suggests that the City undertake in order to address the development/fiscal-related issues that were discussed.

INCORPORATE FISCAL ANALYSIS IN THE REVIEW OF ANNEXATION AGREEMENTS

The first step in evaluating an annexation agreement is to determine the development's type and magnitude. Will the project result in a mixed-use development or will it be entirely residential? Once the development type has been determined the number of development units must be defined (i.e. number of housing units by type, amount of nonresidential development by type, etc.). The type of development will, for the most part, determine both the revenue generated and the required services and facilities. Gathering as much information as possible about the expected development will help generate more accurate fiscal evaluations. Once the development potential has been defined, the annexation's expenditure and revenue characteristics can be determined. A fiscal impact analysis must account for all service costs over the analysis period. Costs should include any expense the government would incur if the development moved forward. Similarly, any costs that would have occurred without the development should not be included.

The importance of evaluating development projects over the extended period of time cannot be stressed enough. Too many fiscal analyses just indicate the cumulative impacts over the development period, which is typically 20—25 years. One important consideration for fiscal impact analysis is the timing of any additional cost or revenue stream. While a project may ultimately have a positive net effect on government finances, this may not be the case initially. It is important that local government decision-makers understand the cash flow between years 1 and 25. Often, developments take years to realize benefits, while costs are incurred early in the project.

It is important for a community to understand the risks involved with approving a specific development proposal. It is also important for the City to understand the return on investment period for an annexation. **Therefore, TischlerBise feels the City's number one priority should be the development and implementation of fiscal impact model for use in evaluating the impact of annexations and other development proposals.** Understanding the fiscal impacts associated with various absorption schedules, or scenarios, will enable the City to negotiate an annexation agreement that involves a sharing of the risks between the local government and the developer.

CONSIDER REVISING METHODOLOGY AND STRUCTURE OF ONE-TIME CAPITAL CHARGES

TischlerBise feels strongly that the City should consider revising the methodology and structure of its sewer and water tap-on fees. The City's water and sewer tap-on fees are intended to cover the cost of extending distribution and collection trunk lines. These fees are determined for each development on an ad hoc basis and are assessed per acre. Although these fees are referred to as tap-on fees, they are really a form of a capacity charge or system development charge intended to cover the cost of collection and distribution.

TischlerBise feels it is in the best interest of the City to revert to a standard approach for covering the growth-related capital costs for water and sewer. The City should also include within the calculations the costs for system treatment, storage and supply from which new development will benefit from. Currently, existing rate payers are subsidizing new development. There are several benefits that will accrue to the City from a standard impact fee or system development charge approach. They are as follows:

- A standardized fee schedule by meter size or equivalent residential connection (ERU) will make for easier administration for the City;
- A standardized fee schedule also adds some degree of certainty for the development community as the development costs are known and can be factored into their pro forma early on;
- The City can use the fees from this fee schedule as a revenue stream to reimburse the developer oversizing sewer and water lines in exchange for development permission;
- A properly designed fee methodology would ensure the City captures its full share of growth-related capital costs. It would also take into account the likelihood of potential annexation areas and would separate out facilities that benefit the entire City versus those that strictly benefit new growth related to annexations, resulting in a tiered fee schedule.

TischlerBise recommends the City reconsider the way it handles site-specific road improvements. The City's substandard road fee is meant to upgrade the roadway leading up to the proposed development, a cost that is typically borne by the developer as part of the exaction process for site-specific improvements. In addition to the previous point, there are several other problems with the methodology and fee structure:

- The fee only covers the cost of one lane of the roadway and is not collected until after the City constructs the upgrade. As a result, the City assumes the risk and costs associated with this upgrade as well as the upgrade of the second lane.
- The fee is based on linear feet of road frontage which means only parcels fronting the road in question are assessed. Interior parcels are not assessed although they benefit from the road improvement. As a result, there is no proportionality relative to demand.

- Nowhere in this fee structure is the City capturing the cost of off-site system capacity required to serve new development, which is likely to be greater than the average given the non-contiguous nature of many annexations.

Rather than assume the financial risk associated with the current practice of exacting a substandard road fee, **TischlerBise recommends the City revisit its policies related to site-specific infrastructure improvements associated with development projects**.

On a somewhat related topic, TischlerBise recommends the City give strong consideration to the implementation of a citywide road impact fee structure through which the City assess the cost of providing systemwide capacity. A citywide transportation impact fee calculation would use vehicle trips and/or vehicle miles of travel as the indicator of demand for growth-related transportation improvements. These demand indicators would then be used to determine the cost per unit of trip capacity, with an overlay for potential annexation areas. A portion of this impact fee or annexation fee could then be used as a revenue stream to reimburse developers for the cost of front-ending infrastructure as condition of development approval.

EVALUATE WHETHER THE CURRENT LAND USE PLAN IS FISCALLY SUSTAINABLE

As stated in a previous section, the City's future growth will require nearly 6,000 acres of land for development, with the majority of acreage in residential land use. The vast majority of this will likely be new suburban development, with a relatively small, though significant, amount of infill and redevelopment. Our experience with Illinois jurisdictions indicate that unless the price points for residential are substantial, most jurisdictions need the revenue from nonresidential development to offset the costs of residential units. **The City should give serious consideration to preparing a fiscal impact analysis of future growth in the City to determine whether the proposed mix of uses is at a minimum, "fiscally neutral."**

EVALUATE LONG-TERM CAPITAL FUNDING OPTIONS

It was noted that the City does not have a dedicated funding source for capital improvements other than park dedication fees and utility-related charges. Therefore, the City is in a position of funding only what it can afford with excess revenue on a year-to-year basis. The City may want to consider preparing a long-term funding strategy (including an evaluation of alternative financing sources) to meet those needs.