WHITE BEAR ANKELE
TANAKA & WALDRON
ATTORNEYS AT LAW

MEMORANDUM

TO: Mike Sawyer

FROM: William P. Ankele, Jr.

DATE: April 15, 2024

RE: Responses to April 10, 2024 Service Plan Comments

This Memorandum addresses comments transmitted by e-mail from Mike Sawyer on April 10, 2024, primarily concerning Exhibit B (Infrastructure Cost Estimates) and Exhibit C (Financing Plan) to the draft Consolidated Service Plan for the Battle North Metropolitan District Nos. 1-4.

All of the material comments in the April 10, 2024 email are addressed below. There are some comments that were not addressed, either because they have already been incorporated in the revised Service Plan, or as otherwise covered in other responses.

Specific changes to the Service Plan incorporating responses to certain comments have already been made to the draft submitted for consideration on April 17, 2024.

<u>Exhibit B Comments and Responses</u>

1. Without a conceptual development plan it is difficult to know whether the $51 MM of improvements is within the ballpark of what it will cost to install the necessary improvements for the development.

   Response:

   The main components of the plan are based on the following:

   - *Improvements to the existing Maloit Road and the Maloit Road entrance.*
   - *Necessary utilities and services which primarily include water and sewer, and for which we have a process in place with ERWSD and the Town.*
   - *Improvements will adhere to the Town Code.*
   - *During the subdivision process, public improvements that are proposed will be presented to the Town for comment.*

2. It appears as though the estimate of costs has some sort of escalator built in. It would be beneficial to understand how the individual line items are calculated. As an example in Phase I, Line S1 shows a quantity of 9,000 LF at $91/LF, which equates to $819,000, but the cost is shown as $941,850. This is prevalent through all of Exhibit B.

   Response:

   A 15% escalation factor was built into each line-item cost.

3. Phase I of the development Line R12 identifies $1,000,000 for a Public Transportation Bus stop, justification would be appreciated.

   Response:

   We have understood that public transportation which could help reduce traffic through Town was an important consideration to the Town. A more robust public transportation hub in this area of Town may improve overall public transportation participation rates. During the subdivision process, improvements that are proposed will be presented to the Town. Cost estimates will be included with the subdivision submittal for any proposed public improvements.

4. Phase I of the development Line R11 (the second R11) identifies $2,000,000 for Hwy 24 improvements, justification would be appreciated.

   Response:

   There are multiple users that use this entrance. Coordination between all users will be required to determine if any improvements are needed. During the subdivision process, improvements that are proposed will be presented to the Town. Cost estimates will be included with the subdivision submittal for any proposed public improvements.

5. Phase I of the development Line A6 at 1.0% likely does not provide adequate construction observation services.

   Response:

   Cost estimates will be included with the subdivision submittal for any proposed public improvements. Currently, there are separate line items for construction testing, surveying and civil engineering. The 1% budget for other construction observation should be adequate for this limited work.

6. Phase I of the development Line A7 at 12% may not provide adequate contingency.

Response:

We feel the 12% contingency, combined with the 15% escalation factor should be adequate. Cost estimates will be included with the subdivision submittal for any proposed public improvements. We have allowed for an increased contingency of 30% for phase II work.

7. Phase II of the development Line R12 identifies $1,000,000 for a Public Transportation Bus stop, justification would be appreciated.

Response:

We have understood that public transportation which could help reduce traffic through the Town was an important consideration to the Town. A more robust public transportation hub in this area of the Town may reduce traffic through the Town. During subdivision review, improvements that are proposed will be presented to the Town. Cost estimates will be included with the subdivision submittal for any proposed public improvements.

8. Phase II of the development Line R11 (the second R11) identifies $1,000,000 for Hwy 24 improvements, justification would be appreciated.

Response:

There are multiple users that use this entrance. Future uses along Tigiwon Road will also need to be considered. Coordination between all users will be required to determine if any improvements are needed. During the subdivision process, improvements that are proposed will be presented to the Town. During this period, cost estimates for any proposed public improvements will be presented to the Town.

9. Phase II of the development Line A6 at 1.0% likely does not provide adequate construction observation services.

Response:

Cost estimates will be included with the subdivision submittal for any proposed public improvements. Currently, there are separate line items for construction testing, surveying and civil engineering. The 1% budget for other construction observation should be adequate for this limited work.

10. Phase II of the development Line A7 at 30% should be justified as to why.

Response:

A larger contingency was used for Phase 2 as the scope of this phase is less defined than Phase 1 which had a smaller contingency.

Exhibit C Comments and Responses

1. The Town may want to require the proponent to show current comparable issues of high-yield debt to justify the proposed 5.00% interest rate for the first issue and a 4.00% interest rate for the second issue.

   Response:

   The response to this question comment is combined with the response to #2. See below.

2. The Town may want to require the proponent to show comparable issues of a similar nature that have a debt service coverage rate of 1.0x and ask for comment on the realistic ability to market debt to investors at this rate.

   Response to #1-2:

   The general intent of Service Plan financial models is to estimate potential bonding capacity under favorable market conditions, with the goal of providing structural flexibility to the Districts at the time any of them choose to raise capital for funding infrastructure. The underwriting assumptions in all Service Plan financial models, including those submitted here, always vary from current market conditions, as they are built from ideal market assumptions to set a ceiling under which the Districts may bond.

   The assumptions, however, do have precedent in the public bond markets. For example, under strong market conditions such as those seen in 2021, rates for early stage nonrated cashflow bonds, similar in structure (1.0x debt service coverage and 6% biennial reassessment) to those submitted with this Service Plan, were in the mid-4.0% range.

   Examples of publicly sold bonds structured this way include:

   - *Jay Grove MD (Erie, Boulder County) – Series 2021 Bonds – $8.470M – Senior Cash Flow Bond sized on 6% biennial appreciation, sized on 1.0x debt service coverage, coupon/yield of 4.250%*

   - *Lanterns MD No. 1 (Castle Rock, Douglas County) – Series 2021 Bonds – $25.482M – Senior Cash Flow Bond sized on 6% biennial appreciation, sized on 1.0x debt service coverage, coupon/yield of 4.500%*

   - *Greenways MD No. 1 (Colorado Springs, El Paso County) – Series 2021 Bonds – $17.386M – Senior Cash Flow Bond sized on 6% biennial appreciation, sized on 1.0x debt service coverage, coupon/yield of 4.625%*

   - *Bradley Heights MD No. 2 (Colorado Springs, El Paso County) – Series 2021 Bonds – $35.000M – Senior Cash Flow Bond sized on 6% biennial appreciation, sized on 1.0x debt service coverage, coupon/yield of 4.750%*

- *Cielo MD (Douglas County) – Series 2021 Bonds – $17.942M – Senior Cash Flow Bond sized on 6% biennial appreciation, sized on 1.0x debt service coverage, coupon/yield of 5.250%*

- *Villages at Murphy Creek (Aurora, Arapahoe County) – Series 2021 Bonds – $12.358M – Senior Cash Flow Bond sized on 6% biennial appreciation, sized on 1.0x debt service coverage, coupon/yield of 5.500%*

The bonds issued by these Districts will be structured to reflect market conditions at the time of borrowing, and they will be sold at rates demanded by investors in that particular market at that particular time of pricing. Stronger market conditions will equate to lower rates and a potentially higher bond size, while weaker market conditions will translate to higher rates, more conservative structures and a lower bond size. In no case will the Districts ever exceed its authorized Service Plan debt limit.

3. Any slowdown in absorption or value of development would impact the ability of the district to pay back its debt in a timely manner.

Response:

A slowdown in development does have the potential to reduce the amount of revenue available to repay debt. However, the risk associated with a slowdown in the pace of development is transferred to the bond investors through a 50 mill cap on debt service taxes. The only obligation of the Districts is to levy the 50 mills through the debt service mill levy imposition term.

4. Based on the nature of the proposed debt issue, the inflationary increase in home values, will result in taxpayers having a permanent 50.00 mill levy on their properties, which will result in a 6.00% tax increase biennially.

Response:

The mill levy that is imposed on homes located within the boundaries of the Districts will be dependent on the amount of public infrastructure that the Districts finance through debt and market conditions at time of issuance. It is also common for metropolitan districts to refinance early-stage debt that was critical to fund upfront horizontal public infrastructure at more favorable lending terms once the district has built out and credit quality has improved. This allows the district to reduce the mill levy pledged to debt service payments.

The appreciation in home values is driven by local market conditions and not assumptions included in bond underwriting. While the market has accepted a biennial appreciation rate that is between 2% and 6%, historically home values in Colorado have appreciated at biennial rates ranging from 6% to 8% over the past 20 years.

5. The average price of a home is identified at $1,850,000, which will have an added tax bill of $6,615/year to cover the costs of the MD. As mentioned above, that amount will increase by 6.00% biennially.

Response:

As noted above, the biennial appreciation rate will be driven by local market conditions and not the assumptions used to underwrite bonds issued by the Districts.

6. The plan does not include any detail of the annual operational costs of the district, simply identifies that the first-year costs will be $100,000. The proponent should provide detailed maintenance costs for the improvements that will remain the responsibility of the districts to ensure a 10-mill levy will be adequate.

Response:

The Special District Act requires that the Service Plan include a non-binding estimate of operating costs in the first year of organization. The $100,000 figure is one that is commonly used in Service Plans throughout the State and is intended only to meet the statutory requirement. Actual operating costs for the first year (and beyond), will be determined year by year.

7. There should be further explanation of what infrastructure will be turned over/dedicated to the Town and what infrastructure will be maintained by the district.

Response:

Infrastructure being dedicated to the Town or the Districts will be determined in the future based on Approved Development Plans by the Town.

8. Section VI, Sub F discusses the District Operating Costs and identifies that the initial 10-mill levy for operations. The section further states that the district has the "…ability to increases its mill levy as necessary for provision of operation and maintenance services…". There may need to be some legal interpretation related to this ability without a vote of the taxpayers.

Response:

Appropriate election questions will be posed that will cover the need for operations taxes, and so no legal interpretation will be needed.

Financial Plan Conclusion Comments and Responses

1. While the plan identifies that there will be adequate resources to discharge the debt proposed to be issued by the districts, at a 1.0x coverage for debt service, there is ample concern that the district will not cashflow.

   Response:

   As noted above, the general intent of Service Plan financial models is to estimate potential bonding capacity under favorable market conditions, with the goal of providing structural flexibility to the Districts at the time any District chooses to raise capital for funding infrastructure. The underwriting assumptions used to structure the bonds that will be eventually issued by a District will be dictated by market conditions at that time. As indicated in the sample transactions outlined above, there is significant market precedent for bonds structured with 1.0x debt service coverage and assuming 6% biennial reassessment.

2. Further, without more detailed plans of the development to determine the actual costs of development and then a better estimation of full build-out operational costs, it is very difficult to draw any concrete conclusions as to whether the district has the financial wherewithal to successfully discharge the proposed debt and operate the districts.

   Response:

   The Service Plan is intended to set a ceiling for debt issuance prior to any development being achieved. The market will further constrain the Districts' future debt issuances; bonds will be sized according to market conditions and revenue projected by a market study at the time of issuance. Investors will not purchase bonds that cannot be repaid. It is often the case that bonds issued by metro districts are not able to fully reimburse the developer for eligible public improvements due to market conditions at time of pricing.

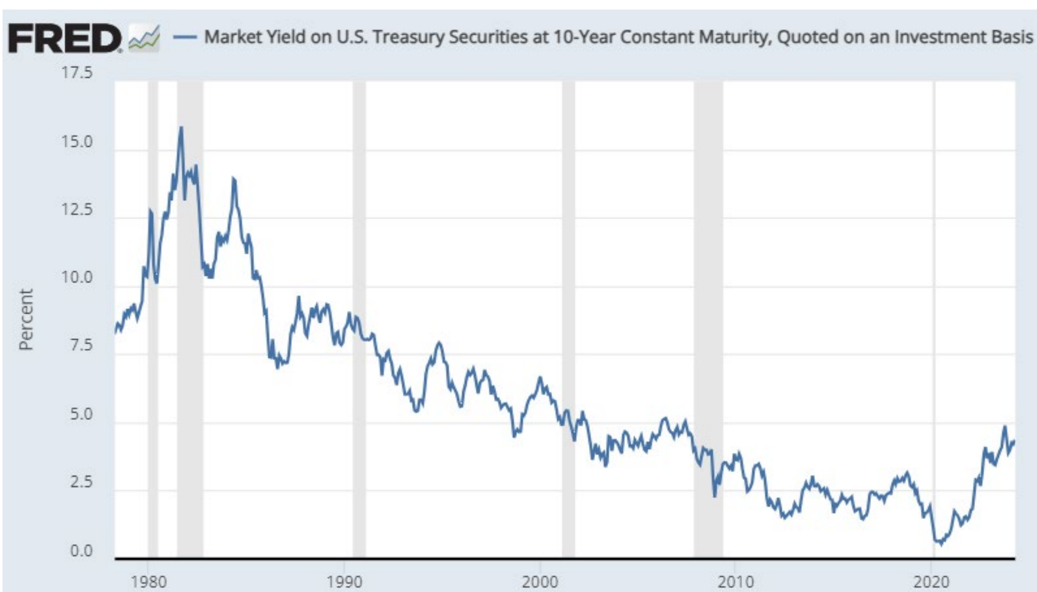
   Furthermore, any bond issuance will require a Market Study be performed to demonstrate that the debt to be issued can, under reasonable development assumptions, be paid according to its terms.

Other Selected Comments and Responses

1. Section VI sub B and C– a maximum interest rate on debt of 18% would be untenable for the project. Would recommend that the number be capped at 10% unless expressed written permission is granted by the Town. I would also suggest that the maximum interest rate also be applied to any proponent held debt. Also, should contemplate what the maximum interest rate would be on advances by the proponent to the development.

   Response:

   The revised Service Plan specifies a maximum interest rate of 15%, rather than 18% as originally drafted, which is believed to be reasonable. The intent of the Service Plan is to provide structural flexibility to the Districts at the time any District chooses to raise capital for funding infrastructure. The maximum interest rate on debt issued by the Districts of 15% is less than the 18% that is a widely accepted assumption in Service Plans adopted throughout Colorado. It is also important to note that the potential scope of this Service Plan is 40 years and while current interest rates are high relative to recent lows over the past few years, we are still in a relatively low interest rate environment when compared to rates over the past 40 years. As an example, the 10-year Treasury note, which is a benchmark rate in the municipal bond market, is currently sitting at just under 4.60% (as of April 11, 2024). That is nearly the highest 10-year Treasury note rates have been when compared to rates over the past five to 10 years. However, when compared to rates over the past 30 to 40 years, that were as high as nearly 16% in the early 1980s, we are still in a relatively low rate environment.



2. Section VI – "The maximum issuance fees and expenses will not exceed three percent (3%)."

Response:

Service Plans statewide generally establish an upper limit on the underwriting discount ranging from 3% to 5%. There is little to no precedent in capping fees for other consultants, which would severely limit the Districts' ability to engage the consultants they choose as necessary to issue debt. In order to issue debt in the public market, consultants with a high-level of experience in these types of transactions, which are nuanced and extremely complex, are necessary. Additionally, the market requires certain features in these transactions, including independent market studies and cashflow forecasts, which are not requirements in other transactions in the broader municipal bond market. The total fees charged by the consultants necessary to draft the offering document range depending on the complexity of the transaction and market conditions at time of issuance. Setting a cap here has the potential to severely limit the Districts' ability to issue bonds in the future.