

# **Review of Proposed Trappe East Development Issues**

Prepared for Friends of Trappe

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## **Purpose and Overview**

This is a review of the various documents (plans, reports, ordinances, resolutions, meeting minutes and agreements) related to the Trappe East development plan (also known as “Lakeside”) on behalf of Friends of Trappe. The purpose of the review is to identify any issues that could adversely affect the Town of Trappe and its current residents. The review included a fairly complete record of the main documents related to this project from 2002 to 2006; however, there were some missing documents that Friends of Trappe was unable to obtain from the city. Therefore, there may be some additional relevant information that could affect the findings of this review.

There are two generalized models to compare this development plan with. One is the “incremental expansion model,” where a larger town routinely expands and extends infrastructure to accommodate ongoing, modest-scale development. This is the common model where the size of the existing town and its tax base greatly exceed the size of the new development and the infrastructure costs associated with it. In this case the risks to the town of funding the new infrastructure are relatively small because failure of a development will not severely impact the town and because the town can reasonably expect development to proceed at some point in the near future. However, due to the fact that the size of the proposed Trappe East development would dwarf the Town of Trappe, this model is not a good fit.

The second model is the “new town” where everything is built from scratch. In this model, the developer has substantial financial backing and funds all new infrastructure. There is no town government to issue bonds, so all funding comes from the private sector. The developer and his financial backers take all the risks associated with the development and receive all the profits that may result. Infrastructure costs are recovered through real estate sales. Two regional examples of new towns are Columbia, Maryland and Reston, Virginia. Both towns failed financially for the original investors due to the high initial costs for building the necessary public infrastructure.

Trappe East is closer to the new town model, in that the development will become a virtual new town with all-new, dedicated infrastructure. While the overall development plan fits the new town model, the public financing of the project infrastructure is that of the incremental expansion model. This raises the question as to whether it is reasonable for the Town of Trappe to assume this magnitude of cost and risk, or whether the developer should be assuming a greater share. Generally the party that assumes the cost and risk is the party that receives the benefits or profits. In this case, the Town and its current residents are unlikely to see any significant benefits from the development and may, in

fact, incur significant costs.<sup>1</sup>

## **Who Pays for the Public Facilities for Trappe East?**

The 2003 *Annexation Agreement* for the 924 acres comprising the proposed Trappe East development clearly states that the developers will pay all costs associated with the public facilities required by the development, including building all roads, all sewer mains and sewage treatment facilities, all water supply and delivery systems, and a public works building.<sup>2</sup> In *Section 5: Public Facilities Agreements*, it states:

*All costs occasioned by the development of the Annexation Property shall be borne by the Assignees or Respective Property Owners (as defined in Section 5.2 hereof), and no costs shall be borne by the Town.* [Section 5, page 7]

And in Section 5.2 it states:

*Petitioners and the Town agree that only those Petitioners who are owner(s) or contract purchasers of the parcel(s) being developed, and/or served by Town water and/or sewer after the date of this Agreement, are responsible for the obligations and costs outlined in this Section 5. The phrase "Respective Property Owners" shall refer to such owner(s) and contract purchaser(s).* [Section 5.2, page 8]

As an example of the unambiguous nature of the language in the Annexation Agreement, it states:

*Sewer and Water. To the extent that public utilities related to providing water and sewer service to the Annexation Property will be necessary or required by the Town to meet the utility service requirements within the Annexation Property, the Respective Property Owners will construct or cause to be constructed, at their sole expense, such public sanitary sewer and water utility extensions or improvements, in accordance with the standards and specifications of the Town.* [Section 5.2(b), page 9]

No mention is made of the Town paying for these costs or facilities. Nor is any mention made of the Town reimbursing developers for these expenses. Funding of public improvements by the developers is consistent with documents from 2003 through March of 2006. The position that the developers will pay for all the

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<sup>1</sup> See *Review of the Fiscal Impact Analysis for Proposed Trappe East Development*, Prepared for Friends of Trappe, by Fodor & Associates, June 12, 2007.

<sup>2</sup> See pages 8-13, *Annexation Agreement and Public Facilities Agreement*, February 5, 2003.

facility costs is also found in the *PUD Plan*<sup>3</sup> of May 2004, a subsequent Annexation Agreement<sup>4</sup>, the *Development Rights and Responsibilities Agreement* (DRRA)<sup>5</sup> of March 2006, and on the Town's current web site.<sup>6</sup>

However, in April 2006 (approximately one month after the DRRA is approved), the developers petitioned the Town for a special tax district so that the Town can raise up to \$60 million through special obligation bond sales to pay for all the infrastructure needed by Trappe East. It is clear from the developers' April 21, 2006 application for the special tax district, that the Town is now to become responsible for paying for all of the infrastructure that the developers build.<sup>7</sup> The Town is also to compensate the developers for all public lands, including parks and open space in the development. This appears to be a complete reversal from the original position where the developers pays all costs, to the current position where the Town is to pay all costs.

*Ordinance 11-2006* creating the Lakeside Special Tax District must comply with all local laws at the time it is enacted. The Annexation Agreement, approved by voters, is a legally-binding document. Since the Annexation Agreement requires that all costs are paid by the developers, there may be grounds for legal challenges to the special tax district and bond issue for failing to conform to the Annexation Agreement.

The public facilities required to serve the proposed Trappe East development are described in the DRRA and the Special Tax District Ordinance. They include:

- New water tower, water treatment, water storage and water distribution facilities;
- Wastewater treatment facility, spray field and wastewater collection system;
- Wastewater administrative facility and lab;
- Parks, open space and construction of lake (recreation facilities not mentioned);
- Roads, curbs, gutters and sidewalks;
- A new public works facility and associated equipment (to serve Lake District);
- New Town administrative facility and associated land (to serve Lake District);
- Expansion of the fire station;

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<sup>3</sup> *Trappe East PN District PUD Plan Narrative*, May 19, 2004 (see the attached "Management Statement," dated 5/18/2004, which specifies developer to build all facilities.).

<sup>4</sup> *Annexation Agreement and Public Facilities Agreement* 8-11-2004, Section 4.

<sup>5</sup> *Development Rights and Responsibilities Agreement*, March 1, 2006 (recorded 3/17/2006).

<sup>6</sup> The current citation from Town web site is included here as *Attachment 1*.

<sup>7</sup> See *Ordinance 11-2006*, which contains *Description of the Public Facilities* (labeled "Exhibit C") in the April 21, 2006 application, as well as the letter to the Town bearing the same date from the developers (labeled "Exhibit 2").

- Fire hydrants and valves;
- Expansion of police force and equipment (station not mentioned);
- Expansion of Town administrative staff to process development applications;
- Stormwater management facilities;
- Engineering and lighting;
- Other public improvements, including the acquisition of land and equipment necessary for development.

## **Special Tax District Considerations**

To create a funding mechanism to pay for the public facilities in Trappe East, the Town Council passed Ordinance 11-2006 creating the “Lakeside Special Taxing District” and endowing it with the authority to raise and spend up to \$60 million through the sale of bonds. Bonds would be repaid through a formula of annual assessments per dwelling unit or parcel within the district. As discussed below, it is not clear that the revenue formula will be adequate to cover bond repayment even though this is required by State law.<sup>8</sup>

A “special tax district” or “local improvement district” is normally an equitable method for generating revenues from a geographic district that reimburses the costs incurred by a municipality for constructing capital improvements □ such as adding sewer mains, sidewalks, street upgrades, etcetera □ that directly benefit the district. This method is used to keep localized costs out of the general tax base by having the beneficiaries of the investment pay the full cost. However, in the case of the Lakeside Special Taxing District, there are some special considerations due to the magnitude of the cost (relative to the small existing tax base) and the apparent financial risk borne by the Town and its current taxpayers, as discussed later.

## **Will the Current Plan Guarantee Bond Repayment?**

Town Ordinance 11-2006 creates the “Lakeside Special Taxing District,” caps the bond amount at \$60 million, and projects the initial bond issue amount to be approximately \$50 million (see Table C, page 5 of Exhibit 2 of the Ordinance).

According to the Special Tax District ordinance, no payment would be made by Trappe East land owners on the bonds during the first 2.5 years while the construction is underway. The payments on the bond during this 2.5-year period would instead be made with the money raised by the bond. This “capitalized interest” amounts to \$5.4 million in additional cost and is included in the initial \$50 million bond amount. Also included in the bond issue is a \$5 million reserve fund, which might be used to pay for cost overruns and/or delays in

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<sup>8</sup> See *Annotated Code of Maryland*, Article 23, Section 44A, Subsection (e)(iii).

construction.

The Special Tax District includes a restrictive bond repayment formula that sets caps on the amount that new lots in the Trappe East subdivision must pay. The Town Council may set the annual tax at any rate, up to the cap. However, the revenues generated by the development do not appear adequate to meet the bond repayment expenses, even if all 2,501 residential units are developed and the maximum tax rate is applied.

As shown in Table 1, based on the tax caps in the Town Ordinance, the maximum possible special tax revenue that can be generated from the Trappe East development is \$3,466,306 per year. This amount will be generated only if all 2,501 units are built. This revenue is \$300,000 to \$500,000 short of the cost required to repay a \$50 million bond at either a 6.5 percent or 7 percent interest rate, as shown in Table 2. Therefore the repayment formula is inadequate to repay the proposed initial bond issue. The shortfall would be much greater if the full \$60 million in bond authority were issued. The Town Ordinance does not include any provisions for increasing the tax caps in the event that revenues are inadequate.

**Table 1  
Proposed Debt Service on Special Obligation Bonds - Trappe East Development**

<b>Property Type</b>	<b># Units</b>	<b>Max Tax per Unit</b>	<b>Max Revenue</b>
Class 1 Rental Apt	336	\$506	\$170,016
Class 2 Attached Units	342	\$1,185	\$405,270
Class 3 Townhomes	326	\$1,475	\$480,850
Class 4 Detached Units	1,497	\$1,610	\$2,410,170
<b>Total</b>	<b>2,501</b>		<b>\$3,466,306</b>

**Table 2  
Special Obligation Bond Payment Costs**

Interest rate (%)	<b>6.5</b>	<b>7</b>
Bond amount	49,716,000	49,716,000
Period (years)	30	30
Annual Payment	<b>3,770,867</b>	<b>3,969,144</b>

As a practical matter, the 2,501 taxable lots in the Lakeside Special Tax District should be created prior to any bond issue so that the Town is assured of a revenue base adequate to cover bond repayment. The amount of the bond issue should be reduced to a level that can be repaid with certainty by the special tax district.

Given the apparent risk and lack of collateral associated with repayment of these special obligation bonds, it appears that they would have a low bond rating and/or high insurance costs. This would make the bonds more difficult to sell to investors and might require a higher bond interest rate than has been anticipated. A higher interest rate would increase bond repayment costs.

## **Bond Expenditure Issues**

Bond expenditures will commence immediately upon the bond issue with the construction of public facilities to serve the future Trappe East development. It is unclear why bond repayment by the Trappe East properties does not also commence at the same time the bonds are issued. Instead, payments by Trappe East properties are suspended for 2.5 years. This allows Trappe East property owners to receive a substantial \$50 million public investment in their property without any up-front commitment of financial resources. It is also significant that all the Trappe East property is under property tax abatement for up to 10 years, meaning that this property is not currently contributing to the tax rolls.<sup>9</sup>

The Trappe East property owners/developers appear to have sole authority to construct all the public facilities. It is not clear how the developers will set the price for such facilities or whether these prices will be fair, reasonable and competitive (since there is no competitive bidding process described).

## **What are the Risks Borne by Town and Current Taxpayers?**

The Town has assumed virtually all the costs associated with the initial stages of development and will assume most of the risks resulting from the possible failure of any component of this development proposal. Possible failures include:

1. Failure by developers to initiate development;
2. Failure to complete the development;
3. Failure to maintain development schedule;
4. Cost overruns for construction of public facilities;
5. Failure to generate adequate revenues to compensate Town;
6. Delinquent tax payments from Special District land owners;
7. Bankruptcy of any of the Limited Liability Companies (LLCs) owning land in the Special Tax District.

Once the Town is committed to constructing the \$50 million in public facilities to serve Trappe East, it will be at risk for any scenario that creates a cost overrun or revenue shortfall. The Trappe East landowners/developers have not posted a

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<sup>9</sup> See Section 8, *Annexation Agreement and Public Facilities Agreement*, February 5, 2003.

performance bond to protect the Town from any of the possible failures. Developers are not required to make any level of investment in the property and will not be required to make any Special District tax payment for 2.5 years.

According to the DRRA developers are under no obligation to develop any of the lots created in this development:

*20.22: **No Obligation to Develop.** It is understood that Petitioner's development of the Project depends upon a number of factors including, but not limited to, the housing and commercial markets, the availability of financing, and the general economic climate of the area. Nothing in this Agreement shall be construed as requiring Petitioner to develop the Project, and any failure to develop the Project shall not be deemed a default of Petitioner under this Agreement, except that no building permits will be issued for any structure unless and until the public infrastructure, utilities, and amenities intended to support and benefit such structures have been constructed, or the construction and completion thereof have been secured to the satisfaction of the Town.*

Also according to the DRRA, any mortgage holders for the Trappe East properties are not obligate by the DRRA terms if they foreclose on any of the properties:

*17.1 **Mortgagee Protection.** Subject to the subordination provisions set forth above, neither entering into this Agreement nor a breach of this Agreement shall defeat, render invalid, diminish or impair the lien of any mortgage on the Property made in good faith and for value. No Mortgagee shall have an obligation or duty under this Agreement to perform the Petitioner's obligations, or to guarantee such performance, prior to taking title to all or a portion of the Property.*

## **Who will Benefit from the Trappe East Development**

As a result of up to \$60 million in public investment for planning and infrastructure in Trappe East (Lakeside District), 924 acres of land will be converted from relatively low value, unserved, raw land, into 2,501 fully-served buildable lots. This action, resulting from the generosity of the Town, will add immense value to these 924 acres.

Those who currently own the land in Trappe East will be the beneficiaries of this financial windfall. These landowners need not develop a single lot, as they will be able to sell their newly minted lots at net a profit on the order of \$50 million to \$100 million. The profits will be generated compliments of the Town of Trappe and its current and future taxpayers.



## **Who Builds the Public Facilities for Trappe East?**

Normally, a city solicits bids from local and regional contractors to perform any major public works project. This competitive process helps protect local taxpayers by assuring that the most qualified and lowest-cost contractor is hired for the job. Competitive bidding is required by state law in many states and may be required in Maryland. The DRRA appears to offer an exclusive, non-competitive, no-bid, construction arrangement to the developers to build all of the public facilities funded by the Town's \$50 million bond issue.<sup>10</sup>

DRRA Section 4.1.4 (p 19) states:

*Petitioner has the exclusive right to deal with builders, contractors, subcontractors and material suppliers of the Petitioner's choice, subject to Petitioner's agreement to employ local contractors, subcontractors and material suppliers provided that they are appropriately qualified and competitively priced.*

Not only do the Trappe East developers receive an exclusive arrangement to do all the construction, but they also appear to be free to set the prices they charge the Town. There is no detailed cost estimate or fixed-cost agreement for any of the projects. There is no firm budget for any of the projects. The only estimate of costs is contained in the Special Tax District ordinance listing \$39 million in construction costs for public facilities.<sup>11</sup>

The Town's sole function regarding construction of public facilities is to approve each public works project as to design and safety and to dispense the bond funds to the developers. The Annexation Ordinance (11-2006) creates the authority to enter into "Construction and Funding Agreements," however no such agreements were available for this review.

This situation relies on an extraordinary amount of trust in the developers to perform all work on schedule, at the lowest possible cost, and at adequate standards of quality. The arrangement does not appear to offer the Town any recourse for overcharges or failures by the developers.

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<sup>10</sup> See also *Trappe East PN District PUD Plan Narrative*, May 19, 2004, indicating that all public facilities will be constructed by the developer.

<sup>11</sup> See Table B of Exhibit 2 of Town Ordinance 11-2006, *Report on Reasonable Basis of the Special Tax*, by MuniCap, Inc., November 1, 2006.

## **Are the Developers' "Contributions" to the Town an Appropriate Incentive?**

As part of the DRRA, the developers have agreed to make a number of payments to the Town. The developers' payments include:

- \$250,000 toward Fire House improvements within 12 months of initiation of construction.
- \$65,000 per year for Town Planner position and health insurance (until 500<sup>th</sup> residential unit completed).
- Payments to cover the cost of staffing and equipping a Town police department with three officers for one year (or alternatively one officer for three years).

Additional funds are promised by developers that are contingent upon residential development:

- \$1,500 one-time payment to "Town Center Enterprise Fund" for each residential building permit issued by Town.
- \$100 annual payment to the Trappe Volunteer Fire Department for each new dwelling unit that is completed (has an occupancy permit).

In order to determine the merit of these payments, they must be considered in the context of the costs and liabilities incurred by the Town. The Town will incur substantial cost in administering the development approval process. According to the DRRA, "Development Approvals" means all permits, approvals, actions, and other entitlements approved or issued by Town in connection with development of the Property including, but not limited to:

- (a) Establishment of a Planned Neighborhood ("PN") zoning district for the Property;
- (b) PUD Plan approval for any Phase(s) of Development of the Property;
- (c) Lot line adjustments and/or preliminary and final subdivision plats;
- (d) Special exception approvals;
- (e) Sewer and/or water reservations or allocations;
- (f) Development permits;
- (g) Variances;
- (h) Street vacations;
- (i) Site plan approvals;
- (j) Special taxing and/or financing districts;
- (k) Grading permits;

- (l) Building permits; and
- (m) Occupancy permits.

The developers' payments are primarily oriented towards services that benefit the developers. For example, the Town has not needed a full-time Town planner. This position is being funded almost exclusively to serve the needs of the developers. While the payment for Firehouse improvements may benefit the Town, the developers are also creating a greater demand on the all-volunteer fire department to provide protection to 924 additional acres of development property.

The Town has agreed to waive the \$2,761 capital facilities impact fee on the first 500 residential units built. The cost of the waiver is equal to \$1.38 million. This cost greatly exceeds the combined value of the developers' payments listed above.

The Town has also agreed to provide full property tax abatement on all 924 acres of annexed properties for a period of up to 10 years. While the cost of this tax abatement to the Town has not been estimated here, it may also exceed the combined value of the developers' payments.

Given the potential costs, risks, and liabilities to the Town resulting from the proposed development, the developers' contributions appear to be a meager and inadequate incentive.

## **Conclusions**

The Town of Trappe is assuming virtually all costs and risks associated with the construction of public facilities and infrastructure for the Trappe East development proposal. In contrast, the developers receive all profits that may result. The developers have no legal commitment or obligation to complete any of the proposed development. The risks involved in a development of this scale are enormous and the costs for any failure will be borne largely by the current and future residents of Trappe. Since this is a speculative development, its success is dependent upon the real estate market, which is currently very weak.

The investment by the Town of Trappe of \$50 to \$60 million in new infrastructure to serve Trappe East is premised upon the construction of 2500 new houses that will contribute taxes to eventually repay the bonds over 30 years. The plan calls for the Town to fund infrastructure construction before the residential development occurs, placing the Town at risk for any failure to complete the development.

It appears that the Trappe East land owners/developers are using the Town of Trappe as a means to greatly enhance the value of their property. The developers started with relatively low value vacant farmland in 2002. The Town has annexed their property, planned and zoned the land, and will administer the subdivision and platting. The next step will be for the Town to issue bonds to build all the public facilities and infrastructure necessary to serve future development. Not only will this vastly increase the value of the developers' land, the bond funds will go directly to the developers themselves to pay them for building these public facilities.

## **Recommendations**

Due to the apparent financial risk the Trappe East project places on the Town of Trappe, the Town should consider several courses of action to protect the Town government and local taxpayers:

- The Town of Trappe should hire an independent municipal attorney and public finance expert (or city auditor) to review the proposed Special Obligation Bond issue and repayment through the Lakeside Special Tax District. This review should place special attention on the repayment formula, the risks incurred by the Town, and the possible consequences of partial or complete failure of the project.
- Unless it can be shown, via the independent legal and financial review, that the special obligation bond issue and subsequent expenditures will be secure, fiscally sound and free of risk to the Town, the bonds should not be issued

and the Town should take action to terminate the bond offering.

- If the Town of Trappe determines that this project has reasonable risks, is commercially viable, and is financially and fiscally sound, the Town should consider purchasing all the land in the proposed Trappe East development to capture the enormous increase in land values that will result from the Town's investment in planning and infrastructure. The Town would capture this value by re-selling the fully-serviced lots to developers.
- The Town should seek a legal review of the Special Tax District to determine if it complies with the Comprehensive Plan and local laws. Specifically, whether or not it complies with the Annexation Agreement that expressly states in clear and unambiguous language that the developers are to pay for all public facility improvements in Trappe East and that the Town will pay none of these costs.

Other actions to protect the Town from risks associated with this project include:

- Require open, competitive bidding on all public works projects in the Trappe East development. The standard competitive selection process assures local taxpayers of the best value and results through competitive bidding, use of a performance contract, and requirements for bonding and insurance.
- Require that, in the event any of the undeveloped lots are sold by the current landowners, the seller would repay their full share of the bond issue associated with those lots. This compensates the Town for its investments and improvements in the property that have added to the property's value. It also avoids the risks and legal costs associated with ownership transfers.
- None of the documents reviewed provided any information about the qualifications or financial capacity of the developers to build 2,500 new homes. Since the fiscal and financial success of the development is dependent on such qualifications and financial resources, the Town should obtain a financial statement and documentation of qualifications from each of the development partners.
- None of the documents reviewed contained a real estate market analysis for the proposed development. Given the weak condition of the current real estate market, demand for the planned new homes may be very low. A professional real estate market analysis should be prepared with a demand analysis, demographic analysis, and sales projections.

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## **Attachment I**

Citation from Town of Trappe Web Site: <http://trappemd.net/annex.htm>  
June 24, 2007

### **Who will absorb the cost of this annexation and any future developments proposed?**

- “all costs occasioned by the development...shall be borne by the petitioners and no costs shall be borne by the Town”
- “all construction, operation and maintenance...will be guaranteed with security agreements, bonds, letters of credit...” - Default on part of the developer will not fall back on the Town, without some monetary means of finishing the project. Any developer will be required to provide monetary security to ensure that necessary improvements will not be paid for by the Town.
- “petitioners agree to construct, at their expense, public roadways, extensions and improvements as reasonably necessary to serve Annexation Property” - Developers must build all necessary roads, etc. according to the Comprehensive Plan. Any developer must build and improve roads to accommodate future development.
- “intersection improvements at one or more points along US Route 50 will be required to accommodate development” - Developers must make improvements to the Route 50 intersections according to Town and State standards.
- “petitioners agree to construct, at their expense, public sanitary sewer and water utility extensions or improvements”
- “petitioners will pay the entire cost of constructing said sanitary sewer system...shall...dedicate the system to the Town” - All water and sewer costs are the burden of the developer; the use of our current sewer and water system will not be extended to serve any new development in the annexed area.
- “construction expenses related to arsenic removal shall be borne by developer and the Town, in proportion to the number of dwelling units at build out and the current number of units in the Town” - Without development, current Town residents will be required by law to fully fund the expense of Arsenic removal, this will offer some relief.