CITY COUNCIL COMMUNICATION:

03-028

AGENDA:

JANUARY 27, 2003

SUBJECT:

INTEREST RATE FOR SPECIAL ASSESSMENTS

TYPE:

RESOLUTION
ORDINANCE
RECEIVE/FILE

SUBMITTED BY:

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FINANCE DIRECTOR

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ITEM 85

OFFICE OF THE CITY MANAGER

CITY OF DES MOINES, IOWA

SYNOPSIS —

The interest rate to be utilized on unpaid installments for City-assessed projects is established by City Council. The current index used to determine the interest rate to be applied to special assessments is no longer quoted or published in *The Wall Street Journal*. Staff recommends that the City Council approve a new index at the sum of the asked yield of the current ten-year Treasury note plus 200 basis points to more accurately reflect current financial market conditions.

FISCAL IMPACT —

There is no cost to the City associated with this change.

RECOMMENDATION —

Approval.

BACKGROUND —

The maximum interest rate allowable for special assessments is established by a committee comprised of the Treasurer of the State of Iowa, Superintendent of Credit Unions, Superintendent of Banking, and Auditor of the State of Iowa as set out in Sections 74A.4 and 74a.6(2) in the *Code of Iowa*. During the past decade, the committee has set this maximum rate at 9 percent.

The interest rate is applied to only the balance that remains unpaid beyond a period of 30 days after the date of first notice of the final project schedule. All or a part of an assessment may be paid during the 30-day period without an interest charge.

While the committee set out above established the maximum interest rate allowable for assessed projects, there is no minimum rate established by the Code of Iowa. As a result, the interest rate to be utilized on unpaid installments for City-assessed projects is established by City Council, up to the committee-established maximum.

By Roll Call No. 87-1870, dated April 27, 1987, a procedure was established to calculate the interest rate to be used on special assessment projects. That procedure involved first determining the base figure and then adding one-half of one percent (½ percent) to that base figure. The base figure was the interest rate on a 30-year Government National Mortgage Association (GNMA) certificate at a nominal interest rate of 10 percent as shown by commercial or governmental indices of acceptable independent compilation. The resulting interest rate could not exceed the maximum interest rate for special assessments established by the state committee.

As the base figure—the 30-year GNMA certificate at the nominal interest rate of 10 percent—is no longer quoted or published in *The Wall Street Journal*, it has become necessary to change the procedure used to determine the interest rate. There are several factors to be considered when establishing an interest rate for special assessments:

1. Since interest rates have declined, the GNMA certificate at 10 percent appears to be a high index to use as a base figure. The new index needs to more accurately reflect current financial market conditions.

2. If the interest rate on special assessments is low in comparison to the return available on investments or the interest rates on home mortgages, automobile loans, consumer loans, and credit card purchases, people defer payment on the lower interest rate special assessments in favor of maintaining investment earnings and/or making payment on the higher interest rate loans. The effect of such occurrences is to allow certain taxpayers a low-interest loan at the expense of other taxpayers.

3. The City is not able to assess projects until such time as a project is complete and the final assessment schedule (based on actual costs) is determined. As a result, the City must “front end” the construction cost during the construction period and whatever time is required to obtain reimbursement through the assessment procedures. Frequently, the construction phase can consume two years. To the extent that assessments are not paid on time, or at all, the City’s cost of money is increased by an amount which cannot be predicted at the time the rate is set.

4. It seems prudent to continue the procedure that assures uniform treatment among special assessment projects to prevent wide variations in the rate of interest charged taxpayers on similar projects at or about the same time.

5. By Roll Call No. 87-974, dated March 16, 1987, it had been directed by City Council “that the City shall charge the actual rate of interest that it costs the City to borrow the money for assessed projects.” That directive is difficult to implement because the assessments are levied and the interest rates fixed prior to the time when all the costs of money on a particular project are known. It would be best to have an index that reflects the general level of the cost of money at the time of assessment while being able to recoup City costs.

Since the special assessment lien is most comparable to a mortgage loan, an index that reflects rates similar to mortgage rates is most desirable. The following is proposed to be utilized in establishing future special assessment project interest rates on assessment payments made after the initial 30-day period in which all or a part of the assessment may be made without interest:

• A base figure will be established using the asked yield of the currently traded ten-year Treasury note as published in *The Wall Street Journal* every Friday. Thirty-year mortgages are typically priced to the ten-year Treasury note as most mortgages are assumed to have a life of seven to ten years. Special assessment liens are normally paid off in that same time frame.

- Two hundred basis points would be added to the base figure to arrive at the final interest rate to be used. Two hundred basis points are equivalent to 2 percent. Thirty-year mortgage rates, when priced to the ten-year Treasury note, typically will include an addition of 200 to 225 basis points.

- This method of determining the interest rate for special assessments will be done on the second Friday preceding the date on which the assessments are levied.

Following are a comparison of the interest rates for special assessments using the current index versus the proposed index since 1995:

For the past eight years, the differences in the indexes were usually plus or minus less than 1 percent.