

# LAND-SECURED FINANCING CURRENT TOPICS AND PRACTICES



CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

SESSION THREE:  
REAL ESTATE MARKET AND CFDs

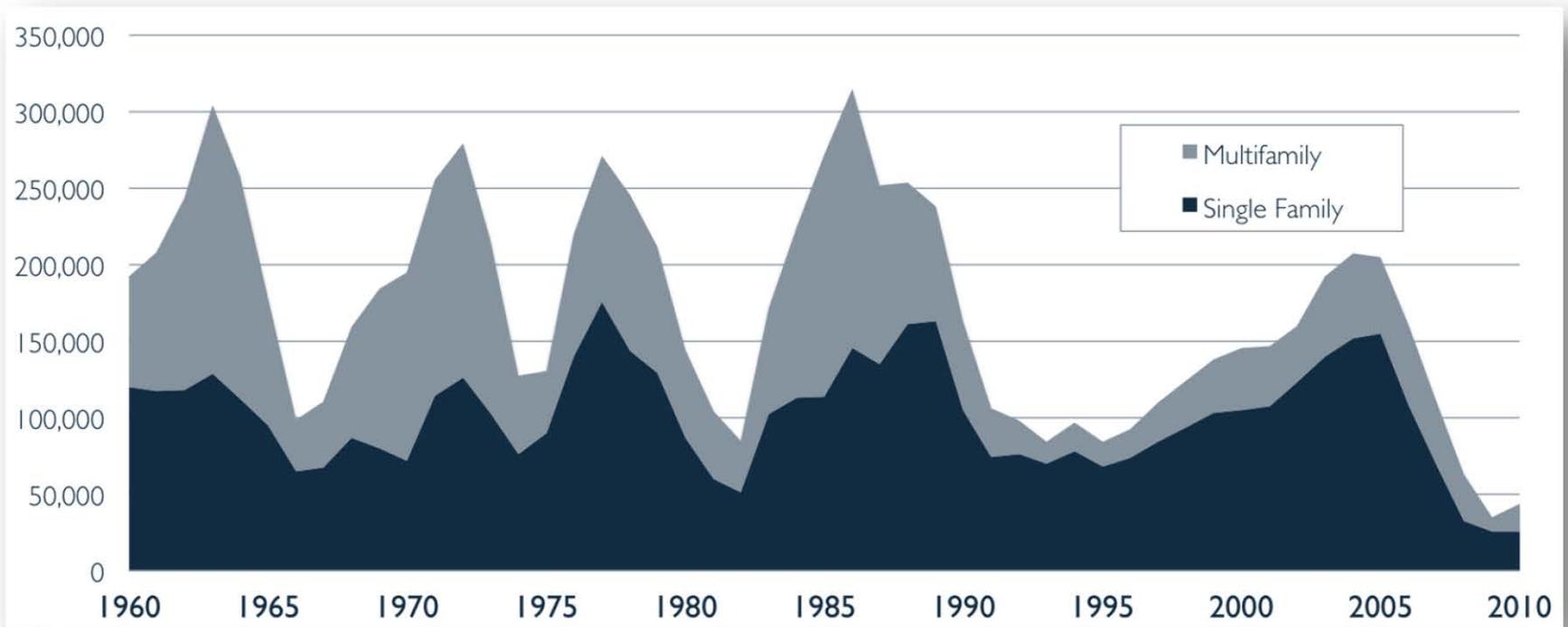
## THE GREAT RECESSION AND LAND-SECURED FINANCING DISTRICTS IN CALIFORNIA

HOW DID THEY DO AND WHAT HAS CHANGED?

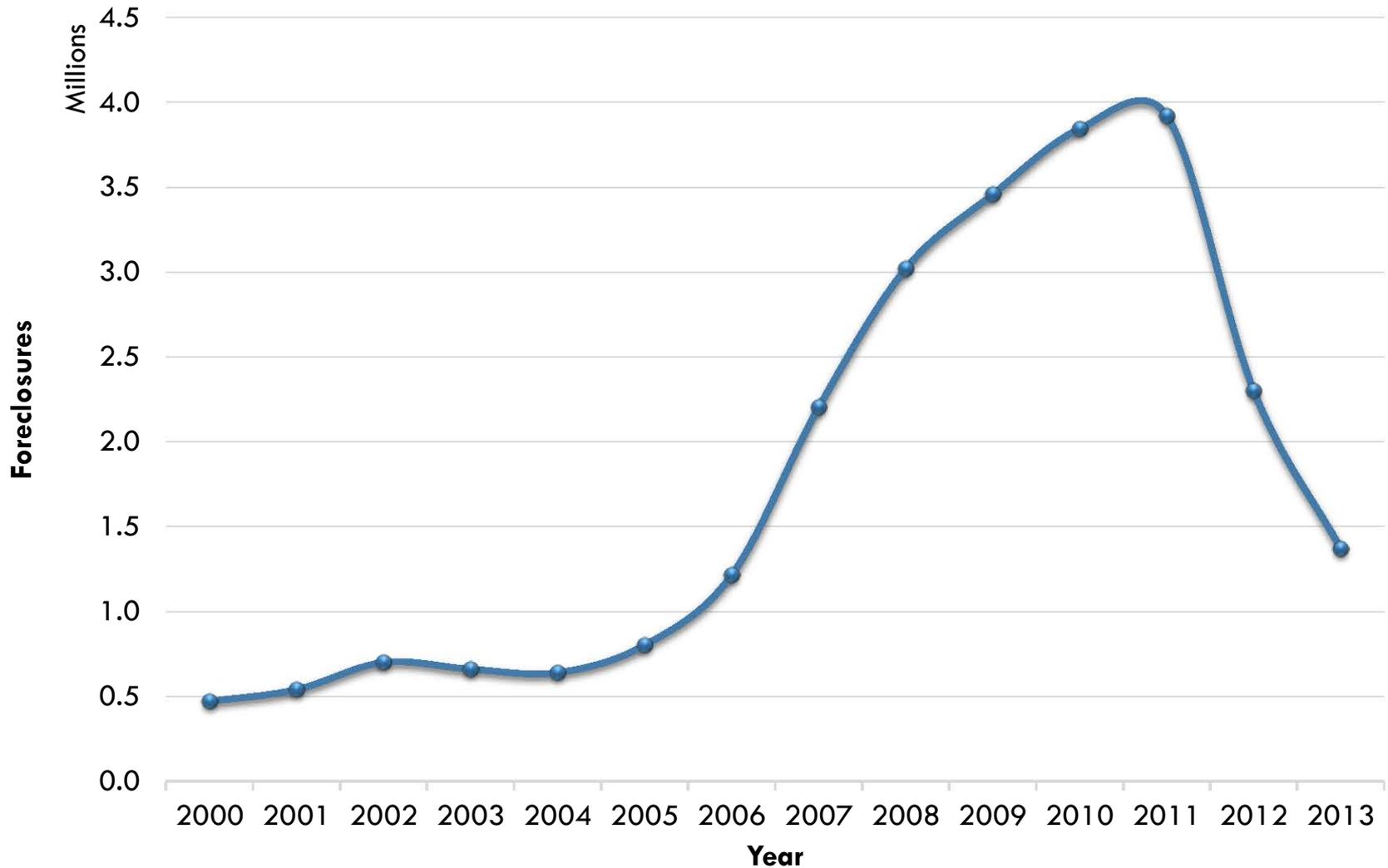
MAY 1, 2015

CONCORD, CA

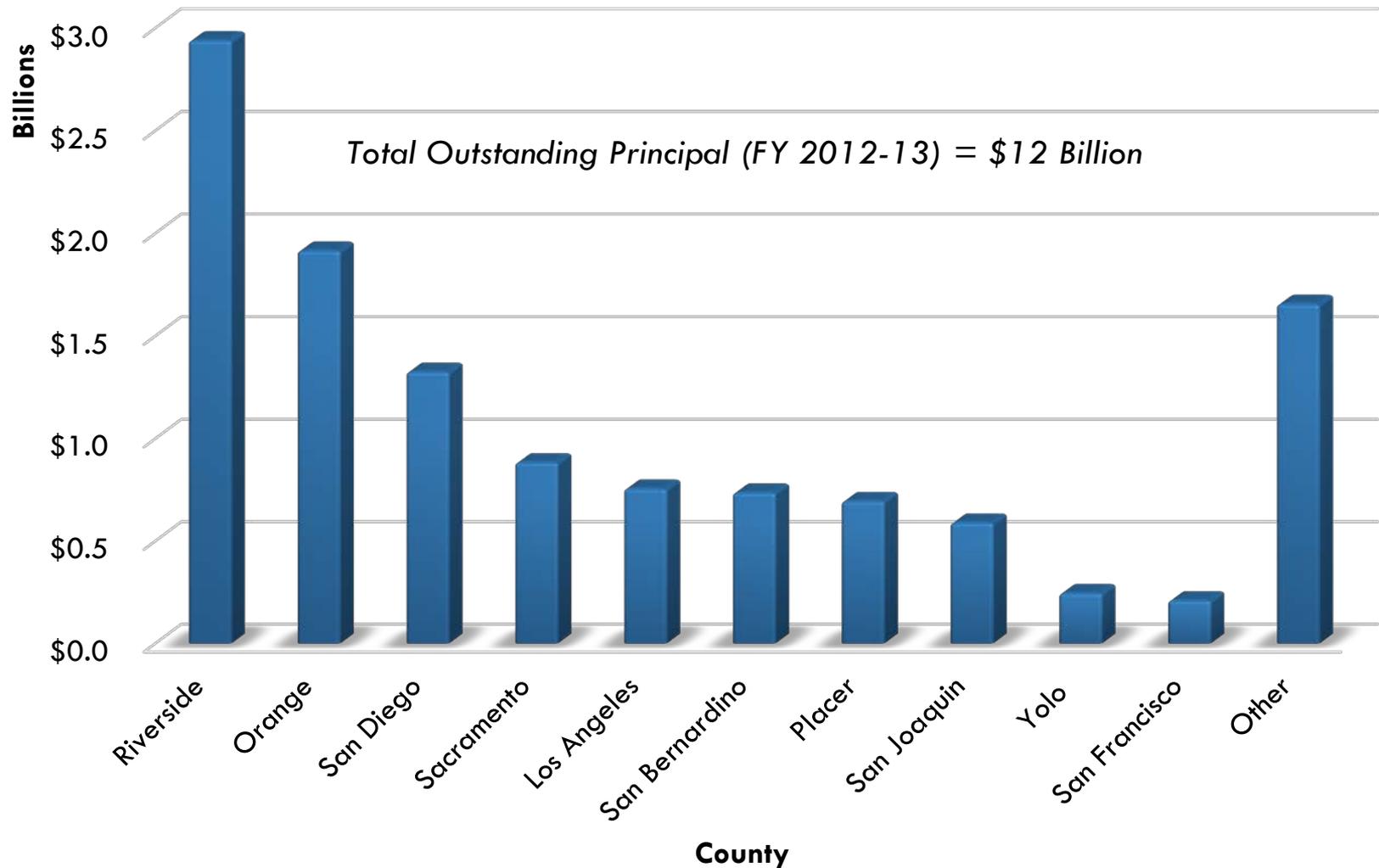
# Impacts of the “Great Recession”: New Construction Permits in California 1960-2010



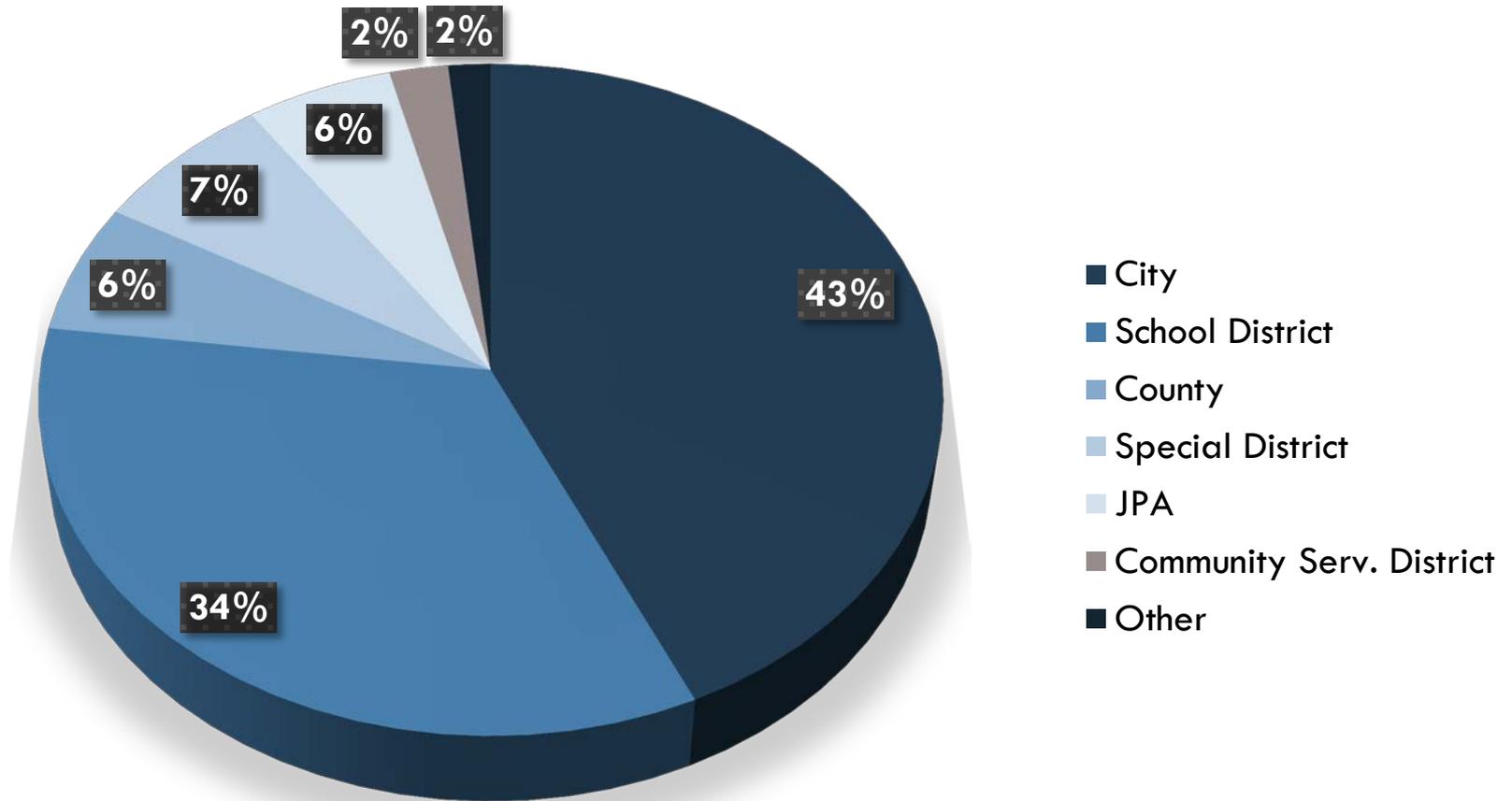
# Impacts of the Great Recession: Foreclosures in the U.S. 2000-2013



# Mello-Roos Bonds Outstanding



# CFD Issuers by Type of Agency



# CFDs During the Great Recession: How Did They Do?

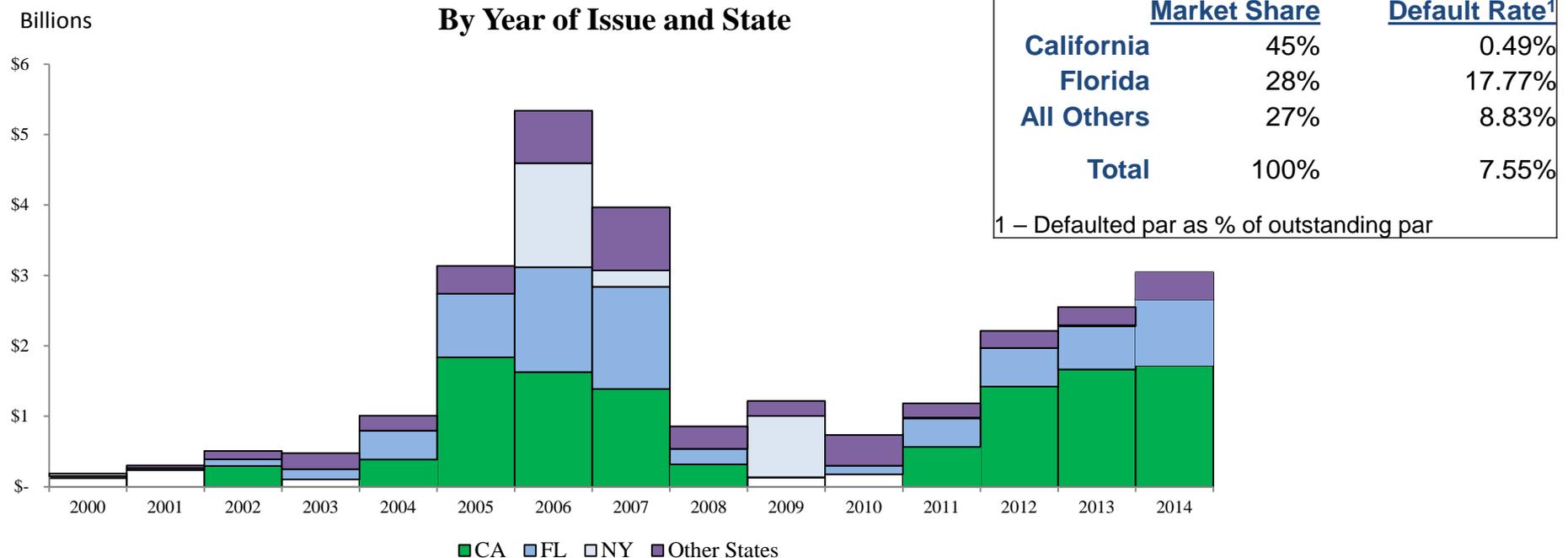
- Generally, it was an impressive performance
  - Different ways of measuring performance
  - How should we define “default”:
    - Missing a debt service payment?
    - Drawing from the reserve fund?
    - Bondholders do not get paid full principal investment?
- Very few Mello-Roos bonds truly defaulted during recession; only 0.49% of outstanding bond principal remains unpaid
- Policies, procedures and guidelines turned out to be effective

# National Land Secured Bond Defaults

## National Land Secured Market

Bonds Issued 2000-2014 and Still Outstanding (as of 12/31/14)

2,398 issues, \$26.9 billion



# California Land Secured Bond Defaults

## Expectations for stress:

- Hardest hit regions
  - ▣ Central Valley, Inland Empire
- Projects with bankrupt developers
  - ▣ SunCal/Lehman
  - ▣ Reynen & Bardis, Dunmore Homes
  - ▣ Empire Land, Kimball Hill Homes
  - ▣ Others. . .
- Late cycle projects
  - ▣ 2006 and 2007 bond sales

=> Actual impact on outstanding bonds has been more muted

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## Actual Payment Defaults:

- ▣ Borrego Water CFD: \$6.9 million
- ▣ Lathrop CFD: \$49.3 million

## Reserve Fund Draws:

- ▣ Merced (Bellevue Ranch, Moraga)
- ▣ Northstar CFD
- ▣ West Patterson CFD
- ▣ Western Hills (Diablo Grande)
- ▣ Several CSCDA pooled issues
- ▣ Several timing or delinquency-related draws that were quickly replenished

## Others:

- ▣ Palmdale (Ritter Ranch) - again
- ▣ Nevada County (Wildwood Estates) - still
- ▣ lone - still

# What Changed in Latest Cycle?

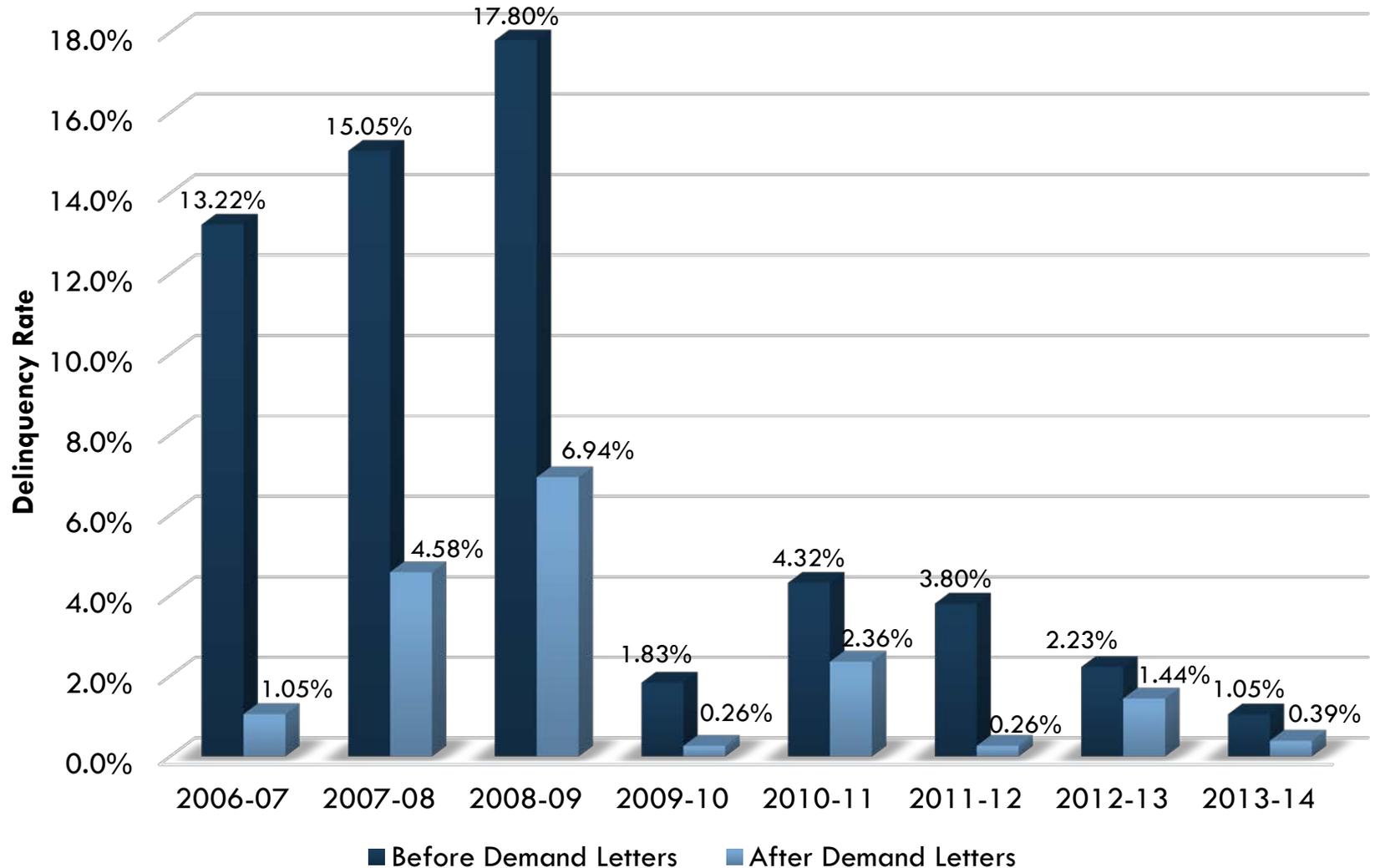
- **Leverage: Lending practices**
  - Project phasing
  - Use of proceeds to enhance value, acquire completed facilities
  - Local policies requiring developer-posted LOCs
  - Value-to-lien and quality of appraisals
- **Governance: Statutory and regulatory framework**
  - SEC crackdown on fraudulent underwriting practices
  - Issuers required to adopt local goals & policies for CFD
  - Roving JPAs outlawed in response to '90s abuses
  - Quality of initial disclosure improved, requirement for continuing disclosure
  - CDIAC policy guidance on appraisal and disclosure standards
  - Ongoing CDIAC education and training of issuer community
- **Active District administration**
  - Engaged bond-related professionals: issuers, underwriters, consultants, appraisers

# Delinquency Management: A Key Component in Effective Administration

- Demand letters should be sent immediately after missed payments (December and April installments)
- For homes in foreclosure, send demand letters to bank
  - Mello-Roos lien is senior to mortgage lien
  - Accelerated foreclosure provision is quite an effective motivator
- Even in Teeter Plan counties: don't wait to act
  - Cumulative delinquencies are harder to remedy
  - Land-secured districts can be removed from Teeter at any time
- Strip Mello-Roos taxes if homeowner cannot pay full bill
- Inform Tax Collector that payment plans won't work for special taxes and assessments



# Managing Special Tax Delinquencies: Sample Central Valley CFDs

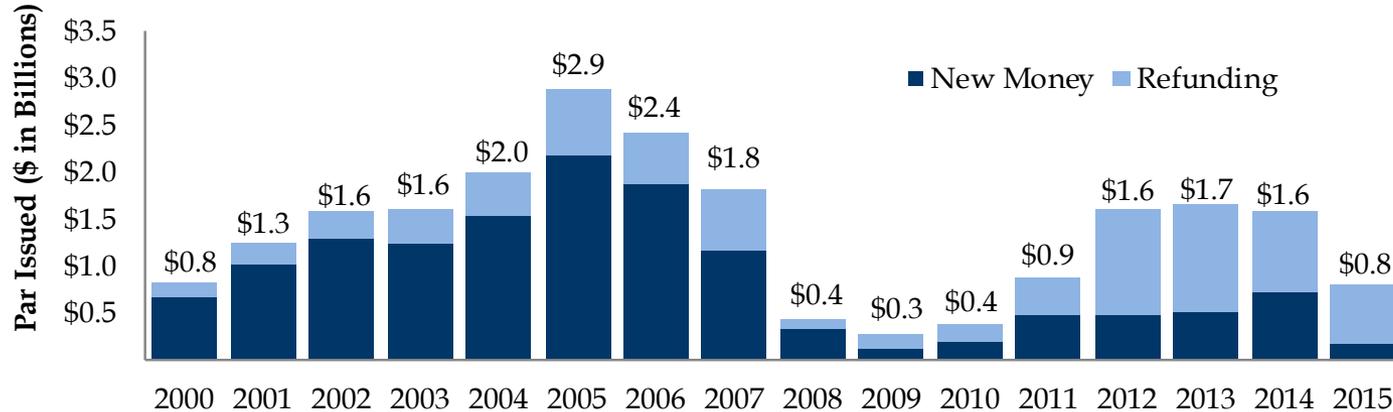


# Insights from California Market

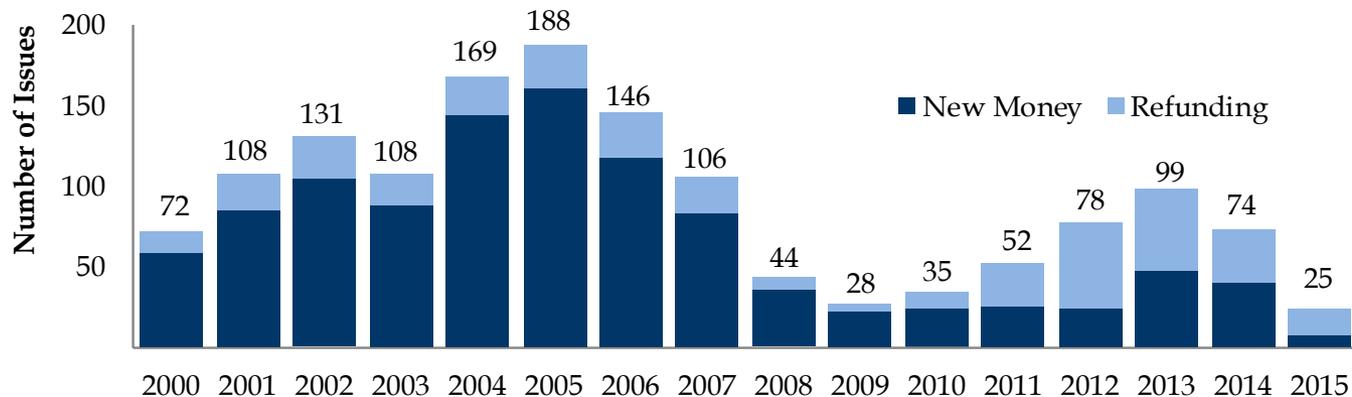
- **Difficult development environment**
  - ▣ CEQA and other standards create tortuous, time-consuming and expensive process  
=> *Effectively winnows viable projects*
- **Changing market landscape**
  - ▣ Ascendance of national builders, demise of many regional builders  
=> *More staying power through downturn*
- **Location, location, location**
  - ▣ Geographic features limit supply of entitled land in key areas bolstering value  
=> *Problems occurred in fringe areas*
- **Over-leverage**
  - ▣ Extended from developers to homeowners  
=> *Market stress affected built out districts, not just raw land projects*  
=> *But residential delinquencies have been fairly “digestible” by lenders*
  - ▣ Foreclosure and bankruptcy of developer can be more problematic
  - ▣ Larger developer delinquencies can cause reserve draw and halted construction  
=> *Toxic combination was developer and lender stress*

# California Land Secured Market Today

**Annual California Land-Secured Issuance Since 2000  
By \$ Amount Issued**



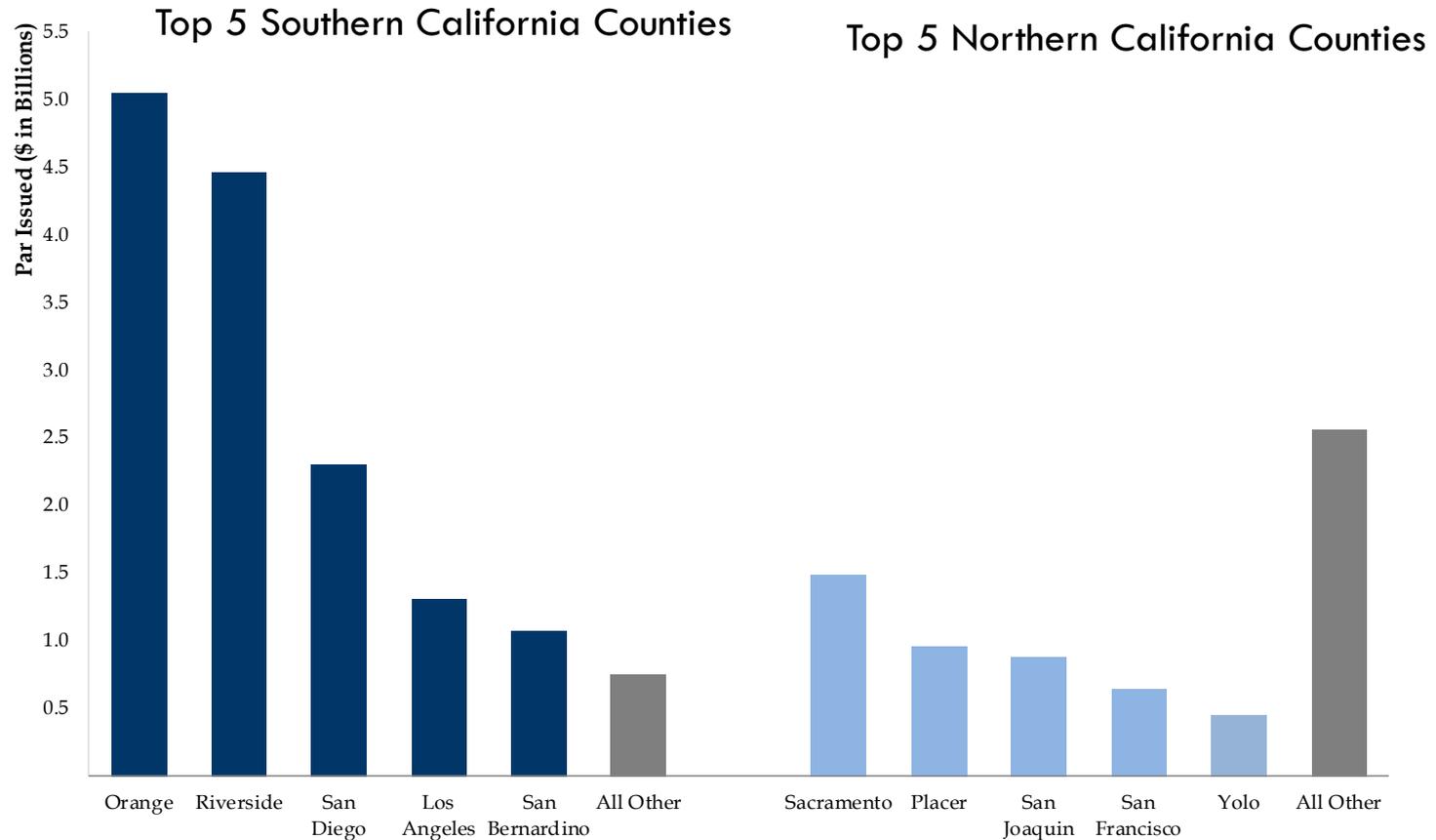
**Annual California Land-Secured Issuance Since 2000  
By Number of Issues**



# Issuance Volume by Region

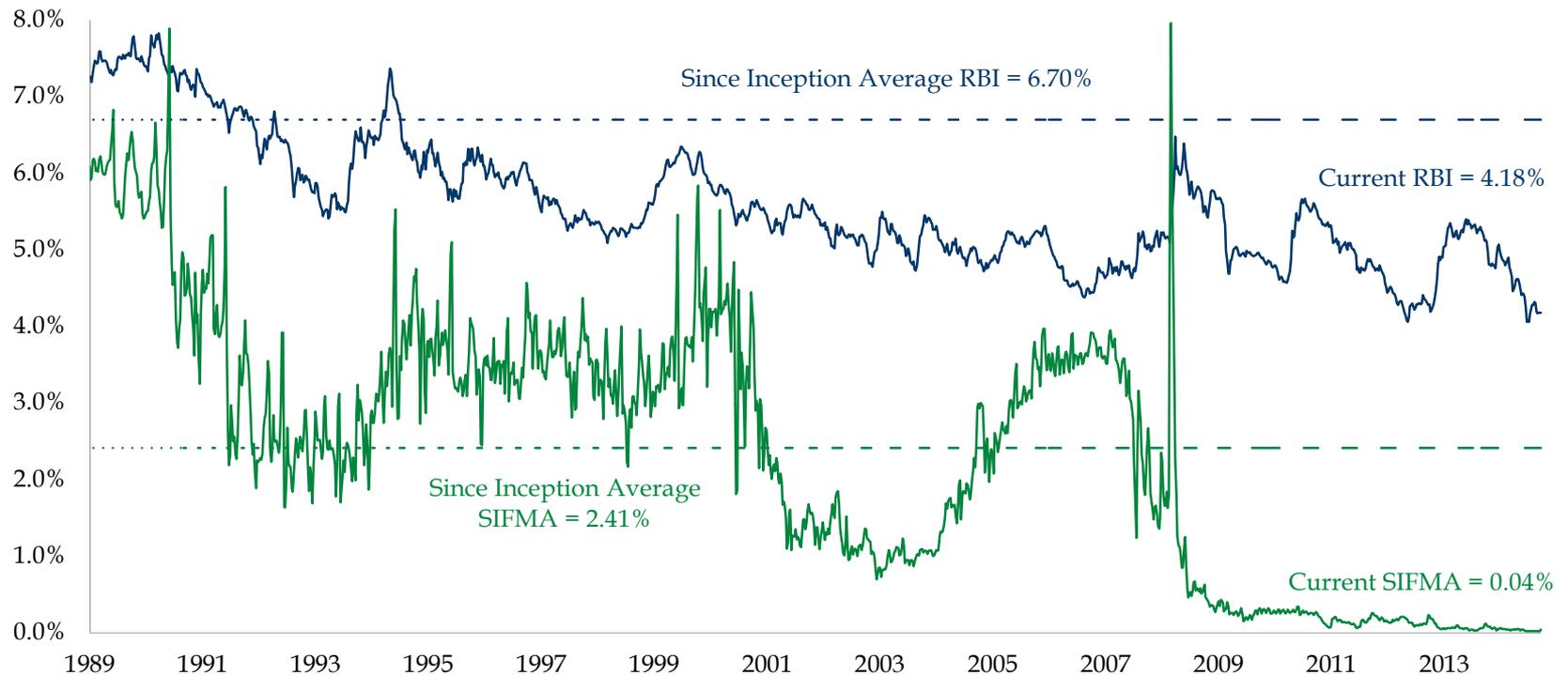
- 69% of issues and 68% of par issued by Southern California issuers since 2000

California Land-Secured Bonds by County of Issuer  
From 2000 - 2015 YTD\*



# Low General Interest Rate Environment

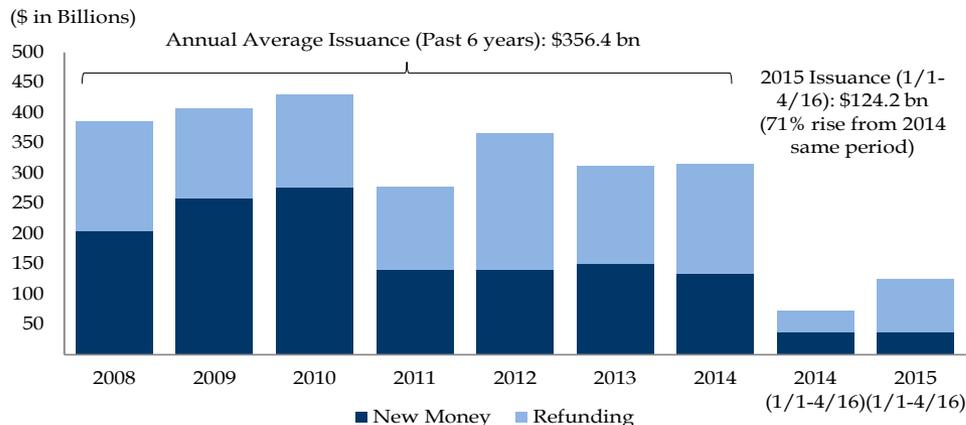
## Long Term Revenue Bond Index (RBI) and Short-Term SIFMA Index



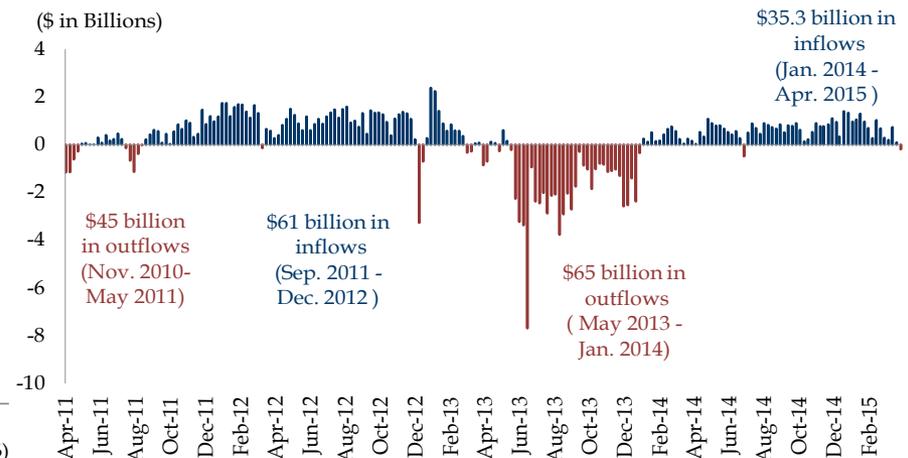
# Municipal Bond Supply and Demand

- Municipal interest rates are influenced by macro-economic conditions and more technical supply-demand trends
- Issuance volume has been down, dominated by refundings
- Investor interest has ebbed and flowed in uncertain rate environment

## Municipal Market Annual Supply



## Municipal Mutual Fund Flows



# Marketing Considerations for New Issues

- **Narrower base for land-secured credits**
  - Most sensitive sector to supply/demand
  - Investors “reach for yield” in low rate environment -- but to a point
  - Results in “spread compression” between strongest and weaker credits
- **Institutional interest**
  - High yield funds flows tend to drop amid rising interest rates
  - Institutional interest increases with issue size of \$25 million or greater, promise of future liquidity
- **Retail interest**
  - Ebbs and flows depending on market conditions and investment alternatives
  - Sophisticated retail investor demand for “story” credits remains strong
- **Development “story” is important**
  - Investors carefully evaluate strategic advantages of projects: location, competition, developer, development momentum
  - Geographic diversification is helpful

# San Mateo Bay Meadows CFD - Overview

Redevelopment of the 170-acre site of former racetrack into mixed-use community

## □ **Location**

- 20 miles southeast of San Francisco
- Intersection of Highways 101 and 92
- Walking distance to CalTrain station

## □ **Development plan**

- 1,066 residential units
- 802,000 sq ft class A office
- 85,000 sq ft retail
- Private high school campus (Nueva)

## □ **Developer**

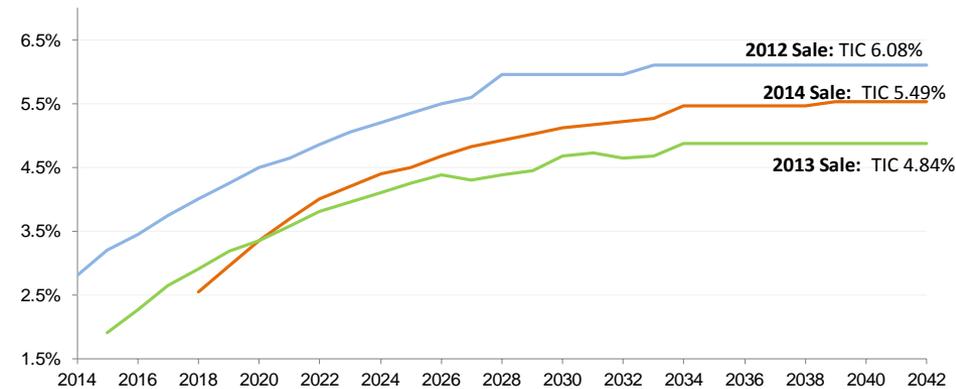
- Wilson Meany Sullivan/ Stockbridge Capital



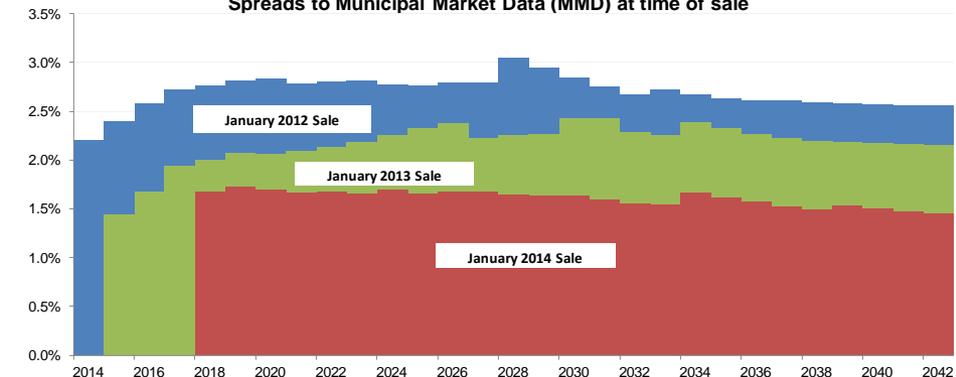
# San Mateo Bay Meadows CFD - Bonds

- **\$31.8 million January 2012 sale**
  - ▣ No vertical development, VTL of 6.5-to-1
  - ▣ 10 institutions and 157 retail investors
  - ▣ True interest cost of 6.05%
- **\$26 million January 2013 sale**
  - ▣ Developer responsible for 94% of taxes
  - ▣ 8 institutions and 213 retail investors
  - ▣ TIC of 4.84%
- **\$28.5 million January 2014 sale**
  - ▣ Developer carries 80% of max tax levy; Tri Pointe Homes 8%; Shea 7%; Nueva School 5%
  - ▣ 10 institutions and 211 retail investors
  - ▣ TIC of 5.48%

Bond Yields on January 2012, January 2013 and January 2014 sales



Spreads to Municipal Market Data (MMD) at time of sale



# An Industry Study of CFD Reserve Fund Draws: Contributors and Correlations

- CFD Bond Sales and Bond Draws:
  - 1,510 CFD bond Issues in California from 2000-2013
  - 31 of these had reserve fund draws; a draw percentage of 2.05%
  - Of the 31 with draws, 7 draws appear to be for administrative reasons
- Issuers' track records were most telling factor
  - 16 issuers had 27 of the 31 reserve fund draws
  - 14 of the 16 issuers had draws on one or more of their first five bond issues
  - Agencies with polices based on CDIAC guidelines experienced minimal draws