

**CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION
CURRENT TOPICS AND PRACTICES IN LAND-SECURED FINANCING**

**OVERVIEW OF RECENT/EXPECTED HOUSING MARKET CONDITIONS
AND
THEIR RELATIONSHIP TO NEW COMMUNITY FACILITIES DISTRICTS**

**BY
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SEPTEMBER 6, 2018

INTRODUCTION

TODAY YOU WILL HEAR FROM MANY GREAT SPEAKERS ON CRITICAL CURRENT PRACTICES PERTAINING TO CFDS

THE GOAL OF MY PRESENTATION IS TO FOCUS SPECIFICALLY ON THE ECONOMIC ASPECTS UNDERLYING CFDS

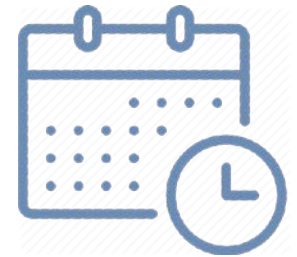
Amount

- AT FORMATION, SETTING SPECIAL TAXES DETERMINES THE **AMOUNT OF SPECIAL TAX REVENUES TO FINANCE DEBT**
- SPECIAL TAXES, BOND INTEREST RATE AND COVERAGE > **AMOUNT OF PROCEEDS TO THE DEVELOPER**



Timing

- WITH REGARDS TO THE BOND SALE, THE **TIMING** WITH RESPECT TO THE DEVELOPMENT PHASE.
 - THIS IS DETERMINED BY THE **CONCENTRATION VERSUS DIVERSITY OF OWNERSHIP**:
 - LAND OWNERSHIP SINGLE DEVELOPER – DEVELOPER RECOVERS INFRASTRUCTURE COSTS
 - BUILDERS PURCHASE PARCELS FOR PROJECTS
 - CONSTRUCTION OF HOMES AND OCCUPANCY BY HOMEOWNERS



INTRODUCTION

ISSUER TEAM AND DEVELOPER TEAM: COLLABORATE BUT THEY HAVE CONFLICTING INTERESTS



ISSUER MOTIVATION:

- MUNICIPAL BOND FINANCING
- ISSUER NAME ON OFFICIAL STATEMENT
- ISSUER OVERSEES ADMINISTRATION CALLS-HOMEOWNERS ACTIVISTS
- HOMEOWNERS TREATED EQUITABLY – POLICIES TO PROTECT HOMEOWNERS



DEVELOPER MOTIVATION:

- PERCEPTION OF PASSING ON THE SPECIAL TAX TO HOMEOWNERS
 - BUT LENDERS CONSIDER ALL PROPERTY TAXES WHEN QUALIFYING PURCHASERS
 - NUMEROUS STUDIES BY EE: HOMES WITH ST VS NO ST
 - SAME HOUSING PAYMENT LEVELS
 - SO MARKET PRICES ADJUST
- NON RECOURSE FINANCING OFF-BALANCE SHEET PERHAPS MOST SIGNIFICANT FACTOR

INTRODUCTION

WHAT ARE THE BEST PREDICTORS OF A SUCCESSFUL CFD BOND?



ISSUER HAVING POLICIES RELATED TO TAX BURDENS AND TIMING OF BOND FINANCINGS

- **ISSUER PUBLIC FINANCE MANAGEMENT - NO DRAWS ON RESERVE FUNDS**
 - RATING AGENCIES, SINGLE ISSUE ONLY, QUANTITATIVE METRICS
 - COASTAL VS RURAL – GENERAL INDICATOR BUT MANAGEMENT SUPERIOR INDICATOR
- **ADHERENCE UNDER VARYING ECONOMIC CONDITIONS AND DEVELOPER INFLUENCES.**
 - CFD BOND ISSUES ARE CURRENTLY VERY COMPLEX, AS COMPARED TO 1980s.
 - CFD BOND ISSUES CONSTANTLY EVOLVE OVER TIME, REQUIRING INTERPRETING ISSUER POLICIES APPROPRIATELY.

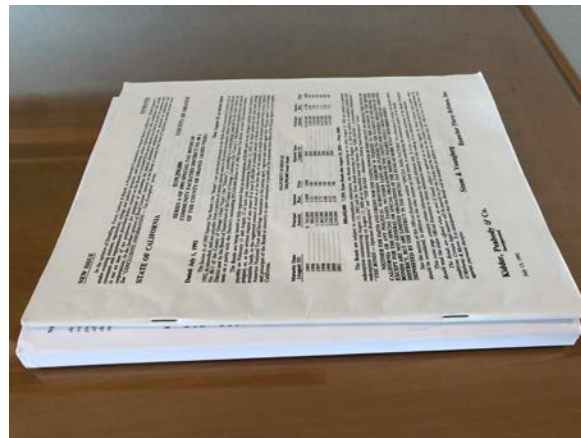
FINANCE TEAM FOLLOWING SEMINAR CURRENT PRACTICES (CONTINUOUS EVOLUTION)



- **EE BACKGROUND** PHD. 500 + BOND ISSUES \$15 B
- **SHARE EXPERIENCES** BUT CFDS EVOLVE SO NEW IDEAS/CONCEPTS
- **BOTH MUNICIPAL BOND PROFESSIONALS AND ISSUERS LEARNING TOGETHER**

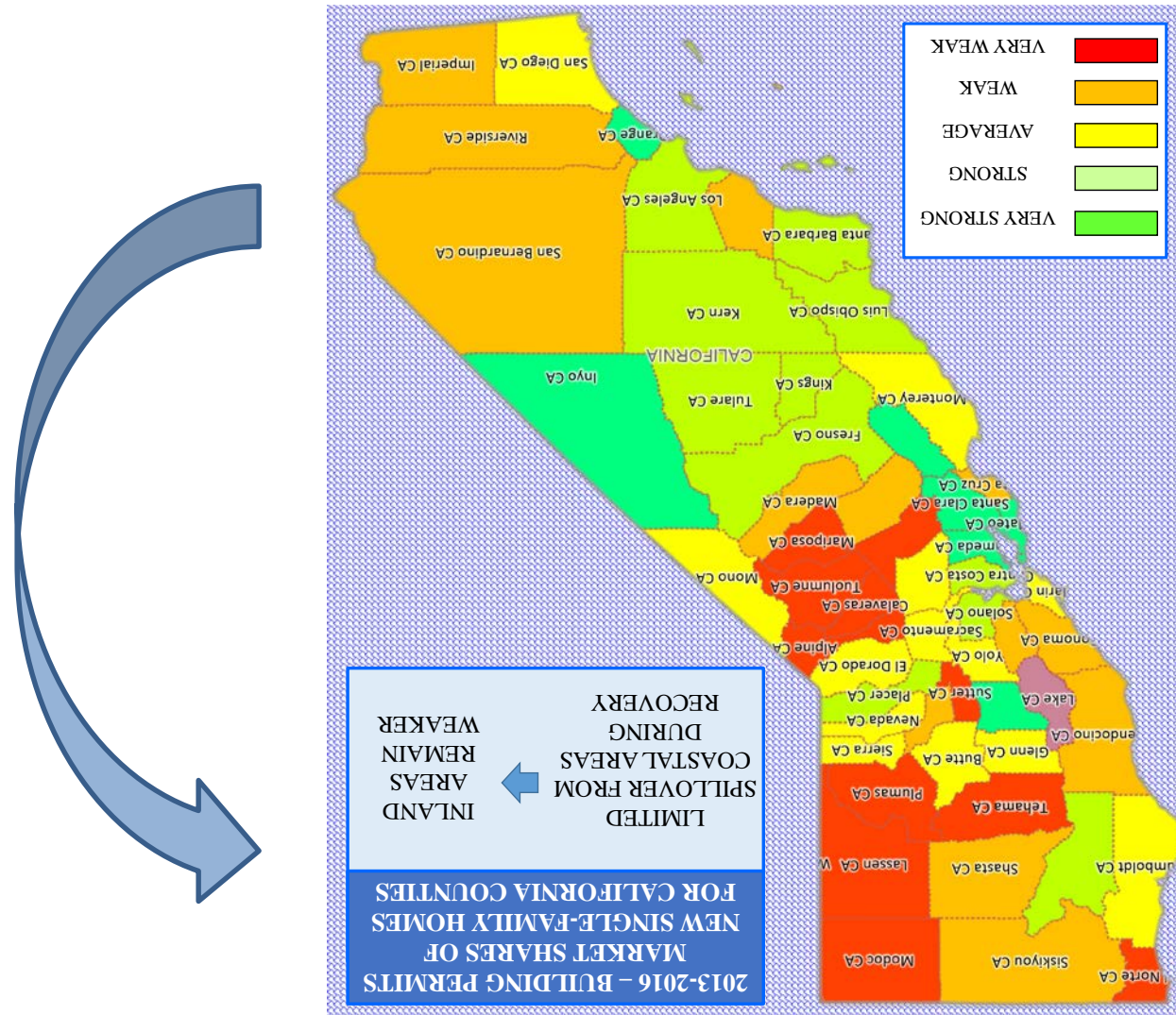
COMPARISON OF OFFICIAL STATEMENTS PRIOR-1992 VS. RECENT-2016

YEAR	<u>COUNTY OF ORANGE</u>	<u>POWAY UNIFIED SCHOOL DISTRICT</u>
ISSUE SIZE	1992 \$119 Million	2016 \$15 Million
HOMES/ACRES	12,259 HOMES 359 NON-RES ACRES	279 HOMES
MAIN TEXT	77 PAGES	72 PAGES
APPENDIX	80 PAGES	168 PAGES
MARKET SHIFTS	*FROM CONDO TO SINGLE-FAMILY *FROM COMM/IND. TO APARTMENTS	SINGLE-FAMILY HOMES 176 OCCUPIED
VALUE/DEBT RATIO	3 TO 1	8 TO 1



CURRENT HOUSING MARKET RECOVERY

MAJOR STRUCTURAL SHIFT: PRODUCT TYPES AND GEOGRAPHIC AREAS



OVERVIEW

1. **FOR CFD FORMATIONS, WHAT ARE THE CRITICAL ECONOMIC RISK FACTORS?**



2. **FOR CFD BOND SALES, WHAT ARE THE CRITICAL ECONOMIC RISK FACTORS?**



3. **MACROECONOMIC FACTORS**

****FREE RAIN RIDE*



4. **WHAT IS THE NEW HOUSING MARKET PARADIGM:**

STRUCTURAL SHIFTS IN HOUSING PRODUCTS AND GEOGRAPHIC AREAS



WHAT ARE THE CHARACTERISTICS OF MILLENNIALS:
ASPIRATIONS VS. ACTUAL CHOICES



5. **WHAT ARE THE POTENTIAL IMPACTS OF THE TAX CUTS /JOBS ACTS
ON NEW CFD HOUSING PROJECTS ?**

****NOT PAY TAXES*





I. MAJOR CHALLENGES AT FORMATION

WHICH PROVIDES BETTER PROTECTION OVER TIME - ISSUER'S TOTAL TAX BURDEN OF 1.72% VS. 2.00%?

- **2.00%** CURRENT BASE PRICES ONLY – PROVIDES SAFEGUARDS FOR HOUSING MARKET CHANGES
- **1.72%** USE OF DEVELOPER PRICES WHICH INCLUDE APPRECIATION, OPTIONS/UPGRADES, PREMIUMS, ETC.

TECHNIQUES OBSERVED TO MAXIMIZE SPECIAL TAX REVENUES

- | | | |
|-------------|--------------------------------|--|
| +10% | SPECIAL TAX SQ. FT. CATEGORIES | THE SMALLER, THE MORE REVENUE |
| + 9% | APPRECIATION | EXTRAPOLATION OF RECENT TRENDS, BUT FUTURE UNCERTAIN |
| +12% | OPTIONS/UPGRADES | DEPENDS ON STRENGTH OF ECONOMY |
| +8% | PREMIUMS: LOT SIZES / VIEWS | AVERAGE, BUT VARIES SIGNIFICANTLY FOR SPECIFIC HOMES |
| +39% | AGGREGATE IMPACT | |

IF MARKET SOFTENS AND PRICES STABILIZE, THEN, NO APPRECIATION, OPTIONS/UPGRADES OR PREMIUMS

- DEVELOPER PRICES WILL ADJUST TO **CURRENT BASE PRICES ONLY**: TAX BURDEN FROM **1.72%** TO **2.00%**
- NOTE: ONCE SPECIAL TAXES SET, DO NOT ADJUST WITH CONDITIONS: **FULLY PLEDGED TO BONDHOLDERS**



**ISSUER POLICIES REGARDING PRICE POINTS USED TO SET SPECIAL TAXES
MORE SIGNIFICANT THAN TAX BURDEN PERCENTAGE RATE**

EXAMPLES OF TECHNIQUES FOR MAXIMIZING SPECIAL TAX REVENUES AND POTENTIAL SAFEGUARDS

1- TAX CLASS 5-TAX CLASSES
2000-2499 100 SQ.FT.

TAX CLASSES SQ.FT.	LOWEST TAX RATE	EACH CLASS TAX RATE
2000 - 2099	\$2,000	\$2,000
2100 - 2199	Use Above	\$2,100
2200 - 2299	Use Above	\$2,200
2300 - 2399	Use Above	\$2,300
2400 - 2499	Use Above	\$2,400
AVERAGE	\$2,000	\$2,200
	Increase	10.0%

SPECIAL TAX BURDENS ROLE OF TAX BURDEN % VS. COMPUTATION OF PRICE POINTS (EXCLUDES AD VALOREM OF 1.0%)			
	PERCENT	DEVELOPER	CDIAC
BASE PRICE		\$200,000	\$200,000
SUPPLEMENTS			N/A
> SIZE TAX CLASS SQ.FT.	10%	\$20,000	
> FUTURE APPRECIATION	9%	\$18,000	
>OPTIONS/UPGRADES	12%	\$24,000	
>PREMIUMS LOT SIZE/VIEWS	8%	\$16,000	
SUB-TOTAL		\$278,000	
SPECIAL TAX 1.00%		\$2,780	\$2,000
ONCE SET, THEN FIXED			
REAL TAX BURDEN		1.39%	1.00%
IF MARKET SOFTENS			
INITIAL RATE TO MEET		72%	1.00%
1.0% IF MARKET SOFTENS		SET AT 1.72%	OK AT 1.00%
		INITIALLY	

TECHNIQUE TO MAXIMIZE REVENUE:

- MORE TAX CLASSES CAN BE USED TO INCREASE REVENUES, BY ABOUT + 10%

POTENTIAL SAFEGUARD:

- SET TAXES USING CDIAC STANDARD TO ABSORB IMPACT IF MARKET SOFTENS

HOUSING PRICE PATTERNS IN SOUTHERN CALIFORNIA

2000–2006: VERY STRONG APPRECIATION IN INLAND AREAS

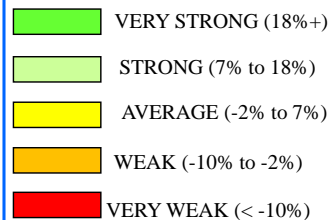
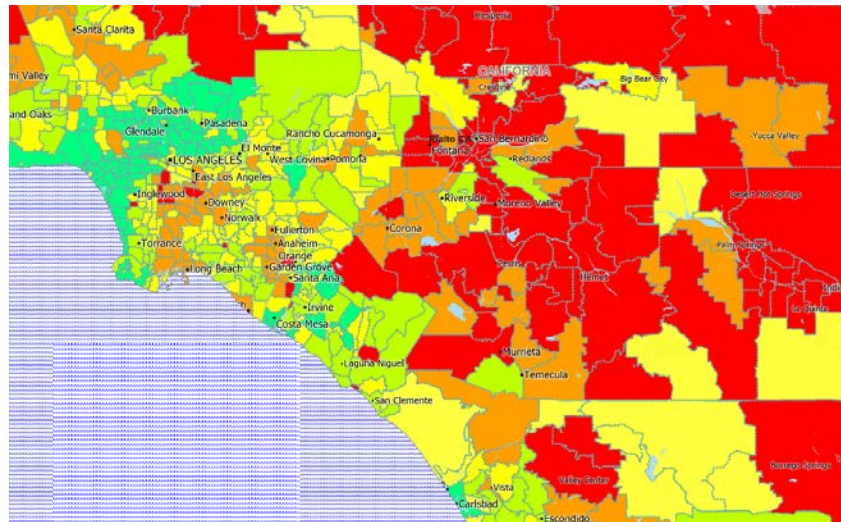
2017–2018 HOME PRICES STILL BELOW PRIOR PEAK LEVELS IN INLAND AREAS

HOUSING PRICE LEVEL CHANGE 2018-CURRENT VS. 2007-PRICE PEAK BY SCAL ZIP

ROAD BACK TO
2007 PRICE PEAK
CONTINUES FOR
SOME
GEOGRAPHIES



MORE INLAND
THAN COASTAL
AREAS REMAIN
BELOW PEAK
LEVELS



II. MAJOR CHALLENGES REGARDING TIMING OF BOND ISSUANCE



DEVELOPER HAS A STRONG INCENTIVE TO HAVE BONDS ISSUED AS EARLY IN THE PROJECT DEVELOPMENT AS POSSIBLE



HIGHEST RISK LEVEL EARLY ON:

- CONCENTRATION OF RISK OF OWNERSHIP IS HIGHEST WHEN DEVELOPER OWNS ALL THE LAND
- TYPICALLY, THE BOND PROCEEDS GO TO THE DEVELOPER AS REIMBURSEMENTS FOR INFRASTRUCTURE

MITIGATING RISK:



- RISK IS DIMINISHED WHEN BUILDERS PURCHASE PARCELS FROM DEVELOPER PROVIDING SOME DIVERSIFICATION AND CONSTRUCTION
- RISK IS MINIMIZED WHEN PROJECT IS FULLY CLOSED OUT TO HOMEBUYERS ALL HOMES ARE CONSTRUCTED AND OCCUPIED
- SINCE 2009, MOST BONDS ISSUED WITH BUILDER MODELS OPENED AND/OR HOMEOWNERS



CAREFULLY CONSIDER BOND ISSUANCE TIMING TO MITIGATE RISK

III. MACROECONOMIC CONDITIONS



FACTORS NATIONAL IN SCOPE AND HAVE SUBSTANTIAL IMPACTS ON THE HOUSING MARKET

1. ECONOMIC-EMPLOYMENT CYCLE
2. HOUSING MARKET CYCLE: NEW HOME PERMITS
3. HOUSING PRICE PATTERNS
4. MORTGAGE RATE LEVELS
5. LENDERS MORTGAGE LOAN CRITERIA
6. GAS PRICE TRENDS

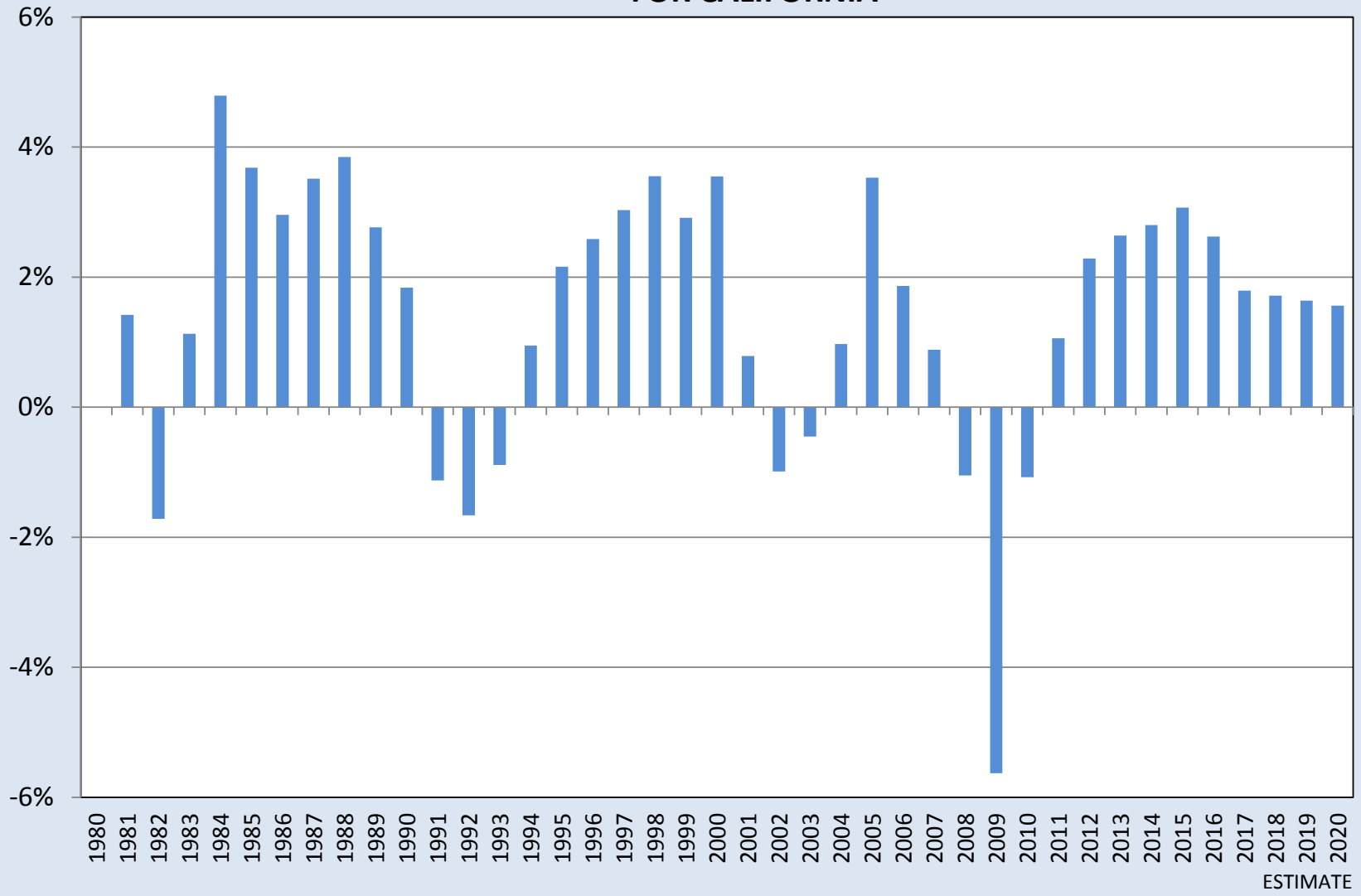
FACTORS ARE BEYOND CONTROL AND SUBJECT TO CHANGE

** FREE TRAIN RIDE*

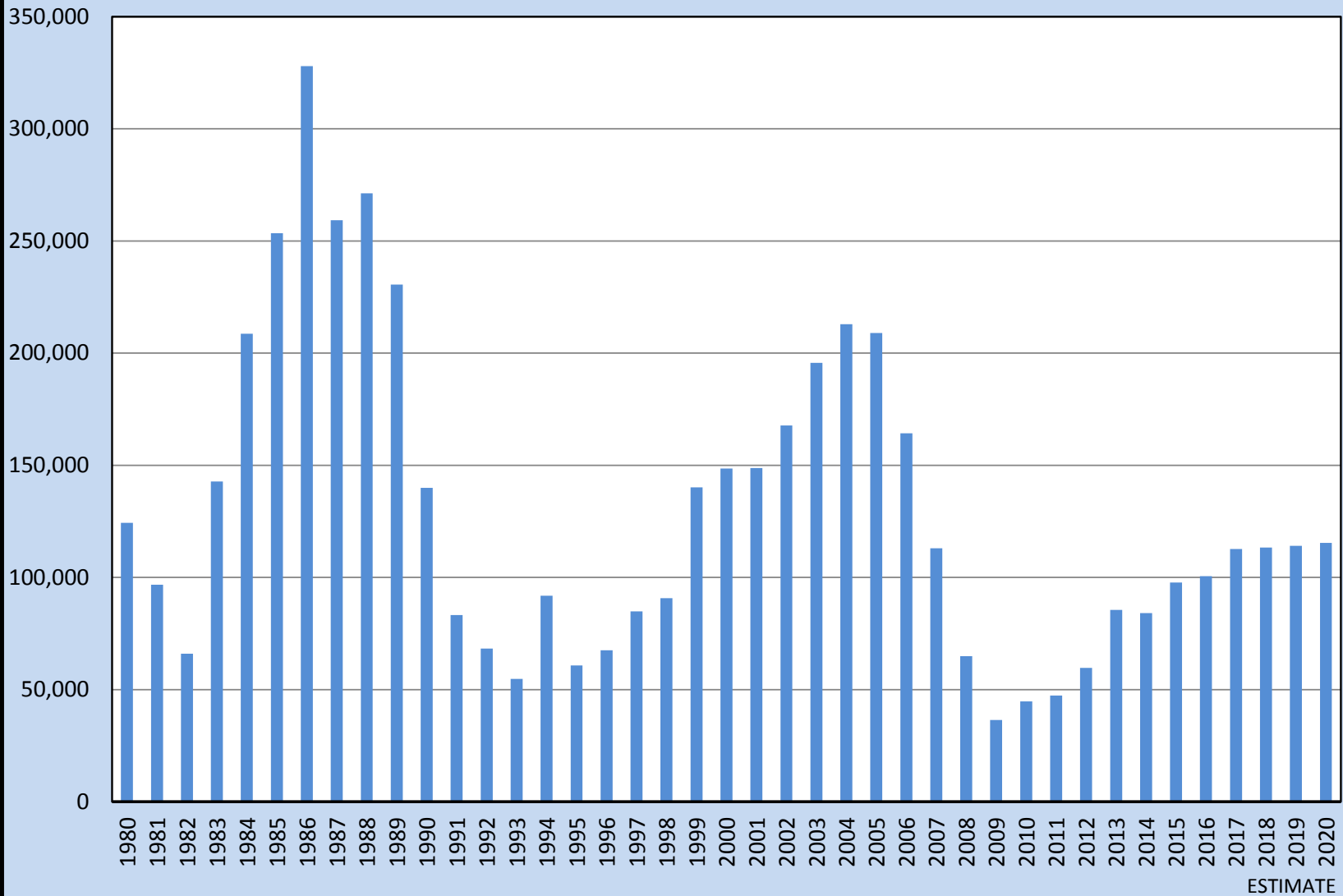


**WHEN FORECASTING THE FUTURE, DO NOT *EXTRAPOLATE” THE CURRENT TREND:
ECONOMY/MARKET HAS SELF-CORRECTING MECHANISM THAT WILL REVERSE THE TREND**

ANNUAL CHANGES IN TOTAL EMPLOYMENT FOR CALIFORNIA

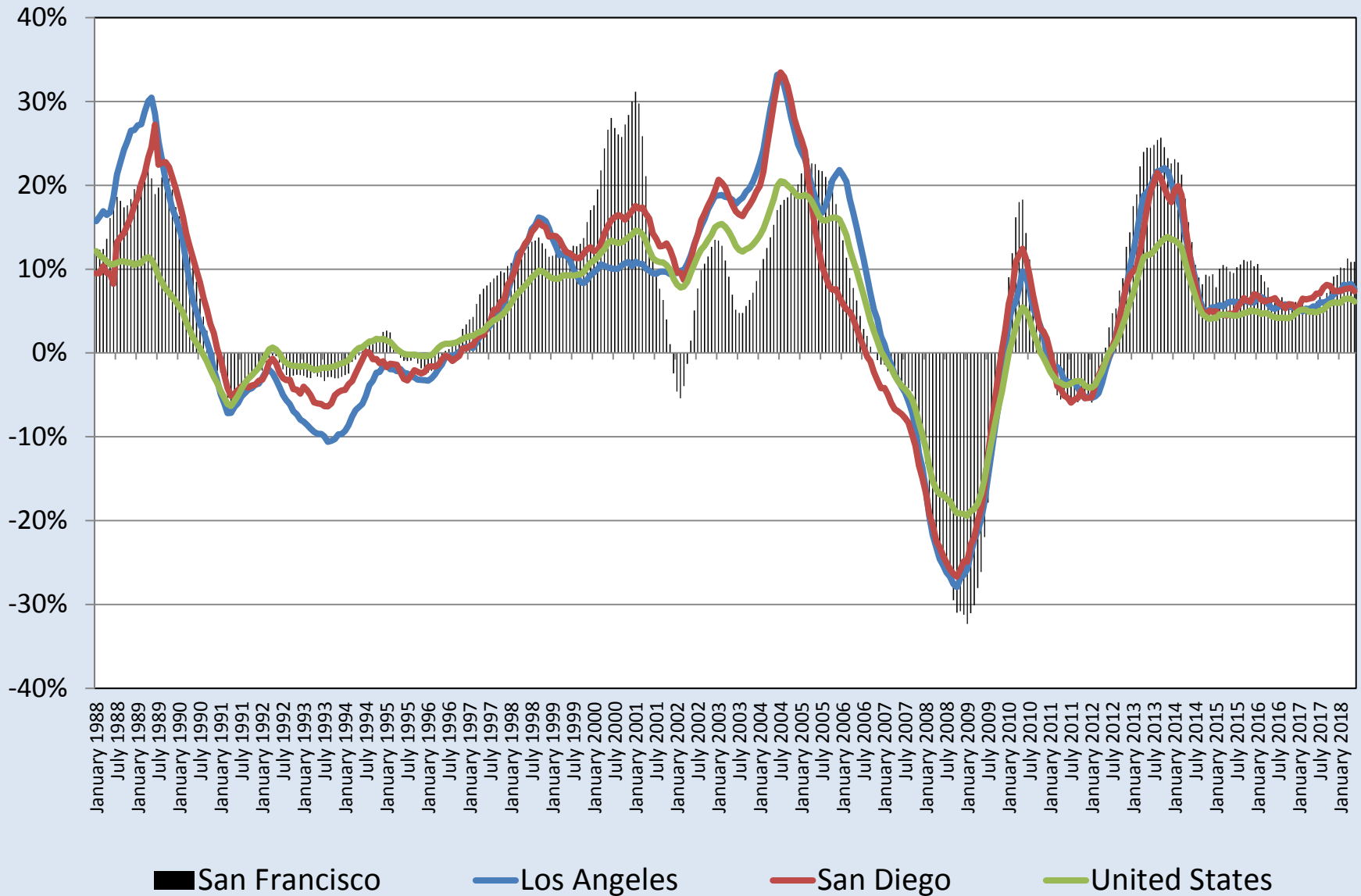


NEW SINGLE AND MULTIPLE-FAMILY HOMES CALIFORNIA - ANNUALLY



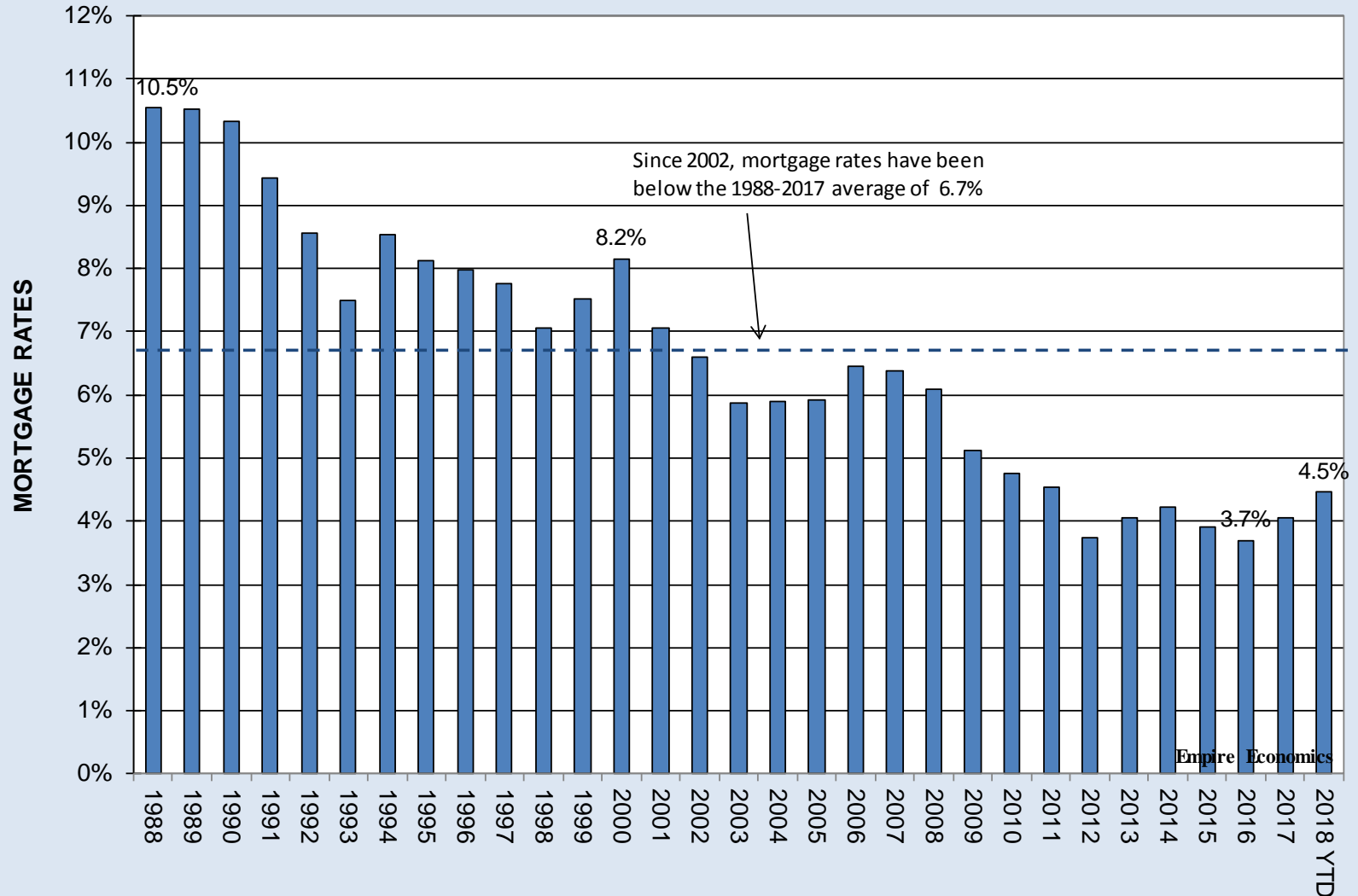
HOUSING PRICES: UNITED STATES AND CALIFORNIA REGIONS

HOUSING PRICE CHANGES - ANNUALLY

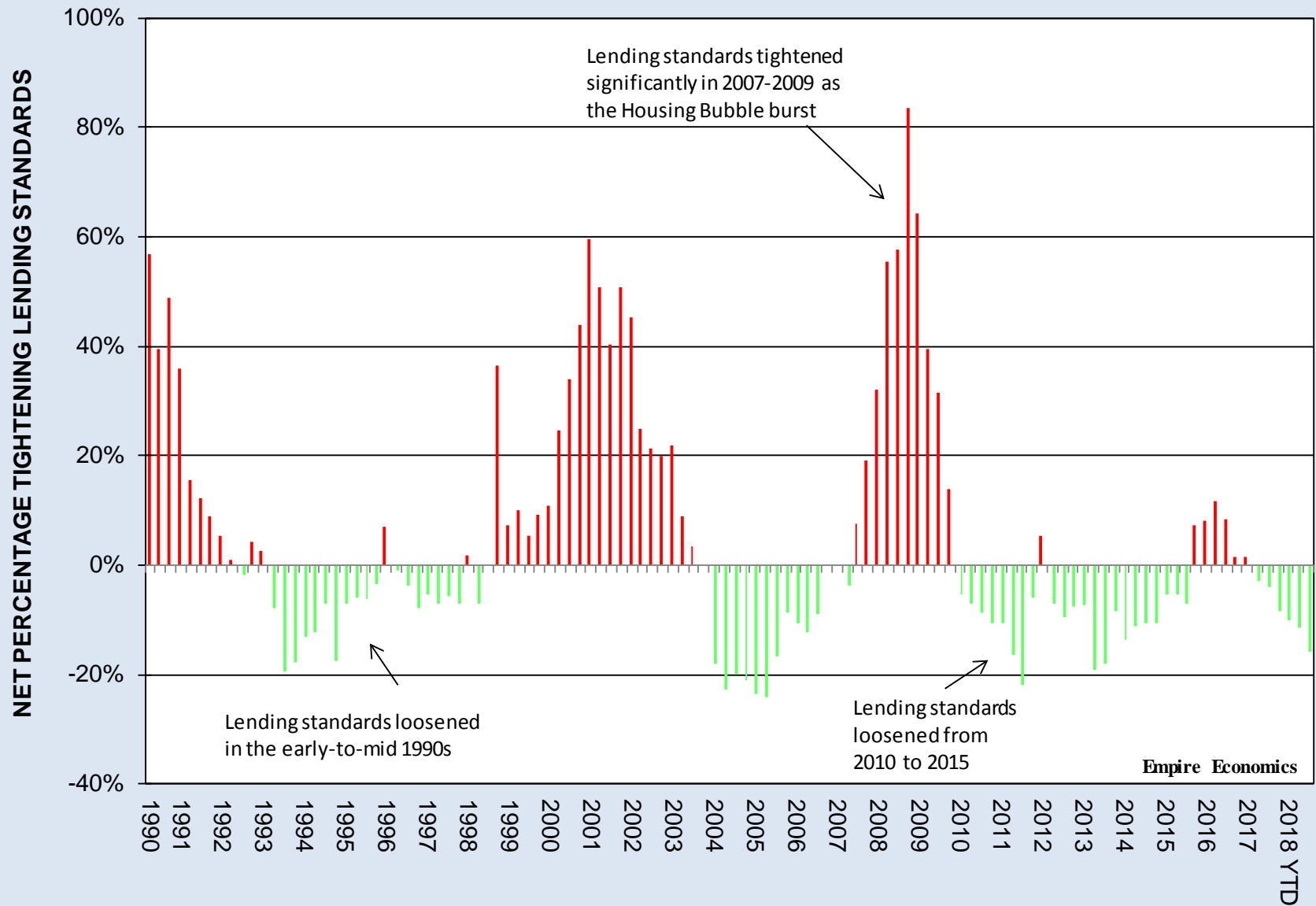


UNITED STATES: MORTGAGE RATES

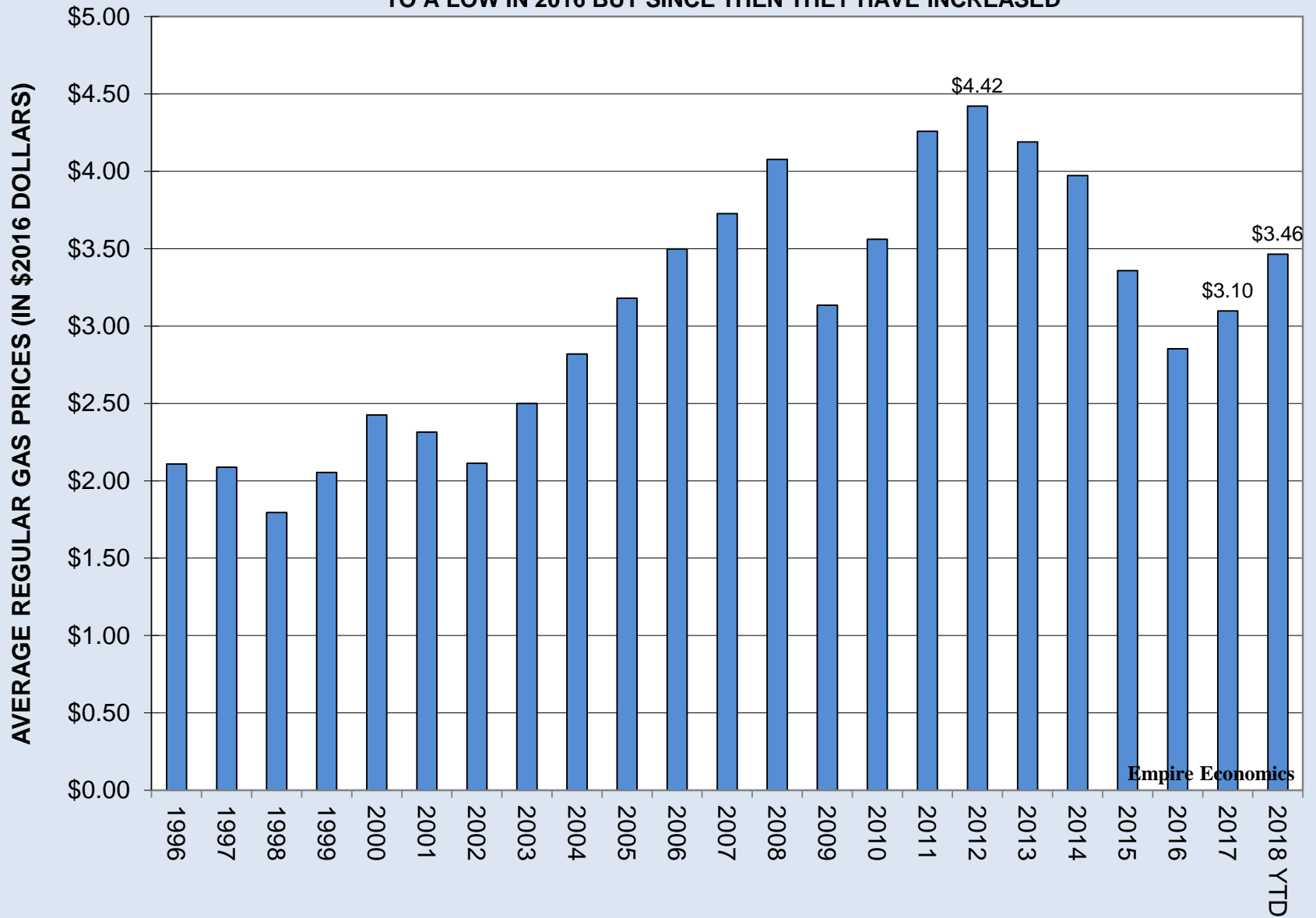
MORTGAGE RATES AT RECENT LOW LEVELS



UNITED STATES: FEDERAL RESERVE'S SENIOR LOAN OFFICER SURVEY



CALIFORNIA: AVERAGE GAS PRICES
AFTER REACHING A PEAK LEVEL IN 2013, GAS PRICES DECLINED
TO A LOW IN 2016 BUT SINCE THEN THEY HAVE INCREASED

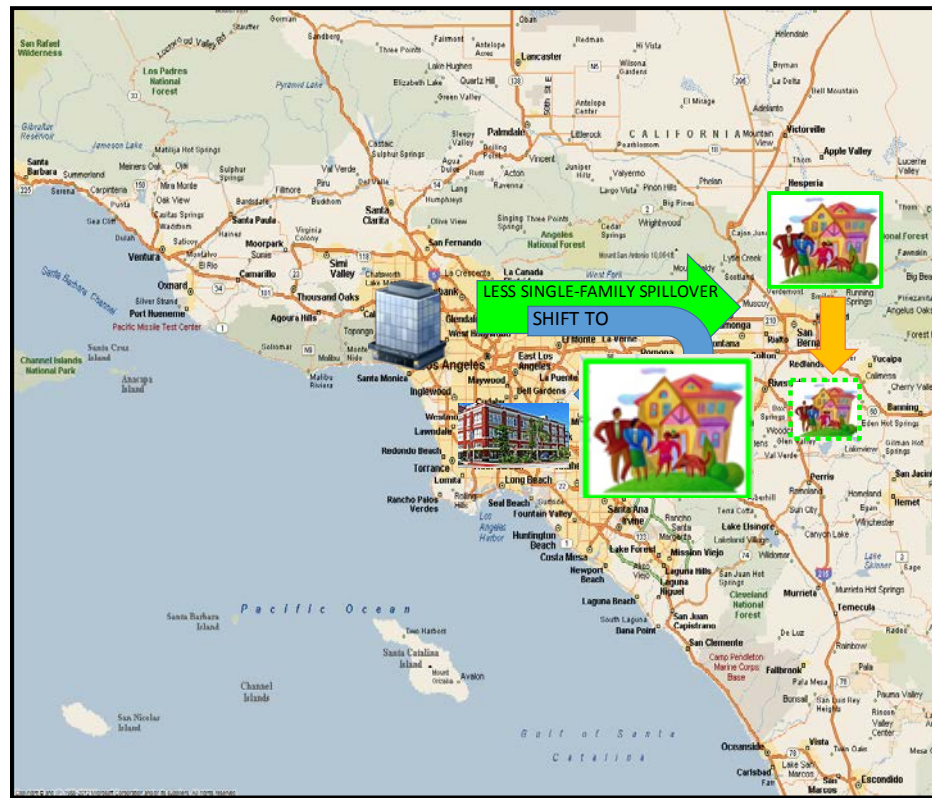


III. HOUSING MARKET MAJOR PARADIGM SHIFT MILLENNIALS: AGES 18-36



ALTHOUGH EMPLOYMENT GROWTH WAS STRONG, THERE WERE EXTRAORDINARY SPECIAL FACTORS CAUSING MAJOR MARKET SHIFTS DURING 2013-2016

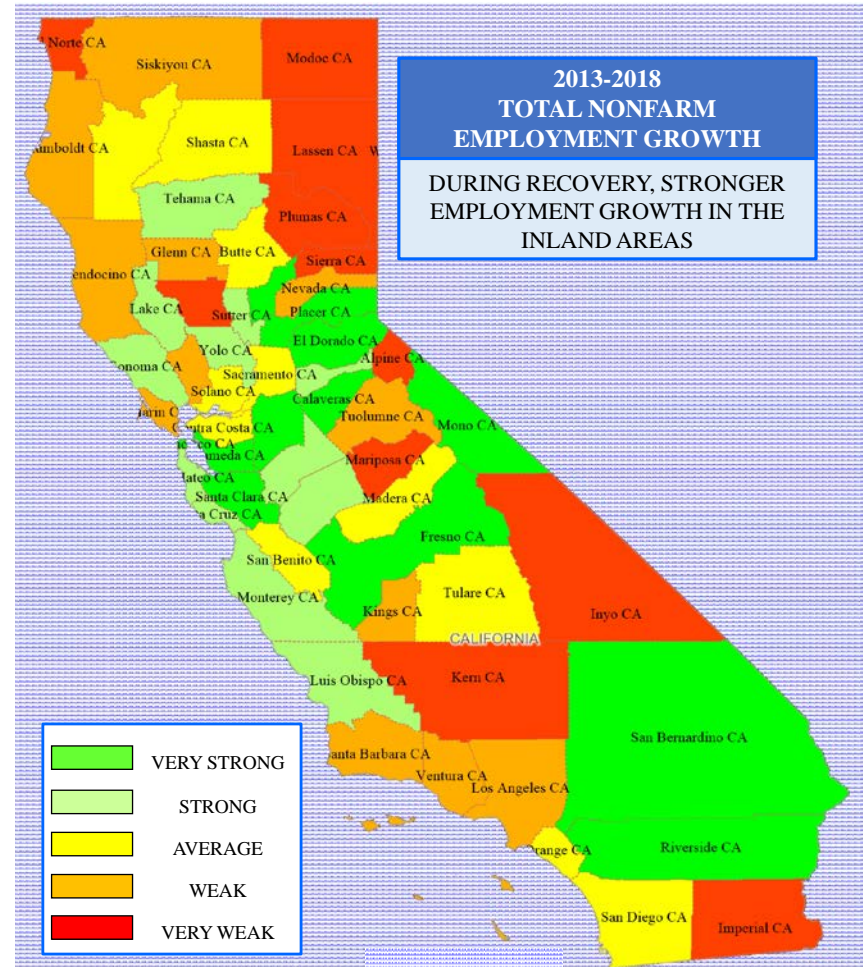
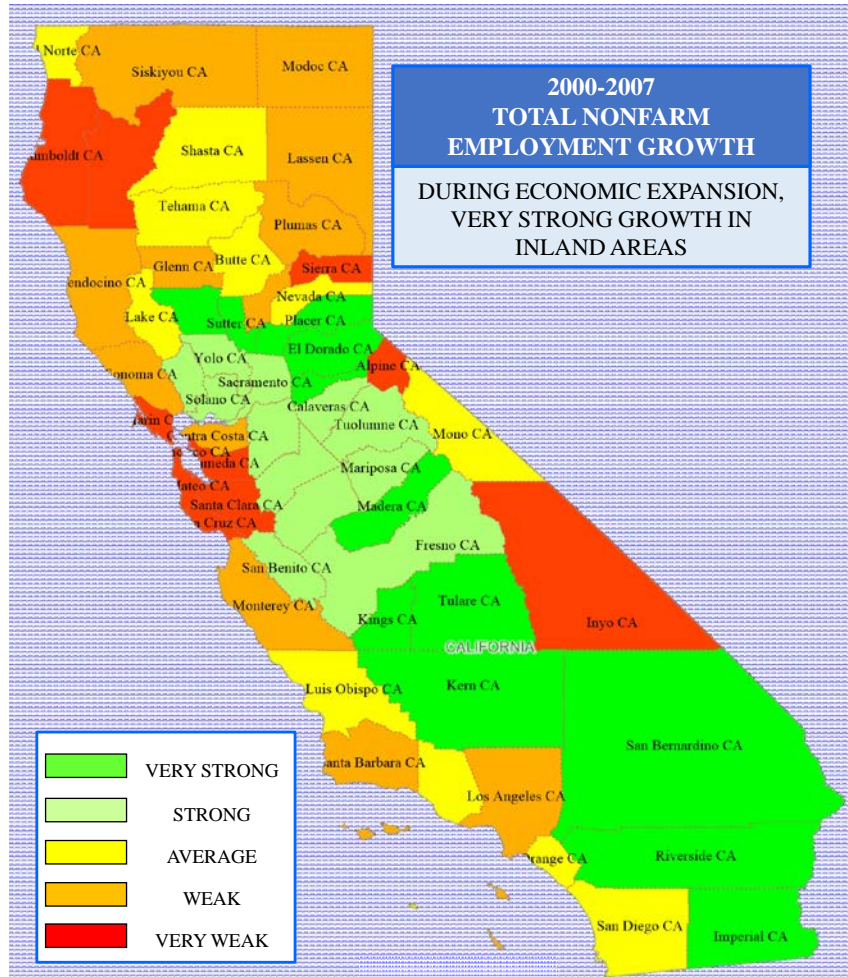
A SURGE IN NEW APARTMENT DEVELOPMENT IN THE COASTAL AREAS DISPLACED THE TRADITIONAL DEMAND FOR NEW SINGLE-FAMILY HOMES IN INLAND AREAS



**SINCE 2013, A
REDUCTION OF
ABOUT **50,000** NEW
SINGLE-FAMILY
HOMES IN THE
INLAND EMPIRE**

A. OVERVIEW OF ECONOMIC-EMPLOYMENT CONDITIONS

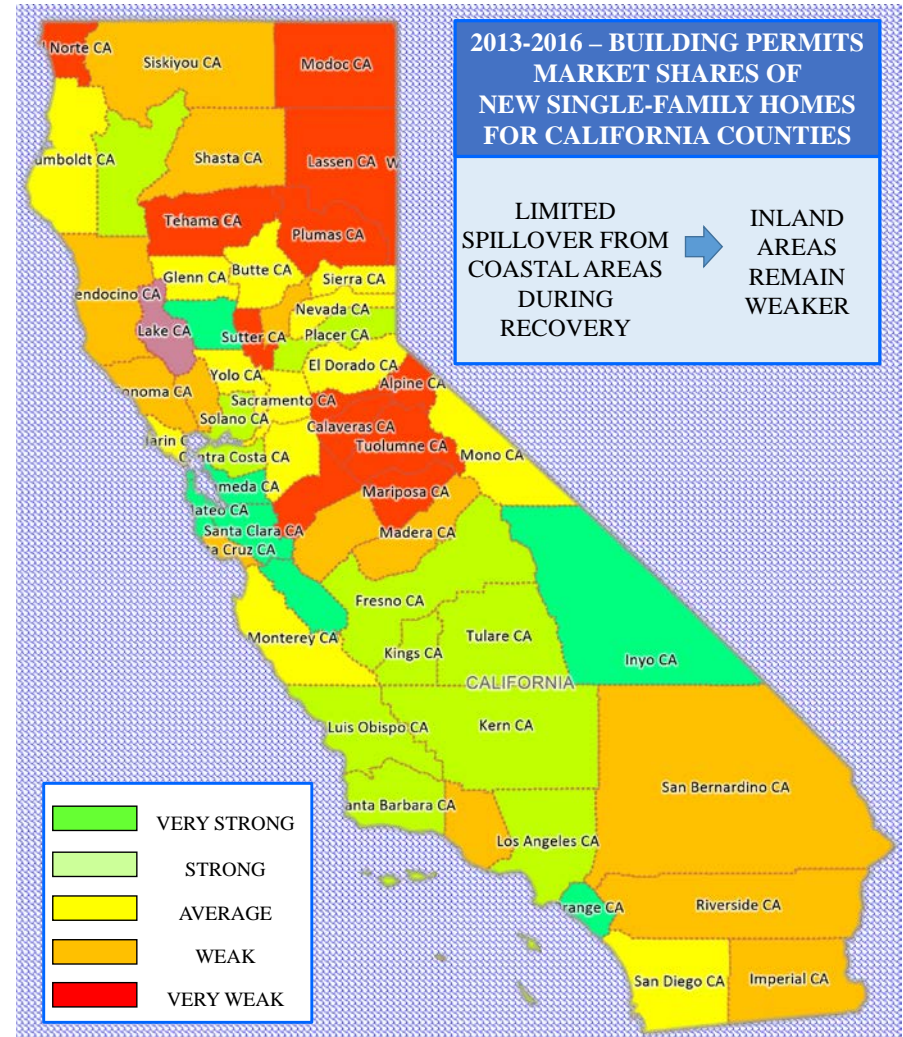
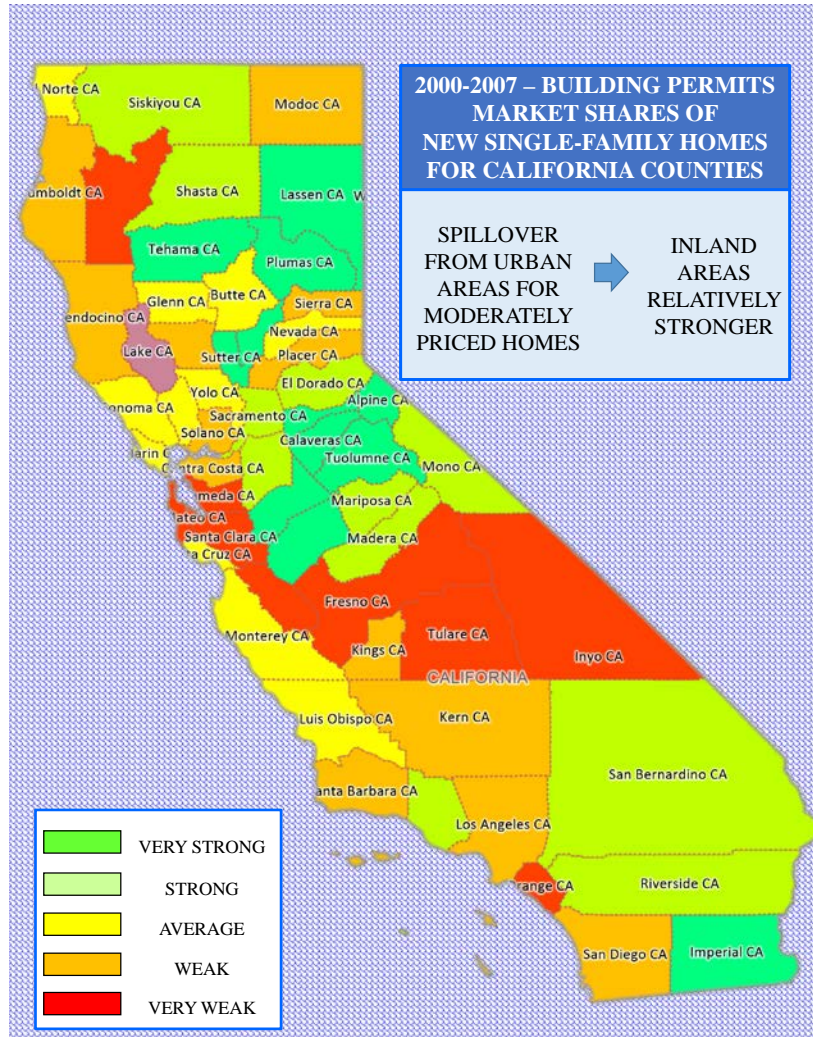
2000–2007: RELATIVELY STRONG EMPLOYMENT GROWTH IN INLAND AREAS
2013–2018: ALSO RELATIVELY STRONG EMPLOYMENT GROWTH IN INLAND AREAS



B. OVERVIEW OF SINGLE-FAMILY HOMES MARKET STRUCTURAL SHIFTS

2000– 007: STRONG DEMAND FOR SINGLE-FAMILY IN INLAND AREAS

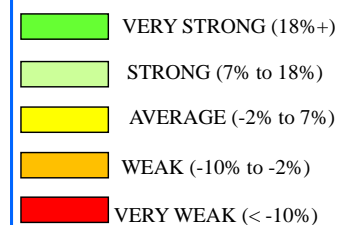
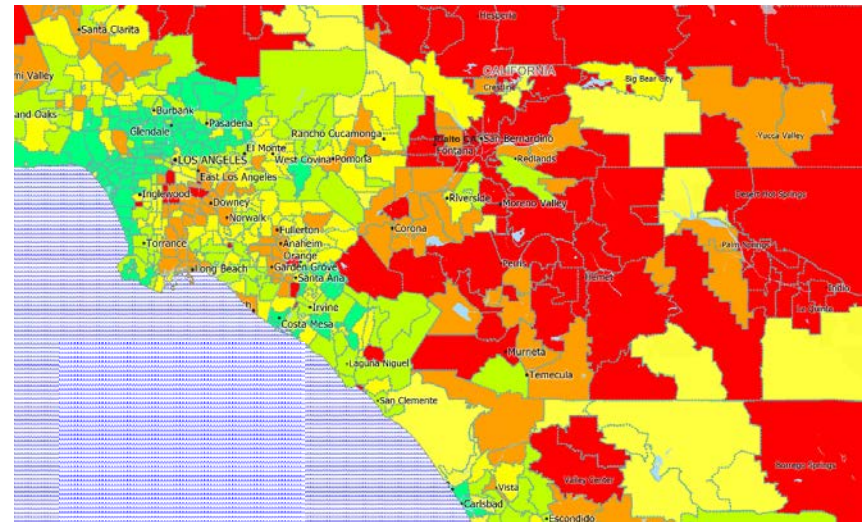
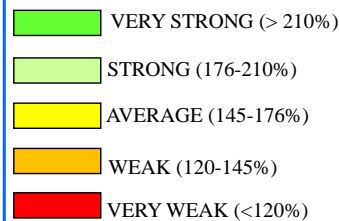
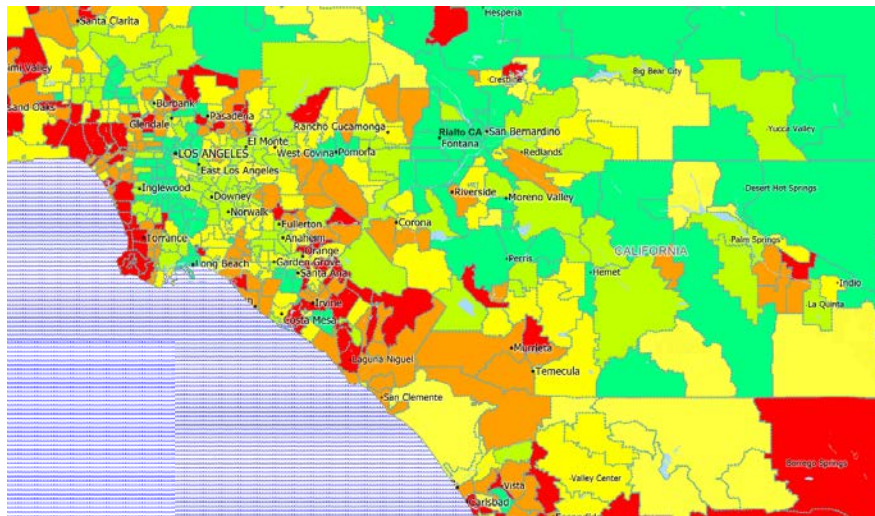
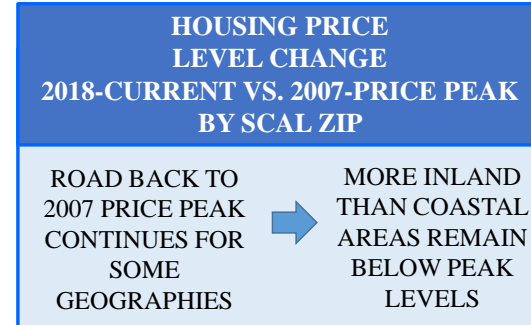
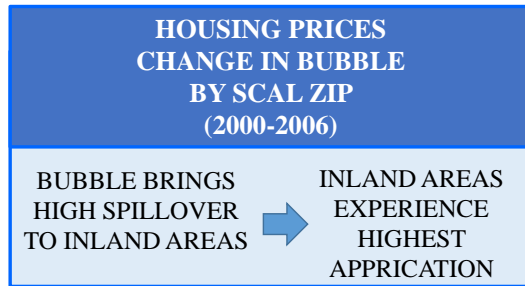
2013–2016: WEAK DEMAND FOR SINGLE-FAMILY AND INLAND AREAS



C. HOUSING PRICE PATTERNS IN SOUTHERN CALIFORNIA

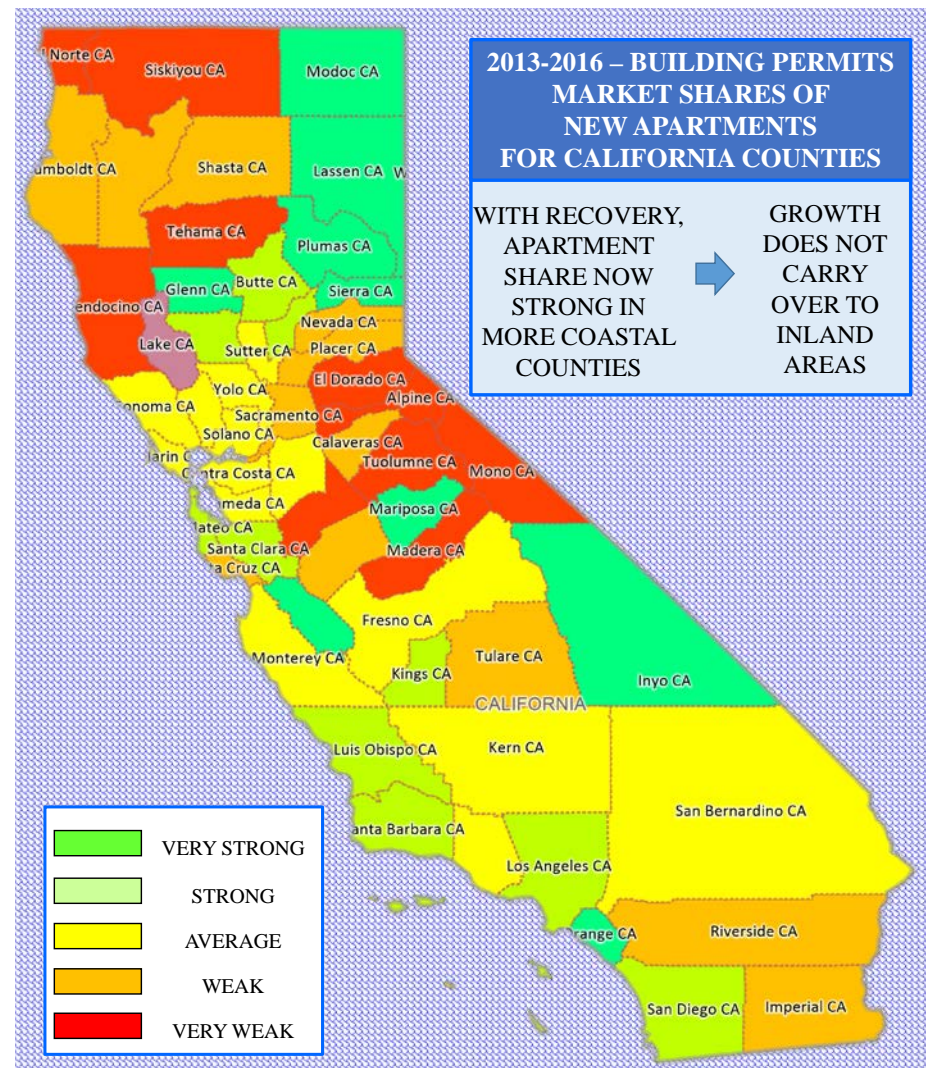
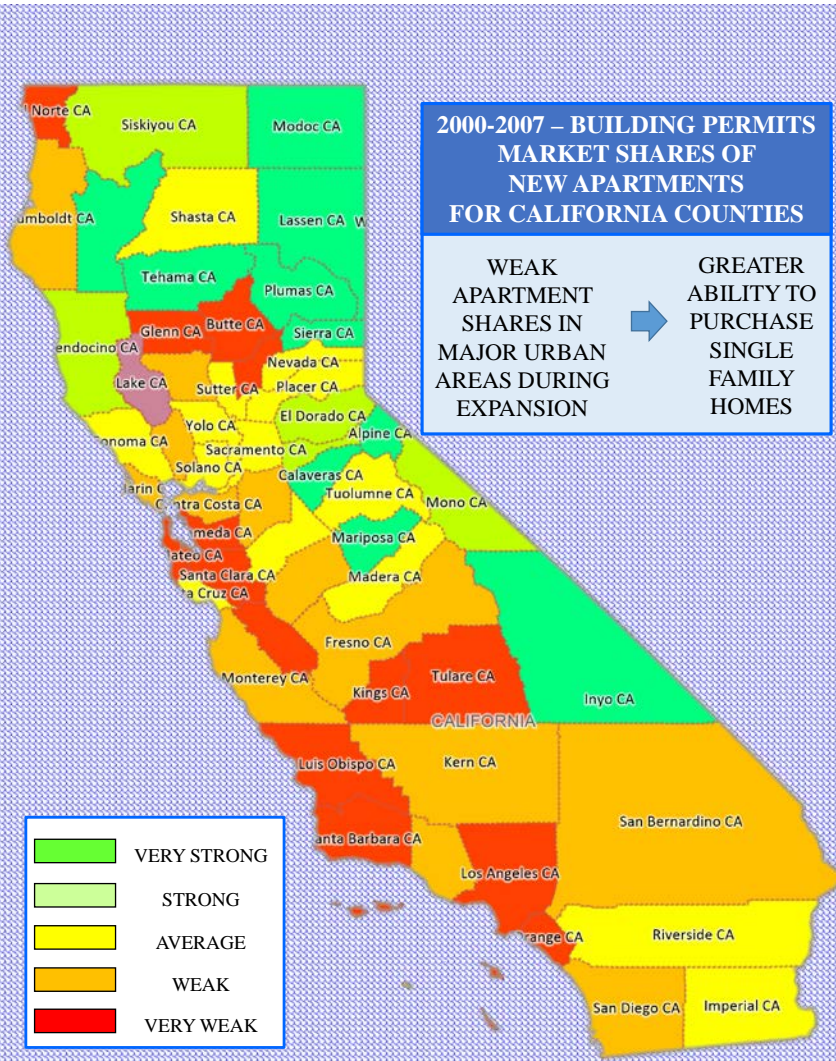
2000–2006: VERY STRONG APPRECIATION IN INLAND AREAS

2017–2018: HOME PRICES STILL BELOW PRIOR PEAK LEVELS IN INLAND AREAS



D. OVERVIEW OF APARTMENT MARKET STRUCTURAL SHIFTS

2000–2007: FOR SC, WEAK DEMAND FOR APARTMENTS IN COASTAL AREAS
 2013–2016 FOR SC, STRONG DEMAND FOR APARTMENTS IN COASTAL AREAS



IV. - CONTINUED

CHARACTERISTICS OF MILLENNIALS: ASPIRATIONS VS. ACTUAL HOUSING MARKET CHOICES



MILLENNIALS (AGED 18-36) ARE MOST SIGNIFICANT FACTOR DRIVING STRUCTURAL SHIFT

1) MILLENNIAL INCOME A DRIVER IN HOUSING PREFERENCE



- HIGHER INCOME: CAN PURCHASE A HOME IN URBAN AREA, BUT SOME STILL PREFER TO RENT
- MODERATE INCOME: PURCHASING A SINGLE-FAMILY HOME BUT IN THE SUBURBS, A LONG COMMUTE
- LOWER INCOME: POTENTIALLY LONG-TERM RENTERS

2) MILLENNIALS CURRENTLY HAVE STRONG PREFERENCE FOR RESIDING IN URBANIZED AREAS:



- STRONG/DIVERSIFIED URBAN EMPLOYMENT CENTER PROVIDES MANY OPTIONS FOR EMPLOYMENT
- CLOSE PROXIMITY TO THEIR CURRENT PLACE OF EMPLOYMENT (PREFER SHORTER COMMUTE)
- ABUNDANCE OF CULTURAL, DINING AND ENTERTAINMENT OPPORTUNITIES

3) MILLENNIALS CURRENTLY ACCEPT APARTMENTS-RENTALS VS. HOMEOWNERSHIP



- COMFORTABLE RENTING VS OWNING – PERSONAL FLEXIBILITY
- GENERALLY DELAYING MARRIAGE AND HAVING CHILDREN
- RENTING AN APARTMENT SOLVES THEIR HOUSING AFFORDABILITY CHALLENGE
- MANY NEW APARTMENT COMPLEXES OFFER RESORT LIKE FEATURES

FORECAST OF FUTURE DEMAND FOR NEW SINGLE FAMILY FOR-SALE HOMES IN INLAND AREA

**HIGH PROPORTION OF MILLENNIALS REGARD HOMEOWNERSHIP AS SIGNIFICANT COMPONENT OF THEIR
VISION OF A SUCCESSFUL LIFESTYLE (PER SURVEYS) BUT HAVE CHALLENGES GETTING THERE**

**8%
Lag**

MILLENNIALS WAITING LONGER TO PURCHASE HOMES THAN PRIOR GENERATIONS

- CURRENTLY, ~32% OF MILLENNIALS OWN HOMES
- AT SAME AGE, COMPARED TO GENXERS (NOW 37-52) AND BABY BOOMERS (NOW 53-71), MILLENNIALS LAG BY 8%

MILLENNIALS FACE CHALLENGES IN BECOMING HOMEOWNERS

- SAVING A SUFFICIENT AMOUNT FOR A DOWN PAYMENT, A MAJOR CONCERN BY MANY
- QUALIFYING FOR A MORTGAGE - IMPACTED BY STUDENT DEBT
- ACCEPTING MOVE TO A SUBURBAN/RURAL AREA NECESSARY TO FIND MODERATELY PRICED HOUSING
 - MAJOR LIFESTYLE CHANGE FROM AN URBAN TO A SUBURBAN ENVIRONMENT
 - UNDERTAKING A MAJOR COMMUTE BETWEEN THE URBAN/EMPLOYMENT AND SUBURBAN/HOUSING



**EXPECTATIONS OF MILLENNIALS:
TIME HORIZONS FOR PURCHASING A HOME – MOST LIKELY 3-5 YEARS IN FUTURE**

V. POTENTIAL IMPACTS OF THE TAX CUTS AND JOBS ACTS ON NEW HOUSING PROJECTS



HISTORICALLY, THE U.S. GOVERNMENT HAS PROMOTED HOMEOWNERSHIP AS BENEFICIAL TO ITS CITIZENS



- TO INCENTIVIZE HOMEOWNERSHIP, ABLE TO DEDUCT PROPERTY TAXES AND MORTGAGE INTEREST
- CURRENT HOUSING MARKET PRICE STRUCTURE HAS CAPITALIZED THESE DEDUCTIONS

**WHILE THE TAX CUTS AND JOBS ACT (TCJA) GENERALLY LOWERS FEDERAL INCOME TAXES,
IT IS A MAJOR PUBLIC POLICY SHIFT**



- SALT (STATE INCOME TAXES, SALES TAXES AND LOCAL PROPERTY TAXES) LIMITED TO \$10,000/YEAR
- MORTGAGE LOAN INTEREST DEDUCTIBILITY REDUCED TO \$750,000 FROM \$1,000,000
- HOUSEHOLDS WILL NEED TO UTILIZE AFTER TAX DOLLARS, POTENTIALLY REDUCING HOUSING PRICES

THE IMPACTS OF THE TCJA NOT FULLY UNDERSTOOD UNTIL 2018 TAX RETURNS FILED DURING SPRING 2019

**Spring
2019**

- THE HIGHER THE HOME PRICE/HOUSEHOLD INCOME, GREATER AMOUNT OF NON-DEDUCTIBLES
- THE HIGHER THE INCOME OF THE HOMEOWNER, HIGHER THE TAX RATE, THE GREATER PRICE IMPACT

CHARACTERISTICS OF THE CALIFORNIA HOUSING MARKET

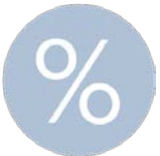
NEW FOR-SALE HOMES IN CALIFORNIA HAVE SIGNIFICANTLY DIFFERENT CHARACTERISTICS MAKING THEM POTENTIALLY MORE AT RISK DUE TO THE NEW TAX POLICIES:



- **CALIFORNIA'S HIGHER PRICES FOR NEW HOMES** RESULT IN HIGHER LEVELS OF AD VALOREM PROPERTY TAXES WHICH ARE ABOUT 1%
 - ADDITIONALLY, NEW HOMES OFTEN HAVE SPECIAL TAXES, UP TO AN ADDITIONAL 1%.



- **CALIFORNIA'S HIGHER STATE INCOME TAXES** OF PURCHASERS AND HIGHER PROPERTY TAXES ARE MORE IMPACTED BY LIMITATION OF A \$10,000 DEDUCTION FOR STATE INCOME TAXES, SALES TAXES AND PROPERTY TAXES (SALT)



- CALIFORNIA'S HIGHER HOME PRICES, ESPECIALLY IN COASTAL AREAS, OFTEN HAVE MORTGAGES THAT EXCEED \$750,000 SO **MANY WILL NOW LOSE THE INTEREST RATE DEDUCTION** ON THE PORTION OF THE MORTGAGE BETWEEN \$750,000-\$1,000,000.



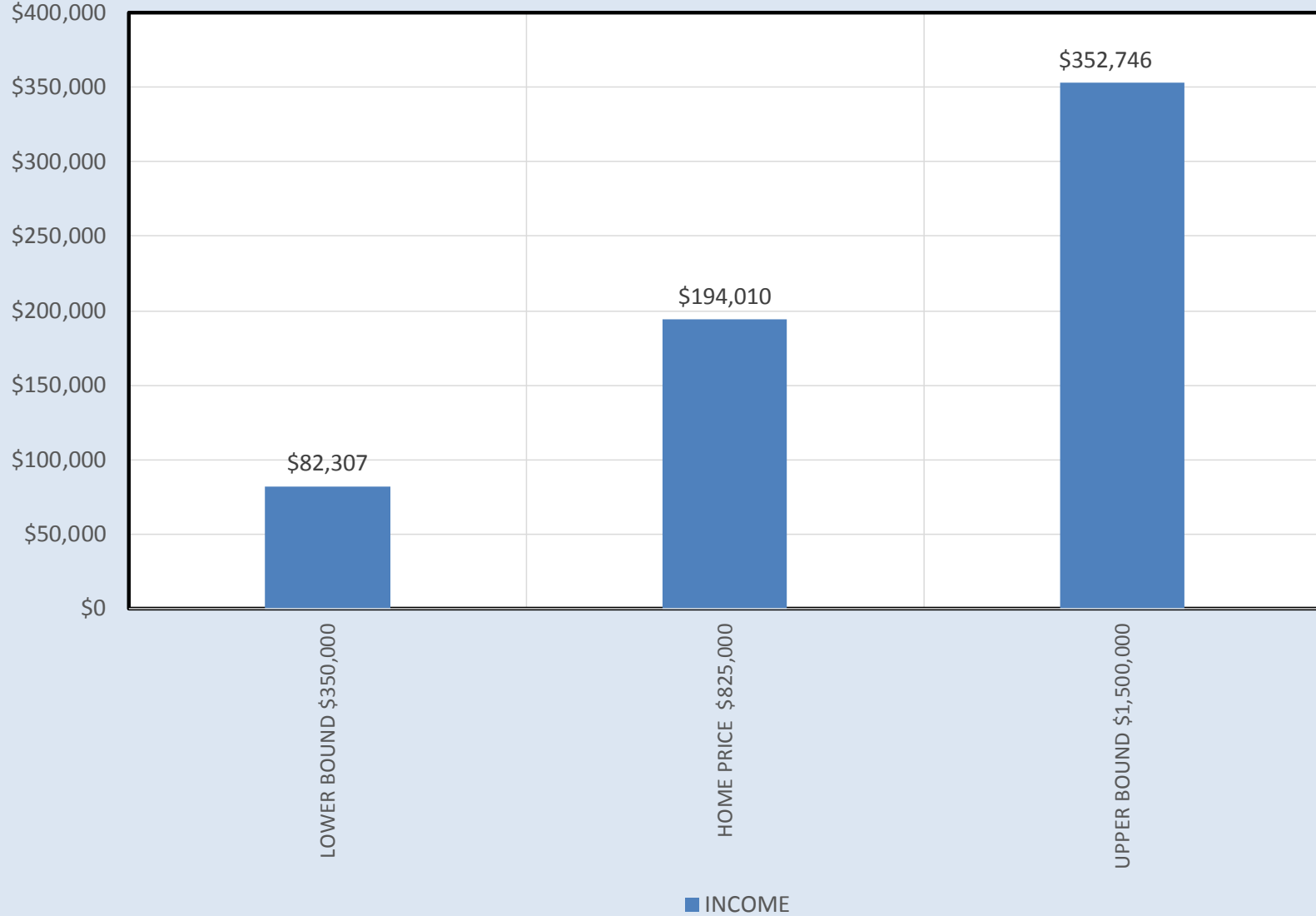
- **FINALLY, NEW HOME SALES HAVE SIGNIFICANT DIFFERENCES THAN EXISTING HOMES:**
 - EXISTING HOMES:
 - GRANDFATHERED PROVISIONS FOR MORTGAGE INTEREST (BUT NOT FOR SALT)
 - MORE DISCRETION TO DELAY THE SALE OF THEIR HOME, UNLIKE BUILDERS THAT REQUIRE SALES TO MAINTAIN THEIR CASH FLOWS.



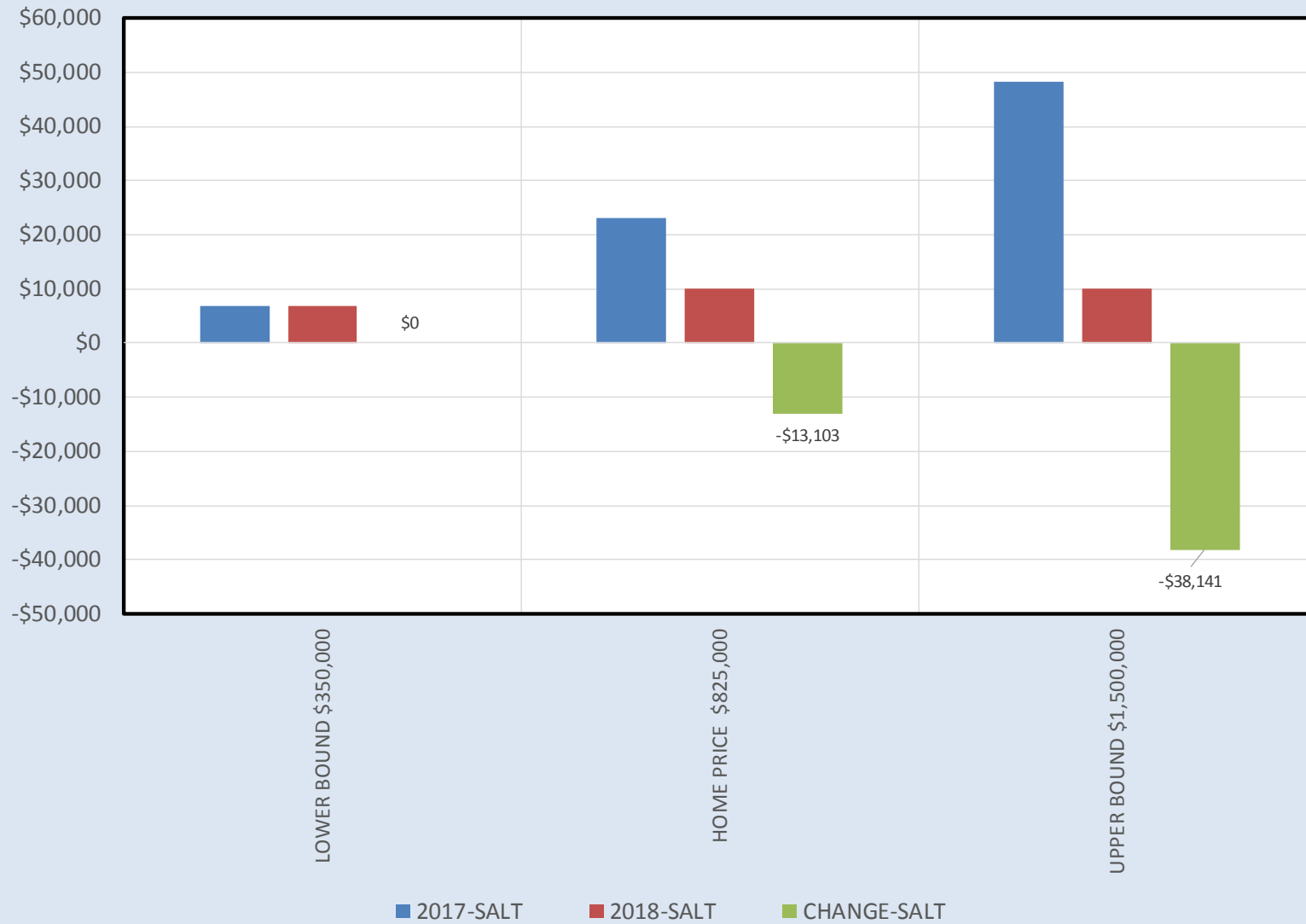
** NOT PAY TAXES*

THEREFORE, CALIFORNIA'S HOUSING MARKET, IN PARTICULAR, IS EXPECTED TO BE MORE IMPACTED THAN THE US MARKET AS A WHOLE

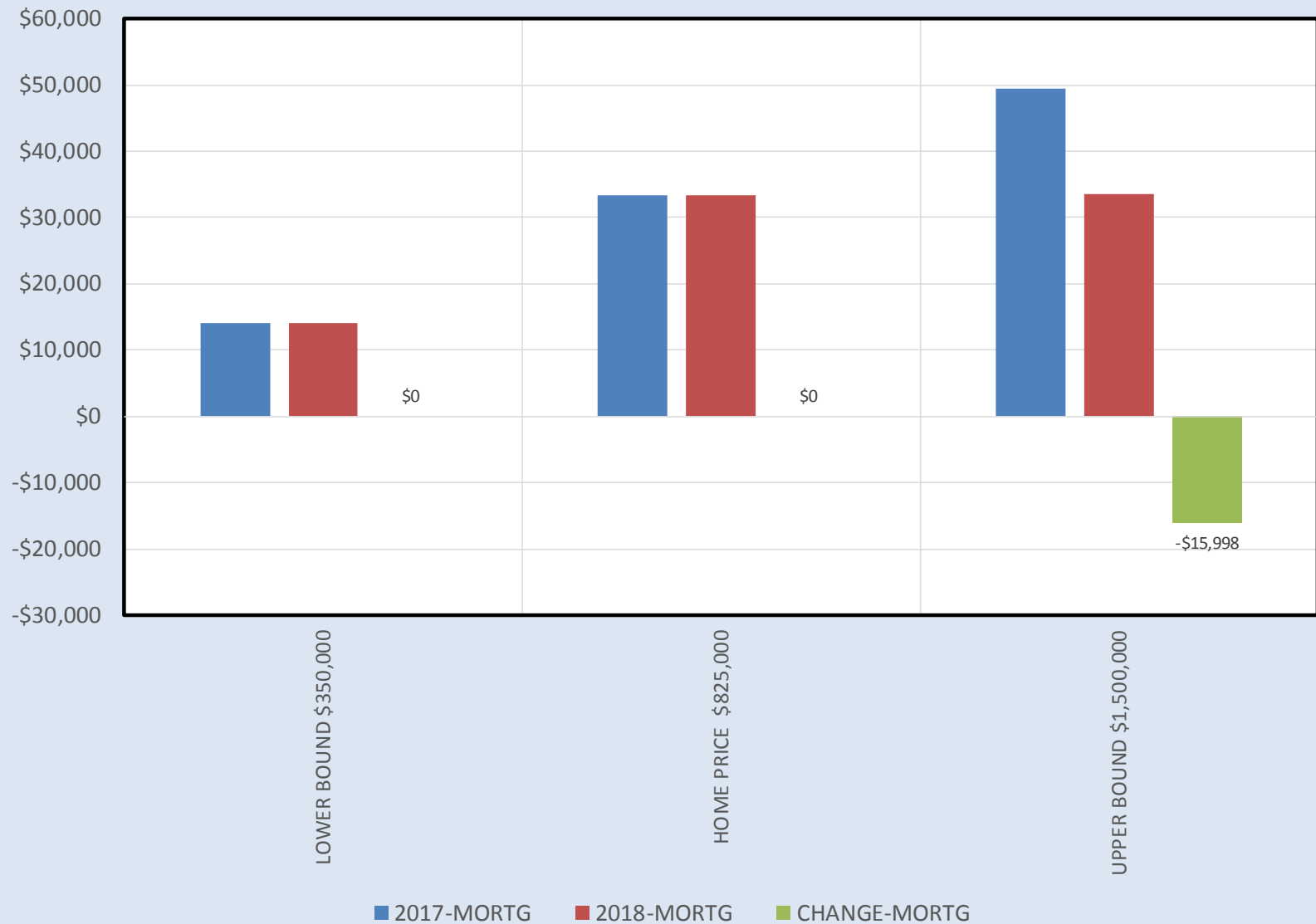
RELATIONSHIP OF HOUSING PRICES AND ESTIMATED INCOME LEVELS BY MARKET SEGMENTS



FEDERAL HOUSING TAX SUBSIDY- SALT ONLY: AMOUNTS AND CHANGES 2018-TCJA VS. 2017

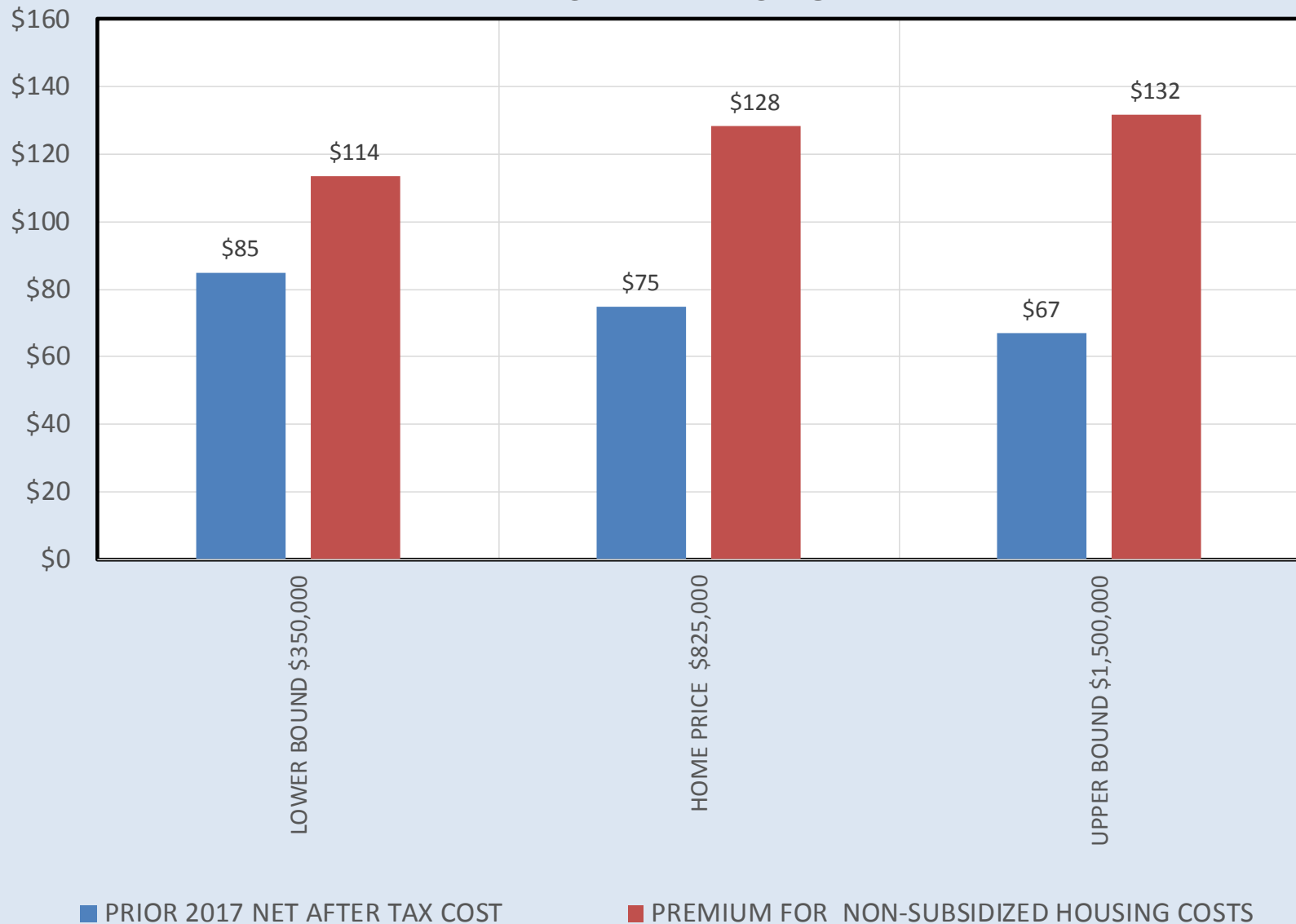


FEDERAL HOUSING TAX SUBSIDY-MORTGAGE INTEREST ONLY AMOUNTS AND CHANGES: 2018-TCJA VS. 2017



CHANGE IN 2017-SUBSIDIZED VS.2018 NON-SUBSIDIZED HOUSING COSTS

***INVESTMENT PERSPECTIVE ***



CONCLUDING THOUGHTS

YOU ARE REPRESENTING YOUR PUBLIC ENTITY POLICIES FOR YOUR FUTURE RESIDENTS

1. DEVELOPER REQUESTS CFD (AMOUNT / TIMING) – ASSIST WITH INFRASTRUCTURE FINANCING



2. ISSUER TEAM AND DEVELOPER TEAM – FORMULATE DEAL STRUCTURE BUT CONFLICTS



3. MACROECONOMIC FACTORS DETERMINED BY NATIONAL CONDITIONS - BEYOND OUR CONTROL

ECONOMIC CYCLE



MILLENNIALS



TAX - REFORM



4. BUT YOU CAN CONTROL THE SAFEGUARDS THAT ARE PUT IN PLACE

PROTECT ISSUER AND FUTURE RESIDENTS

* FORMATION POLICIES

* BOND ISSUANCE POLICIES



**TODAY SHARE CURRENT KNOWLEDGE,
BUT CFDS EVOLVING - SAFEGUARDS CRITICAL**

