

CDIAC

CALIFORNIA
DEBT AND
INVESTMENT
ADVISORY
COMMISSION

CURRENT TOPICS AND PRACTICES IN LAND-SECURED FINANCING

SESSION FIVE: Current Practices and Strategies Related to Bond Issuance

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Bond Issuance Process

- **May immediately follow formation or occur much later**

- **Timing considerations**
 - ▣ Development momentum
 - ▣ Credit quality
 - ▣ Bond market conditions
 - ▣ Bond-funded project readiness
 - ▣ Proceeds used to acquire completed infrastructure

- **Federal tax law constraints**
 - ▣ “Reasonable expectations” of spending proceeds within 3 years

Bond Capacity Considerations

How much in project funds can a CFD support?

- **CFD Parameters**

- ▣ Maximum bond authorization
- ▣ Eligible project funds
- ▣ Maximum annual tax rates and annual escalator (if any)

- **Value of land supporting debt**

Determined at issuance

- ▣ Standard minimum value to debt ratio of 3-to-1

- **Maximum tax capacity and debt service coverage**

- ▣ Based on maximum annual special tax revenues projected at build-out
- ▣ Minimum coverage typically 110% annual debt service

- **Bond market conditions**

- ▣ Lower interest rates = more bond proceeds within same revenues
- ▣ Interest rates are driven by *broad economic factors* and *specific credit quality*

Borrowing Cost and Development Status

Borrowing cost %

Raw land
Low land values
Concentrated ownership
High development risk

Backbone infrastructure complete
Ownership may include builders
Vertical construction underway
Pre-sale activity

Fully built-out
Diversified ownership/leases
Higher property values
Special tax collection history

Development momentum

Key Credit Considerations

- **Issuer:** reputation and experience
- **Local Economy:** employment options, real estate cycle, sales activity
- **Property:** location, attractiveness, environmental condition or hazards
- **Developer(s) Strength:** experience, financial resources, equity invested, loans
- **Development Plan:** entitlements, development schedule, approvals, absorption schedule, product mix
- **Development Status:** status of backbone infrastructure, “in tract” infrastructure, vertical construction, sales or leasing activity
- **Product Demand:** demographics of competing projects
- **Special Tax:** burden on property, debt service coverage
- **Property Values:** value-to-lien
- **Legal Structure and Covenants:** foreclosure provisions, reserve, type of debt

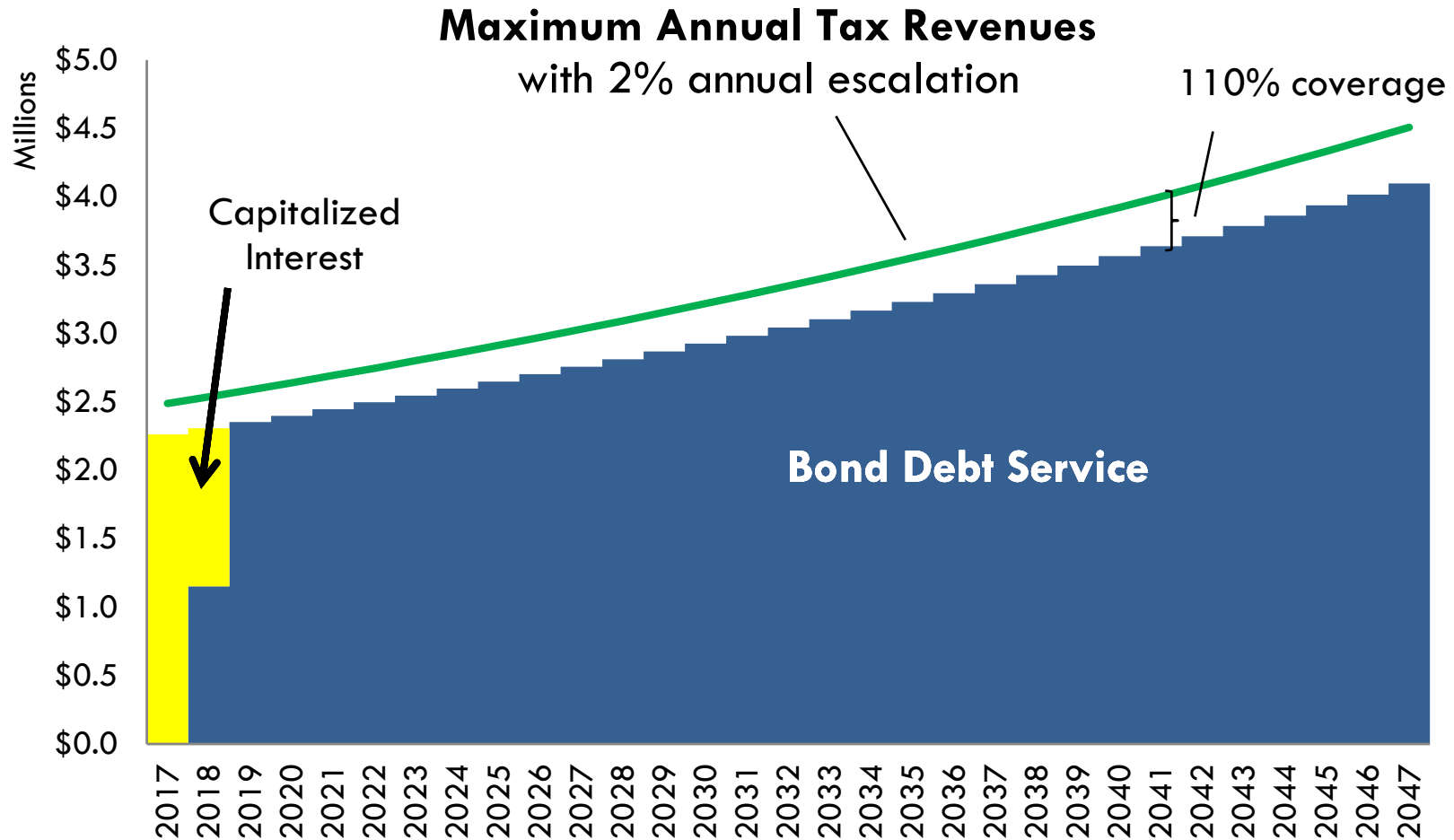
What Makes for a Strong Credit?

	Stronger	Weaker
Region	<ul style="list-style-type: none"> • Infill • Low competition • Community support 	<ul style="list-style-type: none"> • Fringe location • High competition • Community disdain
Developer	<ul style="list-style-type: none"> • Experienced track record • Financing in place • Strong “intangibles” 	<ul style="list-style-type: none"> • Inexperienced entity • Weak pro forma • Weak “intangibles”
Project	<ul style="list-style-type: none"> • Geographic diversity • Ownership diversity • Development momentum <ul style="list-style-type: none"> • Entitlements in place • Sales underway • High value-to-debt ratios 	<ul style="list-style-type: none"> • Geographic concentration • Ownership concentration • Development stagnation <ul style="list-style-type: none"> • Land use approvals pending • Limited construction progress • Low value-to-debt ratios

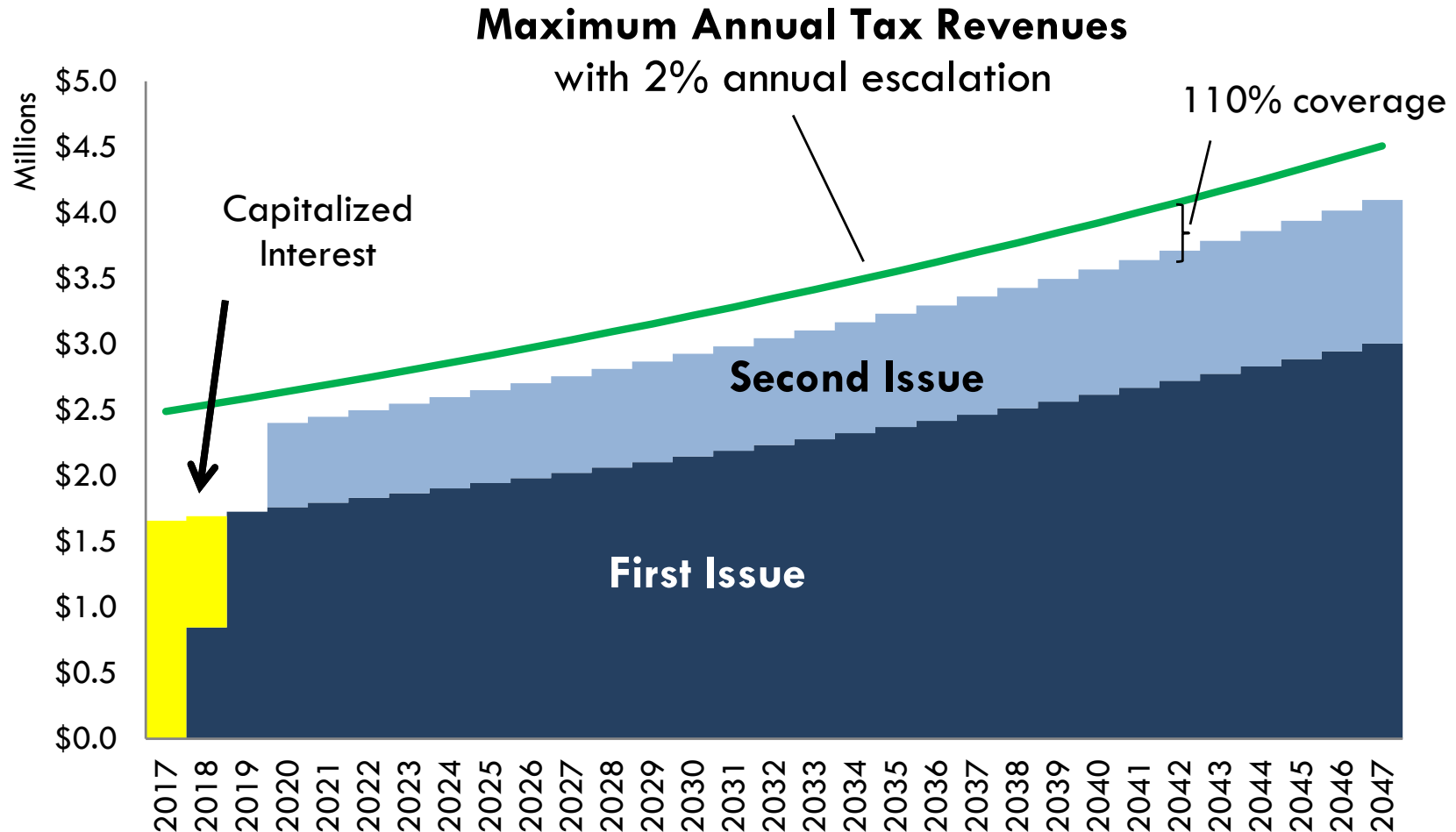
Determining Property Values

- **Issuer promises to pursue accelerated foreclosure if taxes aren't paid**
 - ⇒ Value of property at a foreclosure sale is **key** to “land secured” credit quality
- **Assessed value (AV) sometimes used**
 - ▣ Completed projects or modest debt
- **Appraisal often used to determine property value**
 - ▣ “Bulk sale” value of property recognizing the bond-funded improvements
 - ▣ Comparable sales usually used to establish retail price of end product, discount rate, absorption affect value
 - ▣ An absorption report can inform expected timing of build out and sales
- **A “composite value” uses AV and appraised values**
 - ▣ i.e. AV for individually-owned homes, appraised value for balance of property

Leveraging Tax Capacity – One Issue



Leveraging Tax Capacity – Phased Issues



Case Study: El Dorado Blackstone CFD

- **CFD No. 2005-1 (Blackstone)**
 - ▣ 990 acre residential subdivision in unincorporated El Dorado Hills
 - ▣ Entitled for 1,466 residential homes

- **First bonds issued in 2005**
 - ▣ \$28.9 million outstanding at average coupon of 5.22%

- **First homes completed in 2007**
 - ▣ Project stalled amid housing market crash
 - ▣ By 2016, more than 817 homes completed

- **2016 Special Tax Bonds issued in two series**
 - ▣ Refunded in full the 2005 Bonds
 - ▣ Raised \$4.2 million in new project funds

Blackstone CFD Marketing Map

THE NEW HOME COMPANY www.chaparral@nwhm.com

- 1 Chaparral**
3-5 Bedrooms, 2.5-4 Baths
1,994 – 2,422 sq. ft.

MERITAGE HOMES meritagehomes.com/sacramento

- 3 Solstice**
3-5 Bedrooms, 2.5-5.5 Baths
2,672 – 4,575 sq. ft.

K. HOVNANIAN HOMES khov.com/blackstone

- 4 The Estates**
Up to 6 Bdrms, Up to 5 Baths
2,385 – 3,878 sq. ft.

LENNAR lennar.com

- 2 The Ridge**
3-5 Bedrooms, 2.5-4.5 Baths
2,861 – 4,253 sq. ft.

- Summit View**
4-5 Bedrooms, 2.5-4.5 Baths
2,707 – 4,253 sq. ft.

- 7 Palisades**
3-4 Bedrooms, 2-4 Baths
1,429 – 2,426 sq. ft.

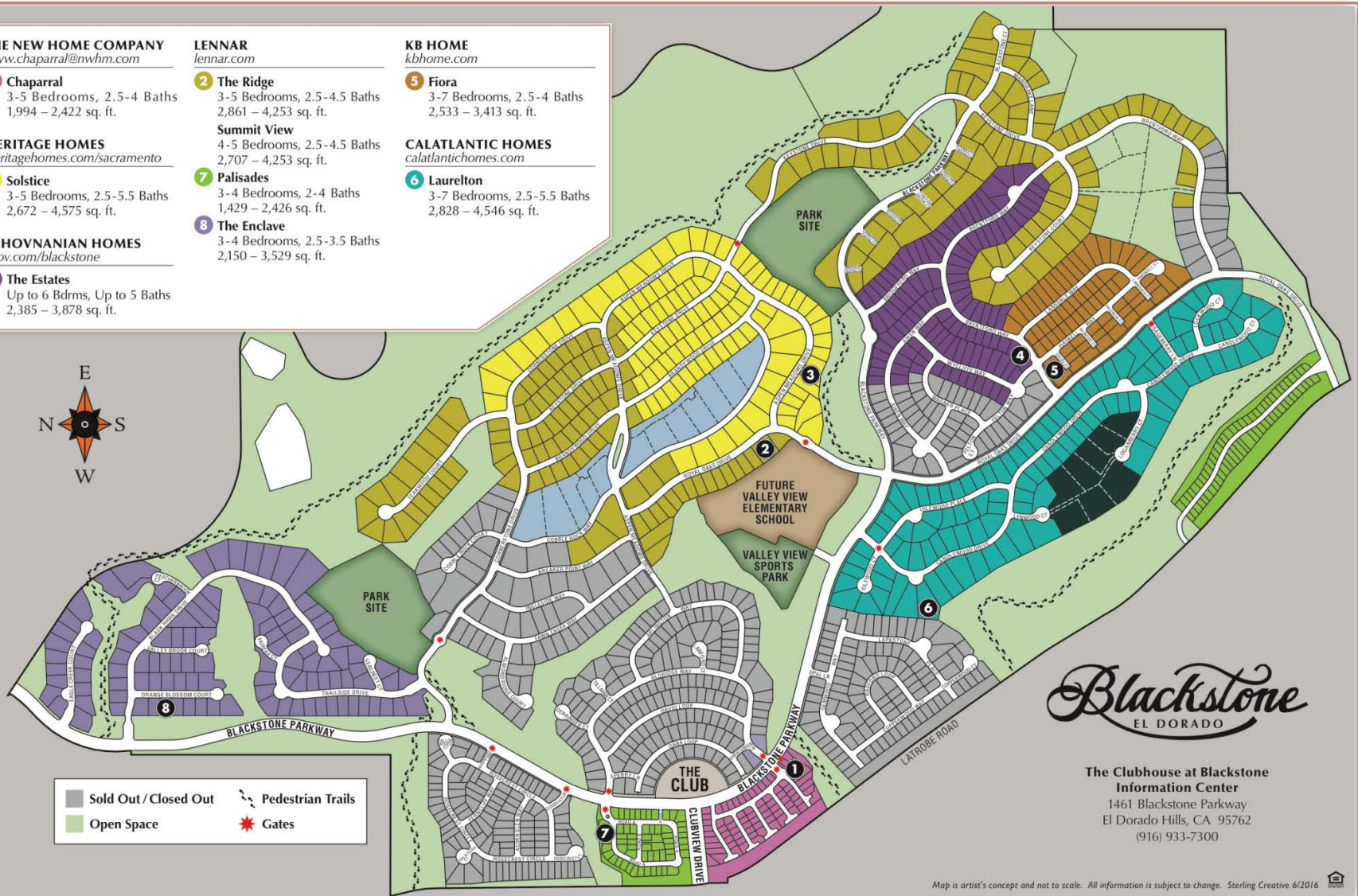
- 8 The Enclave**
3-4 Bedrooms, 2.5-3.5 Baths
2,150 – 3,529 sq. ft.

KB HOME kbhome.com

- 5 Fiora**
3-7 Bedrooms, 2.5-4 Baths
2,533 – 3,413 sq. ft.

CALATLANTIC HOMES calatlantichomes.com

- 6 Laurelton**
3-7 Bedrooms, 2.5-5.5 Baths
2,828 – 4,546 sq. ft.



Blackstone
EL DORADO

The Clubhouse at Blackstone
Information Center
1461 Blackstone Parkway
El Dorado Hills, CA 95762
(916) 933-7300

Blackstone CFD: Status as of 2016

- ❑ Six merchant builders were actively selling homes
- ❑ Wide array of home product offerings –style, bedrooms, price points
 - ❑ Base sale prices from \$420,000 to \$757,000



Standard Pacific – Laurelton



K Hovnanian – The Estates



KB Homes – Fiora



Lennar - Summit View



Meritage – Solstice

Blackstone: Development Status

Special Tax Levy by Land Use

	<u>Parcels</u>	<u>Planned Homes</u>	<u>Anticipated FY16-17 Tax Levy</u>	<u>% of</u>
Completed homes	817	817	\$1,432,865	59.1%
Single Family Lots				
Village 6 - K Hovnanian	74	74	119,612	4.9%
Village 6 - KB Homes	38	38	61,422	2.5%
Village 5A, 7, X, Y and Z - Lennar	277	277	534,629	22.0%
Village 5B - Meritage	30	30	59,682	2.5%
Lot W - New Home Co	72	72	73,546	3.0%
Village 3 - Standard Pacific	59	59	117,374	4.8%
Unimproved Custom Lots (5)				
Lot Y and Z - AKT West Villy	2	3	3,979	0.2%
Village 3 and 7 - AKT West Villy	6	14	11,936	0.5%
Village 5A - Di Re D & S	5	12	9,947	0.4%
Partially Improved Tentative Map				
Lot V - Lennar	1	70	-	0.0%
Total	1,381	1,466	\$2,424,990	100.0%

Large portion of tax levied on completed homes

Most of the rest was under active development by a diverse mix of builders

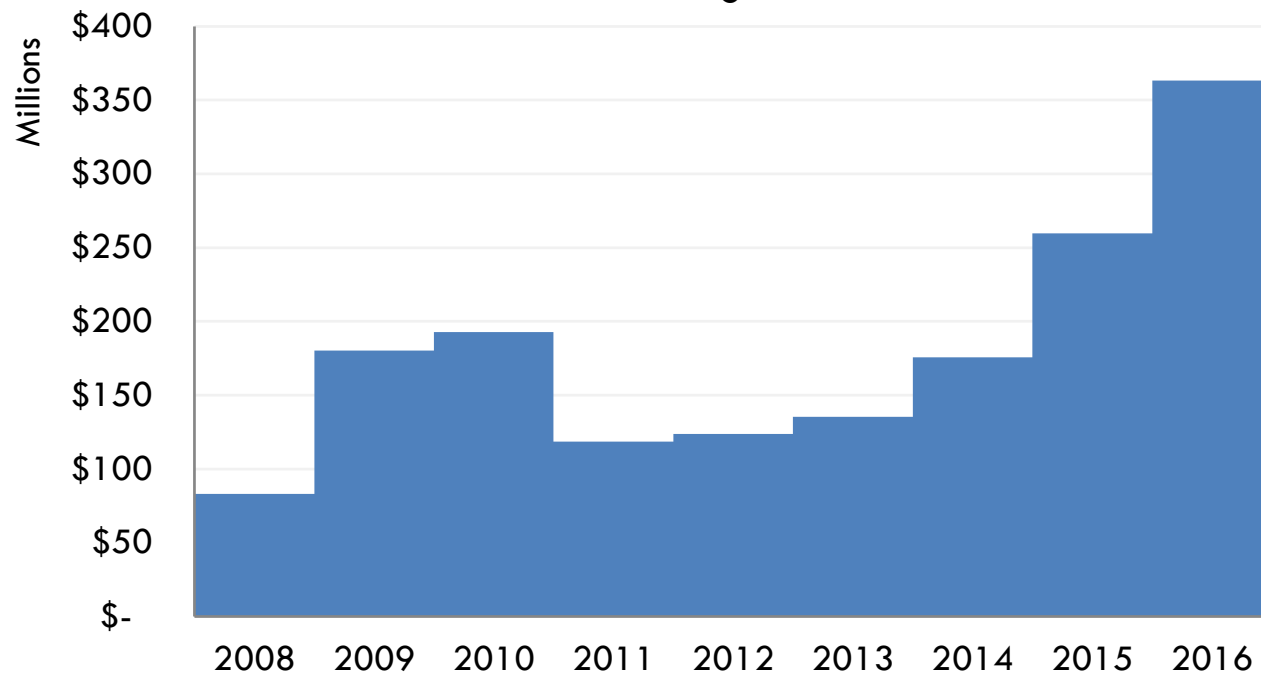
Source: Official Statement

Blackstone: Property Values

- **Rebounding home prices and construction bolstered property values**
 - ▣ \$302 million of assessed value attributable to 604 completed homes
 - ▣ Sought an appraisal of balance of property

Blackstone CFD Historic Assessed Values

FY2007-08 through FY2015-16



Source: 2016 Official Statement

Blackstone: Parcel Level VTL Ratios

Individual Parcel Value to Bonded Debt Categories

<u>Value-to-Debt Category</u>	<u>Parcels</u>	<u>Composite Value</u>	<u>Allocated Bond Share</u>	<u>Est. FY17 Tax Levy</u>	<u>% Levy</u>
20:1 and Greater	687	\$386,477,383	\$16,058,494	\$1,199,480	49%
Less than 20:1, greater than or equal to 10:1	311	97,556,210	6,455,934	482,223	20%
Less than 10:1, greater than or equal to 5:1	365	78,732,629	9,486,610	708,597	29%
Less than 5:1, greater than or equal to 3:1	15	1,581,558	384,524	28,722	1%
Less than 3:1, greater than or equal to 1:1	3	187,097	79,901	5,968	0%
Total	1,381	\$564,534,877	\$32,465,463	\$2,424,990	100%

Aggregate value-to-lien over **17 to 1**
based on a mix of assessed and
appraised value

98% of the special tax is levied
on parcels with a VTL \geq **5 to 1**;
nearly half is levied on parcels
with VTL \geq **20 to 1**

Blackstone: Tax Burden and Delinquencies

Special Tax Collections and Delinquencies

Fiscal Year	Total Special Tax Levy	Amounts Delinquent			
		At Fiscal Year End		As of May 1, 2016	
		In \$	As %	In \$	As %
2011-12	\$ 2,081,905	\$1,464	0.1%	\$0	0.0%
2012-13	2,121,188	0	0.0%	0	0.0%
2013-14	2,162,937	3,984	0.2%	1,523	0.1%
2014-15	2,211,118	1,554	0.1%	1,554	0.1%
2015-16	2,244,541	-	-	17,249	0.8%
				\$20,326	

Very low delinquencies
as a % of annual levy

Illustrative Tax Burden

	Anticipated FY16-17 Amount
Basic 1% Property Tax Rate	\$ 5,205
GO Overrides	282
Total General Tax	5,487
Blackstone Special Taxes	1,616
Other Taxes and Fees	1,242
Total Taxes and Charges	\$ 8,345
Assessed Value	\$ 520,500
Total taxes as % of AV	1.60%

Total annual property taxes on a typical homeowner in the CFD amounts to about \$8,350 or approximately 1.6% of the assessed home value

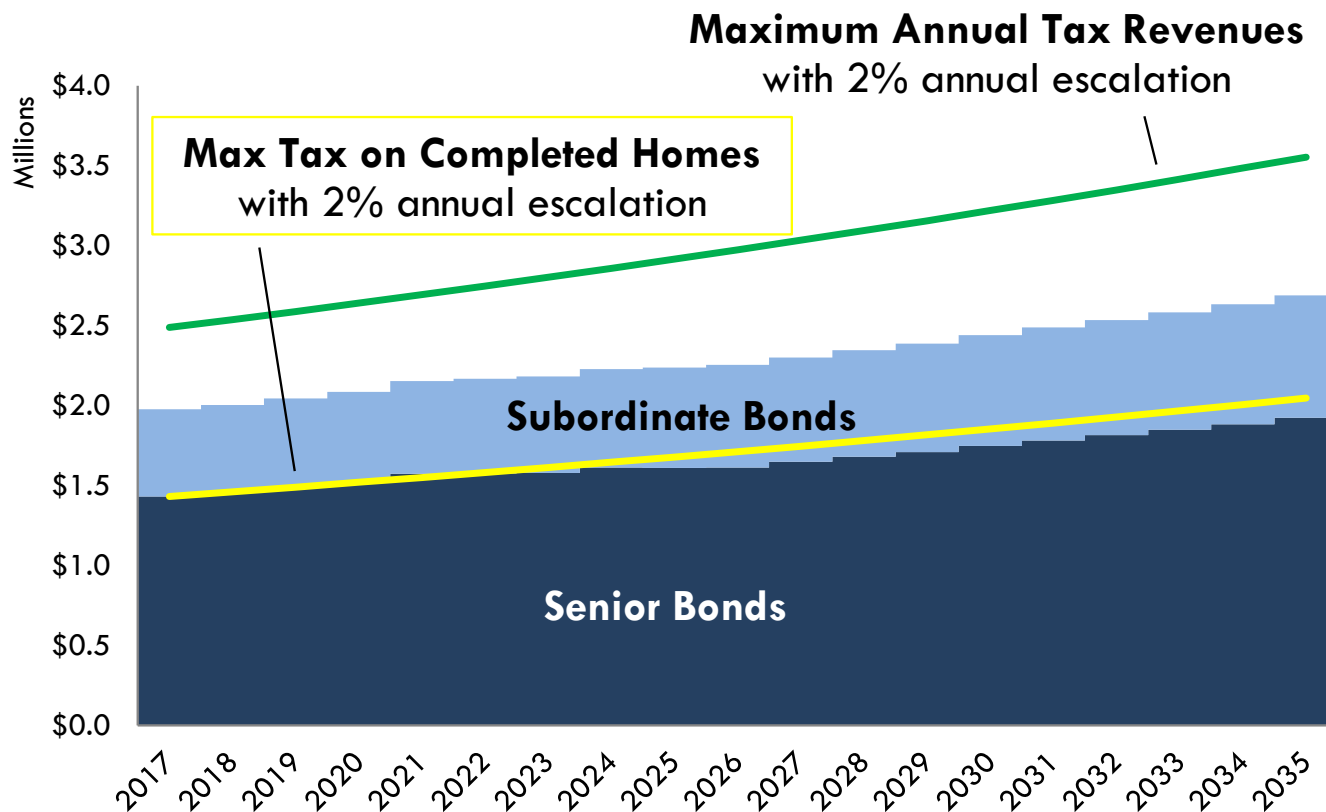
Blackstone CFD: 2016 Bond Sale

□ \$20.9 million Senior Bonds

- ▣ S&P Rating BBB
- ▣ AA bond insurance and surety
- ▣ Combined true interest cost: 3.02%

□ \$7.2 million Junior Bonds

- ▣ Cash funded reserve
- ▣ Not rated



Source: 2016 Official Statement

Bolstering Credit and/or Bond Capacity

□ **Phased financings**

- Bond issuance can be phased Financings for larger projects are often phased as development and/or need for funds proceeds
- Additional bonds test limits extent of future dilution for parity bonds

□ **Credit enhancement**

- Developer may be asked to post a letter of credit (LOC) to secure first year(s) of special taxes
- If Developer's balance sheet is particularly strong, an LOC can be procured to support variable rate bonds issuance

□ **Escrow Bond**

- If key credit or ABT thresholds can't be met at issuance, a portion of bond proceeds can be held in escrow until thresholds are met or used to pay back bonds if not met
- Avoids issuance cost for a subsequent bond sale
- Makes more economic sense when proceeds can be invested at attractive rate or for very short timeframe; flattening yield curve improves efficiency

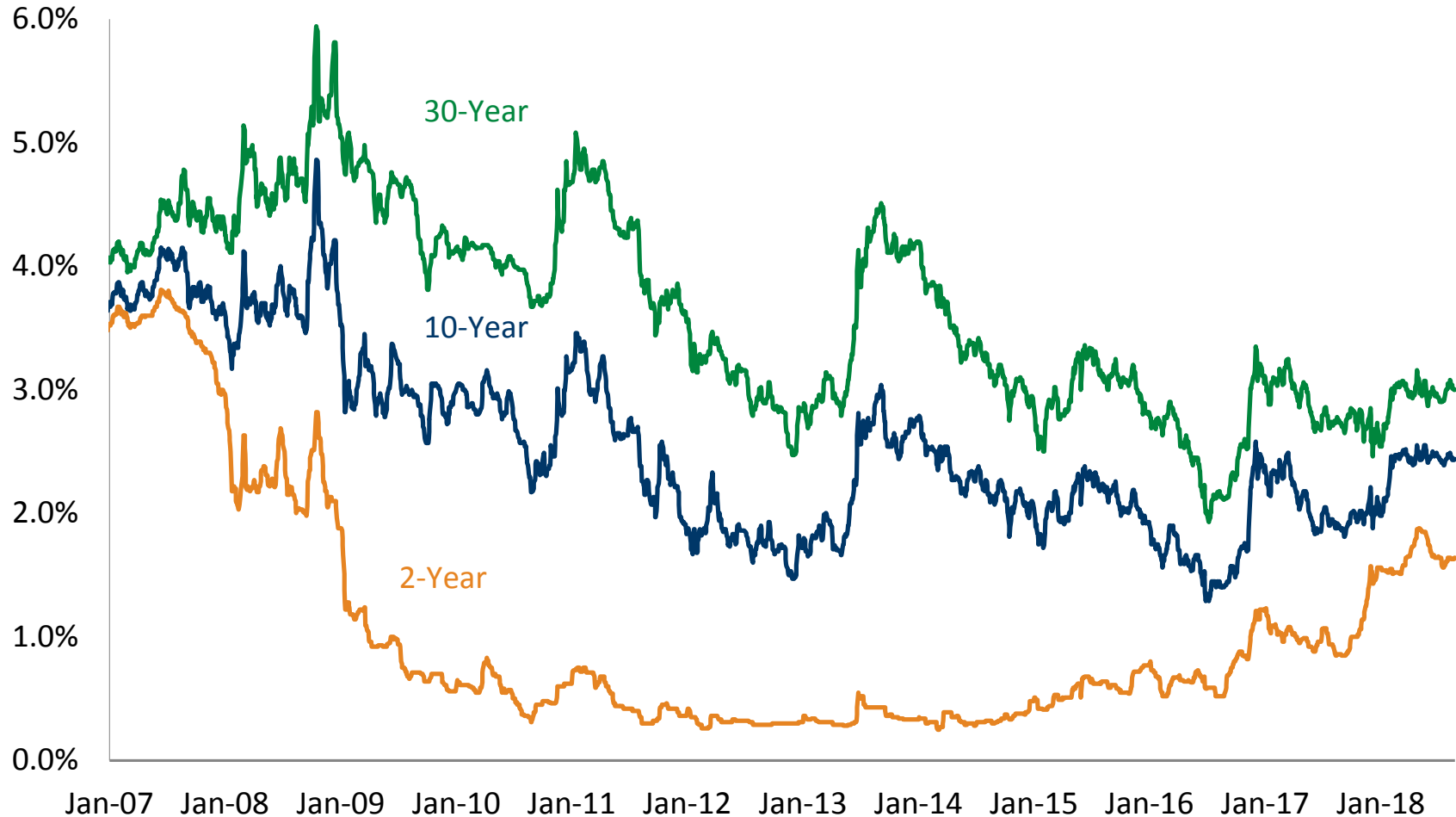
Private Placement Alternatives

- ❑ **Distribution to smaller universe of buyers**
- ❑ **To commercial banks for cost, ease and timeliness**
 - ❑ Higher credit quality
 - ❑ Shorter tenor (generally < 10 years or < 20 years)
 - ❑ Smaller to moderate in size
- ❑ **To sophisticated institutional or individual investors for “suitability”**
 - ❑ Higher risk tolerance
 - ❑ Often larger denominations (\$100,000 or \$250,000)
 - ❑ Possible “big boy” letter
- ❑ **Consequences for interest rate - and liquidity**
- ❑ **New regulatory focus**

Bond Market Conditions

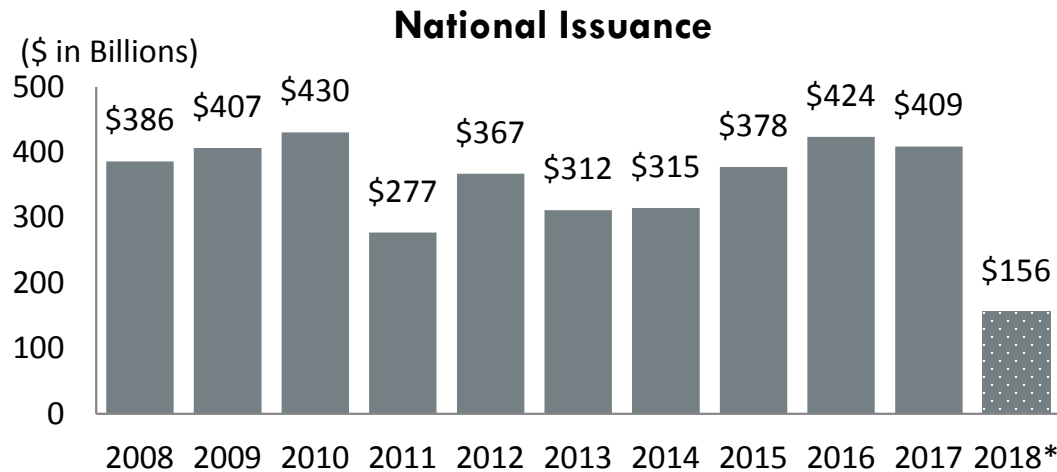
Low General Interest Rate Environment

AAA Municipal Market Data (MMD) Index Since 2007



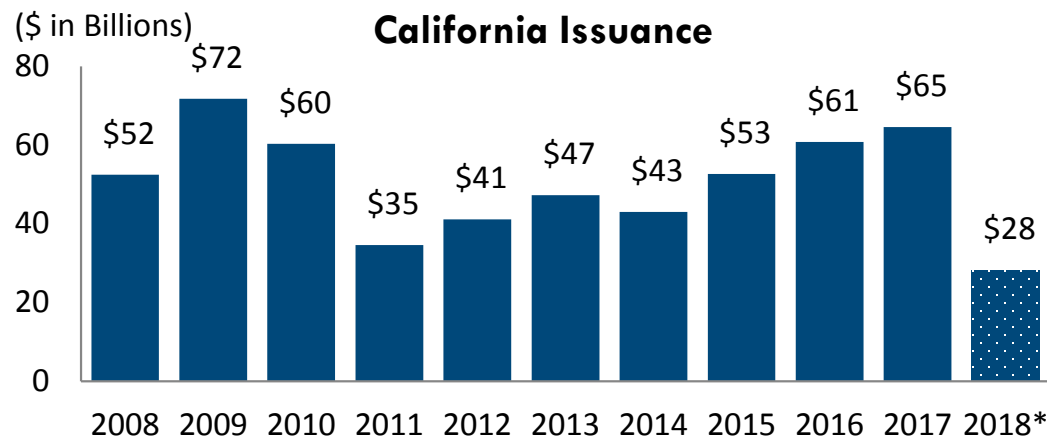
Light Municipal Market Annual Issuance

Municipal Market Annual Volume Through 2018Q2



- Federal tax reform spurred rush to market in late 2017 after slow year
- Pulled forward some issuance
- Eliminated “advance refundings”

- “Negative net issuance”

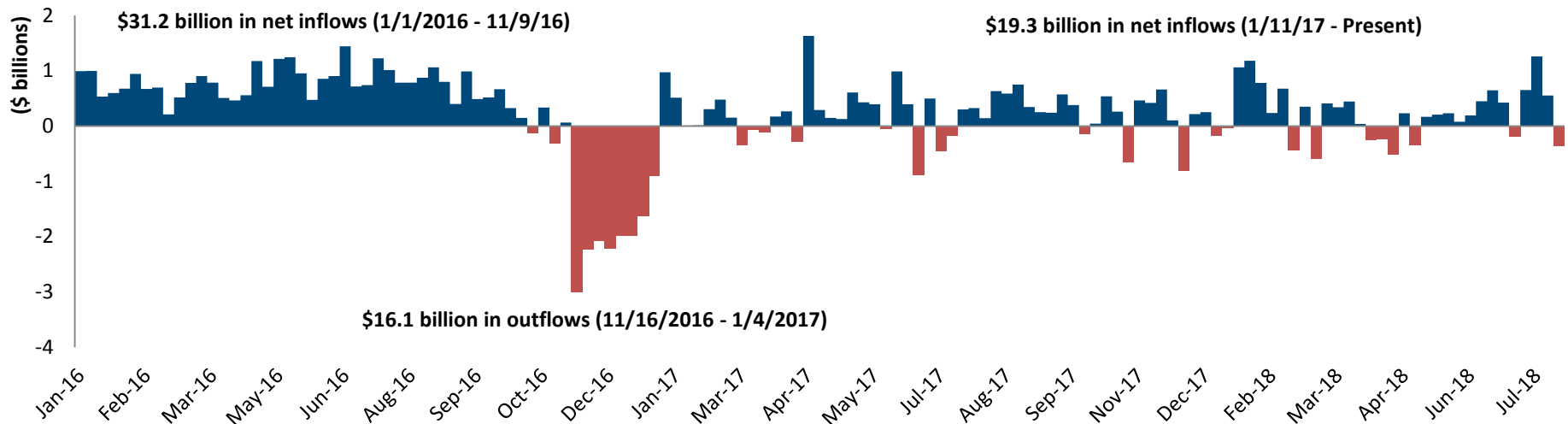


Source: SDC/ Thomson Reuters, Through 6/30/2018

Strong Municipal Bond Demand

- **Deep pool of investors seek tax-free investment income**
 - ▣ Bond funds, bank trusts, insurance companies, high net worth individuals
- **Investor interest has remained strong**
 - ▣ Reaching for yield in low interest rate environment

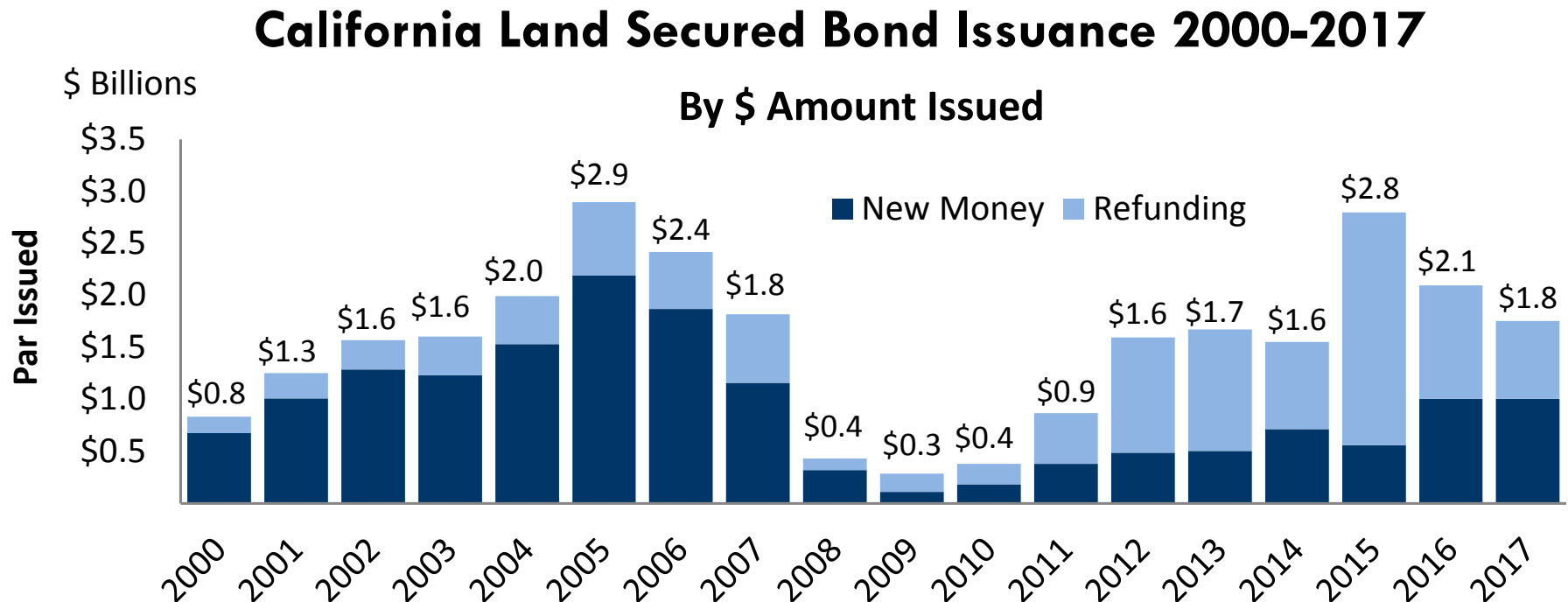
Weekly Municipal Bond Mutual Fund Flows Since 2016



Source: Lipper fund flows as of 8/2/18

California Land Secured Bond Issuance Trends

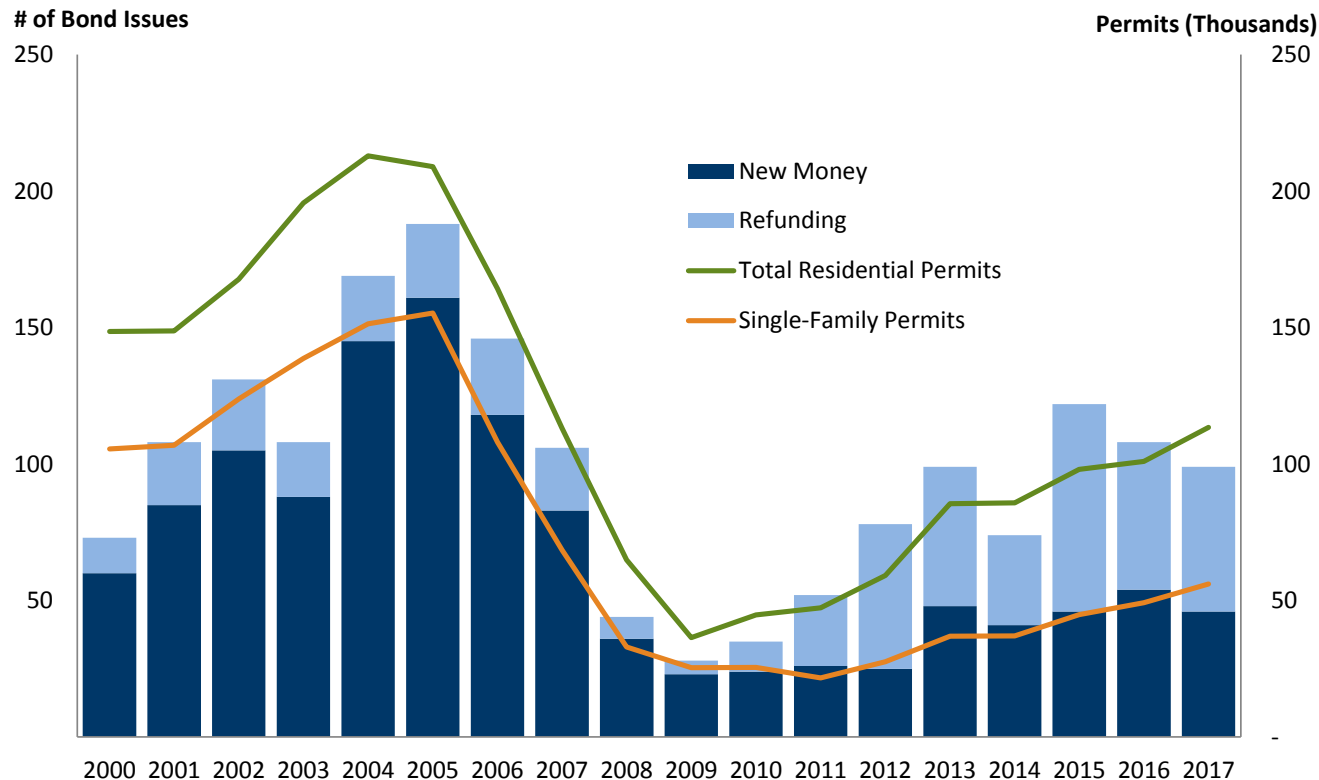
- Volume has rebounded since the recession, with active refundings



California Land Secured Bond Issuance Trends

Single family building permits represent a smaller share of all residential permits with potential consequences for issuance activity

California Land Secured Bond Issuance 2000-2017

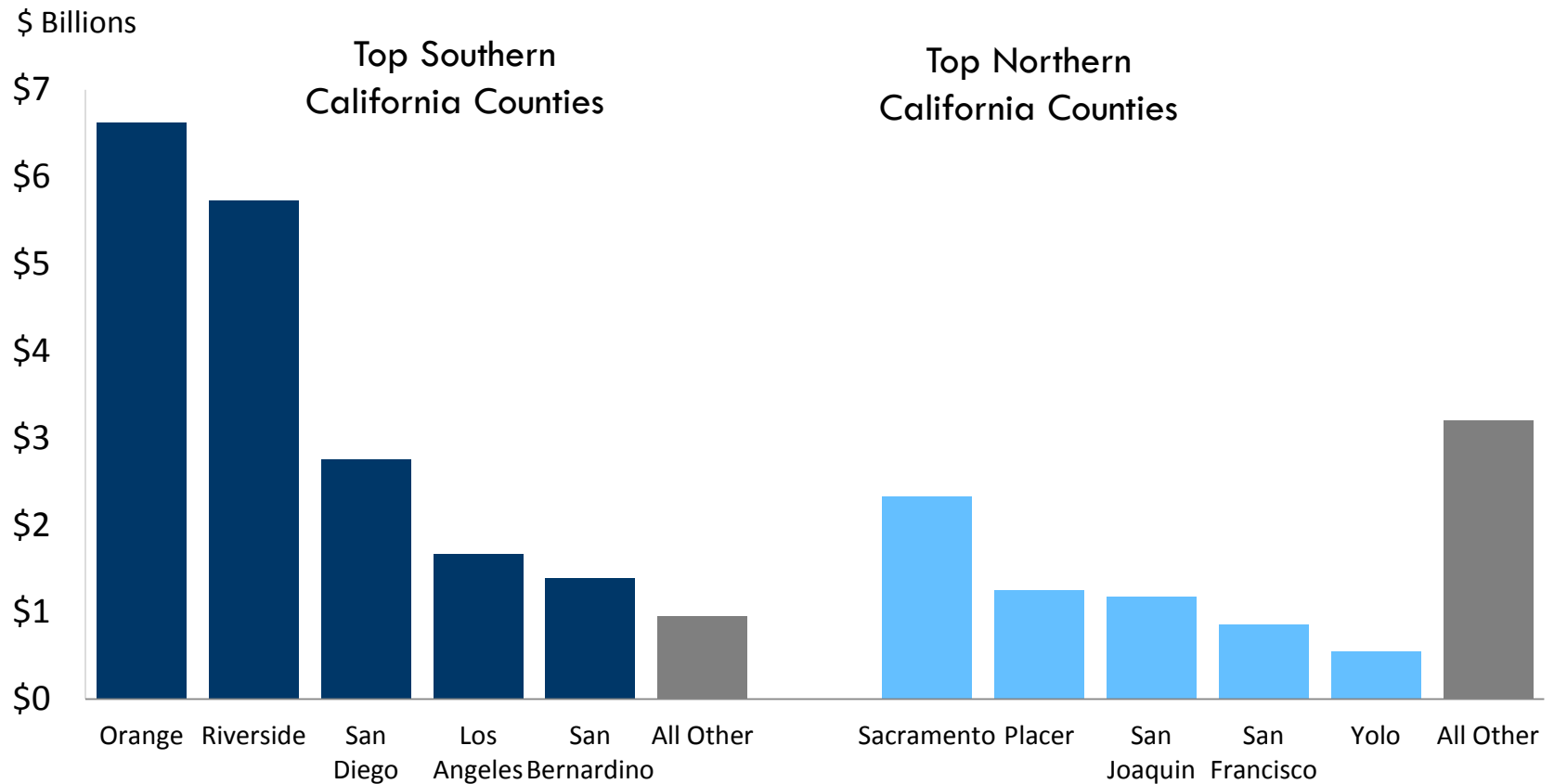


Source: SDC, California Department of Finance

Land Secured Issuance Volume by County

Nearly **70%** of issuance by Southern California issuers

California Land Secured Bond Issuance 2000-2017



Marketing Land Secured Issues

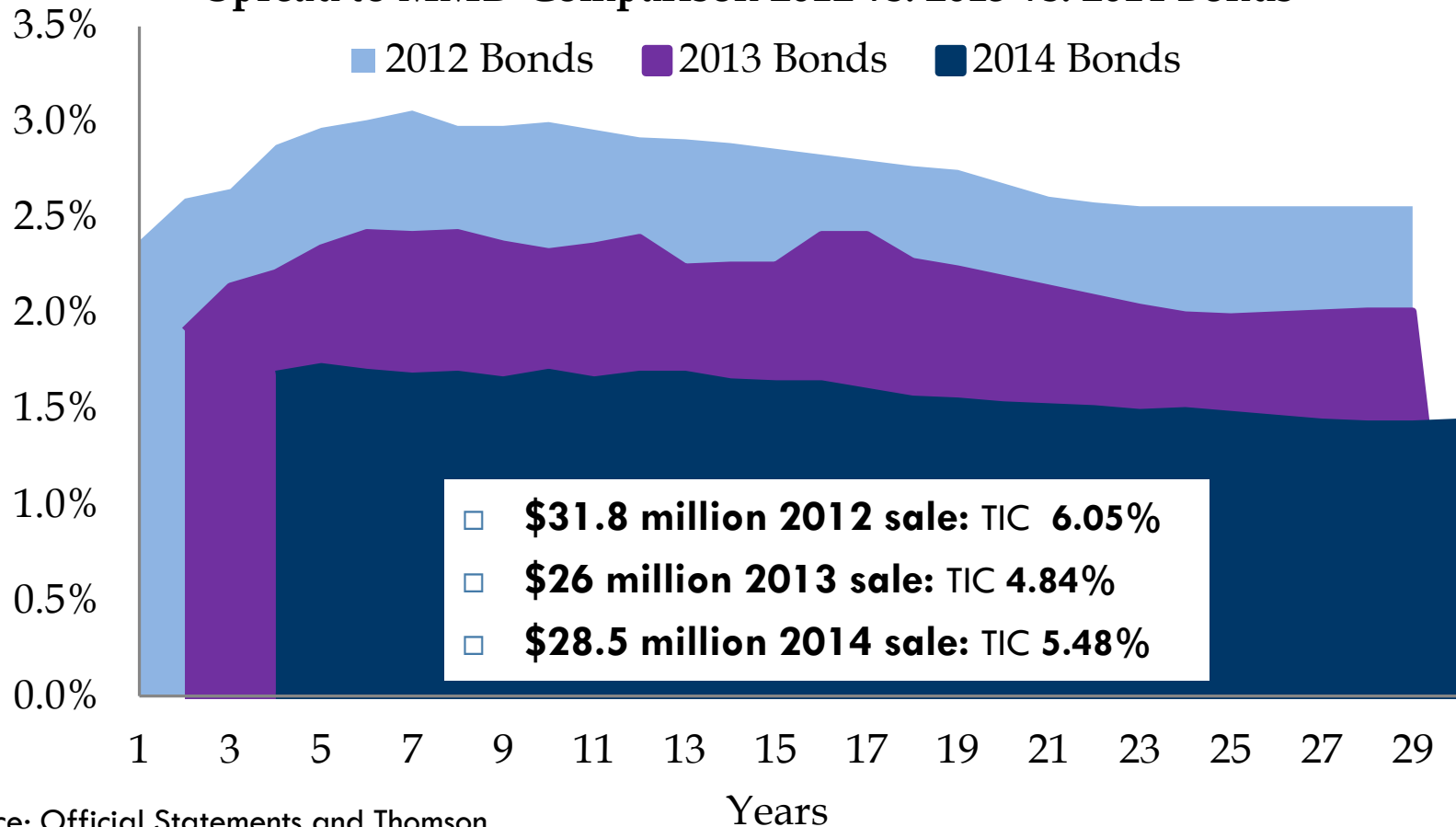
- **Narrower base for land-secured credits than general municipal bonds**
 - ▣ Most sensitive to supply/demand
 - ▣ Investors “reach for yield” in low rate environment -- but to a point
 - ▣ Results in “spread compression” between strongest and weaker credits
- **Institutional investor interest**
 - ▣ High yield funds flows tend to drop amid rising interest rates
 - ▣ Interest increases issue size \geq \$25 million
- **Individual “retail” investor interest**
 - ▣ Ebbs and flows depending on market conditions and investment alternatives
 - ▣ Sophisticated retail investor demand for “story” credits remains strong
- **Development “story” is important**
 - ▣ Location, competition, developer, development momentum
 - ▣ Geographic diversification is helpful

Cost of Capital: Bay Meadows

Credit spreads narrowed as development progressed

Credit Spreads to AAA Municipal Market Data Index

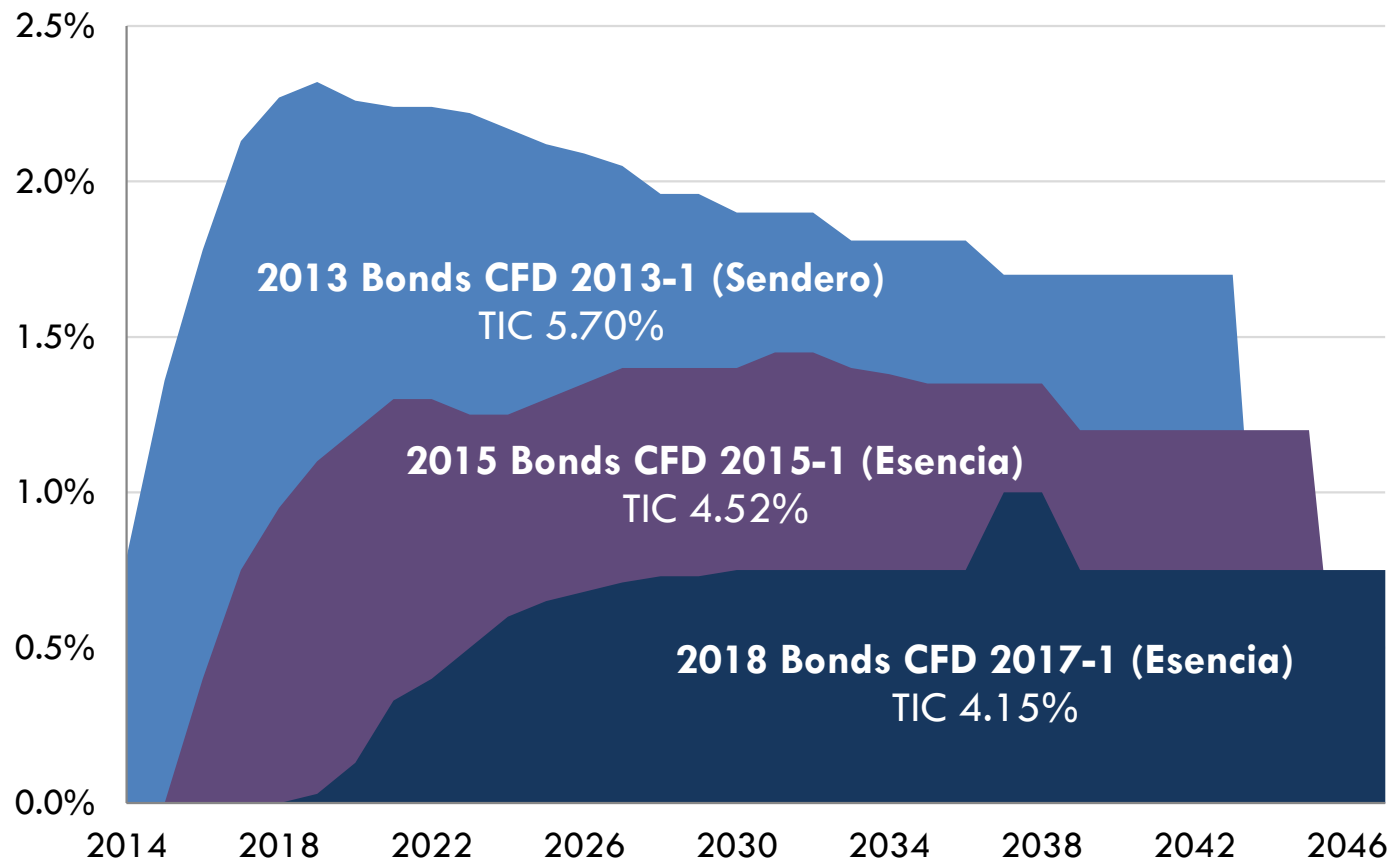
Spread to MMD Comparison 2012 vs. 2013 vs. 2014 Bonds



Cost of Capital: Rancho Mission Viejo

Credit spreads narrowed with broader market trends and project momentum

Credit Spreads to AAA Municipal Market Data Index



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