



CDIAC

CALIFORNIA
DEBT AND
INVESTMENT
ADVISORY
COMMISSION

CURRENT TOPICS AND PRACTICES IN LAND-SECURED FINANCING

SESSION SEVEN: Ongoing District Administration

Bradley R. Neal, Shareholder, Stradling Yocca Carlson & Rauth, P.C.

Susan Goodwin, Managing Principal, Goodwin Consulting Group, Inc.

Eileen Gallagher, Managing Director, Stifel, Nicolaus & Company

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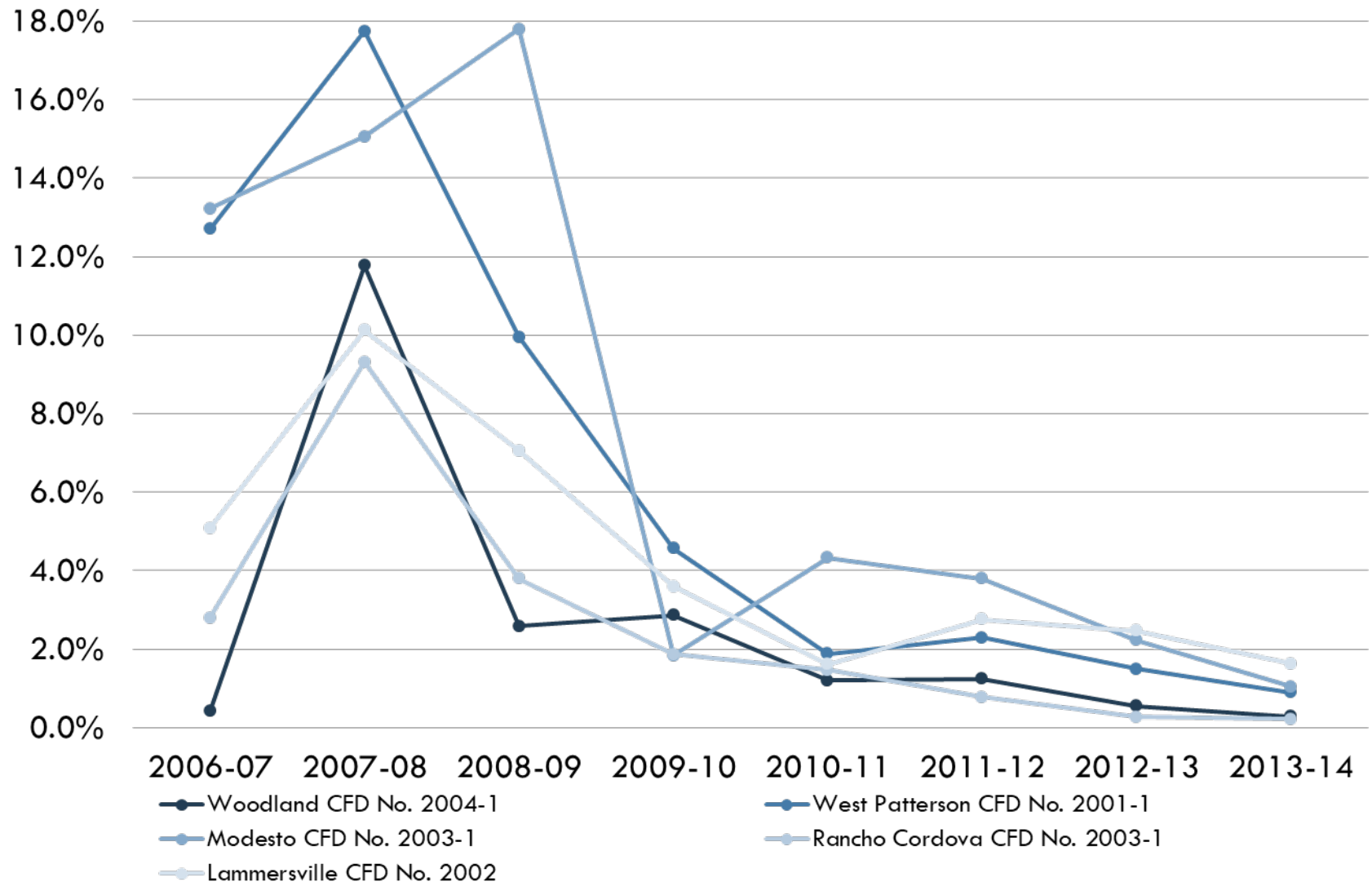
CFD Amendment Process

- After formation, may amend facilities/services to be financed or rates/apportionment of special taxes
- Amendment process is similar to formation process:
 - Petition to amend CFD
 - Resolution of Consideration (ROC) to begin change proceedings
 - Public hearing 30-60 days after ROC is adopted
 - Election (if < 12 reg. voters, landowner election)
 - Resolution of Change adopted
 - Record Amended Notice of Special Tax Lien
- If bonds are outstanding, covenants in Indenture or Fiscal Agent Agreement must be followed
- Facilities and services may be ***eliminated***, but not added without procedures identified above

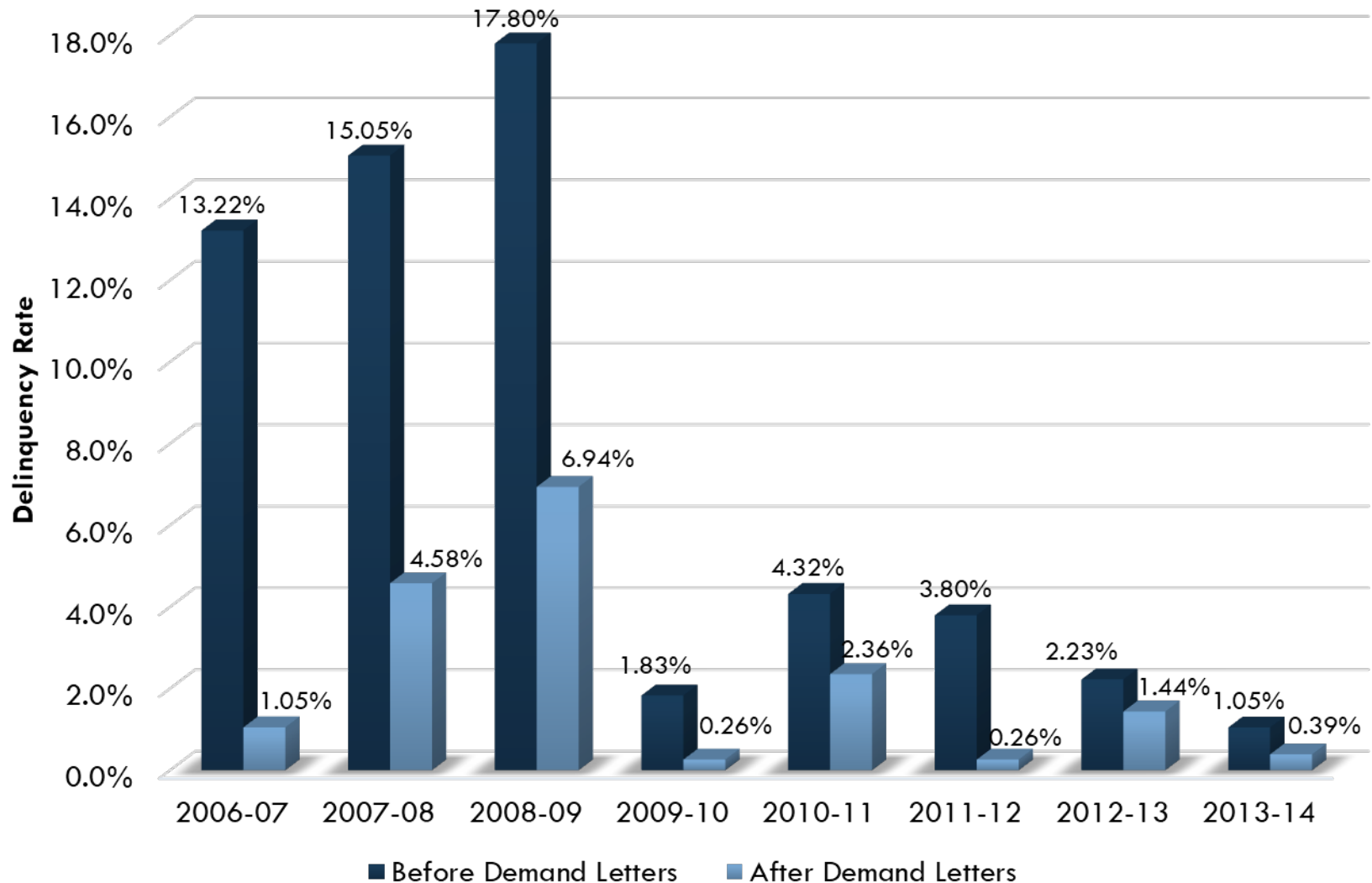
Delinquency Management: A Key Component in Effective Administration

- 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 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 will not work for special taxes and assessments

Sample of Five CFDs in Northern California: Delinquency Rates Through Recession



Managing Special Tax Delinquencies: Sample Central Valley CFDs



Ongoing Administration: New Bond Issues and Refundings

- Provide special tax projections to underwriter to size bond issue
- Prepare tables for Preliminary and Final Official Statement
 - Information requested has increased considerably since recession
 - Investors and underwriters vary in their requests for data
 - Administrator must work with appraiser to organize value-to-lien data in format requested by investors and underwriters
- Administrator is identified as source of many tables in OS and takes on the associated liability thereof

Ongoing Administration: New Bond Issues and Refundings

Credit tables from Official Statement of a 2007 New Money Bond Issue:

Homebuilder or Owner	Residential Units	Maximum Special Tax for FY 2007-08•	Percent of Total Max Tax*
Various Woodside Entities (Woodside Homes)	559*	\$695,836	49.01%
Cresleigh Homes	369	235,185	16.56
Sunridge Park, LP (Kimball Hill Homes)	176*	220,037	15.50
Beazer Homes Holding Corporation	135*	168,778	11.89
Rancho 80 LLC (Syncon Homes)	80*	100,017	7.04
Total	1,319	\$1,419,853	100.00%

Zone	District Annual Max. Special Tax	Percentage of Total Spec. Tax	Total Bonded Debt Lien	Appraised Value	Value to Lien
Various Woodside Entities (Woodside Homes)	\$695,836	49.01%	\$6,765,106	\$67,050,000	9.91
Cresleigh Homes	235,185	16.56	2,286,536	26,210,000	11.46
Sunridge Park, LP (Kimball Hill Homes)	220,037	15.50	2,139,257	21,450,000	10.03
Beazer Homes Holding Corporation	168,778	11.89	1,640,908	15,470,000	9.43
Rancho 80 LLC (Syncon Homes)	100,017	7.04	972,390	10,250,000	10.54
TOTAL	\$1,419,853	100.00%	\$13,804,197	\$140,430,000	10.17

Credit tables from Official Statement of a 2018 New Money Bond Issue

Special Tax Category (2)	Planned Units	Maximum Special Tax at Buildout (3) (FY 2016-17 \$)	Percent of Maximum Special Tax at Buildout	Appraised Value	Allocated Bond Debt (4)*	Value-to- Lien Ratio*
Developed Property						
Unit 1	11	\$17,098	2%	\$1,361,389	\$298,175	4.57
Unit 2	57	99,214	10%	14,774,066	1,730,206	8.54
Unit 3	6	10,444	1%	742,576	182,127	4.08
Subtotal	74	\$126,755	13%	\$16,878,031	\$2,210,507	7.64
Final Map Property						
Unit 1	24	\$37,305	4%	\$2,970,303	\$650,563	4.57
Unit 2	15	26,109	3%	2,097,677	455,317	4.61
Unit 3	78	135,766	14%	9,653,486	2,367,650	4.08
Subtotal	117	\$199,180	20%	\$14,721,467	\$3,473,530	4.24
Undeveloped Property						
Owned by Lennar (5)						
Unit 7 (6)	79	\$137,507	14%	\$3,712,863	\$2,398,004	1.55
Unit 9	51	88,770	9%	2,396,912	1,548,079	1.55
Unit 10	54	93,992	10%	2,537,907	1,639,142	1.55
Unit 11	47	81,808	8%	2,208,919	1,426,661	1.55
Owned by Winn	85	132,121	14%	6,872,340	2,304,077	2.98
Subtotal	316	\$534,197	55%	\$17,728,941	\$9,315,963	1.90
Buffer (7)						
Owned by Lennar						
Unit 8	49	\$85,289	9%	\$2,302,915	\$0	N/A
Unit 9	8	13,925	1%	375,986	0	N/A
Owned by Winn	9	13,989	1%	727,660	0	N/A
Subtotal	66	\$113,203	12%	\$3,406,561	\$0	N/A
Total	573	\$973,334	100%	\$52,735,000	\$15,000,000	3.52

Credit tables from Official Statement of a 2018 New Money Bond Issue

Value to Lien (1)	Planned Units	Maximum Special Tax at Buildout (2)	Appraised Value	Allocated Bond Debt (3)(4)*	Average Value-to- Lien Ratio	% of Allocated Bond Debt
Greater than 5:1	33	\$57,439	\$12,045,000	\$1,001,698	12.02	6.7%
3:1 to 5:1	158	268,495	19,554,498	4,682,339	4.18	31.2%
Less than 3:1						
Unit 7	79	137,507	3,712,863	2,398,004	1.55	16.0%
Unit 9	51	88,770	2,396,912	1,548,079	1.55	10.3%
Unit 10	54	93,992	2,537,907	1,639,142	1.55	10.9%
Unit 11	47	81,808	2,208,919	1,426,661	1.55	9.5%
Winn	85	132,121	6,872,340	2,304,077	2.98	15.4%
Subtotal	507	\$860,132	\$49,328,439	\$15,000,000	3.29	100.0%
Other (5)						
Unit 8	49	\$85,289	\$2,302,915	\$0	0.00	0.0%
Unit 9	8	13,925	375,986	0	0.00	0.0%
Winn	9	13,989	727,660	0	0.00	0.0%
Subtotal	66	\$113,203	\$3,406,561	\$0	0.00	0.0%
Total	573	\$973,334	\$52,735,000	\$15,000,000	3.52	100.0%

Credit tables from Official Statement of a 2018 New Money Bond Issue

<u>Special Tax Category (2)</u>	<u>Land Use Designation</u>	<u>FY 2016-17 Maximum Special Tax Rate</u>	<u>Units/Acres</u>	<u>Estimated FY 2016-17 Maximum Special Tax Revenue</u>
<u>Developed Property</u>				
Unit 1	SFR 4-7	\$1,554	11 units	\$17,098
Unit 2	SFR 3-5	\$1,741	57 units	\$99,214
Unit 3	SFR 3-5	\$1,741	6 units	\$10,444
<u>Final Map Property</u>				
Unit 1	SFR 4-7	\$1,554	24 units	\$37,305
Unit 2	SFR 3-5	\$1,741	15 units	\$26,109
Unit 3	SFR 3-5	\$1,741	78 units	\$135,766
<u>Undeveloped Property</u>				
Unit 7	SFR 3-5	\$12,537	16.6 acres	\$207,860
Unit 8	SFR 3-5	\$12,537	12.9 acres	\$161,224
Unit 9	SFR 3-5	\$12,537	13.8 acres	\$173,259
Unit 10	SFR 3-5	\$12,537	13.7 acres	\$171,880
Unit 11	SFR 3-5	\$12,537	11.9 acres	\$148,561
Winn Property	SFR 4-7	\$12,537	23.7 acres	\$296,872
Total				\$1,485,590

Items Requested for POS for Bond Refundings

- **Breakdown of development by:**
 - Owner, tax category, village, or phase
 - Status of construction
 - Finished lots
 - Stucco stage
 - Framing stage
 - Completed, not sold
 - Completed, sold
- **Number of parcels in value-to-lien categories:**
 - 15:1 to 20:1
 - 10:1 to 15:1
 - 5:1 to 10:1
 - 3:1 to 5:1
 - 1:1 to 3:1

Items Requested for POS for Bond Refundings

- History of appraised value in CFD
- History of delinquencies in CFD
- 5 or 10 largest taxpayers in CFD
- Parcels within each special tax category
 - Developed Property, Final Map Property, Undeveloped Property
 - For Developed Property, parcels within each category
- Projected tax for current or next fiscal year
- Maximum special tax for current or next fiscal year
- Value-to-lien ratio by parcel, by owner, by village, by development status
- Number of parcels with a PACE lien and amount of each lien

Disclosure Obligations

- **SEC regulatory mandate**
 - ▣ Market transparency for investors
 - ▣ SEC doesn't directly regulate municipal issuers except for anti-fraud statutes.
 - ▣ SEC *compels* municipal reporting by requiring underwriter to secure agreement per SEC Rule 15c2-12(b)(5)
- **Continuing disclosure agreement**
 - ▣ Issuer promises ongoing information for investors to monitor value of the security
- **SEC Focus on MCDC**

Securities Exchange Act of 1934

Rule 10b-5:

“It shall be unlawful for any person. . .

(a) to employ any device, scheme or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. . .”

=> Applies to any circumstance where a municipal bond issuer is “**speaking to the market,**” including when filing annual Continuing Disclosure Reports or Event Notices.

Continuing Disclosure Commitment

- ❑ **Continuing Disclosure Agreement**
 - ❑ Form included in Preliminary Official Statement, sent to investors
 - ❑ Executed at closing
- ❑ **Ongoing reports**
 - ❑ Timing specified in Agreement
 - ❑ Annual audited financial statements
 - ❑ Certain updates to information in the Official Statement
- ❑ **“Material events” reporting**
 - ❑ Within 10 days of occurrence
- ❑ **CDIAC reports**

Material Events

- Delinquent payment of principal or interest
- Unscheduled draws on debt service reserve funds
- Unscheduled draws on credit enhancement
- Substitution of credit or liquidity providers, or their failure to perform
- Tender offers
- Defeasance of the Bonds
- Rating changes
- Bankruptcy, insolvency, receivership or similar event of obligated person
- Other events - *if material*

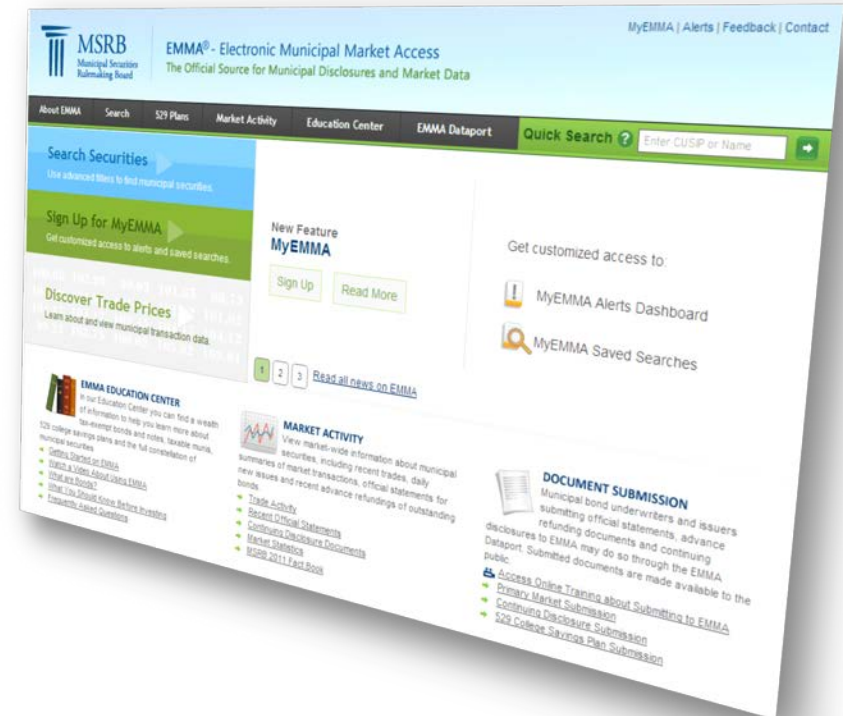
Market Perspective on Continuing Disclosure

- **Investors need to know the value of securities after initial issuance**
 - ▣ What are bonds in their portfolio worth?
 - ▣ How are they valued on financial statements?
 - ▣ What is a fair price should the bonds be sold in the secondary market?

- **Large municipal bond “secondary market”**
 - ▣ \$3.9 trillion of municipal bonds remain outstanding
 - ▣ About 1 million securities and 50,000 issuers
 - ▣ \$495 billion of municipal securities issued in the primary market in 2017
 - ▣ About \$11 billion of municipal securities traded daily and 39,000 daily trades

Vastly Improved Disclosure Dissemination

- **The MSRB's Electronic Municipal Market Access (EMMA®) website**
 - Promotes market transparency
 - Provides centralized, free public access to trade data and disclosure information on virtually all municipal bonds
 - Serves as a platform for issuers to communicate with investors
- **Training videos and manuals available on the website to assist issuers with compliance**



<http://emma.msrb.org>

Refunding Opportunities

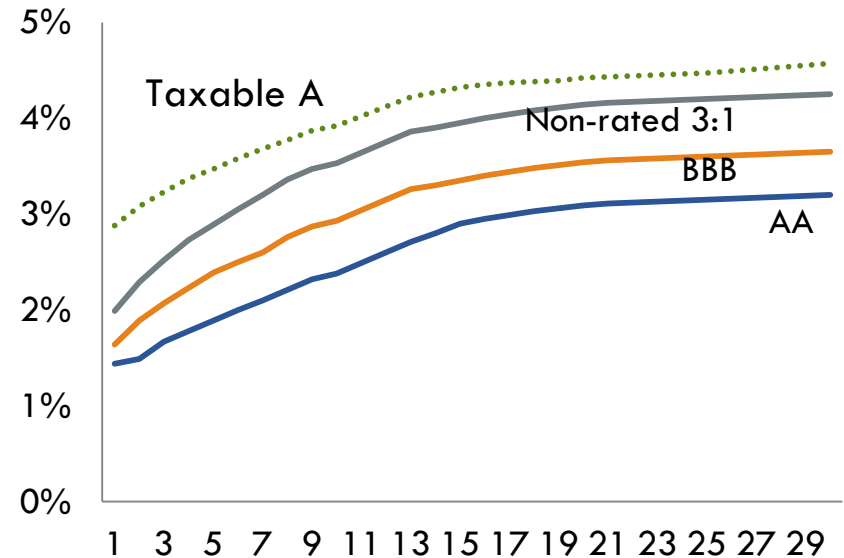
□ Why Refund?

- ▣ Lower overall interest rates
- ▣ “Rolling down the yield curve”
- ▣ Improved credit quality
- ▣ Need to change legal covenants
- ▣ Workout/restructure

□ Federal tax law changes

- ▣ Eliminated “advance” refundings
- ▣ Can refinance on a tax-exempt basis only within 90 days of a “call date”
- ▣ Taxable refundings of tax exempt debt may still offer economic savings

Illustrative Yield Curves



Source: Stifel, as of 8/27/18

Rating Criteria and Insurance

- **Most land secured bonds are initially sold without rating**
 - ▣ As project proceeds, credit quality generally improves
 - ▣ Large, built-out residential districts can be similar to a limited tax general obligation credit
 - ▣ May qualify for investment grade ratings
- **Standard & Poor's (S&P), Moody's and Fitch all rate land secured credits**
 - ▣ Rating criteria were historically conservative
 - ▣ S&P recently released revised criteria; new criteria have resulted in some significant rating upgrades
- **Two bond insurance companies remain active in municipal market**
 - ▣ Build America Mutual (BAM) and Assured Guaranty (AGM)
 - ▣ Both rated "AA" by S&P
 - ▣ May offer bond insurance and/or surety reserves

IRS Spending and Tracing Requirements for Municipal Bond Proceeds

- **Investment of bond proceeds**
 - Must be consistent with permitted investments set forth in Indenture/Fiscal Agent Agreement, issuer's investment policies and IRS Regulations
- **Bond proceeds are subject to Arbitrage calculation/rebate:**
 - Calculate and pay arbitrage rebate every 5 years, if any
 - Only applicable if investment earnings exceed bond yield
 - Various exceptions to arbitrage rebate available for:
 - Bona fide debt service funds
 - Construction funds
 - 6 month expenditure
 - 18 month expenditure
 - 24 month expenditure

IRS Spending and Tracing Requirements for Municipal Bond Proceeds

- **Bond proceeds transferred to other agencies pursuant to Joint Community Facilities Agreements must be traced as well.**
 - Preferable not to disburse bond proceeds to other public agencies except for reimbursement
- **Bond proceeds should be traced for the term of the bonds + three years**
- **IRS spend down requirements for new money bond proceeds in the construction fund:**
 - 3-year temporary period (85% rule)
 - 5-year hedge bond rules
 - year 1 = 10%
 - year 2 = 30%
 - year 3 = 60%
 - year 5 - 85%

Municipal Advisor Rule

- Dodd-Frank Act amended the Securities Exchange Act of 1934 to add a new requirement that all “Municipal Advisors” register with the Securities and Exchange Commission.
- A “municipal advisor” includes anyone that provides *advice* to or on behalf of a municipal entity or obligated person with respect to *municipal financial products* (municipal derivatives, GICs and investment strategies) or *the issuance of municipal securities*, or undertakes certain “solicitations” of a municipal entity.
- “*advice on the issuance of municipal securities or financial products*” includes advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues.

Municipal Advisor Rule

- Although a grey area, many Special Tax Consultants for CFDs in California have concluded that they are “Municipal Advisors” and required to register with the SEC as such because they advise CFD bond issuers on structuring the levy of the Special Tax, among other things.
- However, persons only providing *information* as opposed to *advise* with respect to a bond issue (for example, a market absorption analyst or appraiser) are not considered “Municipal Advisors.”
- Municipal Advisors have a *fiduciary duty* to act in the best interests of their clients.
- Underwriters are not Municipal Advisors and do not have a fiduciary duty to act in the best interests of the municipal bond issuer.
- Municipal bond issuers are strongly recommended to retain a Municipal Advisor on all bond issues.

Impact of MA Rule on Underwriters

- **Underwriters cannot provide “advice” to a municipal issuer unless:**
 - ▣ Responding to a Request for Proposals (sent to at least 3 firms)
 - ▣ Issuer relies on an Independent Registered Municipal Advisor (an “IRMA”)
 - ▣ Underwriter has been engaged for that particular financing
- **Objective information and refunding analysis not construed as “advice”**
 - ▣ An underwriter can provide typical bond sizing and refunding analysis using generic assumptions with internal clearance and appropriate disclosures
- **IRMA letter:** issuer declares intent to rely on an IRMA for advice
- **Engagement letter:** issuer declares intent to hire an underwriter on a particular financing
- **G-17 letter:** underwriter discloses non-fiduciary role to issuer

Regulatory Fine Print

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