National Association of Home Builders

An Overview of Special Purpose Taxing Districts

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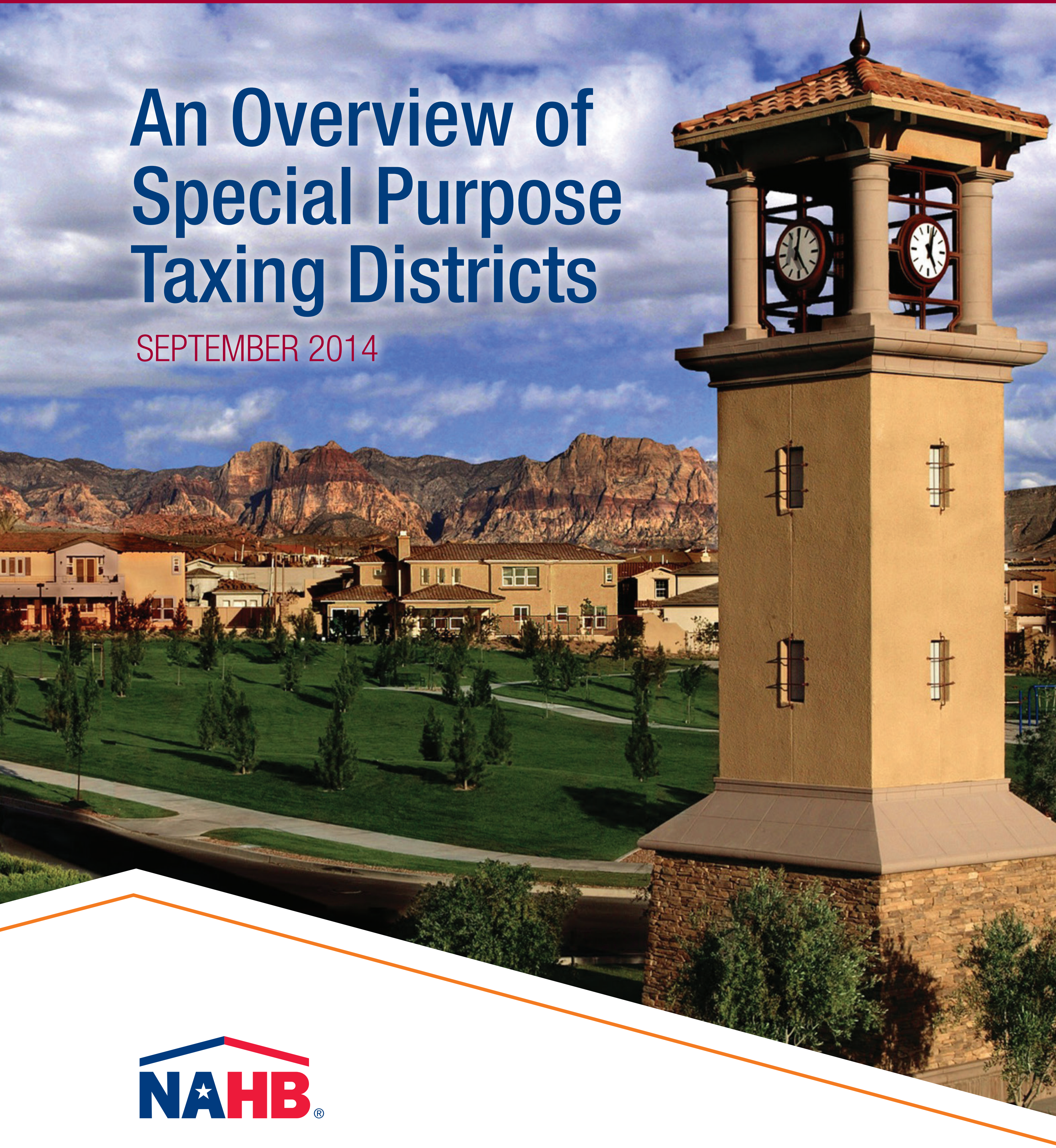

NAHB®

The National Association of Home Builders is a Washington-based trade association representing more than 140,000 members involved in remodeling, home building, multifamily construction, property management, subcontracting, design, housing finance, building product manufacturing and other aspects of residential and light commercial construction. NAHB is affiliated with 800 state and local home builders associations around the country. NAHB's builder members will construct about 80 percent of the new housing units projected for this year.

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This publication is designed as a resource to provide accurate and authorative information in regard to this subject matter covered with the understanding that its authors are not engaged in rendering legal, accounting, and other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

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About Development Planning & Financing Group, Inc. ("DPFG")

DPFG is primarily a transaction-oriented national real estate consulting firm which provides professional services to the private sector in matters of development and public finance. More information on DPFG may be found at www.dpfg.com.

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SPECIAL PURPOSE TAXING DISTRICTS

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Infrastructure Financing Challenges

The U.S. banking crises that occurred in late 2008 resulted in a major shift in the way land development projects, especially residential projects, are financed. Basically, commercial banks, which were doing most of the upfront funding on land development projects in the great real estate boom days, continue to shy away from doing business in this sector of the economy. This shift has created a huge void in finding up-front funding to cover the significant development costs that must be incurred before a single lot or home is sold or a business is occupied. The financing gap is currently being filled by expensive asset-based loans and private equity, which are typically three to five times more expensive than the cost of commercial lending if it were available, thus preventing many development projects from moving forward. Additionally, the construction of residential homes and commercial facilities from the "great boom days" has left many communities with public improvements that have no capacity to accommodate future development.

In addition, jurisdictions have been struggling in their approach to providing funding for the new facilities required by new growth. As may be expected, the jurisdictions have dusted off their impact fee ordinances and are now beginning to raise impact fees in an attempt to fund public improvements, as this is a financing tool with which they are familiar. The problem with this approach is that impact fees arrive too late in the process to fund the construction of public improvements in advance of growth; by the time impact fees are collected, the growth has already occurred causing stress on existing facilities.

The second challenge with impact fees is the manner in which they are estimated. Among other things, when credentialed professionals have evaluated impact fee studies prepared by the jurisdictions and/or their consultants, they have commonly found the following shortcomings with impact fees studies: (i) the utilization of overly aggressive land use and/or growth projections; (ii) construction costs utilized in the fee study do not correspond with the jurisdiction's Capital Improvement Plan; (iii) current levels of service are not documented properly or utilized within the study; (iv) other jurisdictional funding sources for public improvements are ignored or improperly applied; (v) land and/or construction costs are inflated; (vi) construction cost estimates are not prepared by licensed professionals; (vii) impact fees are being utilized to correct current levels of service deficiencies within the jurisdiction; (viii) impact fee studies are not compliant with the requirements of the state's enabling legislation; (ix) lack of multiple services areas, and (x) math and/or logic errors are present. All of these issues result in home builders and home buyers funding public improvements that are in excess of the benefit that they receive.

For more information on impact fees, see the National Association of Home Builder's ("NAHB") publication entitled Impact Fee Handbook. The publication is available online at www.nahb.org/fileUpload_details.aspx?contentID=184609.

A Better Way to Finance Public Improvements

A more efficient and effective way to fund public improvements in advance of growth, while at the same time ensuring that new growth pays for the improvements, is through the use of Special Districts (as herein defined). One may want to view the taxes and/or assessments that are levied by Special Districts as a "user fee" rather than a "tax", meaning that the Special District is created over a specific land area and the dollars are being collected by the Special District to pay for the public improvements that are benefiting the landowners within the Special District. In other words, the Special District residents are paying for public improvements for which they derive benefit and existing municipal residents who are outside the Special District boundaries are not paying for the Special District improvements. As a result, Special Districts are much more transparent and easily understood than impact fees. More importantly, Special Districts provide a more efficient form of financing because infrastructure improvements can be delivered in advance of growth, are funded exclusively by property owners within the Special District, are secured by liens that ensure collection of the funds by the Special District, and often deliver higher-quality public improvements than might otherwise be economically feasible.

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Additional advantages of Special Districts over impact fees include:

- Special Districts cover a specific geographic area and as such there is a clearer connection between the taxes/assessments being levied by a Special District and the benefits that the residents in the Special District are receiving.
- Special District taxes / assessments are levied on an annual basis and therefore are not rolled up into the home price/mortgage as is the case with impact fees.
- Over time Special Districts draw upon a large pool of citizens to finance public infrastructure and don't place this financial burden solely on new residents as is the case with impact fees.
- Special Districts often require the preparation of an annual budget thereby making them more accountable and transparent to the residents.
- Special Districts may be used in combination with other financing mechanisms thereby accelerating the financing of public improvements in advance of growth.
- Impact fees do not readily allow for the issuance of bonds to finance the construction of infrastructure in advance of growth.

In order to foster continued growth in the housing recovery, the public and private sectors should increase the use of Special District financings because this type of financing is the key to unlocking local and regional capacity problems associated with public improvements for newly developing areas.

Introduction to Special District Financing

Special District ("***Special District***") financing involves the issuance of tax-exempt bonds to finance public improvements within a specified geographical area, or district. Districts may construct public improvements ("Construction District") and/or purchase public improvements ("Acquisition District") that have been constructed by the developer through bond proceeds. The bonds are repaid from the special taxes, assessments, and/or an ad valorem property tax imposed on the land within the district. Property owners in the district thus finance the improvements without any city-wide taxpayer subsidy. The bonds are typically underwritten in private offerings managed by underwriting firms who specialize in this type of land-secured financing. See Exhibit B for a detailed description of the players and processes involved in Special District financing.

Various state statutes and local ordinances provide authorization for Special District financing. The nomenclature for Special District varies according to location, but some of the more common Special District names include metropolitan districts ("***Metro District***"), municipal utility districts ("***MUD***"), public improvement districts ("***PID***"), special improvement districts ("***SID***"), special assessment districts ("***SAD***"), community facility districts ("***CFD***"), improvement districts ("***ID***"), community development districts ("***CDD***"), and tax increment financing districts ("***TIF***"). The tables that follow illustrate some of the more common Special Districts. They are intended to be illustrative and not exhaustive, in terms of both the financing tools as well as the states listed. Additional information related to the other available infrastructure financing options and where they are authorized may be found in the NAHB's publications *Building for Tomorrow: Innovative Infrastructure Solutions* (2003), *Infrastructure Finance—Does Your State Encourage Innovation?* (2012) as well as *A Summary of State Legislation to Encourage Innovative Infrastructure Financing Options* (2012). All three of the NAHB's publications may be found online at www.nahb.org.

Infrastructure for which Special District financing may be used is defined by state statute. In some jurisdictions, Special Districts are also used to fund specific public services, such as public safety, snow removal and/or street cleaning and maintenance. However, this publication focuses on Special Districts with broader authorization to finance public infrastructure improvements needed to support growth and development.

Commonly, most Special Districts are allowed to finance public water and sewer systems, public roadways and other transportation improvements, drainage projects, public safety as well as public parks and recreational facilities. The determination of which Special District to utilize is dependent upon a number of factors including but not limited to: (i) Special Districts allowable pursuant to state law; (ii) jurisdictional policies, (iii) the type of public infrastructure to be financed; (iv) the phasing schedule of the project; (v) other available financing sources; and (vi) the competitive environment. A listing of the types of facilities eligible for financing through selected Special Districts has been included in the tables on pages 6 through 9.

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Special Districts are typically, but not always, separate political subdivisions from the jurisdiction that creates the Special District. The obligation to repay the Special District bonds is passed on to the end users of the property located within the Special District's boundaries.

Based upon the type and location of the Special District, the district may issue general obligation, revenue, special assessment and/or special tax bonds to finance eligible public improvements.

The bonds issued by Special Districts typically have terms ranging from 20 to 40 years, with tax-exempt interest rates ranging from 3 to 7 percent. Typically, the only security for the bonds is the property located within the Special District itself—no other forms of developer financial assurance is required. As the Special District is typically a separate political subdivision from that of the establishing jurisdiction, the establishing jurisdiction does not have to repay bondholders should the developer or property owners default on the debt obligations of the Special District. Nowhere was this fact more readily apparent than in the state of Florida when during the Great Recession approximately $4 billion in community development district bonds went into default, yet not one Florida jurisdiction was required to fund the debt service on the defaulted bonds. Additionally, not one jurisdiction in which the defaulting districts were located had their credit rating downgraded.

A Special District's ad valorem taxes, special assessments or special taxes are imposed in addition to the traditional statutory property taxes on real property within the Special District and are authorized for a specific period of time to fund specific improvements, or debt service thereon, within the Special District. Depending upon the type of bond being issued, the repayment of the bonds will be accomplished through the payment of additional ad valorem taxes in the case of general obligation bonds, special assessment payments in the case of special assessment bonds or special tax payments in the case of special tax bonds. Sales taxes, various excise taxes and/or user fees can also be utilized to support Special District revenue bond financing.

Further, Special District ad valorem, special assessments and special taxes carry the same priority as real property taxes, meaning that in the case of delinquency or non-payment, collection is enforced in the same manner as real property taxes. Because real property taxes have precedence over private liens, including mortgages, the governmental entity and the Special District have the right to ultimately to collect delinquent amounts by a tax sale of the property.

Public hearings to establish Special Districts, advance disclosure in real estate contracts, deeds, or marketing materials to purchasers of property within the Special District may be required by enabling legislation or policy guidelines published by the governmental entity.

Special District Financing Advantages

The use of Special District financing creates a "win-win-win" scenario for the development community, the jurisdiction and the homeowner as follows:

Private Sector Benefits

1. **Non-Recourse Financing** – In most cases, Special District financings are non-recourse borrowings to the developer, meaning that if the developer defaults on the bonds, the only recourse to the Special District is to foreclose on the property. The security for the bonds is either an assessment lien on the individual lot or parcel in the case of a special assessment or special tax levy bond; an increase in the ad valorem property taxes of the property contained with the Special District in the case of a general obligation bond; or the revenue stream created by an asset financed by the Special District, such as a water treatment facility or parking garage in the case of a revenue bond.

2. **Long-Term Financing** – Unlike traditional construction financing, which has a 2 to 3 year term, the typical term of Special District bonds ranges from 20 to 40 years.

3. **Reduces Equity/Third Party Borrowings** – The use of Special District financing to finance a portion of the project's public improvement costs reduces the amount of equity and/or traditional lending required.

4. **100% Debt Financing** – Conventional financing sources typically require equity contributions, whereas Special District financing is 100 percent debt financing. Additionally, no personal and/or corporate financial guarantees are required with Special District financing.

5. **Tax-Exempt Interest Rates** – Special District bonds are issued at tax exempt interest rates and therefore are less expensive than the interest cost of borrowing from conventional sources (including potential lender participation).

6. **Interest Reserves** – Special Districts may borrow up to 3 years of capitalized interest to fund debt service requirements while the project is under construction. During the capitalized interest period, property owners within the district are not required to pay debt service on the bonds as this is funded by the Special District.

7. **No Acceleration Provisions** – Development loans typically have an acceleration provision in which the lender may foreclose on property for the entire loan amount; whereas with Special District financing, the district may only foreclose on the property for which the assessments and/or taxes are levied and unpaid.

SPECIAL DISTRICTS

Selected State Special Districts

	Arizona		California	Colorado		Delaware	Florida
Description	**CFD**	**RD**	**CFD**	**Metro**	**SID**	**SID**	**CDD**
Jurisdiction Availability							
Establish in County	X	-	X	X	X	-	X
Establish in a Municipality	X	X	X	X	X	X	X
Available Bond Types[1]							
Revenue Bonds	X	X	-	X	-	-	X
General Obligation Bonds	X	-	-	X	-	-	X
Special Assessment Bonds	X	X	-	-	X	X	-
Special Tax Levy Bonds	-	-	-	-	-	-	-
Maximum Bond Term (Years)[1]	**25**	**30**	**40**	**30**	**30**	**30**	**40**
Eligible Capital Public Improvements							
Roadways	X	X	X	X	X	X	X
Water	X	X	X	X	X	X	X
Sewer	X	X	X	X	X	X	X
Drainage	X	X	X	X	X	X	X
Lighting	X	X	X	X	X	X	X
Traffic Control	X	X	X	X	X	X	X
Natural Gas	-	-	X	-	-	-	-
Telephone	-	-	X	-	-	-	-
Electrical	-	-	X	-	-	-	-
Cable TV	-	-	X	X	-	-	-
Landscaping	X	X	X	X	-	X	X[2]
Recreational Facilities/Parks	X	X	X	X	-	X	X[2]
Civic Buildings	X	X	X	-	-	X	X[2]
Schools	-	-	X	-	-	X	X[2]
Police Facilities	X	X	X	X	-	-	X[2]
Fire Facilities	X	X	X	X	-	-	X[2]
Pedestrian Malls	X	X	X	X	-	-	-
Parking	X	X	X	X	-	X	X[2]
Other	-	X	-	-	X	-	-
Child Care Facilities	-	-	X	-	-	-	-
Hazardous Waste Remediation	-	X	X	-	-	-	X[2]
Solid Waste	-	-	-	X	-	X	X[2]
Mosquitoes/Pest Control	-	-	-	X	-	-	X[2]
Transit Facilities	-	-	-	-	-	-	-
Provision of Ongoing Operations and Maintenance Costs	Limited	Limited[3]	Limited	X	Limited	-	X

Hawaii	Idaho		Illinois	Maryland	Montana
CFD	CID	LID	SSA	STD	SID
X	Limited	X	X	X	-
X	X	X	X	X	X
-	X	-	-	-	-
-	X	-	X	-	-
-	X	X	-	-	X
X	-	-	X	X	-
30	**30**	**30**	**40**	**30**	**20**
X	X	X	X	X	X
X	X	X	X	X	X
X	X	X	X	X	X
X	X	X	X	X	X
X	X	X	X	X	X
X	X	X	X	X	X
X	-	-	-	-	X
X	-	-	-	-	X
X	-	-	-	-	X
X	-	-	-	-	X
X	-	-	-	X	X
X	X	X	-	X	X
X	X	X	-	X	-
X	-	-	X	X	-
X	X	-	-	-	-
X	X	-	-	-	-
X	-	-	-	-	-
X	X	X	-	-	X
-	-	-	-	-	-
X	-	-	-	-	-
X	-	-	-	-	-
-	-	-	-	X	-
-	-	-	-	X	-
-	-	-	X	X	-
Limited	Limited[3]	-	X	X	X

Footnotes:

[1] Pursuant to state statute.

[2] With approval of jurisdiction.

[3] Operations Only.

Note: Dashes (–) equate to a NO answer.

LEGEND:

CDD	Community Development District
CFD	Community Facilities District
CID	Community Improvement District
GID	General Improvement District
ID	Improvement District
LID	Local Improvement District
Metro	Metropolitan District
MUD	Municipal Utility District
PID	Public Improvement District
SSA	Special Service Area District
SSD	Special Service District
SID	Special Improvement District
STD	Special Taxing District
TIDD	Tax Increment Development District

SPECIAL DISTRICTS

Selected State Special Districts (continued)

	Nevada		New Mexico		New York	North Carolina	Pennsyl-vania
Description	**SID**	**GID**	**PID**	**TIDD**	**ID**	**SAD**	**NID**
Jurisdiction Availability							
Establish in County	X	X	X	X	-	X	-
Establish in a Municipality	X	-	X	X	X	X	X
Available Bond Types[1]							
Revenue Bonds	-	-	X	-	-	X	-
General Obligation Bonds	X	X	X	-	-	-	-
Special Assessment Bonds	-	X	-	-	X	X	-
Special Tax Levy Bonds	-	-	X	X	-	-	X
Maximum Bond Term (Years)[1]	**30**	**30–40**	**30**	**25**	**None Given**	**30**	**40**
Eligible Capital Public Improvements							
Roadways	X	X	X	X	X	-	X
Water	X	X	X	-	X	X	X
Sewer	X	X	X	-	X	X	X
Drainage	X	X	X	X	X	X	X
Lighting	X	X	X	-	X	-	-
Traffic Control	X	X	X	X	-	-	-
Natural Gas	-	-	X	-	-	-	-
Telephone	-	-	X	-	-	-	-
Electrical	-	-	X	-	-	-	-
Cable TV	-	-	X	-	-	-	-
Landscaping	X	X	X	X	X	-	-
Recreational Facilities/Parks	X	X	X	X	X	X	-
Civic Buildings	-	-	X	-	-	-	-
Schools	-	-	X	-	-	-	-
Police Facilities	-	-	X	-	-	-	-
Fire Facilities	-	X	X	-	-	-	-
Pedestrian Malls	X	X	X	-	-	-	-
Parking	X	X	X	-	X	-	X
Other	-	-	-	-	X	-	X
Child Care Facilities	-	-	X	-	-	-	-
Hazardous Waste Remediation	-	-	-	-	-	-	-
Solid Waste	-	-	-	-	-	-	-
Mosquitoes/Pest Control	-	-	-	-	-	-	-
Transit Facilities	-	-	-	-	-	-	-
Provision of Ongoing Operations and Maintenance Costs	-	X	X	X	X	-	X

South Carolina	Texas		Utah		Virginia	Washington
ID	MUD	PID	SSD	ID	CDA	CFD
-	X	X	X	X	-	X
X	X	X	X	X	X	X
X	X	-	X	-	X	-
X	X	-	X	-	-	-
X	-	X	X	X	-	X
-	-	-	-	-	X	-
40	**30**	**40**	**25**	**20**	**40**	**30**
X	X[2]	X	X	X	X	X
X	X	X	X	X	X	X
X	X	X	X	X	X	X
X	X	X	X	X	X	X
X	-	X	X	X	X	X
X	-	X	X	X	X	X
X	-	-	-	X	X	-
-	-	-	-	-	X	-
X	-	-	X	X	X	-
-	-	-	-	-	-	-
-	-	-	-	-	X	-
X	X	X	X	X	X	X
X	-	X	-	X	-	X
X	-	X	-	-	X	-
-	-	-	-	-	X	X
X	-	-	X	-	X	X
X	-	X	-	-	-	X
X	-	X	-	-	X	-
X	-	-	X	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	X	-	X	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
Limited	X	Limited	-	-	X	-

Footnotes:

[1] Pursuant to state statute.

[2] With approval of jurisdiction.

[3] Operations Only.

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LEGEND:

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SSA	Special Service Area District
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SID	Special Improvement District
STD	Special Taxing District
TIDD	Tax Increment Development District

8. **Accelerate Construction** – The use of Special District financing allows the developer to advance the construction of facilities, which may have had to wait until additional financing and/or project revenues were available with other financing approaches, such as impact fees.

9. **Additional Facilities** – The additional financing capacity provided by Special District's allows the developer to fund additional amenities and/or enhanced facilities which may otherwise have not been possible thereby potentially enhancing the marketability of the project to homebuyers.

10. **Impact Fee Credit** – To the extent that the developer is funding public improvements through the Special District for which the jurisdiction is also collecting an impact fee, the jurisdiction must provide a credit against the impact fee to insure that new growth is not paying for the public improvement twice—once through the impact fee, and a second time through the Special District.

Public Sector Benefits

1. **"Growth Pays for Growth"** – As Special Districts typically only encompass a specific project boundary and not the entire jurisdictional boundary, Special Districts are well designed to ensure that growth is paying for itself without burdening the existing residents of the community.

2. **Preserves Debt Capacity of Jurisdiction** – The utilization of Special Districts allows the jurisdiction to preserve its statutory bonding capacity for other public improvements.

3. **New Source of Capital Funding** – The use of Special District financings provides an additional capital funding source for the jurisdiction's financial tool box.

4. **"Off Balance Sheet" Financing** – Typically, Special Districts are separate and distinct from the jurisdiction in which they were established, and as such, the jurisdiction is not financially responsible for the debt obligations of the Special District.

5. **Competitive Advantage Among Public Entities** – The use of Special Districts allows the jurisdiction which offers such financing to be more competitive than jurisdictions which do not.

6. **Fulfillment of Public Purpose Objectives** – The use of Special Districts may assist the jurisdiction in accomplishing its public purpose objectives.

7. **Provision of Additional Amenities** – The use of Special Districts may assist in the construction of public amenities which may otherwise have not been possible or may allow the developer to fund improvements to a higher quality standard.

8. **Faster than Impact Fees** – As Special Districts may fund the construction of public improvements in advance of growth, they are much more efficient than impact fees, which arrive after growth as already occurred and can't be spent until they accumulate.

Home Owner Benefits

1. **Lower Home Prices** – As portions of the public improvement costs are financed through the Special District, it is not necessary to recover these costs through the home price thereby allowing homes to be sold at a lower price point than that which otherwise be possible.

2. **Additional Amenities** – Typically projects which utilize Special Districts have additional and/or enhanced public amenities (e.g. parks, trails, landscaping, open space, etc.) than non-Special District communities. These additional amenities create value not only for the jurisdiction and the master planned community, but also for the homeowner's residence.

3. **Advanced Construction of Improvements** – The use of Special District financing allows the developer to install improvements in an accelerated manner than that which would have otherwise been available.

4. **Reduce Operations and Maintenance Expenses** – Special Districts may fund operations and maintenance expenses of the project thereby lowering HOA dues. As the operations and maintenance taxes are deductible for tax purposes and HOA dues are not, this provides an additional economic benefit to the homeowners.

Other Considerations

1. **Lender Consent May be Required** – With the exception of revenue bonds, similar to regular property taxes, Special District special assessment/tax liens and ad valorem taxes have priority over any traditional lending. As such, it may be necessary to secure the consent of underlying lending institutions to establish the Special District. In our experience, obtaining the lender consent has not been difficult as most lenders understand that the establishment of the Special District will enhance the project's residual land value, and Special District bonds will be issued over an extended period and often will be utilized to "take out" the lender's development loan.

2. **$5,000,000 Bond Issuance (Special District Sweet Spot)** – In order for an underwriter to garner the interest of institutional bond investors, a Special District bond issuance should be equal to or greater than $5 million. As institutional investors have hundreds of millions of dollars to invest, and the time

it takes to place $1 million is the same as $100 million, they tend to look for larger transaction amounts, and $5 million is typically the lowest amount which they will consider. It is preferred to sell Special District bonds to institutional investors as opposed to accredited investors, as it is easier to negotiate with 3 or 5 institutional investors as opposed to 300 accredited investors should bonds ever default and need to be restructured.

3. **Public Bidding/Prevailing Wage** – When considering the use of Special Districts, one has to be cognizant of the fact that the use of the Special District to construct and/or acquire public infrastructure may require the use of public bidding and the payment of prevailing wages. The requirements for public bidding and prevailing wage vary from state-to-state and from district-to-district, so it is important to understand the specific requirements of your state and Special District.

   While having to publicly bid the public improvements that will be financed by the Special District requires additional time and overhead, with the exception of the payment of prevailing wages in those states where this is required, public bidding should not result in dramatic increase in costs. Generally the contractor understands that the Special District improvement work is a developer-driven project, and that if the contractor increases their pricing related to the Special District improvements, chances are the developer will not have them participate in the construction of other non-Special District improvements.

   As is relates to those states that require the construction of public improvements through Special Districts to adhere to the tenants of the Davis-Bacon Act,[1] the cost of public improvements can increase between an estimated 10 to 30 percent. If an infrastructure project has limited labor involvement, such as the paving of a roadway, the cost increase will generally be on the low end of the scale, while an infrastructure project that demands a significant amount of manual labor to complete—such as the landscaping of a public park—could drive up the cost of the landscaping by as much as 30 percent. Accordingly, should your state require the payment of prevailing wage, one will want to fund non-labor intensive public improvements through the Special District as opposed to labor-intensive projects in order to minimize construction costs.

4. **Construction District vs. Acquisition District** – Special Districts can function as a Construction District and/or an Acquisition District. A Construction District is when the Special District issues bonds to fund the construction of the public improvements through the use of bond proceeds. In this instance, the construction contract is in the name of the Special District as opposed to the developer's construction entity. On a monthly basis as construction takes place and draw requests are received, the district engineer will verify that the improvements that are the subject of the draw request have been constructed. Assuming there are no deficiencies in either the draw request or construction work, the district engineer will approve the draw for payment. Once approved by the district engineer, the draw request is typically approved by the district board and the trustee is instructed to fund the draw request through funds held within the Construction Account.

   In the case of an Acquisition District, the developer's construction entity is typically the contracting entity, and the developer funds the construction of the public improvements as they would normally do in the regular course of business. Once the improvement has been completed, the project will be inspected by the jurisdictional engineers and district engineer. Once the punch list items have been completed, the Special District will issue bonds and "acquire" the completed improvement from the developer through the funds held within the Acquisition Fund.

   Most Special Districts are set up to do both Construction Districts as well as Acquisition Districts. However, given the constraints within the capital markets, more-and-more Special Districts are being established to issue bonds to fund the construction of public improvements through Construction Districts. The use of Construction Districts is also the most efficient and cost effective method, as the developer is not having to incur financing costs twice; once through equity and/or a traditional construction loan, and a second time through the Special District.

5. **Operations and Maintenance Costs** – Not only can Special Districts finance the construction and/or acquisition of the public infrastructure, but they may also levy ad valorem taxes and/or additional charges through assessment bonds to fund the ongoing operations and maintenance of public facilities within the boundaries of the Special District. While the rules related to the methods, timing and amounts that can be funded vary from state-to-state, the ability to finance operating costs through a tax rate as opposed to an HOA fee can lower the HOA fee and allow the home owner to deduct these tax payments from their income taxes. Such a tax deduction is not allowed for HOA fees.

[1] The Davis-Bacon Act of 1931 is a United States Federal law that establishes the requirement for paying the local prevailing wages on public works projects for laborers and mechanics. It applies to "contractors and subcontractors performing on federally funded or assisted contracts in excess of $2,000 for the construction, alteration, or repair of public buildings or public works.

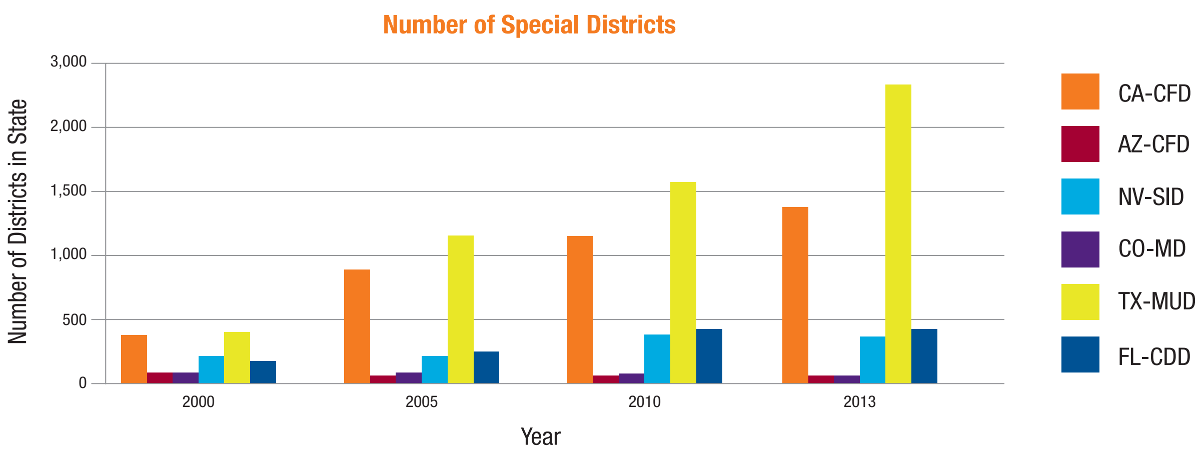
Special District Trends and Opportunities

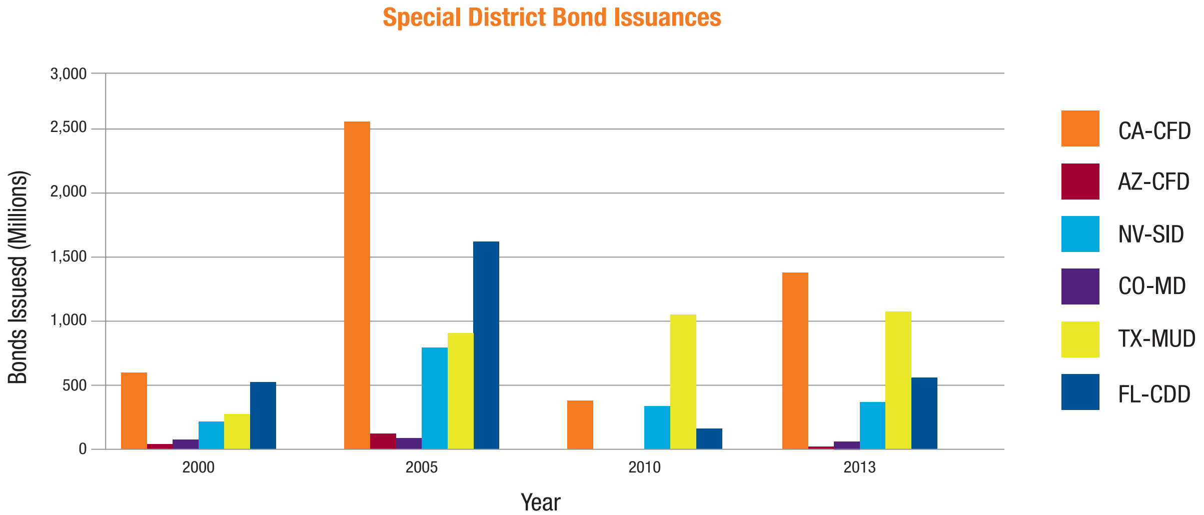
The "Great Recession" caused those involved in issuing Special District bonds across the U.S. housing market to recoil and apply very conservative bond issuance practices when the market was at its weakest points. However, as the U.S. housing market continues to improve, Special District bond issuance criteria is moving towards what one would expect in a normalized market.

Historic Trends

The illustrations below provide a historical snapshot of the use of various Special District financing vehicles in the states of California, Arizona, Nevada, Colorado, Texas and Florida for the time period 2000, 2005, 2010 and 2013.

Special Districts • Historic Trends





Source: Stifel Nicolaus (from selected national/state and local publications)

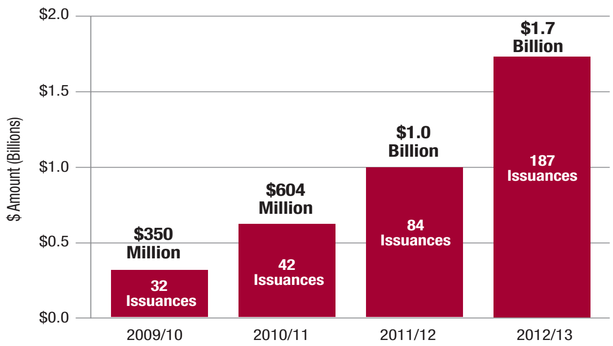
Current Trends

A number of current trends and opportunities in the Special District arena follow.

Special District Bond Issues on the Rise

The absolute number and amount of Special District bond issues has been increasing steadily from past years. For example, in California, the use of CFD bonds has been accelerating in recent years, according to the California Debt Investment Advisory Commission, as follows.

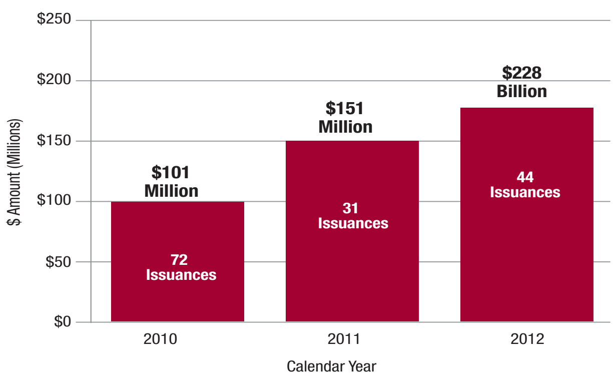
CFD Bond Issuance



Source: California Debt Investment Advisory Commission.

Additionally, according to the Municipal Securities Rulemaking Board, the number and amount of CDD bond issues in Florida has been growing in recent years, as illustrated in the following.

CDD Bond Issuance



Source: Municipal Securities Rulemaking Board.

The growth in the number and amount of bond issues is the result of general economic improvement in the U.S. housing sector. Another ancillary reason why Special District bond issues are on the rise across the nation is because the residential housing industry is still experiencing difficulty in obtaining financing for upfront public infrastructure costs from commercial banks and other financial institutions. Steve Heaney, a Managing Director of Stifel Nicolaus, said recently that, "It is expected that the use of Special Districts will continue to accelerate throughout the U.S. especially if conventional lending sources continue to sit on the sideline".

Accelerating Bond Issuance Timing

As the U. S. went deeper into the "great recession," the timing as to when Special District bonds were issued was pushed to the back-end of the project's development cycle. For example, it was common for the public agencies in California to be unwilling to issue bonds until a substantial number of residences (i.e., 50 to 100 percent) were constructed and occupied by homeowners in the project. As the housing recovery unfolds, Special District bonds are being issued at the front-end of developments that are located in "Class A" markets. For example, on July 13, 2013 the Santa Margarita Water District issued $57,420,000 in Community Facilities District No. 2013-1 bonds on a project known as the Village of Sendero, which is located in a Class A market in Orange County, California. At the time of the bond issue, the Village of Sendero project had been graded, and the major infrastructure (i.e., water, sewer, storm drain, utilities, and arterial roads) were substantially complete. Furthermore, at the bond issuance date, all planned residential property was either conveyed or under option to merchant builders; however, no homeowners were present.

Additionally, the City of Austin in the state of Texas issued $12,590,000 in Special Assessment Revenue bonds, Series 2013, on July 17, 2013, for the Estancia Hill Country PID. Estancia Hill Country is a mixed use development encompassing 593 acres in the City of Austin's extraterritorial jurisdiction. The bonds are entirely secured by assessment liens on the first phase of the project, which consists of 216 acres anticipated to be developed as 386 single family lots, 450 multifamily units, and 83 acres of commercial/office uses. Additional bonds are expected to be issued as additional phases of the project are developed. Construction of the improvements had just begun at the time of the bond issue, and any costs spent prior to closing were reimbursed to the developer at closing. All remaining infrastructure costs are being paid monthly directly from bond proceeds. On the bond issuance date, the residential lots were under contract with a merchant builder, and the sale was expected to finalize within 30 days after the bond closing. No contracts were in place for any of the multifamily or commercial/office parcels.

One would expect to see more Special District bonds being issued at the front end of developments in "Class A" and "Class B" markets if the recovery continues to expand and build greater strength and confidence.

Bonding Capacity Increases as Home Prices Increase

As residential home prices increase across the U.S. housing market, so does the potential to increase the bonding capacity of Special Districts. For example, in California, a $50,000 increase in home price can result in an additional $5,000 per unit increase in CFD bond proceeds that can be used to pay for a project's public infrastructure. Likewise, in Texas, a $50,000 increase in home price can result in an additional $5,500 per unit increase in public improvement district bond proceeds that can pay for public infrastructure, assuming a tax rate of $1.00 per $100 of assessed value.

Larger Upfront Bond Issues as Project Values Increase

Most Special Districts employ an independent appraiser to determine the property value that is typically the sole source of bondholder security in the event of non-payment of annual special taxes or assessments. In a rising market, it's imperative that the land developer provide the appraiser with all relevant recent land closings, as well as all pending purchase contracts they know about in order to establish an accurate value that's current. Often, the appraiser will use sales comps that are too old and no longer reflective of the value changes that have occurred in the marketplace, especially if the market has experienced quick value movements. The higher the appraised value, the larger the Special District bond issue can be, because many public agencies have limits or minimums on value-to-lien ratios. For example, in California, the community facilities district statute states that a bond issue must have a value-to-lien ratio of 3 to 1, unless certain exceptions are met. When a Special District bond issue is constrained by a value-to-lien ratio, the bond issue will typically be split into two bond issues, with the second bond issue occurring later in time after the project has increased its value by constructing more improvements or by finished lot prices increasing. As the market continues to improve and appraised values increase, this will cause the amount of upfront Special District bonds to increase.

Bonding Capacity Decreases when Interest Rates Rise

The Federal Reserve policy for many years has been to keep interest rates low to induce economic development. Now that the U.S. housing market is recovering along with other industries, the Fed will be under pressure to increase interest rates. Currently, Special District bond issue rates across the U.S. are very low. For example, in California, the Menifee Union School District priced Community Facilities District No. 2011-1, on October 10, 2013, at an average coupon rate of 5.85 percent with a 30-year bond term. In Texas, the Estancia Hill Country PID priced its bonds on July 16, 2013 at an average coupon rate of 5.88 percent with a 15-year bond term. In Florida, the Union Park Community Development District priced its 2013 bonds on November 1, 2013, at an average coupon rate of 7.5 percent with a 30-year bond term. Most economists agree that interest rates eventually have no place to go but up. It is important to note that it typically takes 9 to 12 months to form a Special District and issue bonds, so development projects are already subject to potential interest rate increases that could occur over this timeframe even if one started today. It is anticipated that interest rates on Special Districts will increase as the U.S. housing market continues to build strength. An average coupon rate increase of 1 percent on a Special District bond term of 30 years results in 10 percent less gross bond proceeds, which can be financially significant when issuing multi-million dollar bond issuances.

Many U.S. housing markets are recovering, and traditional financing for a development project's public infrastructure is still difficult to obtain. What is available is very expensive. Special Districts can help fill the financing void, and the trends that are occurring with these districts are looking more favorable and attractive as the market continues to recover. The implementation of a Special District does require some lead time, so if a development project is ready to enter the market, one may want to start the Special District process sooner versus later, because interest rates will not stay low forever.

Lessons Learned From the "Great Recession"

The "Great Recession" played financial havoc with the global economy and severely impacted both the public and private sectors with equal ferocity. One may believe that a number of new insightful financial lessons were learned as part of the "great recession," but in fact, the old lessons remain the new lessons.

Public Sector Lessons

1. **Special Districts Work as Intended** – Special Districts protect the jurisdiction from financial liability. As Special Districts are separate political subdivisions from that of the jurisdiction that created the district, the jurisdiction is not responsible for the debt obligation of the Special District. Additionally, the non-payment by the jurisdiction of a defaulted Special District does not appear to negatively impact the credit rating of the jurisdiction.

2. **Absorption Rates** – Have realistic expectations regarding the absorption rates of projects so that bonds are not issued in excess of that which can be reasonable absorbed over a 3 year period.

3. **Flexibility** – Special Districts should be created to allow for changes in land uses and alternative construction projects. This will minimize administrative time associated with the Special District.

Private Sector Lessons

1. **Guarantees** – Mark Twain said, "A man who carries a cat by the tail learns something he can learn in no other way". The same can be said about guaranteeing Special District bonds. Never provide corporate and/or personal guarantees related to the issuance of Special District bonds, or one may potentially experience a very painful learning experience.

2. **Absorption Rates** – Have realistic expectations regarding the absorption rates of your project. Very few master planned communities in the United States experience sales rates in excess of 1,000 units per year for an extended period. Prior to the downturn, many developers across the United States were issuing bonds assuming linear increases in their sales projections, pushing sales figures in excess of 1,200 units per annum. The great majority of these optimistic absorption rates did not materialize.

3. **Over-leverage** – Special District financing is a vital component of the capital stack however, it will not finance 100 percent of the project's public improvements. As such, when estimating the amount of Special District bonds that can be supported by a development project; care should be taken not to dramatically increase the effective property tax rate of the project so that it is not competitive with other development projects. If one is using the Special District to finance the maximum amount public improvements given the district's underwriting criteria, and this causes the effective tax rate of the project to be dramatically higher than the competitive market, the bonds should be structured in such a manner to allow the pay down the effective tax rate of the Special District and fall within an acceptable range of the competitive supply.

4. **Build Flexibility into Special District Agreements** – As no one has a crystal ball as to what will occur over the time involved in a development project, one should create operational flexibility within the Special District operating agreements to allow for changing economic and market forces.

5. **Know Where the Exit is Located at all Times** – Special Districts should be established in such a manner to enable the developer to limit their financial exposure in the case of a severe downturn. The time to plan for a graceful exit from the Special District is when the district is established, not when it is in trouble.

Concluding Comments

Given the financing challenges that the development community continues to face in light of the "Great Recession", combined with ongoing jurisdictional demands for the development community to provide more-and-more of the jurisdiction's public improvement needs, the necessity for the use of Special Districts is anticipated to accelerate over the foreseeable future. Not only do Special Districts allow for the provision of public improvements in advance of growth, they also allocate these costs in a fair and equitable manner to the areas which are deriving their benefit, thus avoiding the use of impact fees, which are an ineffective and inefficient means of financing public improvements.

Lastly, Special Districts play an important role of filling the financing gap left by the departure of traditional lending institutions, allowing developers to provide necessary public improvements in a timely and efficient manner, while at the same time allowing growth to pay for itself, and without financially burdening the jurisdiction or its existing residents.

APPENDIX | Exhibit A

Selected Case Studies

A small sampling of recent Special District financing transactions is shown below.

Eastmark – A 2,170-acre project located in Mesa, Arizona. The developer issued both CFD general obligation and special assessment bonds to finance the acquisition of approximately $3.6 million in roadway improvements.

Estancia Hill Country – Estancia Hill County is a 593-acre project located in the Lake Travis area of Austin, Texas. The developer issued approximately $12.6 million in PID special assessment bonds to construct water, sewer, drainage, roadways, landscaping and trails out of bond proceeds.

Village of Sendero – This project represents approximate a 416-acre project in Orange County, California, in which the developer issued $57.4 million in CFD special tax bonds to finance the acquisition of water and fire improvements.

Sienna Plantation – This 944-acre project located in Fort Bend, Texas, issued $4.7 million in MUD general obligation bonds to acquire water, sewer and drainage improvements.

Summerlin – At the time of publication these bonds have not been issued; however, the developer is anticipating approximate a $25 million SID special assessment bond issue to finance the acquisition of water, sewer and drainage improvements related to Village 16A of this approximate 22,500-acre development located in Clark County, Nevada.

Union Park – This 580-acre project located in Pasco County, Florida, issued $9.6 million in CDD special assessment bonds to acquire and construct water, sewer, roadway, landscaping, and trail improvements.

Eastmark

Summerlin

Eastmark

Sienna Plantation

Selected Case Studies
Recent Bond Transactions

Description	Eastmark		Estancia Hill County	Village of Sendero	Sienna Plantation	Summerlin	Union Park
Project Location:	Mesa, AZ	Mesa, AZ	Austin, TX	Orange Cty., CA	Fort Bend Cty., TX	Clark Cty., NV	Pasco County, FL
Project Type:	MPC	MPC	MPC	Mixed Use Residential	Residential	MPC	MPC
Size (Acres):	2,170	2,170	593	416	944	22,500 (Approx.)	580 (Approx.)
Land within Assessment Area:	231	N/A	216	416	NAP	398	248
District Type:	CFD	CFD	PID	CFD	MUD	SID	CDD
Bonds Issued:	Special Assessment	General Obligation	Special Assessment	Special Tax	General Obligation	Special Assessment	Special Assessment
Bond Issuance Date:	7/15/2014	5/21/2014	7/17/2013	7/13/2013	7/9/2013	4th Quarter 2014 (Est.)	11/1/2013
Bond Amount:	$3,367,000	$3,250,000	$12,590,000	$57,420,000	$4,700,000	Estimated to be $25,000,000	$9,630,000
Maximum Bond Term:	25 Years	25 Years	5–15 Years	30 Years	23 Years	20 Years	5–30 Years
Bond Interest Rate:	2% to 5.4%	1.5% to 5%	4.5% to 6%	2% to 5.7%	0.75% to 4%	7% (Estimate)	7.375%–7.500%
Status of Land when Bonds Issued:	Partially Developed	Partially Developed	Planned and Entitled	Major Improvements Completed	Partially Developed	Entitled and Engineered	Limited Development
Value to Lien Ratio:	10 to 1	NAP	3 to 1	3.74 to 1	NAP	Minimum of 3 to 1	No appraisal in Official Statement
Contracts with Builders?	Yes	Yes	Yes	Yes	Yes	Not Determined as of Publication	Yes
Construction or Acquisition District:	Acquisition	Acquisition	Construction	Acquisition	Acquisition	Roadways, Water, Sewer,	Acquisition and Construction
Infrastructure Financed:	Roadways	Roadways	Water, Sewer, Roadways, Drainage Landscaping, Trails	Water, Fire	Water, Sewer, Drainage		Water, Sewer, Roadways, Trails Landscaping, Professional Fees, Community Amenities

EASTMARK

Assessment Area No. 2 and General Obligation Bond - Series 2014

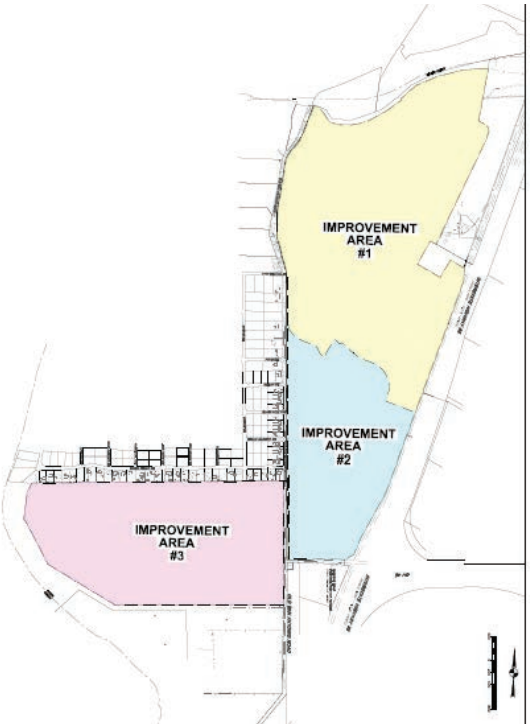
Project / Developer Information	Special Assessment Bond	General Obligation Bond
Project Name:	Eastmark	Eastmark
Project Location:	Mesa, AZ	Mesa, AZ
Project Type:	Master Planned Community	Master Planned Community
Size (Acres):	2,170	2,170
Land within Assessment Area:	231	NAP
Developer:	DMB Mesa Proving Ground, LLC	DMB Mesa Proving Ground, LLC

Special District Financing Snapshot		
District Type:	Community Facilities District	Community Facilities District
Issuing Agency:	Eastmark Community Facilities District No. 1	Eastmark Community Facilities District No. 1
Bonds Issued:	Special Assessment	General Obligation
Bond Issuance Date:	15-Jul-14	21-May-14
Bond Amount:	$3,367,000	$3,250,000
Maximum Bond Term:	25 Years	25 Years
Bond Interest Rate:	2% to 5.4%	1.5% to 5%
Status of Land when Bonds Issued:	Partially Developed	Partially Developed
Value to Lien Ratio:	10 to 1	NAP
Contracts with Builders?	Yes	Yes
Construction or Acquisition District:	Acquisition	Acquisition
Infrastructure Financed:	Roadways	Roadways

ESTANCIA HILL COUNTRY
Assessment Area No. 1

Project / Developer Information	
Project Name:	Estancia Hill Country
Project Location:	Austin, TX
Project Type:	Master Planned Community
Size (Acres):	593
Land within Assessment Area:	216
Developer:	SLF III - Onion Creek L.P. (Stratford Land)

Special District Financing Snapshot	
District Type:	Public Improvement District
Issuing Agency:	City of Austin, Texas
Bonds Issued:	Special Assessment
Bond Issuance Date:	7/17/2013
Bond Amount:	$12,590,000
Maximum Bond Term:	5 Years to 15 Years
Bond Interest Rate:	4.5% to 6%
Status of Land when Bonds Issued:	Planned and Entitled
Value to Lien Ratio:	3 to 1
Contracts with Builders?	Yes
Construction or Acquisition District:	Construction
Infrastructure Financed:	Water, Sewer, Roadways, Drainage, Landscaping, Trails



VILLAGE OF SENDERO

Series 2013 Special Tax Bonds

Project / Developer Information	
Project Name:	Village of Sendero
Project Location:	Orange Cty., CA
Project Type:	Mixed Use Residential
Size (Acres):	416
Developer:	RMV Community Development, LLC

Special District Financing Snapshot	
District Type:	Community Facilities District
Issuing Agency:	Santa Margarita Water District
Bonds Issued:	Special Tax
Bond Issuance Date:	7/13/2013
Bond Amount:	$57,420,000
Maximum Bond Term:	30 Years
Bond Interest Rate:	2% to 5.7%
Status of Land when Bonds Issued:	Major Improvements Completed
Value to Lien Ratio:	3.74 to 1
Contracts with Builders?	Yes
Construction or Acquisition District:	Acquisition
Infrastructure Financed:	Water, Fire

SIENNA PLANTATION

Municipal Utility Disctrict No. 10

Project / Developer Information	
Project Name:	Sienna Plantation
Project Location:	Fort Bend Cty., TX
Project Type:	Residential
Size (Acres):	944
Land within Assessment Area:	NAP
Developer:	Sienna/Johnson North L.P.

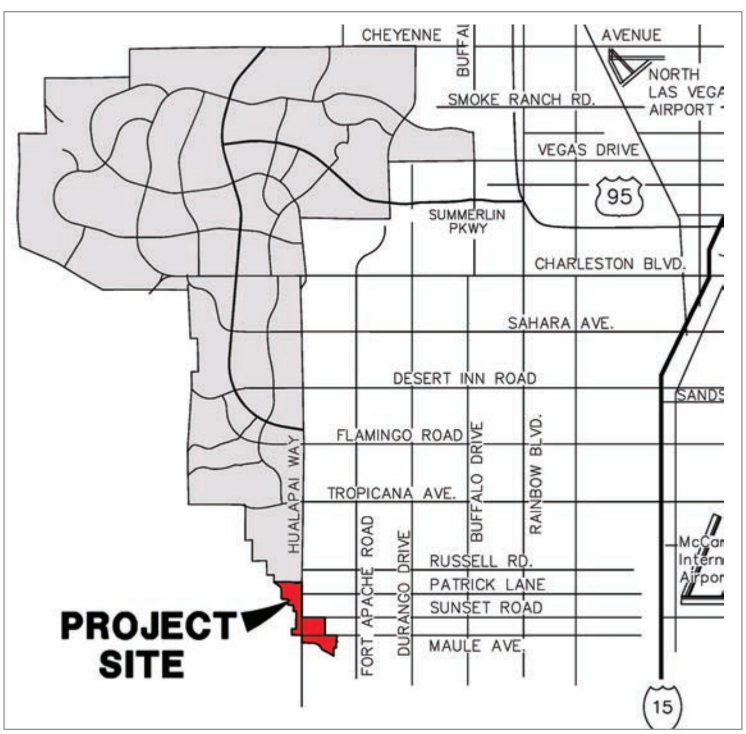
Special District Financing Snapshot	
District Type:	Metropolitan Utility District
Issuing Agency:	Sienna Plantation Municipal Utility District No. 10
Bonds Issued:	General Obligation
Bond Issuance Date:	7/9/2013
Bond Amount:	$4,700,000
Maximum Bond Term:	23 Years
Bond Interest Rate:	0.75% to 4%
Status of Land when Bonds Issued:	Partially Developed
Value to Lien Ratio:	NAP
Contracts with Builders?	Yes
Construction or Acquisition District:	Acquisition
Infrastructure Financed:	Water, Sewer, Drainage

SUMMERLIN

Village 16A

Project / Developer Information	
Project Name:	Summerlin
Project Location:	Clark Cty., NV
Project Type:	Master Planned Community
Size (Acres):	22,500 (Approx.)
Land within Assessment Area:	398
Developer:	Howard Hughes Company, LLC

Special District Financing Snapshot	
District Type:	Special Improvement District
Issuing Agency:	Clark County, Nevada
Bonds Issued:	Special Assessment
Bond Issuance Date:	1st Quarter 2015
Bond Amount:	Estimated to be $25,000,000
Maximum Bond Term:	20 Years
Bond Interest Rate:	7% (Estimate)
Status of Land when Bonds Issued:	Entitled and Engineered
Value to Lien Ratio:	Minimum of 3 to 1
Contracts with Builders?	No
Construction or Acquisition District:	Not Determined as of Publication
Infrastructure Financed:	Roadways, Water, Sewer, Storm Drain

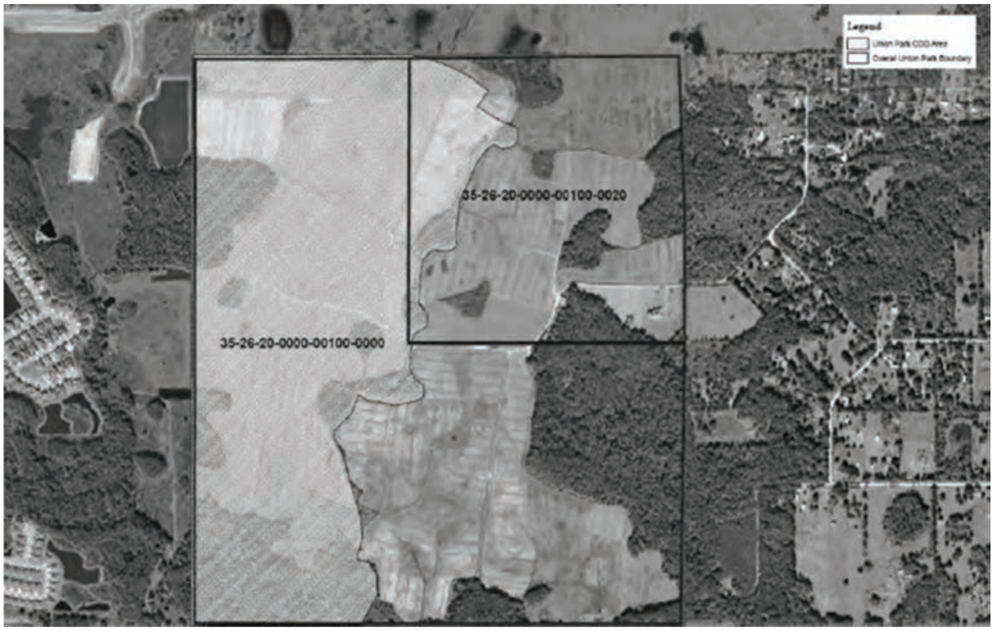


UNION PARK

Capital Improvement Revenue Bonds, Series 2013A-1/A-2/A-3

Project / Developer Information	
Project Name:	Union Park
Project Location:	Pasco County, Florida
Project Type:	Master Planned Community
Size (Acres):	580 (Approx.)
Land within Assessment Area:	248
Developer:	Metro Development Group (Goldenranch Property, LLC)

Special District Financing Snapshot	
District Type:	Community Development District
Issuing Agency:	Pasco County, Florida
Bonds Issued:	Special Assessment
Bond Issuance Date:	11/1/2013
Bond Amount:	$9,630,000
Maximum Bond Term:	5-30 Years
Bond Interest Rate:	7.375%-7.500%
Status of Land when Bonds Issued:	Limited Development
Value to Lien Ratio:	No appraisal in Official Statement
Contracts with Builders?	Yes
Construction or Acquisition District:	Acquisition and Construction
Infrastructure Financed:	Water, Sewer, Roadways, Trails, Landscaping, Professional Fees, Community Amenities



Assessment Area A1-A3
(upper right corner of photograph)

APPENDIX | Exhibit B

Special Districts – Players and Process

The specific procedures for establishing a Special District differ from state-to-state; however, each state generally follows some common formation procedures. In most states the developer is required to prepare an application and/or plan of finance related to the establishment of the Special District along with a landowner petition requesting establishment of the Special District to the jurisdiction in which the development project is located (e.g. municipality / county). In most instances the developer/landowner will also be asked deposit funds ranging from $10,000 to $40,000 to pay for the jurisdiction's staff time as well as the jurisdiction's outside consultants (see Special District Financing Team Section below). During the petition and formation process, an operating agreement is typically created which covers such topics and procedures as: (i) the construction of public improvements; (ii) the governance of the District; (iii) the operations of the Special District; and (iv) the issuance of bonds.

The following sections provide additional information on the professionals typically involved in a Special District financing; a typical transaction procedural outline, as well as common underwriting criteria for Special District bond issuances.

Typical Special District Financing Team

Special District financing is a type of public/private partnership in which the jurisdiction, developer and/or Special District representatives work together to create the Special District and issues bonds to fund public improvements which not only further a jurisdiction's public policy goals but also drive economic growth. In addition to the developer's and the jurisdiction's staff, there are many other professionals who are typically involved in a Special District financing as follows:

1. **Underwriter** – The entity who is retained by the Special District to prepare the official statement related to the bond offering, purchases the bonds from the issuer, and sells the bonds to investors via the underwriter's distribution network.

2. **Underwriter Counsel** – Typically a private sector attorney or law firm engaged to represent the interests of the underwriter in connection with the Special District underwriting. The duties of the underwriter's counsel may include the review of the bond resolution and documentation on behalf of the underwriter; review of the accuracy of the disclosure in the official statement; preparation of purchase contract and/or official statement; and delivery of the Internal Revenue Code 10b-5 opinion as to the completeness and accuracy of the information presented in the official statement.

3. **Disclosure Counsel** – An attorney or law firm retained by the Special District to provide advice on Special District obligations and prepare the official statement and/or continuing disclosure agreement. The disclosure counsel and underwriter counsel are often one and the same.

4. **Bond Counsel** – An attorney or law firm engaged by the Special District to give the traditional bond counsel opinion. Such opinion customarily opines that the Special District bonds have been validly issued and that the bonds are tax-exempt. The bond opinion may also address related Special District matters such as state and local tax exemption and the enforceability of certain security provisions. Additionally, the bond counsel may prepare or review and advise the issuer regarding, authorizing resolutions, bond contacts, official statements and validation proceedings. The bond counsel is engaged by the Special District while the underwriter counsel is retained by the underwriter.

5. **Developer Counsel** – The attorney or law firm engaged to represent the interests of the developer in connection with the Special District underwriting. The duties of the developer's counsel may include the review of the bond resolution and documentation on behalf of the developer, and review of the accuracy of the developer's disclosure in the official statement.

6. **Developer Financial Advisor** – A firm that advises the developer in relation to the Special District and typically prepares all of the necessary applications and petitions required by the jurisdiction establishing the Special District. Additionally, the firm may advise as to which Special District and/or bond type best addresses the developer's business plan and timing requirements. The advisor may also assist in matters of cash flow analysis and the review of bond documents.

7. **Jurisdictional Financial Advisor** – An individual or firm that advises the municipality and/or Special District on matters pertinent to the Special District bond issue such as structure, timing, marketing, fairness of pricing, terms and bond rating. The financial advisor may also provide services related to advising on cash flow and investment matters.

8. **Appraiser** – The individual or firm who prepares the appraisal for the property securing the Special District assessment or special tax levy bond issue. Appraisals are typically not required for general obligation bond issuances. The appraiser is generally hired by the underwriter.

9. **Market Consultant** – The individual or firm who prepares the market study of property securing the Special District bond issue if required as part of the bond issuance. The market consultant is typically retained by the underwriter.

10. Trustee – The financial institution designated by the Special District to act in a fiduciary manner for the benefit of the bondholders and enforces the terms of the bond contract. In many cases the trustee acts as custodian, paying agent, registrar and transfer agent for the bonds.

Typical Transaction Process/Time Line

Depending upon the type of Special District being established, it generally takes between 9 and 12 months to establish the Special District and to issue bonds.

The diagram below provides a high-level view of the transaction process related to typical Special District formation and bond issuance.

Special District Underwriting Criteria

Similar to traditional bank financing, it is easier for development entities that have large balance sheets and are generating significant cash flow to obtain Special District financing than for those development entities that do not have such resources. Additionally, the underwriting criteria for Special Districts vary according to the type of Special District being utilized as different districts have different rules, and the type of bond being issued, as different bond types have different collateral. The guidelines below are meant to provide a general framework of typical underwriting criteria and/or issues.

Developer/Project Related Considerations

1. **Development Plan** – What is the developer's business plan surrounding the project? Do they intend to sell raw land, semi-improved development parcels or finished lots? Does the conceptual land use plan appear to be in line with current and/or expected market conditions? Has the developer entered into any agreements with home builders and/or other end users that will assist in diversifying the tax base?

2. **Regulatory Hurdles** – Has the developer obtained all of the entitlements and permits necessary to develop and provide public services (e.g. water/sewer/drainage/roadways/utilities/etc.) to the project? Are there any environmental issues or legal challenges that could delay or derail the project from moving forward and thus the ability of the developer to repay the Special District bonds?

3. **Project Status** – What is the current development status of the Project? Has the developer provided any public infrastructure to the project? Have any parcels been sold to home builder or commercial users that would help to diversify the tax base and diffuse the risk of a single developer property tax payer who is not making their Special District tax payments?

4. **Developer Experience** – Does the developer have experience in developing projects similar to the type for which Special District bonds are being sold? Has the developer ever utilized Special District financing in the past, and have they made their debt service payments in a timely manner?

5. **Developer Reputation** – Does the developer have a good reputation for doing what they say they are going to do and delivering on their promises (both written and verbal)?

6. **Property Tax Payments** – Is the developer current on its property tax payments on the land to be contained within the boundaries of the Special District? Has the developer ever defaulted on Special District bond payments in the past?

7. **Current Developer Credit Lines** – Has the developer secured other lines of credit to finance the development of the project? Does the developer have sufficient financial resources and/or commitments to complete the project as well as meet any unexpected shortfalls (this could come from cash, credit lines, third party debt, equity, partners, product sales, etc.)?

8. **Developer Equity** – Has the developer invested significant dollars into the project so that they have "skin in the game" to ensure that they are motivated to have the project succeed?

9. **Current Market Conditions** – What is the current and near-term market outlook for the land uses contained within the project? Is there sufficient demand for the land uses to be developed?

10 Land Value – Is there sufficient value in the land to support current underwriting criteria and bond buyer expectations?

Sienna Plantation

Special Assessment/ Special Tax Levy Bonds

With special assessment bonds and special tax levy bonds, the repayment of the bonds is secured by a specific lien on the property and is paid off over time through the annual assessment payment or special tax levy, which is generally collected as part of the property owner's regular property tax bill.

Typically these bonds are not rated by the rating agencies as they are considered riskier than other municipal bonds, so the bondholders expect additional security as follows:

1. **Foreclosure Covenant** – As the jurisdiction establishing the Special District typically has no obligation to fund the debt obligations of the Special District (e.g. no financial exposure), if the property owners within the boundaries of the Special District fail to pay the Special District taxes and/or assessment payments, the Special District covenants allow the municipality to bring foreclosure proceedings against the district's delinquent property owners. Generally this provision is initiated when the Special District delinquency rate exceeds 5 percent. However, in Special Districts with large concentrations of commercial buildings, this covenant could be triggered when any property falls delinquent. Once initiated, the foreclosure sale's proceeds are utilized to pay off the assessment lien on the delinquent property or properties. The timing related to the foreclosure process varies from state-to-state.

2. **Value-to-Lien Ratio** – As the land is the ultimate security for the assessment or special tax levy bonds, the bond buyers want to be assured that there is sufficient value in the property to pay off the underlying property lien in the event of default. For this reason many Special Districts (and investors) require that the property value subject to the lien or special tax be at least 3 times the principal amount of the bonds sold. In other words, the Special District property should have a "value-to-lien" ratio of 3 to1. In most cases, the property subject to the assessment or special tax lien is appraised by an Member of the Appraisal Institute, who values the fair market value of the property assuming the sale of the assessed property to one buyer within a 12-month marketing window and that the improvements to be financed by the Special District and/or for which completion guarantees have been provided are in place as of the date of the appraisal.

3. **Reserve Fund** – Land secured bonds also require a reserve fund, which is a cash fund reserve equal to the lesser of 10 percent of the bond amount; 125 percent of the average annual debt service; or the maximum annual debt service on the bonds. The reserve fund is utilized to fund the debt service related to delinquent assessment or special tax payments. To the extent that the reserve fund is not utilized the balance in the fund is utilized to make the last year's debt service payment.

General Obligation Bonds

1. **Tax Levy** – The security for repayment of Special District general obligation bonds is an increase in the ad valorem property tax levied by the Special District on property contained within the district boundary. Depending on which state the Special District is established and what type of Special District is being utilized, the Special District tax levy may be limited to a maximum tax levy, as is the case with a Colorado metropolitan district, or it may be an unlimited ad valorem tax, as is the case with Arizona's community facilities districts. To the extent property taxes including the Special District's ad valorem tax go unpaid; such unpaid taxes become a tax lien on the property. Generally the tax lien is not satisfied or removed until the taxes are paid or the property is finally vested in a purchaser under a tax lien sale.

2. **Guarantees** – In some instances a corporate entity may be asked to provide a guarantee to fund the difference between the actual debt service requirement related to the general obligation bonds and a pre-determined target Special District ad valorem tax rate ("Target Tax Rate"). Typically, guarantees are only provided in instances where the Special District is issuing general obligation bonds in an amount greater than that which the existing assessed valuation of the Special District may finance at the Target Tax Rate.

3. **Reserve Fund** – Depending upon the circumstances surrounding the bond issuance, the amount of the reserve fund is determined by the Special District, underwriters and financial advisors at the time of bond issuance.

4. **Bond Insurance** – In some instances, to make the bonds more marketable or to achieve an investment grade rating for the bonds, bond insurance is obtained. Bond insurance is a type of insurance policy that is purchased to guarantee the repayment of principal and interest payments to the bondholders in the event of a default. The provision of bond insurance will typically lower an issuers cost of borrowing.

Revenue Bonds

1. **Revenue Generation** – The security for the issuance of Special District revenue bonds is the income stream generated by the facilities financed by the Special District. For instance, if the Special District financed a public parking garage, the income derived from monthly and daily parking revenues would be utilized to repay the principal and interest of the revenue bonds.

2. **Debt Service Coverage Ratio** – In sizing the amount of the revenue bond, Special Districts will often require that certain debt service coverage ratio ("DSCR") be utilized. The DSCR is ratio of cash available to meet the principal and interest payments on the bonds. A DSCR of 1.0 means that the cash generated equals the amount of debt service payment on the bonds. A DSCR of less than 1.0 indicates that there are insufficient funds available to meet the bond debt service obligation, while a DSCR in excess of 1.0 indicates excess available after meeting the debt service payment of the bonds. Depending upon the type of public improvement being financed, DSCR requirements may vary from 1.3 to 2.0 or higher. To the extent that the funds collected in excess of the debt service requirement are not needed, they are ultimately utilized to fund eligible construction costs not funded through bond proceeds.

Eastmark

Bond Funds

Once a Special District bond has been issued, the bond proceeds are deposited with the bond trustee in separate interest bearing accounts as outlined below:

1. **Project or Acquisition Fund** – Utilized to pay the costs of constructing and/or acquiring the public improvements, typically under a construction draw-down process in the case of a Construction District or through a one-time pay-out in the case of an Acquisition District.

2. **Cost of Issuance Fund** – Established to pay the costs associated related to the establishment of the Special District as well as the fees of the underwriter, legal counsel, financial advisor, trustee, appraiser and market consultant as appropriate.

3. **Capitalized Interest Fund** – Created to fund interest payments on the bonds during the construction period for a period not to exceed 3 years.

4. **Bond Fund** – Established to collect Special District taxes and/or assessment payments which are then utilized to make the debt service payments on the outstanding bonds.

5. **Reserve Fund** – The Special District typically requires that the portion of the funds raised through the bond issue be set aside in a reserve fund for the purpose of funding debt service should a default occur. The reserve fund is equal to the lesser of 125 percent of the average annual debt service, 10 percent of the principal amount of the bonds or the maximum annual debt service. The Reserve Fund can also be used to pay debt service and can be applied to abate the special assessments at the end of the financing term.

Although Special District bonds may also be issued on a taxable basis, the majority of the Special District bond issuances are structured to ensure the interest on the bonds is exempt from federal, and in many cases, local income taxes. To achieve tax exemption, the bonds must not be deemed as "private activity bonds" as outlined in the Internal Revenue Code 141(b). A "private activity bond" is a bond that finances improvements utilized in a private trade or business. If a bond issue is deemed a private activity bond, the interest on the bonds is taxable for federal, state and local income tax purposes. The bond counsel to the transaction will opine on whether the bonds quality for tax-exemption or not.

Innovative Infrastructure Finance Resources from NAHB

NAHB has developed extensive, credentialed resources on an array of infrastructure financing approaches that fund new roads, schools, water and sewer capacity, and on, in a manner that does not place a disproportionate burden on the buyers of new homes. These municipal finance tools are more necessary and relevant than ever before as funding streams remain constrained for both the public and private sectors. These resources highlight the need for the public and private sectors to collaborate on effective solutions and use multiple financing tools in combination.

They include the three-part series *Building for Tomorrow: Innovative Infrastructure Solutions*, *Infrastructure Finance: Does Your State Encourage Innovation?*, and *Infrastructure Solutions: Best Practices for Process-Oriented States*; a January 2012 report on *Municipal Finance Development Tools after the Great Recession*; and an *Impact Fee Handbook* and supplemental critique *Proportionate Share Impact Fees*.

All of these reports are downloadable for free from NAHB's web site www.nahb.org:

Municipal Finance Development Tools After The Great Recession

Impact Fee Handbook

Proportionate Share Impact Fees

Building for Tomorrow: Innovative Infrastructure Solutions

Infrastructure Finance: Does Your State Encourage Innovation?

A Summary of State Legislation to Encourage Innovative Infrastructure Finance Options

Infrastructure Solutions: Best-Practices for Process-Oriented States

Disclaimer

The information provided herein was collected and provided for the convenience of the reader and is not intended to be a comprehensive discussion of the subject matter.

While effort was made to ensure that the information is accurate and up-to-date, neither the authors nor the National Association of Home Builders certify the accuracy of the information presented herein.

The information provided herein is provided for informational purposes only and is not intended to be and does not constitute financial, legal and/or other advice, is general in nature and not specific to individual circumstances. Before utilizing Special District financings one should seek the advice of financial and legal advisors in addition to undertaking one's own due diligence.