

# Session Three

## District Formation: Considerations and Strategies

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**CURRENT TOPICS AND PRACTICES IN  
LAND-SECURED AND DEVELOPMENT FINANCE**

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POMONA, CA**

# Land-Secured Districts at a Glance

*Two types of districts, but CFDs are the focus of this presentation*

## Assessment District (AD)

- **1913 Act (district formation)**
- **1915 Act (bond issuance)**
- **Requires 50+% support**
- **Assessments must be spread proportionally to “special benefit”**
  - ⇒ Burden of proof on issuer results in potential litigation risk
  - ⇒ *Less frequently used option*

## Community Facilities District (CFD)

- **Mello Roos Act of 1982**
  - ⇒ Adopted in wake of Proposition 13
- **Requires 2/3rds approval**
  - ⇒ By electorate if 12+ registered voters in the district, otherwise by landowners, weighted by acreage
- **Tax spread on a “reasonable” basis**
  - ⇒ *Most frequently used option*

# Preparing for District Formation

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## ■ Internal Organization

- Which departments will be involved?
- Who is the primary contact person?
- How will policy issues be vetted?
- Is the team aware of all existing agreements and entitlements?
- Are there any political issues related to the developer or the development?
- Does the issuer already have established Goals and Policies for Land-Secured Districts?

# Preparing for District Formation

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## ■ Establish Resources for Formation

- Dedicated staff time
- Deposit from developer(s)
- Organize consulting team
  - Legal counsel
  - Financial advisor
  - Special tax consultant
  - Bond underwriter

# Preparing for District Formation

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## ■ Documentation of Deal Points

- Development Agreement or Disposition and Development Agreement
- Financing Plan/Implementation Document
- Term Sheet negotiated between parties to inform:
  - Acquisition Agreement
  - Rate and Method of Apportionment (RMA)
  - Bond Indenture/Fiscal Agent Agreement

# Preparing for District Formation

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- **Comprehensive Funding Strategy**
  - Is there an adopted Financing Plan?
  - Is the CFD/AD to act in conjunction with other mechanisms?
    - Infrastructure Financing District (IFD)
    - Impact Fee Program
  - How does funding of public services fit in?
  - What is the timing of required infrastructure and services?

# Preparing for District Formation

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- **Coordination with Affected Agencies**
  - Factor in existing or proposed financing districts
  - Consider approved but unissued general obligation bonds
  - Joint Community Facilities Agreements (JCFA)
  - Joint Powers Agencies

# Preparing for District Formation

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- **Developer initiated process**

- Most common circumstance
- Property owners may file petition to initiate CFD
- Developer provides a deposit for non-contingent costs

- **Issuer initiated process**

- Sometimes used for large, broad districts for a tax spread not tied to ad valorem
  - i.e. Santa Cruz countywide CFD for Libraries, Altadena Library District CFD



# Preparing for District Formation

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## ■ Choice of Issuer

- Typically city, county, school district or special district
  - At least 51% of bond-funded projects must be owned by sponsoring public agency
- Alternatively may be a financing authority
  - Local agency (i.e. River Islands or Tejon Ranch)
  - Conduit issuer (i.e. CSCDA, CMFA)

⇒ *Governance and marketing effectiveness vary for each*

# Understanding Developer's Plan

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- **Application from Developer(s)**
  - Project information: land uses, timing, values
  - Land ownership information
  - Financial information
  - Deposit
- **Financing District Proposal**
  - Special tax categories and rates
  - Improvement areas/future annexation areas
  - PayGo, extended term, transition
  - Facilities and services to be funded
  - Number and timing of bond issues

# Developers' Objectives for Financing

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- **Maximize net construction proceeds for infrastructure**
  - Two percent (2%) special tax escalator
  - Limit special tax for services
  - PayGo, extended term
- **Minimize burden on undeveloped property**
  - Capitalized interest
  - Phasing of bond sales
  - Maximum levy on developed property
- **Limit future discretionary actions that affect funding capacity**
- **Flexibility for changes in land use, infrastructure plans, and maximum special tax rates**

# Core Documents Needed for Formation

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- 1) Boundary Map**
- 2) Rate and Method of Special Tax Apportionment (RMA)**
- 3) Eligible Facilities**
- 4) Acquisition Agreement and any Joint Facility Agreements**

# Formation Considerations: District Boundaries

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- **Can be tailored to areas of political support or development phase**
- **Can be non-contiguous**
- **Only property within the District and subject to the special tax is included within property valuation**
- **Bigger is better from a credit perspective but smaller provides more flexibility and control for a developer**

# Formation Considerations: Structure of District

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- **Separate CFDs, or improvement areas or tax zones**
  - How similar are distinct phases of project?
  - What is the likelihood that the development plan or product mix may change?
- **Considerations with multiple landowners**
  - Cross-collateralization
  - Oversizing and corresponding reimbursements
- **Future annexation areas can be used for flexibility**

# Improvement Areas (IAs)

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- Separate geographic areas within one CFD
- Separate RMA for each improvement area
- Separate bond issues for each improvement area (usually)
- Changes within an IA require vote of electors only in IA
- IAs can be established at CFD formation or added upon annexation into CFD
- Provides for “bite-sized” pieces of a project

# Future Annexation Area

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- One or more parcels in initial CFD boundaries
- Any property that might join the CFD in the future is designated as Future Annexation Area in CFD boundary map
- “Election” is a signature on a “Unanimous Approval Form”
  - May include maximum tax rates different than those in other areas of CFD
  - Each annexation could have a different maximum tax rate if warranted
- No meetings of legislative body are required for annexation
- Low cost, accelerated annexation procedure



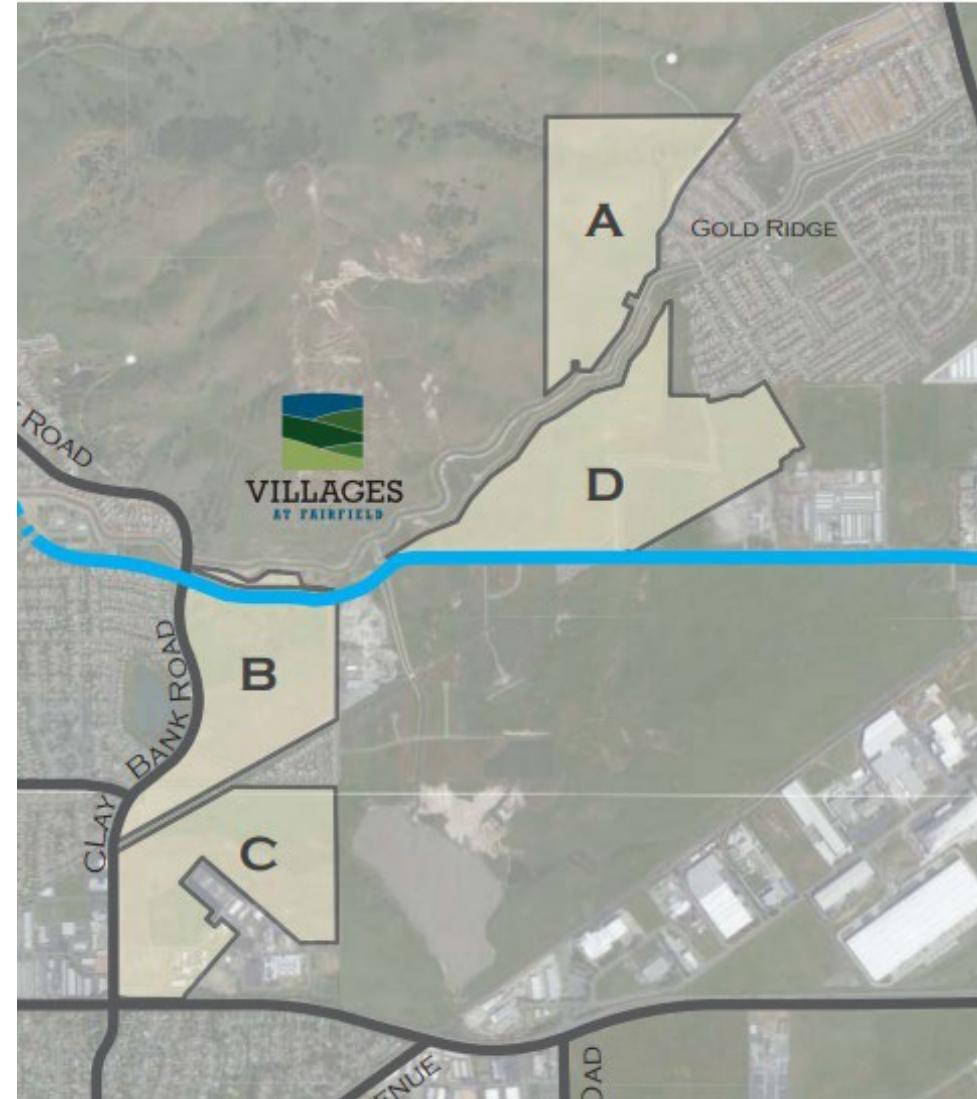
# Improvement Areas for Each Project Phase

## City of Fairfield

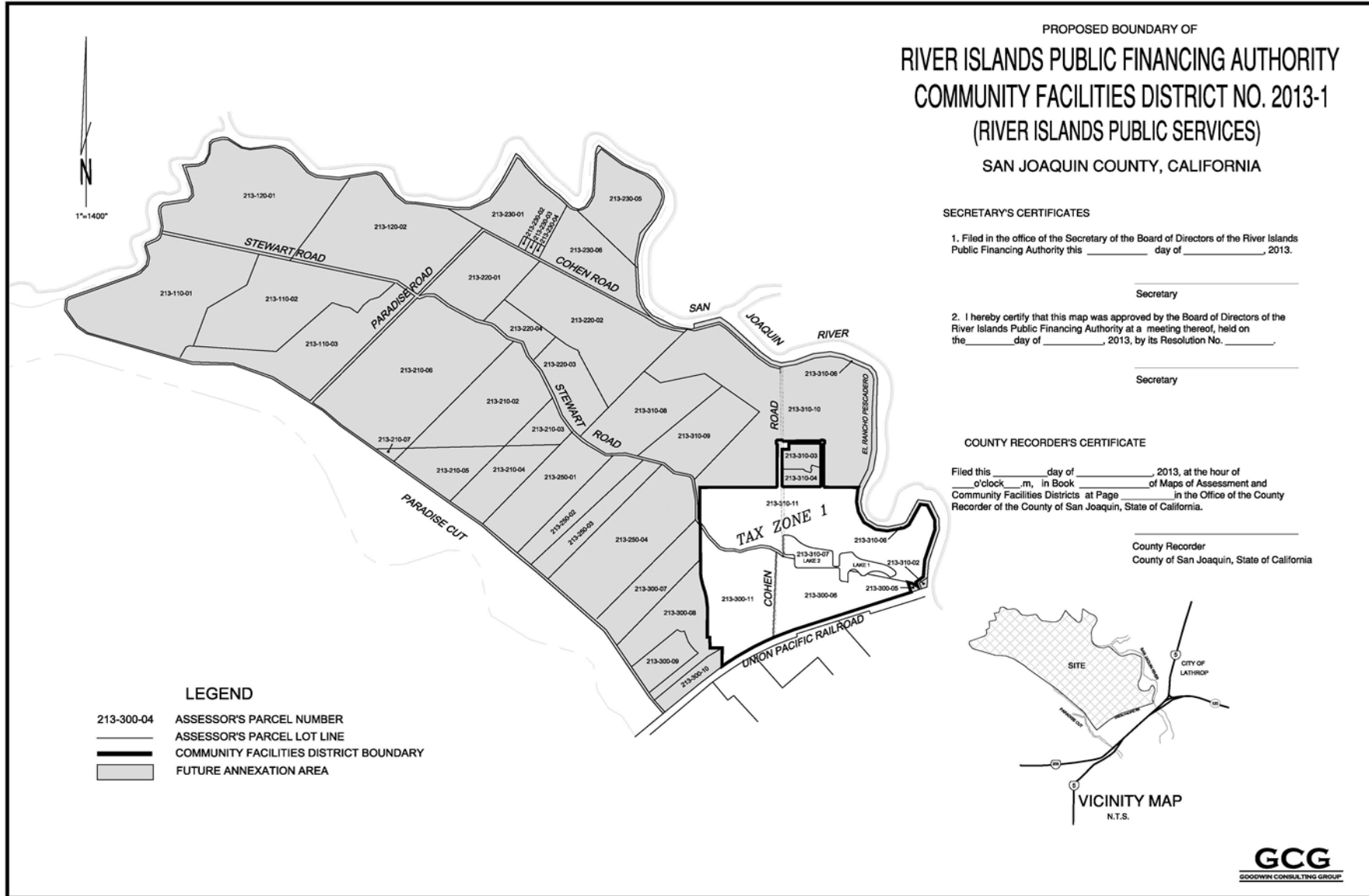
### CFD No. 2016-1

#### (Villages of Fairfield)

- One CFD
- Distinct improvement areas (IAs) by project phase
- 3 IAs annexed to date
- 3 separate securities
- One “brand” in market



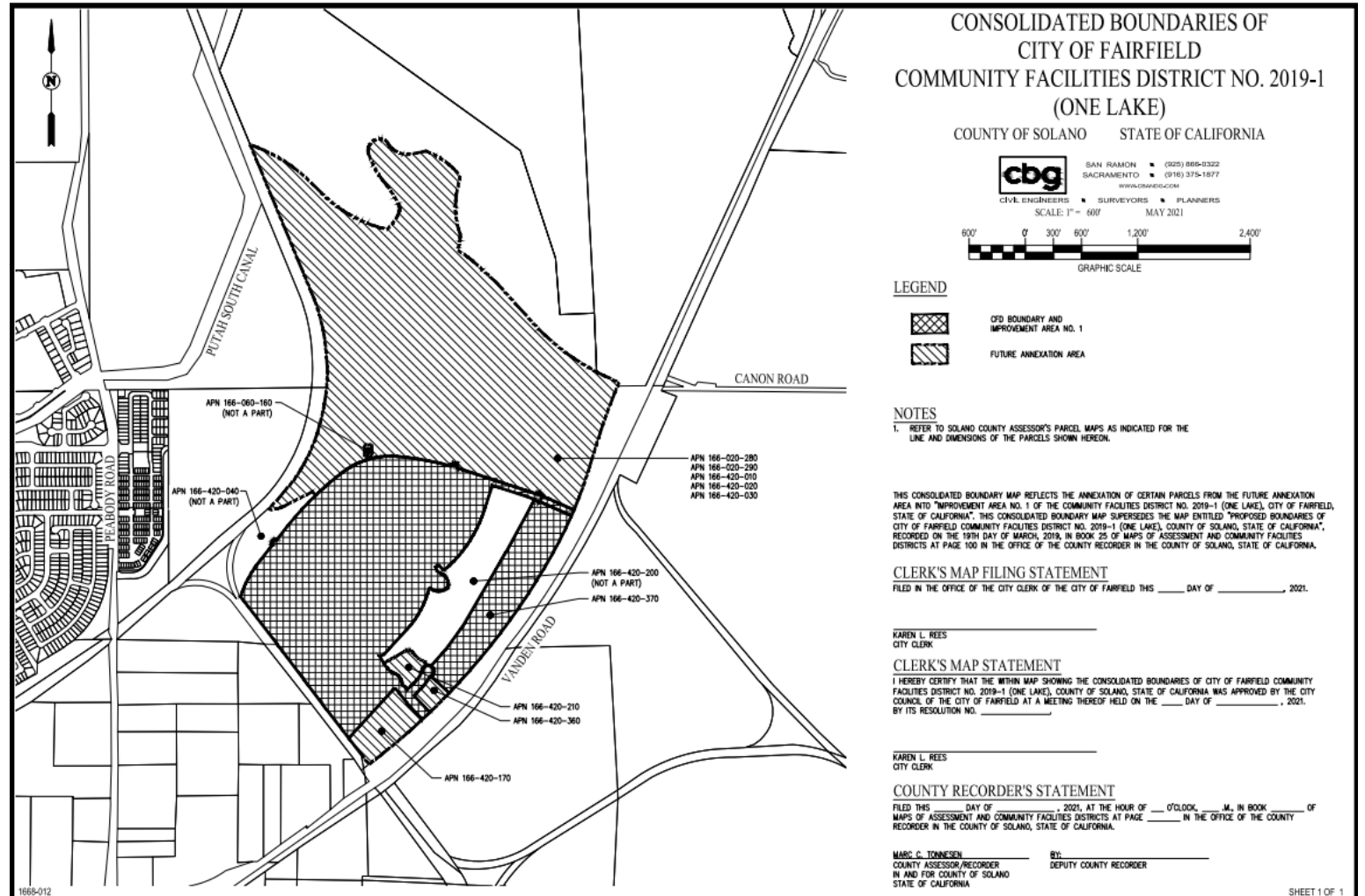
# CFD with Future Annexation Area



# Flexibility to Annex - or Not

## City of Fairfield CFD No. 2019-1 (One Lake)

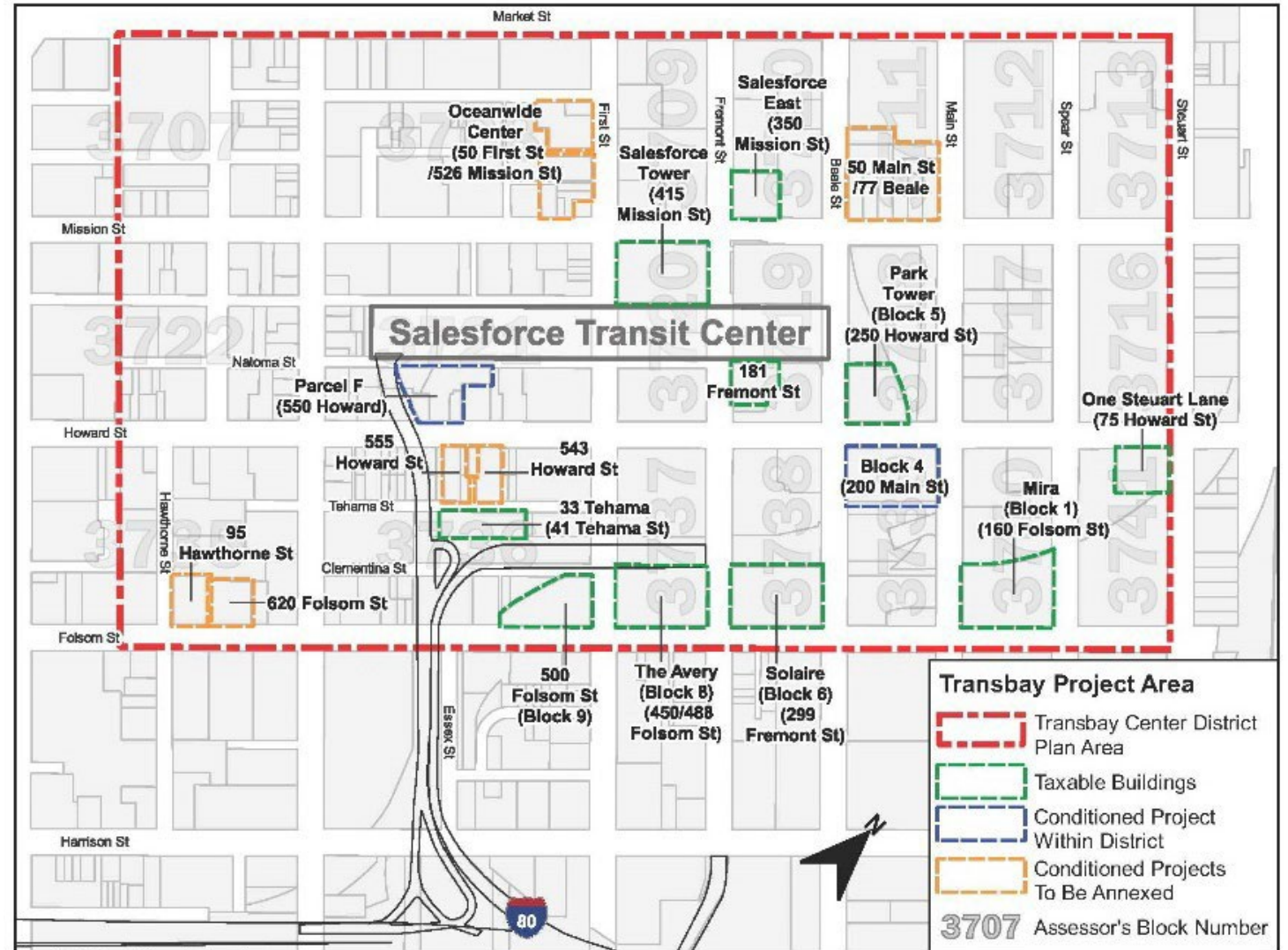
- Phase 1 in IA No. 1
- Phase 2 in Future Annexation Area
- *Subsequent decision to create a separate CFD for Phase 2*





# Non-Contiguous CFD and Future Annexation Area

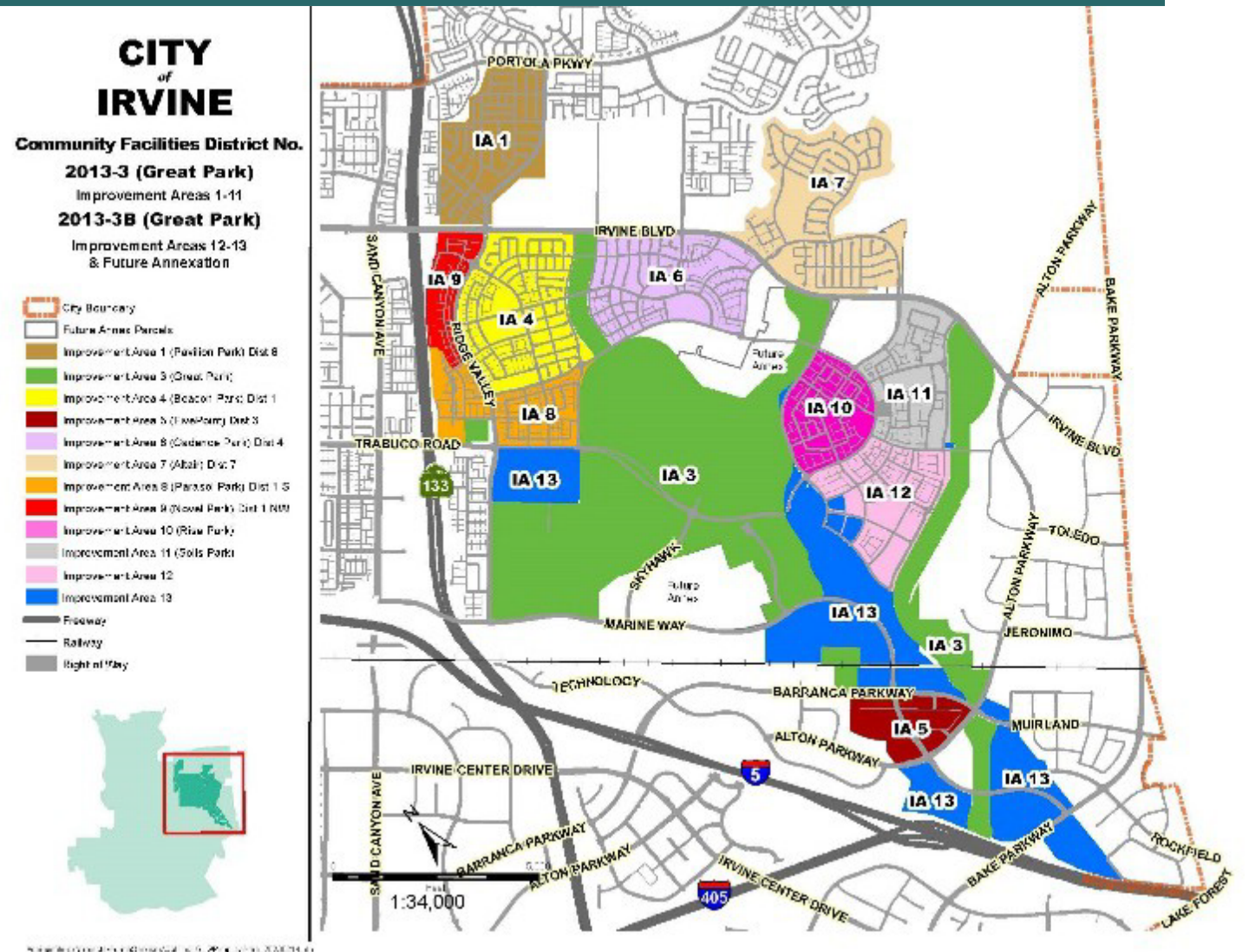
- Non-contiguous parcels
- Future Annexation Area overlaps up-zoned land use planning area
- Additional annexations from into the CFD on a *parcel* basis



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# Mix of Separate Districts and Improvement Areas

- **Irvine's Great Park**
  - Former Marine Corps Air Station closed in 1999
- **Development plans**
  - 10,500+ residential units
  - 4.8 million sq. ft. of commercial, retail, industrial, and R&D space
- **Two large CFDs**
  - More than 13 improvement areas formed to date
  - Future Annexation Area



# Formation Considerations: Special Tax Structure

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- **Categories and maximum tax rates**
  - Market rate vs. affordable units
- **Term, transition, escalators**
- **PayGo**
- **Backup special tax mechanism**
- **Prepayment options**

# Services Special Tax

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- Annual stream of revenues to fund public services
- Usually levied in perpetuity
- No legal limit on annual escalation
- Often implemented to mitigate fiscal deficits projected in a fiscal impact analysis
- Include component for CFD administration costs
- Reduces capacity to fund public infrastructure

# Allocating Tax Capacity

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- Services Special Tax vs. Facilities Special Tax
- Sharing tax capacity among multiple public agencies
- Timing of funding needs
  - Facility, services, maintenance needs, now and in the future
  - Timing of funding needs for each public agency
- All-in Tax Burden
  - Up to 2% of estimated home value for residential property
  - “Reasonable” rates for commercial uses
  - Includes 1% base property tax rate, plus any GO overrides, services tax, other special taxes and assessments

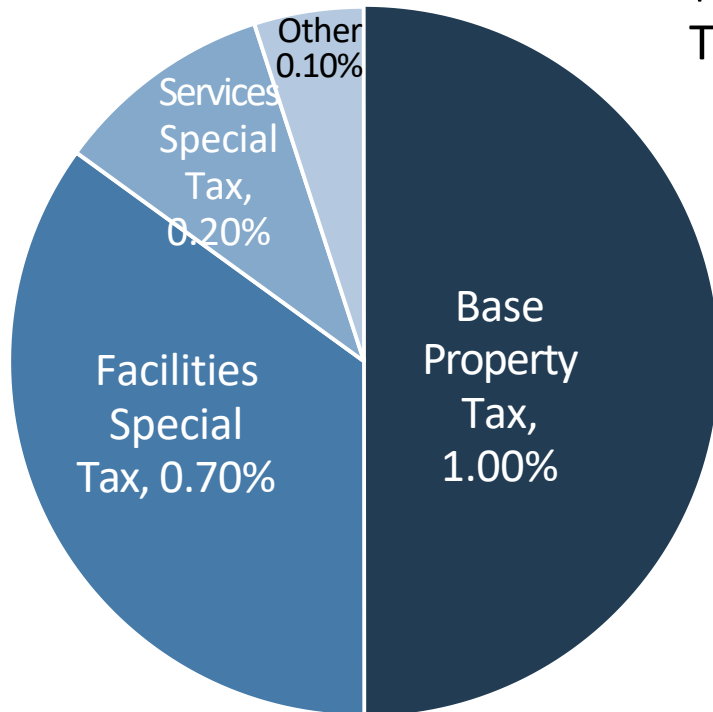


# Illustrative All-In Tax Burden

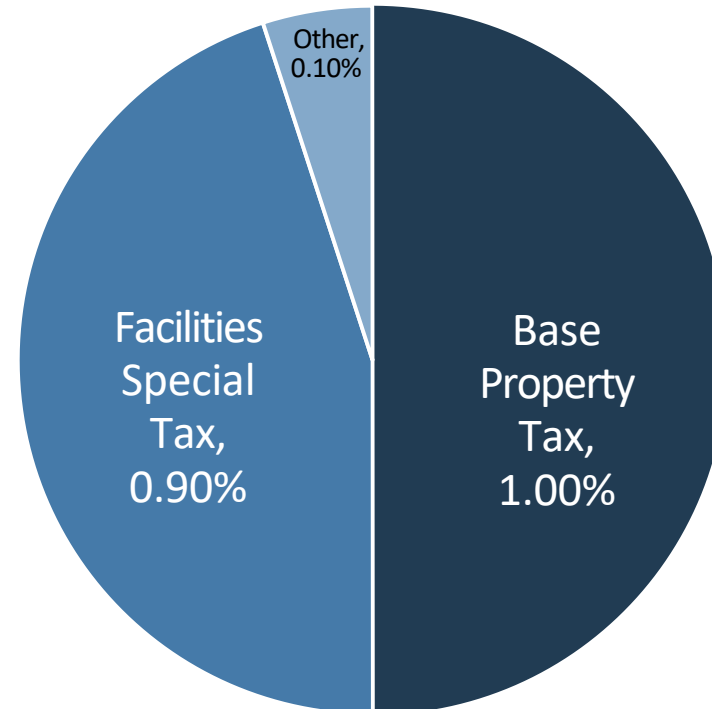
Estimated Home Price	\$ 600,000	\$ 1,200,000
Homeowners Exemption	<u>(7,000)</u>	<u>(7,000)</u>
Estimated Assessed Value	\$ 593,000	\$ 1,193,000
<b>Ad Valorem Property Taxes</b>		
Base 1% Property Tax	\$ 5,930	\$ 11,930
City GO	120	240
Local School District GO	180	360
Regional Community College District GO	<u>90</u>	<u>180</u>
	\$ 6,320	\$ 12,710
<b>Direct Charges</b>		
Proposed CFD Facilities Tax	\$ 3,000	\$ 6,000
Proposed CFD Services Tax	600	1,200
Local School District CFD	500	1,000
Lighting & Landscaping District	90	180
Library Service Tax	<u>50</u>	<u>50</u>
	\$ 4,240	\$ 8,430
<b>Total Ad Valorem and Direct Charges</b>	\$ 10,560	\$ 21,140
<b>Overall Tax Burden</b>	<b>1.76%</b>	<b>1.76%</b>

# Allocating Capacity: Services vs. Facilities

200-unit Project  
\$500,000 Home Price 2%  
Total Tax Rate



Annual Services Costs Funded = \$200,000  
Net Construction Proceeds = \$10.5 million



Annual Services Costs Funded = \$0  
Net Construction Proceeds = \$13 million

# Bond Capacity Considerations

## *How much in project funds can a CFD support?*

- **CFD Parameters**

*Determined at district formation*

- Maximum bond authorization
- Eligible projects
- Maximum annual tax rates and annual escalator (if any)

- **Value of land supporting debt**

*Determined at bond issuance*

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

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

- Based on maximum annual special tax revenues projected at build-out
- Minimum coverage typically 110% annual debt service
- Administrative expenses may be paid before or after debt service

- **Bond market conditions**

- Lower interest rates = more bond proceeds within same revenues

# District Formation: CFD Legislative Approvals

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- **Resolution of Intention (ROI)**

- Council/Board declares its intent to establish district

- Identifies proposed boundary, tax formula, eligible facilities, maximum bond amount

- **Public hearing**

- At least 30 days but not more than 60 days later

Often occur at one Council/Board meeting

- **Election**

- 2/3rds approval required

- Vote by electorate if 12+ registered voters in the district, otherwise by landowners, weighted by acreage

- **Resolution of Formation (ROF)**

- Approves final tax formula, boundary map, and eligible facilities, and max bond authorization