

COMMUNITY FACILITIES DISTRICT (CFD)

Jesse Stayton, Jr.
CBO Mentor Project

TABLE OF CONTENTS

OVERVIEW 3

A) MELLO-ROOS COMMUNITY FACILITIES ACT OF 1982 4

B) FORMATION OF A CFD 5

 LOCAL GOALS AND POLICIES 5

 RESOLUTIONS NEEDED TO FORM CFD 5

 FORMATION CONSIDERATIONS 6

C) PROCESS FOR ISSUING BONDS 6

 1) RESOLUTIONS NEEDED TO ISSUE BONDS 7

D) SALE OF BONDS 7

E) POST SALE RESPONSIBILITIES 8

 1) CDIAC ANNUAL REPORTING 8

 2) FEDERAL TAX (ARBITRAGE) 8

 3) TAX LEVIES AND COLLECTIONS 8

 4) COUNTY ROLE 8

F) CONCLUSION 9

APPENDIX 10

 RIVERSIDE UNIFIED CFD No. 21 10

 FORMATION OF CFD No. 21 10

 INTENT TO INCUR DEBT AND CALLING SPECIAL ELECTION 10

 ISSUE BONDS AND APPROVE BOND SALE 11

OVERVIEW

I am writing this paper to discuss the formation of Community Facility District (CFD) as a revenue source a district can use to build school facilities. There are many funding options available to school districts in California to pay the cost of construction for new facilities. State and local general obligation bonds, Certificates of Participation, developer fees and the district general fund can provide revenue for school construction, the rationale that a CBO would use to choose a CFD as an income source follows.

A CFD is commonly used by school districts to fund school construction to mitigate the effect of new development on the educational program. The district and the developer share a common interest in having quality school facilities to serve the potential home owners. The CFD positions a district to use its tax exempt status to reduce the cost of money the developer might otherwise have to pay to mitigate the effect of development. CFD's require voter approval, just as general obligation bonds do, but developers are usually the only voters in the CFD boundary. This fact eliminates the need to conduct a costly bond campaign to ensure approval. A CBO has the flexibility to determine what the special tax will be based on using formulas to create a Rate and Method of Apportionment (RMA). These factors combine to make a CFD an attractive alternative to fund school construction that will mitigate the affects of development.

The need for CFD's was recognized after the economic affect of proposition 13 began to be felt by public agencies. The Mello-Roos Community Facilities Act of 1982 was enacted to give public agencies an alternative funding source to finance desperately needed facilities.

Mello-Roos rules are very flexible but the organization and process needed to implement it in a school district is complex and confusing. It is a process that will involve legal counsel, underwriters, appraisers, district officials, board support and approval. A CBO must be familiar with the process and be able to assemble the proper team in order to be successful in implementing a CFD.

I will outline the steps a CBO needs to accomplish to form a CFD, issue bonds, and the tasks needed to comply with on-going obligations that result from the activities related to the CFD. A CBO must coordinate the delivery of required periodic reports of activity related to the CFD. The stakeholders requiring reports of CFD activity include but are not limited to bondholders, taxpayers, the state and federal government.

A) MELLO-ROOS COMMUNITY FACILITIES ACT OF 1982

The Mello-Roos Community Facilities Act of 1982 is a flexible funding tool for local governments in the state of California for community facilities and services. The Act allows for the levy of voter approved special taxes. The Act is so flexible that there is no standard application of it; instead the facts of each situation dictate how you will ultimately use it. The Act can apply to developed and undeveloped areas.

Mello-Roos has three distinct phases. The development of a package of proposed governmental powers represents the first phase of the process followed by the granting of those powers to a local legislative body and finally the exercise of those powers by financing new facilities and/or services. The CBO must provide leadership in the planning and execution of these steps.

This special tax is levied on real property and can be used to pay for facilities, services, debt service on bonds or any other debt for which the proceeds are used to finance facilities. The CBO must ensure that adequate taxes are levied to accomplish the goal. The CBO must also monitor tax levies to ensure they are collected and if not initiate proceedings to foreclose on property to ensure enough cash flow exist to pay off bond debt. A district has a covenant responsibility to ensure the taxes are collected.

Public facilities can be financed by a Community Facility District(CFD) to purchase, construct, expand, improve or rehabilitate those facilities as long as the useful life is five years or greater.

Services that can be financed by CFD's are very limited. The following services qualify for CFD funding; Police protection Services, jail services, fire protection services, Ambulance service, maintenance of parks, flood services, environmental cleanup, recreation services, library services, maintenance of museums and maintenance of school sites. CBO's should coordinate Joint Powers agreements with other agencies, so that all of the needed infrastructure and services are provided within one CFD if possible.

Some of the advantages of using the Mello-Roos special tax are more favorable rates available to developers via this financing vehicle compared to conventional financing. The bonds issued are tax exempt, so the investor is willing to accept a lower interest rate, which in turn lowers the borrowing cost of the bond. The CBO wants to encourage well planned developments within his district boundaries. It is in the best interest of the district to help the developer raise the needed funds to ensure quality infrastructure, especially school facilities.

The bonds are likely to have better terms than commercial loans. A developer cannot generally obtain long term loans at as low a rate of interest commercially as can be generated with Bonds.

B) FORMATION OF A CFD

There are several actions to complete the process. The CBO should setup an appropriate team to administer the process and implement CFD financing. The team should include the Chief Business Official, Facilities Director or Architect, Appraiser, Underwriter, Fiscal agent and Bond counsel.

Local goals and policies

The CBO must work with the Board of Education and his team to draft and adopt local goals and policies as it pertains to the use of Mello-Roos they must include the following:

- 1) The priority given to facility improvements within the CFD boundary***
- 2) The credit quality required for bonds that are issued***
- 3) How affected property purchasers are informed of the special tax.***
- 4) Criteria for evaluating the equity of the tax formulas, including limits on the tax.***
- 5) Standard, definitions and assumptions to be used for appraisals of the taxable property.***
- 6) Children of Mello-Roos financed facilities have priority access to CFD financed school.***

Resolutions needed to form CFD

The CBO will submit several resolutions to the Board of Education for approval before completing the formation of the CFD.

- 1) A resolution to accept the petition (if applicable)***
- 2) A resolution to Approve Deposit and Reimbursement Agreement (if applicable)***
- 3) A resolution to approve boundary maps***
- 4) A resolution of intent to form the CFD***
- 5) A resolution to incur Bond indebtedness***
- 6) A resolution approving the joint Community Facilities agreements or joint powers agreements (if applicable)***

Public hearings must be held between thirty and sixty days after the resolution approval to incur bond indebtedness. If fifty percent of the owners file a written protest the proceedings are abandoned, If not, the Board of Education will pass a resolution to form a CFD and deem it necessary to incur bonded debt and a call to election. These actions grant the governmental powers needed to form a CFD.

The Board of Education must adopt an ordinance to levy the special tax if the election is successful.

Formation Considerations

A CBO must consider the Bond market and the viability of achieving the financial goal given market conditions. Outside advisors usually assist CBO's in formulating this information.

A CBO will need bond counsel to ensure compliance with federal tax law. Bond counsel will ensure not more than five percent of the funds will be used for private facilities, since the Internal Revenue Service will potentially declare the bonds taxable if this percentage is exceeded.

The CBO and his team will determine the optimum CFD boundary. This boundary will determine where the tax will be levied.

One of the most important aspects of the CFD is the Rate and Method of Apportionment (RMA). The RMA is the basis for determining the special tax. The tax can be based on square footage, lot size and other factors. The only requirement is that the tax is reasonable.

The CBO, with the advice of the underwriter, must set the maximum amount and term bonds will be issued. The CBO must set an appropriation limit for the CFD, sufficient enough for it to operate.

The CBO and a Facility Consultant/Architect develop preliminary plans and cost estimates for the facilities that will be financed by the CFD.

A petition must be filed to form a CFD. Either the District or the land owners can submit the petition to form a CFD. The petition contains the RMA and description of the planned facilities.

C) PROCESS FOR ISSUING BONDS

A CBO can use the special tax levy to fund school facilities projects directly or issue bonds and use the tax to pay bond debt. A CBO will generally decide to issue bonds to fund immediate facility needs.

The district must select a Fiscal agent and Trustee to administer the bonds. The Fiscal agent will act as registrar and authentication agent. The fiscal agent receives bond payments from the district and pays the bond owner. Bond counsel will create the provisions for bonds and the administration of them. A Trustee has additional responsibilities. The Trustee holds many of the funds and accounts created for bond issuance, including the reserve fund. The Trustee also protects the rights of the bondholders and for that reason is preferred over a Fiscal agent by the Bond market.

A CBO will engage an **Appraiser** to prepare an absorption analysis. The purpose of the analysis is to determine how quickly the developer's homes will sell. This data will help determine when bonds should be issued, since the bonds will be paid back by tax levies on the eventual homeowners.

The CBO must submit a report of proposed debt issuance as required by the California Debt and Investment Advisory Commission (CDIAC) at least thirty days before the bonds are sold

Federal law requires bond issuers to prepare an Official Statement. The official statement must contain all the facts needed to evaluate the bonds for sale. This document is normally prepared by counsel but should be reviewed by the CBO and must be approved by the Board of Education.

1) Resolutions needed to issue bonds

The following resolutions related to the sale of bonds will need to be prepared and submitted to the Board of Education for authorization.

- 1) *Resolution approving Indenture*
- 2) *Resolution approving the bond purchase contract or notice of sale*
- 3) *Resolution approving the Official Statement*

D) SALE OF BONDS

Mello-Roos bonds may be sold by a private sell or public sale. In most cases bonds are sold to underwriters in **private (negotiated) sales**. The underwriter then sells the bond for a profit to other investors. A bond purchase contract is signed by both parties. In **competitive bond sales**, the CBO hires a **financial advisor**. The advisor prepares a Notice of Sale outlining the terms and maturity schedule. Underwriters submit sealed bids with an offer to purchase the bonds. The signed winning bid and Notice of Sale constitute the contract.

Bond closing is the final step in the sale of bonds. A closing date is set when all of the documents will be finalized and executed. The date is usually about two weeks after the purchase contract has been signed or bond award. The district receives the proceeds from the bond sale and the bonds are released to the purchaser. Once the final documents are signed bond counsel prepares closing transcripts, sets of certified or original closing documents, for the local agency and other stakeholders.

E) POST SALE RESPONSIBILITIES

1) CDIAC annual reporting

The annual reports are required by the California Debt and Investment Advisory Commission (CDIAC). The CBO will report on the assessed value of parcels, amount of bonds outstanding, and the balance in the reserve fund, construction fund, and capitalized interest. Reports on the level of delinquencies and foreclosure are also required.

2) Federal Tax (Arbitrage)

Excess bond earnings (arbitrage) must be rebated to the federal government. The CBO must ensure this process occurs at least every five years.

3) Tax levies and collections

The special tax must be levied annually by the district. The task must be coordinated with the Tax collector who is usually the local County. This task should be handled by the same office designated to respond to taxpayer questions, since they will have detailed information about each parcel tax. A CBO may elect to employ a CFD administrator for this purpose.

The district has the responsibility to monitor tax collections. The district has the right to foreclose if taxes are not collected.

4) Local County role

The local County will have on-going responsibilities for a district CFD. The County will receive the special tax, enforce payment, send the tax to the district, and report delinquencies to the district. The CBO must monitor these activities to ensure they are carried out correctly and to determine if action is needed to correct anomalies.

F) CONCLUSION

The Mello-Roos Act of 1982 provided districts with a much needed funding tool for the construction of schools. The Act gave districts a flexible funding tool, but the process to form a Community Facility District can be daunting to manage.

The formation of a CFD involves assembling a team of experts to manage the process and administer the resulting bonds. The team will include the CBO, Architects, Appraisers, Bond counsel, Underwriters and the Board of Education to name a few.

The formation of the CFD takes many actions by the Board of Education. The CBO must provide leadership and guidance to the Board during this portion of the process. The purpose of these Board actions is to ensure all constituents are notified of the districts intent to create debt. There are several public hearings to allow comment and dissent.

The process to issue bonds requires the advice and guidance of experts. The underwriter and bond counsel play a key role in this process. In most cases districts sell their bonds in private (negotiated) sales but the Mello-Roos act allows for a competitive sale as well. A bond closing process transfers ownership of the bonds to the purchaser and gives the bond sale proceeds to the district.

Districts must monitor and report many facts and activities related to the CFD on a regular basis. An annual report to the California Debt and Investment Advisory Commission (CDIAC) on key indicators of the financial health of the CFD must be submitted. The district is responsible for the annual tax levy and must coordinate with the local county to ensure the levy is in place. The district must monitor and report on the collection of the special tax. The district must report any excess earning on bond proceeds to the IRS at least every five years.

The process to create a CFD and the ongoing administration can be complex and will involve many professionals both inside and outside of a district. The time and cost of forming a CFD is worth the investment when you consider the funding is providing a facility that will serve the tax paying community for decades to come.

APPENDIX

Riverside Unified CFD No. 21

The Riverside Unified school district decided to form a Joint Community Facilities District with Western Municipal Water District of Riverside County for the purpose of financing the design, construction and acquisition of public facilities needed to meet the increased demand created by the development contained within the boundaries of CFD 21. I choose CFD 21 as a case study because I live within the boundary and pay the special tax levy.

Formation of CFD No. 21

The districts CBO prepared the following resolutions for adoption during the November 7, 2005 Board of Education meeting, as outlined in this papers section titled “Steps needed to form a CFD”:

- 1) Resolution declaring Intention to establish Community Facilities District No.21***
- 2) Resolution declaring the necessity for Community Facilities District No. 21 to incur bond indebtedness.***
- 3) Resolution approving Joint Community Facilities Agreement with Western Municipal Water District of Riverside County (Community Facilities District No. 21) (see attached)***

A public hearing was scheduled for December 12, 2005 to allow public comment regarding the establishment of Community Facilities District No. 21 and incur a bonded indebtedness not to exceed \$16,000,000. The public hearing was scheduled more than thirty but less than sixty days after the resolution to incur bond indebtedness.

Intent to Incur Debt and Calling Special Election

After the public hearing on December 12, 2005, the Board of Education was asked to approve several resolutions that lead to the conduct of the special election and ultimately the issuance of bonds. The resolutions were as follows:

- 1) Resolution of Establishing Community Facilities District No. 21 and establishing the boundaries thereof.***
- 2) Resolution determining the necessity for Community Facilities District No. 21 to incur bond indebtedness not to exceed \$16,000,000 for providing public facilities for the improvement area no. 1, Improvement area No. 2 and Improvement Area No. 3 of the Community Facilities Districts, and calling Special elections for the Community***

Facilities District and the improvement areas on propositions for incurring such bonded indebtedness.

3) Resolution Calling Special Election and submitting to the voters of improvement area No. 1, Improvement area No. 2 and Improvement area No. 3 of Community Facilities District No. 21 Propositions with respect to the annual levy of special taxes within the improvement areas to pay principal and interest on bonds of the Community Facilities District which may be issued and sold to finance public facilities for the improvement areas, and establishing an appropriations limit for the Community Facilities District.

(See attachment)

The approval of the last two resolutions scheduled an election for January 3, 2006. The CFD was approved by all voters. On January 17, 2006 at a regular Board of Education meeting the district CBO submitted a resolution for Board approval of the results of the Special election. The resolution was presented as follows:

1) Resolution declaring the results of the consolidated special elections within Community Facilities District No. 21 and within Improvement area No. 1, Improvement area No. 2 and Improvement Area No. 3 Thereof. (See attachment)

Issue Bonds and Approve Bond Sale

At the May 21, 2007, Board of Education meeting the district CBO prepared a resolution to issue bonds, appoint a fiscal agent, approve a bond purchase agreement and authorizing negotiation of terms of the sale, approving preliminary official statement, final official statement and the continuing disclosure agreement. The resolution was worded as follows:

1) Resolution Authorizing the issuance of bonds of Community Facilities District No.21 designated 2007 special tax bonds in aggregate amount not to exceed \$4,000,000, appointing a Fiscal Agent, approving bond purchase agreement and authorizing negotiation of terms of the sale of bonds, approving preliminary official statement and authorizing preparation of the final statement and approving continuing disclosure agreement. (See attachment)

Riverside chooses to combine many resolutions together, which is fine as long as the requirements of the Mello-Roos act are met.

