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Real Estate Munis Coveted in Riskless Return Chase.

Debt backed by real estate is the best-performing part of the \$3.7 trillion municipal market this year when factoring in price swings as housing foreclosures ebb.

Land-backed munis, known as dirt bonds, earned 10.3 percent this year through Sept. 23, beating the 7.7 percent advance for all munis, according to S&P Dow Jones Indices. After accounting for volatility using Bloomberg's risk-adjusted return calculator, the real-estate securities have gained 7.5 percent, exceeding the 5 percent advance for the whole market.

Debt repaid from land districts, mostly in Florida and California, is profiting as the housing market strengthens amid a recovering economy, said John Miller, co-head of fixed-income at Nuveen Asset Management LLC in Chicago. Foreclosure filings have averaged about 111,000 the past three months, down from a peak of 367,000 in 2010, according to RealtyTrac Inc.

"You have a more stable and steady improvement in the demand for new homes that are constructed today within these districts," said Miller, who helps manage \$94 billion of munis, including \$4.9 billion of dirt bonds. "There's good income coming from the bonds with relatively low volatility."

Fee Backing

Munis backed by real-estate projects are issued to help finance construction and are repaid with assessment fees charged to homeowners.

The housing crisis that deepened during the recession caused some developments financed with munis to fall into payment default. Of the 448 active municipal defaults as of Sept. 10, in which issuers hadn't made full payments, about half were for land-secured debt, according to Municipal Market Advisors, a research firm based in Concord, Massachusetts.

The bulk of distressed land-backed munis came to market from 2005 to 2007 for home developments in Florida called community development districts, Miller said. Many of the securities have reworked payment schedules to revive construction, he said.

"The bonds were restructured in some way," Miller said. "The development restarted and it's no longer as much distressed."

The entire housing market is on the upswing. New homes sold in August at the fastest clip since 2008, Commerce Department figures showed yesterday.

Backyard Buyer

For Jason Diefenthaler at Wasmer, Schroeder & Co. Inc. in Naples, Florida, the development districts are often a car-ride away. The firm oversees \$3.5 billion of munis. Its \$63 million High Yield Municipal Fund, has 7.5 percent of assets in land-backed debt, Diefenthaler said.

"We have a lot of these deals in our backyard," Diefenthaler said. "We have the ability to hop in our

car, call the developer, go over get a site visit and talk to the finance team to see where sales are going.”

Land-backed securities are gaining as investors seek riskier debt for higher yields compared with top-rated munis, Diefenthaler said. Yields on benchmark 10-year munis maturing in 10 years, at 2.25 percent yesterday, fell to the lowest since May 2013 this month, data compiled by Bloomberg show.

High-yield munis, a category including land-backed debt, have gained 13.2 percent this year, S&P data show.

Roll Tide

“What we’ve had is really a rising-tide scenario,” for high-yield munis, Diefenthaler said.

Wasmer Schroeder prefers developments in wealthier areas along Florida’s coasts, he said. The state’s community development districts fold assessment fees into property-tax bills, making it more likely that homeowners will make full payments, he said.

“Your repayment mechanism is really very tax-like,” Diefenthaler said.

Wasmer Schroeder in April bought dirt bonds sold by the Midtown Miami Community Development District, he said. The district sold \$91.8 million of unrated, tax-exempt bonds to refinance debt it sold in 2004 to help fund parks, roadways and parking facilities, according to bond documents.

Nuveen held about \$42 million of the bonds as of Aug. 31, Bloomberg data show.

The performance of the bonds since their sale five months ago underscores the demand for the category. Debt maturing in May 2037 traded with an average yield of 4.88 percent on May 21, down from 5.25 percent when it was sold April 22.

“That was tremendously oversubscribed,” Diefenthaler said of the deal. “We got a fraction of the bid that we put in.”

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