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Bonds Emerge Unscathed from Devastating California Fires.

LOS ANGELES — The devastating California fires destroyed lives, homes and businesses, but haven't killed the state's unassailable optimism.

With federal and state aid and insurance payouts estimated in the billions, investors, analysts and government finance officials all expect that homes and businesses will be rebuilt, and that the impact on local government bottom lines will not be as devastating as the fires' wrath.

More than 245,000 acres and an estimated 8,400 structures burned in the northern California fires that started Oct. 9 and were expected to be contained by Friday, according to the California Department of Forestry and Fire Protection.

No long-term impacts are anticipated for local governments, school districts or holders of bonds in the region's assessment districts, according to analysts and bond investors.

"Despite the damage inflicted by the Northern California wildfires, affected public finance issuers will likely endure minimal, if any lasting credit effects," said Moody's Investors Service in an Oct. 23 report.

"Given the nature of the structural damage, the rebuild will likely take years to complete, and because of high property values in the affected areas and the availability of insurance proceeds, we expect most home and business owners to rebuild," S&P Global Ratings said in an Oct. 25 report.

S&P, which rates 77 issuers in the affected area, said property tax relief to homeowners may lead to near-term stress on local governments.

"Right now, we are going through a triage of helping property owners who have been affected to get their home values reassessed," said Erick Roeser, Sonoma County's treasurer-tax collector.

The county hopes to have a better sense as to how many homes in Sonoma County will be reassessed in the next few weeks, Roeser said.

"As that process gets underway, Californians will be aided by state laws designed to ease the burdens they face, including property tax reductions," S&P analysts wrote. "However, while providing support to residents, these incentives could create pressure for local governments."

State law provides for property value reassessments and corresponding property tax adjustments, S&P analysts wrote. The state also has a Special Fund for Economic Uncertainties that can backfill property tax losses to local governments impacted by reassessments.

The Department of Finance can allocate funds from the special fund if authorizing legislation is enacted, S&P analysts wrote. Since that involves the state budget process, several months could pass before local governments see such relief, S&P said.

Though local governments could experience a short-term crunch, S&P said the rebuild will likely result in a boost to sales tax and assessed value further along in the rebuild.

Moody's rates 32 credits with public ratings and five with nonpublic ones in the affected areas of Napa, Sonoma and Mendocino counties, though not all are in the impacted areas.

"We are conducting individual assessments, but most issuers have strong credit quality and we expect few will face a difficult and extended recovery period," Moody's analysts wrote.

The 21 school districts, along with three rated cities, two community college districts and a hospital district, carry a combined assessed valuation of $386 billion, Moody's said. This far exceeds estimates that damage costs could reach as high as $6 billion, analysts said.

National rates of fire insurance coverage for homeowners exceed 90% as compared to only 15% of homeowners in Harris County, Texas who were insured for flooding losses caused by Hurricane Harvey, Moody's said.

Though State Farm, the largest insurer, is estimating a $4.6 billion loss, people are insisting on rebuilding, said Michael Ginestro, former director of municipal research for Bel Air Investment Advisors.

"I think the Valley comes along stronger than ever three to five years from now," Ginestro said.

Ginestro doesn't expect there will be delays in getting state funding out.

"I think Gov. Brown knows this is a huge part of the state's GDP — and that we need to bring this part of the state back fairly quickly," Ginestro said.

In Sonoma County, finance officials say it is too soon to say what the impact on the county's bottom line will be.

"We have a very resilient county," Roeser said. "The board and county workforce reacted in a really amazing way."

The people are united in their effort to help people get started on the rebuilding process, Roeser said.

"As far as the impacts to the county, I can only guess what the impact will be in the long run, but in the short run, we are helping people on the rebuilding process," Roeser said. "We are a great destination and a great place to live and I don't see that changing."

Roeser noted that S&P Global Ratings said no rating changes were needed for the three impacted counties.

Without exception, everyone interviewed said the affluent region best known for the $58 billion wine industry will rebuild. They also said that that Mello-Roos bonds and similar assessment debt for community facilities districts were not likely to be affected.

Dan Massiello, senior vice president of public finance for Kosmont Cos., looked at some of the assessment districts in areas devastated by fire.

"The assessments are not like ad valorem taxes – the assessments are absolute; they are an override through special taxes," Massiello said. "The value of the property is security to the bondholders."

The assessments are senior to the mortgage, Massiello said. So the issue becomes one of if homeowners would decide to abandon their properties and not pay taxes. That is an option that no one interviewed believes is likely.

The only way the Mello-Roos or similar “dirt” bonds would be at serious risk is if 100% of the homeowners defaulted, because then there would only be a half year of reserves to cover debt service, Massiello said.

“I would guess that people would want to stay and not lose their property for the lack of making tax payments while they rebuild,” Massiello said.

“There is always a risk in land-secured bonds that if the value of the property drops significantly then the property owners are less inclined to pay their taxes and assessments,” said Patricia Eichar, a land-based attorney with Orrick, Herrington & Sutcliffe.

“That is a risk inherent in all land-secured debt – that the property owners might abandon the property —and then the only option is to take the land and foreclose,” Eichar said.

But given that most of the areas in northern California impacted by the fire were affluent areas, Eichar does not think that is likely.

“Maybe a handful of property owners will walk away, but that is what reserve funds are for,” Eichar said.

“If you compare it to the Oakland Hills fire [in 1991], the property owners in that entire community rebuilt,” she said. “It took some longer than others, but they rebuilt – and that is what I would expect to see here.”

There may be some one-off dirt bonds with slim coverage and a small tax base, but the general redevelopment agency space and so-called dirt bonds will likely be more attractive to investors, Ginestro said, because there is federal and state funding combined with private insurance to fill any gaps.

It might be a different conversation in a less affluent part of the state, Ginestro said, but the people in Santa Rosa are not likely to move away. And both Sonoma and Napa counties are double-A rated, he said.

The private insurance companies could be the wild card.

“If they don’t front the money quickly those bonds could see an impact,” Ginestro said. “But State Farm is the largest carrier and they are a pretty solid insurance company.”

Investors do have one positive: the Mello-Roos is non-ad valorem, so it will not fluctuate even if the value of the property declines significantly, said Tom Schuette, partner and co-head of the Investment Research & Strategy department at Gurtin Municipal Bond Management.

Property taxes on the other hand, are based on assessed values – so could will go down as the property value declines, he said.

“So, they have to hope that a sufficient number of owners continue to make their payments,” Schuette said. “I suppose if you hold these bonds you are essentially banking on these homeowners wanting to hold onto the property even if their home has been destroyed. If they don’t pay their Mello-Roos, the taxing district can start foreclosure proceedings.”

The bondholders should be in good shape, but the cities will have a battle of their own, Massiello said. Property taxes in California are due Nov. 1 – and there is a line of people at the assessor's office in affected counties asking that there property taxes be reassessed.

"We have a FEMA center in downtown Santa Rosa where property owners can address a variety of needs," Roeser said. "Part of the process it that they can apply for a calamity reassessment."

The amount of ad valorem property taxes collected will in many cases go down, because the houses will be reassessed based on the land, instead of on the now non-existent structures.

The school districts and governments could feel the crunch. For instance, if the land was assessed at $200,000, but with improvements at $400,000, the total assessment went down by $200,000.

The Bond Buyer

By Keeley Webster

October 26 2017, 1:18pm EDT