

# **Bond Case Briefs**

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## **No Deed, No Taxes, No Problem With These Dirt Bonds.**

- **Utah, Colorado developers finance with ‘cash flow’ securities**
- **In dirt-bond twist, investors have no property to foreclose on**

Question: What do you call a dirt bond without any dirt?

Answer: Cash-flow limited-tax general obligation bonds.

“Dirt bonds” are used to help pay for new real estate development, and have been a prominent, if risky, feature of the municipal-bond market for decades, especially in fast-growing states like California, Colorado, Texas and Florida. They may have different names in each of the states, but are typically sold with no or low credit ratings and carry comparatively high yields. The bonds are repaid by property taxes and special assessments, and investors’ ultimate security is foreclosure on the property.

But now we have a dirt bond without any property to foreclose on. Bond buyers are still helping to pay for a new real estate development, but they don’t get the deed to the land should it stall or never take place.

That’s not all the bond buyer doesn’t get. Payment dates may come and go, but the issuers of these bonds tell the buyers up front that they won’t get paid principal or interest until a date years in the future, and maybe not even then. These payments won’t be made until people move in and the cash — property taxes — starts to flow.

### **Theoretical Maturity**

These bonds have a maturity date, but that’s only theoretical; it may take even longer to catch up on those accrued debt-service payments. And if you’re not caught up by a certain year after that, you’re out of luck, because these bonds also have a termination date beyond which the bondholder’s claims are worthless.

I hadn’t seen such a thing before. I couldn’t even have imagined such a thing and called it a municipal bond. Perhaps we are at a certain point in the credit cycle, where investors are willing to absorb increasing amounts of risk. And the risk is undeniable. Land-secured deals account for about \$2.3 billion of munis currently in payment default, or about 18% of the total, excluding Puerto Rico, Municipal Market Analytics data show.

This particular brand of land deal seems to have made its debut in Utah this year, but it’s been used in Colorado for a few years. In Utah, the structure appears to have reached perfection, or maybe the vacation-home market there is red hot. Muni-financed development deals appear to be revving up there. Of the 66 that have been sold in the state, three were from 2009, one in 2010, six in 2013, nine in 2020 and 47 this year, data compiled by Bloomberg show.

Consider, for example Pine View Public Infrastructure District No. 1, which in November sold \$13.8 million in cash-flow limited-tax GOs. The unrated deal was sold through a preliminary limited

offering memorandum to qualified institutional buyers in minimum denominations of \$500,000.

The proceeds of the deal are going to help pay for a development of 1,202 single-family homes on more than 300 acres in Toquerville, Utah, which had a population of 1,870 in 2020, according to the offering documents, and which is in southwest Utah near Zion National Park.

There's a helpful aerial map of Pine View PID No. 1 in the memorandum and there's not a lot there. It says so numerous times in the memorandum. Home construction hasn't commenced, and isn't expected to until the third quarter of 2022.

And then, these words: "It is not anticipated that there will be any Pledged Revenue available to pay accrued interest on the Bonds until 2025, and it is not anticipated that there will be any Pledged Revenue to pay principal on the bonds until 2042."

### **'No Guarantee'**

The memorandum goes on to state: "These dates represent a forecast and there is no guarantee that any payments will be made on or after such date or, further, that the Bonds will be repaid prior to their discharge date of March 1, 2062."

These are relatively new creatures in MuniLand, "cash flow" securities. There's no definition of "cash flow securities" available in the Municipal Securities Rulemaking Board's Glossary, for example.

And yet, there's a market for such things. These Pine View Public Improvement District No. 1 bonds were priced by underwriter D.A. Davidson at par to yield 6% in 2051, which is 448 basis points above what top-rated issuers expect to pay. The underwriter didn't respond to an email for comment. A call to the developer wasn't immediately returned.

My first reaction to "cash flow securities" was sheer amazement, and my second was "I love these," because they're the ultimate manifestation of dirt bonds.

Why do such things usually default? Because they run out of time. Because the developers can't get the houses built and sold fast enough. Because the fuse is lit the day the bonds are priced. I bet we'll see a lot more such deals.

### **Bloomberg Markets**

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