

National Federation of Municipal Analysts

Recommended Best Practices in Disclosure for Land Secured Debt Transactions

The National Federation of Municipal Analysts (NFMA) is an organization of over 1,000 members, primarily research analysts, who evaluate credit and other risks of municipal securities. These individuals represent, among others, mutual funds, insurance companies, broker/dealers, bond insurers, and rating agencies.

One of the main initiatives of the NFMA is to promote timely and complete disclosure of the financial and operating information needed to assess the credit quality and risk of a municipal debt issue. The NFMA's efforts have ranged from global disclosure-related issues to more detailed, sector-specific work such as these Recommended Best Practices in Disclosure. For further information on the NFMA's continuing work in the area of disclosure, please see the "disclosure guidelines" and "position statements" pages of the organization's web site at www.nfma.org.

In order to develop our Recommended Best Practices in Disclosure, diverse groups of NFMA analysts worked with non-analyst professionals in each sector to develop "best practices" guidelines for certain market sectors. These Recommended Best Practices are descriptions of the sector-specific financial and operating information needed to help analysts do their jobs. The NFMA believes that the best practice in disclosure will always be the one that provides a steady flow of timely information from borrowers to the market. Initial drafts of our Recommended Best Practices in Disclosure were widely circulated, and an industry comment period was used to seek input from interested parties. Subsequent to the comment period, the papers were revised. For certain sectors, Comment and Response papers were drafted; these papers are available on the NFMA web site, providing additional information on the comments received.

Following is the most recent version of the Recommended Best Practices in Disclosure for this sector. This document is not intended to supplant the amendments to SEC Rule 15c2-12, but to be used in conjunction with the guidance provided in those amendments. It is important to note that the NFMA's disclosure efforts are a continuing process. These guidelines are not static documents, and will be revisited and changed as market conditions warrant. We encourage interested parties to submit comments at any time to lgood.nfma@worldnet.att.net, so that they can be considered in the development of future versions of these Recommended Best Practices in Disclosure.

The NFMA Recommended Best Practices in Disclosure are not intended to be "one size fits all" recommendations, and all the information requested may not apply to every transaction in the sector. We encourage the providers of information to indicate when a specific item requested in the Recommended Best Practices is not applicable to a specific transaction.

SUMMARY OF RECOMMENDED BEST PRACTICES

Set forth below is a summary of our Recommended Best Practices in Disclosure for Land Secured Debt Transactions. A detailed discussion of each of these items is included in this paper and we encourage a thorough reading of this entire paper.

Information Provided: Disclosure documents prepared for both the primary and secondary market should address each of the following:

<u>Issuers</u>	<u>Developers</u>
• Bond Information	• Project Construction
• Delinquencies	• Development Status
• Land Valuation and Debt Burden	• Financial Information
• Ownership Concentration	• Credit Facilities
• Development Status	• Unit Sales/Commercial Activity
• Foreclosure/Tax Lien Sales	• Corporate Structure
• Other Material Factors	• Delinquencies/Bankruptcy

Primary Market: Primary market disclosure documents should also provide detailed information on each of the following:

- Plan of Development
- Experience of the Developer
- Appraisals and Absorption Studies, as applicable
- Potential Conflicts of Interest

Timing and Frequency of Reporting:

	<u>Report</u>	<u>Timing</u>
	POS	At least one week before pricing
<i>Issuers</i>	Annual	3 to 4 months after the end of the Reporting Period
	Interim	2 to 3 months after the end of each tax collection period
<i>Developers</i>	Annual	3 to 4 months after the end of the Reporting Period
	Interim	45 days after the end of each quarter or semi-annual period

Forum for Reporting:

- Provide the name of a contact person and agree to talk to market participants
- Post reports on the Internet with free access
- Provide reports directly to investors and other market participants

RECOMMENDED BEST PRACTICES

Land Secured Debt Transactions: Land secured debt transactions have a variety of structures but, generally, are debt issues sold to finance public infrastructure improvements for residential, commercial, or industrial development. These types of transactions are known by a variety of names throughout the country, as set forth in an Appendix to this paper. The term “land secured debt” as used in this paper refers to municipal debt that facilitates real estate development, where debt proceeds are used to finance the construction of public facilities. The debt is payable from and secured by taxes or assessments levied on the property, which, in turn, are secured by a lien on the property. In some cases—Texas and Colorado, for example—the Issuer can levy taxes without limit as to rate. In other cases—Arizona, California, Florida, Illinois, Maryland, Nevada, Virginia, and Washington, for example—the assessments are fixed or the tax has a variable component but normally subject to a ceiling. The requirement to pay these assessments or taxes is usually a limited obligation of the property owner. To enforce this obligation, there is typically a government foreclosure or tax lien sale process—subject to different provisions in different states. In some cases, land secured debt is rated by one or more of the major national rating agencies and/or benefits from insurance or a bank letter of credit. However, in most cases, these debt transactions are not rated, at least initially, and constitute a notable portion of the high yield debt market.

Land secured debt is often issued in anticipation or at the beginning stages of development. In these cases, a Developer is often the principal taxpayer or assessee. The rate, extent, and manner of the development of the property are important variables and the Developer’s experience and financial resources are an integral part of the credit evaluation. Development activity and the Developer’s continued financial solvency is material to the analysis of these debt issues, and, therefore, the Developer is crucial to the flow of information and must be part of the process. In those cases where the land secured debt is being issued to refund a prior debt issue, the role of the Developer will depend on the level of development that has taken place since the original debt issue. We recommend that the financing team and other market participants communicate to Developers the importance of the data and stress that investors will expect and rely on the information.

Developers and Significant Merchant Builders: We consider “Developers” to be those entities primarily responsible for carrying out the development and improvement of the land securing the debt financing. Depending on the circumstances, these Recommended Best Practices would apply to Developers responsible for 10% to 20% or more of the aggregate assessment lien or annual tax supporting debt service on the debt. “Significant Merchant Builders” would be those entities responsible for 5% or more of the annual assessment or special tax who have acquired their property with the intent to complete the final improvements, *i.e.* build the houses or commercial buildings. Once a Developer or Significant Merchant Builder falls below this threshold, it would no longer need to provide information in accordance with these Recommended Best Practices, although in all cases at least one secondary market report should be provided after the initial sale of the debt. Please note, these Recommended Best Practices ask for different information from Developers and Significant Merchant Builders, with that from the later mostly confined to basic operating data.

Preparation of Information: Most of the recommendations in this paper are general to the land secured segment and attempt to cover differing situations in the various states where this type of debt is issued. Issuers, investment bankers, financial advisors, and other parties responsible for the disclosure process must use their professional judgment to determine what items are relevant for disclosure in a particular transaction. If a particular data point is not relevant to a transaction—or, upon the achievement of certain development milestones, becomes irrelevant—we would expect it to be dropped from the reporting model. If items that may not be included in these guidelines are relevant to a particular transaction, then those items should be incorporated into the disclosure report. It is our Recommended Best Practice that *all* members of the financing team actively participate in the formation of the items to be included in the secondary market disclosure reports as early as possible in the financing process.

We recognize that the data needed to analyze a land secured debt will vary from issue to issue and state to state. However, there is information that is relevant to nearly all debt issues. An outline of this information is set forth below and it is our Recommended Best Practice that when providing disclosure to either the primary market or in annual secondary market reports, each of these areas, to the extent applicable, be addressed. We have divided this information into information typically provided by Issuers and information typically provided by Developers and Significant Merchant Builders. We note that some Issuers may require Developers to file their own annual secondary market disclosure reports; in other cases the Issuer collects the information from the Developer and completes one integral report. Either method is acceptable provided that the report is clearly labeled as to which information is being reported. We recommend that Issuers “tie in” Developers in some manner to comply with their disclosure undertakings in the development agreement or other document.

Information Provided by Issuers: The following information should be provided in primary offering documents and in annual secondary market disclosure reports.

Bond Information

- **Principal Outstanding**—The principal amount of debt outstanding after the most recent debt service payment, including a debt service schedule and/or a summary of recent unscheduled bond redemptions showing which maturities were redeemed.
- **Reserve Fund**—The balance in the reserve fund and the reserve fund requirement. This information should be provided on an annual basis and in interim reports.
- **Construction Fund**—If debt proceeds will fund a project (as opposed to reimbursing amounts already expended), the balance in the construction fund, along with the adequacy of such fund to complete the project as planned and the status of completion of the project.
- **Debt Service/Redemption Fund**—The balance in the fund to be used to make debt service, including information regarding prepayment of the assessment lien or special tax.
- **Other Fund Balances**—As necessary and material.
- **Contact Person**—The name, address, telephone number, and e-mail address of a person to contact with questions.

Delinquencies

- **Amount of Delinquencies**—Aggregate amount of the annual assessment or special tax and percentage delinquent. This information should be provided on an annual basis and in interim reports after each assessment or tax collection period. In areas where assessments or taxes are advanced irrespective of delinquencies, such as under the “Teeter Plans” in California, Issuers should report the underlying level of delinquencies. The Issuer should also report as soon as practicable any decision to discontinue the participation in such arrangements).
- **Foreclosure/Tax Lien Sales**—Status of foreclosure, tax lien sales, or other applicable remedies, including the date(s) of legal actions, along with a statement of the compliance by the Issuer with any debt covenant to initiate collection of delinquent assessments or special taxes. If the Issuer does not wish to answer questions about the status of any foreclosure or tax lien sale matters, then it should provide the name and contact information of the law firm processing any legal actions.
- **Significant Property Owners**—Detailed information on delinquencies and foreclosure or other actions relating to “Significant Property Owners,” defined as those responsible for 5% or more of the aggregate assessment lien or annual special tax. In situations where an Issuer can levy an unlimited tax, the threshold could be higher—10% for example—if the Issuer has taken the appropriate steps to increase the tax levy on the other, non-delinquent parcels.

Land Valuation and Debt Burden

- **Valuation**—Aggregate assessed value or similar indications of property values, broken out between structure and land values if possible.
- **Debt Burden**—Aggregate assessment lien or bonded indebtedness.
- **Overlapping Debt**—Overlapping land secured debt of the Issuer and/or, if available, other Issuers. Once the development has reached a critical stage (when perhaps 20% or less of the assessment or special tax revenues are generated from unimproved parcels), this information should, in most cases, no longer be necessary.
- **Overall Tax Rate**—In those states with the flexibility to increase the tax levy percentage to pay debt service, the overall tax rate on the property.

Ownership Concentration/Characteristics

- **Significant Property Owners**—Identification of Significant Property Owners, along with detailed information of their ownership position, including number of parcels and/or acreage, development status, assessed values, debt burden/overlapping debt.
- **Land Use/Zoning**—Material changes to the zoning or land use (*i.e.*, residential, commercial, industrial) from the land uses/zoning set forth in the official statement.

Development Information

- **Assessed Improved and Unimproved Parcels**—This breakdown should be based on assessed structure versus land value showing the aggregate assessed values, number of parcels and/or acreage and proportionate debt burden/overlapping debt. Once the development achieves a critical stage, perhaps 80%, these data should no longer be necessary.
- **Building Permit/Certificate of Occupancy/Water or Sewer Connection Activity Information**—Annual and cumulative update of information that is available to the Issuer indicating new building activity. For example, a water district might provide new water connections, whereas a city might provide building permits. Once the development achieves a critical stage, perhaps 80%, these data should no longer be necessary.

Other Material Factors Affecting the Development Potential of the Land

- **Economic, Environmental, or Legal Matters**—Any other material matters known to the Issuer that would have a material impact on land values, development potential, or the likelihood of property owners to pay their assessments or special taxes.

Information Provided by Developers: As with reports prepared by Issuers, the necessary data that Developers should provide will vary from issue to issue. However, there is basic information needed to perform a complete credit analysis of the debt issue. Therefore, our Recommended Best Practice is that in the primary market and in annual and interim secondary market disclosure reports, Developers address each of the following areas as applicable to the type of project under development (*i.e.*, residential, commercial, industrial):

- **Project Construction**—Status of the debt-financed project if the Developer is responsible for construction along with any portion that is Developer financed.
- **Development Status**—Status of other in-tract infrastructure, grading, and vertical construction by parcel and/or acreage.
- **Financial Statements and Development Pro-Forma**—Audited financial statements, or, if such statements are not available, unaudited financial statements, prepared in accordance with generally accepted accounting standards that have been reviewed by an independent certified public accountant. Developers should also provide an update to the financing plan for the development, including sources of cash inflows and material changes to the information set forth in the official statement.
- **Credit Facilities**—Status of credit facilities used to finance development, including increases, reductions, changes in providers, or elimination of lien provisions.

- **Unit Sales**—For residential development, sale of lots, distinguishing among developed, partially developed, and undeveloped lots (sometimes referred to as raw, paper or finished lots), houses, or parcels as appropriate. If the Developer sells a parcel in either a residential, commercial or industrial development, information regarding that sale should include the name of the purchaser, along with the material terms of the transaction. If the Developer is coordinating the receipt of sales data from Significant Merchant Builders, they should be identified. If the Developer declines to coordinate the receipt of this information, then the Significant Merchant Builders should provide it with the same frequency and in the same time frame as the Developer.
- **Ongoing Commercial Project Activity**—If the project is a commercial venture, information, such as occupancy statistics and years remaining on material leases to show the commercial activity and status of the project.
- **Corporate Structure**—Material changes to the structure of the Developer organization and the entities or individuals that control the Developer.
- **Delinquencies/Bankruptcy**—Any delinquencies in the payment of property taxes, assessments, or special tax or a bankruptcy filing by the Developer or related entities in other project areas.
- **Contact Person**—The name, address, telephone number, and e-mail address of a person to call with questions.

Developers should provide a report within a reasonable time period if any of the following occur:

- **Delinquencies**—Any delinquencies in the payment of the Developer's property taxes, assessments, or special taxes.
- **Bankruptcy or Dissolution**—Bankruptcy or dissolution of the Developer or entity controlling or controlled by the Developer.
- **Abandonment or Sale**—A decision to abandon, list the property for sale or sell the project.
- **Credit Facilities**—Withdrawal of material credit facilities that are not replaced in a reasonable period of time.
- **Legal Action**—Information about litigation—governmental or private—which could have a material adverse effect on the development of the project or the Developer.

Primary Market: In addition to the data items specified above, the official statement should also address the following matters:

- **Plan of Development**—A description of the plan for development of the property with, ideally, a map and/or aerial photograph of the project area showing the location of debt-financed infrastructure and other planned development. This description should also include the debt and Developer financed construction necessary to complete the development; pro forma financial information that shows the sources and uses of funds to carry out the development plan; and a discussion of the financial resources, or lack thereof, available to complete the project.

- **Experience**—The Developer’s practical experience with similar projects involving land secured debt financings, and the financial wherewithal to complete the project as planned. If the Developer is a partnership, the experience of the person(s) managing the partnership should be provided, along with a description of the partnership agreement.
- **Appraisals and Absorption Studies**—An appraisal and absorption study should be included, either in summary or in their entirety, as appendices to the official statement. The appraisal should clearly discuss (i) the approaches used to determine the valuation (and, if applicable, why certain approaches were omitted); (ii) the assumptions and, if applicable, the discount rates used in the valuation approaches; (iii) how expenses over and above the debt proceeds necessary to complete the development were taken into account in the valuation; and (iv) how the assessment or special tax lien is treated in determining the value.
- **Assessed Values**—Aggregate and significant parcel assessed valuations, along with a brief explanation of how the assessed values are determined, a listing of significant pending appeals of valuation, and the base year of the valuation.
- **Conflicts of Interest**—A description of any agreements or understandings that would create a potential conflict of interest between the Developer, the Issuer, or other parties that are material to the development activity.
- **Foreclosure or Tax Lien Sales**—A statement regarding past compliance with the Issuer’s foreclosure or tax lien sale covenants relating to other land secured debt issues and the Issuer’s usual practices for enforcing its foreclosure or tax lien sale responsibilities.
- **Developer Compliance with Covenants and Agreements**—Developer compliance with any other agreements between it and the Issuer in the past.

Exemptions: Given the nature of land secured debt and the need for information with respect to these types of transactions, it is our Recommended Best Practice that Issuers and Developers agree to provide secondary market reports in accordance with this paper even if the transaction fits within an exemption from reporting under the Amendments..

Frequency of Reporting: With respect to the frequency of reporting, our Recommended Best Practices are as follows:

Issuers—Issuers should provide information on the collection of assessments or special taxes on an interim basis. In states where assessments or taxes are due in installments, information on each installment should be provided after the end of each collection period, along with the balance in the reserve fund and the reserve fund requirement. The remaining information should be included in an annual report.

Developers and Significant Merchant Builders—Developers and Significant Merchant Builders should provide operating data, particularly permit, construction, sales, and other operating data, on a semi-annual or quarterly basis. Complete financial and operating information would be provided by Developers on an annual basis. Significant Merchant Builders would only need to provide semi-annual or quarterly reports.

Timing of Reports: With respect to the time when disclosure reports should be provided to the market, our Recommended Best Practices are as follows:

Primary Market Disclosure—With respect to preliminary official statements, the offering documents should be “on the street” and available to potential investors at least one week before the proposed pricing date.

Annual Reports—We recommend that Issuers, Developers, and Significant Merchant Builders provide the annual disclosure report within three to four months after the relevant information becomes available (the “Reporting Period”). This could be either a specified date or a specified period after the end of the fiscal year, bond year or other relevant period. To the extent the Issuer’s audited financial statements are not available at that time, they should be provided in a separate submission at a later date. Whatever Reporting Period is used, the material operating data relevant to the development and credit analysis of the land secured debt transaction should be provided in a timely manner.

Interim Reports—Issuers should provide the interim report covering the collections of assessments or special taxes and the reserve fund balance within two to three months after the end of each collection period. Developers and Significant Merchant Builders should provide interim reports within 45 days after the end of each quarter or semi-annual period.

Forum for Reporting: Our Recommended Best Practices are for Issuers, Developers, and Significant Merchant Builders to agree to:

- Respond verbally and/or in writing to bondholders, underwriters, potential investors, or other market participants about credit matters.
- Post primary market and secondary market disclosure reports on the Internet and make them available at no charge.
- Mail disclosure reports to interested parties upon request (at no charge).

Adherence to Recommendations: We strongly encourage market discipline on the sell and buy side of the market to enforce compliance with these Recommended Best Practices. We believe that adherence to these disclosure practices will increase the liquidity and efficiency of the land secured debt market, and, in the long run, provide a lower cost of funds to Issuers.

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NFMA constituent societies, individual members, or their firms may not agree with all provisions of these Recommended Best Practices. The NFMA is not a regulatory agency and compliance with the practices advocated herein does not constitute a “safe harbor” from any State or Federal rules or regulations. Nothing in this paper is to be construed as an offer or recommendation to buy or sell any security or class of securities.

APPENDIX

The following is a list of the states that have significant amount of land secured debt transactions as of the date of this paper.

<i>State</i>	<i>Common Names</i>
Alabama	Improvement Districts
Arkansas	Municipal Property Owners Improvement Districts
Arizona	Community Facilities Districts or Local Improvement Districts
California	Mello-Roos Community Facilities Districts or 1915 Act Assessment Districts
Colorado	Metropolitan General Improvement, Water and Other Special Districts
Florida	Community Development Districts
Hawaii	Improvement Districts
Illinois	Special Service Areas
Maryland	Special Taxing Districts or Community Development Authorities
Minnesota	Special Assessment Districts
Nevada	Local/Special Improvement Districts or Special Assessment Districts
New Mexico	Special Assessment Districts
New Jersey	Improvement Districts
Pennsylvania	Assessment Districts
Texas	Municipal/Public Utility Districts, Water Control/Improvement Districts, Drainage/Levee/Public Improvement Districts, Road Utility Districts
Virginia	Community Development Authorities
Washington	Local Improvement Districts or Consolidated Local Improvement Districts