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Behind a Struggling California Dirt-Bond Deal

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LOS ANGELES — A developer's plans to resuscitate a master-planned community in Cathedral City, Calif. have stumbled, resulting in reserve draws to make bond payments on $11 million in outstanding community facility district special tax bonds.

The developer, Inland Community Corp., began buying up parcels in the tract in 2014 after the original lead developer failed to complete the project.

The master plan is for 1,362 single-family homes, commercial development and an elementary school in Cathedral City, a desert community of 50,000 near Palm Springs. But only about 200 houses were built, all before the new developer stepped in, according to Tami Fox, Cathedral City's administrative services director.

The Riverside County city is in the Coachella Valley amid a string of desert resort towns, of which the most well-known is Palm Springs.

Riverside County issuers have sold more CFD debt than any other county in California, with $4.1 billion by fiscal year 2014-15.

It is also the county with the most CFDs reporting reserves below the required level, according to the most recent annual report on Mello-Roos debt produced by the state treasurer's California Debt and Investment Advisory Commission.

The Community Facilities Act, also known as Mello-Roos after the authors of the legislation, was approved in 1982 to allow the formation of special tax districts to finance infrastructure for private development or schools.

California had 921 community facilities districts with 1,477 separate bond issues totaling $16.9 billion of new money and refunding debt in fiscal 2014-15, according to the report. That is the initial par amount of any reported debt that is still outstanding; it does not count debt that has reached full maturity.

"In Riverside County, not only did 21 of its 345 CFDs report less than required reserves, 12 of those agencies reporting have none of their required reserve on hand," CDIAC's report said.

A $570,857 draw was made on the reserve fund for Cathedral City Community Facilities District No. 2000-1 on Sept. 1 to make a bond payment, according to a September 13 filing posted on the Municipal Securities Rulemaking Board's EMMA website. A second $245,929 draw on the reserve was made March 1 to make the payment on that date, according to a March 9 filing.

Now at $654,171, the reserve fund balance is below the required $1.2 million, according to the disclosure filing.

The unrated bonds were sold in 2000 to finance infrastructure for the proposed 1,362-unit Rio Vista Village, a master-planned single-family home community. Inland Community Corp has since rebranded the project to Verano.

"The unscheduled draw on reserves is due to the delinquencies in the district," according to the March 9 disclosure notice.

Major property owners responsible for greater than 5% of the special tax levy are delinquent in payment of the special taxes for fiscal year 2015-2016, Fox said.

The bonds were in a similarly precarious situation in 2014 when draws were made twice on reserves to make the bond payments, because the special taxes backing the bonds were delinquent. The unrated bonds are not considered a debt of the city, Fox said, but city officials are responsible for foreclosing on the properties if the special taxes don't get paid.

The city was forced to foreclose on properties after delinquencies grew from one property in 2006 to 20 properties behind on taxes in Aug. 21, 2013, forcing the city to draw on reserves in 2014.

The master developer ran into problems in 2005-2006 when the single-family home market began to crater, Scott said. Other developers tried to resuscitate the project, but timing worked against them when the recession hit, she said.

Inland, also abbreviated to iComm, a relative newcomer, began buying the foreclosed properties with the aim of completing the project.

The city finds itself back in the same situation despite efforts by iComm to bring the project back to life.

iComm purchased many of the properties out of foreclosure, forming separate limited liability corporations, some backed by loans and others with investors, Fox said.

The Los Angeles-based residential land development company develops everything from raw land to finished lots. On its website, it also lists as a specialty non-performing loans secured by distressed residential land assets.

IComm has been working on obtaining entitlements – approvals from the various city and state regulatory agencies necessary to build out the remaining lots, Fox said. Prior to iComm acquiring parts of the master-planned community, much of the infrastructure had been completed including a community center and a park.

Jim Ahmed, iComm's CEO, did not respond to phone calls.

Law firm Green, de Bortnowsky & Quintanilla, LLP was hired to handle the disclosures in 2014 and today.

"Portions of the project are still moving forward," Fox said. "The portions that are not moving forward are the parcels that we are initiating foreclosure proceedings on."

The filings showed that 205 of 342 parcels or 78.7% were delinquent in September, but that number has been reduced to 91 parcels or 66%, according to disclosure filings.

Burnett Development Corp. began construction on the project in late 1999 and completed most of the backbone infrastructure in the first four phases of the master plan, according to information on IComm's website. Burnett began to have financial troubles in 2002 and World Development took over as master developer the following year. Sections of the project were sold to merchant builders. World Development partnered with Capstone Advisors in 2004 as an equity partner.

"We have a community of homes with a potential of 1,300 or 1,400 homes and a couple hundred homes have been built," Fox said. "We aren't financially obligated for the bonds, but it impacts the city from the standpoint that it could become blighted."

iComm has not added any new houses, but it rehabbed the community center and common areas and worked with the homeowners' association board on some items, Fox said.

"They have made a significant enough investment to make it successful," she said. "They just need more time and the market has not been in their favor as of yet."

The Palm Springs-Cathedral City-Rancho Mirage area has experienced some construction of infill projects, but hasn't experienced much traction with new home development, Fox said.

Larry Kosmont, founder of the development and government consultancy that is working with the Cathedral City to sell properties held by its former redevelopment agency, says right now is a good time to be working through entitlements.

The timing is right because replacement costs to build new houses are close to the price on a square footage basis of purchasing existing housing stock, said Kosmont, who isn't working with the city on the Verano project.

The Coachella Valley is a retirement and resort community with little industry , and most of the jobs are in retail and hospitality, Kosmont said.

"Cathedral City is a middle class to working class community subject to the housing cycles," Kosmont said. "A lot of folks live there by choice for retirement," but it's less attractive to potential working-age homeowners because jobs aren't there, he said.

Kosmont said housing starts are picking up in California suburban markets, though exurban markets like Cathedral City can take longer to spark.

"We are seeing older projects coming back now that have busted up Mello-Roos – projects that started before the recession hit," Kosmont said.

Bill Huck, who founded San Diego-based Common Bond Capital Partners in 2012 to rehabilitate projects similar to Verano, said the desert economy in that area seems quite healthy.

He's not familiar with what hurdles the developer may be experiencing on Verano. "One thing is true in general, when these projects get stuck in the mud – it's like the old saw, a rising tide raises all boats – unless it's really stuck in the mud," Huck said. "It could be the economy has come back around, but inertia on the project means it hasn't benefitted."

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