September 3, 2011

Bankruptcy Ruling may Affect CDDs

US Federal Court Bankruptcy judge K. Rodney May confirmed the reorganization plans of property developer Fiddler's Creek LLC, which includes Fiddler's Creek Community Development Districts 1 and 2 as creditors. But owners of Florida community development district bonds (CDDs) have been left in a lurch.

The judge agreed with Fiddler's Creek's argument that bondholders should not be regarded as creditors and therefore do not have legal standing in the case. This judgment might be taken as a precedent in other cases involving developers who frequently rely on tax-exempt bonds (a.k.a. dirt bonds) to fund infrastructure development costs. It has also given Fiddler's the chance to restructure their municipality debt.

This landmark case has become Florida's first bankruptcy case in which the bondholders are not classified as creditors even though the bonds were sold with security linked to the assessment of the land being developed. Currently, $5.1 billion, or 70%, of CDD bonds outstanding from Florida are in default.

Andrew Sanford, Chief Investment officer for ITG Holdings, one of the bondholders of Fiddler's, said, "The [reorganization] plan changed the assessment structure, and the assessments, and we didn't have a say in it. I think it will really be a chilling prospect for a lot of [CDD bond] buyers."

Fiddler's reorganization plan basically restructured the amortization schedule and assessments securing roughly $100 million of defaulted dirt bonds and bondholders could not object.

The recession hit Florida's property sector badly resulting in many housing projects left incomplete except for infrastructure such as roads and utility facilities that were funded by dirt bonds.

Fiddler's LLC was a grandiose project covering almost 4,000 acres for 6,000 residences near Naples and Marco Island. Located in the south-west of Florida, it comprises a variety of housing products like "custom-built luxury homes" as well as a club and spa, tennis courts, swimming pools and one golf course with another being planned later. Some 1,782 homes are built or in construction.

To fund infrastructure costs of public roads and utilities for the project, Fiddler's formed two CDDs that sold 10 series of unrated, uninsured 30-year tax-exempt bonds between 1999 and 2006. These bonds were secured with assessments on the land that are collected on property tax bills through the CDDs, which are overseen by board members who may either be appointed by the developer or elected by homeowners.

Assessment on the land is to be paid by the developer or landowner until the property is sold to the home purchasers, who will then take over payment of the assessment. As it stands, most of Fiddler's assessments have not been paid since October 2008.

Fiddler's was successful in proposing the restructure of the bonds, as well as operations and maintenance costs of the CDD, by capitalizing interest on the bonds and deferring payments by several years. They said the plan would result in bondholders being paid in full.