



## **Community Development Districts: Financial and Accountability Issues**

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*This report summarizes financial and accountability issues involving community development districts in Florida. The information in this report reflects data from FY 2011-2012. Sarah Ayers, consultant to the LeRoy Collins Institute, is the author; Robert Eger and Joseph Vonasek provided financial data and Ken van Assenderp generously shared valuable insights and made substantive contributions\*. In 2014 the legislature passed and the governor signed SB 1632, an act which reorganized and renumbered provisions within Chapter 189 F.S. The law did not change the state substantive law and law-based policy on districts and, therefore, the substantive and policy discussions and recommendations in this report apply fully and are unaffected.*

The financial health of governments is of great importance to society, and special districts are no exception. These local units of government play a vital role in the provision of a variety of public works throughout the state of Florida, and when their financial stability is threatened, so is their ability to deliver those services.

Research on Florida's special districts reveals that many are in a state of financial decline since the Great Recession, with Community Development Districts (CDDs) demonstrating the most severe problems.<sup>1</sup> Data infer that the 2008 collapse of the real estate market may be the key causal factor of the growing financial decline in CDDs. This report addresses the decline in Florida's CDDs seeking to explain the nature of the fiscal problems. Focusing on the 221 CDDs that are currently experiencing at least some level of fiscal distress (defined as any sustained deviance from regularly meeting financial obligations such as debt service payments), our analysis identifies two important observations that policy makers and the general public should be aware of:

- Notwithstanding expressed legal requirements in the state-created charter and other related general laws, there are structural inadequacies that have enhanced the impact of the financial decline of CDDs.<sup>2</sup> Such structural inadequacies include: (1) uninformed and counterproductive sales and marketing of parcels; (2) ineffective ongoing financial disclosure; (3) "over-leveraged" non-ad valorem assessments imposed and levied on real property by district boards; (4) inadequate and ineffective validation proceedings; and (5) unclear disclosure of the demarcation between home owner associations and CDDs.

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- Notwithstanding expressed legal requirements, the relationship of CDDs to state and local governments is tenuous with two basic problems. For various reasons, there is little use, reliance and enforcement of reporting from CDDs to state and local governments. This has eroded the ability of state and local governments to exercise applicable oversight
- available through existing law and has led to an ineffective compliance system where limited consequences are applied when CDDs fail to submit the required reports. Next is the extent to which CDDs are or can be held accountable by any other entity for their compliance requirements and financial soundness. The major legislative reforms that occurred in the 1980s were predicated on accountability. We find inconsistencies concerning the degree to which CDDs are held accountable by outside entities. On one hand, CDDs are established as autonomous special purpose local governments, independent from the state and local general purpose governing authorities. On the other hand, as with all local governments, CDDs are subject to all applicable state laws and processes. Accountability of CDDs is, to the extent that state government has involvement with the operations of CDDs, poorly defined and fragmented. We identify the fragmentation noting that seven different arms of the state possess some involvement or decision-making with CDDs.

Structural inadequacies and fragmented accountability may be related to the financial decline of CDDs, raising questions about what, if any, the response of the state should be. While the growing financial distress that has emerged in conjunction with the fall of the real estate market appears to be an unprecedented problem for CDDs, it is unclear how CDDs are accountable, when they experience property foreclosure, or the developer of lands within the District experiences bankruptcy, thereby leaving the District with limited revenue sources to amortize its debt. One direct state response is imposed if the CDD itself seeks bankruptcy, the CDD must seek approval from the Governor.

Finally, with the rise of financial declines, the accountability issue of faltering compliance with reporting has also emerged. As with all units of government, state law requires CDDs to report annually on their finances, and our research shows that there has been a noticeable decline in reporting since the 2005-2006 fiscal year. In short, this analysis finds that:

- About 40% of the state's 575 CDDs are experiencing some degree of financial or fiscal distress.
- Financial declines of CDDs appear to be more severe compared to other types of special districts.
- The difficulties of many CDDs may flow from the 2008 decline of the real estate market, although some were experiencing problems prior to this.
- CDDs established between 2003 and 2007 are most likely to be in financial distress.
- CDD foreclosures and developer defaults appear to represent uncharted territory for Florida courts, as seen by contradictory treatment in recent cases, which may complicate efforts to improve this system of local government.
- There is a lack of uniformity among state officials and agencies regarding the definition of financial distress, and its implications.
- Seven different arms of the state possess some role of oversight or monitoring over CDDs, but no single agency has meaningful authority to respond.

- Legislative retooling for CDDs does not appear to be a high priority for elected officials, but should be on the radar of Floridians because there could be tax, assessment, infrastructure, and service implications of any legislation.
- Current accountability issues mirror the findings of 1995 Office of Program Policy Analysis and Government Accountability (OPPAGA) review.

This report flows from ongoing research by the LeRoy Collins Institute on state-local relationships in Florida. Though special districts--especially CDDs--are local governments with one or more special purposes, distinguishing them from general purpose local governments, they are largely understudied and even ignored, although important reforms occurring in the 1980s and discussed in the Collins Institute report on special districts, "Piecing Together the Governing Puzzle: An Exploration of Florida's Special Districts" have been presented. Our effort here focuses on the financial viability and accountability of CDDs. We conclude that there are some red flags regarding CDD financial status and accountability that would indicate a response from state legislators and the public at large.

Our work complements that of the Governor's Office of Policy and Budget that is reviewing all of Florida's special districts pursuant to Executive Order Number 12-10, issued by Governor Rick Scott in January 2012.<sup>3</sup> This review of special districts is designed to examine efficiency and accountability in governance, with published reports on mosquito control, fire control/rescue, and expressway and bridge districts.<sup>4</sup> The governor's review appears to share our goal of providing updated assessments while contributing to Florida's existing body of knowledge on a unit of government that is understudied.

Our findings mirror those of an OPPAGA study<sup>5</sup> issued nearly 20 years ago. The OPPAGA report looked at all independent special districts, including CDDs, and concluded that, depending upon the special purpose, some special districts may not be the best option for providing services and infrastructure. There is conflicting evidence on whether fragmented service is cost-efficient and that non-compliance with reporting is not being properly enforced. While special districts are not the most salient issue for policymakers and citizens, our view is that the state-local relationships within CDDs are important, and, especially given their long-standing nature, merit a more current review in view of the decades since the major reforms of the 1980s.

This report serves as a contribution to that goal, and provides the following content:

- Background regarding CDD creation by law, their structure, and operation.
- An examination of the financial distress of CDDs, specifically:
  - Describing how and when the financial declines began
  - Quantifying and defining financial distress
- A description of the accountability of CDDs,
  - The relationships among CDDs and the state
  - The reporting requirements of CDDs
  - The possible ramifications and implications
- Examination of CDD financial and accountability considerations
- A geographical context for financially distressed CDDs
- More specific focus on CDDs' structural, intergovernmental, financial and accountability considerations
- Questions and practical concerns based on financial and accountability findings
- The future of CDDs

## **The Creation, Establishment, Operation, and Structure of CDDs**

There are about 1,635 special districts operating in Florida, 575 of which are Community Development Districts (CDDs). CDDs operate under the authority of, as created and chartered by, Chapter 190, Florida Statutes. In addition, some requirements of Chapter 189 apply to CDDs. The Department of Economic Opportunity (DEO), Division of Community Development, which also has some authority over these districts, provides on its website a Chapter 189-based definition, ". . . a local unit of special purpose, as opposed to general-purpose, government within a limited boundary, created by general law, special act, local ordinance, or by rule of the Governor and Cabinet." (Section 189.403(1), Florida Statutes).<sup>6</sup> Interestingly, this definition is flawed because, as pointed out elsewhere, only the Legislature may create an independent district by or pursuant to general law. CDDs, created and chartered by Chapter 190, are only established on real property by rule or ordinance.

According to DEO, "special districts are very similar to municipalities and counties in that they all have governing boards with policy-making powers, provide essential governmental services and facilities, and operate in a limited geographical area." They differ from general purpose governments in that they only "provide local, specialized governmental services, and have very limited, related, and specific prescribed powers to carry out their limited special purpose." CDDs, in particular, are special districts whose limited single special purpose is to act as an alternative mechanism to manage the provision of infrastructure systems, facilities and services to the real property within a community development.

As population growth has been a prominent issue in Florida over the past four decades, the state and local general purpose governments have increasingly embraced the CDD model as a way of managing the provision of infrastructure. CDDs can benefit general-purpose governments by ensuring that growth in Florida is not borne by the existing population. Special districts pay for themselves by shifting the cost of managing the acquisition, construction, maintenance and financing of infrastructure, systems, facilities, services, communities, and amenities to private real property with benefits to the special district's developers, investors, residents and property owners. As financial pressure has increased on the budgets of local general purpose and state governments, so has their dependence on CDDs. While alleviation of burgeoning infrastructure costs for general purpose governments is not the purpose of CDDs, this is nevertheless a positive externality. The specialized nature of CDDs allows for the provision of infrastructure systems, facilities, and services that are enhanced beyond what the local general-purpose government may be able or willing to provide. Thus, CDDs serve as a mutually beneficial model of governance among existing governments, investors, developers, and district residents.

Statutorily, there are two ways by which CDDs are established: municipalities and counties may pass an ordinance or the Governor and Cabinet may adopt a rule. The law does not define "petitioner". It is usually the developer or a landowner or government initiating the petition for a CDD's establishment. Once the procedural requirements and substantive considerations of the establishment process are completed, the new district functions autonomously because it is an independent special purpose local government.

The process used to establish a “proposed” district of 1,000 or more acres involves the following steps (what technically is “proposed” is the land because the District charter is created already by law):

- A petition is submitted, which includes required information for use by the Florida Land and Water Adjudicatory Commission (FLWAC). The FLWAC is a panel consisting of the Governor and members of the Cabinet, and is charged with handling matters of development and the environment. This petition also includes the consent of landowners to establish the district and is pursuant to a rule, adopted under Chapter 120 by the FLWAC.
- Establishing districts on proposed lands of less than 1,000 acres in size are pursuant to an ordinance adopted by the county commission of the county or the municipality having jurisdiction over the majority of land in the area. However, if the proposed district covers two or more territorial jurisdictions, even if it is less than 1,000 acres, its establishment is pursuant to a rule, in the same fashion as districts that exceed 1,000 acres.<sup>7</sup>
- A copy of this petition is sent to the city or county, along with a filing fee of \$15,000.
- The county or municipality then has the option to hold a public hearing within 45 days, where it expresses support for or objection to the petition. The public hearing must be held at an accessible location and organized with sufficient advertising.
- After all written and oral comments are reviewed, the FLWAC issues a decision on whether to grant or deny the petition. The Commission’s deliberation takes into account factors such as how developable the proposed land is, whether the district would be the best means of delivering the community services to the area, and whether the services and facilities of the potential CDD would conflict with existing services and facilities.
- If the petition is granted, then the CDD is established. All boundaries of the district are officially recognized, and a board of supervisors is appointed within 90 days elected by landowners.

CDDs operate under their state charter in Chapter 190, Florida Statutes<sup>8</sup>, and are governed by a five-member Board of Supervisors. The board members are initially elected by the landowner, usually the developer, and then once the community is composed of residents (who are qualified electors) the board members are elected by qualified electors. Chapter 190 instructs that, “Within 90 days, following the effective date of the rule or ordinance establishing the district, there shall be held a meeting of the landowners of the district for the purpose of electing five supervisors for the district.”<sup>9</sup>

For CDDs less than 5,000 acres, elections of board members by qualified electors occur according to the following provisions:

- The district must be in existence for six years before the qualified elector process starts.
- There must be at least 250 qualified electors residing in the CDD.
- At the next general election, two of the three members who are up for election, are elected by qualified electors to four-year terms.

- The third member up for vote stands for election on an acreage basis to a four-year term.
- Thereafter, the two members whose terms were not up stand for a qualified elector based election to four-year terms.
- Then two years after that, the member who was elected to the four-year term by landowners now transitions to a qualified elector based election.

CDDs 5,000 acres or more use the same criteria and process, except that it begins ten years after the initial appointment in and by the establishing rule or ordinance and requires 500 electors, instead of 250.

Prior to establishment, Chapter 190 instructs the petitioner to provide non-binding estimates of costs based on available data for the proposed construction and services, the distribution, location, and use of the land within the district, as well as estimated regulatory costs. The petitioner must also address the impact of the proposed district on any real property within the external boundaries of the district.

The boards of CDDs possess many expressed general law powers limited to implementing the special purpose. Some of the most important powers include: (1) assessing, imposing and levying assessments; (2) approving budgets; (3) managing the acquisition, construction, operation, maintenance, and financing of the infrastructure systems, facilities and services of real property; (4) controlling the use of funds generated by the district; (5) approving the firing and hiring of key personnel; and (6) financing bond or debt capital improvements.

As provided in their state-created charter, the general and special powers of all CDDs are not only limited by their single special infrastructure management purpose but also by both substantive and procedural limitations of law. The substantive limitations include, for example, complying with, being subject to and functioning consistently with all applicable land use planning and permitting laws. The procedural limitations include expressed compliance with state law on government-in-the-sunshine, public records, ethics, competitive procurement, incurring bonded and other public debt, imposition and levy of revenue, ethics and conflicts of interest.

CDDs are subject to many of the same reporting requirements as cities and counties. They are required to approve and adopt an annual district budget by October 1 of each year. As stated in FL. St. 190.008 2(b), local general-purpose governments do not have any authority over the CDD's budget, but information sharing is a means to enhance collective understanding of each party's operations within a jurisdiction. For example, the local municipality may read through a CDD's budget and express objection to or agreement with certain items, but it cannot ultimately overrule the CDD's actions. The goal here is to prevent duplication or overlapping of services, while still preserving the independence of the special district.

CDDs have been granted infrastructure management powers for acquisition, construction, maintenance, operation and financing. CDDs have a variety of financial tools available to them in executing their special purpose. They can borrow money and issue bonds, levy property taxes, levy non ad valorem special assessments, charge user fees, and issue tax-exempt bonds. The

issuance of tax-exempt bonds is the primary financing mechanism for managing the acquisition or construction of infrastructure. The combined amount of bond financing for Florida's CDDs is approximately \$6.5 billion.<sup>10</sup> Bond amortization allows the district to impose and levy non-ad valorem assessments on property, which are collected primarily by the Tax Collector, and used to secure payment of debt service on the bonds.

In order to carry out their purpose, state law grants CDDs the power to “finance, fund, plan, establish, acquire, construct or reconstruct, enlarge or extend, equip, operate, and maintain systems, facilities, and basic infrastructures” relating, for example, to water, roads, sewer, buses, parking, conservation areas, security, fire control, and any other needs within the district that have received development approval. Use of municipal bonds by the District to acquire and prepare the raw land for development, enables the developer to construct residential and commercial capital. Some capital infrastructure systems, facilities, works and improvements constructed or acquired by the CDD remain owned by the CDD but often some are dedicated to and owned by the applicable county or city while the debt is still amortized by the CDD.

In addition to population growth, high income and state-imposed limits on local governments' fiscal activities have a direct relationship with the rate of growth of the community developments located within CDDs.<sup>11</sup> Population growth is important to CDDs since more people means a need for new communities which require infrastructure. Income also drives the establishment of CDDs because the more prosperous a society becomes, the greater its demand for specialized services. State-imposed limits on general-purpose local governments' financial activities encourage CDD establishment because they relieve some of the financial burden the general purpose government would otherwise assume regarding new development. Since general purpose local governments are often reluctant to raise taxes, CDDs are an alternative way for local governments to meet the public demands that surpass budgetary and political constraints.

There are three alternatives available to provide infrastructure to property, each with different degrees of efficiency and accountability:

- 1) private developer and other private mechanisms with high efficiency but relatively little public accountability;
- 2) general purpose local governments with high public accountability but often low efficiency and;
- 3) independent special purpose local government alternatives, such as CDDs, with relatively high single-purpose efficiency and high accountability requirements of local government.

The substantive context, however, is fundamental. It goes to the essence of the state-created CDD charter's single special purpose. When the CDD manages the construction, acquisition, maintenance, operation and financing of infrastructure to lands on which the county or municipality has planned and permitted the growth, the CDD management is used by, accounted for and relied upon. It is for this purpose that the CDD's capital facilities report is filed annually with the county or municipality where the CDD functions.

### **CDD versus Homeowners Association**

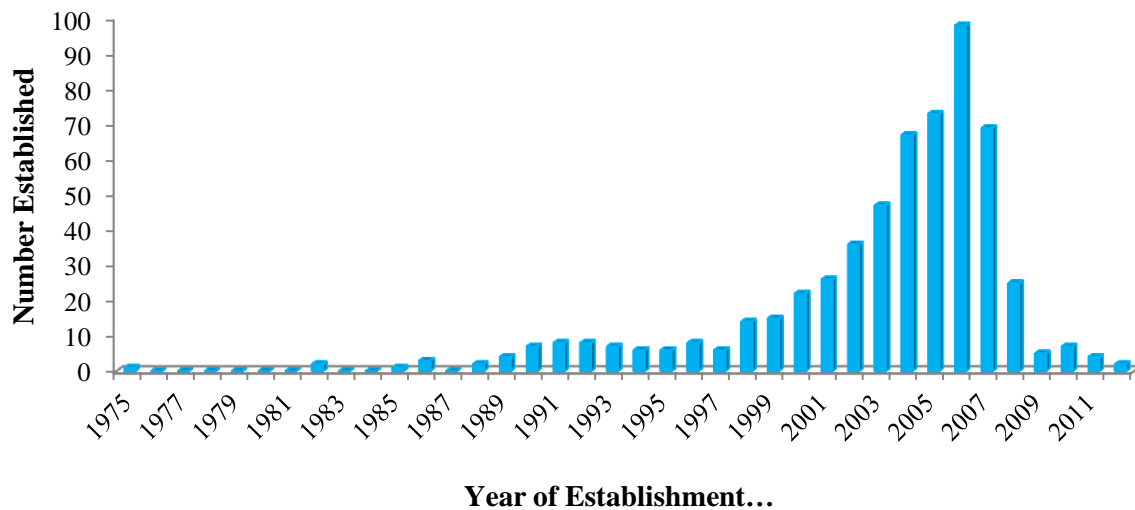
While the CDD is a special purpose government, a homeowner association (HOA) is a private entity established on property by restrictive covenants recorded by developers. HOAs have a focal purpose to manage private commonly owned property and related amenities on behalf of unit owners. They are not governments. In particular, they are not CDDs and are not designed

and organized to manage basic public infrastructure. While there is some practical overlap (for example, landscaping entrance ways or common property), the purpose and use of a homeowners association are not the purpose and use of CDDs projected to provide infrastructure to serve future land use.

### How and When the Financial Distress Began

As real estate growth in Florida entered the new millennia, property values rose at a precipitous rate. Coinciding with the property escalation, CDD establishment increased. The external conditions of rapidly rising home values and poorly regulated banking and lending practices amplified the rate of establishment of CDDs. Between 2003 and 2007, 354 CDD petitions were granted.<sup>12</sup> This is a 213% increase in the number of CDDs established over the previous period between 1998 and 2002. The peak was in 2006, when 98 CDDs were established. On average 71 were established annually over this period. Chart 1 graphically illustrates this dramatic increase. This period of overextension laid the foundation for what are the current accountability and financial problems gripping at least 221 of the districts.

**Number of Florida CDDs Established by Year**



Source: Robert Eger and Joseph Vonasek. 2014.

**Chart 1<sup>13</sup>**

Just as the rise in property values accelerated CDD establishment, the fall in values put the brakes on new community developments and the related use of CDDs to manage the provision of infrastructure. In 2009 and after, the number of new CDDs established each year was in the single digits. Some CDDs—especially the newer ones containing unsold properties—found themselves unable to collect sufficient assessment amounts, due to fewer new residents buying property in the communities and existing homeowners unable to make their mortgage payments.

The New Port Richey based CDD, Longleaf, embodies this scenario. In 2006, this district defaulted on over \$23 million in bonds amid depressed property sales.<sup>14</sup> Even when lots, houses,



and commercial buildings in a CDD are unsold, the developers are still responsible for payments on the properties and must decide whether to attempt to cover the payments themselves, or walk away. As a result, a number of CDDs in 2012 were in default, the land associated with the district has been foreclosed upon. CDD remedies to this economic situation include the use of sold tax certificates and tax deeds to get the delinquent assessments to use to pay the bond payments, or debt restructuring.

Debt restructuring, as a remedy in times of financial stress, has experienced varying success and should be studied through an effectiveness lens toward remedies in future times of stress. Using the effectiveness lens, unsold property not only hurts the developer, and the banks that made construction loans, but also impacts existing district landowners some of whom are residents.

When bond payments are not made, the maintenance of the infrastructure within CDDs (which is not funded by assessments to amortize bond financing but rather by operations and maintenance assessments) might be hampered as well. This further erodes the already dwindling property values and drives away potential buyers. It is important to note that these effects are not confined solely to developments that use CDDs. CDDs are not structured to uniquely usher in these problems but appear to be experiencing distress like many other property developments. While some CDDs established since 2003 have been able to maintain their fiscal integrity, it is in the interest of Floridians to understand the extent to which so many are deteriorating, whether the issue is temporary or more long-standing, and how the existing protections of law may not be applied or disclosures made.

As evidence of the impact of the housing market decline on CDDs, between the years 2007 and 2010, CDDs demonstrated weaker financial standing compared to other special district types, such as fire districts and governor-appointed boards (Eger and Vonasek 2014). A strong real estate market is an essential ingredient in the CDDs' ability to retire the large amounts of debt incurred. Once this supporting factor disappeared, many CDDs found themselves without the means to make debt service payments on the bonds and provide services.

### **Quantifying and Defining Financial Distress**

The structure of CDDs, as it relates to their relationships with other governmental units, consists of an assorted network of information that stems from a wide variety of governmental sources. In addition to the complexity of how CDDs are structured, the inconsistent public awareness about how they operate compounds the challenge of pinpointing where they stand financially and legally. Though there is a variety of opinion regarding when a CDD is considered to be in financial distress, its definition and identification in this report derive from four sources: (1) the Electronic Municipal Market Access (EMMA) database that operates under the Municipal Securities Rulemaking Board (MSRB), which is overseen by the Securities and Exchange Commission (SEC); (2) the state's various determinations of the existence of financial problems; (3) the independent deductions made by the contributors to this report; and (4) the findings published online by securities expert Richard Lehmann. Though continued research into these issues is needed, this report seeks to describe the findings to date.

The starting point for our investigation was accessing a list of CDDs experiencing financial problems identified by noted default authority Richard Lehmann.<sup>15</sup> He is the author of the website, FloridaCDDReport.com, which tracks the financial status of all Florida CDDs.

Financial default occurs anytime a CDD is unable to make its debt service – that is to say, not paying the principal and/or interest payments on the bonds, without drawing from debt service reserves. Out of the 575 CDDs in Florida in 2012, Lehmann identified 221 as demonstrating some form of financial irregularities (these data were not verified and confirmed by the Collins Institute). These 221 are divided into seven categories, according to their most recently observed financial status. For example, the land associated with Amelia Concourse CDD, a 1,300-acre development in Nassau County, went into foreclosure in 2009<sup>16</sup> and is classified in category Default 1D. The following table outlines these seven categories and the number of CDDs that fall into each of them:

|                              | Status      | Description   | Count |
|------------------------------|-------------|---|-------|
| 1                            | Default 1D  | Foreclosure on properties has begun                 | 31    |
| 2                            | Default 1A  | Debt service reserve has been tapped                | 34    |
| 3                            | Default 1C  | In arrears on receipt of assessment payment         | 2     |
| 4                            | Default 1BI | In default on interest payments                     | 76    |
| 5                            | Default 2A  | Bankruptcy filed by builder or landowner            | 14    |
| 6                            | Default 1BP | In default on principal payments                    | 7     |
| 7                            | Watch List  | In danger of defaulting in the future <sup>17</sup> | 57    |
|                              | Total       |   | 221   |
| Source: FloridaCDDReport.com |             |   |       |

In terms of the number of districts, Lehmann’s data suggest that 38% of CDDs are either in default or are likely to default in the coming years. When the financial picture is viewed in terms of dollars, Lehmann estimates that about \$5.1 billion in CDD bonds are in default, which equates to about 75% of the estimated \$6.5 billion total debt.<sup>18</sup> What these data underscore is the variance in estimates regarding the extent of financial decline occurring with CDDs.

Verification of the accuracy of the financial data presented by Lehmann is achieved by comparing Lehmann’s data to the CDDs’ audits on the Auditor General’s website: <http://www.myflorida.com/audgen/pages/specialdistricts%20ac.htm>. Here, CDDs (along with other special districts) are organized alphabetically with links to their audits listed by date in descending order. These audits are performed by private, independent CPAs, who are required to assess the districts’ financial information and issue an opinion on whether financial emergency conditions exist, or if deteriorating financial conditions exist. For every CDD that is classified by Lehmann as experiencing some degree of financial instability, their audits were examined individually to verify that those financial problems currently exist. We find that Lehmann’s conclusions are supported by the CDD audits. At least 221 CDDs are experiencing varying levels of financial distress and the totals among the various categories were largely accurate. However, again, the CDDs’ financial picture becomes blurry when trying to ascertain the most current and most specific state of the CDDs. Because the unraveling of some CDDs is actively occurring, and the real estate market’s future state has yet to show a substantial turnaround, pinpointing the specific status requires continued monitoring. CDDs that fell into distress in 2011-2012 may not be reflected on this website, and, to the extent they exist, would add to this 221 figure. Alternatively, CDDs might have emerged from their financial difficulties over the past two years.

Two caveats should be made regarding the use of this data. First, the information is not used in any official capacity by state agencies; Lehmann’s research is independently conducted and the

website is independently operated. Second, the data are not fully updated, and the most current status of CDDs is not represented.

To view the financial health of these 221 CDDs using an accounting perspective, the following table lists the districts’ mean net assets, mean debt, and mean cash on hand from fiscal year 2010-2011.<sup>19</sup> This table illustrates that the issue of defaulting CDDs is important because they collectively shoulder a substantial amount of municipal debt, and if they continue to demonstrate an inability to retire it, then the logical question becomes: “because under the law neither the state or applicable county or municipality (or their taxpayers) where the CDD is located pays for it, what else can be done to address this phenomenon?”

| Mean Assets, Debt, and Cash on Hand for 221 Distressed CDDs |             |                 |               |                   |
|---|-------------|-----------------|---------------|-------------------|
|   | Status      | Mean Net Assets | Mean Debt     | Mean Cash on Hand |
| 1   | Default 1D  | (2,990,108.77)  | 23,118,110.68 | 290,068.45        |
| 2   | Default 1A  | (203,324.82)    | 15,947,711.82 | 260,134.91        |
| 3   | Default 1C  | (3,517,794.50)  | 6,490,000.00  | 55,919.50         |
| 4   | Default 1BI | (1,151,060.51)  | 23,757,810.51 | 472,634.82        |
| 5   | Default 2A  | 4,612,909.50    | 16,472,662.50 | 927,373.21        |
| 6   | Default 1BP | (2,137,329.14)  | 12,192,142.86 | 122,007.14        |
| 7   | Watch List  | (678,764.98)    | 18,751,960.71 | 659,939.90        |

Source: Florida CDD Financial Audits, as electronically posted by the Auditor General: <http://www.myflorida.com/audgen/pages/specialdistricts%20a-c.htm>, from Fiscal Year 2010-2011, or most recent fiscal year. The total cash on hand for the CDDs within each of the seven categories was averaged.

The significance of mean cash on hand is that it conveys the ability of CDDs to meet their obligations to creditors, whether the creditor is a bond holder, a supplier, or a management firm. That is, some revenue flow, assessments, are used to amortize bonded debt that financed acquisition or construction of infrastructure whereas other assessments are used to pay for CDD management of infrastructure operations and maintenance. Eger and Vonasek’s 2014 research revealed that between 2007 and 2010, CDDs, compared to other special district types, had the most rapidly declining cash on hand. The decline in cash on hand can be viewed as uneventful for a small percentage of CDDs to occasionally experience a cash shortage, regardless of the state of the housing market or their long-term viability. Cash shortages can occur due to revenue timing or bookkeeping issues. However, the four following factors indicate the problem is more substantial: the extent to which cash on hand has dwindled; the number of districts affected; the rate at which it occurred; and how it happened more noticeably with CDDs compared to other types of special districts.

In summary, this portion of the research reveals that, using Lehmann’s information, at least 38% of CDDs are in default or are experiencing events of default. The individual financial audits filed by CDDs serve as verification of this financial trouble. Our data show a direct relationship

between the rate of establishment of CDDs and the strength of the real estate market. Unprecedented levels of CDDs were established between 2003 and 2007, and hindsight shows this growth represented, in part, financial overextension. A number of CDDs are not making timely payments on debt and are failing to complete proposed infrastructure development.

## **Defining Financial Distress**

Seven different units of the state<sup>20</sup> have some role of oversight over CDDs, however, there is no uniformity concerning the definition of financial distress and how it is handled when it comes to CDDs.

The Special District Information Program monitors, oversees, and communicates with CDDs. DEO maintains a comprehensive list of all CDDs (as well as all special districts) on its website, and provides what is called the Florida Special Districts Handbook, which serves as a guidebook for all special districts in complying with the law. Specifically, the Uniform Special District Accountability Act of 1989 delineates all the operational requirements for special districts. The Special District Information Program collects, maintains, and updates information about all types of special districts, including CDDs, and makes uniform special district information available via the Official List of Special Districts Online so that state, legislative, local agencies and the public can monitor and communicate with special districts. To help special districts comply with the requirements of the Uniform Special District Accountability Act of 1989, the program produces the Florida Special Districts Handbook Online.<sup>21</sup>

- The Program has technical assistance and enforcement responsibilities when special districts fail to comply with the Annual Financial Report to the Department of Financial Services and /or the Annual Financial Audit Report to the Auditor General. When noncompliance occurs:
  - The Department of Financial Services and / or the Auditor General notify the program.
  - The Program sends a certified technical assistance letter to the special district to (1) help the special district understand its requirements and, (2) avoid the noncompliance in the future. The letter also provides a statutory required 60-day deadline by which the special district must file the required report or explain why it is unable to meet that deadline. The letter explains what will happen if the special district does not comply with the requirements.
  - The Joint Legislative Auditing Committee meets to discuss any special district that does not meet the deadline imposed in the letter or explain why it is unable to meet the deadline. Depending on the situation, the committee may approve a motion to:
    - direct the Program to declare the special district inactive for dissolution;
    - direct the Program to initiate court enforcement to compel the special district to produce the missing report;
    - delay action;
    - direct committee staff to continue to monitor the district; or
    - some other action.

When it comes to the role of the Auditor General, it can be seen that the state's definition of financial distress is more narrowly defined than Lehmann's FloridaCDDReport.com website, and these financial parameters are defined in s. 218.503 (1), F.S. CDDs are required to annually submit to Florida's Auditor General independently-performed audits within nine months after the end of the fiscal year.<sup>22</sup> One of the objectives of these audits is to see whether the district has met any financial emergency conditions, which the CPA is required to note.<sup>23</sup> These are statutorily defined as being any of the following:

- Failure, within the same fiscal year in which due, to pay short-term loans or failure to make bond debt service or other long-term payments when due, as a result of a lack of funds;
- Failure to pay uncontested claims from creditors within 90 days after the claim is presented, as a result of a lack of funds;
- Failure to transfer at the appropriate time, due to a lack of funds;
- Taxes withheld on the income of employees; or
- Employer and employee contributions for:
  - Federal social security; or
  - Any pension, retirement, or benefit plan of an employee.
- Failure to pay wages and salaries owed to employees; or
- Retirement benefits owed to former employees.

Florida recognizes a second standard, as well. State law makes a distinction between a CDD meeting a **financial emergency condition** and **“being in a state of financial emergency.”** According to the Joint Legislative Auditing Committee, “Prior to 2004, there was no distinction. Since the approval of Chapter 2004-305, L.O.F., the Governor is required to review the circumstances of each entity that has met a condition of a financial emergency and make a determination as to whether state assistance is needed. If state assistance is deemed necessary, the entity is declared to be in a state of financial emergency.”<sup>24</sup> This review is not limited to CDDs; State assistance can take the following forms:<sup>25</sup>

- Requiring approval of the entity's budget by the Governor;
- Authorizing a state loan to an entity and providing for repayment of same;
- Prohibiting an entity from issuing bonds, notes, certificates of indebtedness, or any other form of debt until such time as the entity is no longer subject to this section of law;
- Making inspections and reviewing records, information, reports, and assets of the entity;
- Consulting with officials and auditors of the entity regarding any steps necessary to bring the accounts, accounting systems, financial procedures, and reports into compliance with state laws;
- Providing technical assistance to the entity;
- Establishing a financial emergency board to oversee the activities of the entity; or
- Requiring and approving a plan, prepared by officials of the entity in consultation with the appropriate state officials, prescribing actions that will cause the entity to no longer be subject to this section of law.

The table below reflects the number of special districts that have met one or more condition(s) of financial emergency in the last five fiscal years, or their auditors noted financial difficulties of

some kind. Though CDDs are not differentiated in this chart from other types of independent special districts, the website notes that, “the majority of the special districts reported in the table are Community Development Districts.”

| <b>Fiscal Year</b> | <b>Number of Special Districts that met one or more conditions of a financial emergency or auditors noted financial difficulties</b> | <b>Comments</b>   |
|--------------------|--|---|
| 2007-08            | 83   | The Governor's Office has determined that 45 of these special districts do not need state assistance.                     |
| 2008-09            | 108  | The Governor's Office has determined that 15 of these special districts do not need state assistance.                     |
| 2009-10            | 149  | The Governor's Office has determined that 13 of these special districts do not need state assistance.                     |
| 2010-11            | 127  | The Governor's Office has determined that 11 of these special districts do not need state assistance.                     |
| 2011-12            | 92   | The Governor's Office has not made a determination if these special districts need state assistance for this fiscal year. |

Source: Official Site of the Florida Legislature. [http://www.leg.state.fl.us/cgi-bin/View\\_Page.pl?File=financialemergencies.cfm&Directory=committees/joint/Jcla/&Tab=committees](http://www.leg.state.fl.us/cgi-bin/View_Page.pl?File=financialemergencies.cfm&Directory=committees/joint/Jcla/&Tab=committees) Accessed 04/27/2014.

Not all forms of state assistance are available to CDDs, however. Discussions with special districts’ staff have revealed that state monetary assistance is not a viable option in attempting to rehabilitate financially struggling CDDs. State funds, which can come in the form of grants and surtaxes, among other forms, are available to certain special district types, but not CDDs. To the extent that state loans are available to other special district types, they are not defined in terms of dollars or the precise criteria that must be met in order for a district to qualify.

The DEO website states that, “Special districts are more financially secure because ... special districts can receive state assistance in the event of a financial emergency.”<sup>26</sup> The unavailability of state monetary assistance to CDDs somewhat undercuts the definition of “state of financial

emergency,” at least when it comes to this type of district. It isolates CDDs from the theoretical financial security of special districts. Acknowledging this distinction and the different statutory safeguards for CDDs is important because it further showcases how nuanced the relationship is between CDDs and the state of Florida.

The rise in defaults with CDDs invites the question of: What happens now? CDDs are established on the premise that they are financially independent from the state, as the investors, developers, and CDD residents assume the financial risk associated with the district. Though this independence is regarded as an advantageous form of governance, can we expect CDD problems to stay self-contained? At what point, if ever, does the impact of rising CDD defaults become a public problem?

Understanding how CDDs are structured and financed helps illuminate who wins and who loses with growing defaults as a result of the 2008 recession. CDDs’ debts are secured by the land within the District. A lien exists on the property (initially the property of the developer in the usual case) as a means of ensuring that the municipal bonds will be paid back. The developer and other property owners are responsible for paying these assessments on the debt until lots and houses can be sold. As these sales are made, the new landowners (mostly residents) begin to pay their assessments. CDD residents’ shares are not determined by the value of the properties they’ve purchased, as ad valorem taxes are calculated; the special assessment amounts are determined by the special benefits apportioned peculiar to the property. The assessments are for bond debt service and operations and maintenance (O&M). The bond debt service assessment amortizes the District's bonds, and the O&M assessment funds the District's annual O&M activities. In the event of a CDD’s inability of the developer or initial landowner to fully sell property and establish a sufficient base of assessment-paying residents, land upon which the lien of the CDD is assessed is what investors can fall back on for recourse.

In better economic times, investors choose to buy CDD bonds because a strong real estate market helps promise a safe return. The revenue bonds that finance CDD infrastructure are exempt from federal taxes. While HOAs provide amenities and CDDs provide infrastructure, both can attract investors. Though these bonds are not rated and Florida law caps the yields that new bond issues can offer, the advantages have historically outweighed the risks.

The landscape of the CDD bond market has dramatically changed since the economic and real estate downturn. These bonds were no longer seen as attractive investment instruments. There are reasons to believe that many investors have been burned by the millions of dollars lost in the real estate collapse, and CDD bonds will not be purchased in the future at the same pace. Heritage Isles CDD, in Tampa, defaulted in 2008, and the bondholders ultimately sold their bonds for 25 cents on the dollar to the district as a way to settle the debt.<sup>27</sup>

The IRS is investigating the tax-free status of certain CDDs, and this is causing bond counsels to be duty bound to disclose fully the IRS report and its status in order to write opinions. Since 2009, the Villages Community Development Districts have been scrutinized by the IRS regarding whether some of the assets bought by a tax-free bond were eligible for this exemption.<sup>28</sup> The legal conflict remains unresolved.

The 2011-2012 Annual Report below shows that seven CDDs are currently designated as being in a state of financial emergency.<sup>29</sup>

| <b>Chief Inspector General's 2011-2012 Annual Report: Community Development Districts with Financial Emergency Status</b> |  |   |              |               |                           |
|---|--|---|--------------|---------------|---------------------------|
|   |  | Number of Conditions  | Time on List | Last Reported | Local Governing Authority |
| 1   | Crossings at Fleming Island Community Development District | (3 in FY 10-11)<br>Missed interest payments and debt service payments; uncollected assessments; deficit net assets                  | Since 2001   | FY 10-11      | Clay County               |
| 2   | Fallschase Community Development District                  | (2 in FY 08-09)<br>Deficit fund balance in the general fund and failure to pay creditors within 90 days.                            | Since 2001   | FY 10-11      | Leon County               |
| 3   | Heritage Harbor Community Development District             | No conditions. Declared in a state of financial emergency in FY 06-07.  | Since 2002   | FY 10-11      | Hillsborough County       |
| 4   | Heritage Isles Community Development District              | (2 in FY 10-11)<br>Net asset deficit and failure to meet certain debt service requirements.   | Since 2003   | FY 10-11      | Hillsborough County       |
| 5   | Reserve Community Development District                     | No conditions.  | Since 2001   | FY 10-11      | St. Lucie County          |
| 6   | Stoneybrook Community Development District                 | (2 in FY 10-11)<br>Deficit net assets and failure to meet debt service payments. State of financial emergency declared in FY 05-06. | Since 2002   | FY 10-11      | Lee County                |
| 7   | Viera East Community Development District                  | State of financial emergency declared in FY 05-06.  | Since 2001   | FY 10-11      | Brevard County            |

Source: Executive Office of the Governor; Office of the Chief Inspector General; Annual Report, 2011-2012 [http://www.floridaoig.com/library/Agency/eog/EOG\\_FY2012\\_Annual\\_Report.pdf](http://www.floridaoig.com/library/Agency/eog/EOG_FY2012_Annual_Report.pdf)



In contrast to our finding that CDD default is on the rise due to the 2008 housing market crash, the Chief Inspector General's List of districts in a state of emergency reflects problems that began many years prior to the housing market decline. The seven CDDs listed have all been on the list since between 2001 and 2003, and the number of financial emergency conditions for each of these seven CDDs ranges between 0 and 3. In researching this aspect of the state's handling and treatment of CDDs that are in questionable financial states, we have sought to understand the methodology behind the determination of why certain CDDs rise to the level of necessitating state assistance and others do not. Due to the time period in which these seven districts were added to this list, it is clear that the collapsed real estate market did not fuel their financial decline the way it has for many CDDs established in 2005 and 2006. Therefore, the questions in particular we have made efforts to examine through correspondence with the Chief Inspector General's office are: will any of the approximately 40% of CDDs that have more recently experienced default and other financial problems be reflected on this list in the coming years? Will the decreased real estate market increase the number of districts classified as needing state assistance? If, so, exactly how many CDDs will come under this gubernatorial scrutiny, and what is the time lag associated with the process of making these determinations? Correspondence with state staff did not provide any insight into these questions. Additionally, CDD audits reveal that the term "deteriorating financial conditions" can also be applied to address activities that appear to be troublesome, but fall short of receiving official emergency classifications. CPA opinions can also contain mention of warning signs for the future, without declaring the existence of emergency conditions. For example, the CDD of Aqua Isles is behind in its state reporting, as its last audit submission was for fiscal year 2009-2010. In this report, the CPA notes "warnings trends."

Looking at a CDD that is farther along in its decline is the Villages of Avignon Community Development District in Palmetto. This district, which was established in 2006, initially issued \$2.725 million on bonds, but began defaulting in 2008, according to the Manatee County Clerk of the Circuit Court.<sup>30</sup> In November 2011, it was awarded a \$4.17 million judgment in a foreclosure case against the troubled district developers, 29th Street East Holdings of Palm Beach County. The district's FY 2011-2012 Audited Financial Statement with the Municipal Securities Rulemaking Board (MSRB) notes that no debt service payments have been made since 2008.<sup>31</sup> This district is classified into category Default 1D in Lehmann's database, which represents CDDs experiencing foreclosure. Applying the state's criteria, this district has had deteriorating financial conditions recognized by JLAC for three consecutive fiscal years, from 2008 to 2011. But it has never been deemed "in a state of financial emergency." In JLAC's record of ongoing CDD correspondence, it documents 2009 communication with the district, noting that the "primary developer defaulted on its financial obligations, which caused (the) CDD to default on its outstanding bonds. New ownership entities and funding agreements are in place now." Yet, the Villages of Avignon as recently as fiscal year 2010-2011 had three financial emergency conditions recognized by its CPA in its annual audit, relating to lack of funds, missed payments, and failure to pay creditors. Thus, even with restructured management, the financial future of the Villages of Avignon is questionable and the resulting state treatment of this default is difficult to follow.

The inconsistencies described in this report regarding the state's definitions of CDD financial problems have been observed as far back as 1995, when the OPPAGA issued its Review of Independent Special Districts that Provide Infrastructure and Services to the Public. One of its key findings mirrors the research presented in this report: "...the deteriorating financial condition

of some ISDs (Independent Special Districts) and other local governments may go undetected. The Office of the Auditor General found that, while the statutory criteria for financial emergencies may be valid, their usefulness for detecting fiscal solvency is limited.”<sup>32</sup>

Though the OPPAGA study was published 18 years ago, and several policy adjustments have been affecting CDD requirements in the time since, the significance of this report is that it represents the last official state-sponsored review of independent special districts (which includes CDDs). That nearly two decades have passed since its release underscores one of our findings that these public entities tend to be overlooked and understudied.

Some of the changes to state law on special districts that have occurred since the 1995 OPPAGA publication include<sup>33</sup>:

- In 1997, the following text was added to Chapter 189: “The charter of any newly created special district shall contain and, as practical, the charter of a preexisting special district shall be amended to contain, a reference to the status of the special district as dependent or independent. When necessary, the status statement shall be amended to conform with the DEO’s determination or declaratory statement regarding the status of the district.”<sup>34</sup>
- Also, in 1997, the requirement of a small fee was added, with the following language added to Chapter 189: The state “may assess fines of not more than \$25, with an aggregate total not to exceed \$50, as penalties against special districts that fail to remit required fees to the DEO. It is the intent of the Legislature that general revenue funds will be made available to the DEO to pay one-half of the cost of administering this act.”<sup>35</sup>

In other examples of CDDs in decline, Meadow Pointe IV in Wesley Chapel is foreclosing, and the developers plan to deed the land to creditors. The Tison's Landing Community Development District in Jacksonville filed a lawsuit in 2008 seeking to foreclose on a subdivision developer for not paying assessments to the district.<sup>36</sup> The CDD sought to take possession of land owned by Yellow Bluff Development LLC on Jacksonville's Northside. According to the *Florida Times-Union*, “The property is the Tison's Landing subdivision, a 218-acre tract where the community development district built roads, drainage, water lines, streetlights and a neighborhood recreation center as a welcome mat for the anticipated sale of up to 680 homes. Jacksonville City Council established the community development district in 2005 at the request of Yellow Bluff Development when the residential real estate market was red-hot. The community development district issued \$36.9 million in bonds in early 2006 to develop the property. The work hasn't translated to home sales, however. After Yellow Bluff Development failed to pay its annual assessment to the community development district, the district declared the developer in default and filed the foreclosure suit on June 24, 2008.”

However, these possible consequences exist for any master planned community with or without a district on the property. Moreover, some practitioners and others in the special district community would even suggest that CDDs are better prepared to withstand financial storms compared to non-CDD capital projects. According to CDD expert James Ward, one unique factor that mitigates some of this financial risk is that investors spread the risk around to a greater degree.<sup>37</sup> Also, investors are able to strategically reposition failed communities more quickly than commercial banking institutions. In other words, municipal bond buyers tend to be more sophisticated investors compared to banks, and in the cases of defaulting CDDs, can restructure the debt and find a financial resolution to the defaulted security.

## Accountability

It is important to understand how CDDs are accountable in both times of strong economic health and in times of financial decline. With the health of many of Florida's CDDs in question, it is relevant to understand whether and how to improve accountability, disclosure, preventative and curative provisions in the law. If financial declines persist, what response will – or should – there be by the public and other governmental entities? Investigating the issue of financial distress reveals that CDD establishment, structure, reporting, and monitoring consist of a multi-layered process. The collective monitoring efforts of the Auditor General, DEO, DFS, and the JLAC are the primary entities making up the accountability picture for CDDs.

CDDs have two primary reporting responsibilities: to submit 1) an annual independently-performed audit to the Auditor General and the Department of Financial Services; and 2) an Annual Financial Report (AFR) to the DFS. The CDDs that are required to submit financial audits are those with:

- Revenues, or the total of expenditures and expenses, in excess of \$100,000
- Revenues, or the total of expenditures and expenses, between \$50,000 and \$100,000 that has not been subject to a financial audit pursuant to s. 218.39(1), F.S. for the preceding two fiscal years.<sup>38</sup>

The monitoring of the financial accountability of the CDDs is a function of their reporting. DEO works with the Auditor General's office, which also plays a role in monitoring the districts' affairs, but does not have meaningful authority to compel action. When a district fails to submit its reports in a timely manner, DEO gives technical assistance, which consists of written correspondence to remind the CDD of its responsibilities. The JLAC<sup>39</sup> possesses the power to direct DEO to declare a CDD inactive due to non-compliance with reporting. If a CDD fails to comply with the 60-day deadline, the JLAC also has the power to direct DEO to begin legal proceedings against a CDD to compel compliance or declare it inactive pursuant to the provisions of s. 189.4044, F.S. Few changes resulting from Chapter 2014-22, Laws of Florida have affected Chapter 189.<sup>1</sup>

After its financial review, the Auditor General shares the responsibility with the CDD to notify the JLAC and Governor of irregularities or when any of the financial emergency conditions arise. It is important to note that awareness regarding which districts meet emergency conditions, and the point in time when the financial difficulties first arise, is hindered by the fact that it is up to the districts themselves to proactively communicate this status. What adds to this disconnect is that if a district is experiencing financial problems, it is more likely to lack the operational and administrative capacity to help ensure proper reporting.

The JLAC keeps a master list that documents the communication history with any districts that it has contacted with technical assistance. This document is entitled the, "List of Governmental Entities that have Met a Financial Emergency Condition." An example of the notations recorded on a distressed district reads as follows, "Received letter from district manager - deficit fund balance primarily result of certain construction costs paid by developer on behalf of district - costs were appropriately incurred in anticipation of issuing bonds, but district has decided to

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<sup>1</sup> Chapter 2014-22, Laws of Florida reorganized and renumbered provisions in Florida Statute Chapter 189. This law was approved by Governor Rick Scott May 12, 2014.

delay prospective bond issuance because of current economic conditions.” This master list is separate and distinct from the Chief Inspector General’s list described below.

The Chief Inspector General (CIG) maintains an official list of all government entities that are in a state of financial emergency. This individual is the Governor’s official designee in making this determination. The 2012 list reflects a net of 31 entities, seven of which are CDDs. When districts can demonstrate that they have not met any financial emergency conditions within the past 2 years, the CIG begins a review to determine if they are eligible for release as outlined in Section 218.504, Florida Statutes. Their circumstances are reviewed annually and a determination is made. Gubernatorial approval is required for any districts to be released from this emergency status. One recent example of this involves Yankeetown. This entity was added to the emergency list by executive order of the Governor. Due to improved financial conditions, Yankeetown was officially released in July 2012.

The tools at the disposal of the state for responding to underperforming CDDs, according to DEO, consist of the following courses of action when responding to special districts that have failed to comply with a requirement:

- Citizens can file ethics complaints with the Commission on Ethics
- Counties and municipalities and the Florida Legislature can conduct an oversight review of the district
- The Governor may remove elected or appointed officials under certain circumstances
- The entity that established the special district can amend, merge, or dissolve the special district if it is dependent. If independent, then, in the case of CDDs, the entity that created it is the Legislature, and the establishing entity has no power to alter the charter and any termination must be by or pursuant to general law.
- The state attorney for the area can investigate and prosecute district officials who violate Government-in-the-Sunshine laws.
- The Joint Legislative Auditing Committee can send state auditors to a district if something warrants such action.
- The Joint Legislative Auditing Committee and / or the Department of Management Services can direct the Department of Economic Opportunity to file a petition in Leon County circuit court to compel compliance when special districts fail to file certain financial reports with the state.
- The Department of Economic Opportunity can declare special districts inactive for dissolution.
- 

When it comes to CDDs, in particular, however, not all of these responses are applicable. This list consists of the possible responses to any of the 70+ special district types in Florida, and it is unclear which ones can be used towards CDDs and which ones cannot. Research reveals, however, that the extent to which these actions are executed is questionable. In 2011, legislative changes were implemented that slightly enhanced the JLAC’s authority when responding to non-complying CDDs. The JLAC is now permitted to, in addition to legal action, impose the penalty of withholding state revenue from CDDs (as well as other types of special districts) that do not comply with reporting requirements. However, the effectiveness of this penalty is unclear considering that it appears no state dollars are directed towards CDDs to begin with.

Enforcing reporting requirements has also shown to be a long-standing issue, as OPPAGA documented in its 1995 report. It writes, “...the absence of a cost-effective penalty contributes

to its lack of enforcement of special district reporting requirements.” It is in this context that the expressed requirements in Chapter 190, Florida Statutes, and related laws, are not being followed due to structural and related implementation problems. And, “DCA<sup>40</sup> staff acknowledged that noncompliance is problematic, but pointed out that there is no appropriate penalty available when special districts do not report.”

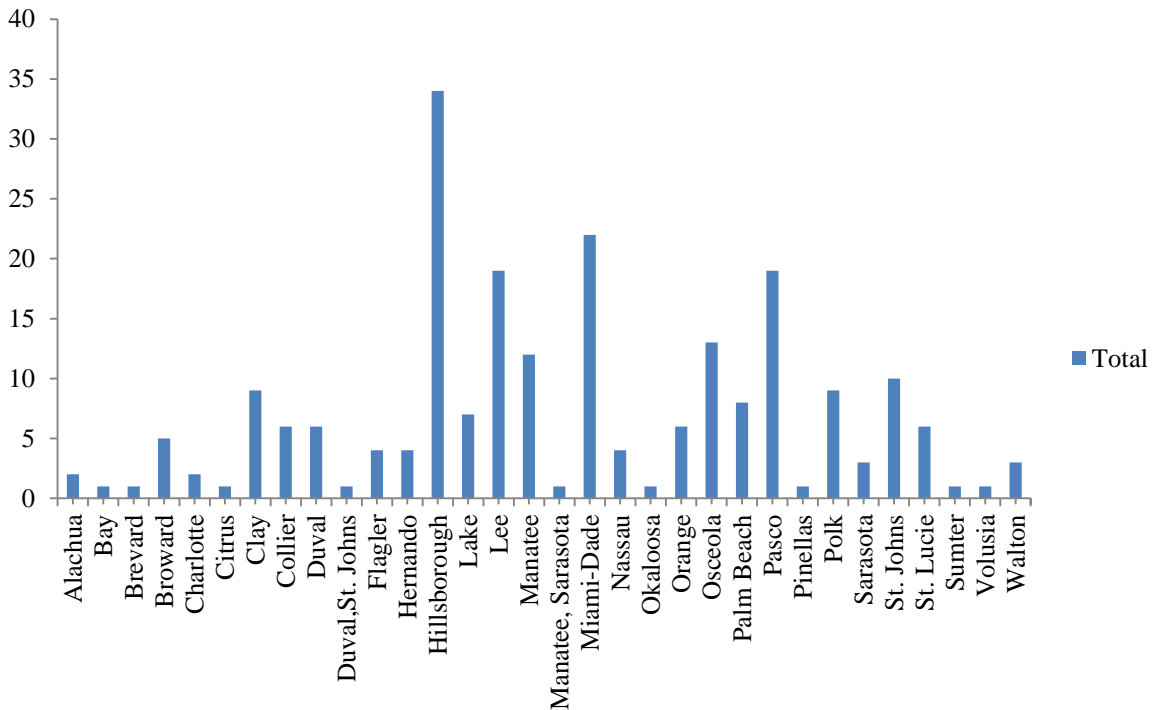
No uniform methods of clear communication exist when what might be considered “normal” operations break down. For example, when CDDs demonstrate erratic financial reporting, their audits reveal financial emergency conditions or missed debt service payments. To the extent that the state involves itself in the affairs of problematic CDDs, the responsibilities are spread out, as opposed to streamlined.

What seems to make for a policy quandary is that the very autonomy that the CDD possess, in order to capture the spirit of local public service, is what is ultimately hindering their ability to be properly managed through the recession. Before so many of the districts began declining, there was much less need to know who was in charge and what the penalties for defaulting were. Now that at least 40% of CDDs are financially stressed, a need exists for a more well-defined source of oversight that possesses a more exacting authority. The Department of Economic Opportunity’s special districts website states that, “Since special districts are separate units of local government - not state or local programs overseen by another level of government - no single state agency or person has the authority to completely oversee special districts.”

### **The Geography of Distressed CDDs**

An understanding of the nature of distressed CDDs is enhanced when looking at it from a geographical perspective. Does the location or region of a CDD play a role in its likelihood to default, or its ability to weather the real estate storm? Charts 2 and 3 shed some light on this issue. Chart 2 groups the known distressed districts by the governing county in which they reside. The results show a disproportionate amount of distressed districts created in the counties of Hillsborough, Miami-Dade, Pasco, and Lee. The counties containing the fewest number of distressed districts include, but are not limited to, Bay, Brevard, Citrus, and Pinellas. Of course, all counties do not have the same number of CDDs and the larger counties with more CDDs will have more defaults.

## Number of Troubled Districts Per County FY 2010-2011



**Chart 2**

Looking at the issue in terms of creation dates, Chart 3 combines total assets and liabilities of these 221 districts, and groups the totals by the year the districts were established. The value in this kind of visual is to show which years have been the worst in terms of net assets for districts created in particular years. The CDDs established in years 2003 through 2006 show liabilities to exceeding assets, which is in clear contrast to the CDDs established in 1997 through 2002, where assets consistently exceeded liabilities. This illustrates the financial downside of CDDs established in the 2003-2006 time period, although this was also a period of great growth in their number. In this period, a booming housing market and rising house prices led to higher debt in CDDs and a dwindling ability to pay for it.

### Troubled CDD Assets and Liabilities Totals by Establishment Year

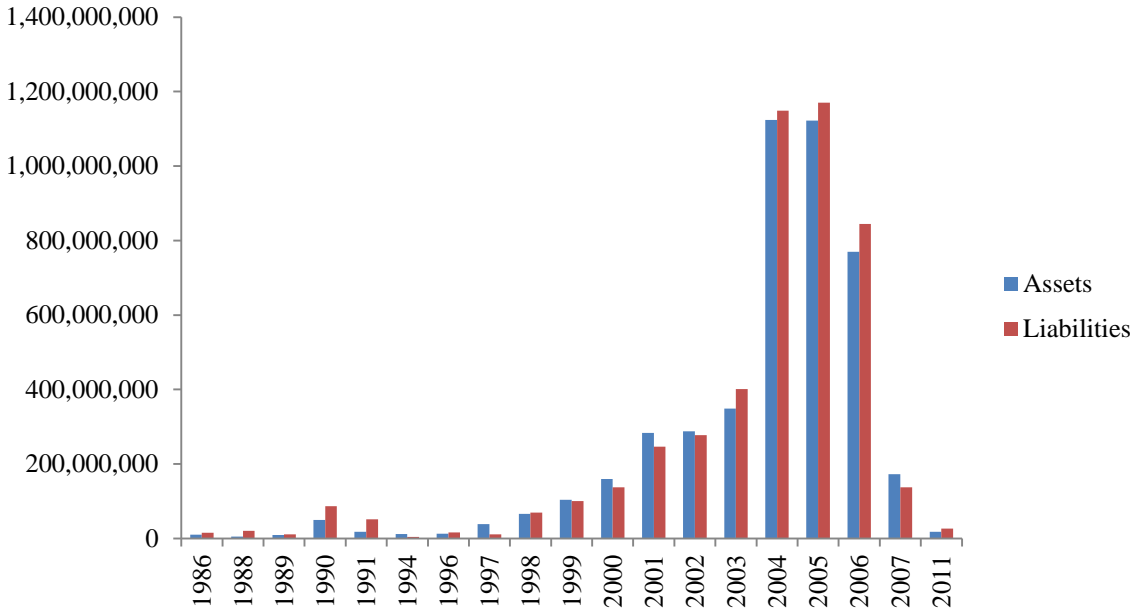
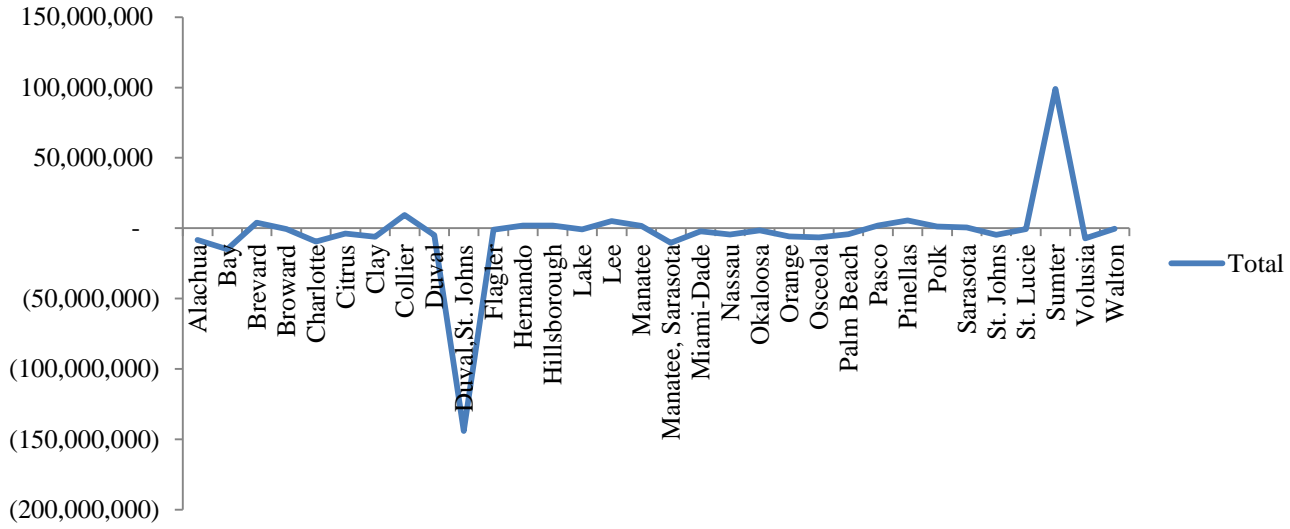


Chart 3

Chart 4 shows mean net assets by county for the 221 CDDs. The value of this graph is to show how variable the severity of distress is, because even counties with a small number of distressed districts can possess a large share of the statewide deficit. The outlier here is the Tolomato CDD which spans both Duval and St. Johns counties and is solely responsible for mean negative net assets of \$144 million. By contrast, though Hillsborough County, at 34, contained the highest number of distressed districts, it shows average assets of about \$1.9 million. A dramatic decline occurred by the next year in the number of districts established, along with a more stable relationship between assets and liabilities. This information would continue to support the housing market theory that there is a direct relationship between the performance of the real estate market and the establishment of CDDs.

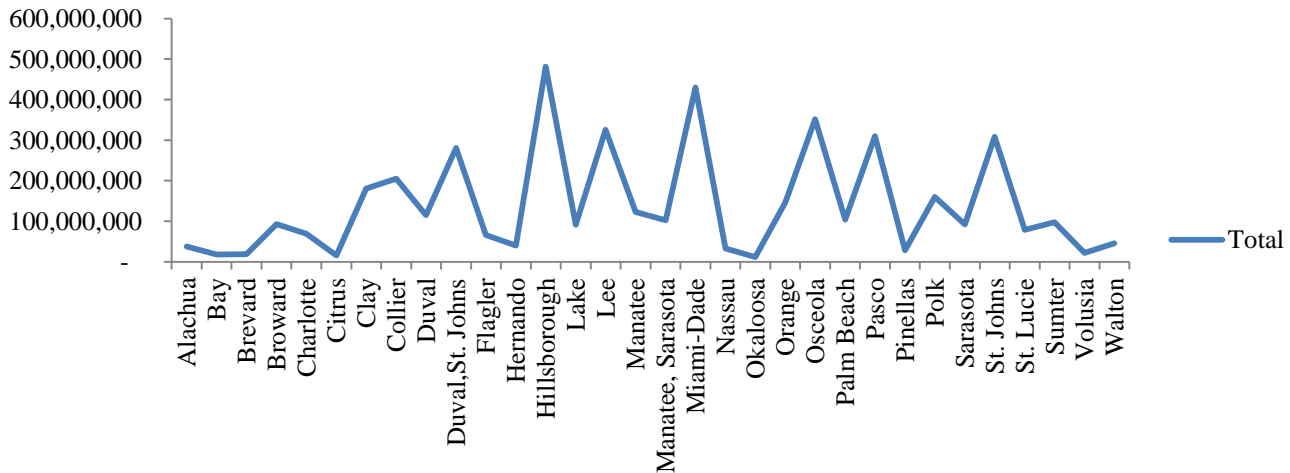
**Mean Net Assets of Troubled CDDs by County for FY 2010-2011**



**Chart 4**

Further demonstrating the variability of the distressed CDD problem are the debt totals by county, which are graphed below in Chart 5. Concentration of debt is seen in Hillsborough, Miami-Dade, Osceola, St. Johns, and Pasco, as well as a few others. The vast majority of debt for CDDs derives from the multi-million, sometimes 30-year, tax-free bonds issued by these special purpose local governments to finance the acquisition or construction of capital projects.

**2011 Outstanding Debt of Troubled CDDs by County**

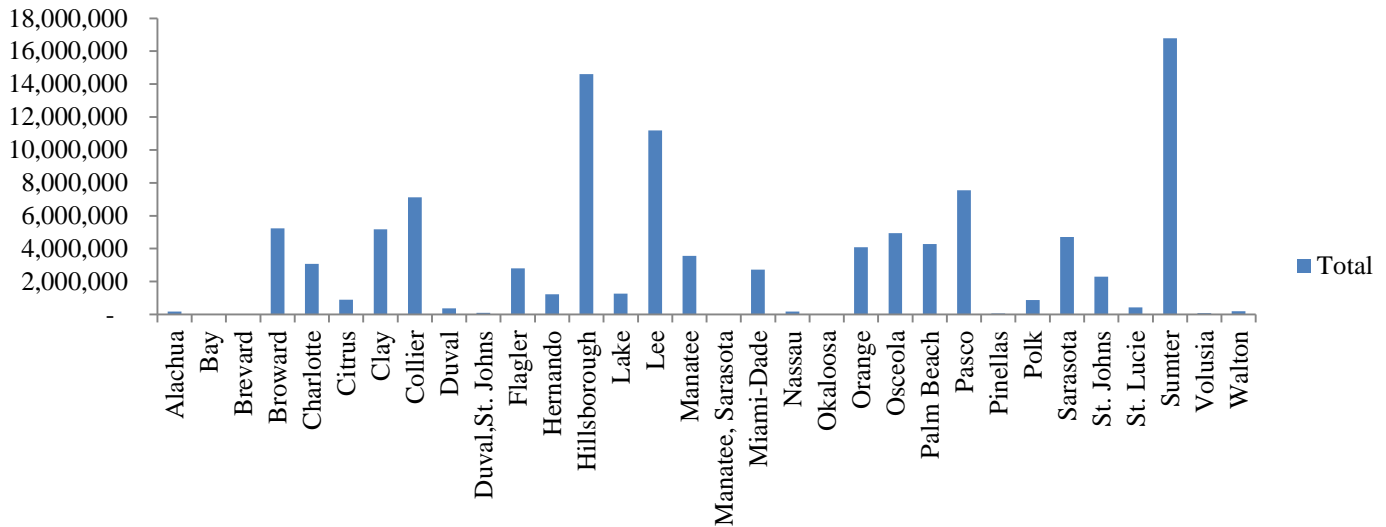


**Chart 5**



Chart 6 shows the average cash on hand by county for fiscal year 2011 for the group of 221 financially distressed districts. The counties of Sumter, Hillsborough, and Lee are shown to be in the best standing, by this basis of evaluation.

**FY 2011 Mean Cash on Hand of CDDs In Financial Distress by County**



**Chart 6**

## Summary

### CDDs’ Structural and Intergovernmental Considerations

To provide considerations and perspectives on the CDDs, so that reforms resulting from the analyses will be practical and efficacious, we note the following:

- The single special purpose of each CDD is to manage and provide basic infrastructure to undeveloped land on which new community development is permitted and planned.
- There are four alternatives available to manage the acquisition, construction, maintenance and financing of basic infrastructure for new communities:
  - Use county or city resources and funding;
  - Use a private developer’s resources and funding;
  - Establish a CDD using its resources and public funding limited to its jurisdiction; or,
  - Use a combination of the above three.

If a CDD is chosen to manage the provision of the infrastructure, then a governing board must be put in place:

- To set up public governing requirements and procedures and to hire management and staff to manage the acquisition, construction, maintenance and financing of the infrastructure; and,
- To prepare and implement a budget, arrange issuance of capital bonds and impose and levy assessments on the land.

Initially, because there are no resident qualified electors living on the undeveloped land to cast any votes, the landowner must elect the governing board members on a one-acre-one-vote basis. Over time, as the District is developed and capital improvements occur on the land, the CDD governing board is replaced. If the CDD is less than 5,000 acres, the District governing board is voted on by qualified voters given that (1) the district must be in existence for 6 years and (2) there must be at least 250 qualified electors residing in the CDD. If the CDD is greater than 5,000 acres the time in existence increases to 10 years and the required number of residents increase to 500.

Once established, CDDs and their governing boards are subjected, similar to all organizations, to changes in the economy. Given the time period of our study, the economic climate for housing and development underwent tremendous changes beginning in 2007. Based upon our data and information, most of the identified financially stressed or defaulting CDDs:

- Involve districts that have been in existence less than 6 years when community development is in the early development stage; and,
- Serve communities in which the number of new residential homeowners who purchased from the developer is small (less than 250 residents) and the landowner-developer still owns most of the property on which the debt assessment is liened.

Our analyses show that if a single CDD is financially stressed or is facing default, the alternatives faced or available today in Florida are:

- If in financial stress, state assistance and aid is technically but rarely available because the risk and the work out options are in tax-exempt bond investors.
- If the financially stressed CDD defaults, the legal options include:
  - Work outs with investors are available and used quite commonly.
  - If assessments are collected by the District and if the homeowner(s) is delinquent, the circuit court may use foreclosure by the District, in coordination with the bond holders and Trustee.
  - If the assessments are collected by the Tax Collector using the uniform collection law and the homeowner is delinquent, then only the use of tax certificate and tax deed procedures are available for a given year.
  - Bankruptcy options are available.

### **Structural Concerns**

In times of financial declines that induce financial stress, structural concerns arise. One aspect is the collection and enforcement of CDD special assessments imposed and levied. The relationship of the District debt to the value of the property becomes skewed in down economic times. Debt assessments remain constant but, due to the economy's impact, the value of the property decreases. This leads to an outcome that the assessment to property value ratios are outside of ordinary limits and the owners can no longer pay the assessments or sell their parcels.

### **Intergovernmental**

The state law requires limited oversight of independent districts. Reports by CDDs to the state and other local governments provide important infrastructure and financing information. However, the receiving governments may not use this information either because of lack of a follow up authority or because they are only required to receive the information. An example is

the facilities report, with annual update. The report is required to be sent to the county or municipality where the CDD is located. While land use in the CDD is preempted exclusively to the county and/or the city, the provision of infrastructure must be coordinated with land use. There is no duty on the county and city to use and to rely on these facility reports (See Section 189.415(1), (2) and (6), Florida Statutes). If these reports are not used and relied upon by the general purpose local governments, the information provided in these reports may impact the ability of the local government to manage their capital facilities budgets and programs.

While independent local governments (counties, municipalities, school boards and special districts) are not supervised, there are various appropriate oversight procedures. Oversight of independent districts authorizes review by the applicable county, but only the government that created the district can revise the created charter. For CDDs, the creating government is the Legislature. There is no practical mechanism in place to implement that oversight.

What are the key issues flowing from this research regarding the future of CDDs?

**1. What can and should be done to mitigate and to ease the impact on stressed and defaulting CDD's?**

We offer the following:

- a. Recognize and understand the importance of state-law reforms of the 1980s.
- b. Consider, review and take action to reduce the oversight issues identified and discussed in this report.
- c. Consider, review, and take action regarding CDD reporting and inter-government relationship identified and discussed in this report.
- d. Take action regarding the inconsistencies in the various general laws as identified, disclosed, and discussed in the Eger and Vonasek report on Special Districts.

**2. What current policies should be reviewed and discussed?**

Consider and assess the following important policy issues:

Oversight of CDDs, as distinguished from oversight of other independent special districts, is best viewed as a method of effective, dynamic and continuing intergovernmental communication of useful information, rather than as a superimposed regulatory effort by state and local government. Such informed decision making is required in oversight (Section 189.438(1), Florida Statutes) requiring communication through reports. The district oversight law today is neither tailor made nor necessarily applicable to CDDs. Oversight requires review by the county or municipality where the CDD is located or by “the government that created the” independent district, Sections 189.428(1), (2) and (3), Florida Statutes. The “government that created” the CDD and its charter is the Florida Legislature, Section 189.4031(2), Florida Statutes, and Sections 190.004(4), 190.005(1)(f) and 190.005(2)(d), Florida Statutes. Therefore, if the review of a CDD is by a county or municipality, it must submit its final report only to the Legislature (which exclusively created the CDD and its charter); and, if the Legislature conducts the review, then it submits its report to itself.

The following changes would improve the operation and accountability of CDDs in Florida:

- The “oversight” provisions in Section 189.428, Florida Statute can be modified.

- To clarify that the government that created and chartered CDDs is the Florida Legislature.
- To provide a practical mechanism by which the Legislature fulfills its oversight duty.
- Require counties or municipalities to use and to rely on the CDDs capital facilities reports (and annual updates) under Section 189.415(6), Florida Statutes.
- Empower and fund the state agencies to assess and to enforce the reports received from the CDD. By way of example: first, fund the agencies in part from substantial fines on CDD officials who fail to file timely and complete information and in part from submission fees; and, second, empowerment of the DEO to assess the reports it received and to enforce its determinations.

## **The Future of CDDs**

The future of CDDs, particularly the ones where the developer is in bankruptcy, is unclear due to the contradictory manner in which Florida courts are treating them, and the unpredictable nature of proposed legislation. In a 2011 Chapter 11 bankruptcy case, Judge Robert Mark allowed the bondholders of the Landmark at Doral CDD to sell off the 120 acres of land contained within the CDD as a means of getting back some of the \$130 million they are owed.<sup>41</sup> The bondholders' rights were asserted in this case, as they were allowed to act as creditors. This legal outcome is in contrast to another bankruptcy case concerning Fiddler's Creek CDD, where one year prior, bankruptcy Judge May came down on the side of the developer, by approving a restructuring of the debt and not allowing the bondholders to act as creditors.<sup>42</sup> It is important to assess and improve the laws dealing with accountability, disclosure, preventative and curative provisions for independent special purpose local governments including CDDs. The Cordoba Ranch CDD is an example of a district where the developer is in the middle of a bankruptcy, and the future of how this fallen community will be handled remains to be seen.

On the legislative front, some efforts have been made to retool the accountability of independent special districts, which includes CDDs. In 2013, Senate bill 538 (House bill 881<sup>43</sup>) was introduced by Senator Jeremy Ring (with eventual Senate co-sponsor Joe Negron) and Representative Lake Ray that sought to effectuate three changes to the way certain independent special districts operated:<sup>44</sup>

1. administratively consolidate with the municipality or county in which they are located if such consolidation will result in increased efficiencies;
2. limit the insurance benefits of district officers and employees to the benefits provided by the local governing authority to its officers and employees;
3. revise the information that must be presented by a CDD to the local governing authority and requiring the information to be provided at a publicly noticed meeting, etc.

This bill ultimately languished in both the Florida House and Senate, but its passage may have brought changes to the accountability of certain CDDs, that is, how answerable they are to outside entities and the responsibilities they possess in accounting for their financial decisions.

Another factor that may further cloud future understanding of the status of CDDs is the inconsistent awareness level that surrounds them. For Floridians in general, and in terms of

importance compared to other fiscal issues, CDDs tend to go under the radar. However, according to CDD expert, James Ward, his experience with the management of these types of districts tells him the opposite when it comes to actual CDD residents. Ward observes that they tend to have a higher level of knowledge regarding their districts, and, moreover, highly value them. He notes that CDD occupants find they like having a representative government that can provide a much higher level of service than traditional local governments and HOAs.

Based on this research, the collapsed real estate market in Florida that accompanied the Great Recession fueled unprecedented financial stress and decline for alarmingly substantial numbers of CDDs. This reality triggered the Institute's concern and related inquiry about determining the impact on Florida including tax payers, land owners, residents, investors, counties, municipalities and state government. We view this report as the first step in exploring the role of CDDs. but one that leaves unanswered three broad questions for future research:

First, what is the impact of the large number of stressed and even defaulting CDDs on society? Second, who is hurt by distressed and defaulting CDDs in these times of collapsed and struggling markets? Finally, what can and should be done to prevent and to ease the impact of stressed and defaulting CDDs?

In summary, the purpose of this report is to expand awareness of the financial and managerial activities of CDDs, because they are an important, if often overlooked, local government in Florida (and other states). This local unit of government tends to operate with minimal public scrutiny, as seen by the scant media attention it receives, the limited amount of public awareness surrounding it, and the low prioritization it is given from elected officials. However, the low visibility of CDDs betrays the significance of the role they play in the lives of citizens. CDDs have broad finance powers as seen by their authority to levy special assessments and issue sizable bonds. Additionally, these districts shoulder the responsibility for the provision of many public services within their boundaries – services that help dictate property values and general quality of life.

Research indicates that at least 40% of these CDDs are experiencing varying levels of financial deterioration. The financial distress is primarily occurring in the form of defaults, but ranges in severity from lacking sufficient reserve fund amounts to wholesale foreclosure and bankruptcy. These fiscal woes appear to stem largely from the collapse of the real estate market, but the fragmented system of accountability undergirding CDDs may exacerbate these difficulties, and interfere with Districts' ability to restore their financial health. State officials possibly lack effective authority over CDDs, as well as clear methods for handling inefficient and underperforming districts.

It is in the interest of all Floridians to gain understanding of the trends delineated in this report because declining financial health for CDDs implies a declining quality of life for much of Florida's population.

## Endnotes

<sup>1</sup> Robert Eger and Joseph Vonasek. 2014. "Piecing Together the Governing Puzzle: An Exploration of Florida's Special Districts." <http://collinsinstitute.fsu.edu/content/institute-research>

<sup>2</sup> The word "structural" is used in this report to mean actual functions, duties and limitations applied by the governing board, staff and consultant advisors to implement the single specialized purpose to manage construction, acquisition, maintenance, operation and financing of infrastructure provision.

<sup>3</sup> <http://www.flgov.com/2012/01/12/governor-scott-launches-probe-to-examine-special-taxing-districts/>

<sup>4</sup> <http://www.flspecialdistrictreview.state.fl.us/Default.aspx?groupId=0>

<sup>5</sup> <http://www.oppaga.state.fl.us/Summary.aspx?reportNum=95-22>

<sup>6</sup> Though this language currently appears on the website for the Department of Economic Opportunity, there are currently only two methods of CDD establishment of the state-law-created uniform charter of CDDs to operate on proposed property: municipalities and counties may pass an ordinance; and the Governor and Cabinet may adopt a rule.

<sup>7</sup> <http://www.flsenate.gov/Laws/Statutes/2011/Chapter190/All>

<sup>8</sup> [http://www.leg.state.fl.us/Statutes/index.cfm?App\\_mode=Display\\_Statute&URL=0100-0199/0190/0190ContentsIndex.html&StatuteYear=2012&Title=%2D%3E2012%2D%3EChapter%20190](http://www.leg.state.fl.us/Statutes/index.cfm?App_mode=Display_Statute&URL=0100-0199/0190/0190ContentsIndex.html&StatuteYear=2012&Title=%2D%3E2012%2D%3EChapter%20190)

<sup>9</sup> <http://www.flsenate.gov/Laws/Statutes/2011/Chapter190/All>

<sup>10</sup> Sigo, Shelly. "Ruling May Hurt CDD Investors in Florida." 2011 August 31. The Bond Buyer.

[http://www.bondbuyer.com/issues/120\\_169/cdd-florida-federal-ruling-bankruptcy-1030646-1.html](http://www.bondbuyer.com/issues/120_169/cdd-florida-federal-ruling-bankruptcy-1030646-1.html)

<sup>11</sup> McCabe, Barbara Coyle. "Special District Formation among the States." Spring, 2000. State and Local Government Review, Volume 32, No. 2: 121-131.

<sup>12</sup> Eger, Robert and Joseph Vonasek. "Special Districts in Florida." 2012.

<sup>13</sup> Our data show that Fallschase (a Planned Unit Development) and within a CDD was initially within a special taxing district by the Leon County Board of County Commissioners (BCC) through the enactment of Leon County Ordinance 75-2. The Fallschase Special Taxing District (which was the subject of debate whether it was a dependent or an independent district, finally resolved by a court order designating it an independent district with an appointed Board), itself, was created February 11, 1975 by Leon County Ordinance 75-6. Due to the District's extensive history of land development financial dealings, on October 14, 1997 the Leon County BCC approved the establishment of the Fallschase Community Development District (CDD) to replace the Special Taxing District. This use of the uniform charter created by general law had the effect of providing infrastructure to the development lands by an independent district with elections controlled initially by its developer landowner (E. Lamar Bailey). A chronology of Fallschase's history (through 2003) has been written by a former Leon County Commissioner and can be found at [www.curg.org/resources/fallschase\\_chrono.pdf](http://www.curg.org/resources/fallschase_chrono.pdf). Until the Legislature enacted F.S. 190 in 1980, there were no CDDs under the Florida Constitution. Thus, it may be contended that the DEO records 1975 date of establishment for the Fallschase CDD should actually be 1997. The 1975 initial establishment date of the PUD/Special Taxing District should be only a footnote to the record. (Eger and Vonasek 2012)

<sup>14</sup> <http://www.tampabay.com/news/business/realestate/cdd-defaults-may-be-disaster-for-a-swath-of-homeowners/1056605>

<sup>15</sup> Florida CDD Report Overview, <http://www.floridacddreport.com/index.cfm>

<sup>16</sup> <http://emma.msrb.org/IssueView/IssueDetails.aspx?id=MS211145>

<sup>17</sup> The "Watch List" category contains 57 CDDs that are deemed as being in danger of future default. This category created by Lehmann does not clearly convey the criteria that a CDD must meet in order to be regarded as in danger. There is not a metric of assessment or financial standard that is defined in his data that delineates when a district shows evidence of being in danger.

<sup>18</sup> <http://www.businessweek.com/news/2011-09-28/florida-dirt-bond-holders-put-at-line-s-end-in-bankruptcy-ruling.html>

<sup>19</sup> Florida Auditor General, <http://www.myflorida.com/audgen/pages/specialdistricts%20a-c.htm>

<sup>20</sup> Oversight entities include the Special District Information Program within the Department of Economic Opportunity, The Auditor General, the Chief Inspector General, the Governor's office, the Joint Legislative Auditing Committee, the Department of Financial Services, and bankruptcy courts

<sup>21</sup> This handbook data is not limited to CDDs.

<sup>22</sup> According to JLAC, "Senate Bill 224 (2011) (now Chapter 2011-144, Laws of Florida) makes substantial changes related to local government financial reporting. One of these changes requires annual financial audit reports and AFRs to be submitted no later than nine months after the end of the fiscal year, beginning with the reports for the 2010-11 fiscal years. This due date is three months earlier than required under previous law for audit reports and

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most of the entities' AFRs.” For more information, visit

[http://www.leg.state.fl.us/cgi-bin/View\\_Page.pl?File=financialreporting.cfm&Directory=committees/joint/Jcla/&Tab=committees](http://www.leg.state.fl.us/cgi-bin/View_Page.pl?File=financialreporting.cfm&Directory=committees/joint/Jcla/&Tab=committees)

<sup>23</sup>[http://www.leg.state.fl.us/statutes/index.cfm?mode=View%20Statutes&SubMenu=1&App\\_mode=Display\\_Statute&Search\\_String=218.503&URL=0200-0299/0218/Sections/0218.503.html](http://www.leg.state.fl.us/statutes/index.cfm?mode=View%20Statutes&SubMenu=1&App_mode=Display_Statute&Search_String=218.503&URL=0200-0299/0218/Sections/0218.503.html)

<sup>24</sup> Florida Joint Legislative Auditing Committee. [http://www.leg.state.fl.us/cgi-bin/View\\_Page.pl?File=financialemergencies.cfm&Directory=committees/join/Jcla/&Tab=committees](http://www.leg.state.fl.us/cgi-bin/View_Page.pl?File=financialemergencies.cfm&Directory=committees/join/Jcla/&Tab=committees)

<sup>25</sup> [http://www.leg.state.fl.us/cgi-bin/View\\_Page.pl?File=financial-emergencies.cfm&Directory=committees/joint/Jcla/&Tab=committees](http://www.leg.state.fl.us/cgi-bin/View_Page.pl?File=financial-emergencies.cfm&Directory=committees/joint/Jcla/&Tab=committees)

<sup>26</sup> <http://www.floridajobs.org/community-planning-and-development/assistance-for-governments-and-organizations/special-district-information-program/reasons-why-special-districts-are-created>

<sup>27</sup> <http://www.bizjournals.com/tampabay/print-edition/2012/11/09/cdd-settlement-signals-recovering-market.html?page=all>

<sup>28</sup> <http://www.bloomberg.com/news/2012-06-04/hidden-billionaire-morse-a-man-behind-curtain-at-villages.html>

<sup>29</sup> [http://www.floridaoig.com/library/Agency/eog/EOG\\_FY2012\\_Annual\\_Report.pdf](http://www.floridaoig.com/library/Agency/eog/EOG_FY2012_Annual_Report.pdf)

<sup>30</sup> <http://www.bradenton.com/2012/01/11/3782490/palmetto-development-district.html>

<sup>31</sup> <http://emma.msrb.org/EP331627-EP36968-EP659010.pdf>

<sup>32</sup> OPPAGA 1995 Review of Independent Special Districts that Provide Infrastructure and Services to the Public

<sup>33</sup> The history of the following statutes can be found at <http://laws.flrules.org/>, and provides a more comprehensive review of the law changes that have occurred over the last 18 years with regard to special districts and the requirements placed upon them:

s. 3, ch. 89-169; s. 1, ch. 92-314; s. 4, ch. 97-255; s. 64, ch. 2011-142; s. 30, ch. 99-378; s. 6, ch. 2010-205; s. 8, ch. 2012-127; s. 1, ch. 98-320; s. 142, ch. 2001-266; s. 1, ch. 2012-16; s. 10, ch. 96-324

<sup>34</sup> <http://www.flsenate.gov/Laws/Statutes/2012/Chapter189/All>

<sup>35</sup> <http://www.flsenate.gov/Laws/Statutes/2012/Chapter189/All>

<sup>36</sup> [http://jacksonville.com/tu-online/stories/080608/bus\\_314138363.shtml](http://jacksonville.com/tu-online/stories/080608/bus_314138363.shtml)

<sup>37</sup> Ward, James P. Chief Operating Officer, James P. Ward & Associates, LLC.

<sup>38</sup> [http://www.leg.state.fl.us/cgi-bin/View\\_Page.pl?File=financialreporting.cfm&Directory=committees/joint/Jcla/&Tab=committees](http://www.leg.state.fl.us/cgi-bin/View_Page.pl?File=financialreporting.cfm&Directory=committees/joint/Jcla/&Tab=committees)

<sup>39</sup> In a December 12, 2012, discussion with a JLAC analyst, support of a direct relationship between financial problems and erratic reporting, or reporting that has ceased completely was offered. In addition, beginning in fiscal year 2005-2006, a noticeable downturn in reporting compliance is observed.

<sup>40</sup> DCA stands for Department of Community Affairs, which, prior to October 2011, housed the Office of Special Districts. This office is now part of the Department of Economic Opportunity, Division of Community Development.

<sup>41</sup> <http://legalnews.arnstein.com/wp-content/uploads/7-10-12-Daily-Business-Review-article.pdf>

<sup>42</sup> <http://www.naplesnews.com/news/2011/jul/29/bankruptcy-judge-approves-fiddlers-creek-reorg-pla/>

<sup>43</sup> <http://myfloridahouse.gov/Sections/Bills/billsdetail.aspx?BillId=50126>

<sup>44</sup> <http://www.flsenate.gov/Session/Bill/2013/0538>