

# *CITY OF FORT LAUDERDALE*

## OFFICE OF THE CITY AUDITOR

*Community Development Districts Discussion Paper*

*Report #17/18-09*

June 27, 2018



## Memorandum

Memo No: 17/18-10

Date: June 27, 2018

To: Honorable Mayor and Commissioners

From: John Herbst, CPA, CGFO, CGMA  
City Auditor

Re: Community Development Districts Discussion Paper

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### **Background**

During the Public Hearing to Consider a Development Agreement Between the City of Fort Lauderdale, Tavistock Development Company, Pier 66 Parking LLC, Pier 66 Ventures, LLC, and Sails Ventures, LLC on the City Commission Regular Meeting of June 19, 2018, the concept of using a community development district was proposed by the developer, Tavistock Group. At the request of the City Commission, I have prepared this brief outline of community development districts.

### **Discussion**

A community development district (CDD) is a local, special-purpose government framework authorized by Chapter 190[1] of the Florida Statutes. They are established “to provide a reasonable alternative ... to manage and finance basic community development services; ... thereby providing a solution to the state's planning, management, and financing needs for delivery of capital infrastructure in order to service projected growth without overburdening other governments and their taxpayers.”<sup>1</sup>

Tavistock did not indicate at the meeting precisely what infrastructure they expect to use the CDD for, but it could presumably include marinas, seawalls, interior roadways and lighting, landscaping, water, sewer and stormwater facilities, transportation/ridesharing facilities, environmental cleanup, parks, guardhouses, gates, fencing and security patrol cars.

To accomplish these purposes, the CDD is authorized to levy ad valorem taxes on all taxable property within the district to construct, operate, and maintain assessable improvements. In addition, they may also levy special assessments for the construction, reconstruction, acquisition, or maintenance of district facilities. To facilitate these activities, they may utilize several financing tools, including bonds, bond anticipation notes and bank loans.

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<sup>1</sup> Florida Statutes Ch 190

A CDD is governed by its Board of Supervisors which is elected initially by the landowners, then begins transitioning to residents of the CDD after six years of operation. Like all municipal, county, state, and national elections, the Office of the Supervisor of Elections oversees the vote, and CDD Supervisors are subject to state ethics and financial disclosure laws.

### **Benefits**

As a governmental entity, the CDD is able to borrow at tax-exempt interest rates to finance the construction. This reduces the overall cost of development. Additionally, the residents benefit by having a revenue stream, financed through self-imposed taxes, fees and assessments, to ensure that the facilities are managed and maintained to the quality and service level that they expect.

### **Risks**

There are several concerns with CDDs:

1. Ensuring that they are able to collect sufficient revenue to service their debt.
2. The quality, competency and integrity of those charged with governance.
3. Adherence to IRS rules regulating tax-exempt debt.

### **Revenue sufficiency**

There are 600 Community Development Districts in Florida, 438 of which were begun in 2003 through 2008. They have issued \$6.5 billion in municipal bonds to finance their infrastructure. Since the collapse of the housing market, over 168 of these districts are in default on \$5.1 billion of bonds and, in many cases, the project developer is in financial distress as well. Since some 204 of these projects were launched in 2006 through 2008, all have not yet completed their infrastructure build out, so they have not yet defaulted. However, given the slow turnaround in housing this is often only a matter of time. At least another 20 projects could default before a turnaround occurs.<sup>2</sup>

### **Governance**

There are examples of developers that have issued bonds, but never built the amenities that were supposed to be financed by the debt. The developer behind the Clearwater Cay Development District is currently serving a 40-year federal sentence for fraud. “The bonds were issued to build a water park, high-end retail, a spa, canals with gondoliers and other amenities around the existing apartments that were converted into condos — but the infrastructure was never built. And likely never will be. Federal investigators said the company raised more than \$300 million from buyers, but the operation turned into an illegal Ponzi scheme when it began using money from new buyers to pay the lease-back fees to earlier ones.”<sup>3</sup>

In addition, the boards may lack sufficient time, training and expertise to deal with public records laws, sunshine rules, procurement regulations, and budget and financial reporting requirements, thereby exposing themselves and the residents to significant risk.

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<sup>2</sup> <http://www.floridacddreport.com/>

<sup>3</sup> <http://www.tampabay.com/news/growth/developer-in-prison-but-clearwater-condo-owners-still-paying-the-price/2304494>

### IRS invalidation

A good example of where CDDs may run afoul of the IRS was seen in the Villages. In January 2008, the Villages Center CDD (VCCDD) was notified by the Internal Revenue Service of the IRS' intent to audit several recreational bonds issued in 2003 to determine compliance with tax regulations (mainly due to their status as municipal bonds which are exempt from Federal income tax). The IRS sent three "Notices of Proposed Issues" in January 2009 challenging the tax-exempt status of the bonds on three grounds:

1. the Issuer does not qualify as a political subdivision or "on behalf of the issuer" of tax-exempt bonds pursuant to Section 1.103-I(b) of the Internal Revenue Code regulations,
2. the opinions of value do not support the price paid by the Issuer to the developer for the Series 2003 Facilities and the payment of the sales price for the facilities to the developer by the Issuer is not a governmental use of the proceeds of the Bonds, and
3. the Bonds are private activity bonds the interest on which is not excludable under IRS Section 103.

The position stems in large part from the interrelationship between VCCDD and The Villages developers (since VCCDD has no residents, the Board of Supervisors consists solely of individuals who work for or have an affiliation with The Villages developers, and VCCDD's infrastructure was purchased by the developers-controlled board from the developers). Essentially, the IRS position is that the VCCDD is an "alter ego" for the developers.<sup>4</sup> In 2014, the Villages gave up its fight with the IRS and refunded all of the tax-exempt debt by issuing \$257 in new taxable bonds to avoid penalties.

### Conclusion

CDDs can allow a developer to complete construction of a project at a lower cost through the use of tax-exempt debt. Those savings may flow through to future residents or may simply increase the developer's profit. Residents may also benefit from having a dedicated revenue stream to ensure that the amenities that enticed them to the community are maintained at an acceptable level.

At the same time, the residents of the district take upon themselves the risk and obligation to ensure that the district's affairs are properly managed.

cc: Lee R. Feldman, City Manager  
Alain Boileau, Interim City Attorney  
Jeff Modarelli, City Clerk  
Stanley Hawthorne, Assistant City Manager  
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<sup>4</sup> Richie, Lauren (May 31, 2009). "'What ifs' for The Villages in IRS fight". Orlando Sentinel. Retrieved 10 June 2012