Going to the Public

Understanding public finance can increase commercial finance business

By **Harlan A. Friedman,** president, Lightning Commercial Funding Inc.

Each state has its own rules and regulations regarding the issuance of public debt for private purposes. But some characteristics cross jurisdictions and can help you seek larger and more-profitable transactions.

By understanding how public finance integrates with commercial finance, mortgage brokers can make more money.

Typically, there are two types of public debt: general-obligation bonds and revenue-backed debt. General obligations are secured by the good faith and credit of the issuing agency. Revenue debt, on the other hand, is backed by supporting revenue from a specific project, such as a sewer-revenue bond, or the individual property-owner's payment of taxes, such as a road-assessment district. The collateral for something similar to a road-assessment district is strictly the underlying value of the improved land.

A great deal of the public revenue debt in California, for example, is issued by special districts. Special districts are issuing agencies that are created for the sole purpose of issuing debt for the underlying project. One such district could be a community facilities district created to install roads, sewers or other infrastructure for a new development.

By recognizing that a developer could get public assistance for backbone infrastructure, projects that previously seemed unworkable can start to make economic sense. Once developers discover that they could receive municipal assistance, they can not only move forward with planning the project, but also they might be able to secure more-favorable terms on their conventional financing. This is, in part, because lenders know they will be paid back after the municipal debt is issued.

It bears mentioning that the public must approve the issuance of any such debt through an election. This process can take some time, and the vote is not guaranteed to pass. But if the public approves the funding, the borrower could receive increased security and flexibility.

As a case in point, a developer of a golf-course community was looking for money for developing the course and surrounding homes. The developer and the city agreed that it would be a public course, and the developer explored municipal debt. Community-facility-district bonds ultimately were issued for a portion of the course construction. As such, the developer secured the debt by the expected revenue of greens fees and incidentals. The developer consequently eased the burden of financing the golf course and could then focus on the private financing of the residential subdivision.

Public-financing debt can be used not only for the backbone infrastructure of commercial projects, such as water and lighting, but also to fund development-impact programs, such as building libraries and schools. If a new building has been approved with the stipulation that a library must be built, the taxes that pay the bond debt ultimately will be passed onto the building's tenants. This can once again free up the developer's capital for construction.

Incidentally, much of the first two years' worth of interest can be capitalized in the bond issuance. Again, this offers the developer more freed-up capital to build. Much of the bond debt also is considered off-balance-sheet financing.

How can brokers capitalize on this new information? First, when talking to your developers or real estate brokers, let them know that you understand how municipal debt can benefit them. Approach them with the idea of looking at the issuance of municipal funding to increase their overall return on investment on a project. Dust off some of those projects from your filing cabinets — the ones that never seemed quite feasible before — and look more closely. Will the addition of the issuance of municipal debt now make a project go?

Many times, when developers approach a public agency for their maps, they come up against extraordinary mapping conditions, which translate into more costs and a resulting lower profit margin. Therefore, they are forced to abandon their dream project. By analyzing how municipal debt can help alleviate these costly increases, a project may make more economic sense.

Brokers for developers' private funding can have a captive client. Once you line up the acquisition-and-development loan and the construction loan for them, the rest is up to your perseverance and creativity in closing the loans.

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