Hunting Hill Metropolitan District

Finance Committee Report

December 19, 2018

Members

Al Sullivan, Hunting Hill Metropolitan District (HHMD) Board Member and Chair, and Verona Resident
Dave Hoffman, HHMD Board Member, and Verona Resident

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Introduction

On September 13, 2017 the Hunting Hill Metropolitan District's (District) Finance Subcommittee (Subcommittee) issued a report that gathered facts and parameters in which the District must operate, examined alternatives for funding the District's budget shortfall, and presented recommendations at the September 21, 2017 District Board meeting for discussion with the full Board and taxpayer community. That Subcommittee had been appointed by the Board at the June 12, 2017 District Board meeting and consisted of Board members and Verona residents Al Sullivan and Dave Hoffman; Verona residents Kay Johnson, Tom Hickey, and Tom Hendricks; Managing Partner of Verona Building Company, LLC Greg Fulton; District Accountant Kevin Collins; and District Legal Counsel Jennifer Ivey.

Much has clarified and happened since that report was issued. And several new residents have moved to Verona. This report is an update to review how we got where we are and present what has happened since the last report.

Our problems, in a nutshell, were well-described by the independent financial consultant engaged by Douglas County to examine our Second Amendment to the District's Service Plan proposal (discussed more fully later in this report). The County's financial consultant's two most salient conclusions were:

- "The failure of the Developer to keep pace with the projected build out schedule and with the delinquent Series 2007 Bonds that are accruing interest and compounding at 7% per annum places this District's finances in a dire position."
- "The requirement under the Indenture to levy the maximum debt service levy has left the District with approximately 5 mills to pay for operations and maintenance. This amount has proven insufficient to pay the District's upkeep and administration. As such, an increase from 15 mills to 25 mills is necessary to provide for the District's upkeep and operations."

Succinctly, the District has accumulated a huge debt that has been much more than its existing tax base can support and has been unable to adequately support operations and maintenance from tax levies.

This Updated Report Shows How the HHMD Board Has Responded to These Challenges, With These Goals as Drivers:

- Stabilize and improve the District's financial position
- Protect District property values and the "Verona Lifestyle"
- Do the foregoing as affordably as possible

History of Development in the District

A. Creation of the Hunting Hill Metropolitan District, its responsibilities, and tax requirements

Special districts are a somewhat unique way that Colorado supports new developments and special projects. These special districts are quasi-municipal corporations and political subdivisions of the State of Colorado that collect property taxes that pay off debt issued to fund public infrastructure, and to support ongoing operations and maintenance expenses. Our District was formed in 2007 and issued its $4,000,000 General Obligation Limited Tax Bonds in 2007 (2007 Bonds) which accrued interest at 7%. The placement agent for these 2007 Bonds was Bathgate Capital Partners, LLC (now known as GVC Capital, LLC), a company with which Gregory G. Fulton is affiliated. The trustee for the 2007 Bonds was originally American National Bank who was succeeded by GGF, LLC, another company with which Gregory G. Fulton is affiliated. Proceeds from these 2007 Bonds were used to pay for roads, construct two bridges over the Highline Canal, widen County Line Road at the Primo Road intersection, and provide necessary infrastructure to support development on the property. These 2007 Bonds were to be repaid by ad valorem property taxes and required the District to levy a debt service mill levy up to 45.000 mills (adjusted to 49.750 mills as explained later in this report).

Our District is also responsible for road maintenance, landscaping, irrigation, and snow removal – all of which must also be supported by District ad valorem property taxes. In sum, District tax levies are for (1) debt service and (2) operations and maintenance. In the 2018 tax collection year, 90% (49.750 mills) of taxes were expended for debt service and 10% (5.527 mills) for operations and maintenance.

B. Fairfield Homes at Hunting Hill, LLC

Fairfield Homes at Hunting Hill, LLC (Fairfield Homes) was the original developer of property in the District, and the organizer of the District. In addition to the 2007 Bonds issued by the District, Fairfield Homes obtained acquisition and construction financing from two banks. Due in large part to the recession of 2008, development of the property within the District did not proceed beyond initial site work and construction of the public infrastructure. Fairfield Homes declared Chapter 7 bankruptcy which called into question the repayment schedule and value of the 2007 Bonds.

In lieu of foreclosure Fairfield Homes transferred the property between the Highline Canal and County Line Road to one of the lending banks. This is the property now owned and being developed by Richmond American Homes.

The remaining property of approximately 37 acres was transferred to Hunting Hill Acquisition Co., LLC, which was formed by the other of Fairfield Home's lending banks. GGF, LLC became the sole member of Hunting Hill Acquisition Co., LLC.

B. Verona Building Co., LLC

On March 1, 2010 Hunting Hill Acquisition Co., LLC was re-named Verona Building Co., LLC (Verona Building). The majority of the holders of the 2007 Bonds became shareholders in Verona Building with Gregory G. Fulton as managing partner. This new company assumed the obligations of Fairfield Homes under various agreements with the District. Verona Building assembled a new development team that proposed to develop "Verona" as a luxury, low maintenance, age-restricted (55+) community of 418 single-family units. Development commenced in 2010 and the first closing was in August 2011. For a while, construction continued apace but stalled in 2015. The last closing by Verona Building was in early 2016. When Verona Building ceased building, 108 of the planned 418 residences were completed.

To further facilitate development of public infrastructure in Verona, the District issued its $2,000,000 Capital Recovery Fee Revenue Bonds during 2013 (2013 Bonds). The 2013 Bonds were supported by Capital Recovery Fees rather than ad valorem taxes.

C. Richmond American Homes of Colorado, Inc.

In March 2018 Richmond American Homes of Colorado, Inc. (Richmond) closed on the property between the Highline Canal and County Line Road. They have gained approval from Douglas County to build 53 single-family residences. They are currently installing infrastructure and roads. Sales are expected beginning in the third quarter of 2019.

There are two important financial issues with this development from the District's perspective beyond the fact that the Richmond homes will increase the tax base of the District. First, Richmond has agreed that they will form an HOA that will be responsible for landscaping, irrigation, snow removal, etc. This means the District will not be responsible for these additional expenses. Richmond has confirmed this in a letter to the District. Second, the District's Capital Recovery Fees are still in place and apply to Richmond's development. These fees will be paid to the District as building permits are pulled and, since the 2013 Bonds were retired in April 2017, the Capital Recovery Fees are not pledged to pay off any debt. The Capital Recovery Fees are $5,000 per unit, which is approximately $7,000 per unit at this time after considering the unpaid interest also owed on these previously imposed fees, and will provide bridge money for the District of about $371,000. This one-time money will be helpful as the Board deals with finances "as the dust settles" on additional District development.

D. Century Communities

Century Communities (Century) has a contract to purchase the remaining undeveloped property from Verona Building and has put down a non-refundable deposit. They are currently working on site plans and obtaining Douglas County approvals. They hope to wrap this up about March of 2019. They plan to construct 310 units, a mixture of townhomes and condominiums, with sales beginning in the second quarter of 2020.

There will be no Capital Recovery Fees coming to the District from Century's development. The Capital Recovery Fees for the property now owned by Century were fully paid by Verona Building in 2017 to facilitate the sale of the remaining property. That payment allowed the District to fully redeem its 2013 Bonds in April 2017.

E. Prospects for success in increasing the District's tax base

The history recited here shows the District's fundamental financial difficulties have resulted from the failure of the development to build out as scheduled. For several years there has been many less than the number of proposed residences supporting the debt service and operations and maintenance expenses. All that time, interest on those 2007 Bonds had been compounding at 7%. Even with the District paying all it could, that $4,000,000 had become $5,841,940.15 on December 1, 2018. At that time only 108 residences were on the tax rolls supporting that considerable debt service on the 2007 Bonds.

The key to a better financial picture is to increase the District's tax base. The developments underway by Richmond and proposed by Century will do that. There is reason to be optimistic that these projects will be successful. These are well-established and experienced builders. As part of the District's effort to refund the 2007 Bonds (discussed below), we were required to have a competitive market area analysis done for the benefit of prospective bond purchasers. That was done by a firm, Metrostudy, whose conclusion was, "Hunting Hill will be able to successfully capture its share of the CMA's growth with its product lines of attainable product in a high quality location within a supply-constrained sub-market area where demand remains strong as new jobs continue to be created. The community should develop a strong presence in the CMA and perform well through completion."

Highlights and Key Findings from the September 13, 2017 Report, and Subsequent Actions

The group that presented the September 13, 2017 Subcommittee report was identified in this report's introduction. Briefly, they were five residents, the District's accountant and legal counsel, and the Verona Building developer. Summarized below are the key facts, issues, and recommendations in that report, along with updating comments where appropriate.

- <u>Recommendation to establish a standing finance committee</u>. Because there were many moving pieces accompanied by considerable uncertainty, the Subcommittee report recommended establishing a smaller standing committee. To align with open meetings laws, this committee could consist of two Board members empowered to meet with resource people as deemed desirable, but not to include other Board members. The Board appointed Al Sullivan and Dave Hoffman to this role at the meeting on September 21, 2017. We have continued to work on District financial issues, meeting as needed with the District's legal counsel and accountant. We have provided updates at every Board meeting, recommended actions to the full Board, and gained approval for next steps. This work primarily focused on the Second Amendment to the Service Plan and refunding the 2007 Bonds.

- <u>Developer Advance and Reimbursement Agreement</u>. Developer advances are normally used to fill the gap during early stages of a new development until the tax base is able to support the development. Substantial developer advances were made in the early years because no other funds were available. The District's budget for 2017, as originally adopted on December 12, 2016, included $143,000 in developer advances which was 82% of the budget. Developer advances ceased in early 2017, actually totaling only $47,220 for that year. Under the District's Advance and Reimbursement Agreement with Verona Building, interest accrues at 8%. The total of developer advances and accrued interest is projected to be $957,081.59 at the end of 2018.

The District's obligation for repayment of developer advances is limited. The Advance and Reimbursement Agreement in effect between the developer and the District states, "The District shall make payment for the Advances, subject to annual appropriation and budget approval, from funds available within any fiscal year and not otherwise required for operations, capital improvements and debt service costs and expenses of the District." Currently all District funds are required to support operations, capital improvements and debt service costs and expenses of the District. As such, the District's adopted budget for 2019 does not include reimbursement for developer advance payments.

- Service Plan and 2007 Bond Indenture restrictions. The District operates under a Service Plan approved by Douglas County that functions as our "governing document." At the time of the last report, the Service Plan and its First Amendment placed a cap on our debt service mill levy of 45.000 mills, and on operations and maintenance of 15.000 mills, but also imposed an overall cap of 50.000 mills.

  The 2007 Bonds required the District to levy up to 45.000 mills in order to make required debt service payments. Because of the delays to development within the District, even by assessing the full 45.000 mills, the District was not able to pay the full amount of the required interest and principal payments. However, as long as the District assessed and paid over the revenue from the full 45.000 mills, it was not in default under the 2007 Bonds.

  The practical effect of the Service Plan and 2007 Bond restrictions was that only 5.000 mills were available to support the District's operations and maintenance expenses. That is woefully inadequate. For example, in the current year, that 5.000 mills generated about $34,000. But the District's snow removal budget alone for this year is $70,000, and about $25,000 was spent for snow removal early in the year.

  The Subcommittee report recommended pursuing a Second Amendment to the Service Plan, hopefully done on an administrative or otherwise expedited basis that would be less costly than a material modification. The new Finance Committee met with the Doulas County Board of County Commissioners during one of their working sessions, along with our legal counsel and accountant, to request an administrative or expedited consideration of the proposed Second Amendment to the Service Plan. While sympathetic, the Commissioners didn't want to go quite that far because the expedited route would also have removed public notice requirements. But they did agree, and directed their staff, to work with us on a request that would be simpler and less expensive than a full material modification because we only had to address financial issues and would not need to run our request through the Planning Commission. The District Board approved pursuit of such a Second Amendment to the Service Plan by the Finance Committee.

  On October 9, 2018 the Board of County Commissioners unanimously approved the District's request for a Second Amendment to the Service Plan. That amendment left the debt service cap at 45 mills but raised the operations and maintenance cap to 25 mills and the overall cap to 60 mills. The amendment also served as authorization for the District to refund its 2007 Bonds. It was necessary to leave the debt service cap at 45 mills because the Finance Committee could not then be certain on that date that 2007 Bonds could be refunded with a lower debt service mill levy. As discussed below, the District was able to refund the 2007 Bonds with its 2018

Limited Tax General Obligation Refunding Bonds in the amount of $7,090,000 (2018 Bonds) that require only up to 31.659 mills be assessed for debt service.

- What we knew of further District development plans. We now have more clarity, reported above, about further development. In September 2017 we reported the best information then available. Richmond has pursued their development, though they are behind the schedule proposed then. That has delayed the District's receipt of Capital Recovery Fees. Back in September 2017 the remaining Verona Building property was being considered by Century to build residences and Evergreen Company to build apartments. Our report noted that Evergreen might need to get a waiver from Shea Homes from the 2005 deed restriction that applied to the portion of the property in which they were interested and which prohibited apartments. It turns out that was the case, and Shea declined a waiver. Subsequently Century became interested in that portion as well and it is all now under contract for proposed single-family residences. Additionally, Century has decided to purchase the "clubhouse property" and build single-family residences on it.

- Thoughts on funding 2018 and 2019. The Subcommittee report recommended funding the 2018 operations and maintenance budget, and likely the 2019 and part of the 2020 budget, largely from the Capital Recovery Fees expected from Richmond's development and from the District's General Fund which had a balance of roughly $384,000 then. Though Richmond fell behind the schedule they had suggested, we have managed to get through 2018 without the Capital Recovery Fees which are now expected to begin in early 2019. These Capital Recovery Fees are included in the District's adopted 2019 budget.

- Thoughts on funding 2020 and beyond. The Subcommittee report addressed how we might fund ongoing operations and maintenance of the District once the Capital Recovery Fee payments from Richmond were complete. Using the best information we could gather from Richmond, Century, and Evergreen, we developed projections using the then current mill levy parameters and meeting the District's legal obligations regarding the 2007 Bonds and developer advances. It represented "where we were" without changes to the Service Plan, developer advance agreement, or refunding the 2007 Bonds. Those projections showed that (again, without changing the Service Plan or bond refinancing), increased revenue in the form of fees would be required beginning in 2021 to meet annual general and administrative, and operations and maintenance costs, even if no developer advances were repaid. The amount needed in these projections was highest in 2021, at $678/unit for that year. Over time as more development occurred and residences came onto the tax rolls, the amount per residence decreased and was in the range of $402 to $532/unit in other years. If developer advances are repaid, revenue would need to increase by the amounts paid to the developer. Of course, we recognized that there will usually be differences between projected and actual results because events and circumstances frequently do not occur as projected.

  The Subcommittee report also recommended refinancing or restructuring the 2007 Bonds to get a lower interest rate and reduce the District's debt service expense, noting that this should be done "when the iron is hot." Potential bond buyers would want to see more than vacant land, so it was important to have solid and promising information about further development. As

Richmond proceeded and Century firmed up its plans, this became possible. With Board approval as new authorizations were needed, and working with D. A. Davidson & Co. as bond underwriter, Thompson Coburn, LLP as underwriter counsel and disclosure counsel, Ballard Spahr, LLP as bond counsel, and very strong support from the District's legal counsel and accountant, the 2007 Bonds have been refunded. The deal closed on November 21, 2018 with funds being held in escrow until December 1, 2018 (which resulted in a lower call premium being paid by the District). The 2018 Bonds carry interest of 5.625% as against the 7% rate of the 2007 Bonds. Very importantly, the District is required to levy only up to 31.659 (35.000 adjusted rate, as explained below) mills to service these new bonds, allowing a no-cost "switch" from debt service to operations and maintenance. Our debt service mill levy cap is higher than this, but that is now irrelevant.

Discussion of mill levies is made a bit complicated because levy rates have been adjusted, as allowed by the Gallagher Amendment to the Colorado Constitution. The Gallagher Amendment seeks to hold the ratio constant between commercial and residential property taxes by making periodic adjustments to the residential assessment rate. The State Legislature enacted a Gallagher Adjustment in June 2017 which decreased the residential assessment rate from 7.96% to 7.20% beginning in tax collection year 2018. Had the District not adjusted their mill levies for the effect of the Gallagher Adjustment as required by its Service Plan, the District's tax revenue would have decreased. So when we talk about the District's mill levy rates that were in effect at the time of the September 13, 2017 report and current rates, these differ by the adjustment. In particular, most conversations about the 2018 Bonds have used the new adjusted rates, whereas most conversations about mill levies allowed by the Second Amendment to the Service Plan have used the older unadjusted rates. To illustrate the effects of these adjustments, the "old' and "new" rates for important District items are tabled below:

Levy Item	Past Rate	Adjusted Rate
2019 Budget Debt Service (Required)	31.659	35.000
2019 Budget O&M	18.341	20.277
2019 Budget Total	50.000	55.277
2018 Budget Debt Service (Required)	45.000	49.750
2018 Budget O&M	5.000	5.527
2018 Budget Total	50.000	55.277
Difference in Required for Bonds – 2007 vs. 2018	13.341	14.750
O&M Cap under Service Plan before 2nd Amendment	15.000	16.583
O&M Cap under Service Plan 2nd Amendment	25.000	27.638
Debt Service Cap under Service Plan (Original & with Amendment)	45.000	49.750
Total Cap under Service Plan before 2nd Amendment	50.000	55.277
Total Cap under Service Plan 2nd Amendment	60.000	66.333

At the December 10, 2018 meeting, the Board certified 2019 mill levies of 35.000 for debt service and 20.277 for operations and maintenance, totaling 55.277 mills using adjusted rates.

This is the same total as levied in 2017 for 2018 tax collections, so for this next year there has been no increase in effective District tax rates in total. Also, the bond refunding freed up 14.750 mills at the adjusted rate that could be reallocated from required debt service to operations and maintenance. The Board adopted the 2019 budget and certified mill levies for tax collections in 2019 with this new allocation, with the new levy for operations at 20.277 mills (adjusted rate) and the new mill levy for debt service at 35.000 mills (adjusted rate). Thus, we have been able to significantly increase the operations and maintenance revenue without raising overall total effective tax rates. This reallocation of District taxes has been significant. This year 63% of taxes support debt service and 37% support operations and maintenance, as opposed to 90% and 10%, respectively, in the past.

The District's Current Financial Picture

Taken together, the Second Amendment to the Service Plan and refunding of the 2007 Bonds have significantly improved the District's finances. Some taxes that were necessary to support debt service can now be applied to operations and maintenance. And current and future District Boards now have the flexibility to provide operations and maintenance mill levies that are able to fund the costs of operations and maintenance and preserve our property values and lifestyle issues. We believe these actions have been the best "work around" for difficult problems that District taxpayers did not create and over which they had very little control until recently when residents acquired voting control of the District Board.

We believe the District's finances can be fairly stable in the near term. Again, we expect bridging funds as Richmond pays Capital Recovery Fees that will be helpful. Of course, that is one-time money. Future revenues will be dependent on the progress of the Richmond and Century developments, and their actual sales, as well as assessed valuations of properties throughout the District.

Remaining Issues

This past year has been busy but productive. We like to think most of the "heavy lifting" for the Finance Committee has been done. But we will need to monitor developments in the District and bring recommendations to the full Board if warranted.

There is also the need to review transactions and reconcile the developer advances between Verona Building and the District, particularly since the last formal update to the schedules of the Advance and Reimbursement Agreement occurred on April 28, 2016.