Economic Development Sector

Municipalities often issue economic development bonds, sometimes known as land-secured bonds, to raise capital for development projects. The proceeds from economic development bonds are often used to finance the construction of infrastructure necessary for a new project, such as roads or sewers, but can also be used to revitalize existing structures. Such development projects can range from neighborhood development to commercial area revitalization, and thus can vary significantly in scope and size. There are typically two phases to evaluating the credit risk of these projects: construction/development risk and revenue generation to repay debt risk. These projects generally focus on housing or retail developments in undeveloped, blighted or generally underutilized areas.

If the bond issuance is being used to finance the construction of a project, then the completion schedule should be an integral part of analysis. There are many factors that can help to determine the extent that construction risk is present. Assessing the complexity of the project and the track record of the developer can help to determine how likely the project is to be completed on time and on budget. Environmental regulations and issues regarding permits or zoning can lead to substantial delays in certain cases. Such delays are common for construction projects, yet they are often anticipated and accounted for through feasibility studies.

Projects that are undertaken in conjunction with a city or county, but require special approval from the state, may have a higher risk of construction delay than those which only rely on approval from the entity that is partnered in the project. In most cases, the bond covenant identifies a worst-case scenario for delays or other construction hurdles and stipulates that the issuer maintain a reserve fund with capital sufficient to withstand those delays. This allows the debtor to continue to service debt despite lack of revenue from project completion.

Different types of economic development projects result in different methods of servicing debt. A housing development may use property taxes to service their debt, while the redevelopment of main street may be backed by a combination of property and sales-tax revenue. Sales-tax revenue, dependent on successful sales levels at the property can be inferior to property revenue as a source of repayment. It is also important to note, the property tax bond secured by the tax lien primes mortgage debt on the property. Demographic data, such as per capita income and population trends, can allow for projections of future demand for a given project. The project developer's prior success with marketing or running a similar entity may provide insights into future demand and durability of the project.

Often, economic development bonds are issued for revitalization purposes. Addressing the reason for revitalization can help provide insights into future performance and potential risk factors. If the area is blighted, in the current over retailed environment, assessing the demand for more retail is essential. As another example, a revitalization project in an area affected by natural disaster indicates that without necessary safeguards, the new development may be susceptible to similar issues in the future. Understanding how these factors have affected past developments and investigating the ways in which they will be mitigated in future is an integral part of analysis.