

# EHLERS ADVISOR

APRIL 2009

BOND SERVICES • TIF FINANCING • DEVELOPMENT/REDEVELOPMENT MANAGEMENT • STRATEGIC & FINANCIAL PLANNING

## INSIDE THE ADVISOR

### Recent Municipal Market Trends

Bond market changes in the last six months, and navigating the "uncharted waters" in the future.

—Page 2

### Legislative Update

How the Governor's proposed Budget Bill affects local governments.

—Page 2

### IRS and SEC Focus on Post-Issuance Compliance Activities for Tax-Exempt Debt

Making sure you comply with arbitrage rebate requirements and continuing disclosure.

—Page 3

### The Emergency Economic Stabilization Act and Troubled Asset Relief Program

—Page 4

## Proposed Distressed TID Legislation is Important to All Communities

*Michael C. Harrigan, Chairman/Senior Financial Advisor*

The national economic downturn has negatively affected a number of Tax Incremental Districts (TIDs) across the state, with the potential to affect many more. Reductions in the value of existing property within TIDs to reflect market conditions have decreased tax increment collections, and many communities are anticipating further reductions in the next valuation cycle.

Some projects within TIDs have also experienced foreclosures that have or are expected to result in development projects being entirely removed from the tax rolls, further exacerbating the situation. Finally, many economic development projects that were projected to positively contribute to TID increment generation have been delayed or withdrawn due to diminished demand combined with severely restricted credit availability for developers.

TIDs experiencing a decline in increment collection, or the failure of projected increment to materialize, may be unable to meet financial obligations that they have already incurred. In most cases, these financial obligations contain provisions that would require any debt service shortfalls to be assumed by the general taxpayer. This additional burden on taxpayers could be significant. In the most extreme cases, it could lead to a default on TID revenue obligations (Community Development Authority

Lease Revenue Bonds and similar revenue-backed securities).

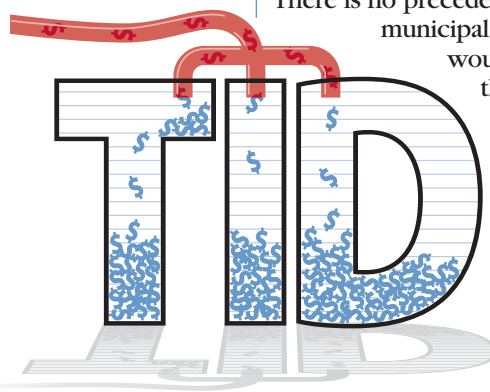
There is no precedent for a default of a Wisconsin municipal obligation and the impacts would be far reaching. In addition to the immediate concerns of investors not being repaid (many of these investors being individual Wisconsin residents and community banks), a default would increase the future cost of credit for all municipalities. It may also make credit entirely unavailable for some

communities, could stifle future economic development, and would lead to protracted and costly litigation for the parties directly involved.

In the case of very small municipalities with limited financial resources, the prospect of a default and the subsequent cost of litigation could also present the

real possibility of a municipality seeking bankruptcy protection; another circumstance without precedent in the State.

In some cases, the restructuring of existing debt obligations to match diminished increment collections is a possible solution. To facilitate this, however, certain revisions will be needed to the TID law for the benefit of "distressed" TIDs. A summary of the changes that are currently included in the draft legislation are found in the inset shown in the center of this page.



### Summary of Draft Bill For Relief for Distressed TIDs

- The draft bill would create a special statutory category of "distressed tax incremental districts" under Section 66.1105, Wisconsin Statutes.
  - Ability to designate a TID as distressed would be limited to TIDs created by the local governing body before January 1, 2008.
  - To qualify as distressed, a resolution must be adopted certifying that project costs incurred under the TID exceed the revenues from all sources that are expected to be generated.
  - A public hearing must be held and the resolution declaring the TID as distressed would need to be approved by the Joint Review Board.
  - If the resolution is accompanied by an independent financial report demonstrating the projected revenue shortfall, then the Joint Review

(TID SUMMARY DRAFT BILL continued on page 4)

# Recent Municipal Market Trends

By Dave Wagner, Senior Vice President/Senior Financial Advisor

Since the upheavals in the capital markets in October 2008, the municipal bond market has quieted down. Bonds are still being sold and at relatively attractive interest rate levels when viewed from a historical perspective. As often happens, there was a bottoming out of interest rates in January, and a general trend upward followed as more municipalities gear up annual capital financings. Nonetheless there have been significant interrelated changes in the municipal bond market in the last six months.

- Due to losses on investments and guarantees, bond insurers have all but left the market, with only two major insurers left who are active.
- Not surprisingly, fewer municipal bonds are being insured and underlying bond ratings are more important than ever.
- Fewer banks are profitable and, therefore, in a position to make use of the tax-exempt feature of most municipal bonds.
- Retail buyers and their surrogates, municipal bond mutual funds, are now buying a larger share of the bonds that are being sold by municipalities.
- Municipal bond interest rates on even the highest rated bonds have increased versus yields on U.S. Treasury Bonds of comparable maturities, reflecting a “flight to safety.”
- Six months ago, 20-year bonds carried yields twice that of 2-year bonds. Today 20-year bonds require yields four times those of 2-year bonds (this is called a steeper yield curve).

## Future Trends

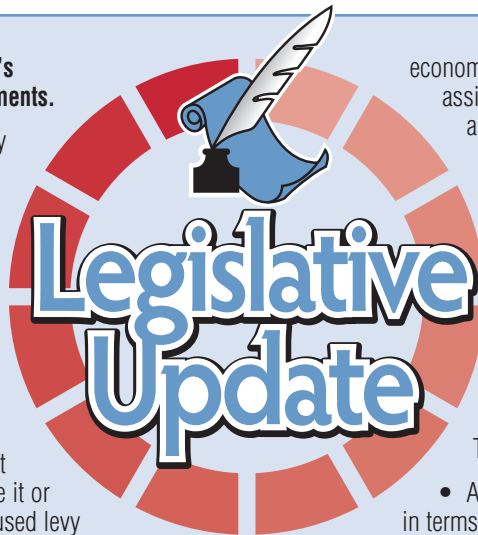
Although it is much trickier to make predictions than to review the past, the past normally can provide some guidance. Typically current trends will continue for the shorter term, and over the longer term trends tend to reverse much as a pendulum tends to swing. However, there are three big reasons why we may be in more uncharted waters.

1. No one knows when we will hit bottom in terms of falling incomes, declining assets and falling corporate profits.
2. Bond rating agencies and all municipal market participants, including municipalities, are under

(FUTURE MUNICIPAL MARKET TRENDS continued on page 3)

### Below are notable provisions of the Governor's proposed Budget Bill that affect local governments.

- Levy limits would be renewed in essentially the same form as existed for local budget years 2008 and 2009. The two notable changes are:
  - The allowable increase in levy would be increased from 2 percent to 3 percent (or the amount of net new construction, if greater); and,
  - The new allowable levy would be based on the previous year's allowable levy instead of the actual levy. This important change would eliminate the need to “use it or lose it,” providing flexibility to carry unused levy capacity into the following year.
- State shared revenue payments, in general, would be decreased by 1 percent from the 2009 payment, although the impact from community to community will differ. In general, communities with high property value per capita will lose a greater percentage, but in no case will a community's aid payment be decreased by more than 15 percent. Actual decreases in payments will be calculated using January 1, 2009 equalized values which will not be published until August 15. An estimate of the impact on individual communities, based on January 1, 2008 values, can be found on the Legislative Fiscal Bureau Web site at <http://www.legis.state.wi.us/lfb>. From the menu, choose publications/recent publications/Estimated County and Municipal Aid Payments Under AB 75 (3/19/09).
- Prevailing wage rates would apply to any private projects receiving public funding. If adopted, this would subject most private



economic development projects that receive TIF assistance to paying prevailing wages. Public assistance invoking prevailing wages could be as direct as receiving a cash development incentive. It could be as indirect as buying land from the city or village where the sale price reflected a write-down from the cost of assembly. The practical effect of this provision in most cases would be to increase the amount of TIF dollars needed and potentially lengthening the cost recovery period. In certain cases, it may render particular projects infeasible, at least from a TIF cost recovery standpoint.

- Annual TIF fee. While not necessarily significant in terms of its impact, we would note that the Governor's budget would impose an annual \$150 fee on each active Tax Incremental District or Environmental Tax Incremental District in a community.

Separate legislation pertaining to Tax Incremental Financing contains the following provisions.

- “Distressed TID” legislation – see separate article on page 1.
- Assembly Bill 109 would allow a city or village to extend the life of a TID by one year past the time at which all other project costs have been recovered. At least 75 percent of the increment received in the additional allowed year would need to be spent to benefit affordable housing (defined as housing that costs a household no more than 30 percent of its monthly gross income). The balance would be used to improve the quality of existing housing stock. This bill was referred to the Assembly Committee on Housing on March 4, 2009.

# IRS and SEC Focus on Post-Issuance Compliance Activities for Tax-Exempt Debt

By Todd Taves, Executive Vice President/Financial Advisor

When a community issues debt obligations, it agrees to undertake ongoing activities designed to ensure compliance with IRS rules and to provide updated information to the markets. While these requirements are not new, post-issuance compliance activities have been under renewed scrutiny by the Securities & Exchange Commission and the Internal Revenue Service since early 2007. Two areas in particular that are worth mentioning are arbitrage rebate and continuing disclosure.

## Arbitrage Rebate

Proceeds from tax-exempt bonds or notes (“bonds”) are subject to rules concerning the time periods in which funds must be spent. They are also subject to rules on the amount of interest earned on the temporary investment of those proceeds that can be retained by the issuer. (Amounts earned in excess of the “arbitrage yield” on certain bonds must be rebated to the IRS if specific exceptions are not met). Even if a community has earned no positive arbitrage (typical in today’s market), it must still be able to account for a variety of activities. These include the expenditure of all bond proceeds, the investment interest earned thereon, whether or not applicable spend-down tests have been met, and if not, an arbitrage rebate calculation.

Reporting arbitrage rebate liabilities to the IRS is the responsibility of the bond issuer. In response to concerns that many issuers were not tracking or reporting their liabilities, the IRS distributed a survey in 2007 to 207 non-profit corporations that had received proceeds from tax-exempt debt obligations. The organizations receiving the survey were required to provide detailed responses. They had to address the policies and procedures in place to ensure compliance with a variety of post-issuance compliance activities including arbitrage compliance, use of proceeds and recordkeeping. While 90 percent of the respondents indicated that they had policies and procedures in place, requests for follow-up information indicated that most adopted the policies

only after receiving the survey.

This first round of surveys was followed by a second round targeting local government issuers. These surveys were sent out in February of 2009 to approximately 200 randomly selected communities that issued tax-exempt debt obligations in 2005. Three Wisconsin cities, one Minnesota city, and one Minnesota school district reported to us that they had received this survey, and we are in the process of assisting them in responding. The Minnesota city that received the survey has a population of less than 1,000, which reinforces that post-issuance compliance is not just a concern for “large” issuers. A copy of the survey can be found on Ehlers website at [www.ehlers-inc.com](http://www.ehlers-inc.com) and is a useful guide for assessing your own community’s status with respect to your post-issuance compliance program.

## Continuing Disclosure

Bond markets, which trade municipal and other types of bonds, rely in part on information disclosed by issuers to determine the price of a bond on an initial and ongoing basis. Initially, a community provides this disclosure in the form of its “Official Statement” prepared as part of the process of a bond offering. Communities also have an ongoing disclosure responsibility, which can either be full or limited. Full disclosure status, which requires the preparation and filing of an annual report submitted to the marketplace, applies when a community has \$10 million or more in outstanding debt principal.

Communities with less than \$10 million in outstanding debt principal may qualify for the small issuer exception which places them in a limited disclosure status. At present, this requires that information be provided to bondholders only upon their request. As of July 1, 2009, however, this will change, and any future issues, even if they qualify under the small issuer exception, will be subject to an annual filing requirement. (The content of this filing is still being determined, but it is

expected to be less comprehensive than that required for a full disclosure issuer).

Failure to comply with ongoing disclosure responsibilities, whether full or limited, is considered a “material event” (a breach of the bond issuer’s obligations to bondholders). This must be disclosed to the markets immediately, and in official statements of the community’s future bond offerings. This in turn may impact the community’s access to capital markets and the interest rates it receives.

## Summary

Monitoring arbitrage rebate liability and ensuring that ongoing disclosure responsibilities are met are two important facets of your post-compliance debt issuance program. Ehlers can assist your community in meeting these responsibilities. If you have questions as to how arbitrage considerations or continuing disclosure requirements apply to you, please contact your Ehlers Financial Advisor.

## FUTURE MUNICIPAL MARKET TRENDS

(continued from page 2)

- greater scrutiny by the Federal Government.
- 3. The American Recovery and Reinvestment Act of 2009 (“ARRA”) makes a number of changes related to municipal bonds and municipal infrastructure financing programs. Recently, Ehlers provided commentary to clients regarding the Build America Bonds program.

## Guidance Going Forward

As market conditions change and as new options are introduced, Ehlers’ approach to designing customized financial solutions for your community will remain the same: to identify all suitable options and to discuss each alternative with you so that you can make an informed decision as to which option will best meet your overall objectives and needs.

# The Emergency Economic Stabilization Act and Troubled Asset Relief Program

By Ken Herdeman, President and Brian Mann, Asset Manager, BBE Community Investment Partners

One of the provisions of the Emergency Economic Stabilization Act passed last fall was the creation of the Troubled Asset Relief Program (TARP). TARP was created to buy the troubled assets (often referred to in the media as "Toxic Assets") on banks' balance sheets. However, TARP funds have been used for just about anything other than the purpose for which they were intended. Since TARP's enactment last fall, \$198 billion has been invested directly into financial institutions, most in the form of preferred stock purchases. This is about 80 percent of the initial \$250 billion allocated for this purpose. The remaining \$450 billion is spread out among AIG, the auto companies, and other asset guarantee programs.

To date, 22 banks in Illinois, six in Minnesota, and 11 in Wisconsin have received TARP funds. The complete list can be found on the Treasury's website\*. Banks have accepted the funds for a variety of reasons, determining the strategy behind each is important in separating those that needed the funds to remain well-capitalized and those that wanted the funds to reignite lending or

purchase other banks. Depending on the size of the infusion accepted, it should be fairly easy to see the major changes on the balance sheet once the first quarter call report data is made available.

In addition, the Federal Reserve Bank now requires banks to administer mandatory "stress tests." Most banks have been performing analyses similar to these for years - a process that involves shocking the balance sheet with hypothetical interest rate changes and economic environments. The Treasury has picked out the 19 largest institutions and will apply their own assumptions about the economy in an effort to determine how much capital will be depleted at each bank in a given scenario. Ultimately, the goal is to uncover what level of additional investment would be required from the government if they want to avoid traditional bankruptcy.

Lastly, due to the resurgence of bank failures in the last 18 months, the FDIC has increased insurance assessments. For many years, the reserve fund was sufficient, and no additional premiums

were required of many banks. The increased assessments are an important consideration for public depositors.

An important measure of banking performance and profitability is their net interest margin, which is essentially how much a bank earns on loans and investments less the amount they are paying on deposits and borrowings. Since FDIC premiums are an addition to the cost of funds calculation, we may very well see a proportionate decline in the rates offered on deposit products. Some banks may try to make up the difference by increasing loan rates, but that will be a difficult endeavor given the current lending environment.

If you have questions on the Emergency Economic Stabilization Act or the Troubled Asset Relief Program and how they may affect your banking relationships, contact Ken Herdeman at (262) 796-6164 (kherdeman@bankersbankusa.com) or Brian Mann at (651) 697-8568 (bmann@bankersbankusa.com).

\*[www.treas.gov/initiatives/eesa/transactions.shtml](http://www.treas.gov/initiatives/eesa/transactions.shtml)

## Summary of Draft Bill For Relief for Distressed TIDs (continued from page 1)

Board must approve the designation. If no such report is submitted, the Joint Review Board would have the discretion to approve or disapprove the designation.

- Extend maximum life of such TIDs to 40 years to allow additional time to amortize TID obligations (but without any extension of the expenditure period).
- Expand revenue-sharing/pooling opportunities for such TIDs.
  - Authorize donor TID to have a life which matches the recipient TID (but in no case longer than 40 years).
  - Authorize distressed TIDs, which are industrial or mixed-use TIDs, to be recipients of sharing/pooling amendments.
- Prohibit project plan amendments which would add to project costs of such TIDs.

The foregoing changes would provide the opportunity for municipalities and their creditors to seek market solutions through restructuring of debt obligations as a first remedy, reducing the potential for a default situation. In light of the present extraordinary economic circumstances, we believe strongly that these revisions would be in the best interests of the State, local taxing jurisdictions, their taxpayers and bondholders.

This legislation fortunately will NOT be needed by a majority of Wisconsin communities with TIDs. The legislation will, however, benefit all Wisconsin communities in that the prevention of defaults on any Wisconsin public debt issues will maintain the strength of Wisconsin municipal debt in the capital markets for all participants.

**Please encourage your legislators to support this important legislation.**



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