
Muni Experts: SEC Sent Message with Harrisburg Deal.

The Securities and Exchange Commission's fraud accusations and settlement with Harrisburg, Pa., could be an effective deterrent, some market observers say, even if Pennsylvania's capital city appeared to suffer little consequence from the SEC's actions.

"I think this is a very serious step that should not be taken lightly by any of the participants involved and certainly not the industry," said John Hallacy, director of municipal research for Bank of America Merrill Lynch.

On Monday, the SEC charged Harrisburg with securities fraud for providing misleading information about its deteriorating finances. The commission did not assess a fine, given the city's wobbly balance sheet, and city officials signed a cease-and-desist order.

"There was no monetary penalty, which irks some people, but perhaps more important is the emphasis that disclosure has to be transparent and truthful. That's the most important message," said Hallacy.

According to the SEC, Harrisburg failed to properly disclose required information to the Municipal Securities Rulemaking Board's EMMA website, and also made misleading statements about its credit rating and debt payments. From January 2009 to March 2011, the city failed to provide annual financial information or material event notices, forcing investors to seek out other public sources of information, the SEC said.

The U.S. attorney's office for the Middle District of Pennsylvania in Harrisburg is reviewing the SEC's report. "Beyond that, the U.S. attorney's office has no comment," said media relations officer Heidi Havens.

Harrisburg, with a population of 49,000, is staring at roughly $350 million of bond debt that it cannot pay, largely tied to financing overruns related to an incinerator retrofit project. It missed its last three general obligation payments and is under state receivership.

Hallacy said issuers are still on the hook, even if professional advisors erred or misled. "The professionals' task is to make sure everything is in order, but still it is the issuer's document. It's really a partnership," he said.

"Harrisburg never submitted formal audits, then withheld general obligation bond payments," said Bill Brandt, president and chief executive of Chicago workout firm Development Specialists Inc. and chairman of the Illinois Finance Authority. "I think if you're a troubled municipality with debt in the marketplace, you have to make the right disclosures on EMMA. Sunlight is the best disinfectant.

The SEC's action is "more of a knockdown pitch than chin music, whether it's aimed at a left-hander, a right-hander or the whole lineup. Harrisburg is the right kind of batter for this kind of pitch," Brandt added, invoking baseball analogies.

Anthony Figliola, vice president of Empire Government Strategies in Uniondale, N.Y., said that without proper disclosure, investors must rely on speeches and budget presentations as tools to decide whether to invest in municipal bonds.

“Budgets sometimes can be depicted as works of fiction,” he said. “What’s happening in Harrisburg is the tip of the iceberg for what happens in the whole municipal marketplace. Politicians have to be held accountable for what I call fuzzy math.”

According to Hallacy, the municipal bond industry can better deal with the implications of financial troubles when local officials are more forthcoming. “Negative news is not always an impediment in coming to the markets, although it might have an effect on pricing” he said. “But a distressed community can obtain financing. It can happen.”

James Spiotto, head of the special litigation, bankruptcy and workout group at Chapman and Cutler LLP, agreed with Brandt and Hallacy about the deterrent effect.

“Sometimes it’s like the grammar school teacher telling you not to do it, and then the message will get across for all. It’s important that the SEC get that message out.”

Spiotto said fractured leadership breeds the worst cases of municipal distress. In Harrisburg, for instance, Mayor Linda Thompson and the City Council have fought repeatedly. The council three times in 2011, all by 4-3 votes, rejected a state-sponsored recovery program that Thompson supported, prompting Pennsylvania officials to push Harrisburg into receivership.

“You can’t stress it enough, the importance of elected officials working together,” Spiotto said.

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