Bond Case Briefs

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Illinois City Allowed Back Into the Bond Market.

A distressed suburb of Chicago will be allowed to go back to the municipal bond markets after it promised to take steps to avoid repeating previous episodes in which it raised money under false pretenses and misused millions of dollars, federal regulators said on Friday.

The city of Harvey, Ill., agreed not to sell municipal bonds for the next three years without first retaining independent counsel to tell investors the truth about what the money would be used for and how the city planned to repay its debts. In addition, Harvey agreed to hire a consultant to straighten out its troubled finances and to have an outside auditor certify that its financial statements were accurate instead of leaving investors to rely on the city comptroller's word.

Until recently, Harvey employed an outside comptroller under contract, who gained an extraordinary degree of power over the city's finances.

The settlement came five months after the Securities and Exchange Commission took the unusual step of going to federal court to keep Harvey from selling any more municipal bonds. The emergency order came in June as Harvey was preparing to raise money to help a developer build a supermarket. The city of about 25,000 residents, which is south of Chicago, was issuing the bonds under a federal provision that lets local governments share the value of their bonds' tax exemption with commercial enterprises. The provision is supposed to promote the well-being of cities by giving companies a lower cost of capital when they agree to invest in worthy local developments.

Harvey's case was the first time the S.E.C. had ever sought an emergency court order to stop a municipal bond sale. In its complaint, the S.E.C. said that Harvey had issued bonds fraudulently three times since 2008 and was likely to do so again without an injunction.

Harvey had told bond buyers that it was raising money to revamp a large dilapidated former Holiday Inn hotel and retail complex, which gained notoriety when it was used to film an indoor car-chase scene for the movie "The Blues Brothers." The hotel site is near a busy stretch of interstate highway, and Harvey said the bonds would be repaid from a dedicated stream of occupancy and sales taxes that it would collect from travelers and shoppers who used the refurbished complex.

But the prospectus also said that the securities were "general obligation bonds," which are repaid out of a municipality's general revenue. The distinction is important, because general obligation bonds have long been marketed a city's most reliable pledge and a safer investment than bonds repaid with proceeds from tolls or limited revenue — particularly the projected revenue of an unfinished nonessential city project. The false statements left Harvey's investors bearing more risk than they knew of or were compensated for.

The S.E.C. said that even after raising about $14 million, Harvey had not done the necessary renovations but instead engaged in a complicated shell game in which some of the money was improperly transferred to the developer, who has since left the country, and some to the city comptroller, Joseph T. Letke.

Regulators said that the city council was told falsely that some of the payments were loans and that the dealings had clouded the title to the hotel property, which was now standing unusable by the highway, “with dangling wires and exposed studs.” In addition, regulators said the struggling city had used another part of the bond proceeds to meet its payroll and carry out general operations. Using long-term bond proceeds for day-to-day operations is widely seen as a sign of severe distress. The S.E.C. also said Harvey had not issued audited financial statements since 2008.

The S.E.C. said Mr. Letke was improperly paid $269,000 of the bond proceeds when he was working not only as the city’s comptroller but also as a financial adviser to the city on the bond sales and a consultant to the would-be hotel developer. It said Mr. Letke had failed to tell investors he had received this money, as required, or to update them on the hotel debacle and explain how the city would repay the bonds. Regulators also told the court that the name of Mr. Letke’s consulting firm, Letke & Associates had changed to Alli Financial, and that it continued to provide advisory and comptroller services to several other municipalities and private entities in the region south of Chicago.

The S.E.C. named Mr. Letke as a defendant in its complaint against Harvey last summer, asking the court to bar him, his companies and his employees from participating in future municipal bond sales. It also asked the court to freeze Mr. Letke’s assets and order him to give back the $269,000. That litigation is still pending. No one responded to messages seeking comment that were left at Mr. Letke’s firm, or with his lawyer, on Friday.

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