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## **U.S. Charter School Median Ratios Spotlight Growing Enrollment and Volatility.**

In this CreditMatters TV segment, Standard & Poor's Senior Director Laura Kuffler-MacDonald discusses the findings from our recent report on charter school median ratios, namely growing enrollment and volatility across the states.

[Watch.](#)

Aug 13, 2015

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## **S&P: U.S. Charter Schools' Median Ratios Reveal a Young Sector Growing Rapidly but with Volatility.**

Standard & Poor's Ratings Services' view of the U.S. charter school sector is mixed. The growth and volatility of charter school ratings exceed that of our other public finance sectors and we expect that to continue as this one evolves, schools adapt to local political climates, new financing opportunities emerge, and schools continue to access the capital markets to secure funding for facility needs. However, the charter schools' small size and relatively short operating history and limited financial flexibility present performance uncertainty and potential for rating changes.

We believe the long-term general environment for charter schools is improving gradually. However, with exceptions that vary by state, we expect downgrades will continue to outpace upgrades in 2015 because of the difficulties individual schools face. In our opinion, charter school margins and balance sheets will remain slim throughout their institutional lifetime, either intentionally as part of their mission, or unintentionally as a reflection of school performance. In either case, this limits the potential for upgrades. In addition, increased competition for enrollment, covenant violations, and debt and capital plans for many schools continue to put pressure on individual credit profiles, which we believe leads to increased ratings volatility and the potential to lower ratings.

The factors that will most influence performance are the schools' management, charter environment, financial performance, covenant violations, and financial obligations. (Watch the related CreditMatters TV segment titled, "U.S. Charter School Median Ratios Spotlight Growing Enrollment And Volatility," dated Aug. 13, 2015.)

### **Overview**

- Sector performance is mixed, with greater growth and volatility than other public finance sectors.

- The schools' small sizes and short operating histories present uncertainties about future performance.
- We expect downgrades to outpace upgrades in 2015.
- Charter school margins and balance sheets will remain thin for various reasons.

[Continue reading.](#)

10-Aug-2015

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## **Observers: SEC Delay on MA Conduct Rule May Foreshadow Changes.**

WASHINGTON — The Securities and Exchange Commission has asked for an extension to decide whether to approve the Municipal Securities Rulemaking Board's proposed Rule G-42 on the core duties of municipal advisors.

The request for more time, published late last week, is the second extension the SEC has sought. Some observers say that means the SEC may have some concerns about the proposal and that the commission and the MSRB may be negotiating some changes.

The proposed core conduct rule has already gone through three comment periods - two with the MSRB and one with the SEC, the latter of which generated 15 comment letters. Most of those commenting raised concerns. The SEC plans to solicit more comments on the proposed rule in the 30 days after its order to extend its consideration of it is published in the Federal Register. It will have an additional 90 days from Aug. 6 to determine whether to approve the MA proposal.

The MSRB has not yet responded to the 15 comments made to the SEC, but said in a release Friday that it plans to reply soon through a letter that will be made available on its website. The delay in filing a response letter is another indication changes may be coming on the proposal, observers said.

The proposed rule delineates how MAs would comply with the fiduciary duty they owe municipal issuer clients - a duty to put clients' interests first that was mandated by the Dodd-Frank Act. MAs would have less stringent "duty of care" requirements in dealing with all other clients. Under the duty of care requirements, MAs would have to: exercise "due care" in their work; be qualified to provide advisor services; conduct a "reasonable inquiry" into the background of a client's request; and show they've done a reasonable investigation to ensure their advice is appropriate.

Dealer groups and issuers have been concerned about several portions of the rule, including one that would prevent an MA from acting as a principal in transactions with issuer clients that are directly related to transactions on which the MA is providing advice. Both dealers and issuers have argued for a narrower ban, with the Securities Industry and Financial Markets Association saying in its May letter that the ban should not apply to business affiliates of a firm that had no knowledge of an MA relationship between a municipal client and the MA.

Groups also asked for several clarifications on language in the proposal, including what constitutes reasonable diligence in confirming advice is suitable for MA clients.

The MSRB's planned letter in response to the comments the SEC received in late May could lead several of the groups who commented before to do so again, representatives of several of those groups said.

## **The Bond Buyer**

by Jack Casey

AUG 7, 2015 3:27pm ET

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### **[MSRB to Cut Underwriting Fee; Raise Initial, Annual Fees.](#)**

WASHINGTON — The Municipal Securities Rulemaking Board has announced that it will increase its initial and annual fees while lowering its underwriting fee to better distribute costs among regulated entities based on their level of involvement in muni market activities.

In a change to its Rule A-12 on initial and annual registration fees, the MSRB will raise both its initial fee to \$1,000 from \$100 and its annual fee to \$1,000 from \$500. Both increases will be implemented on Oct. 1.

An amendment to Rule A-13 on underwriting and transaction fees will reduce the underwriting fee to \$0.0275 per \$1,000 of the par value of primary offerings from the current \$0.03 per \$1,000 of par value. That change will be implemented on Jan. 1.

The fee changes, which were filed with the Securities and Exchange Commission late Monday, are the result of a “holistic fee review” the MSRB said it undertook to balance its projected surplus in its technology fund with potential decreases in its future operating revenues.

The MSRB said the changes are “effectively revenue neutral” and support its “continuous and ongoing efforts” to “reasonably distribute fees among all regulated entities based on the level of involvement by brokers, dealers, municipal securities dealers and municipal advisors in the municipal securities market.”

The annual fee has not changed since 2009 and in 2014 it only covered 3.5% of the MSRB’s total expenses instead of the 5% it had covered in 2009, even as the number of regulated entities rose. The MSRB said the annual fee is “the primary way dealers share in the costs and expenses of operating and administering” the board and said the increase is a way for entities to “more fairly contribute” to MSRB costs.

The increase in the initial fee will be the first since the fee was adopted in 1975. The MSRB called the higher fee “reasonable” and said it would help defray a significant portion of administrative and operational costs.

Of the more than 2,000 dealers and municipal advisors registered with the MSRB in 2014, only about 140 dealers were assessed underwriting fees and 840 were assessed transaction and technology fees, according to the regulatory notice.

Among the “highly concentrated” group of regulated entities paying these market activity fees, less than a dozen dealers accounted for about 52% of the payments. These findings led the MSRB to lower underwriting fees because the dealers who primarily pay them are also most of the payers of the transaction and technology fees.

Jessica Giroux, general counsel and managing director of federal regulatory policy for Bond Dealers of America, said BDA appreciates the MSRB’s effort to create a more balanced distribution of fees

among all regulated entities.

“The BDA’s historical concerns have always been that the broker dealer underwriting fees finance the majority of the MSRB’s operation,” Giroux said. “However, it appears that the MSRB has taken such concerns into consideration as they evaluated their new fee structure.”

Securities Industry and Financial Markets Association managing director and co-head of municipal securities Michael Decker said SIFMA is continuing to vet the MSRB’s fee changes, but that they “won’t appropriately balance the MSRB’s expenses among all the regulated parties” because the board still does not require non-dealer municipal advisors “pay their fair share of the MSRB expenses.”

He also said a separate proposal in the MSRB’s regulatory notice to permanently collect the technology fee, \$1.00 per transaction for each interdealer and customer sale report to the board, goes back on an understanding market members had when the rule was approved in 2011 as a temporary measure until the MSRB’s capital reserve rose to an appropriate level.

The MSRB will no longer allocate the money collected from the technology fee specifically for capitalized hardware and software expenses, it said in the notice. Instead, the revenue will be generally used “for the most appropriate organizational uses,” the MSRB said.

## **The Bond Buyer**

by Jack Casey

AUG 11, 2015 1:21pm ET

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## **[How to Not Be the Next Detroit.](#)**

“The next Detroit” makes an eye-catching headline, but a [new report by Pew Charitable Trusts](#) aims to help cities avoid that publicity by outlining some lessons learned from the last seven years of municipal bankruptcies. “Until now,” the report said, “lawyers and financial analysts have conducted most post-bankruptcy analyses, focusing on the effect on investors who buy and insure municipal bonds. But state and municipal leaders need to weigh broader impacts on residents and workers.”

Among the lessons were:

- Early state intervention in local governments’ financial emergencies can help avert a crisis.
- Governments in bankruptcy should develop broad outreach plans that include all stakeholders to help resolve conflicts.
- It’s critical for governments to have long-term recovery plans upon exiting bankruptcy that outline immediate financial fixes and long-term strategies (like investing to promote economic growth).
- Local officials can promote fiscal health and increase their city’s capacity to deal with the ups and downs of the business cycle by budgeting over the long term.
- Regular monitoring of local government finances can help state officials detect early signs of distress.
- A temporary manager or financial monitor can be a successful alternative to filing for Chapter 9.

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## **Are Governments 'Paying for Failure' With Social Impact Bonds?**

A social policy experiment is spreading across the country as a new way to finance, deliver, and improve public services and problems. But its merits are so far unproven.

Three years ago, New York City launched an ambitious and unprecedented social policy experiment at its jail on Rikers Island. Thousands of teenage inmates began receiving group therapy aimed at improving their moral reasoning by addressing their beliefs and thought processes in a step-by-step treatment. The goal was to reduce the number of repeat offenses once the inmates were released. Academic studies using the method, known as moral reconditioning therapy, had reported success in reducing recidivism. Still, no one had ever scaled up these studies to accommodate anything like the 9,240 inmates the four-year Rikers Island program aimed to serve. This month, the program is coming to an abrupt end.

The reason for the program's demise has to do with another feature of the experiment: It was financed entirely with a \$9.6 million loan from Goldman Sachs. New York City was to pay the investment firm back if the repeat offense rate went down by at least 10 percent over four years. In June, a preliminary report showed the program not only was missing its recidivism target, it had no impact on the rate altogether. Goldman Sachs moved swiftly and took a contract option to cancel the program one year early. The first social impact bond program in the United States has officially failed.

"Everyone went into this understanding what they were getting into," says David Butler, a senior adviser at MDRC, a nonprofit social policy research organization that managed the treatment program at Rikers. "These things are risks. Just because something works in one environment doesn't mean it will work somewhere else."

Unpredictable as they are, programs like the one at Rikers are not going away. In fact, these attempts to link altruistic policy goals with the pursuit of private profit have been gaining steam as the latest promising innovation in public finance. The mere announcement of the Rikers project back in 2012 was a catalyst for action in dozens of other jurisdictions. Cash-strapped governments quickly became sold on the concept that they can use private money from investors for preventive social programs — money the government will have to pay back only if the programs produce the desired measurable outcomes. In 2013 alone, 28 state and local governments applied to the Rockefeller Foundation and Harvard's Social Impact Bond Technical Assistance Lab to receive help in developing such programs.

Media outlets have often touted the innovative financing tool with few notes about the complicated nature of the projects. Last year on Capitol Hill, where bipartisan support is famously elusive these days, a \$300 million proposal pushed by President Obama to allocate federal funds for social impact bond projects in the states managed to attract proponents on both sides of the aisle.

But as the enthusiasm for social impact bonds has grown, so has skepticism about the concept of partnering with the private sector to accomplish social goals. Last spring, a congressional hearing on the subject ended on a negative note as critics questioned the complicated structure of program contracts between governments, investors and the various private operators involved. "I don't get this at all," said Maine independent Sen. Angus King, squinting with disbelief. "I think this is an

admission that government isn't doing what it's supposed to do. This strikes me as a fancy way of contracting out."

That hearing was followed by a report last summer that the world's first social impact program, located in the United Kingdom, had not reached its target goal required to trigger early payments to investors. That development and the news from the Rikers project underscore the fact that the merits of social impact bond programs are entirely unproven. The programs are so new, in fact, that people are still arguing about what to call them. Some say that referring to them as bond investments is misleading because they are not like actual government bonds that are bought and sold on a public market. That's why many proponents prefer to call them "pay for success" programs. But what does "pay for success" imply, asks Indiana University Public Affairs professor Craig L. Johnson. "That right now we're paying for failure?"

The bond programs may or may not save governments money in the long run. Even though the Rikers project didn't work, Goldman Sachs said last month that its three other social impact bond investments had shown "encouraging progress." Still, it's much too early to tell if any of these endeavors will actually bring about the kind of change that social scientists and governments are hoping for.

Social impact bonds got their start five years ago in the U.K., at a prison in Peterborough, a city of about 190,000 people situated 100 miles north of London. Investors and social services professionals formed a group called Social Finance and made Peterborough their first investment. For a cost of about \$8 million over six years, the provider, One Service, is giving comprehensive assistance to offenders who have served short sentences, in an effort to help them become self-supporting when they are released. Caseworkers help get ex-cons ID cards, set them up with doctors, encourage them to take classes and help them find counseling.

The argument for doing something at Peterborough was compelling. In Britain, 60 percent of those who serve short-term sentences land back in jail within a year. The Peterborough program, which will conclude next year, aims to reduce recidivism by 7.5 percent. The buzz about it and its new financing method via private investors led to the flurry of experiments at the state and local level in the United States. In December 2013, New York became the first state to try social impact bonds, launching a program aimed at reducing recidivism and increasing employment among 2,000 ex-offenders. All told, more than two dozen states and localities have now taken up or considered a social impact bond project.

These bond deals are being used to address all sorts of social problems, including early childhood education, homelessness, health and criminal justice. No two projects are the same. Each must draw up its own contract with service providers and with the project evaluators who track the outcomes. None of the new projects can be modeled after an existing one; each is its own social experiment and must be built from the ground up. For example, the Massachusetts juvenile justice bond program is financed with \$18 million from six organizations, including nonprofits. The state is setting aside money every year for a separate fund to pay back investors if the seven-year project meets its goals. The Rikers Island project, on the other hand, was financed entirely by Goldman Sachs, with Bloomberg Philanthropies insuring three-quarters of the money.

The stated goals vary considerably. While the goal at Rikers was to reduce recidivism by at least 10 percent, Massachusetts is targeting a 40 percent reduction in jail days over seven years for the nearly 1,000 offenders in the study. The state estimates this reduction would result in a \$22 million savings, and that is the amount it will pay back investors if the goal is reached. If the program exceeds that goal, Massachusetts estimates it could save as much as \$45 million; however, it would only have to pay out a maximum of \$27 million. Other programs have similarly structured payouts.

Goldman Sachs stood to receive as much as \$11.7 million if the Rikers program significantly exceeded its goal, while New York City estimates it would have recouped a net savings of up to \$20.5 million.

These are complicated agreements — the Massachusetts bond contract is more than 200 pages long — and their very complexity is often cited by their critics as a weakness. Maryland investigated the possibility of using social impact bonds, but the state's Department of Legislative Services concluded in 2013 that the startup cost of designing a program and negotiating a contract would likely exceed the projected savings of a pilot serving several hundred people. That report essentially killed the issue of social impact bonds in Maryland, at least for now.

Indeed, the Rikers experience seems to illustrate that concern. A report on lessons learned prepared last year by MDRC lamented the jail program's "high transaction costs" that weren't covered in the Goldman Sachs loan. And for all the effort, the city's greatest potential for cost savings would have amounted to less than half of a percent of the \$1 billion it costs annually to run the jail.

But whatever the critics may say, it seems likely that governments will be increasingly attracted to these experiments. At a minimum, practitioners argue, they will get the benefits of knowing more about what doesn't work, and can cut their losses. In that sense, says MDRC's Butler, the Rikers program was a success. "This is not the recipe for reducing recidivism for these kids at Rikers," he says. "Learning that was really important."

Still, the task of attracting investors is tricky. Even the philanthropically minded investors drawn to social impact bond projects aren't going to put up money for a program that looks like it was constructed on a wing and a prayer.

Goldman Sachs was reticent to enter the Rikers deal in 2012 until it saw results from previous academic studies that showed moral reconnection therapy could reduce recidivism by up to 25 percent in those participating. And even then, it took insurance from Bloomberg Philanthropies to seal the deal. (As a result, the firm lost \$1.2 million instead of its full investment.) "We're trying to find that sweet spot of allowing every stakeholder to win," says Tracy Palandjian, CEO of Social Finance US, which is a sister company to the U.K. group and is managing the New York state, as well as developing ones in Connecticut, Massachusetts, Michigan and South Carolina. "So even when the state pays back the investors with returns, that still should be smaller than what you gain overall as a state."

But that's where the argument ends, at least for now. Until the social impact projects currently running hit their end dates, no one will know how the numbers play out. And on the social services side, some question whether designing projects focused on short-term behavioral change is the best way to intervene. "It is hard to recreate the kind of concrete turnaround you get in pay for success across a whole lifespan," says Anne Stone, who runs a child development program in Washington state. "I'm not in any way suggesting it's not worthy to move those dials, but is there a way we can be thinking about this in a two-generation approach?"

The fact is, social impact bonds may have started out life as an innovative financing tool. But many who are now taking part in them are finding that the real experiment is in developing a new model for delivering government services. In that sense, supporters hope the projects' immediate impact will be in encouraging more social policy geared toward preventive measures, even if the intangible savings are impossible to quantify. They are hopeful that when a project ends and appears to be working, the government will be willing to pay the full cost of its extension, without any private backers.

Sometimes even the hint of private investment can spur a commitment from government. The Utah Legislature recently agreed to assume some of the costs of a Salt Lake County social impact bond program after Goldman Sachs committed to financing for one. Harvard's Jeffrey Liebman had a similar experience working with a state budget director to find a social impact project for that state. Among the ideas Liebman proposed was a health-care program that would place caseworkers in senior centers to save on Medicaid costs. Instead of going for the financing project, the budget director just opted to include the cost for the caseworkers in the state's budget. "If social impact bonds cause that to happen, that's just as good," Liebman said at last year's Senate hearing.

Still, for Indiana University's Johnson, any kind of mass social impact brought about by these kinds of projects is decades away. "We need a lot more cases to see what works and what doesn't," he says. "The problem I see now is, if you just have a few experiments going, that's not going to tell us how to change. Until people have put up [collectively] hundreds of millions of dollars, we're not going to know if this works."

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BY LIZ FARMER | AUGUST 2015

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## **[How to Conserve Water Without Bankrupting Water Utilities.](#)**

The more water people save, the more money utilities lose. But new pricing models could change that.

Californians are getting very good at conserving water. Since Gov. Jerry Brown ordered a 25 percent reduction in urban water use this April, Golden State residents have surpassed that mandate. Water use for the months of May and June decreased 28.9 percent and 27.3 percent respectively, according to the State Water Resources Control Board. But if Californians were hoping their conservation efforts would lead to a little extra change in the pocketbook, they'll be disappointed.

Water departments across the state are looking to raise rates — in some cases by double digits. That's because as customers use less water, revenues are plummeting. It's a catch-22: Water utilities want and need customers to conserve water, but when that happens, utilities lose much-needed funds to upgrade and repair critical infrastructure. (Governing recently covered the dilemma in-depth.)

This isn't just a California issue. Increasing weather events and a growing population is putting pressure on water resources in every state. So how do water utilities reduce water use and stay in business? They price water differently.

Indeed, Brown's executive order in California explicitly demands that water utilities develop new "rate structures and other pricing mechanisms" to save water. This is also the subject of a new report from Western Resource Advocates, Ceres and the University of North Carolina's Environmental Finance Center. Released in August, the report looks at water connection fees — the one-time fees that most water utilities charge to connect new users and developments to the water system.

While there's been plenty of research on how utilities price the volume of water being sold to encourage conservation, there's been very little of it on water connection charges and how they might lead to water-saving practices. "It's one area that hasn't been looked at," says Peyton

Fleming, communications director for Ceres, a nonprofit organization that advocates for sustainability practices. “We wanted to know, can these water connection charges that are being used all across the country be done a little bit differently and in ways that might be helpful to water utilities and consumers?”

To answer that question, report authors surveyed more than 800 water connection fee structures used by communities in Arizona, Colorado, Georgia, North Carolina and Utah. They found that overall most utilities’ water connection charges — about 90 percent of the 800 local water utilities surveyed — didn’t take into account the types of factors that affect a home’s water footprint. In other words, most users pay the same fee regardless of the size of their lot and house, the type of landscaping they have, and the efficiency of their fixtures, among other things. But the report also found that when financial water-saving incentives are included in water connection fees, many customers make conservation changes to cut their costs. That, as a result, also helps utilities in the long run because less water usage means less infrastructure upgrades and repairs.

Aurora, Colo., is one place that employs such a water connection fee. Back in 2002, it was experiencing one of the worst droughts in its history. Municipal reservoirs only had enough water to last nine months. In response, the city began implementing a number of conservation programs, including a redesigned water connection fee. The utility wanted to develop a structure that would better align fees with water utility costs and provide an incentive to builders to construct more water-efficient developments. So it started offering lower fees to customers with landscaping that requires low water usage and charges no fee at all if the new development requires no water after it’s established. Since it started in 2014, five of six new developments used “zero-water” landscaping in order to get a full refund on their connection charges.

In addition to Aurora, the report also feature three other case studies. “Well-designed connection charges that incentivize water-efficient development show enormous potential to help utilities reduce overall water demand and avoid costly new infrastructure projects,” Sharlene Leurig, director of Ceres’ sustainable water infrastructure program and a co-author of the report, said in a statement. “Unfortunately, very few of the 800-plus communities we evaluated are taking advantage of this valuable tool for encouraging water-efficient growth.”

GOVERNING.COM

BY ELIZABETH DAIGNEAU | AUGUST 12, 2015

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## **[Kansas \\$1 Billion Bond Sale Bolsters Pensions Eyeing Hedge Funds.](#)**

Kansas Governor Sam Brownback is borrowing \$1 billion to let it ride in financial markets as U.S. stocks hold close to record highs.

The state issued bonds Wednesday with a top yield of about 4.93 percent to inject cash into its underfunded workers’ retirement system. Officials expect to gain by plowing the money into stocks, bonds and hedge funds, anticipating that they can make more on the investments than the cost to borrow.

The tactic has been popular with states and cities, which have sold \$105 billion of bonds to make up for years of failing to save enough for benefits promised to public employees, according to the Center for Retirement Research at Boston College. It can aid those that borrow ahead of a stock-market rally, or push them deeper in the hole if they’re caught by a crash.

The ability to come out ahead “is a crapshoot a lot of times,” said Michael Johnson, managing partner at Gurtin Fixed Income Management, which oversees \$9.5 billion of munis in Solana Beach, California. “Longer-term, that tends to be true, but you can’t tell for sure all the time. It’s fairly easy for this to go the other way.”

Brownback, a Republican, proposed the bond sale as a way to reduce annual pension contributions after the state’s revenue declined because of tax cuts. Kansas struggled to balance budgets when the economy didn’t grow fast enough to make up for the lost revenue.

### **Riskier Strategy**

Moody’s Investors Service and Standard & Poor’s both cut Kansas’s credit rating last year because of the budget shortfalls. By 2013, its retirement system was the fifth-worst-funded among states, with about 56 percent of the assets needed to cover the pension checks due as workers retire, according to data compiled by Bloomberg.

The bonds will ease pressure on the budget but do little to fix the retirement system, Moody’s said in a report Monday.

While the borrowing is part of a plan to fully fund the pensions by 2033, “adding \$1 billion of debt to do it represents a riskier strategy than the simpler alternative of making larger annual pension contributions,” the credit-rating company said.

Melika Willoughby, a spokeswoman for Brownback, didn’t return a voicemail or e-mail seeking comment.

### **Returns Slide**

Kansas’s sale comes as the investment earnings of state and local pensions slipped to 3.4 percent during the year ended in June, the worst performance since 2012, according to Wilshire Associates Inc. The funds expect to make about twice that to keep up with their obligations.

State lawmakers stipulated that the taxable bonds can only be sold if the interest rate is 5 percent or less. The 30-year debt, the longest-maturity securities, priced to yield 4.927 percent, data compiled by Bloomberg show.

With the Standard & Poor’s 500 Index close to the record reached in May, the Kansas Public Employees Retirement System wants to pare its domestic-equity holdings and put more into hedge funds, state Treasurer Ron Estes said.

### **Hedge Funds**

“We are looking at hedge funds more as something to add to the mix,” said Estes, who is on the pension’s board of trustees. “We just have to continue making good investment choices. If we beat 5 percent, we’re better off than we were.”

As of June 30, 2014, the plans allocated 2.9 percent to alternatives like private-equity funds, including those from Apollo Global Management, Pine Brook Capital Partners and Warburg Pincus, according to the pension’s annual report.

Over the past 10 years, alternatives have gained 13.2 percent for the Kansas pension plan, beating all other assets. The system assumes 8 percent annual returns.

With bond proceeds, the 281,000-member retirement system will have 73 percent of assets needed to meet projected obligations by 2020, rather than 66 percent, according to estimates in offering documents.

Some governments that have borrowed for their pensions haven't reaped benefits. Those that did so at the end of the 1990s technology bubble and before the 2007 stock-market peak paid more to borrow than they made, according to a study last year by the Center for Retirement Research.

Kansas has fared better. It issued \$500 million of pension bonds in 2004 with a top yield of 5.5 percent.

While those securities looked like a losing bet after the credit-market crisis caused stocks to plummet, the state appears to have come out ahead as markets rebounded, according to the center's study.

"I'd rather my local government not bet on the direction of the stock market," said Hugh McGuirk, Baltimore-based head of municipal investments at T. Rowe Price Group Inc., which oversees \$22 billion of local debt.

"It's a way to delay facing up to some of the difficult decisions they're going to have to make, and it might put them even deeper in the hole."

## **Bloomberg**

by Brian Chappatta

August 11, 2015 — 9:01 PM PDT Updated on August 12, 2015 — 9:55 AM PDT

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### **[Want a Bike Path? Pay for It Yourself.](#)**

Crowdfunding is one way to get a local project done. But wait a minute—what do you pay taxes for?

Your friends ask you to fund their marathon training, their home renovations, even their potato salad. Why not crowdfund something you'd actually use, such as a bike path or a public park?

That's what a growing number of startups are helping people do, as communities with a goal look for sources of financing outside the municipal bond market.

"More and more, people are seeing this as a great alternative avenue ... to going through your tax dollars or local public servant," says Slava Rubin, the chief executive officer of Indiegogo, a crowdfunding platform. Rubin says he started seeing public works projects on the site in 2011, with campaigns funding such small-scale infrastructure projects as a \$1,000 dog park in Chicago, and that he expects interest only to increase.

"Government is a very slow-moving industry, and it's quite bureaucratic. ... Indiegogo, and anybody who creates a campaign, is able to move much more nimbly," Rubin says.

The pickup in crowdfunded infrastructure projects comes at a time of waning city budgets and interest in funding projects, says Erin Barnes, a founder of Ioby, a startup that helps neighborhood residents kick-start public works development. Brooklyn-based Ioby has helped individual contributors fund about \$2 million in projects, such as bike lanes, gardens, and park landscaping.

## **Taking on the Muni Market**

Federal and state governments are spending less on public works projects than in recent years, despite historically low interest rates, with transportation and water infrastructure spending in the U.S. declining about 9 percent from 2003 to 2014, according to a Congressional Budget Office report. Tracy Gordon, a senior fellow at the Urban Institute's State & Local Finance Initiative, says public-private partnerships are starting to fill the void.

"What I hear a lot is that debt is a four-letter word," she says. "There's a strong anti-debt, anti-tax sentiment out there. Politicians are very concerned that voters won't approve a municipality selling bonds ... to fund a project." When municipalities do sell or refinance bonds, it's more likely to pay for a large-scale project with a lot of community visibility, such as a school or a stadium. Crowdsourcing allows communities to target projects with smaller price tags that might otherwise get overlooked.

"They might not rise to the top in some other government processes in financing public projects," Barnes says of the kinds of projects funded on Ioby's platform. "When neighbors fund something in their community, it sends a signal [to city organizations] that there is significant buy-in."

The Downtown Denver Partnership used Ioby to raise \$36,085 for a protected bike lane expected to open this fall, says Aylene McCallum, the director of the partnership's downtown environment division. She says the project garnered significant interest and the selection, design, and construction of the project will take one year compared with three or four years for other buffered or protected bike lanes in the area.

Critics of the project say the city should have funded the project with the tax dollars residents are already paying for such projects, McCallum says. "It was important to explain that we didn't see this as an ongoing funding approach to fund infrastructure," she says. "We saw it as an opportunity to kick-start, if you will, a specific project in downtown Denver to demonstrate to the city that there was broad support for it."

The Urban Institute's Gordon points to another potential problem with the model. "A lot of the things we've talked about seem like amenities for affluent areas," she says. "You have to wonder about that desperately needed capital improvement across town, where perhaps the neighbors aren't as well mobilized."

## **How the Golden Gate Bridge Got There**

Many community-interest projects are still funded by traditional sources. When they are, startups such as Neighborly are helping individuals play a role. The company, which says on its website it is "democratizing the \$3.8T municipal securities market," aims to allow users to buy portions of a municipal bond rather than the whole thing.

"Most people don't think to go, 'Hey, I'm going to go buy a municipal bond,'" says Jase Wilson, the chief executive officer of Neighborly. "It's about breaking down the minimum denomination on one side so there's more of a democratic access. It's about demystifying it."

Wilson says Neighborly seeks to sell municipal securities through its registered broker-dealer and tries to make it easy for investors to understand where their money is going. He says he hopes the company will help rekindle local involvement in the municipal market, which once created such projects as the Golden Gate Bridge. At the moment, the bond market that millennials' grandparents invested in is gone, he says.

"They would go buy bonds in their own community for a project they support," Wilson says. "They

would put [the bond certificate] under their bed and clip the coupon, and they would just get some ice cream. It was super local, super hands on, super regenerative.”

Mitchell Moss, an urban planning professor at New York University, says crowdfunding municipal bonds would be a breakthrough for issuers, underwriters, and investors.

“It’s a terrific way to access capital very inexpensively,” Moss says. “We could have a revolution in the municipal bond market by making it as easy to use as an ATM.”

## **The Shakeout**

Jouko Ahvenainen, the executive chairman of Grow VC Group, which works on crowdfunding investment models, says bringing municipal bonds to digital investing services will make the market more efficient. Still, Ahvenainen says, the market is fragmented, and it’s too early to tell how the nascent sector will shake out.

“There will be consolidation and companies with models that disappear,” says Ahvenainen, whose company works on crowd-based investment models.

It will depend on how well technology can get investors to provide the capital the issuer needs, says Thomas Doe, the president of the research firm Municipal Market Analytics. Although the impact of companies such as Neighborly won’t be seen until more deals are done, the tax-exempt status of municipal bonds is piquing investors’ interest, he says.

“People are intrigued. They’re engaged by the passion and excitement displayed by a couple of these firms,” he says. “It may happen in smaller communities first.”

Gordon, of the Urban Institute, says increased access to household investors doesn’t necessarily mean governments will start issuing more debt.

“It doesn’t replace large-scale infrastructure projects or maintenance,” she says. “I don’t see these firms displacing governments.”

## **Bloomberg**

by Amanda Albright

August 12, 2015 — 8:23 AM PDT

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## **[Making U.S. Pensions Honest About Returns Means Bigger Deficits.](#)**

Oregon taxpayers and retired public employees will have to dig a little deeper to pay for the state pension’s decision to be more honest about investment returns.

The Oregon Public Employee Retirement System on July 31 reduced its forecast for how much it expects to earn next year to 7.5 percent from 7.75 percent, increasing the hole to be filled by taxpayers and state workers by \$1.7 billion to \$73.4 billion, according to state data.

States and cities have been shortchanging pensions for decades, as high return assumptions lowered the amount of tax money needed each year to finance the plans. The funds, already \$1.4 trillion short, according to the Federal Reserve, face scrutiny for too-optimistic assumptions as markets

have become more volatile since the 2008 global financial crisis.

An “assumed rate of return” is used to predict how much a pension has set aside to pay retirees. Too high a rate leads to a false impression of a pension’s ability to pay. The average assumed return in the U.S. is 7.68 percent, according to the National Association of State Retirement Administrators.

“The use of such high assumptions is deceptive because it keeps the funded level looking higher than it should be,” said David Crane, public policy lecturer at Stanford University who worked as an adviser to former California Governor Arnold Schwarzenegger. “Too high a return is dishonest.”

### **Decades Old**

State worker pensions from New York to California are considering or have cut targets. Since 2008 more than half the 126 pensions tracked by the retirement administrators’ association have cut assumptions at least once.

Pensions projection returns are based on estimates in place since the 1980s, said Matthew Smith, state actuary for Washington, who has been working with lawmakers to gradually lower the assumed rate of return from 8 percent to 7.8 percent and more in coming years. The rate of inflation has slowed and fixed-income yields have hovered near record lows since the Fed began providing unprecedented monetary stimulus during the recession that ended in 2009. Public pensions earned 3.4 percent during the past year, the weakest since 2012.

“Conditions that led to large market returns in the 1980s and 1990s no longer exist,” said Smith. “It is not reasonable to look at 30 or 40 years of returns and assume they will continue.”

### **Biggest Funds**

The California Public Employees’ Retirement System and New York State Common Retirement Fund, two of the largest public pensions in the U.S., are considering whether to cut forecasts for returns. Texas Municipal Retirement System cut its forecast to 6.75 percent from 7 percent in July.

Calpers, at \$300 billion the largest public pension in the U.S., reported in July that it earned 2.4 percent in its last fiscal year, less than one-third its 7.5 percent target. The fund’s board may consider slowly cutting its rate to 6.5 percent as part of a plan to reduce risk, according to fund documents.

The expected rate doesn’t affect how much is owed to retirees, and missing a target one year doesn’t mean a pension won’t be able to pay benefits, but consistently performing worse than expected increases funding pressure. That adds to stress of governments that recently saw tax revenue restored to levels not seen since before the recession.

“A lower rate of return can force issuers to face up to their funding commitments,” said Tom Aaron, vice president with Moody’s Investors Service.

### **Contribution Adjustment**

Governments that fail to meet assumed returns face a rising unfunded liability unless they make up the difference with higher contributions or reduced benefits.

That can put pressure on other budget items, such as debt services. Pensioners fared better than bondholders in Detroit’s 2013 bankruptcy.

“Lower return assumptions mean the issuer has to put more cash into the pension, to the detriment of other expenditures, like debt service,” said Matt Fabian, partner at Concord, Massachusetts-based Municipal Market Analytics, a municipal bond research firm.

Dallas’s fire and police pension saw its shortfall more than triple to \$4.7 billion, Moody’s said in July after the city cut its estimate, putting the pension in a position of needing more money.

“Pensions will have to line up for money for debt and operations when you cut estimated returns,” said Richard Ciccarone, president and chief executive officer of Chicago-based municipal finance analysts Merritt Research Services.

## **Bloomberg**

by Darrell Preston

August 12, 2015 — 9:00 PM PDT Updated on August 13, 2015 — 6:23 AM PDT

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### **[Berkshire’s Negative S&P Watch Hits Almost 1,000 Muni Bonds.](#)**

Municipal bonds from California to Puerto Rico may lose their second-best credit rating from Standard & Poor’s after the company put Berkshire Hathaway Inc. and its core insurance units on a negative watch.

Berkshire Hathaway Assurance Corp. had the outlook on its AA+ rating cut Tuesday, and S&P began dropping its view of the 966 muni securities the insurer backs on Wednesday, according to data compiled by Bloomberg. Berkshire Chairman Warren Buffett got into the muni-bond insurance business in 2008, after the subprime mortgage market began to implode.

Bond insurance has been thrust into the spotlight in the \$3.6 trillion municipal market as Puerto Rico’s fiscal crisis worsens. Berkshire, for its part, backs just 15 commonwealth securities, and as a secondary guarantor, meaning Buffett is on the hook only if the primary insurer can’t pay, data compiled by Bloomberg show.

Berkshire’s muni-bond unit has mostly shunned the market since 2009, when Buffett warned about swelling local pension liabilities and compared backing states and cities to insuring natural catastrophes.

“In both cases, a string of loss-free years can be followed by a devastating experience that more than wipes out all earlier profits,” Buffett wrote in a letter as part of the 2008 annual report. “We will try, therefore, to proceed carefully in this business, eschewing many classes of bonds that other monolines regularly embrace.”

#### **Insurance Offer**

In the same letter, Buffett said Berkshire offered to take over insuring the \$822 billion of bonds backed by the three largest guarantors, but was turned down. About three-fourths of its secondary-market business instead came by standing behind bonds that were already insured.

Other issuers that have outstanding bonds with a layer of insurance in addition to Berkshire include California, Chicago, Detroit’s water system and New Jersey’s transportation trust fund authority,

data compiled by Bloomberg show.

Berkshire's muni unit is one of the insurers on some debt from Puerto Rico's electric power authority, highway agency and infrastructure financing borrower, Bloomberg data show. It also backs sales-tax bonds, known as Cofina. Some of the securities it guarantees traded this week at 118 cents on the dollar.

Buffett's parent company was put on CreditWatch Negative because of uncertainty around how it will fund its acquisition of Precision Castparts Corp. for about \$37.2 billion, S&P said Tuesday in a report.

Omaha, Nebraska-based Berkshire "is likely to use some of the capital resources available at its insurance companies," the credit rater said.

Berkshire Hathaway Assurance's AA+ rating is the highest of any bond insurer, with units of Assured Guaranty Ltd. and Build America Mutual Assurance Co. ranked one step lower.

## **Bloomberg**

by Brian Chappatta

August 13, 2015 — 2:00 AM PDT Updated on August 13, 2015 — 6:02 AM PDT

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### **[Detroit's Home County Avoids Bankruptcy With State Agreement.](#)**

Wayne County will operate under state oversight and enter into a consent agreement with Michigan, allowing the home county of Detroit to bolster its finances and avoid bankruptcy.

The Wayne County Commission voted 14 to 1 Thursday to approve a consent agreement with the state, Joseph Slezak, a county spokesman said in an e-mail. The pact stops short of Chapter 9 and will allow County Executive Warren Evans to impose pay and benefit cuts. The arrangement, negotiated between Evans and the Michigan treasurer's office, was delivered to the commissioners for consideration on Tuesday.

The move seeks to improve the county's cash position, end its \$52 million annual deficit and lower pension liabilities for its retirement system that is less than 50 percent funded. Wayne isn't alone. Three other Michigan municipalities and two school districts are under consent agreements.

Evans has 30 days to continue negotiations with unions before he can demand employment terms. After that, he has the power to enact wage or benefit reductions on the county's nine unions, which have expired contracts.

"This is a very sad day for Wayne County," said Gary Woronchak, chairman of the commission.

Under the pact, Wayne officials can't issue debt or sell county assets valued at more than \$50,000 without Treasurer Nick Khouri's approval.

## **Jail Bonds**

Moody's Investors Service said in July that the county's move to seek state help and spending cuts are "credit positive." Moody's rates Wayne Ba3, three steps below investment grade, and has noted

that a consent agreement would empower local officials. The county has \$654 million of long-term general-obligation debt outstanding.

A portion of \$143 million outstanding of 10 percent jail bonds traded Thursday at an average of 84.8 cents on the dollar to yield 11.9 percent. That's down from an average of 96.4 cents on June 17, the day Evans asked the state for a financial emergency declaration. The federally taxable bonds that mature in December 2040 back an unfinished jail that costs the county \$14 million a year in debt service.

## **Bloomberg**

by Elizabeth Campbell

August 13, 2015 — 8:20 AM PDT Updated on August 13, 2015 — 9:47 AM PDT

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### **[Bloomberg Brief Weekly Video - 08/13/15](#)**

Taylor Riggs, an editor at Bloomberg Brief, talks with Kate Smith about this week's municipal market news.

[Watch the video.](#)

August 13, 2015

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### **[Puerto Rico Staring at \\$400 Million Short-Term Funding Squeeze.](#)**

Puerto Rico is approaching an inflection point that may prove to be more challenging than the commonwealth's decision this month to skip a bond payment for the first time.

After borrowing internally, omitting debt-service payments and slowing tax rebates, the island is at risk of running out of cash to fund day-to-day operations. Puerto Rico must raise \$400 million through a bank loan or a sale of short-term securities by November, Victor Suarez, Governor Alejandro Garcia Padilla's chief of staff, said Aug. 10 in San Juan.

Garcia Padilla's administration had already alienated creditors before defaulting on \$58 million of bonds Aug. 3 by saying they need to restructure a \$72 billion debt burden that it can no longer sustain. Puerto Rico appears to be betting that investors will provide access to capital markets again once the commonwealth unveils a debt-restructuring proposal Sept. 1.

"They're going to have some severe liquidity issues," said David Hitchcock, a Standard & Poor's analyst in New York. "Without cash-flow financing, they're going to have a very difficult time trying to just pay for ongoing operations as well as their upcoming debt payments in the next six months."

It's not clear how much operating cash Puerto Rico has on hand. The island's Government Development Bank, which lends to the commonwealth and its localities, stopped providing monthly updates as of May, when it had \$778 million of net liquidity. That was down from \$2 billion in October.

## **Anticipation Notes**

Like most U.S. states, Puerto Rico tends to sell tax-and-revenue anticipation notes in the first half of a fiscal year to help finance operating needs before revenue collections pick up.

When the GDB sold short-term debt in October, the last such borrowing for the island, it paid a yield of 7.75 percent for notes that matured in eight months. The discount rate on benchmark six-month U.S. Treasury bills was around 0.05 percent at the time.

Yields on an index of one-year Puerto Rico debt were 39 percent Thursday, more than three times the average of 9.9 percent over the past two years, according to data compiled by Bloomberg. Benchmark one-year municipal debt yields about 0.27 percent.

## **Mounting Payments**

“Whatever little good faith we had has been completely wiped out by this missed payment” by the Public Finance Corp., said Sergio Marxuach, public-policy director at the Center for a New Economy, a research group in San Juan. “And after November, things become a little more unclear.”

Puerto Rico and its agencies face \$1.4 billion of principal and interest payments in December and January, including \$357 million for general-obligation debt, according to data compiled by Bloomberg.

Borrowing another \$400 million may not be enough, Hitchcock said. In fiscal 2015, which ended June 30, the island sold \$1.2 billion of short-term debt and still ended the year with a projected budget gap of as much as \$740 million.

“Ability to access the market can be important for liquidity purposes,” Hitchcock said. “And we feel right now they have very limited market access, if any.”

## **Water Bonds**

Puerto Rico may test market access as soon as Tuesday. The island’s Aqueduct and Sewer Authority, known by the Spanish acronym Prasa, wants to sell \$750 million of bonds to fund capital improvements. While the bonds have a dedicated revenue source in the form of user fees, the agency still anticipates selling the debt at an average interest rate of at least 10 percent. Prasa bonds maturing July 2042 traded Thursday at an average yield of 8.3 percent, or 67.6 cents on the dollar, according to data compiled by Bloomberg.

“It would be amazing if they can get the deal done,” said Matt Dalton, chief executive office of Rye Brook, New York-based Belle Haven Investments, which manages \$3 billion of munis, including Puerto Rico. “I’m just not sure who they’re going to sell it to.”

Moody’s assigned a Caa3 rating to the proposed sale Friday, saying exposure to the government’s financial, economic and political risks indicates a heightened loss potential.

Even though Puerto Rico isn’t setting aside cash every month to make the general-obligation debt payment, officials anticipate the island will have the cash flow to pay the January debt bill, Chief of Staff Suarez told reporters in San Juan on Aug. 10.

Selling \$400 million of additional tax-and-revenue anticipation notes to outside investors would help finance day-to-day government operations beyond November, Suarez said.

Without additional borrowing, the administration would need to consider unpaid furloughs, additional payment suspensions to suppliers or extending IOUs, Marxuach said. That would force residents and businesses to spend less and banks might actually start reducing the amount of credit they extend to companies with contracting work through the government, he said.

“Obviously that’s going to have a negative ripple effect on the economy,” Marxuach said. “All that matters in the market is the perception, and the perception is Puerto Rico defaulted.”

## **Bloomberg**

by Michelle Kaske

August 13, 2015 — 9:00 PM PDT Updated on August 14, 2015 — 11:42 AM PDT

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### **[Municipal Sales Set to Rise, Redemptions Fall; Kansas Sells \\$1B.](#)**

Municipal bond sales in the U.S. are set to increase in the next month while the amount of redemptions and maturing debt falls.

States and localities plan to issue \$10.1 billion of bonds over the next 30 days, according to data compiled by Bloomberg. A week ago, the calendar showed \$8.6 billion planned for the coming month. Supply figures exclude derivatives and variable-rate debt. Some municipalities set their deals less than a month before borrowing.

Kansas State Development Finance Authority plans to sell \$1.01 billion of bonds, New York State Convention Center Development Corp. has scheduled \$640 million, Charlotte, North Carolina Water and Sewer System will offer \$463 million and District of Columbia Hospital will bring \$382 million to market.

Municipalities have announced \$11.4 billion of redemptions and an additional \$18.1 billion of debt matures in the next 30 days, compared with the \$31.2 billion total that was scheduled a week ago.

Issuers from Texas have the most debt coming due with \$7.81 billion, followed by California at \$2.07 billion and New Jersey with \$910 million. Texas has the biggest amount of securities maturing, with \$5.4 billion.

The \$3.6 trillion municipal market shrank by 4 percent in 2014. This year, maturities are poised to drop 38 percent to \$176 billion from the 2014 levels.

Investors removed \$88 million from mutual funds that target municipal securities in the week ended July 29, compared with an increase of \$250 million in the previous period, according to Investment Company Institute data compiled by Bloomberg.

## **Yield Ratios**

Exchange-traded funds that buy municipal debt increased by \$72.4 million last week, boosting the value of the ETFs 0.42 percent to \$17.2 billion.

State and local debt maturing in 10 years now yields 106.083 percent of Treasuries, compared with 103.105 percent in the previous session and the 200-day moving average of 101.035 percent, Bloomberg data show.

Bonds of Michigan and Tennessee had the best performance over the past year compared with the average yield of AAA rated 10-year securities, the data shows. Yields on Michigan's securities narrowed 3 basis points to 2.55 percent while Tennessee's declined 2 basis points to 2.33 percent. Puerto Rico and Illinois handed investors the worst results. The yield gap on Puerto Rico bonds widened 129 to 11.05 percent and Illinois's rose 31 basis points to 4.15 percent.

## **Bloomberg**

Kenneth Kohn

August 10, 2015 — 4:49 AM PDT

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### **[Moody's Updated 2013 U.S. Local Government Medians Support Sector's Stable Outlook.](#)**

The updated 2013 medians for US local governments continue to reflect slow growth in tax bases, marginal increases to fund balances and liquidity, and a steady rise in debt and pension liabilities, which continues to support Moody's view of a stable outlook for the sector. The baseline for the stability is provided by slow growth in full value of property values across all subsectors.

The full report is available for purchase [here](#).

13 Aug 2015

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### **[Moody's: Detroit's Income Tax Revenue Bonds Offer Better Credit Quality than City's GO Pledge.](#)**

New York, August 12, 2015 — The City of Detroit's (B2 positive) \$245 million in income tax revenue bonds will be publicly reoffered by Barclays and now include structural enhancements that make them stronger than the city's general obligation rating, but are not guaranteed to eliminate bondholder risk in any future economic downturn or bankruptcy, Moody's Investors Service says in "Detroit's New Income Tax Revenue Bonds Provide Greater Credit Protection Than the City's General Obligation."

The income tax revenue bonds are not rated by Moody's, but we believe the bonds would be rated in the low Baa to high Ba range. This is due to the meaningful, but untested, bondholder protection and Detroit's ongoing fiscal and credit challenges.

"Default risk with these income tax bonds is much lower than the city's general obligation debt, which carries no special statutory protections and was significantly impaired during the city's recent bankruptcy," author of the report and Moody's VP — Senior Credit Officer Hetty Chang says.

However, Moody's says no guarantee can be made that pledged revenue would not be subject to an automatic stay during bankruptcy proceedings, which raises the possibility of technical or payment default in that scenario.

The income tax bonds share some of the same protection qualities as the city's distributable state

aid (DSA) bonds. The state makes DSA payments directly to the DSA bond trustee, who is responsible for allocating funds for debt servicing. The DSA bonds were not included in Detroit's recent Chapter 9 proceedings. But Moody's notes there are differences in bondholder securities between these bonds.

"We perceive greater security for DSA bondholders because distributable state aid is a state revenue appropriated for local government purposes. The state levies and collects sales tax revenue and has issued bonds for Detroit secured by a lien on that revenue. The DSA's higher degree of state control protects bondholders and warrants the higher rating," Chang says.

Moody's also says Detroit's credit quality continues to be weighed by persistent economic challenges, which directly impact income tax collections. Recent improvements in income tax collections have not recovered to historical levels. Employment remains below pre-recession levels, and population is not rebounding.

Although the risk of default or bankruptcy has lessened for Detroit, the potential for another economic downturn continues to be reflected in the B2 issuer rating. Another recession would elevate financial pressure on the city.

The report is available to Moody's subscribers [here](#).

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### **[Fitch: Pension Obligation Bonds Won't Fix U.S. Public Pensions.](#)**

Fitch Ratings-New York-13 August 2015: Pension obligation bonds (POBs) will not correct unsustainable benefit and contribution practices and are not a form of pension reform, Fitch Ratings says. Issuing POBs is neutral for some governments' credit quality and negative for others. In our view, credit quality is tied to whether governments implement reforms to make their underlying pension obligations sustainable over time.

The Kansas Development Finance Authority's \$1 billion POB issuance this week is the latest issuance of a financing tool often considered by governments with low pension funded ratios. The underlying question is whether they are sustainable without additional reforms to benefits and funding practices.

In the optimal scenario, POBs put cash into a troubled pension system, increasing its potential investment returns (at the assumed discount rate) and decreasing the size of annual contributions. However, this is typically neutral for credit quality because the decline in pension contributions is generally offset by higher debt service and the unfunded pension liability is replaced by bonded debt. At worst, governments using POB proceeds to cover annual contributions that normally would be paid by annual budgetary resources are engaging in deficit financing and creating a higher annual fixed-cost burden and higher liabilities. This is typically negative for credit quality. In all cases, POBs raise timing and investment risks as they are betting that investment returns will exceed the cost of debt service.

According to Thomson Reuters, governments sold \$670 million of POBs in the first half of the year, compared with \$300 million in all of 2014. The growth of these bonds was motivated by the increase in unfunded pension liabilities, which rose sharply since the significant market losses of 2008-2009.

However, those market losses are not the only cause of weakened pensions. The majority of plans lowered benefits and/or raised contributions in response. Fitch expects slow improvements in funded

ratios for most plans as reduced benefits usually apply only to new workers and stronger contribution practices accrue in the form of larger pension investment portfolios. A handful of governments have been unwilling or slow to change benefits or to correct historically inadequate contribution practices that now require much higher contributions. For those pension plans, any gains from issuing POBs will be temporary in the absence of more fundamental reforms.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at [www.fitchratings.com](http://www.fitchratings.com). All opinions expressed are those of Fitch Ratings.

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## **[BDA Testifies Before U.S. Department of Labor on Fiduciary Duty.](#)**

BDA CEO Mike Nicholas testified before the U.S. Department of Labor (DOL) regarding its proposal to expand the definition of “fiduciary” under the Employee Retirement Income Security Act (ERISA).

In his remarks, Nicholas focused on how the proposed expansion would significantly limit the ability of dealers to provide investment advice and recommendations to retirement investors. You can find his prepared remarks [here](#).

Specifically, Nicholas spoke about how the BDA does not believe the proposed rule or the associated exemptions represent the right approach for improving the market for retirement investment advice and services. He further stated that the proposal naturally favors an investment advisory business model over a commission-based brokerage model.

BDA recommendations and concerns include the following:

- The BDA encourages and supports a harmonized multi-agency approach in which the DOL and SEC develop a uniform best interest standard of care
- The BDA believes the Best Interest Exemption is not in the best interests of investors and is especially concerning given restrictions on transactions in taxable or tax-free municipal bonds
- The Principal Trading Exemption explicitly restricts investor asset choice and ignores the existing

broker-dealer regulatory regime

In addition to Nicholas' testimony, BDA has submitted a [comment letter](#) to the Labor Department regarding its [request for comment](#). BDA's letter recommends the DOL to take an alternative approach and urges the DOL work with SEC to craft a rules-based uniform best interest standard of care for investors generally, not just retirement investors.

08-13-2015

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## **[New Rule to Lift Veil on Tax Breaks.](#)**

Cities and states have plied companies with tax breaks for decades hoping to attract jobs and commerce. A new accounting standard will force many to disclose the total annual cost.

The rule approved Monday by the Governmental Accounting Standards Board, the municipal equivalent of the board that sets the standards for corporate reporting, will require government officials to show the value of property, sales and income taxes that have been waived under agreements with companies or other taxpayers. It kicks in starting next year.

Shelby County, Tenn., which includes the city of Memphis, waived about \$48.7 million in property taxes last year, equivalent to 6.5% of its property tax receipts. Chicago channeled \$372 million to nearly 150 special taxing districts in 2014, or \$1 for every \$13 of property taxes billed in the city, according to figures from the Cook County clerk's office, which collects city taxes. Before it was shut down in 2012, a major California tax-incentive program sent about 12% of statewide property taxes to redevelopment agencies—and more than 25% in some counties—often benefiting private industry.

Small towns can make big tax commitments as well. Belleville, Ill., with just 43,000 people about 20 miles east of St. Louis, sent \$15.6 million of property- and sales-tax receipts—a big part of the city's nearly \$97 million in total revenue—to its 19 special taxing districts last year, where the beneficiaries include developers that built shopping centers and residential homes. Special tax districts typically are created for private or public entities to finance, build or operate infrastructure or facilities.

The numbers show how the costs of discounted tax bills, special tax zones or outright waivers are piling up for local governments that in some cases have pressing problems with pensions and other budgetary issues. Deals like Nevada's promise last fall to give Tesla Motors Inc. up to \$1.3 billion in tax breaks for building a battery plant there and the \$8.7 billion of incentives Washington offered Boeing Co. and its suppliers to expand jetliner production in the state have long been subject to complaints that they increase the burden on existing businesses and individual taxpayers while creating too few jobs.

Now, investors, some government officials and others are becoming concerned that the combined effect of such deals over the years may be significantly limiting the financial flexibility of some cities. Governments rarely sum up the value of the tax breaks they have granted, and the accounting board worries that this leaves investors in the dark about the toll.

"These agreements reduce the amount of tax revenue you get, but you never see that, because it's not reflected in the accounting system," said Dean Mead, a research manager at the Governmental Accounting Standards Board. "To understand what they can collect, you need to know about things that would prevent them from collecting taxes."

Cities use a number of incentives to lure businesses or keep them there. They may reduce or even suspend tax collections of businesses for years, or transfer tax receipts directly to developers and employers. Another popular approach is to agree to spend any tax revenue from projects to improve the surrounding areas. That spending then benefits the companies that set up shop, directly or indirectly.

The choices can be difficult, because cities have to compete against rivals in neighboring states for investments that could create jobs. If they don't bid aggressively, they could lose out entirely. But being too aggressive means missing out on tax revenue.

"Anything that gives more transparency to what a government is doing and what is behind government finances, I'm all for it," said Hugh McGuirk, head of mutual-fund company T. Rowe Price Group Inc.'s municipal-bond team. "If we find out that, of the potential tax revenue, they're only realizing 60%, versus another entity that's realizing 98% of potential, maybe they've been a little too generous with their tax incentives."

In Shelby County, Tenn., which competes with neighboring Arkansas and Mississippi for many industrial and commercial businesses, Memphis and other local governments have entered into more than 500 multiyear agreements with companies like Nike Inc., typically waiving 70% and often more of the property taxes that would otherwise be owed.

In a 2013 deal with Nike, Shelby County agreed to abate \$30 million of property taxes over 15 years. That was on top of \$28 million that Memphis had waived. In return, the sportswear company said it would invest \$301 million to expand a distribution center and improve another facility, adding 250 jobs and \$8.75 million in payroll.

Nucor Corp. paid just \$300 in taxes last year on property in Shelby County that ordinarily would have been taxed at \$1.3 million thanks to pacts that extend out as far as 2028. One, a 15-year deal signed in 2012, involved a promise by the steelmaker to add 27 jobs and invest \$113 million in its facility there.

In January, a joint economic-development board for Memphis and the county voted to give Swedish home-furnishings retailer IKEA a combined \$9.5 million in tax breaks over 11 years if it builds one of its stores in the county. An IKEA spokesman said the company plans to break ground this fall and open the store a year later. Spokesmen for Nucor and Nike declined to comment.

Absent such agreements, the county's overall tax rate could be reduced, said Shelby County Trustee David Lenoir, who collects the county's taxes, to about \$4.07 from the current \$4.37 per \$100 of assessed property value. For a house assessed at \$100,000, that would amount to a \$300-a-year tax cut.

"It is a significant amount," Mr. Lenoir said.

County economic-development officials said the incentives have paid off. The joint city-county economic development agency that negotiates many of the tax-incentive agreements estimates that they have created or saved nearly 9,500 jobs and spurred \$2 billion in capital investment since 2011, in the process generating another \$715 million in tax revenue. The estimate includes partial payments by the companies and a computer model's projection of the taxes that will be generated by newly hired employees and the businesses they patronize.

Critics of economic-development incentives say such calculations are only as good as the assumptions that underlie them.

Chicago, meanwhile, has announced plans to eliminate some of the tax districts and freeze spending at others. In Belleville, Mayor Mark Eckert said the city's special tax districts are critical to its economic health. With neighboring troubled East St. Louis, Ill., Belleville has had to fight to retain car dealerships and other businesses.

THE WALL STREET JOURNAL

By THEO FRANCIS

Aug. 4, 2015 5:50 p.m. ET

Write to Theo Francis at [theo.francis@wsj.com](mailto:theo.francis@wsj.com)

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## **Puerto Rico Investors Win Relief From UBS.**

Mom-and-pop investors facing steep losses in Puerto Rico municipal-bond funds are starting to get some money back, following legal victories against the unit of UBS Group AG that sold the funds.

Investors scored their latest win on Tuesday. UBS was ordered to pay about \$2.5 million to a San Juan couple who bought Puerto Rico bond funds that plummeted in value as the island commonwealth's financial crisis deepened, according to law firms Sonn & Erez PLC and Aldarondo & Lopez-Bras PSC, which represented the plaintiffs. The investors had requested up to \$6 million in damages.

Earlier this year, UBS was ordered to pay nearly \$1.5 million, out of about \$5.8 million requested, to investors in three other cases regarding the Puerto Rico bond funds. The cases were decided by arbitrators from the Financial Industry Regulatory Authority, which resolves disputes between brokers and their clients.

The Swiss bank said it faces more than \$1.1 billion in damages tied to its Puerto Rico activities. Roughly 900 cases have already been filed with Finra, and lawyers are preparing to file more in the wake of Puerto Rico's first-ever municipal-bond default this month. More investor losses are likely as the island commonwealth seeks to restructure a debt load that Gov. Alejandro García Padilla has said is unpayable.

UBS said investors in the funds received excellent returns for years, which often exceeded the broader bond market. It said that a roughly \$250,000 award in a recent case was only a small portion of what was sought and doesn't indicate how future cases will be decided.

Each dispute is "based on the facts and circumstances particular to the individual claimant," UBS said. A UBS broker won one Finra case in which an investor had requested about \$9,000 in damages. That investor didn't have legal representation.

"Before it's over, UBS is going to pay hundreds of millions of dollars, maybe more than a billion dollars, over what happened in Puerto Rico," said Craig McCann, president of Securities Litigation & Consulting Group, which is working for individual investors in some of the cases against UBS. "You would think at some point, either the individuals or the corporate entities would see that they have to be more careful about what they're selling investors."

Investors say UBS brokers told them that the Puerto Rico bond funds were safe, when in fact they

were heavily invested in just a few Puerto Rico bond issues, and had used leverage, a risky strategy, to improve returns. They also say UBS reaped millions of dollars in fees by selling and trading the funds and that investors didn't know that UBS largely controlled the market for the funds, making them illiquid and prone to outsize price swings.

The risks of the funds became apparent in mid-2013, when worries about Puerto Rico's finances caused prices on the island's bonds to fall, according to the investor claims. In 2013, roughly \$3 billion of the funds' market value was wiped out, according to an analysis from Mr. McCann's firm.

UBS has disclosed that federal regulators are investigating whether one broker improperly encouraged investors to take out loans so they could buy more shares in the funds. UBS has said it is cooperating with the inquiry.

One UBS broker, Jose Ramirez, has been fired and is the focus of a criminal investigation by the Justice Department, The Wall Street Journal previously reported. At the time, an attorney for Mr. Ramirez said it was "sheer speculation" who was the subject of the probe.

The Securities and Exchange Commission also recommended bringing an action against a current UBS broker, Ramiro Colon, for failure to supervise, according to broker records. Mr. Colon intends to "vigorously defend" against the allegations, the records show.

UBS declined to comment on Mr. Ramirez and Mr. Colon. The SEC and Justice Department declined to comment.

Some of the cases filed by individual investors have been settled, at times for millions of dollars. For those that go to a hearing, the Finra-trained arbitrators who preside aren't required to write opinions explaining their decisions. But they issued an opinion in May, when they awarded Juan Burgos Rosado \$1 million to compensate him for his losses.

The arbitrators said Mr. Rosado was "at age 66 essentially a first-time senior investor with no experience" and "that a proper effort to know her customer would have revealed that to his broker."

For many investors, "their life savings are invested in these kinds of funds," said W. Scott Greco, a lawyer at Greco & Greco PC whose client won an award against UBS. "However small that may be to UBS, it's a very large amount for them."

In a case decided last month, one of the plaintiffs, Francisco Ramis, was a business executive in an aluminum door and window business and was looking for a safe investment that would provide funds for him and his wife after he retired, according to legal documents. He knew Mr. Ramirez, the ex-broker scrutinized by the Justice Department, since childhood.

A lawyer for Mr. Ramirez, Guillermo Ramos-Luiña, said the award was exclusively against UBS. "We have contested all the allegations," he said.

Mr. Ramis initially asked for approximately \$3.1 million, an amount that included punitive damages, and received about \$250,000. Mr. Ramis and his wife are happy they won a damage award, said Francisco Pujol, an attorney in San Juan who represented the couple.

"He really trusted the broker completely because of their friendship," Mr. Pujol said.

THE WALL STREET JOURNAL

By MIKE CHERNEY

Updated Aug. 11, 2015 11:06 p.m. ET

Write to Mike Cherney at [mike.cherney@wsj.com](mailto:mike.cherney@wsj.com)

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## **Edward Jones to Pay \$20 Million to Settle SEC Municipal Bond Charges.**

The Securities and Exchange Commission, moving against abusive practices in the municipal-bond industry, penalized a major brokerage firm for overcharging customers.

Edward Jones will pay \$20 million to settle charges that the St. Louis-based firm and Stina R. Wishman, the former head of its municipal underwriting desk, improperly sold new bonds to customers at prices higher than those negotiated with bonds' issuers, the SEC said. The agency said the firm's practice cost customers at least \$4.6 million.

It is the SEC's first pricing-related case against an underwriter selling new municipal securities.

Edward Jones and Ms. Wishman settled without admitting or denying the SEC's findings. An Edward Jones spokesman said the firm will fully compensate the 13,000 current and former clients who were overcharged between 2009 and 2013. The firm said it cooperated fully with the SEC investigation and has taken steps to enhance its municipal-bond business.

A lawyer representing Ms. Wishman couldn't immediately be reached for comment.

Some analysts said the case opens a new front for the SEC's enforcement efforts in the sale of bonds backed by state and local government-related entities, showing a changing focus from problems related to disclosure to those related to pricing. SEC commissioners Luis Aguilar, Daniel Gallagher, Kara Stein and Michael Piwowar said in a statement the case illustrates the need for better rules on transparency in bond pricing.

"The Commission's recent enforcement action against [Edward Jones] involving the offer and sale of municipal bonds to retail investors highlights the need for clear rules requiring the disclosure of mark-ups and mark-downs," they wrote, urging the Financial Industry Regulatory Authority and the Municipal Securities Rulemaking Board to complete rules mandating increased price transparency. "If not, we believe the Commission should propose rules to address this important issue," they wrote.

Chairwoman Mary Jo White said in June 2014 that the SEC would work with Finra and the MSRB on rules for increased pricing transparency, saying the importance of such disclosure was greater in the current low interest-rate environment, where brokers' compensation can measurably impact investors' returns.

"This information should help customers assess the reasonableness of their dealer's compensation and should deter overcharging," she said.

Small investors make up around 70% of the \$3.7 trillion municipal bond market, either individually or through mutual funds. But researchers have found that significant markups persist on municipal bonds sold to retail investors, long after similar practices in other markets have largely been swept aside by changing technology, competition and enforcement efforts.

Elaine Greenberg, partner in the securities litigation, investigations and enforcement practice at

Orrick, Herrington & Sutcliffe LLP, said the case sends a message to municipal-market participants that the SEC is on the hunt for violations of securities law or MSRB regulations in both the primary and secondary markets.

“They’re really looking at all aspects of the market, whether it’s disclosure, market structure or pricing,” she said. Ms. Greenberg previously served as head of the SEC’s specialized unit on municipal securities and public pensions.

The SEC said that Edward Jones took new bonds into inventory, then wrongly sold them to customers at higher prices.

In some cases, the firm didn’t offer the bonds to its customers until secondary trading began, then sold them at inflated prices. The SEC also charged the firm with failing to adequately supervise some secondary-market trades.

The settlement includes about \$5.2 million in payments to current and former customers who were overcharged, the SEC said. Ms. Wishman agreed to pay \$15,000 and will be barred from working in the securities industry for at least two years. Edward Jones now discloses the percentage and dollar amount of markups on all fixed-income trade confirmations to retail customers, the SEC said.

A marketwide study by Securities Litigation and Consulting Group found that investors paid \$10.6 billion in markups across \$2.5 trillion worth of municipal bond trades between 2005 and 2013, more than half of which were excessive. Fees have been dropping, yet remain above those charged in other, more transparent markets such as stocks, according to S&P Dow Jones Indices LLC, part of McGraw Hill Financial.

“It’s a very visible and painful warning that will put a fire under other firms that aren’t fully compliant with SEC rules,” said Matt Fabian, partner at Concord, Mass.-based research firm Municipal Market Analytics. “It’s important that customers have faith in the prices on municipal bonds offered for sale.”

The SEC called the municipal-bond market “illiquid and opaque” in a 2012 report and called for greater protections for investors.

The report said transaction costs and markups are typically higher for individual investors than for institutions, unlike in U.S. equity markets, and some studies have shown that “the opacity of the market contributes to the relatively higher prices paid by retail investors.”

The SEC’s efforts since have included settlements with underwriting firms for making false statements or omissions in bond documents, brokerages for improperly selling junk-rated Puerto Rico bonds to individual investors, and states for failing to disclose the risk of unfunded pension obligations on the repayment of municipal bonds. The agency has even sought to ban local officials from the market for their involvement in alleged fraud.

Andrew Ceresney, director of the SEC’s Enforcement Division, said Thursday’s move demonstrates the SEC’s commitment to maintaining the integrity of the market, which he called critical to financing U.S. infrastructure such as bridges and schools.

“It also further illustrates our continued focus on the municipal market and ensuring that participants in this market follow all legal requirements,” he said.

THE WALL STREET JOURNAL

By AARON KURILOFF

Updated Aug. 13, 2015 8:43 p.m. ET

—Chelsey Dulaney  
contributed to this article.

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## **[Chicago to Argue for Pension Reforms Before State High Court in November.](#)**

CHICAGO — Lawyers for the city of Chicago will appear before the Illinois Supreme Court in November to argue that a law aimed at shoring up two of the city's financially shaky public pensions is constitutional, according to a Thursday court order.

A Cook County judge had ruled against the law in late July, saying it violates pension protections in the Illinois constitution. The ruling was a setback for Mayor Rahm Emanuel, who has repeatedly said he will not raise taxes without pension reforms.

The Illinois Supreme Court set a calendar for lawyers' written briefs and oral arguments on Thursday.

Cook County Circuit Court Judge Rita Novak rejected Chicago's arguments that the 2014 law results in a net benefit because it will save the municipal and laborers' retirement systems from insolvency and that the law was backed by a majority of affected labor unions.

Novak also took issue with the city's contention that it was not legally on the hook to pay pensions.

The law requires Chicago and affected workers to make bigger contributions to the pensions and replaces an automatic 3 percent annual cost-of-living increase for retirees with one tied to inflation. Those increases are also skipped in some years.

Pension payments are devouring bigger chunks of budgets for Illinois and Chicago and both face crippling spending cuts or big tax increases if those payments are not reduced. Illinois has the worst-funded pension system among U.S. states and a \$105 billion unfunded pension liability, while Chicago's unfunded liability for its four systems is \$20 billion.

Arlene Bohner, a Fitch analyst, said in July that a ruling by the state supreme court tossing out the law "could very well lead to a downgrade."

Representatives for the nation's third-largest city and for the union representing city workers were not immediately available for comment.

By REUTERS

AUG. 13, 2015, 4:40 P.M. E.D.T.

(Reporting by Mary Wisniewski; Editing by Lisa Lambert)

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## **Edward Jones to Pay \$20M to Settle Federal Bond Sales Probe.**

ST. LOUIS — Edward Jones has agreed to pay more than \$20 million to settle claims by federal regulators that the brokerage firm and its former head of municipal underwriting overcharged customers in new municipal bonds sales, the U.S. Securities and Exchange Commission announced Thursday.

The SEC described the case as its first against an underwriter for pricing-related fraud in the primary market for municipal securities. The commission declined to specify the prevalence of such misconduct, saying only that its investigation was continuing.

Municipal bonds are debt securities issued by states, cities, counties and other governmental entities typically to finance long-term public projects such as building schools, highways or sewer systems.

Underwriters are required to offer new bonds to their customers at the “initial offering price,” which is negotiated with the bonds’ issuer. But the SEC said it found that largely between 2009 and 2012, Edward Jones and Stina Wishman — then chief of the firm’s municipal bond underwriting desk — instead took new bonds into the firm’s own inventory and improperly offered them to customers at higher prices.

Edward Jones sometimes didn’t offer the bonds to customers until after trading began in the secondary market, then offered them at prices higher than the initial offering price, the SEC said.

Edward Jones’ customers paid at least \$4.6 million more than they should have for new bonds. Under the settlement \$5.2 million will be distributed to those past and current clients, which Edward Jones spokesman John Boul said Thursday number roughly 13,000.

“We know who they are and what amount they will be compensated” with interest, Boul told The Associated Press, adding that Edward Jones cooperated fully with the SEC’s probe and never hid the scrutiny, having disclosed in SEC filings since 2012 that it was the target of an investigation.

“We are pleased to have this matter resolved,” he said.

The SEC said Wishman will pay \$15,000 and is barred from working in the securities industry for at least two years.

The St. Louis-based firm also was accused of supervisory shortcomings in its review of municipal bond trades on secondary markets, specifically in monitoring whether the firm’s markups charged to customers for certain trades were reasonable.

Neither Edward Jones nor Wishman admits violating any federal securities laws. The SEC credited the firm with recently undertaking “a number of remedial efforts,” including disclosing the percentage and amount of markups on all fixed-income retail order trade confirmations in principal transactions.

Andrew Ceresney, head of the SEC’s enforcement division, said Edward Jones “undermined the integrity of the bond underwriting process,” and that the first-of-its-kind enforcement action “reflects our commitment to addressing abuses in all areas of the municipal bond market.”

By THE ASSOCIATED PRESS

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## **[GASB Statement Requires Governments to Disclose Information on Tax Abatements.](#)**

Norwalk, CT, August 14, 2015—The Governmental Accounting Standards Board (GASB) has issued final guidance that requires state and local governments for the first time to disclose information about tax abatement agreements.

The disclosure requirements in [GASB Statement No. 77, Tax Abatement Disclosures](#), are designed to provide financial statement users with essential information about these agreements and the impact that they have on a government's finances.

Governments often agree to abate or reduce the taxes of individuals and entities to promote economic development, job growth, redevelopment of blighted or underdeveloped areas, and other actions that are beneficial to the government or its citizens. Many state and local governments have tax abatement programs in place and the effects of tax abatements on their financial health and ability to raise revenue can be substantial. However, until now it has been difficult to determine the extent and nature of these effects from financial statements.

"This new guidance will result in people who use governmental financial statements having access to essential information about the tax abatements governments enter into," said GASB Chair David A. Vaudt. "Not only will this mean that they'll have access to information that will allow them to better assess a government's financial health, but it will also make the impact of these agreements much more apparent."

Statement 77 requires governments to disclose information about their own tax abatements separately from information about tax abatements that are entered into by other governments and reduce the reporting government's tax revenues. The new disclosures about a government's own tax abatement agreements include:

- The purpose of the tax abatement program
- The tax being abated
- Dollar amount of taxes abated
- Provisions for recapturing abated taxes
- The types of commitments made by tax abatement recipients

Other commitments made by a government in tax abatement agreements, such as to build infrastructure assets.

The new disclosures about tax abatements that are entered into by other governments and reduce the reporting government's tax revenues include:

- The name of the government entering into the abatement agreement
- The tax being abated
- Dollar amount of the reporting government's taxes abated.

## Transactions.

- [The Bond Lawyer - Summer 2015](#)
- [Stroock: Protecting Pensions And Contract Rights For Public Sector Employees.](#)
- [California Guards Muni Buyers From Bankruptcy With Dibs on Taxes.](#)
- [IRS Webcast: Voluntary Closing Agreement Program Updates for Tax Exempt Bonds.](#)
- [GFOA 20th Annual Governmental GAAP Update.](#)
- And finally, [Valley Forge Sewer Authority v. Hipwell](#) takes us back to the bitter winter of 1777 when our fledgling republic hung in the balance, only to be saved when General Washington's flagging resolve was bolstered when he took a look around and realized, "Hey, this would be a great place for a sewer authority."

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## **SIGNAGE - CALIFORNIA**

### **[Contest Promotions, LLC v. City and County of San Francisco](#)**

**United States District Court, N.D. California - July 28, 2015 - Slip Copy - 2015 WL 4571564**

Plaintiff is a corporation that organizes and operates contests and raffles whereby individuals are invited to enter stores for the purpose of filling out an application to enter a contest. Plaintiff brought suit against the City of San Francisco, challenging the constitutionality of its signage ordinances, which banned the use of "off-site" signage, known as General Advertising Signs, but permitted "on-site" signage, known as Business Signs. The primary distinction between the two types of signage pertains to where they are located. Broadly speaking, a Business Sign advertises the business to which it is affixed, while a General Advertising Sign advertises for a third-party product or service which is not sold on the premises to which the sign is affixed. The paradigmatic example of an off-site (or General Advertising) sign would be a billboard.

The Complaint alleged causes of action for (1) violation of the First Amendment, (2) denial of Due Process, (3) inverse condemnation, (4) denial of Equal Protection, (5) breach of contract, (6) breach of implied covenant of good faith and fair dealing, (7) fraud in the inducement, (8) promissory estoppel, and (9) declaratory relief.

The District Court granted City's motion to dismiss as to all causes of action. The state law claims were dismissed without prejudice so that a state court may decide the state law claims in the first instance.

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## **ENVIRONMENTAL - CALIFORNIA**

### **[City of San Diego v. Board of Trustees of California State University](#)**

**Supreme Court of California - August 3, 2015 - P.3d - 2015 WL 4605356**

City, local association of governments, and metropolitan transit system (MTS) filed petitions for writ of mandate challenging state university system's certification of final environmental impact report (EIR) and approval of campus expansion project. The Superior Court denied the petitions. City, association, and MTS appealed. The Court of Appeal affirmed in part, reversed in part, and remanded with directions. The Supreme Court granted review, superseding the opinion of the Court of Appeal.

The Supreme Court of California concluded that the Board of Trustees was not justified in assuming that a state agency may contribute funds for off-site environmental mitigation only through

earmarked appropriations, to the exclusion of other available sources of funding. That erroneous assumption invalidated both the Board's finding that mitigation was infeasible and its statement of overriding considerations. Accordingly, the Supreme Court affirmed the Court of Appeal's decision directing the Board to vacate its certification of the EIR.

Supreme Court, after determining that state university board of trustees improperly assumed that feasibility of mitigating campus expansion project's off-site environmental effects depended on a legislative appropriation for that specific purpose, would decline to consider whether particular sources of funding could legally be used for off-site mitigation, as question was not properly before the Court on appeal. In environmental impact report (EIR) issued pursuant to the California Environmental Quality Act (CEQA), board went no further in considering the feasibility of fair-share mitigation payments than to assume incorrectly that such payments would require a legislative appropriation for that specific purpose.

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## **ZONING - CALIFORNIA**

### **[Carson Harbor Village, Ltd. v. City of Carson](#)**

**Court of Appeal, Second District, Division 8, California - July 31, 2015 - Cal.Rptr.3d - 2015 WL 4600066**

Mobile home park filed mandate action against city, challenging city's denial of park's application to convert park from rental spaces to subdivision of individually owned lots. The Superior Court entered judgment against city. City appealed. The Court of Appeal reversed in part, affirmed in part, and remanded with directions. Following remand, city held new public hearings and rejected park's application. Park brought another mandate action against city. The Superior Court found in favor of park. City appealed.

The Court of Appeal held that:

- Determination in prior appeal that inconsistency in city's general plan was not available ground for denying application was not law of the case;
- City was permitted to deny application based on inconsistency with open space element of city's general plan; and
- Evidence was sufficient to support city's finding that subdivision was inconsistent with open spaces element of general plan.

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## **ANNEXATION - INDIANA**

### **[Town of Whitestown v. Rural Perry Tp. Landowners](#)**

**Court of Appeals of Indiana - July 29, 2015 - N.E.3d - 2015 WL 4557062**

Remonstrators challenged town's annexation of land. The Superior Court adopted remonstrators proposed findings and conclusions and entered judgment in their favor. Town appealed.

The Court of Appeals held that:

- Town met its burden of demonstrating that annexation area was "needed" and could be "used by the municipality for its development in the reasonably near future," as required to justify annexation, and

- Remonstrators failed to show that annexation would have “a significant financial impact,” as required to defeat the otherwise valid annexation.

Town seeking to annex unincorporated portions of adjacent township met its burden of demonstrating that the annexation area was “needed” and could be “used by the municipality for its development in the reasonably near future,” within meaning of statute governing requirements for annexation. Witnesses testified concerning rapid growth of town, annexation area was to be site of new waste water treatment plant, town had plans to run water mains through the area, town had plans to connect the plant to water lines from subdivision next to the annexation area, preventing annexation of a portion of the area could lead to substantial expense to town, and there was no evidence that town only sought to bolster its tax base.

Remonstrators challenging town’s annexation of unincorporated portions of adjacent township failed to demonstrate that the annexation would have “a significant financial impact,” as required to defeat town’s otherwise valid annexation, even though annexation could result in an increase in property taxes of 52% to 74% for residents of the annexation area. Town’s annexation ordinance provided that property taxes in the annexation area would remain at preannexation levels for 13 years, there was no evidence as to financial impact at the conclusion of the 13-year period, and town’s 13-year plan of accommodation would not be regarded as an effort to “game the system,” in absence of legislative provision barring such arrangement.

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## **ANNEXATION - INDIANA**

### **[Town of Fortville v. Certain Fortville Annexation Territory Landowners](#)**

**Court of Appeals of Indiana - July 2, 2015 - N.E.3d - 2015 WL 4040822**

Landowners filed petition remonstrating against town’s proposed annexation of territory. After a bench trial, the Circuit Court concluded that town failed to demonstrate that the annexation was needed and could be used by town for its development in the reasonably near future. Town appealed.

The Court of Appeals held that, In determining whether a municipality seeking to annex territory fulfills the requirement that the territory sought to be annexed is needed and can be used by the municipality for its development in the reasonably near future, a trial court may, and should, consider non-physical brick and mortar development uses, such as using annexed territory for transportation linkages with other developing areas, to control adjacent development on its borders, and to prevent conflicting land uses.

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## **MUNICIPAL ORDINANCE - LOUISIANA**

### **[Albe v. City of New Orleans](#)**

**Court of Appeal of Louisiana, Fourth Circuit - July 29, 2015 - So.3d - 2015 WL 4598291 - 2014-1013 (La.App. 4 Cir. 7/29/15)**

Motorist cited for traffic violation pursuant to Automated Traffic Enforcement System (ATES) ordinance brought putative class action, on behalf of herself and putative class of automobile owners ticketed for violating ordinance who paid fines directly, contested fines, lost, and paid, or had not yet paid fines and received delinquent notice, against city and automated traffic enforcement systems company, challenging overall validity of ordinance and seeking to have it declared unconstitutional

on its face and as applied.

The Civil District Court denied class certification. Motorist and putative class appealed.

The Court of Appeal held that:

- Class failed to meet numerosity requirement for certification;
- Class failed to meet commonality requirement for certification; and
- Definition of class was overly broad.

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## **BALLOT INITIATIVES - MINNESOTA**

### **[Minnesota Voters Alliance v. Anoka-Hennepin School Dist.](#)**

**Court of Appeals of Minnesota - July 27, 2015 - N.W.2d - 2015 WL 4507988**

The Anoka-Hennepin School District is funded in part by levies approved by voters in the district. In August 2011, the school board passed a resolution to present three levy-funding questions to voters in a special election on November 8, 2011. The ballot questions asked voters whether to: (1) renew an existing levy providing \$1,044 per student per year for the next ten years; (2) approve a levy of \$3 million each year for ten years for technology; and (3) approve a levy of \$12 million per year for ten years as a stop-gap measure if the legislature fails to approve inflationary funding.

In the months before the election, the school district informed voters about the levy questions in multiple ways. The school district conducted two public meetings in September, provided an online property-tax calculator for voters to gauge the effect of each proposed levy, and mailed a one-page notice of special election and a one-page sample ballot to all 81,235 addresses in the district. And it created and disseminated the five-page brochure at issue in this appeal.

Nearly one year after the special election, the Minnesota Voters Alliance filed a complaint with the Minnesota Office of Administrative Hearings, alleging that the school district violated campaign-finance-reporting requirements under Minn.Stat. § 211A.02 (2014) and engaged in unfair campaign practices under Minn.Stat. § 211B.06 (2014) in connection with the brochure.

The Court of Appeals held that a school district's act of placing a levy question on the ballot is not an act to "promote" the levy question within the meaning of Minn.Stat. § 211A.01, subd. 4 (2014). A school district acts to "promote" a levy ballot question within the meaning of Minn.Stat. § 211A.01, subd. 4, only when it urges the adoption of the levy ballot question by express advocacy or by statements that, viewed as a whole, are the functional equivalent of express advocacy.

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## **ZONING - MINNESOTA**

### **[Dean v. City of Winona](#)**

**Supreme Court of Minnesota - August 5, 2015 - N.W.2d - 2015 WL 4637133**

Residential property owners brought action to challenge municipal ordinance limiting to 30% the number of lots on a block eligible to obtain certification as rental properties. The District Court granted summary judgment for city, and property owners appealed. The Court of Appeals affirmed. Owners petitioned for review.

The Supreme Court of Minnesota held that:

- Following sale of property at issue, exception to mootness doctrine for issues that are capable of repetition, yet evade review did not apply;
- Appeal did not present an urgent question of statewide importance requiring immediate review; and
- Supreme Court would not consider Remedies Clause claim for nominal damages, raised for the first time on appeal.

Exception to mootness doctrine for issues that are capable of repetition, yet evade review did not apply, following sale of property at issue, to former property owners' appeal in action brought against city challenging ordinance limiting to 30% the number of lots on a block eligible to obtain certification as rental properties. City's enforcement of the ordinance was ongoing, and there was nothing about the case that was of inherently limited duration.

Former property owners' appeal in action brought against city challenging ordinance limiting to 30% the number of lots on a block eligible to obtain certification as rental properties did not present an urgent question of statewide importance supporting Supreme Court exercise of discretion to consider the case, despite its having been rendered moot by owners' sale of the property at issue. Although the right to rent property was an important property interest and the record was well-developed, the case, involving homeowners of one municipality, was not so urgent or having such broad impact as to require an immediate decision.

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## **MUNICIPAL ORDINANCE - NEW JERSEY**

### **[Timber Glen Phase III, LLC v. Township of Hamilton](#)**

**Superior Court of New Jersey, Appellate Division - August 6, 2015 - A.3d - 2015 WL 4643551**

Owners of apartment buildings brought action in lieu of prerogative writs challenging an ordinance adopted by township assessing an annual licensing fee on residential apartment units. The Superior Court granted summary judgment in favor of township. Owners appealed.

The Superior Court of New Jersey, Appellate Division, held that Licensing Act did not grant township authority to adopt ordinance assessing annual licensing fee on residential apartment units, where Act limited municipalities' licensing authority to temporary residential uses, not permanent dwellings, such that municipalities could not mandate by ordinance licensure of residential rentals for 175 days or more.

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## **UTILITIES - PENNSYLVANIA**

### **[Valley Forge Sewer Authority v. Hipwell](#)**

**Commonwealth Court of Pennsylvania - July 31, 2015 - A.3d - 2015 WL 4598341**

Sewer authority filed a writ of scire facias sur (what the hell is that?) municipal claim against customer, seeking to enforce a lien imposed pursuant to Municipal Claims and Tax Liens Act (MCTLA) for unbilled sewer service to property that was multi-family dwelling with four equivalent dwelling units (EDU) but listed in sewer authority's records as a single-family dwelling. The Court of Common Pleas entered judgment in favor of sewer authority. Customer appealed.

The Commonwealth Court held that:

- Sewer service contract did not allow customer to pay for only one EDU per quarter, and
- Customer's account was delinquent under MCTLA's attorney fee provision.

Sewer service contract did not allow customer to pay for only one equivalent dwelling unit (EDU) per quarter for his multi-family dwelling that was listed in sewer authority's records, and billed as, only a single-family dwelling despite having four EDUs, and therefore there was no unilateral mistake in the formation of contract barring sewer authority from obtaining payment for unbilled service for three EDUs per quarter. Standard contract terms provided for a uniform payment that could change based upon number of EDUs at location and, pursuant to Municipality Authorities Act and sewer authority's code of rules and regulations, all customers agreed to pay a quarterly fee of \$75 per EDU in exchange for sewer service.

Customer's account was delinquent, as would allow sewer authority to recover attorney fees incurred in collection of account pursuant to Municipal Claims and Tax Liens Act (MCTLA), where sewer authority requested payment from customer for \$2925 by a named date for unbilled sewer services for customer's three additional equivalent dwelling units (EDU) in his multi-family property that was listed in sewer authority's records, and billed as, only a single-family dwelling, but payment was not made, despite claim that customer did not pay while pursuing a reasonable contest.

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## **TAX - NEW YORK**

### **[George W. & Dacie Clements Agr. Research Institute, Inc. v. Green](#)**

**Supreme Court, Appellate Division, Third Department, New York - July 30, 2015 - N.Y.S.3d - 2015 WL 4557775 - 2015 N.Y. Slip Op. 06399**

After applying for property tax exemption, property owner, which was not-for-profit corporation and which operated farm, restaurant, and bed and breakfast on property, and provided public training and educational information concerning organic and biodynamic farming and gardening, brought proceedings for tax relief urging that its property was tax exempt for several tax years. All proceedings except one were consolidated. Town's board of assessment review determined property was exempt. Petitioner moved for summary judgment. The Supreme Court denied motion. Property owner appealed.

The Supreme Court, Appellate Division, held that no binding agreement had been reached between board and property owner.

Writings between town's attorney and president of property owner were merely agreement to agree to amplified terms of future writing, and were incomplete as to all terms necessarily material to settlement, and thus no binding agreement had been reached between town's board of assessment review and property owner in proceedings brought by property owner urging that its property was tax exempt. Writings described proposed settlement hypothetically referencing terms that settlement would involve, including that town's attorney "would draw the appropriate settlement papers and provide a copy to" property owner "for approval before submitting them to" court, and writings did not anticipate potential statutory conflict identified with respect to refund.

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## **[The Risk in Appropriation Bonds.](#)**

Not all municipal bonds are created equal. That principle was reinforced this past week, when

Puerto Rico failed to fully pay principal and interest on what market participants call “appropriation bonds.”

This type of bond is repaid only if a state legislature or city council earmarks, or appropriates, payments in the budget. Thus, it lacks the stronger legal protections of other municipal bonds. The missed payment occurred after Puerto Rico’s legislature failed to set aside the money.

In the wake of the drama, some investors say they will think twice before buying this form of debt, which is commonly sold by municipalities on the U.S. mainland, too. The bonds are enticing to some public officials because they can be sold without voter approvals needed for other debt. New Jersey, for example, has \$30 billion of these securities outstanding, according to Moody’s Investors Service.

“We don’t see the bonds as offering proper compensation in terms of yield, relative to other options in the market,” says Bill Bonawitz, director of municipal research at PNC Capital Advisors, which oversees \$6.5 billion in munis and has generally been avoiding appropriation bonds. “You may be at greater risk than you realize.”

Not all Puerto Rico bondholders are getting stiffed. On July 1, Puerto Rico paid in full what was due on its general-obligation bonds. These bonds, which make up much of the \$3.7 trillion muni bond market, are considered to be backed by a municipality’s “full faith and credit” pledge—a promise to pay investors with available revenues, and potentially raise taxes or cut expenditures if there’s a shortfall.

Appropriation bonds do not carry the same pledge. In a prospectus for the Puerto Rico bonds, sold by the Puerto Rico Public Finance Corp., investors were warned in boldface type that the legislature is “not legally bound to appropriate” enough money to pay bondholders.

For individuals buying bonds on their own, highly rated general-obligation bonds are the way to go, says Michael Johnson, head of research at Gurtin Fixed Income Management, which oversees \$9.5 billion. He also suggests paper tied to essential services, such as water and sewer systems, which have dependable revenue streams, regardless of economic conditions. “That gives you less things to worry about,” he observes.

Johnson says his firm is comfortable buying appropriation bonds, but that it consistently reviews municipalities for signs of trouble. The bonds can still have some advantages. They can be used to finance new fire stations, city halls, or other important assets that a municipality could lose if it defaulted. In those situations, keeping current on payments might be a top priority for municipal officials, making a default less likely.

However, Puerto Rico’s governor has said the island’s debt is unaffordable, and it remains to be seen whether its general-obligation bonds also suffer losses.

THERE’S TROUBLE WITH appropriation bonds outside Puerto Rico, too.

Take the Metropolitan Pier and Exposition Authority in Illinois, which sold bonds to finance improvements to Chicago convention center McCormick Place. It said this past week that it couldn’t make its monthly deposit to the bond trustee for a coming debt payment. Illinois, which is facing fiscal challenges of its own, hadn’t passed a budget for the fiscal year, so lawmakers never made the appropriation to allow the authority to make the deposit.

It’s still unlikely the authority will default on actual payments to investors. Lawmakers have time to pass a budget before principal and interest is due in December. The bonds are backed by various taxes, including state sales levies, and there’s enough money in the bank for the monthly deposit.

But the situation prompted Standard & Poor's Ratings Services to slap the bonds with a massive downgrade, from triple-A to triple-B-plus, a move that could hurt the bonds' market value.

BARRON'S

By MIKE CHERNEY

Aug. 8, 2015 1:41 a.m. ET

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## **[Stroock: Protecting Pensions And Contract Rights For Public Sector Employees.](#)**

A look at how, in the current economic climate, some cities and states have attempted to impair contracts and pensions and how the public sector labor force has and can protect against those efforts.

### **INTRODUCTION**

Recently, in an important decision for public employees, the Illinois Supreme Court rejected an attempt by Illinois lawmakers to impair the State's public pension system. The proposed legislative changes would have, among other items, curtailed future cost-of-living adjustments for workers, raised the age of retirement for some, and imposed a cap on pensions for those with the highest salaries. Though no one could reasonably dispute the gravity of Illinois' budgetary difficulties, the court recognized that "economic conditions are cyclical and expected," and "fiscal difficulties have confronted the State before."<sup>1</sup> The Legislature could not attempt to cure budgetary shortfalls on the backs of public employees, even in dire circumstances, because the Illinois constitution provides that benefits promised as part of a pension system for public workers "shall not be diminished or impaired." To the court, "crisis [was] not an excuse to abandon the Rule of law....it [was] a summons to defend it." Thus, the Legislature could not unilaterally diminish the fundamentally and constitutionally preserved retirement benefits of public workers.<sup>2</sup>

The Illinois Supreme Court's decision is one of several recent decisions nation-wide dealing with the constitutionality of a state's seeking to impair contractually bargained-for pension rights of public employees. Yet, the decisions have not all been decided the same way and have had mixed results for public employees.

Even more recently, in a lawsuit filed by a number of New Jersey public employee unions, New Jersey Superior Court Judge Mary Jacobson initially ruled that Governor Chris Christie's attempt unilaterally to withhold \$1.6 billion of contributions from the public pension system to cure New Jersey's budgetary shortfall was unlawful.

The court held that renegeing on the State's financial obligations to public sector workers violated the contract rights of the employees under the New Jersey and Federal Constitutions.

The court concluded that because the State "failed to present any real evidence of an emergency situation or of its having considered any alternatives to cutting out the [pension payments] entirely to balance the budget," the action was unconstitutional.<sup>3</sup> Governor Christie was ordered to make the \$1.6 billion payment to the public pension system because the State had "substantially impaired plaintiff's contractual rights without justification."<sup>4</sup>

However, the New Jersey Supreme Court reversed the lower court ruling. In a lengthy opinion, the court held that the New Jersey legislation that created the annual obligation to fund the severely underfunded pension system ran afoul of the State Constitution's Debt Limitation Clause, a unique New Jersey constitutional mandate prohibiting the Legislature from incurring debts, either by contract or by statute (i.e., without voter approval), exceeding one percent of the annual budget. The court, in its first full paragraph, made absolutely clear that whether New Jersey's "men and women must be paid their pension benefits when due [was] not in question." Instead, the issue was whether the funding legislation in question, Chapter 78, could create a valid and legally enforceable contractual right to an annual contribution from the State into the pension funds in the absence of voter approval. Because of the New Jersey-specific constitutional debt limitation provision, under state law it could not. There was no enforceable contract.

Importantly, on this strictly legal question pertaining to a statutory financing scheme, the court had no occasion to consider whether the State's commitment to pay retirement benefits when due is a valid and binding contract and whether its failure to pay would constitute a violation of the federal or State Contracts Clause. The language of the decision, and the court's repeated emphasis on the narrow question before it, suggests that it remains, at the very least, an open question. Indeed, the court recognized the importance of New Jersey fulfilling its obligations and noted that the State "must get its financial house in order" to "honor its compensation commitment to retired employees." It further emphasized that "the State repeatedly asserted at oral argument that it is not walking away from its obligations to the pensions and to pay benefits due to retirees." Thus, while the decision ostensibly appears to be a victory for the Christie administration, no overly broad conclusions about its substance or applicability of the decision to other jurisdictions should be drawn.

For over a decade, New Jersey has, on average, made less than half of its required annual contributions to its state pension fund and, as in many states like Illinois, with politicians loathe to propose tax increases or to make the budgetary cuts needed to fund shortfalls, attention has now turned to the once believed to be inviolable public sector pensions.

The recent Illinois decision and the New Jersey lawsuit, captioned *Burgos v. New Jersey*,<sup>5</sup> despite their ultimate differing outcomes, provide a path for how public sector unions can utilize state and federal constitutional provisions to protect the safety net that their members have for so long counted on for their retirements. New Jersey's and Illinois' budgetary imbalance and consequent fiscal difficulties are not uncommon. Although the U.S. economy is improving, as evidenced by lower unemployment rates, drastically reduced gas prices, and surging stock markets,<sup>6</sup> fiscal concerns remain for some of the nation's largest cities and states. Recovering from the recession has been harder for certain U.S. municipalities, in part because despite the improved housing and labor markets, tax revenues - the largest source of government funds - have not universally rebounded as quickly. Many American cities are still struggling to adjust to the shrunken revenue streams that resulted from the recession,<sup>7</sup> the decline in federal and state aid, and the decline in property tax revenue.<sup>8</sup> In some recent, well-known severe cases - Detroit, Michigan, San Bernadino, California, and Stockton, California - the impact of the recession, combined with the unwillingness of governments to make hard choices, has pressed municipalities into bankruptcy.<sup>9</sup> Aside from cities and smaller localities, some state governments, are also facing difficult choices in today's challenging economic climate.<sup>10</sup>

Under the guise of these budgetary constraints, policymakers have taken aim at public sector pensions and contracts in an attempt to stabilize finances. Such unilateral attempts to reduce or eliminate altogether contractually bargained-for rights, have been met with challenges across the country, based on both state and federal constitutional grounds. Under numerous state

constitutions, including Illinois', New Jersey's, and New York's, public sector employee pensions are accorded the status of contracts, "the benefits of which shall not be diminished or impaired," under a provision colloquially referred to as the "Non-Impairment Clause."<sup>11</sup> Similarly, under Article I, Section X of the Federal Constitution, states are prohibited from impairing contractual obligations, under a provision known as the "Contracts Clause."<sup>12</sup> The federal Contracts Clause and state non-impairment clauses safeguard the legitimate expectations of employees who devote their lives to public service and ensure that the promises made to municipal workers when they began their careers are ultimately fulfilled. As they have historically, many public sector workers take lower paying jobs precisely for the security and predictability of seniority and a pension. Yet, these protections are not absolute. In truly dire economic circumstances, governments exercising their constitutionally recognized police power may trump these protections and modify or breach labor contracts. Importantly, however, they may only legally so act as a last and necessary resort.

The first part of this article outlines the contours of state non-impairment clauses and the federal Contracts Clause (and state analogs), focusing on how courts analyze challenges made on those constitutional bases. The second part of this article discusses recent legislative and judicial impairments of public sector pensions in both Detroit and Illinois. Last, we examine the state of the law in New York, using recent national developments to inform the analysis.

## **METHODS FOR PROTECTING PENSIONS AND CONTRACT RIGHTS<sup>13</sup>**

### **The Non-Impairment Clause - Protecting Pensions**

Public sector employees in certain states can use the non-impairment clause to protect their pension rights from unilateral reductions imposed by a state or local government. Under many state constitutions, including New York's, pensions are granted contractual status. Article V § 7 of the New York State Constitution declares that, "membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired."<sup>14</sup> Notably, there is no qualification. Thus, any judicial or legislative action that seeks to impair pension rights is arguably a violation of New York's Non-Impairment Clause.<sup>15</sup>

Case law and the legislative history confirms that the purpose of New York's Non-Impairment Clause was "to fix the rights of the employees at the time of commencement of membership in the [pension] system, rather than as previously at retirement."<sup>16</sup> The clause prohibits unilateral action by either the Legislature or the employer that would diminish or impair the rights employees have gained through their membership in the system.<sup>17</sup>

### **The Contracts Clause - Protecting Contract Rights**

In addition to non-impairment clauses, the federal Contracts Clause and its more well-developed caselaw protects all citizens nationwide from having their contract rights modified or impaired by government officials. It applies commonly to labor contracts between government employers and public employee unions. Wage freezes or furloughs, for example, which typically abrogate the collectively bargained-for wage increases of municipal workers, fit neatly within the constitutionally contemplated paradigm of a state impairing a citizens' contractual rights. To challenge the imposition of a wage freeze or furlough, employees have argued that by imposing the freeze, the state is violating its obligations under the federal Contracts Clause, which provides that "[n]o state shall . . . pass any . . . law impairing the obligation of contracts." (Most states have a contracts clause analog that mirrors the federal provision.) In addition to challenging wage freezes or other diminution of contract rights, the Contracts Clause may also be used to challenge a unilateral impairment of public sector pensions in states that recognize pensions as contractual obligations. In

New York and other states, through the Non-Impairment Clause, the constitution not only prohibits the impairment of pensions but expressly recognizes pensions as contracts. Other states have afforded pensions contractual constitutional protection via court rulings.<sup>18</sup>

To establish a viable Contracts Clause claim, employees must show there has been a “substantial impairment of a contractual relationship.”<sup>19</sup> Courts will assess, whether a contractual impairment is constitutional: “(1) whether the contractual impairment is in fact substantial; if so, (2) whether the law serves a significant public purpose, such as remedying a general social or economic problem; and, if such a public purpose is demonstrated, (3) whether the means chosen to accomplish this purpose are reasonable and appropriate.”<sup>20</sup> When a state is impairing its own contracts, as is often the case with municipal and state workers, the impairment is scrutinized more closely than if a state is impairing private contracts.<sup>21</sup> “Courts are less deferential to a state’s judgment of reasonableness and necessity when a state’s legislation is self-serving and impairs the obligations of its own contracts.”<sup>22</sup> Further, the level of review is heightened if the impairment is severe. The United States Supreme Court has recognized “[t]he severity of the impairment is said to increase the level of scrutiny to which the legislation will be subjected.”<sup>23</sup>

The most significant hurdle in prevailing on a Contracts Clause claim from a labor perspective is demonstrating that the impairment did not “serve a significant public purpose” or that the impairment was not “reasonable and appropriate” to accomplish that purpose. In *Buffalo Teachers Fed’n v. Tobe* (“Buffalo Teachers”), the Second Circuit analyzed whether legislation establishing a wage freeze to deal with Buffalo’s fiscal crisis was a violation of the Contracts Clause.<sup>24</sup> There, the court found that the wage freeze did not violate the contracts clause because the freeze was “reasonable and necessary”<sup>25</sup> during an extreme economic crisis in the city of Buffalo during 2003.<sup>26</sup> Buffalo’s population was declining, its poverty rate was above 20% and its credit rating was near junk status. Importantly, the court emphasized that the wage freeze was utilized as a “last resort measure,” imposed “only after other alternatives had been considered and tried,” including, among other things, a tax increase and a city-wide hiring freeze.<sup>27</sup> Other factors the court considered in determining the reasonableness of the wage freeze was that the freeze was temporary, and applied prospectively to future wages, not to past wages already earned.<sup>28</sup> The Buffalo Teachers precedent clarifies that though a government’s interest in addressing a dire fiscal emergency may constitute a legitimate public interest, the existence of revenue shortfalls or other budgetary problems alone does not satisfy the significant public purpose inquiry.<sup>29</sup> Relief from the obligation to pay its workers is useful from a budgetary perspective to any government. But a wage freeze or other unilateral contract impairment is not just another tool for balancing municipal budgets; it is a tool that must only be used as a last resort. <sup>30</sup>

In the case of the New Jersey appellate court, Judge Jacobson began her analysis by stating that New Jersey’s Non-Impairment Clause created a contractual right for pensions between public employees and their employers.<sup>31</sup> While recognizing that the constitutional prohibition is not absolute, the court held that the State’s decision to eliminate \$1.57 billion of its \$2.25 billion obligation to the pension system reflected a substantial impairment “by any measure.”<sup>32</sup> Moreover, because “a State is not completely free to consider impairing the obligations on par with other policy alternatives,” New Jersey’s Governor could not unilaterally cut pensions, more than a year before the end of the fiscal year, before even considering other budgetary alternatives.<sup>33</sup> The court afforded less deference to the State in its analysis of whether the Governor’s actions were reasonable and necessary because the State’s own economic self-interest was at stake. Quoting the Supreme Court’s seminal decision in *U.S. Trust*, the court stated that “[i]f a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contracts Clause would provide no protection at all.”<sup>34</sup>

Though the New Jersey Supreme Court reversed the decision on other grounds, the lower court's decision (and Justice Albin's dissent in the Supreme Court decision) is critical as it used the Contracts Clause analytical framework of *U.S. Trust and Buffalo Teachers* and applied it to the impairment of state employee pensions. A future challenge in New Jersey to the actual reduction of pension payments should pick up on Judge Jacobson's reasoning in this regard. As the Supreme Court found, New Jersey must get its "financial house in order," but to withstand scrutiny, impairing pensions must be a last, not a first resort.

### **Comparing the Non-Impairments Clause and the Contracts Clause**

Since its adoption, the Non-Impairment Clause in New York has most often been used to prohibit the Legislature from altering the formula by which the amount of retirement benefits is determined.<sup>35</sup> In both *Kleinfeldt v. New York City Employees' Retirement System* and *Birnbaum v. New York State Teachers Retirement System*, the New York Court of Appeals explained that even if their decisions invalidating the Legislature's attempt to alter the retirement benefits formula would "plunge[]" the retirement system "into bankruptcy," the court was "not at liberty to hold otherwise" as the constitutional amendment prohibits - without qualification - official action which "adversely affects the amount of retirement benefits payable to the members under [the] laws and conditions existing at the time of his entrance into retirement system membership." <sup>36</sup> In *Kleinfeldt*, the court further emphasized that "[a]lthough fiscal relief is a current imperative, an unconstitutional method may not be blinked." <sup>37</sup>

This reasoning suggests that the Non-Impairment Clause may actually be stronger than the Contracts Clause and a first and threshold line of defense, as the Non-Impairment Clause - unlike the Contracts Clause - may protect pensions even in the event of a fiscal crisis. These New York cases, along with the Illinois decision discussed below, support the position that the Non-Impairment Clause may provide an absolute protection against pension reductions. However, the inviolability of New York's and other state's non-impairment clauses may come into question. Some judges in states with similar non-impairment clauses have found that the pension protection provision is not ironclad. These judges hew more closely to the Contracts Clause "last resort" analysis in determining whether pensions may be impaired.

### **LEGISLATIVE AND JUDICIAL IMPAIRMENTS IN TODAY'S ECONOMIC CLIMATE**

The contours of non-impairment clause jurisprudence can be seen in the recent examples of both Detroit and Illinois. Both illustrate what circumstances may allow for a successful constitutional challenge.

#### **Detroit's Bankruptcy and Public Sector Pensions**

Detroit's bankruptcy filing in 2013 underscores the vulnerability of pensions amidst tough financial times. Detroit's bankruptcy filing was not surprising, as the city had reached rock bottom following "decades of decline" and the "flight of residents and businesses to the suburbs."<sup>38</sup> It stands as the biggest municipal bankruptcy filing in the country's history, a true low for the "hollowed-out relic that once was hub for the U.S. automotive industry."<sup>39</sup> Detroit, like Buffalo in 2003, was in dire economic straits, experiencing significant decreases in population, employment, and revenue. These decreases caused the city's infrastructure to decay, its crime rates to rise, and its borrowing to become excessive.<sup>40</sup> Detroit's debt, upon filing, was estimated to be \$18 billion.<sup>41</sup>

In the face of Detroit's challenging financial circumstances, its public sector employees sought to protect the pensions they were promised. Michigan, like New York, has a constitutional non-impairment clause protecting them. Article IX, § 24 of the Michigan Constitution reads, "[t]he

accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired.” Several public sector employee unions challenged Detroit’s eligibility to file for bankruptcy and its attempt to diminish their pensions. The unions argued that “the city filed for bankruptcy with the sole intention of diminishing pension benefits, and that the filing violates state and federal constitutions.”<sup>42</sup> However, the court explained that although the “the State of Michigan cannot legally provide for the adjustment of the pension debts of the City of Detroit” due to the “prohibition against the State of Michigan impairing contracts in both the United States Constitution and Michigan Constitution . . . [t]he federal bankruptcy court, however, is not so constrained.”<sup>43</sup> The court reasoned that because the Bankruptcy Clause of the U.S. Constitution, and the corresponding Bankruptcy Code, empower the Bankruptcy Court to impair contract rights, pensions – though armed with constitutional contractual status, could be impaired in bankruptcy.<sup>44</sup> The court stated, “[i]t has long been understood that bankruptcy law entails impairment of contracts.”<sup>45</sup> Thus, despite the seemingly absolute language of the Michigan Non-Impairment Clause, Bankruptcy Judge Steven Rhodes found that Detroit pensions could be impaired in order to settle the bankruptcy.<sup>46</sup>

Importantly, the linchpin of Judge Rhode’s ruling was that (1) the situation in Detroit was so dire that municipal bankruptcy was necessary and (2) within that municipal bankruptcy context, impairment of bargained-for rights was permissible.

As a result of the court’s decision, a settlement with the unions, which reduced the pensions of retirees by 4.5% and eliminated their cost-of-living adjustments,<sup>47</sup> was reached by the parties and confirmed by the court on November 7, 2014.<sup>48</sup> Clearly, Detroit’s bankruptcy significantly impacted the lives of the hard working people of Detroit, altering their expectations of retirement.

### **Illinois Workers Fight Back**

Like Detroit and New Jersey, the State of Illinois is enduring persistent economic and budgetary difficulties. Despite the national economic recovery and a recent increase in state income taxes, Illinois is “in a deeper financial hole than ever,” according to a recent state financial report.<sup>49</sup> Illinois has “both atypically large debts and structural budgetary imbalances” that threaten to rapidly expand the State’s already growing debts and deficits. <sup>50</sup> It has the lowest credit rating of any state, and it now faces future credit downgrades, which will further increase the state’s high cost of borrowing.<sup>51</sup> To combat its rising deficits, Illinois, like other governments, turned to legislation to overhaul its pension system. Unlike Judge Rhodes’ decision in Detroit however, the Illinois courts have been unwilling to allow the government to dishonor its pension commitments.

In December 2013, Illinois passed legislation in an effort to close the gap of \$100 billion of unfunded liabilities in the State’s retirement system.<sup>52</sup> This legislation attempted to restore fiscal balance “by raising the retirement age for government employees and cutting cost-of-living adjustments.”<sup>53</sup> Plaintiff public sector unions brought suit to enjoin enforcement of the law on the grounds that it unconstitutionally impaired public employee pension rights under the Illinois Non-Impairment Clause.<sup>54</sup> The State argued that the act was justified as an exercise of its police powers.<sup>55</sup> By order dated November 21, 2014, Illinois Judge John Belz struck down the legislation ruling that “[b]ecause the Act diminishes and impairs pension benefits and there is no legally cognizable affirmative defense, the Court must conclude that the Act violates the Pension Protection Clause of the Illinois Constitution.”<sup>56</sup> Judge Belz “rejected Illinois’ argument that pensions could be cut to protect the public welfare in an emergency, including the state’s precarious financial situation.”<sup>57</sup> He explained that the Illinois “Pension Protection Clause contains no exception, restriction, or limitation for an exercise of the State’s police powers or reserved sovereign powers.”<sup>58</sup>

The Attorney General of Illinois filed a motion to appeal Judge Belz’s ruling.<sup>59</sup> The Illinois Supreme

Court heard oral arguments on March 11, 2015 and on May 8, 2015 the Court unanimously affirmed, finding that state politicians had attempted to correct Illinois' fiscal problems on the backs of public sector retirees without a meaningful effort to distribute the burden among all Illinoisans. Other means, such as increasing state income taxes, had not been considered and even a budgetary crisis was not an excuse to override the clearly stated absolute protection of pensions.<sup>60</sup>

Following Judge Belz's ruling in the lower court, public sector employees of Illinois took the offensive, seeking to challenge additional pension-impairing legislation passed by the State directed towards municipal employees in Chicago. Public Act 98-0641, which came into law in June 2014, "demands increased pension contributions from [Chicago] employees and limits their cost-of-living adjustments" in an effort to "cover a funding shortfall of as much as \$9.4 billion in two city pension funds supporting more than 60,000 workers and retirees."<sup>61</sup> In December 2014, a coalition of unions and city employees filed suit to strike down the legislation. In their complaint, the coalition stated "[u]nless this court strikes down and enjoins implementation of the act, plaintiffs and thousands of other current and retired city of Chicago and Chicago Board of Education employees will be harmed, and the trust that all Illinois citizens place in the inviolability of their constitution will be breached."<sup>62</sup> The outcome of this new litigation should shed further light on the viability of challenges to unilateral pension-impairing legislation in states with non-impairment clauses.

### **Lessons To Be Drawn From Detroit, Illinois and New Jersey**

New York public sector employees can learn from the cases in Detroit, Illinois, and New Jersey despite the still unsettled state of the law. These experiences provide a sense of the circumstances under which a court may permit the abridgement of public worker pensions and when it might resist unilateral legislative or executive action. They also provide useful information on the effectiveness of the two primary legal challenges available to public sector unions to thwart pension and benefit reductions: one based on state non-impairment clauses, as was the case in Illinois, and one, as in New Jersey and Buffalo, based on state and federal contracts clause claims.

In Detroit, the court permitted the impairment of pensions because of the city's bankruptcy and the federal court's perceived ability to invalidate public contracts without violating the Contracts Clause. Detroit's decision rested on the city's dire financial crisis and the federal court's analysis that federal bankruptcy law trumps both the State Non-Impairment Clause as well as the federal Contracts Clause.

In Illinois, despite the State's precarious financial situation, the court did not permit pensions to be impaired. There, the public sector unions pointed to the Non-Impairment Clause, and the court interpreted the clause as an absolute protection against any reduction the state legislature wished to impose upon the public employee pension system. By contrast, in New Jersey, the Supreme Court, assured by counsel that the State "is not walking away from its obligations to the pensions systems and to pay benefits due to retirees" found that a unique New Jersey constitutional provision, prevented the formation of a contract requiring certain pension funding levels. No such constitutional provision exists in New York.

The takeaway is that at the very least in New York - because of the Buffalo decision and the fact that pensions are constitutionally protected contracts - pensions may only be impaired when a municipality is suffering a severe fiscal crisis as in Detroit or Buffalo, and, even then, absent bankruptcy only once all other reasonable alternatives have been tried. However, an unprecedented situation akin to Detroit's bankruptcy is unlikely to occur in the foreseeable future in New York. So long as New York State and its municipalities are not on the verge of dire fiscal crisis, public employees here should find comfort in the state and federal constitutional arguments, which succeeded in Illinois and, at least initially, New Jersey, to bar any attempted pension reduction. A

challenge to pension or contract infringing governmental acts should focus first on the unambiguous constitutional language of the Non-Impairment Clause (“benefits... shall not be diminished or impaired”) and second on whether the government action to abrogate contractual rights or pensions is truly a measure of last resort.

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### **Footnotes**

1 In re Pension Reform Litigation, No. 118585, 2015 IL 118585, 2015 Ill. LEXIS 499 (Ill. May 8, 2015)

2 Id. at \*68.

3 James L. Bromley and Hugh K. Murtagh, Some Pension Promises May be Too Strong To Break, LAW360, (Mar. 10, 2015),

<http://www.law360.com/articles/629964/some-pension-promises-may-be-too-strong-to-break>.

4 Id.

5 Burgos v. New Jersey, No. MER-L-1267-14 (N.J. Super. Ct. Law Div. Feb. 23, 2015).

6 Alejandro Chafuen, The U.S. Economy In 2015: Challenges And Opportunities, FORBES (Jan. 1, 2015, 7:00 AM),

<http://www.forbes.com/sites/alejandrochafuen/2015/01/01/the-u-s-economy-in-2015-challenges-and-opportunities/>. See also Nick Timiraos, U.S. Economy’s Promises, and Perils, of 2015, THE WALL STREET JOURNAL (Jan. 4, 2015, 6:09PM),

<http://www.wsj.com/articles/can-u-s-economy-keep-powering-ahead-1420399994/> (“Economists often disagree, but they share a broad consensus on one point: The U.S. economy is among the world’s best off as 2015 begins.”).

7 Katherine Peralta, U.S. Cities Aren’t Out of the Woods Yet, U.S. NEWS (Nov. 11, 2014, 4:03PM), <http://www.usnews.com/news/articles/2014/11/11/fiscal-hangover-the-crisis-fiscal-impact-on-us-cities> (“The combination of declines in state aid and a slump in returns from property taxes – which is the largest source of revenue for a city – is to blame for the fiscal drain, the report found. Those two revenue sources declined an average of 4 percent across all cities.”).

8 Id.

9 Bankrupt Cities, Municipalities List and Map, GOVERNING (Nov. 7, 2014),

<http://www.governing.com/gov-data/municipal-cities-counties-bankruptcies-and-defaults.html>.

10 See Illinois Public Employee Benefits Act, Public Act 098-0599 § 1(June 1, 2014).

11 N.Y. CONST. art. V, § 7; see also Ill. CONST. art. XIII, § 5; Mich. CONST. art IX, § 24.

12 U.S. CONST. art. I § 10, cl. 1.

13 These arguments do not apply to bilateral negotiations between government officials and public sector employees in efforts to curb contract or pension rights; rather, these arguments apply when government officials unilaterally attempt to alter pension rights. Further, these arguments do not apply to employees who enter the pension system after pension rights have been impaired. There is no claim of pension impairment if it occurred prior to an employee's entrance into the pension system.

14 N.Y. CONST. art. V, § 7. (emphasis added).

15 Barnes et al. v. Arizona State Retirement System et. al., No. CV. 2011-011638 (Sup. Ct. AZ, Maricopa Cnty., 2012) (invalidating act that sought to increase employee contributions to Arizona's retirement system under the Arizona and federal Contracts Clause and under Arizona's Non-Impairment Clause).

16 Guzman v. New York City Emp. Ret. Sys., 45 N.Y.2d 186, 190-91 (1978).

17 Ballentine v. Koch, 89 N.Y.2d at 56.

18 Madden v. Contributory Ret. Appeal Bd., 431 Mass. 697, 701 (2000) ("The State retirement system creates a contractual relationship between its members and the State.") (citing Opinion of the Justices, 364 Mass. 847, 860 (1973)).

19 General Motors Corp v. Romein, 503 U.S. 181, 186 (1992).

20 Sanitation & Recycling Indus., Inc. v. City of New York, 107 F.3d 985, 993 (2d Cir. 1997).

21 Condell v. Bress, 983 F.2d 415, 418 (2d Cir. 1993).

22 Id; U.S. Trust Co. of New York v. New Jersey, 431 U.S. 1, 26 (1977) ("[C]omplete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake. A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all.")

23 Energy Reserves Grp., Inc. v. Kansas Power & Light Co., 459 U.S. 400, 411 (1983).

24 464 F.3d 362 (2d Cir. 2006).

25 Id. at 371. ("Ultimately, for impairment to be reasonable and necessary under less deference scrutiny, it must be shown that the state did not (1) 'consider impairing the ... contracts on par with other policy alternatives' or (2) 'impose a drastic impairment when an evident and more moderate course would serve its purpose equally well,' nor (3) act unreasonably 'in light of the surrounding circumstances'") (quoting U.S. Trust Co., 431 U.S. at 30-31).

26 Id.

27 Id.

28 Id. at 371-72.

29 Donahue v. Paterson, 715 F. Supp. 2d 306, 319-21 (N.D.N.Y. 2010).

30 As discussed in further detail supra at 6-7, a Contracts Clause argument faces additional challenges if the impairment has been imposed in the context of municipal bankruptcy. Certain courts have found that the Contracts Clause does not constrain the federal government and that bankruptcy law “explicitly empower[s] bankruptcy court[s] to impair contracts.” See *In re City of Detroit*, Mich., 504 B.R. 191, 244 (Bankr. E.D. Mich. 2013). Moreover, if a municipality is in a fiscal situation as dire as bankruptcy, the necessity of impairment may be more pronounced.

31 *Burgos v. New Jersey*, supra note 3.

32 *Id.*

33 *Id.* (quoting *U.S. Trust Co. of New York v. New Jersey*, 431 U.S. 1, 31 (1977)).

34 *U.S. Trust Co.*, 431 U.S. at 26.

35 *Kleinfeldt v. New York City Employees’ Retirement System*, 36 N.Y. 2d 95, 99-100 (1976).

36 *Id.* at 102; *Birnbaum*, 5 N.Y.2d 1, 11 (1958).

37 *Kleinfeldt*, 36 N.Y. 2d at 101.

38 Matthew Dolan, *Record Bankruptcy for Detroit*, *WSJ*, (Jul. 19, 2013), <http://www.wsj.com/articles/SB10001424127887323993804578614144173709204>.

39 Karen Pierog and Lisa Shumaker, *Factbox: Detroit Bankruptcy was Years in the Making*, *REUTERS*, (Jul. 18, 2013), <http://www.reuters.com/article/2013/07/19/us-usa-detroit-bankruptcy-factbox-idUSBRE96H1J820130719>.

40 *Id.* at 193.

41 *Id.* at 194.

42 Emily Atkin, *Unions Say Detroit Can’t Show It’s Insolvent*, *LAW360*, (Oct. 18, 2013), <http://www.law360.com/articles/481300/unions-say-detroit-can-t-show-it-s-insolvent>.

43 *Id.* at 244.

44 *Id.*

45 *Id.* (internal citations omitted). In examining the legislative intent behind the Non-Impairment Clause in the Michigan Constitution, the court explained that the Non-Impairment Clause in Michigan is no stronger than the Contracts Clause, and thus pensions could be impaired in bankruptcy just like contracts are impaired in bankruptcy. The court stated, the “constitution could have given pensions protection from impairment in bankruptcy in several ways.” *Id.* at 247. The court then explained that the drafters of the Michigan Constitution could have protected pensions further by prohibiting Michigan municipalities from filing bankruptcy, or by creating a property interest in pensions that bankruptcy courts would be required to respect under state law, or by establishing a secured interest in a municipality’s property, or finally, the drafters could have “explicitly required the State to guaranty pension benefits.” *Id.* (emphasis added). The court concluded that since the drafters took none of these precautions, pensions, because they enjoy

merely a contractual status, are vulnerable to impairment in bankruptcy. Id.

46 Id. at 243-248.

47 Detroit's bankruptcy plan: A phoenix emerges, THE ECONOMIST, (Nov. 7, 2014), <http://www.economist.com/blogs/democracyinamerica/2014/11/detroits-bankruptcy-plan>.

48 In re City of Detroit, (Bankr. E.D. Mich. Nov. 7, 2014).

49 Greg Hinz, State in deepest financial hole ever, CRAIN'S CHICAGO BUSINESS, (Mar. 13, 2014), <http://www.chicagobusiness.com/article/20140313/BLOGS02/140319866/state-in-deepest-financial-hole-ever>.

50 Illinois Public Employee Benefits Act, Public Act 098-0599 § 1 (June 1, 2014).

51 Id.

52 Illinois Public Employee Benefits Act, supra note 41.

53 Brandon Lowrey, Judge Strikes Down \$100B Ill. Public Worker Pension Reform, LAW360, (Nov. 21, 2014), <http://www.law360.com/articles/598731/print?section=employment>.

54 In re Pension Litigation, No. 2014 MR 1, (Ill. Cir. Ct. Sangamon Cnty., Nov. 21, 2014).

55 Id.

56 Id. (emphasis added).

57 Karen Pierog and Lisa Shumaker, Illinois asks high court for pension law hearing as soon as January, (Dec. 4, 2014), <http://www.reuters.com/article/2014/12/05/us-usa-illinois-pensions-idUSKCN0JJ04I20141205/>. See also In re Pension Litigation, supra note 46. ("Pension Protection Clause contains no exception, restriction, or limitation for an exercise of the State's police powers or reserved sovereign powers. Illinois courts, therefore, have rejected the argument that the State retains an implied or reserved power to diminish or impair pension benefits.").

58 In re Pension Litigation, supra note 46. Judge Belz's ruling tends to support the argument that the Non-Impairment Clause is stronger than the Contracts Clause. Belz explained that the Illinois Non-Impairment Clause is absolute, and will still be violated even if the state is in severe financial distress. In contrast, the Contracts Clause, will not be violated if there is a significant public purpose for the impairment.

59 Citation to that article re: AG's swift appeal

60 Rick Pearson, Monique Garcia, and Bob Secter, Illinois pension law greeted with court skepticism, CHICAGO TRIBUNE, (Mar. 11, 2015, 8:05PM), <http://www.chicagotribune.com/news/local/politics/ct-illinois-pension-supreme-court-met-0312-20150311-story.html#page=1>.

61 Lance Duroi, Chicago Pension Reform Bill Unconstitutional, Unions Say, LAW360, (Dec. 17, 2014, 2:29PM), <http://www.law360.com/articles/605332/chicago-pension-reform-bill-unconstitutional-unions-say>.

62 Id.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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## **MSRB: Muni Trading Up 14%, Puerto Rico Bonds Among Most Traded.**

WASHINGTON — Trading activity in the municipal market for the second quarter of this year was 14% higher than the previous quarter as well as the second quarter last year, with several Puerto Rico bonds among the most traded, according to the Municipal Securities Rulemaking Board.

These were among the MSRB's findings in its muni market statistics report for the second quarter of 2015, which was released Wednesday.

The MSRB said there were 2.56 million trades from April through June of this year, up 14% from 2.24 million the year before. The last time trading was that high was in the fourth quarter of 2013, when there were about 2.58 million trades.

The total par amount traded in the muni market also rose in the second quarter to \$742 billion compared to \$739 billion in the second quarter last year. Fixed-rate securities made up 58% of the \$742 billion traded and general obligation bonds issued by the Commonwealth of Puerto Rico in 2014 topped the fixed rate list as the highest traded by par amount. These bonds were the third most traded by par amount overall.

Matt Fabian, managing director at Municipal Market Analytics, said those Puerto Rico bonds "were built to be well traded" by having characteristics like one large term and limited call abilities.

"I would have been surprised if they weren't at the top of the list," Fabian said. He added Puerto Rico bonds shifted from long-term to short-term investors as the bonds got riskier and that the consistent "heavy trading" in the bonds drew hedge funds interested in making money with the liquid holdings.

Michael Decker, managing director and co-head of municipal securities at the Securities Industry and Financial Markets Association, said the GO bonds may have been trading more actively because they are seen as less risky than bonds from Puerto Rico's public corporations.

In total, seven bonds from the troubled commonwealth and its authorities made the MSRB's lists of the Top 50 traded bonds based on par amount and number of trades. The bonds included three issues of COFINA revenue bonds reliant on sales tax collections for repayment, as well as general obligation bonds and taxable Government Development Bank bonds.

The MSRB quarterly data also showed that on the consumer level, buying increased to an average daily par amount of \$5.97 billion in the second quarter, compared to \$5.81 billion a year before, and total consumer purchases were up to an average of 17,009 per day compared to 15,327 the previous year.

The number of variable-rate demand obligation rate resets grew to 135,556 from the first quarter's 133,989, but 2015 data still shows a continuing decline in VRDO rate resets from previous years, the MSRB said.

The self-regulator also received fewer continuing disclosure documents in the second quarter than the year before, with 42,543 in 2015 compared to 43,667 in 2014's second quarter. Twenty-five

percent of all the disclosures were bond call notices, the MSRB said.

THE BOND BUYER

BY JACK CASEY

AUG 5, 2015 4:05pm ET

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## **[IRS Webcast: Voluntary Closing Agreement Program Updates for Tax Exempt Bonds.](#)**

**Watch this free webcast about Voluntary Closing Agreement Program Updates for Tax Exempt Bonds**

**When:** September 3, 2015; 2 p.m. (Eastern)

**How:** [Register for this event](#) (link to registration page). You will use the same link to attend the event.

**Learn about:**

- Updates to the Voluntary Closing Agreement Program
- Background
- Procedural Updates
- Request Submission
- Resolution Standards
- Other updates

Continuing Education Credit will not be offered for this event.

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## **[GFOA 20th Annual Governmental GAAP Update.](#)**

**Training Type:**

Live-Streaming

**Date and Time:**

Nov 5, 2015 - 1:00pm to 5:00pm EST

**Program Description:**

The Government Finance Officers Association (GFOA) will offer its 20th Annual Governmental GAAP update on November 5, 2015, and again on December 3, 2015, using the latest live video and audio streaming technology. The seminar offers an incomparable opportunity to learn everything you need to know about the most recent developments in accounting and financial reporting for state and local governments from the convenience of your own computer. Enjoy all the benefits of the highest quality continuing professional education without the time and expense of travel. Sign up with your colleagues and take advantage of special group rates.

Participate in interactive exercises to test your knowledge of the material being presented. Receive

immediate feedback to your questions during the program from GFOA's Technical Services Center staff.

To learn more, and to register, [click here](#).

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## **[The Bond Lawyer - Summer 2015](#)**

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## **[Palace Intrigue: Stadium Fights Explode in Milwaukee and L.A.](#)**

Back during the previous Gilded Age, even Mark Twain surrendered. "It is a time when one is filled with vague longings," he wrote. "When one dreams of flight to peaceful islands in the remote solitudes of the sea, or folds his hands and says, 'What is the use of struggling, and toiling and worrying anymore? Let us give it all up.'" Were the old gentleman alive today, and if he could see American cities once again falling all over themselves to romance the various plutocrats who own the nation's sports teams, he might abandon the dream of escaping to those peaceful islands and try to find a way to shoot himself to the moon.

I truly thought we were beyond all of this, but that may be simply because I live in Massachusetts, where, at one time or another, public pressure has saved Fenway Park, and has forced the owner of the New England Patriots to build his own stadium with (mostly) his own money, and, most recently, has caused the city of Boston to rise up and tell the United States Olympic Committee and a host of influential local yahoos to pound sand. I don't mean to sound haughty, but why in the hell are so many of our fellow citizens such suckers?

Right at the moment, a few familiar scams are being run out in public. Remarkably, the St. Louis Rams are in the middle of several of them, which is odd because the Rams haven't been central to much of anything since they bolted from Los Angeles. (Along with the Raiders' departure, this left L.A. without a professional football team and, not coincidentally, left the NFL with a handy cudgel to use every time a city balked at the kind of blackmail that gets stadiums built.) Last week, the Rams got a nice little ruling from a local judge that invalidated a city law requiring a referendum before any public money could be used to build a stadium. This was a big step toward constructing a proposed \$1 billion complex, the cost of which would include about \$400 million in public money. St. Louis is being knuckled by an owner named Stan Kroenke, who is worth about \$6 billion and keeps threatening to move his team to Los Angeles, which also is romancing the Raiders and Chargers.

There are serious proposals to build not one but two stadiums in and around Los Angeles, the metropolitan area of which extends to somewhere east of Mongolia. In Inglewood, Kroenke has proposed to build a stadium with a see-through roof. Meanwhile, down in Carson, there's been a roiling brawl over a proposed \$1.7 billion stadium; in June, a City Council meeting nearly devolved into a fistfight. Both the Raiders and Chargers have been flirting with the Carson proposal, but they are being very coy about it. At another City Council meeting, scheduled to update residents on the progress of the onrushing fiscal calamity, neither team bothered to send a representative. The activity has been so frenzied that even John Oliver on HBO noticed and pronounced himself appalled. "Most new stadiums nowadays," Oliver marveled, "look like they were designed by a coked-up Willy Wonka." Welcome to America, big guy.

But nowhere has the scam worked so brilliantly as it has in Milwaukee, where once I watched the Warriors of Al McGuire — and the Bucks of Larry Costello — play basketball in the Milwaukee Arena, which looked like the world's largest rolltop desk. Both Marquette and the Bucks moved to the Bradley Center — now the BMO Harris Bradley Center — in 1988. It was built in the vain hope of attracting an NHL team. It was financed by the family of Harry Lynde Bradley, who got rich as the cofounder of the Allen-Bradley Company. That wealth also finances a variety of conservative causes and politicians. Which brings us all the way around to a new arena proposal and the guy pushing it the hardest, who also happens to be running for president of the United States.

In April 2014, former U.S. senator Herb Kohl sold the Bucks for \$550 million to a pair of hedge-funders named Wesley Edens and Marc Lasry. This was considered at the time to be a wild overpayment for one of the NBA's fiscal basket cases. The new owners promised to keep the team in Milwaukee and "work toward" the construction of a new downtown arena to replace the Bradley Center, which, after all, was 26 years old at the time and, therefore, by the calculations of the people who want to build new arenas with somebody else's money, might as well be Angkor Wat. Luckily, just at their moment of direst need, along came a savior with ambitions named Scott Walker.

Having largely succeeded in rolling back more than a century of progressive government in a state where progressive government was long an institution, and having been elected three times in five years, Walker was gearing up for his presidential run. He proposed to use \$250 million of public money to build the Bucks a new arena so the team would not leave town. Walker's political opponents hastened to note this was the exact amount he proposed to cut from the University of Wisconsin system. But the real action came from his erstwhile allies. Conservative legislators went straight up the wall, inveighing against what was obviously a whopping gob of corporate welfare. (They also weren't thrilled at handing over \$250 million to Edens and Lasry, who previously had contributed a lot of money to Democratic campaigns.) For his part, Walker defended the decision and uncorked almost every discredited argument for publicly funded stadiums that anyone has ever made.

He argued that only \$80 million would come from the state and that local and county government

would cover the rest, as though people lived and paid their taxes in some place called the state, and not in towns or counties. This is the pea-under-the-shells technique. He claimed the state would lose \$419 million over the next 20 years if the Bucks left town. Included in these calculations was his estimate of how much revenue would be drained if the Bucks players were no longer paying taxes in Wisconsin, which implies that the players themselves employ accountants who are stupid, drunk, or dead. He then told ABC News that these deals have been good for local economies all over the country. It was about here when actual economists began to throw themselves out of windows. Walker, who is running for president almost wholly on his conservative bona fides, found himself crossways with the Cato Institute.

That this is as noisy a fight as it has become is a promising sign. So, for that matter, is the fact that the Carson City Council nearly came to blows over a stadium proposal. It means the old sales pitches for this snake oil don't work as well as they used to. Pure civic jingoism doesn't have that old magic anymore. Citizens generally have gotten wise to the fiscal palaver and fast-talking from the people who want to get into their pockets. They aren't as easily conned by politicians, and they aren't as easily flattered by local Babbitts, and they aren't as easily bamboozled by any unholy combination of the two. Unfortunately, there is still blackmail, and the jury is still out on whether that tactic still works.

It certainly seems to be working in Wisconsin, where Walker is trying to get the ransom money transferred as best he can. It remains to be seen whether it will work on behalf of the St. Louis Rams, or the San Diego Chargers, or the Oakland Raiders, a team that has spent almost its entire history playing Oakland and Los Angeles off each other. The problem the NFL had was not that the Raiders were gaming the system but that the Raiders were gaming the system without permission. They were the functional equivalent of the people who go into casinos and count cards. You can see how it's supposed to work by watching how Kroenke plays off St. Louis and Los Angeles, and how the Chargers and Raiders play off two proposed stadiums against the cities where they presently play.

In this new Gilded Age, nothing should surprise us anymore. In Wisconsin, where Walker is moving heaven and earth to get a couple of Democratic sugar daddies a new playpen, his campaign named one Michael Grebe to be its chairman. Grebe's day job is as chairman and CEO of the Bradley Foundation, founded with the same money that once built the Bradley Center, which is obsolete because other money says so. Mark Twain was right. Those peaceful islands look very good right now.

GRANTLAND.COM

by CHARLES P. PIERCE

AUGUST 10, 2015

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## [\*\*Japanese Investors May Add U.S. Munis to Portfolios.\*\*](#)

Japanese investors are about to acquire a taste for U.S. municipal bonds, some U.S.-based money managers contend.

Executives with managers such as Neuberger Berman LLC, Eaton Vance (EV) Management (EV) and Invesco (IVZ) Ltd. say the size, safety and diversification benefits of the \$4.4 trillion muni market are poised to win that segment of the fixed-income universe a chunk of the Japanese money that's been

flowing into U.S. investment-grade corporates in recent years.

Gatekeepers are skeptical.

That prediction says more about the dreams of money managers than the needs of clients such as Japanese pension funds, said Taro Ogai, Tokyo-based managing director of investment consulting giant Towers Watson & Co.'s business in Japan. "I've never heard of a Japanese pension fund who is interested in U.S. muni bonds," he said.

Some pension clients not overly concerned about eventual rate increases could be attracted to munis because of their relative stability in "flight-to-quality" situations, but they should prove to be the exception rather than the rule, said Konosuke Kita, Tokyo-based director, consulting, with Russell Investments.

Meanwhile, a number of executives of corporate defined benefit plans in Japan said they are looking now to invest in multiasset or unconstrained bond strategies, not munis.

But one pension executive conceded that a lack of familiarity may be at issue, saying he's never considered U.S. municipal bonds because "I don't have enough knowledge and information" about that market.

Managers with muni bond businesses such as Neuberger, Eaton Vance and Invesco, say they're working now to address that learning curve, confident that for Japanese investors, to know munis will be to love them.

A confluence of circumstances is setting the stage for potential demand from Japanese investors, said Cynthia Clemson, co-director of municipal investments with Boston-based Eaton Vance Management, in an Aug. 4 interview. Rock-bottom yields for domestic bonds in Japan have pushed investors into U.S. credits, which carry risks that U.S. munis can effectively diversify, she said.

With the 10-year Japanese government bond offering an annual yield of roughly 40 basis points, munis can provide an attractive pickup for Japanese investors even without the tax advantages that endear those bonds to U.S. retail and high-net-worth investors, managers said.

An investment consultant from Mercer's Tokyo office, who declined to be named, said over the past year munis have garnered more attention from institutional and retail investors alike in Japan as a fresh and sizable market following years of considerable allocations to other "spread" instruments, including high grade U.S. corporate and high yield bonds.

Japanese investors have focused on U.S. high-grade corporate bonds in their moves out of domestic bonds, which should magnify the diversification benefits offered by munis, said Ryo Ohira, managing director and head of Neuberger Berman's Tokyo business.

About 10 months ago, Neuberger began including munis in its discussions with clients about credit as a source of "good diversification" for high grade corporates, high yield bonds, bank loans and private debt, he said.

The yield for high grade, AA paper with duration of 5 to 6 years is roughly the same for U.S. corporates and munis at about 2.5%, but cash flows for the latter are steadier than the cyclical flows of the former, said Mr. Ohira. Meanwhile, different investor bases make munis more resilient in times of volatility - like the global financial crisis of 2008, where their drawdown was less than half that of investment-grade corporates, he said.

With “extremely low” default rates compared with corporates, munis allow investors with heavy exposure to high-grade U.S. corporates to diversify their credit risk, agreed Craig Brandon, Ms. Clemson’s co-director of municipal investments at Eaton Vance.

However, defaults by Puerto Rico this month and by Detroit in 2013 may cloud that selling point.

In an e-mail, a credit officer at a large Japanese institutional investor, who declined to be identified, said default rates historically lower than those of U.S. corporate bonds make U.S. municipal bonds a market segment Japanese institutional investors can consider to diversify their credit risk, but Puerto Rico’s recent default could prove a hurdle to doing so for now.

Managers concede the recent headline risk but say those high-profile defaults shouldn’t undermine the long-term story of relative safety.

While munis remain unfamiliar ground for many Japanese pension funds, compared to multisector and unconstrained bond strategies, that could be set to change, predicted Mr. Ohira.

For example, Neuberger Berman hosted a seminar in Tokyo on munis last month attended by 160 executives from pension funds and intermediaries, and the arguments the firm’s executives made regarding diversification struck a chord, he said.

Some pension fund clients already are dipping their toes in the muni waters, but it’s still early days, said Mr. Ohira. He declined to name the firm’s clients.

Robert White, Singapore-based president of Eaton Vance Management International (Asia) Pte. Ltd., said he’s likewise seeing signs of growing interest in munis now in the number of appointments Tokyo-based gatekeepers for institutional and retail clients are making with his team.

As a high-grade, safe asset class, munis are getting the most attention now from banks with considerable holdings of Japanese government bonds and U.S. treasuries on their balance sheets, although intermediaries are also beginning to show interest, said Mr. Ohira. Pension funds could follow, especially as the prospect of rate hikes in the U.S. focuses attention on the resulting capital losses on sovereign bonds, he said.

In an e-mail, Alex Sato, Tokyo-based CEO of Invesco Japan, said his firm has been pitching munis for more than a year now, with retail investors responding more aggressively than institutional investors thus far.

More institutional clients are looking into it now as well, led by financial institutions, said Mr. Sato.

“It’s the regional banks showing interest right now,” with distributors anticipating retail investors and pension funds will follow, agreed Eaton Vance’s Mr. White. That, meanwhile, was the “growth trajectory” for bank loans, another asset segment embraced by a growing number of pension funds in Japan in recent years, he noted.

## PENSIONS & INVESTMENTS

BY DOUGLAS APPELL | AUGUST 10, 2015

— Contact Douglas Appell at [dappell@pionline.com](mailto:dappell@pionline.com) | [@Appell\\_PI](https://twitter.com/Appell_PI)  
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## **Municipal Sales Set to Rise, Redemptions Fall; Kansas Sells \$1B.**

Municipal bond sales in the U.S. are set to increase in the next month while the amount of redemptions and maturing debt falls.

States and localities plan to issue \$10.1 billion of bonds over the next 30 days, according to data compiled by Bloomberg. A week ago, the calendar showed \$8.6 billion planned for the coming month. Supply figures exclude derivatives and variable-rate debt. Some municipalities set their deals less than a month before borrowing.

Kansas State Development Finance Authority plans to sell \$1.01 billion of bonds, New York State Convention Center Development Corp. has scheduled \$640 million, Charlotte, North Carolina Water and Sewer System will offer \$463 million and District of Columbia Hospital will bring \$382 million to market.

Municipalities have announced \$11.4 billion of redemptions and an additional \$18.1 billion of debt matures in the next 30 days, compared with the \$31.2 billion total that was scheduled a week ago.

Issuers from Texas have the most debt coming due with \$7.81 billion, followed by California at \$2.07 billion and New Jersey with \$910 million. Texas has the biggest amount of securities maturing, with \$5.4 billion.

The \$3.6 trillion municipal market shrank by 4 percent in 2014. This year, maturities are poised to drop 38 percent to \$176 billion from the 2014 levels.

Investors removed \$88 million from mutual funds that target municipal securities in the week ended July 29, compared with an increase of \$250 million in the previous period, according to Investment Company Institute data compiled by Bloomberg.

### **Yield Ratios**

Exchange-traded funds that buy municipal debt increased by \$72.4 million last week, boosting the value of the ETFs 0.42 percent to \$17.2 billion.

State and local debt maturing in 10 years now yields 106.083 percent of Treasuries, compared with 103.105 percent in the previous session and the 200-day moving average of 101.035 percent, Bloomberg data show.

Bonds of Michigan and Tennessee had the best performance over the past year compared with the average yield of AAA rated 10-year securities, the data shows. Yields on Michigan's securities narrowed 3 basis points to 2.55 percent while Tennessee's declined 2 basis points to 2.33 percent. Puerto Rico and Illinois handed investors the worst results. The yield gap on Puerto Rico bonds widened 129 to 11.05 percent and Illinois's rose 31 basis points to 4.15 percent.

### **Bloomberg**

Kenneth Kohn

August 10, 2015 — 4:49 AM PDT

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## **San Francisco Seeks Rent Break Through Bonds.**

With tech workers flooding San Francisco, one-bedroom apartment rents have climbed to \$3,500 a month, more than in any other U.S. city. Residents are being priced out. Evictions routinely spark political rallies.

Mayor Ed Lee, under pressure to deal with the soaring cost of living as he runs for re-election, is backing a partial fix: a \$310 million debt sale to build affordable housing that will go before voters in November.

It's the largest housing bond in the city's history.

San Francisco's push bucks the national decline in the sale of municipal debt for housing, which was slashed in half to \$10.7 billion in 2014 from \$20.8 billion a decade earlier. It may revive interest in the bonds as mayors from New York to Seattle seek to add homes for lower-income residents as real-estate prices climb.

"You're seeing cities looking at a variety of ways to try to accommodate poor people," said Howard Cure, director of municipal credit research in New York for Evercore Wealth Management LLC, which manages \$6 billion. "It's a big issue in certain areas where places have gentrified or the rental market is such that it's becoming more unaffordable for working-class people."

In California, cities and counties need to sell housing debt directly after Gov. Jerry Brown dismantled their redevelopment agencies. Those bonds were repaid with taxes from new projects.

### **Below AAA**

That shift may benefit San Francisco, whose fast-growing economy has left investors willing to accept yields on some securities that are lower than top-rated municipals.

When San Francisco sold \$67 million of general obligations on June 23, 10-year securities were priced to yield 2.34 percent. That was less than the 2.37 percent rate on benchmark municipal debt with the same maturity, according to data compiled by Bloomberg. The 20-year bonds yielded 3.62 percent, about half a percentage point more than top-rated debt.

"It's viewed as a very safe credit to the point where you're not going to get much yield above the AAA scale," Cure said. "It's a high-tax state so there's a lot of demand for the bonds to begin with, and the city is doing pretty well."

If approved by two-third of voters, the bonds would be used to advance Lee's effort to build and renovate 30,000 homes over the next five years. The proceeds would fund the construction of rental units and create a program to help residents, including teachers, buy their first homes.

### **'Housing crisis'**

A boom among tech startups seeking to become the next Uber Technologies Inc., Facebook Inc. or Spotify Ltd. has drawn thousands of well-paid workers to California's fourth-largest city, reducing the unemployment rate to 3.5 percent. The influx is fueling higher rents and sparking protests over evictions and affluent condominium developments in working-class neighborhoods.

The median asking price for a San Francisco one-bedroom apartment is \$3,500, \$400 more than in

New York, the second most-expensive city, according to a report this month by Zumper, an online listing service. In June, the median price of a home was \$1.14 million.

“San Francisco’s housing crisis demands aggressive action,” Lee, who’s seeking re-election in November, said in a statement. “Housing that is affordable to low- and middle- income families promotes diversity and equity.”

A separate measure on the November ballot would develop affordable housing from little used city properties.

### **Swaying voters**

The bond issue, approved for the ballot by the county Board of Supervisors in July, won’t increase property taxes. San Francisco voters rejected a \$250 million affordable-housing plan in 2002 — and another \$200 million bond two years later — that included property-tax increases.

If voters approve the latest proposal, the city plans to sell the first of the debt in 2016, said Nadia Sesay, San Francisco’s public-finance director. Revenues from property taxes will be used to repay the 20-year debt, which may include some taxable bonds depending on use, she said.

“The bond will trade great,” said Craig Brothers, a Los Angeles-based money manager at Bel Air Investment Advisors, which oversees \$3 billion. “It will trade like any other San Francisco general-obligation bond.”

By: Bloomberg News August 10, 2015 1:25 pm

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### **[Kansas Tops U.S. Municipal Bond Calendar with \\$1 Bln Pension Deal.](#)**

Kansas will offer \$1 billion of taxable pension bonds in the U.S. municipal market next week in a move that could make investors skittish given a recent default on some bonds in Puerto Rico and credit ratings downgrades in Chicago.

Debt service on the bonds is subject to annual appropriation, meaning that Kansas’ legislature must decide each year whether to allot money to make the payments.

Just this week, there was a default on Puerto Rico appropriation-backed bonds, while credit ratings on more than \$3 billion of Chicago convention center bonds were severely downgraded because an impasse over Illinois’ fiscal 2016 budget blocked a monthly transfer of tax revenue to the bond trustee.

Alan Schankel, a managing director at Janney Capital Markets, said the combination of pension and appropriation bonds will come at a higher cost to Kansas.

“I think anybody has to take a look at appropriation debt and require a little more yield,” he said.

Meanwhile, the Government Finance Officers Association in January advised states and local governments not to issue pension bonds because they carry “considerable risk.”

The practice, which relies on the assumption that invested proceeds will result in higher returns than the interest cost on the bonds, came under heightened scrutiny particularly in the wake of Detroit’s \$1.4 billion issuance that was tied in part to soured interest-rate swaps that helped drive

the city to file the biggest-ever municipal bankruptcy in 2013.

Kansas' deal is the largest on next week's nearly \$5.8 billion calendar of competitive and negotiated municipal bond and note sales.

The state's fixed-rate bonds will be issued through its development finance authority and will be structured with serial maturities from 2017 through 2030 and term bonds due in 2037 and 2045, according to the preliminary official statement.

A state law limits the bond interest rate to 5 percent. Pricing is scheduled for Monday through senior underwriters Bank of America Merrill Lynch and Wells Fargo Securities.

The bonds are rated Aa3 by Moody's Investors Service and AA-minus by Standard & Poor's, which has a negative outlook on the rating due in part to the state's pension payments falling short of actuarially required levels.

Kansas projects that the bond sale will improve the funded ratio for pensions to 73 percent in 2020 from 59 percent at the end of 2014.

REUTERS

Fri Aug 7, 2015

(Reporting by Karen Pierog in Chicago and Hilary Russ in New York; Editing by Paul Simao)

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## **[U.S. Municipal Bond Insurers Set to Withstand Puerto Rico Default.](#)**

U.S. municipal bond insurers will likely weather any potential losses as a result of Puerto Rico's debt crisis but a downgrade to their ratings or a loss of investor confidence longer-term could pose a serious challenge to their post-crisis recovery.

Bond insurers insure about \$13 billion of Puerto Rico's \$72 billion debt load, substantially more than they did in Detroit which centered on a few hundred million dollars of city debt, meaning that losses for the insurers could be much higher.

"We're monitoring it closely because we don't know what any type of settlement or restructuring will be," said David Veno, who analyzes bond insurers for Standard & Poor's.

Bond insurers such as MBIA and Assured Guaranty were hit during the financial crisis after they ventured into mortgage-backed securities in the years before 2007. Ratings agencies slashed their AAA ratings to junk or withdrew them altogether. That meant bond issuers no longer benefited from their coverage.

Bond insurers essentially lend their rating to municipalities who use insurance to lower their borrowing costs.

For example, Puerto Rico's insured bonds are trading at hefty premiums compared to uninsured bonds. Insured debt of the Puerto Rico power authority, which is currently in restructuring talks with creditors, recently sold for around 96 cents on the dollar, while uninsured debt is selling for around 54 cents.

Before the crisis, around half of all new municipal bonds had insurance from nine insurers, with nearly 60 percent covered in 2005. By 2012, that had fallen to just 3.6 percent, although it has climbed steadily to 6.6 percent in the first quarter of this year, Thomson Reuters data shows.

Although insurers have slowly recovered since then, Puerto Rico could be their first major test in terms of losses.

Puerto Rico's Governor Alejandro Garcia Padilla said in June that the U.S. Territory could not afford to pay its debts, adding that all Puerto Rico's bonds were now negotiable. That shocked many investors who believed the problem was contained in Puerto Rico's public corporations.

Puerto Rico actually defaulted on Aug. 1 by paying only a fraction of what was due on its Public Finance Corp (PFC) bonds. None of those bonds were insured,

Crucially, S&P's Veno reaffirmed the ratings on Puerto Rico's two biggest insurers, MBIA - through its National Public Finance Guarantee subsidiary - and Assured Guaranty, after the governor's comments. But a downgrade in response to bigger-than-expected losses could limit their ability to get new business from municipalities that borrow based on their credit ratings.

Key to the health of the insurers will be whether they can maintain the momentum in writing new business or whether bond investors can go without insurance or diversify into firms with little or no Puerto Rico exposure such as Build America Mutual (BAM).

Many stock investors have not stuck around to find out. Shares in both MBIA and Assured plummeted after the governor's statement. MBIA's shares fell to their lowest level since 2010 although they have since recovered some of their losses.

Both companies said in statements they can handle pessimistic scenarios in Puerto Rico. MBIA pointed to the "extremely strong" capital position of its National Public Finance Guarantee subsidiary. Assured said it had the "resources and loss mitigation expertise" to handle its exposure to Puerto Rico.

Assured has \$4.9 billion of net exposure to Puerto Rico and \$12 billion in claims paying resources. It also generates \$400 million from its investments portfolio. Given that municipal claims are paid out over the life of the bond and not all at once means that it is more than adequately capitalized to honor any claims made by investors on Puerto Rico debt.

Assured says a 20 percent loss to the \$773 million of power authority bonds it insures would result in annual claims of just \$13 million. But losses could be substantially higher in the event of a wider and deeper default.

Assured is also rated 'AA' compared to MBIA's 'AA-', giving it an extra buffer in the event of a downgrade.

MBIA's gross exposure of \$4.3 billion to Puerto Rico is lower than Assured's but is closer to claims paying resources of \$4.9 billion at its National Public Finance Guarantee Corp unit. However, MBIA said it has seen business volumes growing since Padilla's speech.

Its lower AA- rating also means a potential downgrade could have a more profound impact.

Still, muni bond investors continue to buy the insurers' products, seeing value in insurance even if they may be distinguishing between the firms.

“Bond insurance will surprise to the upside,” said John Loffredo, a fund manager with MacKay Municipal Managers, who says the firm’s retail clients have been asking for it more frequently since Puerto Rico hit the headlines in 2013.

Loffredo says 26 percent of the firm’s \$13 billion in municipal bonds is insured. That number is as high as 35 percent in the firm’s \$1.4 billion MainStay tax free fund, which Loffredo co-manages.

REUTERS

NEW YORK, AUGUST 5 | BY EDWARD KRUDY

(Reporting by Edward Krudy; Editing by Diane Craft)

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## **Insurance Stocks to Watch as Puerto Rico Defaults.**

The Greek crisis is still fresh in our memories but there seems no end to bad news. Unable to repay its huge debt, Puerto Rico has defaulted. The island’s Government Development Bank could pay back only \$0.6 million of the \$58 million due to its creditors of Public Finance Corporation. The amount was part of the interest on bonds.

Puerto Rico has a hefty debt balance of over \$70 billion. Melba Acosta-Febo, President of the Government Development Bank, stated, “the partial payment was made from funds remaining from prior legislative appropriations in respect of the outstanding promissory notes securing the PFC bonds.”

“First Time Defaulter”

While the default is the first time in Puerto Rico’s history, it raises concerns about the economic future of the island as well as the liquidity of the commonwealth. The picture is of widespread gloom as Moody’s sees this as among the first of bigger defaults on commonwealth debt and Standard & Poor’s portends other defaults over the next few months and signs of dismal liquidity. Going by a Reuters report, Puerto Rico had halted monthly deposits to its general obligation redemption fund for a temporary period.

The \$58 million in bonds were issued by a subsidiary of the Government Development Bank to procure funds for school construction and the creation of landfills among others. While the government bank financed those projects initially, it prudently shifted the liabilities from its own balance sheet by refinancing them through its subsidiary, the Public Finance Corporation. The bonds were already facing downgrades and moved to the junk territory in March by Moody’s Investors Service and Standard & Poor’s.

The Puerto Rico debt includes approximately \$18.6 billion of general-obligation bonds and government-guaranteed debt, \$15.2 billion of sales-tax-backed bonds and \$24.1 billion of bonds issued by government agencies, like the Puerto Rico Electric Power Authority.

Puerto Rico has been stressed by government debt crisis for several years. The island owed many debt payments on Aug 1, of which it could pay only the interest portion of \$58 million.

Way Out for Puerto Rico

The Puerto Rico debt crisis is worse than Detroit's \$20-billion crisis (Detroit filed for bankruptcy two years back) but much lesser than the \$350-billion crisis of Greece. However, Puerto Rico cannot file for bankruptcy as the island is not covered under the U.S. Bankruptcy Code. Moreover, it is unlikely that any institution will come for rescue as we saw in the case of the Greek distress where International Monetary Fund came to rescue.

Nonetheless, Puerto Rico intends to restructure its debt with policymakers so that they can work a way out with creditors and investors. Puerto Rico even fears a government shut down if further funds are not raised.

To add to its woes, the residents of Puerto Rico are moving out as high unemployment and economic instability are forcing them to look for survival outside the island. This, in turn, will hit Puerto Rico even harder as it lower the tax base of the island — the major source of revenue for any economy.

According to Morningstar Inc., about half of the U.S. municipal-bond mutual funds have coverage in Puerto Rico. So the island's default could cause serious damage to the concerned investors, who have already incurred heavy losses after the commonwealth's credit ratings were downgraded to junk and bond prices collapsed.

Sensing tough times, Monarch Alternative Capital LP, which had invested in commonwealth's general-obligation bonds, got rid of some. However, the latest crisis will surely act as a dampener to the fortunes New York-based MBIA Inc. and Bermuda based Assured Guaranty Ltd. (AGO - Analyst Report) that are exposed to Puerto Rico

MBIA Inc. has almost twice the exposure of Assured to Puerto Rico's stressed power authority called Prepa. While the crisis could eat away the statutory capital of MBIA's National Public Finance Guarantee Corp., about 40% of Assured's funds will be washed out as together they insure about 20% of the islands through municipal debt as per media reports.

While MBIA Inc. lost 2% in yesterday's trading, another bond insurer Ambac Financial Group, Inc.'s shares dropped 3.4%.

by Zacks Equity Research

Published on August 04, 2015

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## **[NCPPT, PBBC Co-Hosting P3S for Public Buildings Summit.](#)**

For decades, public-private partnerships have been an effective solution for addressing transportation and other infrastructure needs throughout the United States. As budgets continue to shrink, more state and local governments are turning to P3s to help finance and make much-needed improvements to deteriorating public buildings such as schools, hospitals, courthouses, universities and justice facilities.

The National Council for Public-Private Partnerships and the Performance Based Building Coalition will host the second annual P3s for Public Buildings Summit on October 22-23 in Washington, D.C. This summit is the nation's only educational event dedicated to developing and implementing P3s for buildings that are vital to the everyday functioning of states and municipalities.

Summit topics will include:

- Project Financing
- Federal Policy Challenges and Solutions
- Case Studies of Successful Projects
- The Future of the Marketplace
- International Successes

The P3s for Public Buildings Summit will be held at the Hyatt Regency Washington on Capitol Hill. For more details, including registration information and sponsorship opportunities, visit the [event website](#).

By Editor August 7, 2015

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## **[S&P's Public Finance Podcast: \(Rating Trends, Atlantic City, And Puerto Rico\)](#)**

In this week's Extra Credit, Senior Directors Larry Witte and Dave Hitchcock discuss rating trends over the past 30 years and our recent action regarding Puerto Rico's bond payment default, respectively, and Associate Tim Little explains our rating action on Atlantic City.

[Listen to the podcast.](#)

August 7, 2015

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## **[S&P: Chicago Budget Forecast Remains Grey - City Faces Continued Budget Gaps, Stressed Bottom Lines.](#)**

CHICAGO (Standard & Poor's) Aug. 6, 2015—Chicago's budgetary challenges for fiscal years 2016 to 2018 were highlighted in the release of its annual financial forecast — specifically the hurdles it faces in balancing its budget, even before approaching the issues of its rising debt burden and pension contributions.

We expect that during the next five months, as the mayor progresses with his proposed budget and then what is ultimately adopted by the city council, the city will demonstrate how serious it is about implementing both immediate and far-reaching plans to address the structural cracks in its budget. Given the uncertainty regarding the reform of its police, fire, municipal and laborers plans, we expect city management to consider contingency plans for addressing its pension liabilities, regardless of the outcome for all four of its plans.

In the base case scenario, the city's operating budget gap for 2016 is \$232.6 million; add in its increased pension contributions and debt, and the number rises to \$426 million. The corporate fund is not the only fund that contributes to the pensions; the enterprise funds and library fund also pay a share. The forecast factors in an incremental \$328 million increase in police and fire pensions, based on the assumption that the city will gain state approval of a phased-in approach to the pension payments rather than the \$550 million increase it currently faces, and that the Supreme Court will uphold the city's reformed municipal and laborers pension plans. In our view, it would be more conservative to assume the \$550 million payment. Additionally, the forecast assumes that the city will pay \$100 million more in debt service due to the phase out of its "scoop and toss" practice, in which the city made debt payments from refunding bond proceeds rather than from current

revenues.

The forecast presents two scenarios in addition to the base case: positive and negative. Even in the positive outlook, with revenues more strongly recovering from the recession than in the base-case scenario, there is still an operating budget gap of \$83.0 million in 2017, and it rises to \$132.4 million in 2018. In the negative outlook, which assumes stagnant revenues and more accelerated operating expenditure growth, the city faces operating gaps of \$577 million in 2017 and \$801 million in 2018. The forecast approaches and discusses debt and pension contributions separately and those numbers are not included in the aforementioned figures.

Under Standard & Poor's policies, only a Rating Committee can determine a Credit Rating Action (including a Credit Rating change, affirmation or withdrawal, Rating Outlook change, or CreditWatch action). This commentary and its subject matter have not been the subject of Rating Committee action and should not be interpreted as a change to, or affirmation of, a Credit Rating or Rating Outlook.

Standard & Poor's Ratings Services, part of McGraw Hill Financial (NYSE: MHFI), is the world's leading provider of independent credit risk research and benchmarks. We publish more than a million credit ratings on debt issued by sovereign, municipal, corporate and financial sector entities. With over 1,400 credit analysts in 26 countries, and more than 150 years' experience of assessing credit risk, we offer a unique combination of global coverage and local insight. Our research and opinions about relative credit risk provide market participants with information and independent benchmarks that help to support the growth of transparent, liquid debt markets worldwide.

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## **[MSRB Updates Professional Exams to Include Recent Rule Changes.](#)**

WASHINGTON — The Municipal Securities Rulemaking Board late Friday filed with the Securities and Exchange Commission revised content outlines to its qualification exams for municipal fund securities limited principals, municipal securities representatives, and municipal securities principals that will bring the tests in line with recent MSRB rule changes. The changes to its Rule G-3 on personal qualification requirements, were effective immediately following the filing and will be implemented on Aug. 31, according to the regulatory notice published by the board. They updated the exams to reflect recent rule requirements and rule citations.

The exams for municipal fund securities limited principals and municipal securities representatives, Series 51 and 52, respectively, are designed to measure candidates' "knowledge of rules, rule interpretations and federal statutory provisions" applicable to their respective duties as well as a candidate's ability to apply the rules, interpretations and federal statutory provisions in specific situations, the MSRB said.

Those trying to qualify as a municipal fund securities limited principal must also have previously or concurrently qualified as a general securities principal or investment company or variable contracts limited principal.

Municipal fund securities limited principal candidates have one and one-half hours to complete the Series 51 examination, which consists of 60 multiple-choice questions, and municipal securities representative candidates have three and one-half hours to complete the Series 52 exam, which consists of 115 multiple-choice questions.

The Series 53 examination for municipal securities principal candidates assesses the participants in the same areas as the Series 51 and 52 exams. Candidates are given three hours to answer the exam's 100 multiple-choice questions.

In addition to bringing the Series 53 exam in line with current rules, the MSRB also updated the weightings placed on five of the exam's six parts. The first section, on federal regulations, will stay weighted at 4%, but the second topic area, on general supervision, changed to 23% from 21% of the exam and the third topic area, on sales supervision, changed to 25% from 29%. The fourth topic area, on origination and syndication, changed to 23% from 22%, the fifth topic area, on trading, changed to 10% from 8%, and the sixth topic area, on operations, changed to 15% from 16% of the examination.

The changes were necessary because of a reorganization of rules within the topic areas. There were no substantive changes to the topic areas the exam covers, the board said.

THE BOND BUYER

by Jack Casey

AUG 3, 2015 1:28pm ET

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## **[S&P: The U.S. EPA Finalizes Its Clean Power Plan, But Questions Still Remain.](#)**

The cornerstone of the Obama Administration's environmental program was in the news again on Aug. 3, 2015, when the U.S. Environmental Protection Agency (EPA) issued its final Clean Power Plan rules for reducing power plants' carbon emissions. The final rules add several meaningful modifications to the EPA's June 2014 proposal. Some of the revisions add to the proposed rule's stringencies, such as moderately increasing emissions reduction targets to a 32% emissions reduction by 2030 compared to the 2014 proposal's 30%. Other revisions modestly relax the implementation timelines by a year or two (see table 1). The extensions address some of the concerns cited in the more than four million comments submitted to the EPA in an effort to allay certain concerns surrounding reliability and feasibility, but it also prompts some new questions, and will almost certainly face a high level of scrutiny and, potentially, judicial challenges.

[Continue reading.](#)

06-Aug-2015

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## **[The Counties Where Wealthier People Are Moving.](#)**

Long-awaited migration data show where people are relocating to and the wealth that they're

bringing. [View data for your county.](#)

An influx of new residents can provide local governments with a substantial boost, whether they're adding to tax rolls or spending their dollars supporting local businesses.

Last week, the Internal Revenue Service (IRS) released long-awaited migration data shedding light on migration patterns for counties and states. New data for 2011 and 2012 includes total incomes for those who moved, helping to approximate wealth gained or lost and its potential impact on local budgets.

A range of factors influence a person's decision to move. Most often, employment considerations largely dictate where people opt to relocate. Others, depending on their circumstances, decide more based on family-related reasons. An area's amenities, taxes and educational opportunities also all typically play some role in decisions to move.

Wealthier residents are often tied to specific job locations, such as a corporate headquarters or employment center for a particular industry. So, their occupations may drive decisions somewhat more than other workers. Technology, however, is enabling more employees to work remotely, so job-related considerations may not carry as much weight in moving decisions as they had in the past, said Steve Murdock, a former U.S. Census Bureau director who now teaches at Rice University.

The independently wealthy or retired, on the other hand, typically give greater consideration to regional amenities or quality of health services. But as retirees age and their health deteriorates, they may require more services or move back to where they came from. As a result, Murdock said, these areas that are attracting large numbers of older, wealthier residents need to be replenished with new retirees each year.

"High incomes are both produced by migration and allow for migration," Murdock said.

The IRS reports numbers of actual tax returns, which can be used to approximate households moving to and from each county. Adjusted gross income (AGI) figures serve as a proxy for total household incomes. One way to assess total wealth gained or lost is to compute a net migration AGI, or total AGI for in-migrants minus AGI for outmigrants. The following table lists this measure for counties with 1,000 or more new residents:

[Continue reading.](#)

GOVERNING.COM

BY MIKE MACIAG | AUGUST 5, 2015

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## **[After a Few Years Afloat, Pension Plans Start Sinking Again.](#)**

Public pension plans across the country are missing their annual investment targets by wide margins this year, a trend that could put continued pressure on their governance and benefits.

In fiscal year 2015, which ended June 30, no plan so far has hit its annual return assumption, and major plans are reporting returns as low as 2 percent — well below the annual average target between 7 and 8 percent.

But what's shaping up to be a poor year for pension plans could provide ammunition to those who want to change them. That's because last year, new accounting changes took effect that now take investment returns into account when calculating pension plans' funded status. In fiscal 2014, stocks and bonds soared and many pension plans reported big improvements in their funded ratios. But with low returns this year, some plans could look less healthy than they did a year ago. Plans will publish their new funded status in their annual financial reports, which come out later this year.

"This is going to further call attention to the fragility of these underfunded [plans]," said Peter Kiernan, a public finance lawyer at Schiff Hardin. "States and cities are saying they're restoring their plans to health and that they've made it through the Great Recession [but] they're being proven wrong."

The nation's two largest public pension plans — the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System — reported annual returns of 2.4 percent and 4.8 percent, respectively. The funds, which combine for nearly \$500 billion in assets, have a target annual investment return of 7.5 percent.

Other major state plans are reporting similarly low returns: the Maryland State Retirement and Pension System earned 2.7 percent, the Virginia Retirement System earned 4.6 percent and the Rhode Island State Employees' Retirement plan earned 2.2 percent. New Jersey will likely miss its mark too as the state employee plan has so far earned 4.6 percent on its investments through the first 11 months of its fiscal year. The state plans' targets range from 7 percent in Virginia to 7.9 percent in New Jersey.

At the municipal level, Philadelphia's public employees plan appears headed for an abysmal year as results through February show a mere 0.5 percent return; Los Angeles' investment return for fiscal 2015 was 2.8 percent; and in New York City, four of the five plans posted an investment return of less than 5 percent with one month to go in the fiscal year, while the city's police plan earned 5.4 percent over the same time period.

The poor performance comes after two years of double-digit returns for many plans. Most plans attribute the slump this year to turmoil in the international market, primarily caused by the financial crisis in Greece. Global stocks and bonds, which account for a significant portion of pension plan portfolios, took a big hit this year. In Maryland and Rhode Island for example, global and international equities are about one-quarter of plan investments.

Another big culprit is the bond market with its continued low interest rates, said Keith Brainard, director of research at the National Association of State Retirement Administrators. Indeed, mutual funds indexed to the bond market returned less than 2 percent this past year. Fixed-income bonds tend to account for a smaller percentage of plan assets compared with global equities, but together, these two poorly performing assets can account for around 40 percent of plan portfolios.

Still, one poor year is no indication that pension plan returns will start sinking into the red like they did in 2008 and 2009 after the stock market crash. Many plans also had a poor year in 2012 only to be followed by double-digit returns again.

"As we say with regard to investment returns," said Brainard, "it's a marathon, not a sprint. One year of returns is less important than the longer term trends."

Some plans also released their three- and five-year investment return averages, and even with 2015's low numbers, they're well above the 7 to 8 percent needed for long-term stability because they include the stock market rebound. CalPERS, for example, earned 10.7 percent over each of the

last five years. But plans did not release information on their new 10-year average investment return, which would include the stock market crash in 2008-2009. Using last year's information, which doesn't incorporate 2015's low returns, the 10-year investment return average for many of these plans was around 7 or 8 percent.

Even so, politicians and other stakeholders seeking cuts in pension benefits will likely use the bad year for plans to argue their case. In California, ex-San Jose Mayor Chuck Reed is pushing for a ballot initiative that would amend the state's constitution to let localities make changes to their pension benefits for existing workers. And in New Jersey, Republican presidential candidate and Gov. Chris Christie has underfunded his pension system and wants to reduce the state's financial commitments to retirees.

"Taxpayer advocacy groups will seize on this," said Kiernan. "Any sitting governor that has a problem like this could be affected."

GOVERNING.COM

BY LIZ FARMER | AUGUST 4, 2015

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### [Atlantic City Cut Three Steps by S&P, Citing Lack of Debt Plan.](#)

Atlantic City had its debt rating cut deeper into junk by Standard & Poor's, which said the New Jersey gaming hub has no "clear plan" to address its fiscal woes.

The municipality, which has been run by an emergency manager since January, was reduced three steps to B, the fifth level into junk, and may be lowered further, the ratings company said Monday.

Since Emergency Manager Kevin Lavin released a report in March citing the potential for deferred debt payments and job cuts, there has been no "additional clarity" on how the city can address its \$101 million budget deficit and eroding tax base, Timothy Little, an S&P analyst, wrote in a release.

"The lack of clear and implementable reforms to restore fiscal solvency without payment deferrals or debt restructuring remains uncertain as the city continues to operate in a difficult fiscal environment," he said in the statement.

Bankruptcy protection may be a "potential course of action" if as yet unimplemented solutions are unsuccessful, Little said.

Atlantic City's finances haven't changed since May, when it sold securities with an S&P ranking of A-, the fourth-lowest investment grade, Michael Stinson, the city's revenue and finance director, said Monday. The bonds were issued through a New Jersey program that diverts state aid to debt payments, which lessens the risk to bondholders.

"For a downgrade at this point, it just doesn't make sense," he said.

Atlantic City "continues to make progress" in addressing its budget shortfall and longer-term structural deficit, Lavin, the emergency manager, said in an e-mailed statement.

Governor Chris Christie had appointed Lavin to come up with a plan to revive the finances of the city, where four of 12 casinos closed last year. The governor's move led Moody's Investors Service

and S&P to downgrade Atlantic City because of the risk that a turnaround plan could foist losses on bondholders. Moody's ranks the city Caa1 with a negative outlook.

Bills that the state legislature passed in June, including a measure that would create payments in lieu of taxes from the the city's casinos, are part of the financial plan, Stinson said. The legislation still has to be signed by Christie.

Kevin Roberts and Brian Murray, spokesmen for Christie, didn't immediately return a call and e-mail requesting comment.

Tax-free general obligations due in December 2027 traded Monday with an average yield of 7.26 percent, or about 4.7 percentage points over benchmark munis, data compiled by Bloomberg show.

## **Bloomberg**

by Romy Varghese

August 3, 2015 — 1:17 PM PDT

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### **[Puerto Rico Debt Crisis: A Bond Guide as Potential Defaults Loom.](#)**

Puerto Rico's fiscal crisis reached a turning point this week when one of its agencies, the Public Finance Corp., defaulted on a bond payment for the first time.

Standard & Poor's said the decision could imperil the government's ability to borrow money as it risks running out of cash within the next few months. The rating company said more defaults may follow.

Like other municipal borrowers, the island has many types of bonds, sold by different agencies and backed by different funds and legal safeguards.

Here's a list of the commonwealth's biggest bond issuers, how much long-term debt they have, and when major monthly payments are due, according to data compiled by Bloomberg. Puerto Rico's bond payments total about \$209 million from September through November before swelling to a combined \$1.4 billion in December and January, the data show.

General-obligations: \$13 billion. They're backed by the commonwealth's full faith and credit. The island's constitution says general obligations must be repaid before other expenses. Maturity and interest payments are due in July, with the bulk of other interest paid in January.

Puerto Rico Sales Tax Financing Corp.: \$15.2 billion. These bonds, called Cofinas, are repaid from dedicated sales-tax revenue. A \$6.2 billion portion of the debt, called senior-lien, is repaid first. The remaining \$9 billion, called subordinate-lien, get second dibs. Maturity and interest payments are due in August, with the bulk of other interest paid in February.

Puerto Rico Electric Power Authority: \$8.3 billion. Prepa, as it's called, is the island's main supplier of electricity and repays the debt from what it charges customers. Maturity and interest payments are due in July, with the bulk of other interest paid in January.

Puerto Rico Government Development Bank: \$5.1 billion. The GDB lends to the commonwealth and its localities. When those loans are repaid, the bank can pay off its debt. The agency covered debt

bills due this month. Its next bond payment is in December.

Puerto Rico Highways & Transportation Authority: \$4.7 billion. The highway agency repays its debt with gas-tax revenue. Maturity and interest payments are due in July, with the bulk of other interest paid in January.

Puerto Rico Public Buildings Authority: \$4.1 billion. The PBA bonds are repaid with lease revenue from public agencies, departments and instrumentalities of the commonwealth. Maturity and interest payments are due in July, with the bulk of other interest paid in January.

Puerto Rico Aqueduct & Sewer Authority: \$4 billion. The utility, called Prasa, supplies most of the island's water. The debt is repaid from water rates charged to customers. Maturity and interest payments are due in July, with the bulk of other interest paid in January.

Puerto Rico Pension-Obligation Bonds: \$2.9 billion. The taxable debt was sold to bolster the island's main pension fund. The bonds are repaid from contributions that the commonwealth and municipalities make to the retirement system. The next maturity is July 2023.

Puerto Rico Infrastructure Financing Authority: \$1.9 billion. Called Prifa, the agency has sold the island's rum-tax bonds. These are securities repaid from federal excise taxes on rum made in Puerto Rico. Most of Prifa's bonds mature every July, with additional interest payments in January.

Puerto Rico Public Finance Corp.: \$1.09 billion. The PFC bonds are repaid with money appropriated from the legislature. The agency defaulted on its Aug. 1 debt-service payment because the legislature failed to do so. Maturity and interest payments are due in August, with the bulk of other interest paid in February.

## **Bloomberg**

by Michelle Kaske

August 4, 2015

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## **[California Guards Muni Buyers From Bankruptcy With Dibs on Taxes.](#)**

San Diego Unified School District didn't think it was fair that rating companies cut its bond grades amid California's fiscal woes four years ago.

So school officials cultivated support among other California districts for legislation boosting protection for investors. Their efforts bore fruit last month, when Governor Jerry Brown signed into law a measure clarifying that tax revenue backs the general obligations of schools, cities and other local issuers. San Diego's system, the state's second-largest after Los Angeles, wants the step to boost its credit rank and lower debt costs.

While rating companies haven't acted on the law, investors have taken notice. The extra yield that buyers demand on some San Diego school debt has shrunk to the lowest in more than three months. Bonds of the Los Angeles Unified School District have also gained. Even though the issuers are solidly investment grade, bondholders welcome the added security after Detroit's record bankruptcy and as Puerto Rico moves toward a historic restructuring.

“It eliminates a lot of uncertainty in the market,” said Frances Lewis, director of research in Princeton, New Jersey, at MacKay Municipal Managers, which oversees \$13 billion.

## **Lien In**

The law, which takes effect in January, specifies that voter-approved general obligations of school districts and municipalities are backed by a lien on property-tax revenue. While California statutes could be read as having that protection, it wasn’t explicitly stated. This would “solidify” prioritizing holders of the bonds, Michael Zezas, chief municipal strategist at Morgan Stanley in New York, said in a July 27 research note.

General obligations from California issuers excluding the state total around \$131 billion, according to data compiled by Bloomberg that includes the full value of zero-coupon bonds at maturity.

The San Diego district has about \$2.3 billion of general obligations, according to bond documents. In 2011, amid talk of state funding cuts, Moody’s and Standard & Poor’s lowered the district one step. It’s now graded Aa3 and AA-, fourth-highest, respectively.

The downgrade “wasn’t warranted” since property-tax revenue goes directly to debt payments, said Jenny Salkeld, chief financial officer for the system, which educates about 132,000 students.

## **Holy Upheaval**

School officials began a push to clarify protections for investors, which gained importance after Detroit’s 2013 bankruptcy upended a pledge once held sacrosanct: that communities would make good on debt backed by their full faith and credit.

Amid Detroit’s debt negotiations, investors demanded higher yields on some securities from Michigan. Even in California, some districts saw annual interest rates rise as much as a percentage point, said James Spiotto, managing director in Chicago at Chapman Strategic Advisors LLC, which advises on financial restructuring.

For Mark Wuensch at Principal Global Investors, the new law provides limited comfort: It may not matter how secure investors’ standing is when a community is struggling. Cash-strapped Puerto Rico temporarily halted monthly transfers into a fund that pays down \$13 billion of general-obligation debt, it said in a regulatory filing late Monday.

“The ability to pay is a lot more important than what the law is,” said Wuensch, senior fixed-income analyst in New York at Principal, which manages \$4.8 billion in munis. “You can only tax people so much.”

## **Ratings Shrug**

Credit raters say they don’t expect the law to result in many upgrades. It won’t guarantee timely debt payments or prevent defaults for issuers in economic distress, the companies said.

The district’s advisers said the companies have been too hasty. Mary Collins, a partner at Orrick, Herrington & Sutcliffe LLP, said she plans to explain the law’s significance to analysts and that they should give it a “lot more credence.”

For San Diego’s schools, an upgrade to the top rank could save 0.20 percentage point, or as much as \$30 million for the \$525 million borrowings planned next year, said Mark Young, managing director at KNN Public Finance, which advises the district.

## **Bond Bounty**

San Diego school obligations due in July 2029 traded July 27 at an average yield of about 3.2 percent, or 0.41 percentage point above benchmark munis, data compiled by Bloomberg show. That's the narrowest spread since their sale in April.

Los Angeles Unified general obligations due in July 2026 traded Tuesday with an average yield spread of 0.24 percentage point, below the 0.37 percentage point average since February. Moody's grades the district Aa2, third-highest.

A clear definition of investor protections has also benefited Detroit. The city garnered an investment grade from S&P for a bond sale planned for this month, its first since exiting court protection in December, partly because of a specified first-lien pledge on income-tax collections.

Michigan and Nebraska are also working on laws establishing a statutory lien on general obligations, Spiotto said.

"The municipal market has needed more clarification on this since previously there hadn't been that many bankruptcies," said Lewis at MacKay. "It became much more important to look at what the definitions are."

## **Bloomberg**

Romy Varghese

August 4, 2015 — 9:01 PM PDT Updated on August 5, 2015 — 6:27 AM PDT

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## **[Muni Funds Lose Most Cash in Five Weeks Amid Puerto Rico Default.](#)**

Individuals pulled \$308 million from muni funds in the week through Wednesday, Lipper US Fund Flows data show. That's the largest withdrawal since the period through July 1, during which Puerto Rico Governor Alejandro Garcia Padilla said the U.S. commonwealth can't afford to pay its debts.

High-yield muni funds, which are the most likely to hold Puerto Rico securities, saw about \$58 million of outflows, the most in four weeks. Investors yanked \$208 million from funds holding long-term obligations. Despite the withdrawal, muni prices were little changed this week, according to Bloomberg benchmark indexes.

Puerto Rico said Aug. 3 that it paid just \$628,000 of the \$58 million due on securities sold by its Public Finance Corp. The struggling commonwealth is seeking to restructure its \$72 billion of debt, which is widely held because the interest is exempt from federal, state and local income taxes nationwide.

## **Bloomberg**

Brian Chappatta

August 6, 2015 — 2:49 PM PDT

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## **Puerto Rico Shows Perils of Muni Bonds Backed by Empty Promises.**

Municipal-bond investors are learning that when cash gets tight, promises are made to be broken.

Puerto Rico's default Monday on bonds sold by its Public Finance Corp. underscored the risks of debt backed only by a legislature's pledge to repay. Two days later, Chicago's Metropolitan Pier and Exposition Authority's rating was cut to near-junk from AAA by Standard & Poor's because Illinois hasn't appropriated the money to pay its bonds amid a stalemate over the budget.

Unlike with general obligations or debt that has a claim to specific revenue, buyers have little recourse if politicians walk away from appropriation bonds, a \$197 billion niche of the municipal market. Vadnais Heights, Minnesota, and Menasha, Wisconsin, have already done so. In bankrupt San Bernardino, California, investors may recover one cent on the dollar.

"Appropriation debt is scarier than people want to think it is," said Matt Dalton, chief executive officer of Rye Brook, New York-based Belle Haven Investments, which manages \$3 billion of munis. He said his firm tends to avoid the securities.

Legislators "have to come around the table and appropriate each year, and as you can see, if they're not on sound financial footing, you're taking a lot of risk," he said.

### **Pennies Paid**

Detroit's \$18 billion bankruptcy illustrated the differing legal protections for investors. Buyers of its certificates of participation, which had neither the city's taxing power nor specific revenue streams behind them, recouped 12 cents on the dollar, according to a report this week from Moody's Investors Service. Holders of its general obligations got six times more.

San Bernardino, which filed for bankruptcy in 2012, has proposed giving investors just 1 cent on the dollar for pension-obligation bonds the city voted to stop funding three years ago.

"It's alarming to see if you're in an unsecured position, really how crammed down you're going to get," said John Flahive, Boston-based director of fixed income at BNY Mellon Wealth Management, which oversees \$20 billion of munis. "We've always been cautious toward appropriated debt."

The bonds were the first to take the hit in Puerto Rico, where the government is reeling from \$72 billion of obligations. Faced with a growing cash crunch, the legislature didn't provide funds to cover bonds the commonwealth's Finance Corp. sold to help keep the government afloat. When \$58 million of interest and principal was due Monday, it paid just \$628,000.

### **Bonds Fall**

Finance Corp. securities due in 2031 traded Thursday for 9 cents on the dollar, data compiled by Bloomberg show. They fetched 100 cents as recently as June 2013.

Bonds sold by Chicago's Metropolitan Pier, which operates the biggest U.S. convention center, tumbled Wednesday after S&P cut its rating by seven steps. That came after the authority couldn't make a required deposit into its debt-service fund because the legislature hasn't appropriated the tax money. The agency hasn't missed any interest or principal payments, which aren't due until December.

Its \$208 million of 5.25 percent bonds maturing in 2050 traded Wednesday for as little as 96.7 cents on the dollar, down from \$1.05 when they'd last traded on July 30. That pushed the yield to 5.5 percent from 4.1 percent.

"Investors are going to want more yield for appropriation debt," said Alan Schankel, a managing director at Janney Montgomery Scott LLC in Philadelphia. Puerto Rico and Chicago's Metropolitan Pier are "part of the procession of anecdotes about appropriation debt that we've been hearing about."

## **Jersey Jitters**

States like New Jersey are drawing bondholders' scrutiny, Schankel said. With the second-lowest credit rating after Illinois, New Jersey has about \$30 billion of appropriation-backed debt and related securities, according to Moody's, which rates the securities no higher than four steps above junk.

Investors are demanding a premium to buy the debt. New Jersey bonds due in December 2023, which are funded out of the annual transportation budget, traded Thursday for an average yield of 4 percent, a full percentage point more than general obligations with a similar maturity, data compiled by Bloomberg show.

Kansas will test investors' willingness to purchase bonds with little security when it sells \$1 billion of debt next week through its development finance authority. The proceeds will be used to shore up its underfunded workers' retirement system.

The prospectus circulated to potential buyers warns that if Kansas doesn't allocate cash to pay investors, the agency "has no obligation to seek or obtain any source of moneys for deposit to the Revenue Account, other than State appropriations."

Melika Willoughby, a spokeswoman for Governor Sam Brownback, didn't have an immediate comment on the bond sale.

"Anytime there's a political process involved in getting paid, which is what an appropriation is, you have to be concerned," BNY Mellon's Flahive said. "The market will be very critical in the reward versus risk given the events in the appropriated space."

## **Bloomberg**

Brian Chappatta

August 6, 2015

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## **[Bloomberg Brief Weekly Video - 08/06/15](#)**

Taylor Riggs, an editor at Bloomberg Brief, talks with Joe Mysak about this week's municipal market news.

[Watch the video.](#)

August 6, 2015

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## **Moody's Comments on PREPA's Restructuring Proposal.**

New York, August 06, 2015 — Moody's Investors Service has reviewed the new restructuring proposal filed by the Puerto Rico Electric Power Authority (PREPA; Caa3 negative), which states that non-forbearing bondholders would recover 65%-70% of the original legal promise in cash, depending on maturity, and which makes default a virtual certainty. The EMMA filing also includes alternative plans filed by PREPA, a bondholder group, and a bond insurers' group.

Although bondholder recoveries are volatile and hard to predict, recovery expectations play a large role in Moody's PREPA ratings, and the proposal's overall recovery rates are in line with Moody's expectations at PREPA's current Caa3 rating, which incorporate a recovery range of 65%-80%. Moody's outlines the proposal for the different bondholders in the new report, "Moody's Comments on PREPA's Restructuring Proposal."

In contrast to non-forbearing bondholders, forbearing bondholders would receive an exchange offer, nominally at par. However, these bondholders could still incur substantial losses because the original promise to pay cash would be replaced with a new security that defers interest and principal and would be subject to the risk that it will not be paid.

PREPA's forbearing bondholders, which comprise both insured and uninsured bondholders, hold just over 66% of the authority's \$8.1 billion bonds; the uninsured non-forbearing bondholders hold the remainder.

"For the forbearing bondholders, our analysis suggests a mid-range recovery rate of 67%, based on a discount rate of 7.5%" says Rick Donner, a Moody's Vice President — Senior Credit Officer. "But regardless of the discount rate, we doubt the recovery rate for the forbearing bondholders would be any worse than the 65%-70% cash offer being presented to the non-forbearing bondholders."

Under PREPA's plan, the insured legacy bonds would be excluded from any transactions and would remain unchanged. However, the bond insurers could still incur economic losses, as they are being asked to provide a new wrap for up to \$1.3 billion with zero compensation, even as they continue to carry the risk associated with the current insurance.

Finally, all of the publicly disclosed proposals, including PREPA's, call for deferring debt service for at least five years, to fund capital expenditures.

If a restructuring agreement can be reached, a default in the form of a distressed exchange sometime in the next few months is the most likely outcome. The broad consistency of the proposals and counter-proposals indicates ongoing progress, but substantive creditor issues could very well preclude a deal. And even if PREPA can reach an agreement with its creditors, the execution risk will be substantial, particularly in light of the island's weak economic conditions.

The report is available to subscribers [here](#).

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## **Moody's: Taboo Against Municipal Bankruptcies Has Weakened.**

New York, August 06, 2015 — Municipal bankruptcy, while still a rarity, has become a less unthinkable way for distressed local governments to reduce their debt and pension liabilities, says

Moody's Investors Service in a new report, "Municipal Bankruptcy Still Rare, but No Longer Taboo."

Moody's notes that our median municipal rating is Aa3, and less than 0.5% of all its rated cities, counties and school districts have speculative grade credit ratings. Any growing willingness to pursue bankruptcy among the lowest-rated issuers in this group would have no impact on the overall distribution of Moody's municipal ratings.

Municipal bankruptcies, however, may be more widely considered as the bankruptcies of Jefferson County, AL, Stockton, CA, and Detroit lay out a potential blueprint other distressed municipalities could follow, with Detroit restructuring and emerging in 16 months.

In general, the risks to bondholders and, as a result, the severity of rating downgrades generally accelerate when bankruptcy is seriously considered as an option, says Moody's.

"Emergence from bankruptcy can restore credit quality going forward, but the process itself is radical and often unpredictable," says Moody's Senior Vice President Al Medioli.

Moody's notes that recent municipal bankruptcies have protected pension liabilities at the expense of bondholders.

"There appears to be a dynamic at play that elevates retirees as a group above other creditors, and that further places pensions on a higher plane above all other liabilities, regardless of bond security or legal revenue pledge," says Moody's Medioli.

"The willingness to consider bankruptcy often means the interest of issuers and creditors have become diametrically opposed, which must be reflected in the rating," explains Medioli.

The number of public local government bankruptcies has remained low following the recession, but there has been a noted recent increase against the backdrop of their extreme infrequency since World War II. Moody's points to the slow economic recovery and the rise in government fixed costs, particularly pension costs, as the causes of the rise.

"A more frequent use of bankruptcy by distressed credits does not in and of itself alter our overall stable outlook on the state and local government sectors, but it does underscore how the recent recession has left in its wake significant pockets of financial pressure and a tighter budgetary 'new normal' that is less resistant to new shocks," says Medioli.

For more information, Moody's research subscribers can access this report [here](#).

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## **[Fitch: Medicaid Poses Increasing Risk to U.S. State Budgets.](#)**

Fitch Ratings-New York-07 August 2015: A rebound in healthcare spending and a shift in federal support will put more pressure on U.S. states' long-term budgets, Fitch Ratings says. We expect most states to manage this increase by accelerating their efforts to slow Medicaid spending and taking other budgetary actions. If they do not, they will face long-term budget imbalances.

Last week, the Centers for Medicare and Medicaid Services (CMS) forecast that state and local Medicaid spending growth will average 6.3% annually from 2014 to 2024. The increase is partially due to normalization after recession era rates bottomed at 5.2% in 2007, as well as the statutory downshift in federal funding for the Medicaid expansion that will begin in 2016. Despite the

acceleration, spending growth will remain below historical trends. Between 1990 and 2007, state and local Medicaid spending averaged 9.3% annual growth – this is 3% higher than CMS’ projection for average annual growth between 2014 and 2024. Fitch attributes part of the comparative improvement to states’ ongoing focus on Medicaid cost control.

Fitch believes states have had some success in controlling growth in Medicaid spending, though the challenge remains substantial. One key initiative for a number of states has been implementation of managed care. Between 2001 and 2013, Medicaid managed care spending increased at nearly double the rate of total Medicaid spending. Fitch anticipates this shift toward managed care will likely continue given states’ fiscal pressures. While state and local Medicaid spending growth will remain below historical levels, Fitch believes it will still outpace revenue growth and force states to make challenging budgetary decisions.

CMS’ projections also reflect the scheduled partial shift of costs for expansion under ACA to states from the federal government. Federal coverage for newly eligible individuals in expansion states will begin a multi-year ramp-down in October 2016 from the current 100% to 90% in federal fiscal 2020 and thereafter. States will need to backfill the federal declines.

Fitch notes that several states have reported net budgetary gains from ACA expansion that could fully or partially offset those increased costs. Currently, 28 states and the District of Columbia have expanded under ACA, and three are actively considering it. Nineteen have rejected it but may expand at any time under current law.

CMS projects overall health spending growth will accelerate to 5.8% annually through 2024, up from 4% in 2007. The recession and its aftermath played a key role in suppressing growth of this metric in recent years as well. CMS also attributes the anticipated rebound (in part) to accelerating economic growth. Prescription drug prices are a key factor as well, with spending set to double between 2013 and 2024.

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## **[Puerto Rico Defaults on Most of \\$58 Million Debt Payment.](#)**

Puerto Rico missed most of a \$58 million bond payment Monday, marking the first default by the U.S. commonwealth and escalating its attempt to restructure about \$72 billion in debt.

The payment to bondholders is the first skipped since Gov. Alejandro García Padilla in June said the island’s debts were unsustainable and urged negotiations with creditors, which range from individuals to hedge funds.

Analysts said the missed payment isn’t likely to provoke an acute marketwide reaction from investors, many of which have been inching away for the commonwealth for years amid dire economic news.

But the episode is the latest confirmation that Puerto Rico doesn’t have the money to meet all of its coming obligations, said Emily Raimés, vice president at Moody’s Investors Service.

“This is a first in what we believe will be broad defaults on commonwealth debt,” she said.

The Government Development Bank for Puerto Rico said the island’s legislature didn’t set aside money for the appropriation bonds, a decision that reflects “serious concerns about the Commonwealth’s liquidity” and its need to balance paying bondholders with maintaining essential

services, according to a news release from the bank. The bank did pay about \$628,000 remaining from prior funds.

The nonpayment is another setback for investors in debt from Puerto Rico, which is struggling with a decade of economic stagnation and high unemployment, underscoring the commonwealth's effort to prioritize payments as it attempts to preserve its cash and avoid a government shutdown.

About half of municipal-bond mutual funds in the U.S. have exposure to Puerto Rico, according to research firm Morningstar Inc.

Those investors have already suffered losses as the commonwealth's credit ratings fell to junk in recent years and bond prices plummeted.

Some Puerto Rico bonds sold in 2014 traded Monday at about 69.25 cents on the dollar, down from about 73 cents in mid-July, according to Thomson Reuters Municipal Market Data.

The corporation's missed payment suggests how Puerto Rico may treat different forms of debt going forward, said John Miller, co-head of fixed income at Nuveen Asset Management LLC in Chicago, which manages about \$100 billion in tax-exempt bonds. Investors in the appropriation bonds have little recourse because the bonds are backed only by the legislature's willingness to find the money for them. Other bonds have greater legal protections.

"It is somewhat meaningful that this is their first monetary default," Mr. Miller said. "However, if people have been paying attention to the plans, this was anticipated, and it doesn't really change the orchestrated direction that the government's taking."

That direction has even some former boosters backing away. Monarch Alternative Capital LP, which at one point had about 5% of its now \$5 billion under management invested in the commonwealth's general-obligation bonds, told investors late last week that it sold off part of the position in recent weeks.

"We believe that the probability of a default scenario has significantly increased and could risk extending the timeline for a resolution to the island's situation," co-founder Michael Weinstock and other firm executives wrote to investors in a letter reviewed by The Wall Street Journal.

In particular, he flagged the firm's discussions with the island's political leadership. "We ultimately came to the view that the sentiment of Puerto Rico's leadership had shifted and that they would be unwilling to implement the fiscal reform measures needed to regain the market's confidence and avoid a potential default," the letter said.

A group of Puerto Rico policy makers are working on a restructuring plan and scheduled to present their findings at the end of August. Creditors, including mutual funds, hedge funds and other distressed-debt investors, have been splitting into committees based on which bonds they own.

Puerto Rico has said its debt includes about \$18.6 billion of general-obligation bonds and government-guaranteed debt, \$15.2 billion of sales-tax-backed bonds and \$24.1 billion of bonds issued by government agencies, like the Puerto Rico Electric Power Authority, which is already negotiating a restructuring with creditors. Many investors hold bonds across the different sectors, which could recover different amounts in a restructuring.

The restructuring process is uncertain in part because Puerto Rico is neither a U.S. state nor a sovereign nation.

All states are barred from filing for bankruptcy, but cities, such as Detroit, can seek protection under chapter 9 of the U.S. bankruptcy code. Puerto Rico is lobbying the U.S. Congress for a law allowing some of its entities to access chapter 9 protections. Until such a law passes, the island's leaders must negotiate with creditors without that process.

Matt Fabian, partner at research firm Municipal Market Analytics, Concord, Mass., said that while worries about Puerto Rico have had little impact on the broader market for municipal bonds, a missed payment could spur new selling in other commonwealth debt.

"The Puerto Rico market is huge and diverse," he said. "You have to presume there will be some knock-on selling."

THE WALL STREET JOURNAL

By AARON KURILOFF

Aug. 3, 2015 4:30 p.m. ET

—Rob Copeland contributed to this article.

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## **[Special Report: Multitude of Local Authorities Soak Illinois Homeowners in Taxes.](#)**

(Reuters) - Mary Beth Jachec lives in a three-bedroom house in Wauconda, a village of 14,000 in Illinois, 45 miles northwest of Chicago. Her semi-detached brick home is unassuming. Her tax bills are not.

The 53-year-old insurance manager gets a real estate tax bill for 20 different local government authorities and a total payout of about \$7,000 in 2014. They include the Village of Wauconda, the Wauconda Park District, the Township of Wauconda, the Forest Preserve, the Wauconda Area Public Library District, and the Wauconda Fire Protection District.

Then there is Wauconda Road and Bridge, not to be confused with Road and Bridge, Wauconda Gravel, or with Wauconda Special Road Improvement and Gravel unit - all three of which have imposed separate taxes on her and the village's other homeowners.

Those three road entities come under the auspices of Wauconda Township. Officials there struggled to explain exactly what they each do, and why three separate taxing bodies are needed. The Wauconda Township Highway Commissioner, Joe Munson, said: "They are all for road maintenance." So why three? "I don't know why," Munson said. "It's always been that way."

Jachec, looking at her property tax bill, is dismayed. "It's ridiculous," she said.

A lot has been said about the budget crisis faced by Illinois - the state government itself is drowning in \$37 billion of debt, and has the lowest credit ratings and worst-funded pension system among the 50 U.S. states. But at street level, the picture can be even more troubling.

The average homeowner pays taxes to six layers of government, and in Wauconda and many other

places a lot more. In Ingleside, 55 miles north of Chicago, Dan Koivisto pays taxes to 18 local bodies. "I pay \$271 a month just to the school district alone," he said. "And I don't have children."

## DUPLICATION OF SERVICES

The state is home to nearly 8,500 local government units, with 6,026 empowered to raise taxes, by far the highest number in the U.S. Texas - whose population is more than twice that of Illinois - is second highest with about 5,150 local government units. Florida, with a population 54 percent greater than Illinois, has just 1,650, according to the U.S. Census Bureau.

Many of these taxing authorities, which mostly rely on property tax for their financing, have their own budget problems. That includes badly underfunded pension funds, mainly for cops and firefighters.

The Illinois authorities range from those typical across the nation, such as school and fire districts, to the unusual: for example, districts that raise taxes solely for the purpose of killing mosquitoes, lighting streets or maintaining cemeteries.

A Reuters analysis of property tax data shows that the sheer number of local government entities, and a lack of oversight of their operations, can lead to inefficient spending of taxpayer money, whether through duplication of services or high overhead costs. It leads to a proliferation of pension funds serving different groups of employees. And there are also signs that nepotism is rife within some of the authorities.

There is no central repository of data on the size and geographical boundaries of the local government authorities. The state comptroller does not audit the annual financial reports the local governments submit to it, said Rich Carter, a spokesman for the Comptroller's office.

The state's revenue department does keep data on property taxes collected by counties, but does not track taxes on individual properties. This makes it virtually impossible to systematically determine how many taxing districts overlap on parcels of land, or how much tax residents in a particular area pay unless they are individually surveyed. Because of these gaps and omissions, it is difficult to assess whether multiple layers of government lead to higher taxes.

On average, Illinois' effective property taxes are the third highest in the U.S. at 1.92 percent of residential property values, only behind New Jersey and New Hampshire, according to the non-partisan Tax Foundation. (New Hampshire, unlike Illinois and New Jersey, doesn't have a state income tax or a state sales tax.)

Critics of both the high taxation and the state's governance structure say that it takes too much of a toll on homeowners, discouraging people from either coming to the state or staying in it. Illinois saw net migration of 95,000 people out of the state last year, the greatest in its history and second only to New York, according to U.S. Census data. It is unclear how much, if any, of that exodus might be due to high taxes.

In many Illinois cities and towns, high taxation still isn't enough to keep up with increasing outlays, especially soaring pension costs, and some services have been cut. For example, in the state capital Springfield, pension costs for police and fire alone will this year consume nearly 90 percent of property tax revenues, according to the city's budget director, Bill McCarty. Since 2008, Springfield has cut 11 percent of its police force, closed three libraries, and tapped into other funds to pay pensions, McCarty added.

Sam Yingling, a state representative who until 2012 was supervisor of Avon Township, north of

Chicago, has become an outspoken critic of the multiple layers of local government.

Yingling said when he left the township three years ago, the township supervisor's office had annual overheads from salaries and benefits of \$120,000. He claimed its sole mandated statutory duty was to administer just \$10,000 of living assistance to poor residents. Lisa Rusch, the current Avon Township supervisor, disputed the welfare figure, saying her office provides between \$50,000 to \$70,000 in emergency and general assistance.

Yingling also criticizes the township for its road program. In its budget for the current fiscal year, more than \$1.4 million has been appropriated for road and bridge maintenance. Bob Kula, Avon Township's highway commissioner, says the township maintains just under 13 miles of roads.

## BORROWING RESTRICTIONS

The large number of local governments is a legacy of Illinois' 1870 constitution, which was in effect until 1970. The constitution limited the amount that counties and cities could borrow, an effort to control spending.

So when a new road or library needed building, a new authority of government would be created to get around the borrowing restrictions and to raise more money. Today, for example, there are over 800 drainage districts, most of which levy taxes.

A succession of Illinois governors over 20 years has called for a reduction of the number of government units, but made little progress, partly because of Byzantine regulations. To dissolve one of Illinois' 1,432 townships, for example, state law stipulates that three-quarters of voters in every township in that county must vote to approve.

When that state's newly elected Republican Governor Bruce Rauner established a commission to address the problem of local government, the group quickly discovered that the taxing units continue to proliferate. The net number of local government units increased by 148 between 1998 and 2015, the governor's office reported last month.

"You could probably get by with half as many," said Bill Brandt, the recently retired chair of the Illinois Finance Authority, which funds economic development projects. "But knocking out a local government is easier than it sounds. It requires legislation, and a lot of lawmakers on both sides of the aisle come from local government."

And it isn't only the number of authorities that is a concern. Illinois has about one sixth of America's public pension plans - 657 out of almost 4,000.

Local authorities in Illinois are mandated by law to keep the Illinois Municipal Retirement Fund, with 400,000 local government members, fully funded. They had to contribute \$923 million in 2014, up from \$543 million in 2005.

However, there is no such requirement for the local pension funds. The result: Many of these funds throughout the state are woefully underfunded, and some have less than 20 percent of what they need to meet obligations.

"Pension costs have been going up and up, so pension contributions have been going up and up, and property taxes are the single largest source of revenue to pay for them," Brandt said.

Townships alone provide a striking example of duplicated and costly services.

Cook County is the largest county in Illinois and second largest in America, with Chicago in its borders. There, property tax assessment and collection is done at the county level. But most of Cook County's 30 townships have elected and salaried property tax assessors. They neither assess nor collect property taxes, said Louise Muszynski, an assistant in the Cook County assessor's office.

"They do work," Muszynski said. "They help people at a local level to understand their bills, and help them with appeals."

Northfield Township's road district raised almost \$1.4 million in property taxes in the last fiscal year - even though it contains parts of seven cities. Each of those cities has a government that provides road maintenance services, yet Northfield Township maintains its own network of 29 miles of roads, as well as sewers. It has six plow trucks and other equipment, and a full-time workforce of seven, said Wally Kehr, the township road district foreman, who earns more than \$110,000 a year, according to the main Illinois pension database.

"We give a better service to local people than if the cities provided it," Kehr said.

In a rare instance of local government consolidation, officials in DuPage County, west of Chicago, managed to pass legislation in 2012 giving them the power to cut waste. Since then, they have abolished defunct sanitary and fire protection districts, cut duplicate staff and reduced benefits. Officials estimate savings to taxpayers of \$100 million over 20 years.

#### EMPLOYING RELATIVES

The multiplicity of local governments also affords opportunity for nepotism. Looking at the database of the Illinois Municipal Retirement Fund, the main pension system for local government workers, Reuters identified nearly a dozen instances where husbands employ wives, mothers employ daughters, and fathers hire sons.

In Collinsville Township, in southwestern Illinois, the elected Highway Commissioner, Larry Trucano, employs his son James as a laborer, earning \$71,000 a year, plus pension and health benefits, according to the Illinois Municipal Retirement Fund database. An official at Collinsville confirmed that James was employed by his father. Four telephone calls to Larry Trucano went unanswered.

In Venice Township, Andrew Economy, the township supervisor who earns \$46,300 plus pension - he also runs a local auto repair and tow service - employs his wife, Debra Economy, as administrator. She earns almost \$62,000 plus pension.

Andrew Economy said his wife does the jobs of two employees who retired in 2003 and 2008, and does them efficiently.

In the Village of Rosemont, population 4,000, which services Chicago's O'Hare Airport with hotels and a convention center, eight relatives of Mayor Bradley A. Stephens are village employees, including the police chief.

"Rosemont has never made an apology for the people they hire," said Gary Mack, a village spokesman. "The mayor holds any employees who happen to be related to him to a much higher standard than others."

By REUTERS

AUG. 5, 2015, 9:04 A.M. E.D.T.

(Reporting by Tim Reid in Los Angeles and Selam Gebrikadan in New York; Editing by David Greising and Martin Howell)

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## **[NFMA White Paper on the Disclosure of Potential Conflicts of Interest in Municipal Finance Transactions.](#)**

The National Federation of Municipal Analysts has released the final version of its White Paper on the Disclosure of Potential Conflicts of Interest in Municipal Finance Transactions.

To view the paper [click here](#).

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## **[Proposed MSRB Rule G-42 Moves to Additional Phase of Rulemaking.](#)**

**Alexandria, VA** - The Municipal Securities Rulemaking Board (MSRB) announced today that the [Securities and Exchange Commission \(SEC\) has ordered the MSRB's proposed rule to establish core standards of conduct for municipal advisors into an additional phase of the rulemaking process.](#)

Proposed MSRB Rule G-42, which the MSRB filed with the SEC for approval in April 2015, is designed to serve as the cornerstone of the MSRB's developing regulatory framework for municipal advisors that was outlined in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

In 2014, the MSRB twice sought industry and public feedback on draft versions of proposed Rule G-42. Following filing with the SEC, proposed Rule G-42 was published in the Federal Register on May 8, 2015, and the SEC's initial 45-day period to approve or disapprove the proposed rule was extended an additional 45 days, until August 6, 2015.

On August 6, 2015, the SEC began an additional phase of rulemaking on the proposed rule pursuant to Section 19(b)(2)(B) of the Securities Exchange Act of 1934 (Exchange Act), which may last up to 90 days, during which time the SEC determines whether to approve or disapprove the MSRB's proposed rule. As stated in the SEC's order, this procedural step has been taken to allow for additional analysis and does not indicate the SEC has reached a conclusion or will ultimately disapprove the proposed rule. The SEC invites additional comment from interested parties for 30 days following publication of its order in the Federal Register. [View the SEC order.](#)

In the interim, the MSRB plans to respond to issues that have been raised by earlier commenters on proposed Rule G-42 in a letter to the SEC that will be made available on the MSRB's website. The MSRB will continue to inform market stakeholders as this key rule proposal proceeds through the federal rulemaking process.

The stages of the rulemaking process that apply to self-regulatory organizations are set forth in the Exchange Act and SEC implementing regulations.

Date: August 7, 2015

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## **Municipal Securities Trading Activity Rises in Second Quarter.**

**Alexandria, VA** - The Municipal Securities Rulemaking Board (MSRB) today released municipal market statistics for the second quarter of 2015, showing a significant increase in the number of municipal securities trades compared to previous quarters. Municipal securities trading activity increased 14 percent in the second quarter of 2015 to 2.56 million trades, up from 2.24 million trades in the second quarter a year ago. The number of trades in the second quarter of this year was also up 14 percent from the previous quarter and is the highest quarterly number of trades since late 2013.

The MSRB, which regulates the municipal market, is the official source of municipal market trading and disclosure data, and operates the free Electronic Municipal Market Access (EMMA®) website that disseminates the information in real time. The website also houses aggregate trading, disclosure and new issuance data.

Other second quarter 2015 municipal securities trading highlights:

- Par amount traded increased slightly to \$742 billion, compared to \$739 billion traded in the same period in 2014.
- Customer buying activity also increased, with an average of 17,009 customer purchases each day in second quarter 2015, accounting for 58 percent of the 40,606 total daily trades. Last year's second quarter average was 15,327 and 35,504 total trades.
- The volume of interest rate resets on municipal variable rate demand obligations (VRDOs) rebounded slightly from first quarter 2015, totaling 135,556 in the second quarter compared to 133,898 in the previous quarter. The 2015 numbers continue to show a decline compared to previous years.

The MSRB's quarterly statistical summaries include aggregate market information for different types of municipal issues and trades, and the number of interest rate resets for variable rate demand obligations and auction rate securities. The data also include statistics pertaining to continuing disclosure documents received through the MSRB's EMMA website.

The EMMA website is a centralized online database operated by the MSRB that provides free public access to official disclosure documents and trade data associated with municipal bonds. In addition to current credit rating information, the EMMA website also makes available real-time trade data and primary market and continuing disclosure documents for over one million outstanding municipal bonds, as well as current interest rate information, liquidity documents and other information for most variable rate municipal securities.

Date: August 5, 2015

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## **MSRB Announces New Officers and Board Members for Fiscal Year 2016.**

Alexandria, VA - The principal regulator of the municipal securities market, the Municipal Securities

Rulemaking Board (MSRB), today announced new officers and members of its Board of Directors who will begin their terms on October 1, 2015. The Board makes policy decisions, authorizes rulemaking and oversees the operation of the MSRB's Electronic Municipal Market Access (EMMA®) website. In the coming year, the MSRB will be addressing municipal market structure issues, including additional price transparency for investors, among other topics.

Nathaniel Singer, Senior Managing Director at Swap Financial Group, will serve as Chair of the Board. Colleen Woodell, former Chief Credit Officer of Global Corporate and Government Ratings for Standard & Poor's, will serve as Vice Chair.

New members of the MSRB Board of Directors represent the public as well as entities regulated by the MSRB. New public representatives are Ronald Dieckman, former Senior Vice President at J.J.B. Hilliard, W.L. Lyons; Megan Kilgore, Assistant City Auditor at the City of Columbus Auditor's Office; Mark Kim, Chief Financial Officer at the District of Columbia Water and Sewer Authority; and Andrew Sanford, Senior Vice President at the Chubb Corporation. Joining the Board as bank representatives are Ed Tishelman, Managing Director and Head of the TD Securities Municipal Finance Group, and Dale Turnipseed, Executive Director at J.P. Morgan. Renee Boicourt, Managing Director and Partner for Lamont Financial Services Corporation, joins the Board as a municipal advisor representative.

"The MSRB is gaining a striking level of municipal securities expertise with the new Board members and outstanding leadership," said MSRB Chair Kym Arnone. "I have known Nat and Colleen for decades and they rank among the most committed and knowledgeable market experts. They will ensure that the MSRB continues to fulfill its important mission to protect investors, municipal entities and the public interest. I am also excited to welcome seven new Board members whose deep experience and knowledge about the municipal market will contribute to the important policymaking efforts of the MSRB."

All MSRB Board members are required to be knowledgeable about the municipal securities market and are selected from a large group of applicants. New Board members will each serve three-year terms.

## **MSRB Officers and New Board Members, Fiscal Year 2016**

**Chair-Elect Singer** has served on the Board since 2013 where he chairs the Finance Committee and serves as a member of the Steering Committee. He is also Senior Managing Director at Swap Financial Group, where he is responsible for analyzing strategies, policies and pricing of municipal bonds and derivative-based products. Prior to his position at Swap Financial Group, Mr. Singer was Senior Managing Director and Chief Operating Officer for Bear Stearns & Co. Inc.'s municipal bond department. Mr. Singer has been a guest lecturer at Princeton University's Woodrow Wilson School of Public and International Affairs and its Operations Research and Financial Engineering program, is an Independent Trustee for Reality Shares ETF Trust and is a former board member of Princeton University's Department of Engineering. He has also served as an advisor to the Government Accounting Standards Board in the design and implementation of GASB Statement No. 53 and No. 64, on Accounting and Financial Reporting for Derivative Instruments. Mr. Singer graduated magna cum laude from Princeton University with a bachelor's degree in engineering.

**Vice Chair-Elect Woodell** has been an MSRB Board member since 2013. She currently serves as Chair of the Nominating and Governance Committee, and is a member of the Steering Committee. Ms. Woodell is the former Chief Credit Officer of Global Corporate and Government Ratings for Standard & Poor's. Prior to this role at Standard & Poor's, she was S&P's Chief Quality Officer and Team Leader for U.S. Public Finance. Ms. Woodell has also worked for First Albany Corporation,

Fitch Investors Service and Moody's Investors Services. She is a former member of the Analytic Policy Board at Standard & Poor's and a past president and member of the Board of Governors of the Municipal Forum of New York. Ms. Woodell has a bachelor's degree from Wells College.

**Renee Boicourt** is Managing Director and Partner for Lamont Financial Services Corporation, where she provides transactional and strategic advice to the States of Louisiana and Wisconsin, the New York Power Authority, and the New York City Municipal Water Finance Authority. Renee has also advised the municipal bond insurers regarding Jefferson County, Alabama and Detroit, Michigan. Prior to joining Lamont Financial Services Corporation, Ms. Boicourt was Managing Director for High Profile Ratings at Moody's Investors Service, where she managed ratings for the 50 states, the U.S. territories, the largest cities, as well as airports, surface transportation, and power and water utility issuers. Ms. Boicourt received a bachelor's and master's degree in public policy from University of California, Berkeley.

**Ronald Dieckman** was until 2011 Senior Vice President and Director of the Public Finance and Municipal Bond Trading and Underwriting Department at J.J.B. Hilliard, W.L. Lyons. Mr. Dieckman worked for J.J.B. Hilliard, W.L. Lyons from 1977 to 2011 and held positions as Vice President of its municipal bond trading and underwriting department and as manager of the Ohio municipal bond trading and underwriting department. Mr. Dieckman received a bachelor's degree from University of Cincinnati.

**Megan Kilgore** is Assistant City Auditor at the City of Columbus, Ohio. Ms. Kilgore is responsible for the debt administration for the City, including the issuance and management of all debt. She is also an Adjunct Professor at The Ohio State University's John Glenn College of Public Affairs where she teaches a graduate-level course in public finance. Ms. Kilgore is the founder and president of Ohio Women in Public Finance, a statewide organization dedicated to advancing women's leadership opportunities in public finance by providing education, networking and career resources. She is a 2015 Women for Economic Leadership and Development (WELD) Women You Should Know honoree and a recipient of the 2012 Women in Public Finance's Rising Star Award. Ms. Kilgore received a bachelor's degree from The Ohio State University and a master's degree in public policy and administration from Northwestern University.

**Mark Kim** is Chief Financial Officer at the District of Columbia Water and Sewer Authority (DC Water), where he is responsible for ensuring the long-term financial sustainability of the largest advanced wastewater treatment plant in the world, serving over 2.2 million customers residing in the District of Columbia, Maryland and Virginia. Prior to his position at DC Water, Mr. Kim was Deputy Comptroller for Economic Development for the City of New York, where he directed the economic development agenda of the Office of the Comptroller, including oversight of several city agencies, asset management, and economic research and policy. He also served as Assistant Comptroller for Public Finance for the City of New York. Earlier he was Vice President at Fidelity Capital Markets, Vice President at Goldman, Sachs & Co. and Assistant Vice President at UBS Investment Bank. Mr. Kim received a bachelor's degree from Northwestern University, a law degree from Cornell University Law School and a Ph.D. in public policy from Harvard University.

**Andrew Sanford** joined The Chubb Corporation in 2013 as a Senior Vice President. He is the senior portfolio manager of municipal bond investments, overseeing a portfolio of approximately \$20 billion. He is also a member of the Chubb Investment Department fixed income strategy team. Prior to joining Chubb, Mr. Sanford was a Managing Director at RBC Capital Markets where he managed the Tender Option Bond program and the Direct Purchase portfolio. He also held positions as Managing Director at IXIS Capital Markets, Managing Director at Travelers Investment Group/Citigroup Asset Management, Vice President at Blackrock Financial Management, Assistant Vice President at Fiduciary Trust International and Trading Assistant at Chase Manhattan Bank. Mr.

Sanford received his bachelor's degree from the University of Pennsylvania and a master's degree in business administration from New York University Stern School of Business.

**Ed Tishelman** is Managing Director and Head of the TD Securities Municipal Finance Group, where he is responsible for public finance, as well as the underwriting, trading and distribution of all municipal securities and products. Prior to this position, Mr. Tishelman led the municipal underwriting desk at Bank of America. Earlier he was also Co-head of Municipal Underwriting at JP Morgan, which he joined as a municipal bond salesman and later served as national sales manager. He began his career in municipal finance as a trader at E.F. Hutton and went on to trade municipal bonds institutionally for 16 years, serving as Head of Trading at PaineWebber. Mr. Tishelman received a bachelor's degree from University of Vermont.

**Dale Turnipseed** is an Executive Director at J.P. Morgan, where he is a municipal bond salesman. Prior to joining J.P. Morgan, Mr. Turnipseed was an institutional tax-exempt salesman at Bear Stearns, where he covered mutual funds, investment advisors and insurance companies. Earlier he was an institutional tax-exempt salesman at First Albany Corporation for 17 years. Mr. Turnipseed received a bachelor's degree from Columbia College, Columbia University.

Date: August 4, 2015

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## **[MSRB Holds Quarterly Meeting.](#)**

Alexandria, VA - The Board of Directors of the Municipal Securities Rulemaking Board (MSRB) held its quarterly meeting July 29-30, 2015 where it discussed several rulemaking proposals and corporate matters in preparation for the start of the organization's upcoming fiscal year.

### **Regulatory Topics**

The Board discussed its earlier proposal to require dealers to provide pricing reference information for municipal securities transactions on retail customer confirmations and has directed staff to prepare a second proposal for public comment.

"Based on the feedback we received, the MSRB is developing a new proposal on disclosure of markups and markdowns for a category of principal transactions of municipal securities," said MSRB Chair Kym Arnone. "We are interested in hearing the merits of this approach in comparison with our first proposal to help investors understand the transaction costs and pricing of a municipal bond trade." The MSRB plans to publish its markup proposal in the near future, which will also seek comment on several modifications to the MSRB's initial proposal as an alternative to the preferred new approach. In addition the MSRB will continue to coordinate with the Financial Industry Regulatory Authority (FINRA) on the general subject of confirmation disclosure.

The Board also reviewed draft guidance for dealers on the MSRB's new best-execution rule, which will be finalized in the coming weeks to ensure that dealers have additional guidance to implement new Rule G-18 by the December 2015 effective date. Rule G-18, on best execution, requires dealers to seek the most favorable terms reasonably available for their retail customers' transactions, a step that supports existing MSRB rules and is a key investor protection.

“We are eager to provide the market with additional guidance on the implementation of this important rule,” Arnone said. “We believe the guidance will help ensure investors see a consistent application of the order-handling principles outlined in the best-ex rule.”

Both MSRB rulemaking initiatives advance the vision outlined in the MSRB’s long-range plan for market transparency and align with recommendations in the SEC’s July 2012 report on the municipal securities market.

At its meeting, the Board also discussed comments received on its proposal to modify the application of the standard of independence under MSRB Rule A-3 for the public member of the Board designated to be representative of institutional or retail investors in municipal securities. The Board agreed to continue to discuss ways to ensure that it can benefit from the expertise and knowledge of municipal market participants such as institutional investors as it discusses complex market structure issues.

The Board directed staff to develop a rule proposal on changes to MSRB Rule G-12, on uniform practice, to address outdated requirements for close-out procedures for dealers purchasing municipal securities. The proposal will be a part of the MSRB’s ongoing regulatory efficiency initiative that has resulted in a number of updated and streamlined MSRB rules.

The Board discussed the securities industry’s voluntary initiative to shorten the settlement cycle from the current T+3 cycle to T+2 and agreed it would support any associated MSRB rule changes necessary to accommodate a shortened settlement cycle, contingent on the necessary decisions of other regulators.

The Board discussed MSRB Rule G-10, on the delivery of the investor brochure, and determined to continue discussions on the best ways to address the customer complaint process.

## **Financial and Corporate Business**

Following more than a year’s analysis of its fees, the Board approved a proposal to adjust several MSRB fees to align the organization’s revenues with operational and capital expenses. The MSRB will file with the Securities and Exchange Commission the proposed changes to MSRB Rules A-12, on registration, and A-13, on underwriting and transaction assessments, soon. The Board discussed and approved the MSRB’s annual operating plan and associated budget for the upcoming fiscal year beginning on October 1, 2015 in support of the organization’s strategic goals.

Date: August 3, 2015

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- [U.S. Municipal Credit Report, Second Quarter 2015.](#)
  - [Coalition Creates Guide For Green Muni Bonds.](#)
  - [MSRB to Revise Proposed Rule on Disclosing Bond Price Markups.](#)
  - [Dealers, Issuers: Fed Proposal Too Strict on Munis, Would Hurt Market.](#)
  - [In Post-Detroit Bankruptcy Era, California Protects Investors Before Pensioners.](#)
  - [How One Mississippi County Played Wall Street’s Fiddle.](#)

- [Memo Provides Interim Guidance on Audits of Direct-Pay Bonds.](#)
- [AHS Hospital Corp. v. Town of Morristown](#) - Tax Court holds that hospital operated and used its property for profit-making purpose by entangling its activities with affiliated and non-affiliated for-profit entities, such that hospital did not qualify for property tax exemption for nonprofit organizations; calls modern non-profit hospitals "legal fictions."
- And finally, When Science Attacks is brought to you this week by [Fugle v. Sublette County School Dist. No. 9](#), in which a high school teacher's practical demonstration of centripetal force spins right along until one kid's scrawny little arms give out, he lets go of the rope/cart contraption, and slams into the gym wall, fracturing his faith in science teachers in multiple locations. What's wrong with the traditional kitten in a blender or baby in the dryer?

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## **BONDS - CALIFORNIA**

### **[City of Petaluma v. Cohen](#)**

**Court of Appeal, Third District, California - July 30, 2015 - Cal.Rptr.3d - 2015 WL 4572444**

City brought a petition for a writ of mandate, seeking an order to require the Department of Finance (DOF) to approve expenditures for an interchange and roadway under-crossing that had been approved by the city's redevelopment agency prior to the redevelopment agency's dissolution. The Superior Court denied the petition. City appealed.

The Court of Appeal held that:

- City's planned expenditures were not an "enforceable obligation" under redevelopment agency dissolution law;
- DOF's disapproval of expenditures did not violate the covenant of good faith; and
- DOF's disapproval of expenditures did not result in an unconstitutional impairment of city's contract rights.

City's planned expenditures for an interchange and roadway under-crossing that had been approved by the city's redevelopment agency prior to the redevelopment agency's dissolution were not "payments required under the indenture" and thus were not an "enforceable obligation" under the redevelopment agency dissolution law, even if city's failure to use its bond proceeds for the roadway project would result in the bond losing tax-exempt status and the interest rate on the bonds being increased, where nothing in the language of the first supplement to indenture required that the roadway project actually be funded or constructed, absent evidence of whether the indenture itself contained such a requirement.

The court specified that, although the bonds at issue were enforceable obligations, no enforceable obligation to use those bond proceeds specifically to fund this particular highway project appeared in the record.

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## **IMMUNITY - MARYLAND**

### **[Cooper v. Rodriguez](#)**

**Court of Appeals of Maryland - July 24, 2015 - A.3d - 2015 WL 4497718**

Parents of inmate murdered by fellow inmate on prison transport bus filed suit against State, individual correctional officers who staffed bus, and others, asserting wrongful death and other

claims. Following jury trial, the Circuit Court granted correctional officers' motion for judgment notwithstanding the verdict (JNOV). Parents and State appealed. The Court of Special Appeals affirmed in part and vacated in part. Correctional officer, who was officer in charge, filed petition for writ of certiorari, which was granted.

The Court of Appeals held that:

- Evidence supported finding that corrections officer was grossly negligent and, thus, was not entitled to immunity under Maryland Tort Claims Act;
- Alleged special relationship between officer and inmates was not limitation on common law public official immunity; but
- As an issue of first impression, officer's gross negligence was exception to common law public official immunity.

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## **IMMUNITY - MASSACHUSETTS**

### **[Murray v. Town of Hudson](#)**

**Supreme Judicial Court of Massachusetts, Worcester - August 3, 2015 - N.E.3d - 2015 WL 4602258**

Varsity high school relief pitcher who injured his knee while warming up in the visiting team bullpen brought action against town that maintained the park at which the baseball field was located for negligence. The Superior Court Department entered summary judgment in favor of town. Pitcher appealed.

The Supreme Judicial Court of Massachusetts held that:

- Recreational Use Statute did not shield town from liability, and
- Pitcher's presentment letter provided town with adequate notice of the circumstances of the player's negligence claim.

Recreational Use Statute did not shield town from liability for negligence resulting in injuries to visiting high school varsity relief pitcher, who was injured while warming up in the visiting team bullpen at baseball field in park maintained by town, where the town invited pitcher's team to play an interscholastic baseball game, and it owed the visiting team the same duty of care to provide a reasonably safe playing field that it owed its own students.

Baseball pitcher's presentment letter provided town, which maintained baseball field at which pitcher was injured while warming up in the visiting team's bullpen, with adequate notice of the circumstances of the player's negligence claim, without limitation to any specific theory of negligence, and town reasonably could have investigated those circumstances and determined whether it might have been liable on the claim under the Tort Claims Act, where letter claimed that bullpen was inherently dangerous and described what made it dangerous, including width of the pitching mound, use of wooden "timbers" to enclose the pitching mound, and the poor quality of lighting.

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## **MUNICIPAL ORDINANCE - MICHIGAN**

## **[Shoemaker v. City of Howell](#)**

**United States Court of Appeals, Sixth Circuit - July 29, 2015 - F.3d - 2015 WL 4548336**

Homeowner brought action challenging constitutional validity of city ordinance requiring homeowners or occupants to maintain grassy area between sidewalk and street curb adjacent to their property so that grass, weeds, and other vegetation did not grow in excess of eight inches. The United States District Court entered order granting summary judgment in favor of homeowner. The same court entered order denying city's motion for stay of judgment pending appeal, and homeowner's motion for relief from judgment or order. City appealed.

The Court of Appeals held that:

- Notice to homeowner satisfied notice requirements of procedural due process;
- Procedures city provided to homeowner to challenge allegation that he violated ordinance did not violate homeowner's procedural due process rights;
- Homeowner was precluded from mounting procedural due process claim against city;
- Ordinance did not impair homeowner's fundamental rights; and
- Ordinance did not violate homeowner's substantive due process rights.

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## **AFFORDABLE HOUSING ORDINANCE - NEW JERSEY**

### **[Fair Share Housing Center, Inc. v. Zoning Board of City of Hoboken](#)**

**Superior Court of New Jersey, Appellate Division - July 28, 2015 - A.3d - 2015 WL 4530656**

Housing center brought actions in lieu of prerogative writs seeking declaratory and injunctive relief against city zoning board and private developers, seeking compliance with city's affordable housing ordinance. The Superior Court dismissed with prejudice housing center's complaints. Housing center and city appealed. Appeals were consolidated.

The Superior Court, Appellate Division, held that:

- Neither Fair Housing Act (FHA) nor regulations promulgated by Council on Affordable Housing (COAH) pursuant to FHA required municipality to submit all ordinances impacting municipality's affordable housing obligation to COAH for approval, and
- Provisions in ordinance allowing for voluntary payments in lieu of compliance with ordinance's affordable housing requirements did not require approval of COAH under FHA or regulations promulgated by COAH as condition of enforcement.

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## **IMPACT FEES - PENNSYLVANIA**

### **[Metro Bank v. Board of Com'rs of Manheim Tp.](#)**

**Commonwealth Court of Pennsylvania - July 9, 2015 - A.3d - 2015 WL 4130405**

Bank, which planned to build new branch, sought judicial review of the calculation township's board of commissioners used to assess transportation impact fee for new development, asserting that township should not have included "pass-by trips" when calculating the number of new peak-hour trips generated by the development. The Court of Common Pleas affirmed board's calculation. Bank appealed.

The Commonwealth Court held that the statute providing transportation impact fee calculation for a new development based, in part, on the estimated number of peak hour trips to be generated by the new development does not exclude pass-by trips. Pass-by trips are only excluded when evaluating whether a municipality can assess an additional transportation impact fee.

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## **IMMUNITY - TEXAS**

### **[City of Ingleside v. City of Corpus Christi](#)**

**Supreme Court of Texas - July 24, 2015 - S.W.3d - 2015 WL 4498005**

City brought action against adjacent city for declaratory judgment that natural and artificial structures such as wharves, piers, and docks protruding into bay were functionally part of fast land above high water mark and were not within jurisdiction of adjacent city governing land from shoreline into bay waters. The District Court rejected adjacent city's plea to subject-matter jurisdiction, and it appealed. The Court of Appeals reversed. City petitioned for review.

The Supreme Court of Texas held that city's suit did not raise nonjusticiable political question regarding boundary. City did not seek declaration altering shoreline boundary, but merely asked court to clarify whether "shoreline" could be reshaped by protrusions of natural and artificial fixtures on the fast land.

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## **IMMUNITY - WYOMING**

### **[Fugle v. Sublette County School Dist. No. 9](#)**

**Supreme Court of Wyoming - July 31, 2015 - P.3d - 2015 WL 45989542015 WY 98**

High school student brought action against school and teacher after student suffered injuries during a demonstration of centripetal force in gymnasium, in which students sat in a wheeled cart, pushed the cart, and held onto a 20-foot rope while teacher held onto the other end. The District Court granted school and teacher's motion for summary judgment based on immunity under Governmental Claims Act. Student appealed.

The Supreme Court of Wyoming held that:

- Act's exception to immunity based on the operation or maintenance of a "building" did not apply, and
- Act's exception to immunity based on operation or maintenance of a "recreation area" does not apply to all activities undertaken within the area.

High school student did not present any evidence of a physical defect in gymnasium in his personal injury action against school and teacher for injuries suffered during science demonstration of centripetal force in gymnasium, and therefore exception to governmental immunity in Governmental Claims Act for operation or maintenance of a building did not apply. Even though student alleged a potential defect in lack of padding in gymnasium for demonstration, student's assertions related to the design and supervision of the demonstration, and student's expert reports did not mention defects inherent in gymnasium.

Under the Governmental Claims Act exception to governmental immunity based on the operation or maintenance of a "recreation area," the legislature did not intend for the waiver of immunity from

liability to apply to all activities undertaken within a particular recreation area. Rather, the legislature intended to limit the waiver of immunity to negligence associated with the function of the physical attributes or structure of the recreation area.

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## **TAX - NEW JERSEY**

### **[AHS Hospital Corp. v. Town of Morristown](#)**

**Tax Court of New Jersey - June 25, 2015 - N.J.Tax - 2015 WL 3956132**

Hospital, as taxpayer, sought review of town's denial of property tax exemption under statute granting exemption for nonprofit organizations.

As matters of first impression, the New Jersey Tax Court held that:

- For-profit activities of physicians and nonprofit activities carried out by hospital were unable to be separately stated and accounted for;
- Operation and use of hospital property was for benefit of affiliated and non-affiliated for-profit entities;
- Contracts for physicians employed directly by hospital had profit-making purpose; but
- Management agreement between hospital and contractor related to parking garage was not entered into with profit-making purpose;
- Hospital's agreement with company to provide services including food and nutrition and laundry distribution demonstrated profit-making purpose;
- Gift shop was not reasonably necessary for hospital purpose; and
- Hospital auditorium and fitness center were not operated or used for profit.

For-profit activities of voluntary physicians and exclusive contract physicians and nonprofit activities carried out by hospital were unable to be separately stated and accounted for, such that areas in hospital in which physicians practiced were not exempt from property tax under statute granting exemption for nonprofit entities. For-profit voluntary and exclusive contract physicians were subject to taxation, and voluntary and exclusive contract physicians worked throughout hospital and were not contained within any particular area.

Hospital operated and used its property for profit-making purpose by entangling its activities with affiliated and non-affiliated for-profit entities, such that hospital did not qualify for property tax exemption for nonprofit organizations, since commingling of effort and activities with for-profit entities was significant and substantial benefit was conferred on for-profit entities as a result. Hospital provided substantial subsidies to affiliated and unaffiliated for-profit entities in form of working capital loans, capital loans, and recruitments loans, hospital employees worked at affiliated for-profit entity, and hospital executives also served affiliated entities in executive capacities, making arm's-length transactions impossible.

Compensation hospital paid its executives was not reasonable, as factor weighing in favor of determination that hospital's operation and use of its property was conducted for profit, rendering hospital ineligible for property tax exemption for nonprofit organization, absent evidence of salaries paid for similar positions by similar institutions.

Contracts for physicians employed directly by hospital had profit-making purpose, in violation of requirement under statute granting property tax exemption for nonprofit organizations that property must not be used for profit. Employed physicians were given incentive component in addition to

their base compensation, incentive pools were derived from departmental expenses, and profit was split between hospital and physicians, indicating that revenue-sharing operation was conducted for profit-making purpose.

Management agreement between hospital and private, for-profit contractor to provide services related to visitors' parking garage on hospital property was not entered into with profit-making purpose, such that agreement satisfied requirement that property not be used for profit under statute granting property tax exemption for nonprofit organizations. Hospital paid fixed management fee and bore expenses of operating parking garage, such that fee arrangement with contractor was no different from compensation paid to hospital employees, and hospital operated parking garage at a loss.

Hospital's arrangement with company to provide food and nutrition services, environmental services, laundry and linen distribution, patient transportation, and plant operations maintenance demonstrated profit-making purpose, in violation of requirement that hospital property not be used for profit under statute granting property tax exemption for nonprofit organizations, such that areas of hospital in which company operated were subject to taxation. Hospital's agreement with company demonstrated that both parties contemplated generation of additional revenue in form of reduced expenses, and additional revenue was split between hospital and company.

Gift shop was not reasonably necessary for hospital purpose, but rather served as form of competition to commercially-owned facilities, such that gift shop was not actually and exclusively used for tax-exempt purpose of hospital, as required for gift shop to be exempt from taxation under statute granting property tax exemption for nonprofit organizations. Gift shop did not provide any medical service required by hospital patient, but rather gift shop simply sold items that visitor might bring to patient or use for his or her own purposes, and gift shop was merely a convenience for hospital visitors.

Hospital auditorium was not used for profit, as required for area of hospital in which auditorium was located to be exempt from property taxes under statute granting exemption for nonprofit organizations. Payments were not collected by hospital for use of auditorium.

Hospital fitness center was not used or operated for profit, as required for fitness center to be exempt from property tax under statute granting exemption for nonprofit organizations. Although small amount of hospital employees who used fitness center paid a minor fee, there was not considerable business activity involving fitness center, and no profit was made from fitness center.

Hospital day care center was not exempt from property taxes under statute granting exemption for nonprofit organizations, absent demonstration that day care center was not used or operated for profit.

"If it is true that all non-profit hospitals operate like the Hospital in this case, as was the testimony here, then for purposes of the property tax exemption, modern non-profit hospitals are essentially *legal fictions*; and it is long established that "fictions arise from the law, and not law from fictions." Accordingly, if the property tax exemption for modern non-profit hospitals is to exist at all in New Jersey going forward, then it is a function of the Legislature and not the courts to promulgate what the terms and conditions will be. Clearly, the operation and function of modern non-profit hospitals do not meet the current criteria for property tax exemption under N.J.S.A. 54:4-3.6 and the applicable case law."

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## **Seattle Transit Authority Plans Biggest-Ever Green Muni Bond.**

This week, the Central Puget Sound Regional Transit Authority plans to sell about \$923 million of green bonds, which help finance environmentally friendly projects. It would be the world's largest green-bond issue from a municipal entity, providing a boost to green-bond sales figures that have been tracking below expectations so far this year.

Green bonds have surged in popularity over the last few years, as companies, governments and development banks take advantage of investor demand for securities that are seen as aiding the environment. But this year's volume of green-bond sales has disappointed some advocates amid concerns about whether projects financed with green bonds are truly "green."

So far, roughly \$19 billion of green bonds have been sold this year, according to a tally from the Climate Bonds Initiative, a nonprofit group based in London. The group, however, forecast \$100 billion of new green bond sales this year, a figure that looks unlikely now. Last year, nearly \$37 billion of bonds were sold, the most on record.

The Seattle agency, known as Sound Transit, plans to use proceeds from its sale to expand the region's light-rail system, as well as refinance existing debt used for previous projects. The agency expects to finalize pricing of the bonds on Tuesday.

Brian McCartan, chief financial officer for Sound Transit, said the agency is hoping to diversify its investor base with the new green bonds, as well as promote its sustainability program and deepen the green-bond market.

Unlike some other recent municipal issuers, the agency commissioned a study from research-and-analysis firm Sustainalytics to sign off on the environmental benefits of the agency's new bonds. Green-bond investors say these outside opinions are useful in determining whether a project is truly environmentally friendly.

In its review, Sustainalytics said Sound Transit "aims to support projects that will provide low-carbon public transit" in the region, reducing greenhouse-gas emissions, and found the green bonds "robust and credible." The opinion should "really give investors that additional vote of confidence that the moneys will be used for sustainable projects," Mr. McCartan said. The firm charged a "modest fee" for the review, he said.

The bonds will be repaid from sales-tax collections. They are expected to carry a triple-A rating from Standard & Poor's Ratings Services, the highest rating available, and a Aa2 rating, the third highest, from Moody's Investors Service. J.P. Morgan is leading the deal.

THE WALL STREET JOURNAL

By MIKE CHERNEY

Aug 3, 2015

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## **MSRB to Revise Proposed Rule on Disclosing Bond Price Markups.**

Aug 3 (Reuters) - The Municipal Securities Rulemaking Board is modifying a controversial proposal

that would require brokers and dealers to disclose how much above their cost they sell certain municipal bonds to small investors, the regulator's executive director said on Monday.

The decision follows extensive comments from bond dealers on the costs and redundancies of building systems to comply with the rule, which was proposed last November, and the complexity of determining how to apply it.

The MSRB plans to seek comments on a new two-part proposal in September that addresses some complaints without sacrificing the customer-protection purpose of the rule. It will spell out a preferred new approach as well as a modification of the original proposal that limits the set of bonds requiring the pricing disclosure, Executive Director Lynnette Kelly told reporters.

Since there are no centralized marketplaces for buying and selling municipal and corporate bonds, as there are for trading stocks, retail investors cannot tell if they are getting reasonable prices from their dealers. Individual investors routinely pay as much as 5 percent more than institutional investors and dealers, U.S. Securities and Exchange Commissioner Luis Aguilar said earlier this year.

The MSRB is coordinating its approach to the rule with the Financial Industry Regulatory Authority, which in November published a similar disclosure proposal for corporate bonds traded by retail investors. FINRA's board in July said the regulator would issue a revised version of its proposal later this year.

Disclosure of bond markups should foster more-competitive pricing for retail customers, SEC Chair Mary Jo White and Republican Commissioner Michael Piwowar have said. The SEC must approve all rules proposed by the MSRB and FINRA.

The proposals require dealers to mark on customer trade confirmation statements how much above their cost they are selling bonds or how much below cost they are buying them from investors.

The initial rules applied to relatively small trades of 100 or fewer bonds with a maximum trade value of \$100,000. They would have applied as well only to bonds that brokers or dealers acquired or sold on the same day that they made a similar trade with a retail customer.

FINRA did not elaborate on details of its proposed changes. Kelly said MSRB might modify its initial proposal to apply to a more limited set of trades requiring disclosure.

At a board meeting last week, MSRB directors also voted to give municipal bond dealers guidance within the next few weeks on a new best-execution rule that takes effect in December.

(Reporting by Jed Horowitz; Editing by Chizu Nomiya and Lisa Von Ahn)

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## **[Border Jails Facing Bond Defaults as Immigration Boom Goes Bust.](#)**

Jails built to profit from an illegal immigration boom are weighing down the finances of rural counties in the U.S. Sunbelt as border apprehensions slow and the federal government orders the release of more migrants.

In Texas, the heart of a jail-building boom over the past decade, nine of 21 counties that created agencies to issue about \$1.3 billion in municipal bonds to build privately run correctional facilities

largely for migrants have defaulted on their debt. A dozen other facilities from Florida to Louisiana to Arizona, many that housed immigrants, have also defaulted, according to figures from Municipal Market Analytics, a bond-research firm based in Concord, Massachusetts.

The slowdown in border detentions is putting a fiscal strain on counties that rushed to build jails in anticipation that a two-decade boom in immigrant inmates would continue. Municipalities that banked on those facilities for revenue and jobs are desperate to keep them afloat as a glut of beds goes empty and walls gather dust.

“My fear’s always been that this would happen,” said Joel Rodriguez Jr., judge of La Salle County, Texas, about 67 miles (107 kilometers) north of the U.S.-Mexico border, who is overseeing the fate of a distressed detention center. “When this facility was sold to the county, they sold it as a money-making facility that was going to be a great economic boon.”

### **Almost Empty**

Today the 566-bed facility, called the La Salle County Regional Detention Facility, sits almost empty behind thick coils of razor ribbon in tiny Encinal, whose 579 residents barely outnumber prison beds. Another border detention center was destroyed in a riot by prisoners after cost-cutting efforts led to deplorable conditions. Another, on the banks of the Rio Grande River, is slated to close next month after too few inmates walked through the doors to keep up with big debt payments.

“The number of people detained and incarcerated for immigration matters hasn’t kept up with the pace of construction for these new beds,” said Bob Libal, executive director of Grassroots Leadership, an advocacy organization based in Austin, Texas, that opposes private prisons.

The drop-off follows an almost two-decade boom that saw the number of immigrant detainees mushroom, partly as a result of more people crossing into the U.S. and partly due to a get-tough attitude toward illegal border crossers. County jails grew overcrowded.

### **Good Bet**

“The populations were just hanging off the trees,” recalled Michael Harling, executive vice president at Municipal Capital Markets Group Inc., a Dallas firm that co-managed many of the jail bond issuances in Texas.

Prison operators crisscrossed the South pitching rural towns on the purported economic salvation of detention facilities. Under the arrangement, local governments would typically receive daily fees from the federal government based on the number of beds or persons filling them, and private prison operators would get a portion, usually the lion’s share.

For some of the nation’s smallest and most impoverished communities, locking up immigrants seemed like a good bet. To finance their construction, counties issued debt through conduit borrowers, limiting the county’s liability, while allowing projects to be built quickly.

### **Lease-Purchase**

Last year, Texas counties had \$709 million in scheduled debt service for so-called lease-purchase obligations, most of which are for jail facilities, up from \$273 million in 2000, according to figures from the Texas Bond Review Board.

The increased debt grew right before migration patterns and immigration policy began to shift. Last year, there were 487,000 apprehensions, about the same level as in 1973, compared with a peak of

nearly 1.7 million in 2000, according to the U.S. Border Patrol. That's partly because an improving Mexican economy and drug cartel violence kept fewer people from venturing north.

At the same time, the trend of locking up migrants has eased. More local officials are refusing to detain migrants at the behest of federal immigration officials and the Obama administration recently narrowed the categories of migrants that should be detained.

The number of immigration detainees last year was down 11 percent from 2012, when incarcerations were at an all-time high, according to figures from U.S. Immigration and Customs Enforcement. The average daily population in ICE detention was 31,164 in June, down 16 percent over the same time period a year earlier.

### **Fewer Detentions**

Detentions may continue their downward march. Last month, a federal court rebuked the administration for its policy that jailed a wave of women and children fleeing violence in Central America.

"The system has been built up to be able to house criminal aliens," said A. J. "Andy" Louderback, past president of the Sheriffs' Association of Texas. "When all of a sudden at the stroke of a pen those folks are released to live, work and play in our communities, those beds are going to be vacant."

The Encinal detention center was opened in 2004 after a county corporation issued almost \$22 million in revenue bonds. At the time, local residents warned that revenue projections were too rosy.

### **Leaking Roof**

Last winter, the facility's private operator, Emerald Correctional Management LLC of Shreveport, Louisiana, suddenly pulled out all inmates, said Rodriguez, leaving the county with empty beds, a leaking roof and almost \$20 million in debt.

Since then, the county has assumed responsibility for the facility and, in an effort to salvage the 100 jobs tied to the jail, is working with bondholders to get it back up and running.

Bonds issued for the jail that mature in March 2024 traded July 17 at 40 cents on the dollar, to yield about 25 percent, data compiled by Bloomberg show. The securities are down from 70 cents at the start of the year.

In 2006, the Willacy County Local Government Corp. issued its first bonds, totaling \$61 million, to build a detention facility. The 3,000-bed facility that featured a collection of white Kevlar domes to house inmates became a source of grievances, from maggots in the food to allegations of sexual abuse.

In February, inmates rioted and destroyed the facility with metal pipes. All 2,800 prisoners were removed from the facility, federal officials canceled their contract and Standard & Poor's downgraded the debt to junk.

In Maverick County, where the county seat of Eagle Pass sits along the banks of the Rio Grande River, an immigrant detention facility built in 2007 using \$43 million in revenue bonds is slated to close this month after failing to service its debt. Officials say they never got the promised prisoners and that the project now looks like a bad deal.

"The amount of the loan that was taken out on this facility was just ridiculously too high," said

Maverick County Commissioner Jerry Morales. "It doesn't add up."

## **Bloomberg**

by Lauren Etter

August 2, 2015 — 9:00 PM PDT

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### **[The Cost of Water Is Rising - Financing Tools And Strategies To Help Communities Pay: Butler Snow](#)**

Across America, the cost of water is rising. Getting clean drinking water is not as easy as turning on the faucet. Not only is access to safe water a growing issue across America — it is an expensive one too. Local elected officials throughout the United States, whether in small towns or the country's largest cities, are facing the difficulties of expanding, repairing and bringing into compliance with federal and state regulations their aging drinking water and wastewater systems. In older jurisdictions, pipes installed as long as a century ago will have to be replaced. Repairing and replacing these age old pipes comes with the ever-pervasive task of filling and smoothing the potholes that can result from the repair of these antiquated and dilapidated water and wastewater systems. Additionally, several cities are going to have to make major upgrades to their systems as a result of federal and state enforcement actions and undertake complicated analysis when considering the feasibility of sending their wastewater to a regional system juxtaposed to operating their own wastewater treatment facilities.

It could cost more than \$2 trillion over the next 25 years to replace and expand drinking water and wastewater systems nationally.<sup>1</sup> Both federal and state solutions are being proposed to address this enormous cost that involves innovative financing and in some instances private parties. However, some cities and towns will find it necessary to utilize current tools (perhaps in unorthodox ways) to construct and repair systems because the need is so great. Regardless, the cost is vast and the need is abundant.

#### **National Solutions**

WIFIA - Public works officials around the country are advocating for the use of the Water Infrastructure Financing and Innovation Act ("WIFIA"), a program modeled after the Transportation Infrastructure Financing and Innovation Act ("TIFIA"). WIFIA is an Environmental Protection Agency ("EPA") program that will hopefully spur private sector investment in water infrastructure by providing innovative financing mechanisms for water-related infrastructure projects of national or regional significance.<sup>2</sup> The program attempts to fill in gaps left open by State Revolving Fund ("SRF") programs by providing subsidized financing for large dollar-value projects. Once Congress provides funding, WIFIA could provide low interest rate loan financing for the construction of drinking water and wastewater infrastructure.

AFF Bonds - the America Fast Forward ("AFF") bond program is a President Obama backed proposal similar to the Build America Bond program that would be an alternative to traditional tax-exempt bonds. AFF Bonds would be taxable bonds issued by State and local governments in which the treasury would make direct payments to state and local governmental issuers (through refundable tax credits). The AFF bond program would allow the treasury to make direct payments to state and local governmental issuers in an amount equal to 28 % of the coupon interest on the

bonds. The goal of the AFF bond program is to facilitate greater efficiency, more investors, and lower costs for state and local governmental debt.

QPIBs - the catalyst for Qualified Public Infrastructure Bonds ("QPIBs") is the push for the public and private sector to work together to build infrastructure projects. QPIBs will extend the benefits of municipal bonds to public private partnerships ("P3s") or like partnerships that involve long-term leasing and management contracts, lowering the cost of borrowing and attracting new capital. If approved by Congress, the QPIB bond program would provide financing for airports, ports, mass transit, solid waste disposal, sewer, and water, as well as for other types of surface transportation projects.

## **Local Solutions**

Tax-exempt municipal bonds - The oldest and most frequently used program to finance infrastructure projects is the use of tax exempt government bonds. There is no federal cap on the amount of tax-exempt debt a local can issue (although there may be state or local caps) and each year the federal government forgoes about \$30 billion in revenue through this tax exempt subsidy.

SRF - In the 1970s and 1980s, the federal government provided generous grants to localities to improve their water and wastewater systems.<sup>3</sup> Today, the federal government has assisted communities across the nation by providing appropriations to state revolving loan funds through its SRF program, which states, in turn, can loan out to local projects or to help refinance local debt. Over the last two and half decades, SRFs have provided over \$100 billion, funding more than 33,320 low-interest loans.

## **Footnotes**

1 Tom Curtis, Water Infrastructure: The last and next 100 Years, Journal AWWA, August 2014 <http://www.awwa.org/publications/journal-awwa/table-of-contents/articleid/46499415/issueid/46498556.aspx?getfile=/documents/dcdfiles/46499415/jaw201408curtis.pdf> (accessed July 10, 2015).

2 WIFIA was signed into law on June 10, 2014, as Public Law 113-121.

3 Ryan Holeywell, Financing Water Infrastructure Like Transportation, Governing May 2012 <http://www.governing.com/topics/finance/gov-financing-water-infrastructure-like-transportation.html> (accessed July 10, 2015).

Article by J. Troy Johnston and Tray Hairston

Butler Snow LLP

Last Updated: July 29 2015

*The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.*

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## **[MSRB Revises Content Outlines for its Professional Qualification Examinations for Municipal Securities Dealers](#)**

The Municipal Securities Rulemaking Board (MSRB) today filed a proposed rule change with the

Securities and Exchange Commission (SEC) to revise the content outlines for the Municipal Fund Securities Limited Principal Qualification Examination (Series 51), Municipal Securities Representative Qualification Examination (Series 52) and the Municipal Securities Principal Qualification Examination (Series 53).

The revisions to the content outlines are effective immediately and will be implemented on August 31, 2015, 30 days following the filing date.

[Read the regulatory notice.](#)

[Read the filing.](#)

[Read more about MSRB professional qualification exams.](#)

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## **[IRS Grants Extension of Expenditure Period for Bond Proceeds: Tax Analysts.](#)**

The IRS granted a city authority an extension of the expenditure period for qualified new clean energy renewable bond proceeds after determining that the authority had reasonable cause for its failure to spend all the proceeds and that the remaining proceeds will be spent for qualified purposes with due diligence.

Summary by Tax Analysts®

To read the Private Letter Ruling, [click here](#) (subscription required).

APRIL 28, 2015

Citations: LTR 201531002

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## **[Hawkins Advisory \(Annual Qualified Mortgage Information\)](#)**

This Hawkins Advisory is of interest to single-family housing bond issuers.

[Read the Advisory.](#)

7/28/2015

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## **[US Municipal Credit Report, Second Quarter 2015.](#)**

The municipal bond credit report is a quarterly report on the trends and statistics of U.S. municipal bond market, both taxable and tax-exempt. Issuance volumes, outstanding, credit spreads, highlights and commentary are included.

### **Summary**

According to Thomson Reuters, long-term public municipal issuance volume totaled \$110.4 billion in

the second quarter of 2015, an increase of 6.2 percent from the prior quarter (\$104.0 billion) and 32.7 percent year-over-year (y-o-y) (\$83.2 billion). Including private placements (\$2.5 billion), long-term municipal issuance for 2Q'15 was \$113.0 billion.

Tax-exempt issuance totaled \$99.8 billion in 2Q'15, an increase of 5.2 percent and 34.6 percent q-o-q and y-o-y, respectively. Taxable issuance totaled \$7.9 billion in 2Q'15, an increase of 15.3 percent and 27.7 percent respectively, q-o-q and y o y. AMT issuance was \$2.8 billion, an increase of 16.8 percent q-o-q but a decline of 4.2 percent y-o-y. Year-to-date, municipal issuance totaled \$214.5 billion, up 50.0 percent from last year and well above the 10-year average of \$186.4 billion, largely due to the surge in issuance from the first quarter.

By use of proceeds, general purpose led issuance totals in 2Q'15 (\$28.1 billion), followed by primary & secondary education (\$25.7 billion), and higher education (\$11.2 billion). Other notable sectors that saw an increase in issuance were public power (\$6.3 billion, an increase of 94.4 percent and 122.4 percent q-o-q and y-o-y, respectively), student loans (\$917.1 million, an increase of 109.8 percent and 64.2 percent q-o-q and y-o-y respectively), and seaports/marine terminals (\$525.9 million, an increase of 226.2 percent and 24.8 percent q-o-q and y-o-y, respectively).

Refunding volumes as a percentage of issuance declined from the prior quarter, with 48.6 percent of issuance refunded compared to 62.2 percent in 1Q'15 and 44.9 percent in 2Q'14.

[View the full report.](#)

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## **[PILT \(Payments in Lieu of Taxes\): Somewhat Simplified.](#)**

The Congressional Research Service has published an updated overview of the Payments in Lieu of Taxes program.

The document is available [here](#).

July 27, 2015

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## **[S. 1753 Would Modify and Extend Tax-Exempt Zone Academy Bonds: Tax Analysts](#)**

S. 1753, the Rebuilding America's Schools Act, introduced by Senate Finance Committee member Sherrod Brown, D-Ohio, would expand and permanently extend qualified zone academy bonds, and treat them as specified tax credit bonds.

Summary by Tax Analysts®

The full text of the bill is available [here](#) (subscription required).

JULY 13, 2015

Citations: S. 1753; Rebuilding America's Schools Act

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## **Puerto Rico Official Says Island Will Default on Agency Debt.**

Puerto Rico said it won't make a bond payment due Saturday, putting the commonwealth on a path to default and promising to initiate a clash with creditors as it seeks to renegotiate its \$72 billion of debt.

The government doesn't have the money for the \$58 million of principal and interest due on Public Finance Corp. bonds, Victor Suarez, the chief of staff for Governor Alejandro Garcia Padilla said during a press conference Friday in San Juan.

"We cannot make the payment tomorrow because we do not have the funds available," Suarez told reporters. "This payment will be made as we address how to restructure the government's debt prospectively."

The default marks an escalation in the debt crisis that's been racking the island, where officials are pushing for what may be the biggest restructuring ever in the municipal market. Puerto Rico bond prices have slipped amid speculation that the island won't be able to repay what it owes as its economy stagnates and residents leave for the U.S. mainland.

"An event like this is significant enough that it could hurt prices for Puerto Rico bonds," said Richard Larkin, director of credit analysis at Herbert J Sims & Co. in Boca Raton, Florida. "I can't believe a default on debt with Puerto Rico's name will go unnoticed."

Island officials had said that Puerto Rico may skip the payment on the Finance Corp. bonds, which can be made as late as Monday because Aug. 1 is a Saturday. The Finance Corp., which has borrowed to help balance the government's budget, has about \$1 billion of debt outstanding.

### **No Appropriation**

The securities are paid for with money appropriated by the legislature, unlike general-obligation bonds that are protected by the commonwealth's constitution and have a claim on its tax money. That leaves bondholders with little recourse because the commonwealth hasn't guaranteed repayment and the legislature isn't obligated to allocate the funds.

Faced with a budget shortfall, lawmakers didn't provide the money when they passed the annual spending plan. Island officials said that Puerto Rico's available cash was limited to funding essential services such as health and safety.

Puerto Rico Government Development Bank President Melba Acosta said in a statement Friday that a separate \$169 million debt-service payment for the bank's bonds will be made.

### **Shared Sacrifice**

Garcia Padilla said in June that the commonwealth cannot pay all of its obligations, following years of borrowing to paper over budget shortfalls, and that bondholders need to share in the sacrifice to help steady the island's finances. Officials plan to draft a debt-restructuring plan by Sept. 1.

The governor has drawn opposition from investors including OppenheimerFunds Inc., which said it will fight to ensure that the commonwealth repays its debt. A report by three former International Monetary Fund economists, which was commissioned by a group of hedge funds, said the island can balance the budget without a broad debt restructuring.

Puerto Rico's economy has contracted every year but one since 2006 and is projected to decline by 1.2 percent this year. The island's population shrunk 7 percent in the past decade. Another 245,000 residents are estimated to leave by 2025 as they seek employment on the U.S. mainland. Puerto Rico's June jobless rate of 12.6 percent is more than double what it is in the U.S.

### **Essential Problem**

"The essential problem in Puerto Rico is the economy and the outmigration of individuals," said Phil Fischer, head of municipal research at Bank of America Corp. in New York. "And neither of those seems to be improving."

While Garcia Padilla surprised investors by pushing for a restructuring, two months after he said it would be a mistake to default, the island's worsening debt crisis hasn't rippled through the municipal-bond market. Municipal bonds in July had their strongest return since January as investors recognized that Puerto Rico's problems are unique.

The commonwealth's securities have traded at distressed levels for two years. General obligations maturing July 2035 and originally sold in March 2014 at 93 cents on the dollar traded Friday at an average of 69.5 cents on the dollar, according to data compiled by Bloomberg. The average yield was 12.1 percent.

Puerto Rico debt has lost 10.8 percent this year through July 30, the worst for the period since at least 2007, S&P Dow Jones Indices show.

### **Bloomberg**

by Michelle Kaske

July 31, 2015 — 4:46 PM PDT Updated on July 31, 2015 — 6:48 PM PDT

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### **[Chicago Eyes Issuing Costly Capital Appreciation Bonds.](#)**

The latest general obligation bond proposal from Chicago Mayor Rahm Emanuel could have the cash-strapped city selling up to \$500 million of capital appreciation bonds (CABs), a form of debt that government finance experts say could be costly and risky.

CABs are municipal debt for which payments are deferred until the bonds' maturity while interest compounds. Emanuel's administration on Wednesday proposed a refunding of outstanding GO bonds that would give the city the flexibility to issue CABs or the more commonly used current interest bonds for which interest is paid on a periodic basis.

A spokeswoman for Chicago's finance department said the city has not sold CABs since 2009 and expects to issue current interest bonds for the refunding.

Still, the fact that CABs are listed as an option raised concerns as Chicago struggles with low credit ratings, growing budget deficits and already high borrowing costs.

Richard Ciccarone, president and CEO of Merritt Research Services, said Thursday the move would allow the city to "kick the can down the road" by deferring debt service payments for as long as 40 years.

Laurence Msall, president of the Chicago-based Civic Federation, a government finance watchdog group, called CABs “an extraordinarily expensive form of borrowing.”

“Going into the market and asking creditors to wait 10, 20, 40 years before receiving any payment carries a very stiff premium,” he said.

Emanuel in April announced a plan to clean up the city’s debt practices, including converting variable-rate bonds to fixed-rate and eliminating related interest-rate swaps – a move the Civic Federation applauded, according to Msall.

That plan got fast-tracked after Moody’s Investors Service downgraded Chicago to junk in May triggering \$2.2 billion in accelerated debt and fee payments by the city.

A \$1.08 billion GO bond sale earlier this month resulted in higher borrowing costs for Chicago than most issuers in the U.S. municipal bond market.

The city, the third largest in the United States by population, is struggling with a projected \$430 million fiscal 2016 budget gap. The deficit is due in part to escalating pension payments that include a looming \$550 million contribution increase to its public safety workers’ retirement funds.

Msall said he hoped the city council and its new financial analysis office head will take a close look at the bond proposal.

CABs have proved controversial in the past. California in 2013 enacted a law limiting total debt service on the bonds to four times the principal and maturities to a maximum of 25 years. The law also requires CAB deals to allow early repayment of the debt when maturities are longer than 10 years.

The law was sparked in part by reports that a San Diego-area school district’s \$105 million of CABs would end up costing nearly \$1 billion.

More recently, Puerto Rico’s financially troubled public utility PREPA rejected an offer by bondholders to restructure some of its debt into CABs.

REUTERS

CHICAGO, JULY 30 | BY KAREN PIEROG

(Reporting by Karen Pierog; Editing by Cynthia Osterman)

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## **[Coalition Creates Guide For Green Muni Bonds.](#)**

As municipal bonds have become an integral part of the environmentally conscious “green bonds” movement, a group of investment and advocacy organizations has created a guide for municipalities interested in funding projects with such eco-friendly debt issues.

The Green City Bonds Coalition, founded eight months ago, has created a guide called the “Green Muni Bonds Playbook,” the organization announced during a webinar Tuesday.

The overall green bonds market more than tripled from 2013 to 2014 to \$37 billion in revenues, the coalition says. It could top \$100 billion this year, says “As You Sow,” a coalition member

organization founded to promote corporate environmental responsibility.

The municipal bond share of green bonds is growing as well. There was a single \$100 million green muni bond issued in 2013, but last year there were \$2.5 billion in such issues. This year through early May, \$1.3 billion had been sold, the coalition says. (The Tuesday webinar gathered representatives from municipalities that had issued green bonds.)

The United States needs to invest \$3.6 trillion in its basic infrastructure by 2020 and plow money into transportation systems, waterways and the power sector, the coalition estimates.

Municipal green bonds can fund a number of these projects, including recycling efforts, water quality or availability projects and projects that reduce greenhouse gases. They are like any other bonds, except for the types of projects they fund, says the coalition.

Barbara Whitehorn, chief financial officer for the city of Asheville, N.C., says issuing the bonds was as easy as issuing any other bonds. In Asheville, a \$50 million green bond issue was used to refinance earlier water bonds used for water loss reduction and for transmission and delivery improvements.

“The most challenging aspect of the green bonds [the first ever issued by a municipality in North Carolina] were the reporting aspects that we committed to make on our website” to keep residents informed about the work, she says.

Asheville officials are proud of their progressive reputation and the green bonds fit that profile, she adds.

One of the benefits of issuing green bonds is that they draw interest from those who want to promote sustainability and environmental protection, according to Jonas Biery, debt manager for Portland, Ore.

“We do not have a green bonds capital project ready yet, but we are talking about it,” Biery says. “We have people and institutions that are not usually attracted to muni bonds who are interested because they will be green bonds.”

In addition to As You Sow, coalition members include the Climate Bonds Initiative, an investor-focused, not-for-profit founded to mobilize debt capital markets for climate change; C40 Cities, a network of the world’s megacities dedicated to climate change solutions; the International Finance Corporation, an organization of the World Bank Group; the Natural Resources Defense Council, an international environmental advocacy organization; and the CDP, an organization created to encourage sustainable economies.

The playbook is available [here](#).

FINANCIAL ADVISOR

JULY 30, 2015 • KAREN DEMASTERS

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**TAX - MONTANA**

**[Zinvest, LLC v. Anderson](#)**

**Supreme Court of Montana - July 21, 2015 - P.3d - 2015 WL 4541239 - 2015 MT 204**

Purchaser of tax lien brought quiet title action against owner of real property. The District Court nullified tax deed and quieted title in owner. Purchaser appealed.

The Supreme Court of Montana held that county failed to record its acquisition of tax lien, so as to render subsequent assignment invalid. Although there was an untitled document that stated that property was "struck off" to the county following tax lien sale, amount listed as paid in document did not correspond to amount of taxes owed on property at issue, and property was not individually identified in document.

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## **[Memo Provides Interim Guidance on Audits of Direct-Pay Bonds.](#)**

WASHINGTON - A memorandum recently issued by Rebecca Harrigal, director of the Internal Revenue Service tax-exempt bond office, provides examiners and managers in the office with interim guidance on conducting audits of Build America Bonds and other direct-pay bonds.

The guidance became effective July 20 and will be incorporated into the Internal Revenue Manual, which provides instructions to employees, within the next 12 months.

Direct-pay bonds are taxable bonds for which issuers receive subsidy payments from the federal government equal to some or all of their interest costs. In addition to BABs, direct-pay bonds include new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds and qualified school construction bonds.

"The examination and processing of resolutions of these bonds present unique situations that require procedures specifically tailored to these bonds," Harrigal said in the memo.

In audits of tax-exempt bonds, the bondholders are relevant because if bonds are determined to be taxable, the bondholders will then have to pay taxes on the interest. However, in audits of direct-pay bonds, the bondholders are not relevant because the bonds are already taxable.

Instead, the eligibility for and the amount of the subsidy payments to the issuers is at stake. Issuers file Form 8038-CP tax returns to request subsidy payments.

Under the interim guidance, examinations of direct-pay bonds will follow the procedures generally applicable to audits of tax-exempt bonds, but with the modifications and additional procedures described in the 39-page memo.

The examination of bonds' qualification as direct-pay bonds and the examination of the 8038-CP forms will generally be handled under the guidance in coordinated but separate ways, said Tom Vander Molen, a partner at Dorsey & Whitney in Minneapolis.

An audit of direct-pay bonds will generally be initiated on the issuer's information return to the IRS that reported the bond transaction. Audits of the 8038-CP forms will generally be opened as related cases when the IRS issues a notice suggesting a problem with the bonds, according to the interim guidance.

Additionally, the memo said that the IRS can choose to audit an individual form 8033-CP to look at matters relating to the amount of the subsidy payment that do not relate to the bonds' status as qualified direct-pay bonds, such as if the issuer filed duplicate returns or did not request a subsidy payment in a timely manner.

The interim guidance addresses the statute of limitations for assessing a penalty on subsidy payments in audits. "For purposes of calculating assessment statute expiration dates, the examiner will treat the period for assessment of tax on Form 8038-CP returns as three years from the date the return is filed," the memo said.

This is similar to the statute of limitations on taxing tax-exempt bond interest as a result of an audit. Generally, if the IRS thinks a bondholder needs to pay tax on bond interest in a certain year, the service needs to take action within three years of when the taxpayer filed his or her return for that year.

The interim guidance states that the procedures for settling an audit of direct-pay bonds will generally follow existing procedures that apply to tax-advantaged bonds.

The guidance also describes what should be done if an issuer agrees that its bonds don't qualify for subsidy payments, enters into a closing agreement where future payments are reduced, or receives a final adverse determination letter. It provides procedures for examiners about the collection of payments from issuers.

Bond lawyers viewed the interim guidance positively.

Vander Molen said that for the most part, the procedures seem to be "appropriate." Carol Lew, a shareholder at Stradling Yocca Carlson & Rauth in Newport Beach, Calif, said she was happy to see the memo come out because it standardizes procedures.

Matthias Edrich, of counsel at Kutak Rock in Denver, said that the future publication of this guidance in the IRM "suggests that the Internal Revenue Service is continuing to look at its procedures proactively to make sure its processes are current and tailored to the characteristics of individual categories of bonds."

## **The Bond Buyer**

by Naomi Jagoda

JUL 24, 2015 3:41pm ET

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## **[Municipal Issuer Brief: Positive Dynamics Remain in Place.](#)**

[Read the Brief.](#)

Municipal Market Analytics | Jul. 27

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## **[PAB Issuance Up in 2014, Reversing Three-Year Trend.](#)**

WASHINGTON — Issuance of private-activity bonds subject to state volume caps rose in 2014 following three years of declining issuance, according to an annual survey conducted by the Council of Development Finance Agencies.

The increase in PAB issuance is in line with issuance in the municipal bond market as a whole, which

“bounced back” in the second half of 2014, CDFFA said. States reported cap-subject PAB issuance of \$11.61 billion in 2014 — \$2.79 billion or 31.57% more than the \$8.82 billion issued in 2013.

“Hopefully, this is the start of a trend that will continue, reversing the shrinking private-activity bond market that has occurred recently,” CDFFA officials wrote in their report on the survey. “Increased tax-exempt bond issuance may be a sign that businesses are investing in more projects, or at least larger projects, than have been initiated in recent years. Certainly a variety of indicators suggest that the economy has been improving, and private-activity bond issuance may be another sign of recovery.”

Tax-exempt PABs face competition from bank loans and taxable bonds, particularly when interest rates are low. Rates are expected to increase in the near future, and “this change, coming on the back of a private-activity bond market that is already growing, could result in ample opportunity for bond issuance,” the group said.

Private-activity bonds are issued by public entities to provide low-cost financing for the projects of nonprofit organizations or companies that serve a public purpose.

Issuance of most types of PABs are subject to state volume caps based on a formula published by the Internal Revenue Service. In 2014, state volume caps for PAB issuance were the greater of \$100 per capita or \$296.83 million. Unused cap can be carried forward for up to three years but must be abandoned after that.

The types of bonds subject to the volume caps include certain types of exempt-facility bonds (such as multifamily housing bonds, water and sewer bonds and bonds for hazardous waste facilities), as well as mortgage-revenue bonds, industrial development bonds, student-loan bonds and agricultural bonds.

PABs that are not subject to the state volume caps include 501(c)(3) bonds, veterans’ mortgage revenue bonds and certain types of exempt-facility bonds, such as those for airports, docks and wharves. Data on the issuance of these types of bonds was not included in CDFFA’s report.

CDFFA’s survey is based on data voluntarily reported each year by officials of the state and District of Columbia authorities that allocate PABs based on the state caps. The Internal Revenue Service, which oversees the program, only releases this data on a delayed basis.

Not every state provides data in every year, so some variation in the data can be attributed to their differing participation. Additionally, some of the numbers states report may not be accurate.

CDFFA found that issuance of exempt-facility bonds, mortgage revenue bonds and student loan bonds increased in 2014, while issuance of IDBs declined.

The states that reported the most cap-subject PAB issuance in 2014 were New York, California, Massachusetts, Pennsylvania and Washington. All of those states except for Pennsylvania were also in the top five states for PAB issuance the previous year.

In 2014, the 50 states and D.C. received \$34.53 billion of new volume cap allocation and carried forward \$59.12 billion from 2011 to 2013. In total, states could issue about \$92.08 billion of cap-subject PABs, according to CDFFA.

Issuance in 2014 was about 12.61% of the total volume cap, a slightly greater percentage than the percent of total capacity that was used in 2013. With a greater percentage of total capacity being used in 2014, states reported that they expected to carry forward less cap into 2015 than they

carried into 2014, CDFR said.

## **Housing Bonds**

Issuance of multifamily housing bonds increased 37.13% in 2014 and issuance of tax-exempt, single-family mortgage-revenue bonds increased 55.39%.

Barbara Thompson, executive director of the National Council of State Housing Agencies, said that the numbers confirm what the group has heard anecdotally from its members, which is that “the bond market is truly coming back.”

Multifamily housing bonds are used to finance multifamily rental real estate with units set aside for lower income households. The rental market as a whole has been “booming” since the financial crisis, said Richard Froehlich, chief operating officer and general counsel of the New York City Housing Development Corp.

Also, the U.S Department of Housing and Urban Development’s Rental Assistance Demonstration (RAD) program has encouraged issuance, Froehlich said. The RAD program allows public housing agencies and owners of other HUD-assisted properties to convert their assistance for units to project-based Section 8 contracts. Public housing agencies that make RAD conversions can finance repairs for properties with private money.

Thompson said that the RAD program has created more demand for low income housing tax credits. If a project is financed with tax-exempt PABs, developers can get 4% LIHTCs.

Froehlich and Thompson said MRBs, which allow housing finance agencies to provide mortgages to first-time home buyers who meet certain income restrictions, are becoming more attractive compared to other financing tools. Housing finance agencies are again able to use MRBs to finance mortgages with rates lower than the conventional rates, Thompson said.

## **Student Loan Bonds/IDBs**

Student-loan bond issuance rose in 2014. States reported issuing \$754.3 million of student-loan bonds, compared to \$480.2 million the previous year.

New Jersey did not provide 2013 data to CDFR but reported \$226.1 million of student-loan bond issuance in 2014. States reporting increased issuance of these types of bonds in 2014 included Michigan and Vermont.

Debra Chromy, president of the Education Finance Council, said that student-loan bond issuers in some states can offer loans with more competitive interest rates than Federal Direct PLUS loans, which are made to graduate students and the parents of undergraduate students. People are becoming more aware of this, she said.

Also, for Direct PLUS loans, there’s a loan origination fee, but issuers in some states don’t have upfront fees for their loans, Chromy said.

Issuance of IDBs, which provide financing for small manufacturers, fell to \$269.5 million in 2014 from \$355.8 million the previous year.

IDB issuance in recent years has been far less than the nearly \$1 billion of IDBs states issued in 2009, according to CDFR.

Twenty-two states reported at least one IDB issuance in 2014. The Midwest region was the most active for IDB issuance, CDFFA said.

## **Bolstering Issuance**

Actions could be taken at the local, state and federal levels to increase PAB issuance, CDFFA said.

At the state and local levels, bond programs could be branded better and marketed more. Also, issuers could standardize issuing documents or create private-activity bond banks to help borrowers save costs. And issuers could create their own credit-enhancement programs, CDFFA said.

At the federal level, Congress could pass legislation to increase issuance of certain types of PABs, CDFFA said. One such bill, backed by CDFFA, is the Modernizing American Manufacturing Bonds Act. The bill, which was introduced in June by Reps. Randy Hultgren, R-Ill. and Richard Neal, D-Mass., would increase the types of projects that could be financed with IDBs and the maximum size of an IDB issue.

President Obama's fiscal 2016 budget included a 28% cap on the value of the tax-exemption for municipal bonds, but it also proposed some changes to ease restrictions on PABs. The president proposed creating a new type of PAB called qualified public infrastructure bonds, which could finance certain types of governmentally owned infrastructure projects and would not be subject to state volume caps or the alternative minimum tax. Sens. Ron Wyden, D-Ore., and John Hoeven, R-N.D., have also proposed creating a new type of PAB to finance infrastructure projects. Those bonds, called Move America Bonds, could finance projects that are privately owned and would not be subject to the AMT but would be subject to new volume caps that could be converted to tax-credit allocations.

## **The Bond Buyer**

by Naomi Jagoda

JUL 31, 2015 12:45pm ET

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## **[CDFFA Releases Annual Volume Cap Report.](#)**

Columbus, OH - The Council of Development Finance Agencies (CDFFA) is pleased to announce the release of the [Annual Volume Cap Report: An Analysis of 2014 Private Activity Bond & Volume Cap Trends](#). The report provides complete data of the use of volume cap and the issuance of cap-subject private activity bonds nationwide.

CDFFA found that national private activity bond issuance in 2014 increased for the first time since 2010. The private activity bond issuance figures are in-line with the overall municipal bond market, which bounced back in the last half of 2014.

The Annual Volume Cap Report is available online along with CDFFA's interactive and searchable [National Volume Cap Map](#).

CDFFA collected the information for the report from surveys and interviews with the allocating authority in each state. As a leader in the development finance industry, CDFFA serves as the leading source of private-activity bond volume cap data, reporting, and trends.

CDFA advocates for the preservation of this critical, catalytic financing tool and encourages interested parties to learn more about the Council's efforts at [www.cdfa.net](http://www.cdfa.net).

The Council of Development Finance Agencies is a national association dedicated to the advancement of development finance concerns and interests. CDFA is comprised of the nation's leading and most knowledgeable members of the development finance community representing public, private and non-profit entities alike. For more information about CDFA, visit [www.cdfa.net](http://www.cdfa.net).

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## **In Post-Detroit Bankruptcy Era, California Protects Investors Before Pensioners.**

Before Detroit, many thought general obligation bonds were ironclad. Now they know better.

Starting next year, anyone who buys a general obligation bond from a California locality will stand first in line as a creditor should anything ever happen to cause that locality to restructure its debt. If the law seems redundant to a few people, that's because general obligation debt is supposed to be backed by the full faith and taxing power of the government selling them. In other words, many thought that meant such bonds were unbreakable. So why does California feel the need to clarify that?

The reason goes back to 2013 when Detroit filed for bankruptcy. The city proposed — and eventually pushed through — a restructuring plan that placed general obligation (GO) bondholders behind the city's pensioners when it came to who would recover the most of what they were owed. While pensioners averaged a roughly 90 percent recovery rate, GO bondholders recovered about 80 cents on the dollar. "Everything is different after Detroit," said Robert Christmas, a financial restructuring expert at Nixon Peabody. "There were challenges to things that I think people believed were sacrosanct or hadn't thought about."

California, which has had three cities enter Chapter 9 bankruptcy in the last seven years (San Bernardino is the only one still litigating its case), wants to be clear that its local GO bondholders won't be treated the same way. The new law, Senate Bill 222, places a lien on future property taxes to ensure investors will be repaid. By clarifying that the lien created with each GO bond issuance is a statutory one, it "should reduce the ultimate bankruptcy risk of nonrecovery on local GO bonds, and thus potentially improve ratings, interest rates and bond costs," Christmas said.

These liens don't provide total immunity to bondholders. A statutory lien, noted Matt Fabian in an analysis for Municipal Market Analytics, does not preclude a disruption in payment or ensure that the collateral, in this case tax revenue, will be sufficient for full payment. Still, with California accounting for about 20 percent of all bankruptcies since 2000 and almost 30 percent of all city or county bankruptcies since 2007, Fabian predicts "even small reductions in future California bankruptcies can have a market-wide benefit."

Indeed, Moody's Investor's Service has called the new law a credit positive for California localities. Fitch Ratings, however, has said statutory lien laws have no effect on its credit ratings. California isn't the first state to pass a statutory lien for GO debt, although it is the first to do so in the post-Detroit bankruptcy era. Louisiana and Rhode Island already have laws on the books. Nebraska has been considering one.

Rhode Island provides a good, if somewhat sobering, example of how a statutory lien can play out in

a bankruptcy case. When Central Falls filed for bankruptcy in 2011, the state enacted an emergency statute that placed a lien on property taxes and pledged them to GO bondholders. There were lots of positives from Wall Street's perspective. During the bankruptcy no creditor challenged the lien, and GO bondholders received full and uninterrupted payment of debt service. The judge in that case highlighted the tactic as one he hoped other cities would follow. Central Falls was in and out of bankruptcy in just 13 months, and so its credit rating also began to recover almost immediately. Its rating was moved out of junk status within a month of exiting bankruptcy.

Still, someone has to take a cut. If not GO bondholders, then who? In Central Falls case, it was retirees who settled for roughly half the pensions they were promised. Labor advocates say the move placed a back-breaking burden on retirees who are now living paycheck to paycheck. In California's bankruptcies, GO bondholders and pensioners have been treated fairly equally. But if ever a locality is forced to choose, the new law makes it clear where the favor now lies.

GOVERNING.COM

BY LIZ FARMER | JULY 30, 2015

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## **Municipal Bankruptcy's New Rulemakers.**

Neither Congress nor the Obama administration had a response — or even words of support — when two large U.S. cities lurched into bankruptcy two years ago. And there still isn't a response now as Puerto Rico, a U.S. territory, heads in that direction.

Well, that's not entirely true. As Congress completed its 2016 budget resolution in May, it included for the first time in U.S. history a provision of singular discrimination. It barred so-called "bailouts" to municipal corporations, cities and counties — none of which have ever been "bailed out" — while leaving unchanged support for federal bailouts of nongovernmental corporations, such as major Wall Street banks and automobile companies.

Local governments are facing heightened, long-term credit challenges at a time of profound changes in federalism. In the wake of the Great Recession, the oft-forgotten third branch of the federal government, the judiciary, has assumed the most critical role and responsibility for municipal and urban policy. It is increasingly displacing legislative and executive branches in addressing the long-term solvency of some of the nation's oldest cities — assessing, analyzing and examining the extent to which these cities and counties can achieve a sustainable future.

U.S. bankruptcy judges like Steven Rhodes in Detroit and Christopher Klein in Stockton, Calif., have devoted nearly three years to shepherding the two cities through extraordinary trials on their way to solvency. Moreover, unlike the federal bailouts to Detroit's major, iconic private corporations, these federal judges acted without access to solutions often provided private corporations, such as allowing them to shift the liabilities for pension obligations to the federal Pension Benefit Guaranty Corp.

When Congress adopted the municipal bankruptcy amendments in 1988, the country's experience had been that municipal bankruptcies affected small districts. Therefore, Congress acted to ensure that these small jurisdictions would continue to operate and provide essential public services. Indeed, from 1980 to 2013, the vast majority of Chapter 9 filings were by municipal utilities and special districts, as well as hospital and health-care facilities. In the last decade, however, we have experienced bankruptcies of large localities, from Jefferson County, Ala., to Vallejo, Calif., to

Harrisburg, Pa., to name a few. These more recent, significant urban bankruptcies affect millions of Americans, disproportionately impacting low-income and minority Americans.

In an unprecedented session hosted by the New York Federal Reserve in April, bankruptcy judges involved in the largest municipal bankruptcies spoke of the lessons learned. Judge Thomas Bennett, who oversaw the Jefferson County bankruptcy, addressed the importance of “long-term municipal sustainability” as a key outcome to any successful municipal distress proceeding — in addition to an effective restructuring of a city or county’s debt. Rhodes spoke of the uncertain future of this generation of cities and counties that emerge from municipal bankruptcy given the lack of a federal role in achieving “long-term sustainability,” that is, a plan that entails a structuring of a pensions and debt service.

Rhodes said that he devoted much of Detroit’s bankruptcy proceedings to ensuring any proposed plan of debt adjustment be feasible, implementable by the city and enduring. “I did not want to become known as the judge on Detroit’s first bankruptcy case,” he said. As an example, he noted his decision to preserve the artwork housed at the Detroit Institute of Arts. “To sell the art,” he said, “would be to forfeit Detroit’s future.”

The events of these past few years suggest a fundamental alteration in the federalism created half a century ago under former President Richard Nixon, a federalism that included congressional and administrative support for a general revenue sharing program. Even under Nixon’s predecessor, Congress created the Advisory Commission on Intergovernmental Relations (ACIR), intending it as the nation’s foremost repository of experience and information on intergovernmental structure, finance, process and practice. The ACIR also acted as a critical forum to identify emerging issues, trends and turning points, and as a way to promote stronger intergovernmental communication, cooperation and coordination. Today, that forum is no longer funded.

GOVERNING.COM

BY FRANK SHAFROTH | JULY 2015

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## **[How One Mississippi County Played Wall Street’s Fiddle.](#)**

All signs pointed to a Mississippi county’s bet with Wall Street going south.

Officials in Hinds County, where one in four residents live in poverty, didn’t know what they were getting into, according to an independent audit. They couldn’t explain the mechanics of the interest-rate swaps they negotiated with Rice Financial Products Co., a New York derivatives dealer. They couldn’t say how semi-annual payments on the leveraged bets were determined.

Yet, in the decade since the contracts were first signed, Hinds County netted \$6.7 million on the deal due to collapsing short-term rates in the municipal bond market. That bucks the trend of cities, states and localities exiting interest-rate swaps on much less favorable terms.

“It’s like walking out of the casino with \$6 million,” said Robert Brooks, a finance professor at the University of Alabama’s Culverhouse College of Commerce in Tuscaloosa. “It could’ve gone the other way.”

It's gone the other way for so many others. Since the 2008 financial crisis, municipalities have paid at least \$9 billion to cancel the swaps, according to data compiled by Bloomberg. The contracts were supposed to reduce borrowing costs and protect them against rising payments on floating-rate bonds.

Perhaps the best-known of the interest-rate disasters was Jefferson County, Alabama, about 250 miles northeast of Hinds County. The swaps it bought in 2003, tied to a \$3 billion sewer-debt refinancing with JPMorgan Chase & Co., helped push it eight years later into the largest municipal bankruptcy in history. Only Detroit's, a year later, is bigger.

### **Three Deals**

Hinds County includes Jackson, the state capital. It has 245,000 residents over 870 square miles and its median household income is \$37,626, about \$14,000 less than the U.S. median, according to the Census Bureau.

At least three municipalities profited from swaps with Rice. Durham County, North Carolina, home to Duke University, has netted \$18 million since it executed a swap with Rice in 2004. Miami-Dade County, Florida, has received \$160 million.

Donald Rice, founder and chief executive officer of Rice Financial, didn't return calls seeking comment.

Porter Bingham of Malachi Financial Products Inc. takes issue with the notion that county officials didn't understand the terms of the swaps and their risks. Malachi was paid about \$400,000 to advise on the swaps between 2006 and 2012, according to county records.

"They understood perfectly what they were getting into," Bingham said. The swaps "were assessed and studied."

### **Complicated Wager**

County officials couldn't tell an auditor how the swaps worked. It's little wonder. The terms were a bit complicated.

In floating-rate to floating-rate "basis" swaps, local governments typically pay a bank a short-term tax-exempt rate. In return, they receive 65 percent of the taxable one-month London Interbank Offered Rate, or Libor, plus a set percentage. As long as the federal government doesn't cut tax rates or eliminate the exemption of tax-exempt bonds, the swaps make money for municipalities.

If, however, the government curtails or eliminates the tax exemption, the yield on short-term tax-exempt rates rises and municipalities lose money.

The terms of the deal included this: "If the difference obtained by subtracting USD-LIBOR-BBA from the product of 86 percent multiplied by USD-ISDA-Swap Rate is greater than .005 percent, then sum of USD-LIBOR-BBA, .005 percent, and Constant 1 all multiplied by Factor 1."

### **Got That?**

That was enough to baffle Richard Ryffel, a senior lecturer in finance at Washington University's Olin Business School in St. Louis and a former public-finance banker at Bank of America Corp.

"It seems needlessly complex," Ryffel said. "At some point you get so complicated, and you're speculating anyway, that there's no benefit to it."

The basis swaps that Rice sold to Hinds County, as well as Durham County and Miami-Dade County, did better than typical basis swaps because the terms of the deal were multiplied, juicing returns. Usually swaps are based on a corresponding amount of bonds. But one of the Hinds-Rice deals was leveraged 19 times, with the county basing a \$29.8 million swap on \$1.6 million of bonds.

Hinds County officials “could not explain how the swap was supposed to benefit the county nor did management demonstrate an understanding of the extent, multitude and nature of the various risks inherent in a swap,” according to the independent audit.

Nevertheless, for most of the swaps’ life, rates moved in the county’s favor. Hinds netted \$6.7 million, using the money to pay for projects such as road resurfacing and renovating the county jail.

In March, Hinds County officials decided to quit while they were ahead and terminated the swaps.

“We’ve enjoyed those payments, but the pendulum, we thought, was about to swing the other way,” said Tony Greer, a member of Hinds County’s board of supervisors, elected in 2013. “It was just too risky for us to be in.”

## **Bloomberg**

by Martin Z Braun

July 27, 2015 — 4:00 PM PDT Updated on July 28, 2015 — 7:08 AM PDT

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### **[As Chicagoans Die, Police Pension Burden Hobbles City’s Response.](#)**

An average of six Chicagoans have been shot each day this year, up from five in 2014. In its effort to respond to the carnage, the city is hamstrung by obligations to police, the very people it needs to protect the public.

With the second-largest number of sworn officers in the U.S., Chicago is struggling to pay an extra \$550 million in pension obligations owed to public-safety workers. That leaves the city with little financial flexibility as homicides have risen more than 18 percent from last year and shootings 17 percent.

“They’re fighting a war on two fronts,” said Richard Ciccarone, president and chief executive officer of Merritt Research Services, which analyzes municipal finance.

Red ink is drowning Democratic Mayor Rahm Emanuel’s budget. The city’s projected 2016 deficit is up 45 percent, to \$430 million. The additional pension payments are due next year, and the city has yet to identify money for them. Chicago’s credit rating has been cut to junk because of \$20 billion in unfunded retirement obligations.

New York’s increase in homicides is a third of Chicago’s — 5.5 percent through mid-July — yet Mayor Bill de Blasio has proposed adding 1,300 officers to the city’s 34,500-member force, the nation’s largest. Chicago has no such recourse.

## **Draining Resources**

The Policemen’s Annuity and Benefit Fund of Chicago is only 27 percent funded, and beneficiaries outnumber active officers 13,320 to 12,020, according to its 2014 annual report.

"In normal times, they'd be fighting the battle for public safety," said Ciccarone, who's based in Chicago. "But with the pensions, so much of their capital will be swept away for services already performed."

Chicago underfunded its four pensions by \$7.3 billion from 2005 to 2014, according to bond documents. The retirement system was 36 percent funded as of December, compared with 61 percent in 2005.

The city suffered another setback Friday when a state court struck down a pension restructuring for municipal workers and laborers because it would force them to accept reduced benefits. The ruling could cost residents hundreds of millions more.

At the same time, legal settlement and judgment costs are soaring, from \$82 million in 2011 to \$199 million in 2013. About two-thirds is the result of police-related litigation.

Emanuel will submit his 2016 budget in mid-September, a month earlier than normal, to give the city council time to address the pension shortfall. Asked whether the mayor would push for more police officers, Adam Collins, a spokesman, said it "would be premature to discuss specifics."

Illinois's Democrat-led legislature passed a plan to lower Chicago's extra payment next year to its police and fire retirement systems to \$330 million from \$550 million, but Republican Governor Bruce Rauner has yet to sign the measure.

The higher amount is roughly equal to the annual expense of keeping almost 4,000 cops on the street, the city said in a 2014 report.

Emanuel won re-election in April against Cook County Commissioner Jesus "Chuy" Garcia, who promised to hire 1,000 new officers. The mayor and Police Superintendent Garry McCarthy have resisted hiring in favor of paying current officers overtime. Those costs totaled about \$100 million in each of the past three years.

This year's increase in gun violence isn't unique to Chicago. The number of homicides has jumped more than 30 percent midway through the year in Milwaukee, St. Louis and Houston.

Yet, Chicago's slaughter has been incessant. During the Fourth of July weekend, 62 people were shot, nine fatally. One victim, 7-year-old Amari Brown, was killed by a bullet to his chest. Hundreds attended his funeral.

Chicago officials have been sensitive to the city's image. Emanuel said he expressed his unhappiness to director Spike Lee about his upcoming movie "Chiraq," which examines gun violence in the city.

"I was clear that I was not happy with the title," Emanuel told the Chicago Tribune for an April story. Emanuel and McCarthy point out that the 2014 murder total of 407 was the lowest since the mid-1960s. They blame the proliferation of guns, citing the police recovery of 3,500 illegal firearms this year.

"As much as I am an advocate for better gun-control laws and getting these guns off the street, that's not going to dramatically reduce the violence," said Ira Acree, a West Side pastor and chairman of Leaders Network, a community development organization. "There must be more interest and focus on reviving the economic engine here."

That revival depends, in part, on Chicago stabilizing its fiscal affairs. While officials reject comparisons to formerly bankrupt Detroit, Rauner is blunt.

“Chicago is in deep, deep yogurt,” he said in April.

Violence continues to weigh down city finances. A 13-month-old was killed earlier this month after a shooting suspect fleeing the police ran him down during a chase in a South Side neighborhood. Last week, his mother said she’s suing the city and police.

## **Bloomberg**

by Tim Jones

July 28, 2015 — 2:00 AM PDT

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### **[Bloomberg Brief Weekly Video - 07/30/15](#)**

Taylor Riggs, an editor at Bloomberg Brief, talks with Joe Mysak about this week’s municipal market news.

[Watch the video.](#)

July 30, 2015

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### **[Puerto Rico Fails to Sink Muni Market’s Best Rally in Six Months.](#)**

It doesn’t matter if Puerto Rico defaults, at least not to investors in the \$3.6 trillion municipal market.

With the island just days away from potentially missing a Public Finance Corp. debt payment, state and local-government bonds are poised for the biggest monthly gain since January, Bank of America Merrill Lynch data show. The securities have returned 0.64 percent in July, outpacing the 0.45 percent increase for the broader U.S. fixed-income market.

Munis overcame a rocky start: After Puerto Rico Governor Alejandro Garcia Padilla said the island can’t afford its \$72 billion debt load, individuals yanked \$1.2 billion from muni funds in the week ended July 1, Lipper US Fund Flows data show. The money began flowing back in as munis rallied, showing the lack of fallout from the commonwealth’s long-brewing crisis.

“The municipal market is going to prove very resilient in the face of a default on the PFC bonds in Puerto Rico,” said Tom McLoughlin, head of municipal fixed-income at UBS Wealth Management Americas, which oversees \$1.1 trillion. Investors have “psychologically ring-fenced Puerto Rico because we’ve been talking about it for two years.”

## **Solid Footing**

For the muni market, the Federal Reserve and overseas turmoil were more powerful than Puerto Rico. State and local debt joined Treasuries in climbing this month on signs the U.S. central bank will raise interest rates gradually and as investors sought a haven from Greece’s debt crisis and China’s stock-market swings.

The monthly rally, munis’ first since March, comes as states and cities gain from rising real-estate

prices and a growing economy. State and local tax revenue rose 4.2 percent during the first quarter from the year earlier, according to Census Bureau figures. Only one borrower rated by Moody's Investors Service has defaulted since 2013.

"The overall municipal market is on solid footing," Peter Hayes, the head of municipal debt at New York-based BlackRock Inc., the world's biggest money manager, said in a blog post Thursday. "Creditworthiness is strong and attractive relative yields should continue to draw demand."

That's made Puerto Rico an outlier. After years of borrowing to pay bills as its population declined, officials by Sept. 1 may propose the biggest debt restructuring ever in the muni market. The Caribbean island may miss a bond payment for the first time on Aug. 1, when \$58 million is due from the Public Finance agency.

### **Cutting Holdings**

Investors had time to prepare. Puerto Rico was cut to junk in early 2014, and mutual funds have been paring their holdings of its bonds. Hedge funds now own more of the securities than mutual funds, according to estimates from Morningstar Inc. and Barclays Plc.

The shift has cushioned the impact as the island's crisis escalated over the past month. "The potential for wider market disruption seems fairly muted," said BlackRock's Hayes.

Yields on top-rated 10-year munis were 2.28 percent on Thursday, down from 2.38 percent at the start of the month. Seizing on a slide in borrowing costs, states and cities issued \$36 billion of debt in July, keeping sales on pace this year to be the most since at least 2003, according to data compiled by Bloomberg.

### **Weathering Distress**

Both are signs that the market is able to weather pockets of distress such as Puerto Rico and Chicago, whose credit rating has tumbled as it contends with soaring bills for its pension funds.

"What the market is getting better at is differentiating those risks," said Lyle Fitterer, who oversees \$38 billion as head of tax-exempt fixed-income at Wells Capital Management in Menomonee Falls, Wisconsin.

By some measures, state and local debt is still cheap.

Ten-year munis yield about the same as similar-maturity Treasuries, compared with 96 percent since the start of 2014, Bloomberg data show. A higher ratio signals state and city debt — which is exempt from federal income taxes — offers greater relative value.

For the highest earners, the yield on AAA 30-year munis is equivalent to about 5.8 percent on a taxable security, Bloomberg data show. Similarly dated corporate debt yields 4.09 percent, while 30-year Treasury bonds yield about 2.94 percent, according to data from Moody's Investors Service and Bloomberg.

"Muni bonds on a tax-adjusted basis are still by far the best value out there," said Krishna Memani, chief investment officer at OppenheimerFunds Inc., which oversees \$24 billion in state and local-government debt.

### **Bloomberg**

by Brian Chappatta

## **[Bloomberg Brief Municipal Market Expert Series.](#)**

Taylor Riggs, an editor at Bloomberg Brief Municipal Market, spoke with Justin Land, head of tax-exempt management at Wasmer, Schroeder & Co., about Florida's housing market and community development districts.

[Watch the video.](#)

July 30, 2015

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## **[OppenheimerFunds Chases Distress in Puerto Rico, Long Island.](#)**

OppenheimerFunds Inc., which owns more Puerto Rico bonds than any other mutual-fund company, may be among the hardest hit if the island lapses into a record-setting default on some of its \$72 billion of debt.

The New York-based company, which manages \$24 billion in state and local-government debt, also has a stake in another noteworthy, if smaller scale, case of municipal-market distress.

OppenheimerFunds holds about \$21 million, or 46 percent, of the debt sold by Dowling College in Oakdale, New York. The 2,000-student school is the first municipal borrower rated by Moody's Investors Service to default since 2013, ending the longest stretch without such a lapse in almost two decades.

The dual risk illustrates company's long-held strategy of plowing cash into the most precarious corners of the \$3.6 trillion municipal market to capture higher yields. Over the years, its funds have invested in airline-backed debt, tobacco bonds and real-estate development deals roiled by the housing-market crash.

"The basic high-yield strategy is built to survive a handful of defaults," said Matt Fabian, partner at Municipal Market Analytics, a Concord, Massachusetts-based research firm. "In return, they're compensated by a much higher stream of income."

### **Tactic Succeeds**

The tactic has delivered annualized returns of almost 5 percent over the last five years to the firm's AMT-Free New York Municipal Fund, outperforming 96 percent of its peers, Bloomberg data show. It's the fund with the largest stake in Dowling. Ray Pellicchia, an OppenheimerFunds spokesman, declined to comment on the company's investment in the college.

Yet such high-yield bonds, especially those from Puerto Rico, have made the funds prone to short-term swings.

Over the past month, the New York fund has trailed 97 percent of peers, Bloomberg data show. That came after Puerto Rico Governor Alejandro Garcia Padilla said he'd seek to restructure the island's debt, which caused bond prices to tumble. OppenheimerFunds owns more than \$4 billion of uninsured island securities, Bloomberg data show.

The stakes are lower with Dowling College. Like Puerto Rico, its strains are years in the making. Moody's has rated the school below investment grade since 1997. In March 2014, as enrollment fell by almost half in five years, Moody's dropped the college to Ca, the second-worst rank, citing a "higher probability of default."

### **Default Triggered**

Dowling didn't have the money needed to make bond payments due on June 1, according to disclosure filings. Bondholders agreed to give the school until June 30, 2016, to sort out its finances without going after it for the money they're owed. Pellicchia, the OppenheimerFunds spokesman, said the firm is part of the creditors group.

The college doesn't expect to pay bondholders as long as the agreement is in place, according to the filing.

OppenheimerFunds owns municipal debt the school issued in 1996, 2002 and 2006 through agencies of Suffolk County, New York, and Brookhaven, a town within the county.

Some of the 1996 bonds, which are uninsured and mature in five years, changed hands July 16 at 82 cents on the dollar for an 11 percent yield. The 2006 securities are insured against default by ACA Financial Guaranty Corp.

In connection with the agreement with Dowling, some bondholders bought \$6.7 million of taxable debt to provide the college with needed cash, according to the disclosure filings.

The pact may be a good thing for OppenheimerFunds and other investors. Moody's said the odds of recouping losses are now "modestly improved" because the school has breathing room to implement its strategic plan.

Ralph Cerullo, the college's chief financial officer, didn't return a voicemail left at his office seeking comment.

### **Bloomberg**

by Brian Chappatta

July 27, 2015 — 7:58 AM PDT Updated on July 27, 2015 — 11:43 AM PDT

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### **[Pimco Drawn to Tobacco Bonds for Yield Fix as Puerto Rico Twists.](#)**

As Puerto Rico veers toward a historic default, investors who need a high-yield fix are turning to tobacco instead.

Pacific Investment Management Co. and AllianceBernstein Holding LP, which shed all holdings of the commonwealth's debt, have been buying securities backed by the cash states get from the 1998 legal settlement with tobacco makers. While Moody's Investors Service predicts 80 percent of the bonds may default as a drop in smoking cuts those payouts, the firms say the endgame is predictable, unlike the Caribbean island's: The interest would keep coming until the debt is paid.

Tobacco bonds have returned 2.4 percent in July as prices rallied, more than triple the municipal market's gain, Barclays Plc data show. Some still yield more than 7 percent, a level rarely found on

tax-exempt bonds outside of Puerto Rico.

“In a world where everyone wants income, 7 percent looks OK and tobacco’s risks are known,” said Guy Davidson, who oversees \$32 billion as director of municipal fixed income at AllianceBernstein in New York. Four of the top 10 holdings in the company’s high-yield muni fund are tobacco securities, including those sold by Ohio.

Ohio tobacco bonds due in June 2047 traded Wednesday at 80 cents on the dollar, close to the highest since June 17, to yield about 7.5 percent.

### **Shifting Risk**

The \$34 billion in tobacco securities outstanding are financed with payments companies make under the legal settlement, which are based on how many cigarettes they sell. State and local governments issued the debt to get the cash upfront, shifting the risk to investors if the payments fall short of expectations.

They’ve been a mainstay of the high-yield muni funds that have poured money into Puerto Rico. That’s fostered speculation tobacco bonds could tumble if a default by the commonwealth on some of its \$72 billion of debt leads investors to pull their money from the funds, which would force managers to sell investments to meet withdrawals.

So far, tobacco bonds have weathered the crisis. While individuals yanked money from high-yield funds in the days after Governor Alejandro Garcia Padilla said the island can’t afford its debt, the outflows have abated. High-yield funds pulled in \$11 million in the past two weeks, Lipper US Fund Flows data show.

### **Opportunity Ahead?**

Peter Hayes, who helps oversee \$116 billion as head of municipal debt at New York-based BlackRock Inc., the world’s biggest money manager, said that doesn’t mean the risk has subsided. The commonwealth may miss a payment on Public Finance Corp. bonds due Aug. 1 and is scheduled to propose a debt-restructuring plan a month later.

“That could be a catalyst for another leg down on some of the Puerto Rico bonds — and if we see some additional selling, we might see spillover into the high-yield muni market, like tobacco,” Hayes said. “There might be other buying opportunities ahead.”

The yields on tobacco bonds reflect the risk. The earliest securities didn’t anticipate how quickly smoking rates would fall. In the seven years through 2006, shipments dropped an average of 1.7 percent a year, according to data from the National Association of Attorneys General. The pace of decline almost tripled in the next seven years.

### **Default Risk**

That’s left four out of five bonds prone to default, according to Moody’s.

That prospect doesn’t bother David Hammer, a money manager at Pimco. Though the bonds may not make full principal payments when they’re due, investors will be paid back eventually as long as cigarette shipments don’t vanish entirely, he said.

By comparison, Moody’s estimates that some owners of Puerto Rico securities may receive as little as 35 percent of what they’re owed.

“The difference in tobacco is because you have a claim on those revenues in perpetuity, you’re talking about the extension of the payment schedule as opposed to an actual principal haircut,” said Hammer, who helps oversee \$40 billion of munis for Pimco in New York.

The yields have so far been sufficient to draw buyers, said Davidson of AllianceBernstein.

“While we’re all very cautious about the Puerto Rico contagion effect and having a run on muni high-yield, at these levels there seems to be support,” he said. “For tobacco, it’s steady as she goes, it offers a nice yield, and the contagion to Puerto Rico seems to be pretty modest.”

## **Bloomberg**

by Brian Chappatta

July 28, 2015 — 9:01 PM PDT Updated on July 29, 2015 — 5:59 AM PDT

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### **[Puerto Rico Veers Toward First Bond Default: Questions Answered.](#)**

Puerto Rico Governor Alejandro Garcia Padilla wants to negotiate with investors to reduce \$72 billion of debt he says the island can’t afford.

The U.S. commonwealth has paid bondholders what they’re owed since it was ceded to the U.S. following the Spanish-American War. That may soon change.

Puerto Rico’s Public Finance Corp., which has sold \$1 billion of debt, is likely to miss a \$58 million payment due on Aug. 1. The bonds are repaid with appropriations allocated by the legislature. Faced with a budget shortfall, lawmakers didn’t provide enough money to service the debt.

While the securities are a small share of the island’s debt costs, failing to pay would be a warning shot to investors that officials aren’t afraid to default.

Here are some of the questions you may have, starting right at the very beginning:

Q: What is a default?

A: Investopedia.com defines default as “the failure to promptly pay interest or principal when due. Default occurs when a debtor is unable to meet the legal obligation of debt repayment.” Moody’s Investors Service says a missed payment is a default.

Q: What is the Public Finance Corp.?

A: It’s a subsidiary of the Government Development Bank, which works on the island’s debt sales. It was created in 1984 to sell bonds on behalf of the commonwealth and its agencies. Most of the proceeds it has raised were used to balance Puerto Rico’s budget.

Q: Is a default definite?

A: While officials haven’t said for certain whether they’ll pay the interest and principal bill, it’s likely they won’t.

No money was transferred to the trustee in July to make the payment, and Victor Suarez, Garcia

Padilla's chief of staff, said on July 27 that the island doesn't have the cash.

Investors appear to view a default as a near certain: PFC bonds maturing in 2031 traded on July 30 for 16 cents on the dollar.

Q: What happens if the PFC fails to pay?

A: Bondholders could sue, but they have few remedies. The legislature isn't legally required to allocate the money. The commonwealth hasn't guaranteed repayment and the PFC has no power over taxes to raise funds on its own. Nor are bondholders able to demand early repayment in the event of a default.

The PFC has until the end of business on Aug. 3 to make the payment because the first day of August is a Saturday.

Q: What does a default mean for holders of other Puerto Rico bonds?

Analysts and investors say it may cause Puerto Rico securities to lose value by casting doubt on the government's willingness to pay its other debts. An index of Puerto Rico securities slid this week to a six-year low.

Q: Why won't Puerto Rico just find the money, given that it's not expected to default on other debt payments due the same day?

A: Commonwealth officials say the island's available cash is limited. It's delayed tax refunds, suspended payments to some suppliers and borrowed from its insurance agencies to help preserve cash to continue making payroll and support essential government services.

The PFC bonds have the weakest legal protections, so the island will suffer fewer pitfalls from a default on those bonds.

Q: Which firms are set to receive interest payments on Aug. 1?

A: OppenheimerFunds Inc., Franklin Resources Inc. and Nuveen Asset Management are among those that held PFC bonds as of June 30.

Q: What is the federal government doing in response to Puerto Rico's debt crisis?

A: Treasury Secretary Jacob J. Lew said July 29 that there isn't any discussion of a federal bailout. Lew, the White House and the Federal Reserve have urged Congress to work with commonwealth officials. Bills to allow some Puerto Rico agencies to file for Chapter 9 bankruptcy, introduced in both chambers, haven't advanced so far because of a lack of support from Republican leaders.

Q: Why can't Puerto Rico turn to U.S. bankruptcy court to lower its debts, as Detroit and other municipalities have?

A: Like U.S. states, Puerto Rico's central government isn't eligible for Chapter 9 bankruptcy protection, nor would it be under the legislation proposed in Congress. However, the bankruptcy code never gave Puerto Rico that option for its agencies or publicly run corporations, either.

Q: How much debt does Puerto Rico have?

A: Puerto Rico and its agencies owe a combined \$72 billion. That includes \$13 billion of general-obligation debt, which Puerto Rico's constitution says must be repaid before other expenses, and

another \$5.5 billion guaranteed by the commonwealth.

There is also \$15 billion of debt payable from island sales taxes. Other agencies, such as the Puerto Rico Electric Power Authority, the government power company, have also sold bonds.

Q: Who holds Puerto Rico's debt?

A: Hedge funds hold almost \$22 billion, while local investors on the island have about \$20 billion. More than half of U.S. mutual funds that focus on municipal securities have exposure to Puerto Rico debt, for a combined \$10 billion.

Q: Why can't Puerto Rico and its localities repay the entire \$72 billion?

A: The commonwealth and its agencies have borrowed for years to paper over budget shortfalls, with the expectation that the economy would improve and the need to keep relying on debt would disappear. It didn't. Puerto Rico's economy has declined every year but one since 2006 and, with a population exodus for the U.S. mainland, there's fewer people around to pay taxes needed to finance the debt.

At the same time, health care and retirement expenses are projected to increase. Its employee-retirement system is also deeply underfunded.

Q: What is Puerto Rico doing now?

A: Island officials are working on a debt-restructuring plan, to be finished by Sept. 1, and a five-year fiscal plan to improve the economy and balance the budget. Officials have said it's premature to say by how much it will seek to reduce its debt and which securities could be affected.

## **Bloomberg**

by Michelle Kaske

July 31, 2015 — 9:51 AM PDT

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### **[Chicago Mulls Borrowing That Puerto Rico Rejected as Risky.](#)**

Chicago may allow the use of a type of debt that's fallen out of favor in other municipalities because it saddles taxpayers with higher costs by delaying payments.

Mayor Rahm Emanuel proposed issuing \$500 million of bonds this week in an ordinance that would permit the use of capital appreciation bonds, where borrowers postpone interest and principal payments into one sum at the end of the term. Emanuel's pitch also allows for the more common current interest bonds, which the city said it expects to use.

"We have no intention of issuing CABs," said Chicago Chief Financial Officer Carole Brown, who noted that language has been included in past ordinances. "We do that so we have maximum flexibility. If there is some off chance that there is an investor that wants us to issue bonds with a certain structure, we have flexibility."

Chicago is struggling to plug its deficit and \$20 billion of unfunded pension liabilities. The proposal would give the third-most-populous city a means of borrowing without having to face the costs right

away.

“Given where Chicago is at, it does seem like it’s a way to kind of push off debt payments out longer, which from a credit standpoint is not favorable,” said Michael Johnson, managing partner at Gurtin Fixed Income Management, which oversees \$9.5 billion of munis in Solana Beach, California. “It’s probably not the best idea for them right now.”

Texas restricted the use of CABs in June and California has limited them since 2013. The Puerto Rico Electric Power Authority dismissed a bondholder plan last week to restructure its debt using capital appreciation bonds, citing the disproportionate risks.

## **Abusive Debt**

Chicago hasn’t issued capital appreciation bonds since 2009, Molly Poppe, a city spokeswoman, said in an e-mail.

Use of capital appreciation bonds have come under fire in Texas and California, where lawmakers have passed legislation to limit their use. Former California Treasurer William Lockyer called the debt “abusive” because it passes on large payments to future generations.

“They increase the total cost and lower flexibility going into the future,” said Steve Murray, a senior director at Fitch Ratings. “They can limit future borrowing ability.”

Emanuel also proposed selling \$125 million of wastewater revenue bonds to fund swap termination payments, Poppe said. A separate ordinance would authorize \$2 billion in bonds for O’Hare International Airport, including \$1.7 billion of refunding for savings, and about \$300 million of new money for capital projects and interest, according to Poppe.

## **Bloomberg**

by Elizabeth Campbell and Darrell Preston

July 31, 2015 — 10:26 AM PDT Updated on July 31, 2015 — 12:25 PM PDT

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## **[Moody's: Wide Variation in Pension Metrics for 50 Largest Local Governments Continues.](#)**

New York, July 27, 2015 — Moody’s Adjusted Net Pension Liabilities (ANPLs) increased for 31 of the 50 largest local governments in fiscal 2013, Moody’s Investors Service says in a new report. The 50 largest governments are ranked by outstanding debt in fiscal 2013.

The fiscal 2013 median ANPL increased to 204% of operating revenues from 175% the prior fiscal year, but pension costs and liability burdens still vary widely among the 50 largest local governments. For 14 of the local governments, pension and actuarial costs amount to less than five percent of revenues.

“Relative to revenues and to full value, fiscal 2013 ANPLs exhibited a moderate shift toward heavier burdens, with a small number of outliers continuing to exhibit exceptionally large burdens,” Moody’s AVP — Analyst Tom Aaron says in “Pension Liabilities Rise for Most of 50 Largest Local Governments.”

As a percentage of operating revenues, Chicago (Ba1 negative) remained at the top with adjusted net pension liabilities at 703%, followed by Dallas (Aa1 stable) at 506%, Houston (Aa2 negative) at 458%, Los Angeles (Aa2 stable) at 410%, and Jacksonville, FL (Aa2 stable) at 403%.

ANPL changes in 2013 government reporting exhibited mixed results owing to differences in plan valuation dates spread across 2012 and 2013 calendar years, since Moody's adjustments tie actuarial valuation dates to market-based discount rates in valuing liabilities.

As a result, the 29 issuers with disclosure tied to 2012 actuarial reports saw ANPLs increase an average of 37%. The other 21 issuers that disclosed 2013 actuarial results saw ANPLs decrease by an average of 13%.

Pension plans for the largest local governments also benefitted from strong investment performance in 2013, following almost flat returns in 2012. Moreover, plans with fiscal years ending June 30 achieved solid investment performance in 2014.

Beginning in fiscal 2014, many plan funding disclosures will become more timely as new public pension accounting standards are adopted, since assets and liabilities must be reported at the end of the plan's fiscal year. Moody's expects some local government ANPLs to moderately decline based on these disclosures.

The top 50 local governments with the lowest ANPLs for FY 2013 are Washington, D.C. (Aa1 stable) at 24%, , Cypress-Fairbanks Independent School District, TX (Aa1 stable) at 25%, and Mecklenburg County, NC (Aaa stable) at 29%.

The report is available to Moody's subscribers [here](#).

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## **[Fitch: US Public Pension Contributions May Rise as Returns Lag.](#)**

Fitch Ratings-New York-27 July 2015: Investment returns below public pension plans' benchmarks mean that future contributions from participating state and local governments will have to rise in order to recover lost ground, Fitch Ratings says. On Monday CalPERS reported that its assets gained 2.4% in the fiscal year ended June 30, well below its investment return assumption of 7.5%. The slower investment return performance in fiscal 2015 follows several years of above-benchmark returns for CalPERS and other plans.

CalPERS' returns in fiscal 2015 are likely to be similar to those of numerous large state and local pension plans, the majority of which have June 30 fiscal year-ends. Most plans assume their asset portfolios will grow between 7.5% and 8% annually. The need to hit this target every year means that even in years with low-single digit positive returns, like 2015, plans fall behind in their effort to fully advance-fund their pension benefit obligations.

Most large plans have diverse investment portfolios driven by the need to generate annual returns at or above their investment return assumptions. Over time, investment returns are intended to cover the vast majority of pension benefits owed to retirees, with contributions from employers and employees covering the balance. Ultimately, employers must cover whatever benefits are not covered by investment returns and employee contributions.

Contribution pressures on governments have risen rapidly in recent years, the result of investment losses during the last recession, benefit increases in the decade before that, rising retirements and

flat or declining public workforce levels. Another factor has been governments' unwillingness to fully fund their actuarially-calculated annual required contributions, which over time leaves asset levels depleted and puts upward pressure on future contribution requirements. Fitch found that, in fiscal 2014, only about 40% of plans received their full annual required contributions.

Most public plans had a series of strong annual returns through fiscal 2014, with investment gains well above investment return assumptions. These returns helped to offset asset losses suffered in the 2008-2009 recession, cushioning the upward momentum in annual required contributions.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at [www.fitchratings.com](http://www.fitchratings.com). All opinions expressed are those of Fitch Ratings.

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## **[Puerto Rico Should Collect Unpaid Taxes, Hedge Fund-Backed Economists Say.](#)**

Economists working for a group of hedge funds and other firms with major investments in Puerto Rican bonds said Sunday night that the government could solve its debt crisis largely by stepping up

tax collections and obtaining additional financing over the next two years.

The message of sustainability is sharply at odds with the recent announcement by Puerto Rico's governor, Alejandro García Padilla, that the commonwealth's debt is "unpayable."

The face value of the territory's outstanding municipal bonds is about \$72 billion. In addition, it has about \$40 billion of unfunded pension obligations to public workers on the island, and other unpaid bills. The governor is seeking a moratorium on bond payments.

"There may be an issue of liquidity in the short term," in Puerto Rico, "but the debt itself, in global terms, is sustainable," said Claudio Loser, the chief executive of Centennial Group Latin America, which will officially release its report Monday morning. The consulting firm, based in Washington, was hired several months ago by the group of hedge funds and other investment firms to analyze Puerto Rico's economy and finances.

Mr. Loser said he believed that Puerto Rico would need short-term financing of about \$2.5 billion to get through 2016 safely. That amount, he said, would be used to pay the commonwealth's current overdue bills to vendors, make scheduled payments on existing debt and finance a budget deficit projected to be less than \$500 million.

The economists have decades of experience with the International Monetary Fund.

The governor based his analysis on a study by another group of sovereign-debt experts, known as the Krueger Report for its lead author Anne O. Krueger, also an economist with a background at the I.M.F.

As a result of that report, the governor has appointed a high-level task force to work out a five-year program of structural economic changes on the island. Senior economic figures in his administration have said the moratorium might last for five years, or even longer.

In a response to the report Sunday night, Víctor Suárez, chief of staff to Gov. García Padilla said, "The simple fact remains that extreme austerity placed on Puerto Ricans with less than a comprehensive effort from all stakeholders is not a viable solution for an economy already on its knees."

Mr. Loser said, "We feel that the moratorium is certainly costly and not a good idea." He called instead for an "orderly and consensual discussion" on ways to resolve the debt obligations.

While the I.M.F. is generally associated with bringing fiscal austerity measures to countries in financial trouble, Mr. Loser said his team was not calling for a lot more belt-tightening on the island.

In a briefing for journalists Sunday night, another economist, Jose Fajgenbaum, said that much of the belt-tightening necessary had already been done.

"The deficit has already been reduced," he said, adding that the governor's own analysis also showed that Puerto Rico might even achieve a budget surplus by 2017. The commonwealth has not had a structural budget surplus in more than a decade. Much of its existing debt was incurred by issuing bonds to pay previous debt and to plug budget holes.

The economists also said they were not suggesting that Puerto Rico ought to impose any more tax increases on residents who were already paying the taxes they owe. Mr. Loser said the commonwealth was managing to collect far less of the taxes due than the 50 states, and that it would not have to increase tax rates at all if it could capture what residents are now supposed to be paying.

The advisers also argued that Puerto Rico could improve its finances by allowing for-profit companies to operate its public works. The commonwealth had already contracted with a Mexican firm to operate its largest airport, and turned one of its highways into a toll road.

“If anybody would say that we are promoting fire sales, we are totally against that,” Mr. Loser said. “I want to make that clear.”

The analysts declined to provide details about whether they thought that all of Puerto Rico’s debt was sustainable, or whether the commonwealth ought to default on certain types of debt while continuing to pay other types. Puerto Rico has issued many different types of bonds, including general-obligation bonds and revenue bonds.

“What we have said is there is no need for a general restructuring of debt for the government,” said Mr. Loser. “We are not talking about specific issues.”

He said the complex details of Puerto Rico’s debt structure were outside the scope of the report.

The study was commissioned by a group of hedge funds and other investment firms known as the Ad Hoc Group, which includes Fir Tree Partners, Brigade Capital Management, Monarch Alternative Capital and Davidson Kempner.

The Ad Hoc Group owns about \$5.2 billion of debt, mostly general-obligation bonds and other bonds that are guaranteed by the central government.

Hedge funds and other investment firms that own large amounts of Puerto Rico’s debt have been scrambling since the governor announced late last month that he would seek a “negotiated moratorium” on the commonwealth’s debts.

The announcement caught many of these so-called distressed investors by surprise. They had been buying up billions of dollars of the island’s bonds over the last two years at deep discounts, betting that fears about a Puerto Rico default or restructuring were overblown.

Some of them also offered earlier this year to loan Puerto Rico about \$2 billion, to help get the commonwealth through another year of its perennial budget shortfalls. But the government declined those offers, saying the terms were too onerous.

The island’s financial problems deepened over the last year, particularly after the commonwealth’s credit ratings fell into junk territory. Many of the mutual funds that had previously held Puerto Rico’s bonds then sold them, and the distressed-debt investors acquired them at prices far below what the sellers initially paid.

They hoped for a profit but so far have suffered losses. Some of their holdings fell by nearly 17 percent in the two days after Mr. García Padilla first discussed a debt moratorium in an interview with The New York Times.

Privately, some hedge fund managers have expressed frustration that Mr. García Padilla’s administration and his army of legal and financial advisers have been able to convince many people that only drastic measures like a broad restructuring can save Puerto Rico.

THE NEW YORK TIMES

By MARY WILLIAMS WALSH and MICHAEL CORKERY

JULY 26, 2015

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## **Chicago Loses Bid to Keep Pension Reform Alive Pending Appeal.**

CHICAGO — A judge on Wednesday denied Chicago's request to keep a pension reform law in effect while the city appeals a court ruling that voided the law on constitutional grounds.

Cook County Circuit Court Judge Rita Novak, who tossed out the law last Friday, rejected Chicago's motion to suspend her ruling until the Illinois Supreme Court ultimately decides the law's fate.

Novak's latest ruling means that unless the high court temporarily keeps the law in place, the city's municipal and laborers' retirement systems must refund higher contributions that the affected workers were required to make since the law took effect on Jan. 1. Retirees who received lower cost-of-living increases mandated by the law would also be owed money.

The law required Chicago and affected workers to increase their pension contributions and replaces an automatic 3 percent annual cost-of-living increase for retirees with one tied to inflation. Those increases are also skipped in some years.

The cash-strapped city is betting that the state supreme court will overturn Novak's ruling, which rejected Chicago's argument that the 2014 law results in a net benefit because it will save the retirement systems from insolvency.

The high court in May found public sector workers have iron-clad protection in the Illinois Constitution against pension benefit cuts. That decision came in litigation over a 2013 law that reduced benefits for workers in state retirement systems.

By REUTERS

JULY 29, 2015, 5:58 P.M. E.D.T.

(Reporting By Karen Pierog; Editing by Grant McCool)

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## **Puerto Rico Nears Default as Debt Restructuring Beckons.**

NEW YORK — Puerto Rico on Friday made a payment on debt owed by its Government Development Bank, but the U.S. territory may still be short of the funds needed to pay all of its imminent obligations.

"The GDB will make the \$169 million payment for the debt service on its bonds today," GDB President Melba Acosta said in a statement released Friday. A payment on that debt was due to be made Saturday Aug. 1.

Puerto Rico, however, is expected to default on a \$58 million payment on Public Finance Corporation (PFC) bonds also due Saturday in what is seen as possibly just the first step in the largest U.S. municipal debt restructuring in history.

Whether Puerto Rico defaults may not be known until Monday. According to PFC documents, a

payment falling on a weekend can be made on the next business day, which would be Monday, Aug. 3.

“What could surprise investors is when they actually hear the word ‘default,’ and that a default occurred,” said Lyle Fitterer, head of tax-exempt fixed income at Wells Capital Management, which holds mostly insured Puerto Rico debt.

“The immediate reaction might be a slight sell-off in the marketplace because I think people will start to anticipate, ‘OK, what’s the next series of debt they’re going to default on?’”

Puerto Rico Governor Alejandro Garcia Padilla shocked investors in June when he said the island’s debt, totaling \$72 billion, was unpayable and required restructuring.

The possible default on debt due this weekend would mark the first missed debt payment. According to a 2014 bond offering statement, Puerto Rico has never defaulted on the payment of principal or interest of debt.

A non-payment by Puerto Rico would be the most notable since Detroit, which had about \$8 billion of bonds, defaulted on \$1.45 billion of insured pension bonds before it filed for bankruptcy in 2013.

Victor Suarez, Puerto Rico’s chief of staff, has said the island will do “everything that is possible” to ensure that the \$169.6 million Government Development Bank (GDB) debt payment due Aug. 1 is paid.

The commonwealth is expected to send that payment to the trustee on Friday for payment on Monday, a source familiar with the situation said on Friday.

John Miller, co-head of fixed income for Nuveen Asset Management, had said it would be positive for the short term if Puerto Rico made the GDB payment. But he said if it failed to pay, it could be a negative sign for debt such as its general obligation debt.

Suarez said on Monday that the commonwealth did not have the current cash flow to pay the PFC bonds.

“I bought my (PFC) bonds with the anticipation of them defaulting,” said Ben Eiler, managing partner at First Southern Securities in Puerto Rico. “They’re going to restructure in some form or fashion, and I believe that restructure is going to be higher than that level.”

The likelihood of a restructuring is leading investors to wonder how Puerto Rico will prioritize debt payments versus citizens’ needs.

“We’re beginning to discern a ... mindset on the island that the government is weighing the interest of investors against the economic interest of the island,” said Thomas McLoughlin, UBS chief investment officer wealth management research.

## DEFAULT DEBATE

Suarez told reporters in San Juan on Wednesday that a missed payment would not constitute default. Bond documents state that Puerto Rico’s legislature is not legally bound to appropriate the funds for payment.

However, credit rating agency Standard & Poor’s said it would view non-payment of rated PFC bonds on their due date as a default. Moody’s said it would also consider it a default.

“It (would be) the first failure by the government to pay on a debt to public investors and indicates the weakness of the government’s ability and willingness to pay,” said Timothy Blake, managing director of Moody’s Public Finance Group.

A default could open the door to a fight with investors, although that may be an uphill battle.

“Our reading of the legal documents is that bondholders have very limited remedies,” said David Hitchcock, an analyst at S&P. “Puerto Rico could potentially just ignore the bondholders.”

Officials may give information after a scheduled meeting by a working group created by the governor which was ongoing.

“It’s going to be a long process, a very long, drawn-out process,” said Michael Comes, portfolio manager and vice president of research at Cumberland Advisors in Florida, which holds insured Puerto Rico debt. “It’s kind of like watching the Titanic sink.”

By REUTERS

JULY 31, 2015, 10:49 A.M. E.D.T.

(Additional reporting by Karen Pierog in Chicago and a contributor in San Juan; editing by Clive McKeef and Dan Grebler)

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## **[Nonpayment on Bonds Would Have Consequences for Puerto Rico.](#)**

Debt-ridden Puerto Rico faces its next big test in just a few days, when \$58 million in bond payments come due — and already the government is mounting a defense against the possibility that it will not have the cash.

Government advisers on the island have been sending memos to the news media over the last several days suggesting that even if the government cannot make the payments, it will not technically be in default — something Puerto Rico is desperately trying to avoid. A default would have enormous legal and financial consequences, putting the United States commonwealth in the uncomfortable company of Greece.

The payments coming due are on so-called moral obligation bonds, which the government can issue without any legal requirement to repay.

Despite the advisories from Puerto Rican officials, however, independent financial experts said even a small nonpayment, whether it is technically a bond default or not, would have major reverberations. Failing to pay the moral obligation debt would taint the credibility of all other types of Puerto Rican debt, they said, which in turn would drive down the value of other bonds and raise the cost of whatever money the commonwealth might still be able to borrow at that point.

“This may be a little bit like ‘beauty is in the eye of the beholder,’ ” said James E. Spiotto, a specialist in Chapter 9 municipal bankruptcy law, who is not advising Puerto Rico or any of its creditors. He said Puerto Rico was correct in saying that it had no legal obligation to pay the bonds. But, he added: “From a bondholder’s perspective, there was a promise to pay, a moral obligation, and that promise was not lived up to.” Therefore, he said, the market would say that Puerto Rico was in default, even if bondholders could not do anything about it.

Moral obligation bonds were created in the 1960s by John N. Mitchell, who later became President Richard Nixon's attorney general. Mr. Mitchell devised them at the behest of Nelson Rockefeller, who was then governor of New York.

It was the failure of a moral obligation bond in New York in 1975 that ushered in the financial crisis that engulfed the city that year.

Puerto Rico now seems to be veering down a similar path. The commonwealth is facing overall bond-related debts of \$72 billion and an estimated \$40 billion of unfunded retirement benefits that it owes its public workers. In June, Gov. Alejandro García Padilla began calling the debts "unpayable" and advocating a "negotiated moratorium" on payments.

Since then, a working group created by the governor has been recommending sweeping changes in Puerto Rico's economy — such as an exemption from the federal minimum wage and lower welfare payments. An investor group issued a report this week that said that the commonwealth could climb out of its crisis by raising its tax collection rate — which it said was lower than the average of any of the 50 states — and obtaining bridge loans for the next two years.

So far, the United States government has declined to come to Puerto Rico's rescue. Jacob J. Lew, the Treasury secretary, said in a letter on Tuesday to Senator Orrin G. Hatch, chairman of the Senate Finance Committee, that there should be no bailout of Puerto Rico but that its financial situation was "urgent" and Congress should consider some orderly process to restructure the island's "unsustainable liabilities." Under current laws, Puerto Rico has no access to federal bankruptcy courts.

Despite the governor's pronouncement in June, Puerto Rico has continued making bond payments on time, and officials have even said the commonwealth might borrow another \$500 million.

"They're trying to pay their debts, but they don't have enough cash flow," Mr. Spiotto said. "It's like musical chairs. Ultimately, the music is going to stop, and there's going to be somebody who doesn't have a chair."

The official deadline for payment of the \$58 million is Aug. 1, a Saturday. If the first nonpayment occurs on Monday, the first business day after the deadline, the losers will be the holders of bonds issued by Puerto Rico's Public Finance Corporation.

The corporation, created in 1984 to help Puerto Rico finance various governmental activities, has a little more than \$1 billion of bonds outstanding. It cannot raise taxes, and instead relies on the legislature to appropriate enough money every year to repay the debts as they come due.

But when the legislature completed the current fiscal year's budget, no such appropriation was made. As a result, the corporation did not transfer the payment to the trustee who would, in turn, pay the bondholders.

Independent legal experts confirmed that moral obligation bondholders had no way of enforcing their claims. But they stopped short of saying that Puerto Rico would not be in default.

"It is extremely rare for a government to consider not paying" moral obligation bonds, said Timothy Blake, a managing director at Moody's Investors Service. "Most governments would view that as very negative to their reputation in the capital markets."

Rhode Island considered not repaying a \$75 million moral obligation bond in 2013, after the project being financed — a video game company led by Curt Schilling, the former Boston Red Sox pitcher —

went bankrupt. After extensive debate, Rhode Island decided to keep paying the bondholders to protect its credit rating.

States that issue moral obligation bonds often do so because their constitutions strictly limit the issuance of general obligation bonds, which an entity is legally required to repay. Bondholders could, for example, seek a court-ordered tax increase if that was what it took to get their money.

Because the general obligation bond pledge is so powerful, states have also made it hard to issue too many of the bonds. In many states, they cannot be issued without approval by the voters.

That is why Mr. Mitchell came up with the moral obligation bond. At the time he was seeking to help Governor Rockefeller, who was trying to fight the loss of manufacturing jobs by mounting huge building projects and did not want to go through the unpredictable process of letting voters approve general obligation bonds.

Mr. Blake said lawmakers usually take their moral obligation bonds seriously and appropriate the money each year. But in rare cases where they do not, the bondholders have no way of forcing them.

"The losses can be very severe," he said. Moody's has assigned the bonds of Puerto Rico's Public Finance Corporation the rating of Ca, meaning not only that default is likely but also that any recovery will be small. It is Moody's second-lowest rating.

THE NEW YORK TIMES

By MARY WILLIAMS WALSH

JULY 29, 2015

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## **[NABL 2015 Nominating Committee Report.](#)**

The 2015 Nominating Committee released the slate of officers and directors nominated for the 2015-2016 NABL Board of Directors. The election will be held at the 2015 Annual Meeting on Wednesday, September 9 at the Fairmont Chicago in conjunction with the 40th Annual Bond Attorneys' Workshop. All NABL members are invited to attend the Annual Meeting.

In accordance with NABL's By-laws, the Nominating Committee Report is available [here](#).

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## **[GFOA Comments on Federal Reserve Proposal to Classify Muni Securities as High Quality Liquid Assets.](#)**

This week the GFOA submitted comments to the Federal Reserve Board on its proposal to classify some municipal securities as high quality liquid assets

(HQLA) under the Liquidity Coverage Ratio rule approved by federal regulators in 2014. The 2014 rule established a minimum liquidity requirement for large banking organizations and identified acceptable investments - deemed HQLA - to meet this requirement. However it failed to include municipal securities in any of the acceptable investment categories, despite classifying foreign sovereign debt as HQLA. GFOA raised a number of concerns with the rule before it was approved,

chief among them being the great likelihood that banks will demand higher interest rates on yields on the purchase of municipal bonds during times of national economic stress, or even forgo the purchase of municipal securities altogether, if these bonds don't count toward their HQLA holdings.

In May of this year the Federal Reserve Board introduced a proposed rule that would permit some municipal securities to be classified as HQLA. GFOA's comments to the Federal Reserve are primarily focused on four areas of concern with the proposed rule - (1) classifying investment grade revenue bonds as HQLA in addition to investment grade GO municipal securities; (2) removing the proposal's restriction on a bank's holding of no more than 25 percent of the outstanding amount of any individual muni CUSIP; (3) eliminating the proposal's limitation on the amount of municipal securities a bank could include as HQLA to two times the average daily trading volume; and (4) doing away with the proposal's five percent limitation on the amount of municipal securities that banks could include in their HQLA holdings.

Fourteen other associations joined GFOA in voicing these concerns, including the International City/County Management Association, National League of Cities, U.S. Conference of Mayors, National Association of Counties and the National Association of State Auditors, Comptrollers and Treasurers.

[Download the comment letter.](#)

Thursday, July 30, 2015

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## **[NABL Announces 2015 Award Recipients.](#)**

The National Association of Bond Lawyers has announced two recipients of NABL's prestigious awards.

The Bernard P. Friel Medal recognizes distinguished service in the field of public finance. The Friel Medal will be awarded to John M. McNally, Hawkins Delafield & Wood LLP, Washington, DC. NABL President-Elect and Awards Committee Chair Ken Artin said, "John is very deserving of the award, his service in public finance has not only benefitted his clients but also the practice area nationally. For almost two decades John has been actively involved in numerous projects impacting the municipal market. He has contributed to NABL's educational programs through published memoranda, speaking engagements and publications. He served as NABL president in 2010-2011. His efforts also include participation in programs sponsored by GFOA, NAST, NFMA, SIFMA, Bond Buyer, SEC, MSRB and others organizations with the goal of assisting market participants in matters involving federal securities laws. He is an incredibly well respected securities lawyer deserving of the recognition of the Bernard P. Friel Award."

The Frederick O. Kiel Distinguished Service Award recognizes extraordinary service to NABL over an extended period of time. The Kiel Award will be presented to Robert Dean Pope of Hunton & Williams LLP, Richmond, VA. "Dean is extraordinarily deserving of the Kiel Distinguished Service Award. For decades, Dean, who served as NABL's President from 1987-88, has been a tireless contributor to NABL: countless comment letters, prodigious speaker and panelist at NABL seminar programs and workshops, and most recently, in the Fred Kiel tradition, serving as Editor of The Bond Lawyer publication. Dean unselfishly contributes to NABL every practice day — and many weekends, too — with one goal in mind: to serve NABL members' interests," said Awards Committee member, Drew Kintzinger.

The awards will be presented on Thursday, September 10, in conjunction with NABL's 40th Annual Bond Attorneys' Workshop in Chicago, IL. The 2015 NABL Awards Committee was composed of: Kenneth Artin (Bryant Miller Olive P.A., Orlando, FL), Chair; Antonio Martini (Hinkley Allen, Boston, MA), Vice Chair; Allen Robertson (Robinson Bradshaw & Hinson, P.A., Charlotte, NC); Kristin Franceschi (DLA Piper LLP, Baltimore, MD); and Drew Kintzinger (Hunton & Williams LLP, Washington, DC).

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## **[MSRB Commemorates 40th Anniversary with New Video.](#)**

Alexandria, VA - The Municipal Securities Rulemaking Board (MSRB) today released a video to commemorate its 40th year of promoting a fair, transparent and efficient municipal securities market. The seven-minute video traces the history of the market and highlights the MSRB's role in protecting the public interest in a well-functioning capital market that helps support the construction of bridges, schools and other public projects.

"As the MSRB enters its fourth decade, we celebrate the success of the municipal market in helping ensure that communities have access to needed capital and acknowledge the role of the MSRB in protecting investors and state and local governments," said MSRB Executive Director Lynnette Kelly. "We have a strong legacy of leadership and are proud to continue to uphold the integrity of this critical capital market."

The 40th anniversary video features former MSRB Board members and staff contributing their recollections about the origins of municipal market regulation, the development of the MSRB's landmark pay-to-play rules and the creation of the Electronic Municipal Market Access (EMMA®) website. The video also explores the effects of the Dodd-Frank Wall Street Reform and Consumer Protection Act on the future of municipal market regulation.

"I appreciate the many contributions of MSRB Board members, staff and market participants who have shared their time, expertise and thoughtfulness over the years to help create a regulatory framework that continues to work for this important market," Kelly said.

[Watch the video.](#)

[Read more about how the MSRB has protected the public interest for the last 40 years.](#)

Date: July 29, 2015

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## **[Dealers, Issuers: Fed Proposal Too Strict on Munis, Would Hurt Market.](#)**

WASHINGTON - The Federal Reserve's proposed rule changes are so restrictive that they would either substantially reduce or exclude municipal securities from being considered high-quality liquid assets in banks' liquidity coverage ratios and would hurt the municipal market, dealer groups and issuers are warning.

The Fed proposed modifying its Liquidity Risk Measurement Standards in May to allow some municipal securities to be considered as HQLA. It proposed the changes after muni market participants complained about the rules jointly adopted by the Fed, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation in September 2014, that exclude munis from HQLA consideration because of concerns they are not liquid or easily marketable.

While the dealer groups and issuers sent the Fed comments letters praising its efforts to try to include some munis as HQLA, they said the proposed conditions for doing so are so strict that they are unhelpful and unworkable in some cases.

The limitations on the types of bonds allowed and the amount of holdings of such bonds the banks could have “negates the ability of an institution to use municipal bonds to comply with the liquidity coverage ratio,” Mike Nicholas, the chief executive officer of Bond Dealers of America, told the Fed. The dealers and issuers also said the Fed’s proposed changes would be of very limited use because the OCC and FDIC have not budged from the rules established in September, which exclude all munis as HQLA. All but two of nine of the largest financial institutions that must comply with the liquidity rules are primarily regulated by the OCC, according to Fed data.

“We are seriously concerned that this amendment was not also jointly proposed by the OCC and FDIC,” the Securities and Industry Financial Markets said in a letter signed by Michael Decker, a managing director and co-head of munis for the group.

The liquidity rules are designed to help the nation’s largest financial institutions better cope during times of financial stress by requiring them to meet liquidity coverage ratios. An LCR is defined as the ratio of HQLA to total net cash outflows. Assets are considered HQLA if they can be easily and quickly converted to cash with little or no loss of value during a period of liquidity stress.

Under the modifications to the rules the Fed proposed in May, munis would only be eligible as HQLA if they are, at a minimum, uninsured investment grade general obligation bonds. Munis also would not qualify as HQLA if they exceed: 25% of an individual CUSIP; an amount equal to two times the average daily trading volume of an issuer’s bonds over the previous four quarters; and 5% of a bank’s total stock of HQLA. The “restrictions and limitations are unfounded” and “will discourage bank investment in the U.S. municipal securities market, thereby negatively affecting the ability of state and local governments to finance vital investment in domestic infrastructure,” Decker said.

“The effect of these limitations on the inclusion of municipal securities within the definition of HQLAs will be to increase borrowing costs for state and local governments, including [New York City], because banks will be disincentivized to purchase and hold municipal securities,” said Alan Anders, the deputy director for finance in New York City’s Office of Management and Budget.

The dealer groups and issuer particularly s took issue with the exclusion of revenue bonds from consideration as HQLA, saying many revenue bonds are backed by revenues from a wide variety of systems or assets. They urged the Fed to include certain investment grade revenue bonds as HQLA.

The failure to include revenue bonds as HQLA is “based on a misconception” and “is unnecessarily excluding many of the highest quality and most liquid and actively traded municipal securities from HQLA consideration permanently,” said Nicholas.

Decker and Anders both rejected the idea that a revenue bond is less secure because it is not backed by the full faith and credit of the issuer.

“A general obligation bond can be a very secure form of financing, but it is not inherently or

necessarily more secure than a revenue bond,” Decker wrote. Anders added it would be “preferable and more accurate” to focus on the investment grade of a bond instead of whether it is a GO or revenue security.

BDA and SIFMA also pushed the Fed to allow insured bonds to qualify as HQLA as long as they would be investment grade if uninsured.

Decker argued the bond issuer is still obligated for all debt service payments even if the bonds are insured and that investors generally look at the ability of the issuer to meet its obligations instead of the insurance “wrapping” the bonds.

“Insurance never makes bonds less liquid ... but the proposal seems to reflect that as true,” Decker wrote.

Build America Mutual Assurance Company CEO Sean McCarthy also urged insured bonds be considered as HQLA, saying this would “advance the [Fed’s] goals for improving the security and stability of the U.S. financial system.”

The dealers and issuers pushed the Fed to eliminate its CUSIP and trading volume restrictions. Nicholas said the CUSIP cap would “unreasonably restrict” HQLA status for muni bonds because, unlike corporate bonds, many large bond issues are structured with a mix of serial and term bonds with different maturities that result in multiple CUSIPS. The cap would greatly limit the amount of an overall muni offering that a bank could hold, he said.

“BDA urges the [Fed] to remove the CUSIP restriction and allow financial institutions to include investment grade municipal securities set aside as HQLA in quantities that the regulated institution believes can be sold within a 30 day period,” Nicholas wrote.

SIFMA took a similar approach, saying a better way to manage the concentration of risks in bonds would be to eliminate the 25% rule and apply the “sophisticated” systems banks already have that take into account factors like the issuer, the credit quality, and the maturity.

The commenters said the trading volume restriction proposal is not only flawed but also unworkable. BDA said it is unaware of any system or source that would provide access to the kind of trading information needed to comply with the restriction. The group also said the provision is “backwards-looking” from a market perspective because it would ignore times of increased trading volume when opportunistic buyers buy bonds as yields rise.

Decker said investments that may be highly sought after in a stressed market may trade “relatively infrequently because they are held by institutional investors as buy-and-hold investments.” He added that volumes can appear low when holders do not want to sell and expose themselves to taxable gains and that “there is no indication that historic trading volume, even as recent as the preceding four quarters, is an indication of liquidity.”

The dealer groups and issuers also challenged, and urged repeal of, the Fed’s proposed stipulation that municipal bonds only make up 5% of the overall HQLA holdings.

The established rule, which doesn’t take effect until Jan. 1, 2017, already limits the overall holdings of level 2A and 2B HQLA to 40% and 15%, respectively.

Anders said there is “no basis for imposing additional limitation” on top of those “imposed on other HQLAs at the same level as municipal securities.”

In addition, some of the commenters pushed for a reclassification of certain munis as level 2A, saying they are more secure than the level 2B-rated corporate bonds and thus deserve a higher rating.

Decker said it is wrong that Europe treats munis at a higher HQLA level, 2A, than the U.S. He said the discrepancy “creates an awkward situation where U.S.-specific securities are treated worse domestically than internationally.”

THE BOND BUYER

BY JACK CASEY

JUL 27, 2015 5:05pm ET

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## **U.S. Municipal Bond Investors Stash Cash Ahead of Expected Rate Rise.**

Investors in U.S. municipal bonds are sitting on more cash than they have in years, in part because they're wary of the \$3.7 trillion market at a time when interest rates are expected to rise.

Levels of cash in some portfolios are higher than they have been for at least the past few years, according to interviews with managers from 10 different firms of varying sizes.

And cash has grown to record levels over the last decade in the open-end muni mutual funds tracked by investment research firm Morningstar, according to data the firm provided to Reuters.

Between March 2014 and March 2015, cash rose by \$6.2 billion to \$31.9 billion, the biggest such jump in at least 10 years. In 2005, it was at only \$8.9 billion. Cash is now at 5.5 percent of holdings, almost double the 3 percent 10 years ago. The data do not include closed-end funds.

The Federal Reserve is expected on Wednesday to point to a growing U.S. economy and stronger job market as it sets the stage for a possible interest rate hike in September.

“A lot of my investors who've been with me for a long time know that it can be very painful when rates go higher,” said Michael Pepe at JHS Capital Advisors, who focuses on municipal investments. “They'd rather earn nothing than lose 10, 20, 30 percent.”

Feeding the flows of cash are seasonally strong summer bond calls, coupon payments and maturities. Some investors are not reinvesting, whether by choice or because there is not enough supply to meet demand.

Bond investors are especially sensitive to the risk of rising interest rates, as prices of bonds they already own generally fall when rates rise. Investors on the sidelines say they are ready to jump back in but they will wait until bond prices decline.

CREDIT SHOCKS

Several factors have led investors to hesitate. They do not know how far or how fast yields on longer-term bonds could rise in response to a Fed hike of short-term rates. They have also had credit shocks with negative headlines out of Puerto Rico and Chicago. And global factors, including China's stock market slump, have triggered global markets' volatility that has even spooked investors in some safe-haven securities.

At BlackRock, portfolios are at 5 or 6 percent cash, compared with 2 percent on average normally, said Peter Hayes, head of BlackRock's municipal bond group.

"Our time horizon on that cash isn't very long. We don't advocate for sitting on cash for a long period of time," Hayes said.

In June alone, investors received \$56.6 billion through current and advanced refundings and maturing bonds and notes, according to Interactive Data's MuniView.

JHS Capital Advisors' clients are usually almost fully invested, Pepe said. But currently, they have on average 30 percent allocated to cash and some are as high as 40 percent, the highest levels ever.

Muni investors are not alone in increasing their cash levels. According to a July Bank of America Merrill Lynch survey of global fund managers for all asset classes, cash levels have soared to 5.5 percent, the most since December 2008.

Some muni investors are reluctant to jump back in. Burt Mulford of Eagle Asset Management said June didn't see as much reinvestment as usual.

"The challenge for the retail investor ... is finding the bond to replace the bond that just got called," he said, because yields are now so low.

Eagle has about 5 percent cash currently - down slightly from a month ago but much higher than its average 1 percent cash position, Mulford said. The last time it was as high was the summer of 2013, during the so-called "taper tantrum," when bonds sold off, driving up yields, after the Fed began curtailing its bond buying.

The hefty cash levels are just one indicator that the muni market is in the doldrums. Returns so far this year have been tepid at 0.69 percent, according to the S&P National AMT-Free Municipal Index, and investors have pulled money out of municipal bond funds for 11 of the past 12 weeks.

Though the cash buildup is prompted partly by fear, it also positions the market for a lift because investors will be liquid enough to jump back in when valuations improve.

"If you do get some of that scare, a dislocation in the market, we have the dry powder to redeploy," said Julio Bonilla, portfolio manager at Schroders. "Every portfolio manager out there right now is very focused on maintaining some form of liquidity."

That could mean a better second half of 2015 for munis.

"We are definitely more optimistic for the second half of 2015," said Eagle's Mulford. "The trend is gradually turning around."

Dawn Daggy-Mangerson, director of McDonnell Investment Management's municipal portfolio team, said the firm had studied muni performance every time the Fed began a cycle of interest rate rises in the past 25 years. In all four instances - 1994, 1997, 1999 and 2004 - munis showed positive returns of about 5 percent or more annualized for two years after the hikes.

"It's expensive to sit in cash," she said. "And people have been wrong about rising rates for the last couple of years. The longer you're wrong, the more it's going to hurt you."

REUTERS

(Reporting by Hilary Russ; Additional reporting by Jennifer Ablan; Editing by Megan Davies and Martin Howell)

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## **Potential Risks in Voluntary Reporting of Bank Loans.**

A current hot topic in the world of municipal finance is the issue of voluntary reporting of information regarding direct bank loans to governmental entities or conduit governmental entity borrowers. The Municipal Securities Rulemaking Board (MSRB) has strongly encouraged municipal issuers to voluntarily report this information, through its Electronic Municipal Marketplace Access system (EMMA).

The MSRB has published a number of notices and advisories over the last few years in support of its position that this information should be voluntarily provided. The MSRB's expressed concern is that such loans often contain terms that may adversely affect the parity position, rights or collateral of existing bondholders or the liquidity of the issuer, and that information regarding such loan terms, and the risks presented to bondholders, is not readily available to the secondary market.

Inextricably intertwined with this voluntary reporting initiative is the consideration of whether governmental notes issued as part of these loans constitute municipal securities under federal securities laws. Characterization of bank loans as securities potentially subjects the issuer and other participants in the transaction to anti-fraud and other provisions of federal securities laws and regulations enforced by MSRB, the U.S. Securities and Exchange Commission (SEC) and other regulators.

The MSRB first raised the issue of the potential application of the federal securities laws to bank loans when it published Notice 2011-37 on Aug. 3, 2011, aimed generally at municipal advisers involved in such loans. The MSRB stated that if such loans were properly characterized as a municipal security, a municipal adviser participating in the private placement of a loan would be required to register with the SEC as a broker-dealer, thereby subjecting the adviser to the rules and regulations of the MSRB. Among other things, the municipal adviser would become subject to MSRB Rule G-23, which precludes municipal advisers who are also broker-dealers from becoming underwriters or placement agents for municipal issues for which they are serving as financial advisor.

Later that year the MSRB provided additional guidance to professionals involved in bank loans that might be characterized as municipal securities. In Notice 2011-52 (Sept. 12, 2011), the MSRB cautioned that if a broker-dealer serves as a placement agent for a "direct purchase" by a bank of municipal securities or as a placement agent for a "bank loan" that is, in fact, a municipal security, the broker-dealer is subject to all MSRB rules, as well as other federal securities laws. Further, the MSRB explained that a municipal adviser becomes subject to the rules and regulations governing municipal advisers if it advises a government issuer on whether to enter into a bank loan that is, in fact, a municipal security, or on a direct purchase by a bank of the issuer's securities followed by a restructuring of the securities that is considered a primary offering.

The MSRB followed up on Notice 2011-52 with Notice 2012-18 on April 3, 2012, in which it provided guidance on how to actually do the voluntary filing through EMMA of information regarding a bank loan. According to the MSRB, the EMMA posting may be done by either filing copies of the bank

loan documents, or a summary of the documents containing the following information: the lender; the borrower; purpose of the loan/financing; security for repayment; third-party guarantees; source of repayment; dated/closing date; par amount; interest rates, including method of computation; payment dates; maturity and loan amortization; optional, mandatory and extraordinary prepayment provisions; entity tax status; events of defaults/remedies; current borrower credit rating; governing law; CUSIP number, if applicable; and redistribution rights, if applicable.

The MSRB also restated in Notice 2012-18 its prior cautionary advice to broker-dealers and municipal advisers regarding bank loans potentially constituting municipal securities, thereby subjecting them to existing securities law requirements. However, the MSRB did acknowledge that SEC Rule 15c2-12 (which, among other things, imposes various duties on a broker or underwriter regarding issuer or obligated person initial and continuing disclosure) would not apply to a bank loan that is negotiated and made directly by a bank since there is no underwriter or placement agent involved who is subject to this rule. While a bank loan made with the participation of an underwriter or placement agent may also be exempt from Rule 15c2-12 under certain circumstances, the participating broker would be required to report the loan to the MSRB under Rule G-32. And, in any event, the MSRB has signaled that the greater transparency and disclosure needs of the secondary market overshadow these “technicalities.”

The MSRB’s statements on voluntary reporting and the classification of bank loans as municipal securities culminated in its Jan. 29 publication of Notice 2015-03. In this notice, the MSRB incorporated the substance of the prior notices and set forth its “best practices” for voluntary reporting of bank loans. However, and perhaps as a harbinger of things to come, the MSRB includes two important cautionary notes regarding information that is voluntarily filed for bank loans under its guidelines: all voluntary disclosure information “may” be held to the same standards of materiality and timeliness of information disclosed under SEC Rule 15c2-12; and bank loan disclosure information provided should be consistent with the requirements of SEC Rule 10b-5 such that the information is not false or misleading in the context in which it is provided.

These comments from the MSRB present the obvious and important question of whether an issuer that voluntarily files a report regarding its bank loan activity is subjecting itself to MSRB jurisdiction and potential securities fraud exposure where none may otherwise exist. So far, there is no clear answer.

There is little doubt that the policy behind the MSRB’s voluntary disclosure initiative is sound or that the secondary market for municipal securities would benefit from greater access to information regarding such bank loans.

However, significant legal and jurisdictional questions remain unresolved, including when and under what circumstances bank loans may constitute municipal securities and the scope of a disclosing party’s potential liability. Not the least of these concerns is the possibility that by posting voluntary information on EMMA, the issuer or borrower is subjecting itself to potential securities law regulation and Rule 10b-5 liability if that information is later determined by a regulator or a court to have been materially inaccurate or incomplete. This is particularly true where the regulators have not provided any safe harbors or other firm guidance that can be relied upon with legal certainty.

Of course, there is also a concern that based on the MSRB’s rather clear trajectory, the SEC may in the future take the position that an issuer’s failure to do a voluntary bank loan posting, where the issuer has outstanding municipal securities, constitutes a basis for a securities fraud proceeding, on a theory that the failure to file caused the information then available to the secondary market to be materially inaccurate or misleading.

Such a concern may not be as untenable as it may initially appear, particularly in light of a prior

enforcement proceeding brought by the SEC against the city of Harrisburg, where it took a substantially similar position. In the consent order entered in that proceeding, the SEC found that, when considered against the total mix of information available to investors and potential investors, the city's failure to make its required continuing disclosure filings constituted actionable securities fraud.

In addition, the Municipalities Continuing Disclosure Cooperation Initiative undertaken by the SEC in 2014 clearly demonstrates that regulators are actively seeking out new, innovative and aggressive enforcement techniques regarding municipal securities.

There likely will be additional developments in this area, as the signals from the MSRB and the SEC are clear as to their position on the issues. Issuers, obligated persons, banks, broker-dealers and municipal advisers would be well advised to pay close attention to future developments.

**Daniel J. Malpezzi and Timothy J. Horstmann, The Legal Intelligencer**

July 28, 2015

**Daniel J. Malpezzi** and **Timothy J. Horstmann** are attorneys with the law firm of McNeese Wallace & Nurick in Harrisburg, and practice in the firm's financial services and public finance groups. The firm represents state and local governments and agencies as issuers of revenue bonds and general obligation bonds. The firm also routinely serves as underwriter's counsel and counsel to conduit borrowers, banks and trustees. Malpezzi can be reached at [dmalpezzi@mwn.com](mailto:dmalpezzi@mwn.com) and Horstmann at [thorstmann@mwn.com](mailto:thorstmann@mwn.com).

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## **[How Hedge Funds Are Profiting from Puerto Rico's Pain.](#)**

Puerto Rico is in the throes of a fiscal crisis and Congress appears unwilling to help. House and Senate legislation that would extend Chapter 9 protection to municipalities in Puerto Rico is opposed by the Republican majority, even though it would not cost US taxpayers a penny.

Opposition to the legislation is based in part in a concern for bond investors. Congressman Trent Franks (R-AZ) told Bloomberg Politics that investors relied on the fact that infrastructure investments on the island were protected from the threat of bankruptcy, and that changing the bankruptcy rules in the middle game would be unfair.

However, the history of municipal bonds suggests otherwise. In the late 1920s and early 1930s, thousands of US municipalities defaulted on their bonds. The problem started in Florida, where local governments overbuilt infrastructure. With the onset of the Depression, municipal defaults spread to many other states, with especially high concentrations in North Carolina, New Jersey, Michigan, Ohio and Arkansas.

There was no municipal bankruptcy law at the time, giving rise to uncertainty over creditor rights and complex litigation. In 1934, Congress addressed the situation by adding Chapter 9 to the bankruptcy code, creating a mechanism for municipal debt adjustment. The new law passed by a wide 45-28 margin in the Senate and its enactment was applauded by municipal finance experts.

The idea that the lack a legal bankruptcy mechanism protects bond investors from default risk is clearly refuted by the Depression experience, as well as by the more recent default by Harrisburg, Pennsylvania — a state that explicitly forbid a Chapter 9 filing for the city. In fact, Puerto Rico bonds

have been paying substantially higher coupons than US Treasuries for years - despite their favorable tax treatment - suggesting that investors were aware of and demanding compensation for default risk.

Further, the 1934 law changed the rules for municipal bondholders in the 48 states, yet it was welcomed by market participants and almost no one would advocate repealing it today. Although cities in Puerto Rico and other U.S. territories had outstanding bonds at the time, none appear to have been in default, perhaps explaining why the 1934 legislation was not extended to US possessions.

A better criticism of legislation extending Chapter 9 to Puerto Rico is that it is insufficient. If the bill were enacted, the commonwealth government would not be able to declare bankruptcy. Further, as noted bond commentator Kristi Culpepper explains, public corporation debt backed by service charges and other "special revenues" cannot be adjusted in a municipal bankruptcy process, leaving revenue bonds issued by some publicly owned corporations out of the process. But Chapter 9 could be applied to some classes of public corporation debt as well as the obligations of Puerto Rico's 78 "municipios" (local governments). As I reported in *The Bond Buyer* earlier this year, a number of these municipios are flat broke and would thus be eligible for the Chapter 9 process.

While Culpepper and congressional Republicans are correct in arguing that Chapter 9 extension is an incomplete solution to Puerto Rico's debt problem, it is far better than the prevailing alternative of no federal action whatsoever.

It thus appears that the only real reason for not extending Chapter 9 to Puerto Rico is investor protection - but just who are these investors? Much of the commonwealth's debt has been snapped up by hedge funds at steep discounts. If the funds can compel Puerto Rico public sector entities to service their bonds on time and in full, they will make substantial profits. One out of every five dollars of this profit will go to hedge fund managers, who are taxed at lower capital gains rates. Securities regulations have helped hedge funds and other Wall Street institutions corner the market on Puerto Rico bonds by prohibiting trades of less than \$100,000 for any newly issued securities. With this minimum in place, individual investors are effectively barred from buying commonwealth bonds.

Since the source of repayment for government bonds is often tax revenue, Wall Street interests are really trying to maximize their take from taxpayers - and not just taxpayers in Puerto Rico. A very large proportion of Puerto Rico government revenue comes from taxpayers in the fifty states.

Public sector entities in Puerto Rico receive over \$7.2 billion in federal grants annually. This amount represents over 10% of the Commonwealth's GNP and 22% of total government spending. I have uploaded a list of recipient entities and amounts for FY 2013 here.

Further, according to [USASpending.gov](http://USASpending.gov), the US federal government spent a total of \$21.3 billion in Puerto Rico in fiscal year 2014, while the IRS reports that commonwealth residents and corporations contributed just \$3.6 billion in federal tax revenue during the same year. The difference between these two figures - net transfers from taxpayers in the fifty states - represents about a quarter of Puerto Rico's GNP.

Thus, Puerto Rico and its governments derive much of their revenue from US taxpayers. Although federal grants are always made for a specific purpose, government revenues and expenditures are fungible. Governments receiving federal support can shift their own-source revenue away from federally subsidized priorities and towards other purposes - such as enriching hedge fund managers.

By denying the Chapter 9 option to Puerto Rico municipalities and public corporations, congressional Republicans might well be doing a disservice to the middle class taxpayers they claim to represent.

**By Marc Joffe, The Fiscal Times**

July 28, 2015

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- [MSRB Announces Regulatory Topics to be Discussed at Upcoming Board Meeting.](#)
  - [BDA Submits Comment Letter to Labor Department on Fiduciary Duty Proposal.](#)
  - [S&P U.S. State and Local Government Credit Conditions Forecast: Financial Management Stands Out In an Age of Economic Limitations.](#)
  - [Pennsylvania May Sue Firms Over Ex-Harrisburg Mayor's Bond Deals.](#)
  - [Fitch: Statutory Liens Do Not Boost U.S. Municipal Debt Ratings.](#)
  - [Senate Panel Passes Tax Extenders Bill with Bond, P.R. Provisions.](#)
  - [IRS Memo: Procedures for Conducting Examinations of Direct Pay Bonds.](#)
  - [NABL: Disaster Tax Relief Bills Introduced in House and Senate.](#)
  - And finally, asking [75 year old Mr. LeFebre](#) to take the stand and recount the history of the rural road (dedication dispute) on which he's resided his entire life? What could possibly go wrong? This. This is what could go wrong. "When he was a child, LeFebre's parents would take him and his siblings to the dam to ice skate in the winter." Your Honor, permission to treat the witness as nostalgic.
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## **IMMUNITY - GEORGIA**

### **[Fuciarelli v. McKinney](#)**

**Court of Appeals of Georgia - July 16, 2015 - S.E.2d - 2015 WL 4313845**

State university professor brought retaliation action against university, Board of Regents, university president, and former acting vice president under Taxpayer Protection and False Claims Act (TPFCA). The trial court dismissed claims. Professor appealed.

The Court of Appeals held that:

- University, Board, and president and former acting vice president in their official capacities were entitled to sovereign immunity, but
  - Professor was not required to obtain Attorney General's approval before filing suit against president and former acting vice president in their individual capacities.
- 

## **OPEN MEETINGS - GEORGIA**

### **[Gravitt v. Olens](#)**

**Court of Appeals of Georgia - July 16, 2015 - S.E.2d - 2015 WL 4314382**

Attorney General brought a civil action seeking to enforce Open Meetings Act (OMA), alleging city and city mayor had negligently violated the OMA by refusing to allow a member of the public to

attend and videotape a meeting of the city council, and sought the imposition of civil penalties and the award of attorney fees pursuant to the OMA. The Superior Court denied the defendants' motion to dismiss the action on the basis of sovereign and official immunity, and granted summary judgment in favor of the Attorney General. Defendants appealed.

The Court of Appeals held that:

- City was not entitled to assert sovereign immunity to bar enforcement action;
- Mayor's actions were ministerial, and therefore he was not entitled to official immunity;
- City was not a "person" subject to imposition of civil penalties;
- Genuine issue of material fact existed as to whether citizen was removed from open public meeting at the direction of the mayor precluding summary judgment;
- Imposition of \$2500 civil penalty each for second and third OMA violations was excessive; and
- Defendants' acts lacked substantial justification, such that attorney fees were recoverable under OMA.

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## **TORTS - MASSACHUSETTS**

### **[Rodriguez v. City of Somerville](#)**

**Supreme Judicial Court of Massachusetts - July 20, 2015 - N.E.3d - 2015 WL 4389881**

Elementary school student's father brought negligence action against city under Massachusetts Tort Claims Act after student suffered injuries when metal door frame fell off school's front door and struck him in head. The Superior Court denied city's motion to dismiss on basis of improper presentment. City appealed. The Appeals Court dismissed appeal. Father sought further appellate review.

The Supreme Judicial Court of Massachusetts held that:

- Appeal was not moot;
- Denial of city's motion to dismiss action for failure to meet presentment requirements of Tort Claims Act was immediately appealable; and
- Letter sent to mayor on behalf of student did not meet presentment requirements set forth in Tort Claims Act.

City's appeal from denial of motion to dismiss student's negligence action was not moot, even though parties had both filed amended pleadings and additional parties had been joined since filing of appeal, where underlying issue was whether student had made proper presentment to city in the first instance.

Orders denying motions to dismiss based on immunity from suit fall into the limited class of cases for which an interlocutory order is immediately appealable under the doctrine of present execution.

Letter sent to mayor on behalf of injured second grade student did not meet presentment requirements of Massachusetts Tort Claims Act as a condition for filing negligence suit against city. Letter did nothing more than state that student was injured in accident at public school and that counsel was seeking a copy of school's report of incident as well as reports of any other incidents at same school, and letter did not identify any legal basis for a claim against city, much less actually present a claim that city could reasonably be expected to investigate.

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## **LIABILITY - NEW HAMPSHIRE**

### **[Dolbeare v. City of Laconia](#)**

**Supreme Court of New Hampshire - July 15, 2015 - A.3d - 2015 WL 4264718**

Visitor to city-owned park who tripped and fell on a mat at playground brought negligence and nuisance action against city. The Superior Court denied city's motion to dismiss pursuant to the recreational use immunity statutes, but transferred questions for review. City brought interlocutory appeal.

The Supreme Court of New Hampshire held that:

- Visitor's use of playground equipment was "outdoor recreational activity," within meaning of statute eliminating a landowner's duty of care to keep premises safe for entry or use by others for outdoor recreational activity, and
- Visitor's use of playground equipment constituted the "use of land," within meaning of statute immunizing a landowner who without charge permits any person to use land for recreational purposes from liability for unintentional personal injury or property damage.

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## **UTILITIES - NEW JERSEY**

### **[Township of Wyckoff v. Village of Ridgewood](#)**

**Superior Court of New Jersey, Appellate Division - July 15, 2015 - Not Reported in A.3d - 2014 WL 10093617**

The Village of Ridgewood ("Village") is a municipal corporation that owns and operates the Ridgewood Water Utility ("Utility"). In addition to providing water to the residents of Ridgewood, the Utility provides water to three other municipalities ("Plaintiffs") pursuant to franchise agreements.

Plaintiffs challenged the validity of three ordinances enacted by Ridgewood that increased the water rates charged by the Utility to its customers by a total of thirty-one percent over the course of 2010, 2011, and 2012. Plaintiffs claimed the water rates established in these three ordinances improperly permitted the Utility to include millions of dollars of Ridgewood's municipal operating expenses, such as the cost of providing health insurance to non-Utility employees, police department salaries and expenses, fire department salaries and expenses, and the fees charged by Ridgewood's corporation counsel.

Plaintiffs claimed Ridgewood used the Utility as a means of providing a clandestine form of municipal tax relief to its own residents, consequently imposing an improper tax burden on Plaintiffs' residents in the form of higher water rates. Stated differently, the net effect of these improper allocations of expenses by the Utility created a de facto lack of uniformity between the rates charged to Ridgewood's residents and those charged to non-residents.

Specifically, Plaintiffs claimed that the Utility rate ordinances Ridgewood adopted in 2010, 2011, and 2012 are: (1) inconsistent with N.J.S.A. 40A:31-10(a), which requires annual rental charges to be "uniform and equitable for the same type and class of use"; (2) in violation of N.J.S.A. 40A:31-10(c), which limits the type of costs that can be included in establishing water rates; (3) in violation of the Equal Protection Clause of the United States and New Jersey Constitutions; and (4) arbitrary, capricious, and unreasonable.

The Village asserted that the rates established by the three challenged ordinances are in accordance with the Act and were set at levels sufficient to pay all of its operational expenses, as authorized by N.J.S.A. 40A:31-10(c)(1), as well as include sufficient revenue to establish a surplus or contingency fund to meet unanticipated expenses, as permitted under N.J.S.A. 40A:31-10(c)(2). According to the Village, the Utility would have faced a budget deficit if it had not enacted the rate increases reflected in these three ordinances. Finally, the Village denied that the methodology used to establish the rates in these three ordinances created a de facto rate disparity favoring the residents of Ridgewood at the expense of the ratepayers who reside in the other municipalities. The Village maintains that every Utility customer was charged the same rate, regardless of the customer's place of residence.

Plaintiffs' case was certified as a class action on May 13, 2011. After nearly three years of discovery and motion practice, the parties filed cross-motions for summary judgment, with both sides claiming the case was ripe for disposition as a matter of law. Instead of deciding the summary judgment motions, the Law Division judge invoked her authority under Rule 1:13-4(a)2 and sua sponte transferred the case to the Board of Public Utilities (BPU). Plaintiffs appealed.

The appeals court reversed, finding nothing in the nature of this controversy and the relief Plaintiffs seek that falls outside the jurisdiction of the Superior Court or is inconsistent with its function and responsibilities under the Prerogative Writ Clause of the New Jersey Constitution.

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## **UTILITIES - OREGON**

### **[Rogue Valley Sewer Services v. City of Phoenix](#)**

**Supreme Court of Oregon - July 16, 2015 - P.3d - 2015 WL 4322642**

Sanitary authority brought declaratory judgment action against city alleging city ordinance was invalid and sought to enjoin city from collecting a 5% franchise fee. The Circuit Court granted summary judgment in favor of city, and authority appealed. The Court of Appeals affirmed. Authority appealed.

The Supreme Court of Oregon held that:

- City had authority as home-rule municipality to impose the franchise fee on the authority;
- Imposition of fees on the sanitary authority by city was not preempted by state law; and
- Authority failed to preserve for appeal its argument that the Circuit Court erred when it granted summary judgment as to the calculation of city's franchise fee.

City ordinance provided for collection of a fee from sanitary authority, not a tax, and therefore city had authority as a home-rule municipality to impose franchise fee on the authority for its use of city's rights-of-way for the authority's operations within the city.

Statutory provisions governing municipal regulation of public utilities and taxation on public utilities operating without a franchise did not preempt the imposition of fees on a sanitary authority by city. Neither provision unambiguously expressed a legislative intent to preempt local action, and provisions and legislative history suggested that the legislature in fact did not intend to preempt local governments from imposing such conditions on the use of their rights-of-way by sanitary authorities.

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## **LABOR - PENNSYLVANIA**

### **[Philadelphia Firefighters' Union, Local 22, Intern. Ass'n of Firefighters, AFL-CIO ex rel. Gault v. City of Philadelphia](#)**

**Supreme Court of Pennsylvania - July 20, 2015 - A.3d - 2015 WL 4401552**

Firefighters' union and its officers brought action against city, mayor, and fire commissioner seeking peremptory judgment requiring city to promote employees from promotional lists for fire captain and fire lieutenant into all budgeted vacancies.

The Court of Common Pleas granted peremptory judgment. City, mayor, and commissioner appealed. The Commonwealth Court reversed. Union and officers appealed.

The Supreme Court of Pennsylvania held that neither city's home rule charter nor its civil service regulations required vacancies for positions of fire captain and fire lieutenant to be filled immediately by promotion, but rather, merely mandated that when vacancies were being filled, they should be filled by promotion as opposed to by outside hiring, and thus, firefighters' union was not entitled to peremptory judgment requiring city to exhaust promotional list before establishing a new list, or to promote from a particular list before it expired.

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## **MUNICIPALITIES - PENNSYLVANIA**

### **[In re Concord Twp. Voters](#)**

**Supreme Court of Pennsylvania - July 20, 2015 - A.3d - 2015 WL 4419023**

Township resident filed petition to place on ballot a referendum question seeking to change township's governmental status from second class to first class. The Court of Common Pleas denied petition. Resident appealed. The Commonwealth Court affirmed. Resident filed petition for allowance of appeal.

The Supreme Court of Pennsylvania held that, as a matter of first impression, second-to first-class township referendum questions shall be submitted to voters at the first general or municipal election occurring at least ninety days after fulfilling both the population density ascertainment and petition signature filing requirements as set forth in the statute.

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## **DEDICATION - SOUTH DAKOTA**

### **[State v. Niemi](#)**

**Supreme Court of South Dakota - July 15, 2015 - N.W.2d - 2015 WL 42939742015 S.D. 62**

Landowners filed declaratory judgment action against township seeking determination that road traversing property was not public road. Owners of land accessible by road intervened and filed counterclaims asserting that road was public or that they were entitled to prescriptive easement. The Circuit Court found that road had been dedicated to public use by implication. Landowners appealed.

The Supreme Court of South Dakota held that evidence supported finding that roadway was public road by operation of implied common-law dedication.

Evidence supported finding that actions of landowners and predecessors in interest expressed intent to dedicate road traversing property as public road, and that township accepted dedication, so as to establish that roadway was public road by operation of implied common-law dedication. Original homesteader requested or acquiesced in township's maintenance of road, other predecessors in interest similarly acquiesced and allowed township to pay for and install cattle guard, female landowner's first husband requested road maintenance, after female landowner became record owner, she acquiesced in maintenance of road, township had maintained road at request of surrounding landowners for over 80 years, and public had used road to access dam, school, and adjacent properties for decades.

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## **REFERENDA - TEXAS**

### **[In re Woodfill](#)**

#### **Supreme Court of Texas - July 24, 2015 - S.W.3d - 2015 WL 4498229**

Supporters of referendum petition challenging city's equal rights ordinance filed petition for writ of mandamus seeking to compel city council to either repeal the ordinance or submit it to popular vote.

The Supreme Court of Texas held that:

- City secretary certified that petition had a sufficient number of signatures, and thus city council had a ministerial duty to reconsider ordinance and either repeal it or submit it to popular vote;
- Supporters of petition did not have an adequate remedy by way of appeal; and
- Supporters of petition could seek mandamus relief in an original proceeding in the Supreme Court.

City secretary certified that referendum petition challenging city's equal rights ordinance had a sufficient number of signatures, and thus city council had a ministerial duty under city's charter to reconsider the ordinance and either repeal it or submit it to popular vote, even though secretary also noted city attorney's finding that there were an insufficient number of signatures due to the invalidity of many signature pages. Secretary unequivocally stated that she was "able to certify" that the number of signatures verified on the petition was more than required, and secretary did not adopt or certify city attorney's finding.

City council could not refuse to reconsider equal rights ordinance that was challenged in referendum petition that city secretary certified as having a sufficient number of signatures, despite city council's alleged concern that petition was tainted by forgery and perjury. City charter gave city council no discretion to reevaluate the petition once it was certified by city secretary, but rather required immediate action.

Supporters of referendum petition challenging city's equal rights ordinance did not have an adequate remedy by way of appeal for city council's failure to perform its ministerial duty after certification of the petition by the city secretary to either repeal the ordinance or submit it to popular vote, and thus supporters were entitled to mandamus relief. Appellate process would not resolve the case in time for referendum to be placed on next general election ballot.

Supporters of referendum petition challenging city's equal rights ordinance, who sought to compel city council to perform its ministerial duty after petition was certified by the city secretary to either repeal the ordinance or submit it to popular vote, could seek mandamus relief in an original proceeding in the Supreme Court, despite contention that petition should have been filed in District Court. Election Code expressly authorized Supreme Court or a Court of Appeals to "issue a writ of

mandamus to compel the performance of any duty imposed by law in connection with the holding of an election.”

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## **REFERENDUM - WYOMING**

### **[City of Casper v. Holloway](#)**

**Supreme Court of Wyoming - July 17, 2015 - P.3d - 2015 WL 4385984 - 2015 WY 93**

City resident filed complaint challenging city clerk's determination that there was an insufficient number of signatures on municipal referendum petition. The District Court granted summary judgment to resident. City and clerk appealed.

The Supreme Court of Wyoming held that:

- Clerk's determination was subject to judicial review by way of declaratory judgment, and
  - A signatory to a municipal referendum petition remains a qualified elector when his or her address within city is different from the one on the voter registration list.
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## **TAX - GEORGIA**

### **[Fulton County Bd. of Tax Assessors v. Piedmont Park Conservancy](#)**

**Court of Appeals of Georgia - July 16, 2015 - S.E.2d - 2015 WL 4314595**

Charitable corporation appealed county board of tax assessor's denial of its charitable tax exemption as to its building in park owned by the corporation but occupied in part by lessees operating two restaurants. The trial court granted the corporation a tax exemption as to those portions of the building not occupied by the restaurants. Board appealed.

The Court of Appeals held that corporation was entitled to a proportional ad valorem tax exemption.

Charitable corporation was entitled to a proportional ad valorem tax exemption as to portions of its building not occupied by income producing restaurant tenants, where its building remained devoted entirely to its mission of furthering recreational and educational activities in park, its activities continued to be undertaken for the benefit of the public, and the organization's use of income generated at the property was used in furtherance of its religious, educational, and charitable purposes.

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## **[Nonprofit Hospitals in 2015: 15 Findings and Thoughts.](#)**

Wells Fargo Securities, the capital markets and investment banking division of Wells Fargo & Company, recently released a [report on the state of nonprofit hospitals](#) and how they fared in the first half of 2015.

In the report, called "NFP Hospitals H2 2015 Update," George Huang, municipal securities research director at Wells Fargo Securities, provided some thoughts on recent developments and looked ahead to the remainder of the year.

Here are 15 findings and thoughts from the report.

### **Political and legal challenges**

1. The Supreme Court decision in the King v. Burwell case to uphold subsidies on federal exchanges provides stability for hospitals' strategic and operational planning.
2. The Affordable Care Act is a key issue in the 2016 presidential election. However, there is no consensus on Republican "repeal and replace" plans.
3. Congress is pursuing minor amendments to the ACA, but repealing the 2.3 percent medical device tax and the Independent Payment Advisory Board would require bipartisan compromises.

### **Health insurance exchanges**

4. Health insurance enrollment in 2015 under the ACA totaled 10.2 million at the end of March, down from an estimate given earlier that month of 11.7 million people and exceeding the 9.1 million HHS year end-target.
5. Further enrollment growth is likely as individual mandate penalties increase, according to the report. However, adverse selection risk remains, as there is a continued lack of consumer awareness and poor healthcare and health insurance literacy.

### **Medicaid expansion**

6. Although the optional nature of Medicaid expansion limited implementation, Wells Fargo believes most states will eventually opt in. Governors and legislatures in 29 states, plus Washington, D.C., have already made the decision to accept Medicaid expansion.
7. At least seven state governors (Ala., Alaska, Mo., S.D., Tenn., Utah, Va. and Wyo.) are currently open to expansion but may lack sufficient state legislative support. After failing to persuade his legislature to expand Medicaid, Alaska Gov. Bill Walker, a Republican-turned-independent, said he plans to unilaterally accept additional federal and Mental Health Trust Fund Authority money to expand Medicaid in his state.
8. If no other states expand Medicaid in 2016, the Washington, D.C.-based Urban Institute estimated there would be 4.2 million people who otherwise could have gained coverage through expansion.
9. Member hospitals of St. Louis-based Ascension Health benefited more from Medicaid expansion than health insurance exchange enrollments, while hospitals in non-expansion states experienced noticeably less improvement in payer mix. Ascension Health hospitals located in states that expanded Medicaid saw 32 percent fewer uninsured patients in 2014 than in 2013, while the system's hospitals in non-expansion states only experienced a 4 percent decline during the same time period, according to a Kaiser Family Foundation study. Ascension Health hospitals in Medicaid expansion states also saw a 7.4 percent increase in Medicaid discharge volumes from 2013 to 2014. That compares to a 1.4 percent increase for hospitals in non-expansion states during the same time period. Additionally, Ascension Health hospitals in Medicaid expansion states saw an 8.2 percent increase in Medicaid gross revenues from 2013 to 2014 and a 63.2 percent decrease in revenue from self-pay, according to the study. Ascension Health hospitals in non-expansion states saw a 9.4 percent decline in Medicaid gross revenues from 2013 to 2014 and a 2.6 percent increase in revenue from self-pay.

### **Medicaid enrollment**

10. As of April 2015, there were 71.1 million total people enrolled in Medicaid.

11. As of that time, Medicaid enrollment was up 21.3 percent over average monthly enrollments prior to the ACA's 2014 open enrollment period.

### **Capital markets**

12. Hospital bonds continue to be high demand, and that demand has outpaced supply, even in a higher issuance year.

13. In the first half of 2015, hospital bond volume was up dramatically — 87.5 percent year-over-year.

14. About 80 percent of the hospital bond volume increase in the first half of this year was refunding/combined money deals, so issuance pace is likely to slow when rates rise.

15. Hospital bonds have still been good investments in the first half of 2015, as they are delivering positive returns in excess of other classes of municipal bonds. As of July 16, investing in hospital bonds would have earned an investor a total return of 0.83 percent for year-to-date 2015. By comparison, investing across asset classes as measured by broader indices like the Municipal Bond Index and the Revenue Bond Index, the year-to-date total return would have been 0.18 percent and 0.53 percent respectively.

### **Becker's Hospital Review**

Written by Kelly Gooch | July 22, 2015

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### **[Investors See Golden Opportunity in Chicago's Budget Woes.](#)**

Mayor Rahm Emanuel has warned Chicago homeowners that property tax bills could “explode” without budget relief from Springfield. The Chicago Public Schools are facing massive budget cuts that would force hundreds of layoffs. Residents across the city are paying higher fees for water, vehicle stickers, cable TV and more.

But there is one group that looks at Chicago's financial mess and sees a golden opportunity: the affluent individuals, investment funds and other global companies that buy the city's debt.

Some city bonds sold this month pay returns on par with what investors earn on lucrative but risky junk bonds sold by distressed oil and gas companies. Unlike corporate bonds, the city's debt is guaranteed by an unlimited flow of tax dollars from Chicago residents.

The forces making Chicago bonds a hot commodity are as old as the free market. As the risk grows that the city will default on its debt, investors demand higher returns. Some risk-averse buyers avoid Chicago debt altogether.

But to investors who can tolerate the risk of default - or think it is overstated - Chicago bonds can look tantalizingly lucrative.

Those investors are betting that Chicago residents will ultimately shoulder the cost of the city's massive borrowing, whether by enduring service cuts, by indebting future generations or by paying significantly higher property taxes.

The investment banking arm of the London-based bank Barclays declared in a research report last month that Chicago city bonds “present attractive strategic opportunities,” reasoning that city officials could increase sales and property taxes.

“Even in the worst-case scenario, the median tax bill would have to increase only 15 percent (or \$756) to address the pension issue fully next year,” the report said.

Chicago debt is being marketed not only to investors in government bonds but also to some wealthy speculators who more typically gravitate to distressed companies. One analyst told the Tribune he is touting Chicago to his hedge fund clients as an investment less risky than troubled energy companies — and just as profitable.

These investors’ gain is Chicagoans’ loss. This month’s two-part \$1.1 billion bond deal will cost the city roughly \$150 million more in interest in today’s dollars than if the city still carried the A-level credit rating it had less than two years ago, the Tribune calculated.

Chicago Public Schools is likely to pay similar penalties if it follows through on plans to borrow up to \$1.2 billion later this year. Some analysts have been touting CPS bonds as well, noting that while the schools’ financial situation is more dire, the district’s fate is largely dependent on the city that controls it.

Concord, Mass.-based Municipal Market Analytics accurately predicted in April that Chicago school bonds would drop to junk status but encouraged buyers to consider them anyway.

“The situation in the city will compromise the ability to keep quality schools, to keep the streets clean,” said partner Matt Fabian. “But for investors who can stomach the ups and downs that are probably coming for Chicago, (the bonds) give an attractive amount of income.”

The three major debt rating agencies have differing opinions on the city’s future, with Moody’s Investors Service giving the city a junk status rating and a 5 percent chance of defaulting on its loans within three years. Fitch Ratings and Standard & Poor’s maintain a low investment-grade rating of BBB+.

All three agencies cite Chicago’s estimated \$20 billion in pension debt, the result of many years in which the city put off paying its full share of worker pensions. A Cook County circuit court judge on Friday struck down Emanuel’s plan to scale back benefits for some city workers.

Chicago has more than \$8 billion in outstanding long-term bonds, the result of years of ambitious borrowing that included loans to pay for questionable projects and short-lived expenditures.

The city technically lacks the ability to default on that debt. Illinois, like about half of states, does not allow cities or school districts to declare bankruptcy, and a bill to change that stalled in committee this year.

Still, Chicago’s poor ratings put the city’s debt off limits for some firms. Sarasota, Fla.-based Cumberland Advisors, for example, does not buy debt rated below A.

Some less conservative investors see potential for high returns, especially if they believe the risk of default is overstated.

“Most people think it’s not a triple B credit but it’s really in the single A category,” said Jon Barasch, director of municipal evaluations at New York City-based Interactive Data, a firm that evaluates municipal bonds.

The process that sets interest rates is far from scientific. The bank underwriting the bond sale surveys investors to gauge how much interest they will demand, then works with city or school finance officials to determine what they are willing to pay in interest.

The people reaping the benefits of Chicago and CPS' high interest payments are mostly individual investors who buy bonds either directly or through funds that invest their money. Bond dealers also buy the debt and resell it to investors.

To help local governments raise money for long-term projects, the federal government doesn't collect taxes on most municipal bonds. As a result, the bonds appeal particularly to well-off individuals in higher tax brackets who accept low returns in exchange for a chance to preserve their wealth and reduce risk.

The \$347 million in tax-exempt bonds Chicago sold July 16 offered investors yields of up to 5.69 percent — almost unheard of for tax-backed debt issued by a city.

Buyers of those bonds stand to earn at least 50 percent more than those who invested in Philadelphia bonds issued this month.

The other part of Chicago's deal — \$743 million in taxable bonds priced July 15 — caused a stir beyond the typical market for government debt.

Because officials wanted to use borrowed money to cover short-lived expenditures and close budget gaps, Chicago had to give up the federal tax exemption and offer yields approaching 8 percent — rates more typical of the corporate sector — to compensate for what investors would lose to taxes.

That put Chicago in the same ballpark as for-profit companies — a group considered far more likely to default — and even then the city's debt stood out as lucrative. The rate of return on Chicago's taxable bonds is only slightly lower than the Barclays U.S. corporate high-yield bond index, a benchmark rate of return for companies rated junk status.

"You have a very attractive interest rate for the potential risk," said Triet Nguyen, a managing director at New York City-based NewOak, an independent research and advisory firm that focuses on corporate and municipal debt.

Nguyen said he recommended Chicago taxable bonds to his hedge funds clients. His reasoning: They could earn returns more typical of junk bonds issued by troubled oil and gas companies — at much lower risk.

"I would take the credit of the city of Chicago over any of the smaller energy companies any day," said Nguyen, who lives in suburban Lake Forest. "They can certainly go bankrupt at any time, and Chicago at this point doesn't even have that option."

The additional \$150 million Chicago can expect to pay through 2042 on the bonds issued this month as a result of its deteriorating credit comes on top of a similar penalty on bonds issued in May. That \$674 million tax-exempt deal will cost \$70 million more — in today's dollars — over the life of the debt than if the city had maintained the A3 rating from Moody's Investors Service that it carried as recently as February 2014, according to the Tribune's calculations. The city's 2015 budget is \$7.3 billion.

Emanuel, who already has increased a variety of city fees, said in a plan released in March while he was running for re-election that "property tax bills will explode next year" in the absence of comprehensive pension relief from the Illinois legislature.

As with other cities, Chicago's debt contracts pledge that officials will increase property taxes "without limitation" if the city can't find money elsewhere to make debt payments.

Wells Capital Management, an investment management firm under the umbrella of San Francisco-based Wells Fargo, has increased its investment in debt from the city and CPS over the past year.

"We believe the city has the ability to raise revenue and cut expenses," said Wells Capital portfolio manager Lyle Fitterer. "If you are a citizen within the city you don't necessarily want to hear that."

## **The Chicago Tribune**

July 26, 2015

By Heather Gillers

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## **[CDFA National Development Finance Summit.](#)**

**Charleston, SC  
November 3-6, 2015**

Join CDFA in Charleston, South Carolina for the 2015 National Development Finance Summit! Hosted by the South Carolina Jobs-Economic Development Authority (JEDA), the CDFA National Summit brings together the leaders and dealmakers in the development finance industry to discuss best practices, trends, and project financing solutions.

[Learn more.](#)

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## **[City Upside Down: How Houston Lost Control of its Wallet.](#)**

One of the world's biggest economic hubs is on the brink of a financial crisis, experts say. It's spending far more cash than it's bringing in. Revenue is growing, but not nearly as fast as expenses are. City worker pension costs are through the roof, and there aren't any long-term solutions on the table. Despite all this, many residents think everything is great. After all, it ranks at the top of some global "best of" lists nearly every day, and it's become known throughout the nation as the No. 1 place to work, shop, live, raise a family and make a name for yourself.

But the truth is, Houston is in trouble. It's billions of dollars in debt, and the trouble's been brewing in your backyard for years.

"Cities create the platform for the stage upon which all business is done," said Jim Noteware, a Houston-based real estate developer and former director of Houston's Department of Housing and Community Development. "Cities create the roads, sewers and waterlines, but they also create

human infrastructure, and all of those in Houston — like across many cities in the country — are breaking down. It's been happening in front of all of our eyes, and nobody's paying attention."

While Noteware has been a critic for quite some time, new data from the Greater Houston Partnership's Municipal Finance Task Force reveals the staggering extent of Houston's financial turmoil. The GHP has been combing through the city of Houston's finances in cooperation with city officials since June 2014. The Houston Business Journal received exclusive access to the report before it was released to the public, and it reveals serious issues that could have a significant impact on Houston businesses. City officials did not immediately return calls for comment.

### **Problem 1: Revenue is growing, but not as fast as expenses**

In 2011, the city reported \$1.84 billion in general fund revenue and \$1.9 billion in expenses. That \$60 million gap is the steepest difference reported in recent years. But, between 2017 and 2020, the city predicts a cumulative deficit of \$484.6 million, according to a presentation to the city's budget and fiscal affairs committee.

The city's general fund is what it sounds like - — it finances some of the city's most critical services: Houston Police Department, Houston Fire Department and other local government employees. Since these services don't generate money, the fund relies heavily on property and sales taxes to pay for them - about 80 percent of the general fund's revenue comes from those two sources.

The fund is vital for a city to keep its pulse. Without it, you'd have a pothole-ridden city in shambles, with no established unit tasked with preventing crime and a defunct governmental core. A city in that shape can't effectively attract new business, retain existing ones or lure professional talent. Ask Detroit.

"(The city of Houston is) following an unsustainable budget path, so we're already getting bad services for our taxes," said Steven Craig, interim dean of the College of Liberal Arts and Social Sciences and economics professor at the University of Houston. "Do you want your car to get fixed once a year or once a decade? That's a real expense."

In large part, the leech on the city's wallet is legacy payments — specifically, \$3.3 billion worth of unfunded pension payments.

### **What's it mean for businesses:**

An extreme degradation of day-to-day service deliveries. At its most fundamental level, that means people will see fewer police officers and firefighters. Road and infrastructure repairs have already slowed down, so if you're an employer in Houston, it might get tougher to sell new talent on Houston.

"Businesses are very concerned about their ability to attract talent," GHP President Bob Harvey said. "As we know, talent is all about quality of life. Quality of life is impacted by the quality of city services. The huge progress that we've made in recent years to improve our quality of life and our reputation in the country is being impacted by our roads, I can promise you that."

That same challenge applies to the GHP's primary task of selling employers on headquartering in Houston. When the city's aesthetics gather too much dust, cracks and damage, the partnership has a hard sell to make, and that's not even counting issues beneath the city's surface.

"Frankly, looking at the city's municipal facilities right now, it's beyond embarrassing," said Harvey.

## **Problem 2: The city's bloated with \$12.9 billion in debt**

Houston is buried under a colossal \$12.9 billion outstanding debt in short- and long-term debt obligations. Of that \$12.9 billion, \$9.6 billion is part of the city's enterprise fund, which is made up of systems that generate their own revenue and have additional taxes dedicated to funding them. The Houston Airport System, the Convention and Entertainment District and the city's water and sewage systems are part of that enterprise fund. So, there's an established plan to reduce that debt, but the debt is still there.

The remaining \$3.3 billion is Houston's general obligation debt, which was borrowed for capital expenditures like facilities and construction projects. The city's debt payments on that \$3.3 billion shortfall are spread through 2043, but the lion's share of the payments will happen before 2021. The debt payments peak in 2018, when Houston will have to shell over \$360 million; by 2030, debt payments are either just above or well-below \$100 million.

So until 2020, the city's wallet is going to be historically pinched, and that's for a plan that solves only one of the two \$3.3 billion debt chunks.

The bigger problem lies in the city worker's unfunded pension fund. Houston hasn't put enough money into its pension fund, and it's past the point of no return. To date, the city hasn't funded \$3.3 billion in employee pensions. There's no plan on the table for funding those pensions — that's what makes it more toxic than Houston's \$12.9 billion debt.

In all likelihood, the pensions will have to be paid from the city's general fund, the GHP report said. That spells a further downgrade in city services.

"Everybody blames pensions as the big issue, and it is," Noteware said. "These (municipal) workers think they made a deal with the city, but the city is not a credit-worthy borrower."

In 2014, Houston paid 25.5 percent of the Houston Police Department's payroll toward its pension fund — basically, if a police officer was hypothetically paid a \$100 salary, the city took \$25.50 of its own (or borrowed) money and put it toward the pension fund. That's an exorbitant contribution; the average pension payment should hover around 11 percent to 13 percent per payroll in a healthy municipality, GHP officials said.

A big catch of pension payout is that the city isn't getting anything in return. It's an investment that yields nothing, and the debt it's causing could potentially ransack the city's credit rating.

"The city is going to be paying tax money now for ... services that were delivered five, 10 and 50 years ago," Craig said. "As a taxpayer, that means that I'm going to be paying money and getting nothing back. On average, nobody likes to do that. The city is calling me up on the phone and saying, 'Please, send me \$100; I'm not going to give you anything for it.'"

### **What's it mean for businesses:**

Houston's residents aren't getting any return on a large sum of their taxes. For businesses in a competitive environment, any investment that doesn't yield a return is almost always unjustifiable.

Companies usually respond faster than residents when it comes to tax code changes, so that means that more companies will relocate their headquarters outside the city's taxable boundaries, Craig said.

"Business leaders outside of Houston are saying, 'Well, as long as those silly competitors are in

Houston, I have a cost advantage over them,” Craig said. “If you’re a business leader in Houston, you’re thinking about looking to get your firm out of the city.”

It’s harder to sell a business on staying in the city limits, Harvey said. Instead, businesses can move their headquarters to one of the numerous counties with gentler tax codes less than 20 miles away. When business moves outside the city, experts largely agree that its workers do, too.

“Two years ago, I spoke with an (executive at Ernst & Young), and he was recruiting and trying to bring companies into Houston,” Noteware said. “In 2013, the company recruited 20 very large, new employers in the Houston region. None of them are located in Harris County. They all went to Brazoria County, Montgomery County, Lawler County and other counties. We’re not building our own job base.”

### **Problem 3: Taxes are already high, and raising them isn’t a sustainable solution**

Property tax is Houston’s largest single revenue source. Between 2012 and 2014, the city earned a collective \$2.7 billion in property taxes. During fiscal year 2015, the city of Houston estimates it will scoop up over \$1 billion in property tax. Houston, like all Texas cities, doesn’t have an income tax, so our relatively high property tax rate is a fair trade-off for businesses that come to Houston, experts say.

Despite the city’s record-high revenues, Houston is in record-high debt. In a scenario where businesses relocate out of Houston at a faster rate, experts agree that those businesses’ workforces will follow them into the suburbs. That’s when the city might be pressured to hike up the already high property tax.

Another challenge that Houston faces is its credit rating. On July 2, New York-based Moody’s Investors Service gave Houston a “negative” outlook. It didn’t officially downgrade the credit rating, Harvey said, but it showed that a lower credit score isn’t a foreign possibility for the city if it fails to rein in its expenses.

“If the next thing that Moody’s does is a downgrade, then immediately, all of our debt is more expensive. So, that’s more pressure on your budget. Will there be huge pressure to raise taxes? Absolutely,” Harvey said. “It’s a very common path for cities to take. They take that path until their business community revolts. At that point, forget business attraction — what you’ll see is business exits.”

### **What’s it mean for businesses:**

If Houston even mentioned the possibility of a property tax hike, companies could begin the exodus out of Houston’s city limits, said Harvey.

“The worst thing we can do right now is signal that the city is going to raise its taxes to deal with this issue and basically tell businesses that it’s going to be less and less favorable to do business in the city limits,” Harvey said.

Noteware said he’s spoken to a number of Houston commercial property tenants, and they’re already “buckling” under the weight of Houston’s high property taxes. The two basic solutions for a colossal debt are to either lower expenses or raise revenue, and the city’s one malleable tool that raises revenue is taxes. But, even that likely wouldn’t be enough.

“It is mathematically impossible for the city to fulfill all of its obligations. It’s not just that the existing day-to-day operations are unsustainable,” Noteware said. “But, when you look at the total

debt that has been accumulated ..., it's in excess of \$10 billion. The city's general fund is only \$2.2 billion. The city could collect taxes for the next few years and pay nothing out. I mean, (it could) just turn out the lights and stop."

### **Now what?**

The first step of solving a problem is acknowledging its existence. If the people holding the city accountable are aware of its short fallings, that puts Houston in a critical position of control. Now, it's leadership's responsibility to pull Houston out of the depths.

"Right now, public attention is the most important thing," Noteware said. "Public awareness and public attention."

Politically, the timing of the data's release is significant. With Mayor Annise Parker relinquishing her role as Houston mayor in January, there will likely be a slew of hopeful successors preaching fiscal reform. To date, there's around half a dozen of those hopefuls gearing up for campaign season, including Rep. Sylvester Turner (D-TX) and Ben Hall, who lost the mayoral election to Parker in 2013.

In bringing this information to light, the GHP faced a unique challenge. For an organization the job of which is to recruit businesses to Houston, detailing the city's fiscal floundering is going to make that mission harder to achieve.

"That's one of the issues we face as a partnership — bringing this issue forward. We think it's critical that the city address these issues now and that we don't continue to defer this issue," Harvey said. "But, by bringing this issue forward, it's going to get more local and national publicity, and it's going to be more of a requirement that we act. You can't raise this issue and not act, because the whole country's going to be saying, 'What did they do?'"

### **Houston Business Journal**

Cara Smith  
Editorial intern

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### **[Illinois Conduit's Program Offers Boost to Smaller Hospitals.](#)**

CHICAGO — The Illinois Finance Authority is rolling out a new financing program this summer to help smaller hospitals purchase equipment and meet federal healthcare record-keeping mandates.

The authority also has in the pipeline a series of deals totaling more than \$1 billion that received board approval this month for the University of Chicago, a large healthcare system, and two downtown Chicago-cultural institutions.

The MedCap Program offers medium-term capital for various medical projects. The program is "aimed at small-to-medium sized hospitals, of which there are many in the state, to help them meet their mandates for electronic medical and healthcare record keeping," said Pamela Lenane, a vice president who focuses on the healthcare sector for the IFA.

“It could also help them with upgrade technology assets” and other equipment needs,” she said.

The state has 52 hospitals that carry a critical access designation. The IFA is initially marketing the program to smaller, independent hospitals that lack the same access to low-cost capital as larger systems, and it could eventually expand the program to also help continuing care and retirement facilities.

The authority has been looking to expand its programming and Lenane said it saw a need on the equipment/IT/medical records front. It’s distributing marketing materials to hospitals and financial advisors and sharing information on the program at various hospital meetings over the summer.

The program offers tax-exempt financing with terms of up to 10 years, step up payments, and a draw down option, with fixed authority and bond counsel fees. The benefits include reduced issuance costs and fees, a simplified process, and standard documentation. For transactions under \$20 million, the borrower would pay an issuer’s fee of between \$5,000 and \$12,000. Interest rates on a tax-exempt loan could range from a low of 1.69% to 2.82% on terms between two and 10 years.

The debt would be securitized by collateral via a Uniform Commercial Code filing with no revenue pledge required and could be structured outside of a hospital’s master trust indenture. Lenane said those are significant benefits because security and collateral issues for short-lived projects like IT and other equipment pose a challenge.

The bonds would be directly purchased by a lender. The IFA is in discussion with various lenders and has a commitment from Bank of America Merrill Lynch.

The board gave preliminary approval for an up to \$585 million new money and refunding of 2007 bonds for the University of Chicago. The sale is tentatively expected to include nearly \$350 million of new money and up to \$250 million of refunding bonds. The sizing could be cut if the university decides to go with a taxable structure. Those securities would be issued by the university and not the IFA.

The university is working with lead manager Barclays Capital Inc. The co-managers include Wells Fargo Securities, Loop Capital Markets LLC, and William Blair & Co. Its advisor is Prager & Co. LLC and bond counsel is Chapman.

The university carries ratings of Aa2 from Moody’s Investors Service, AA from Standard & Poor’s, and AA-plus from Fitch Ratings. Standard & Poor’s assigns a negative outlook. The school has been adding to its debt load to finance campus wide projects. Moody’s last year dropped its rating by one level.

“Indications are that the university’s investment in strategic priorities is yielding favorable results that will position it well in the future,” Moody’s said in downgrading the elite school. “However, risk is elevated over the next several years until the university is able to translate its strategic successes into strengthened cash flow to absorb growing debt service.”

Standard & Poor’s said its negative outlook reflects worse-than-anticipated fiscal 2013 financial performance combined with the university’s strategic financial plan that anticipates deliberate deficits through fiscal 2018 and \$300 million to \$500 million in additional debt from fiscal 2015 to 2018.

The university has a total of \$3 billion of outstanding bonds.

The university’s strengths include its “global prominence as an elite research university, with

exceptionally strong student demand at both the undergraduate and graduate level, demonstrated fundraising prowess for strategic initiatives, and growing unrestricted liquidity,” Moody’s said. The IFA board also approved an up to \$500 million new money and refunding for OSF Healthcare system. The sale also allows the hospital system to refinance a taxable loan that helped finance its acquisitions of Kewanee Hospital and St. Anthony’s and finance a new tower at one of its facilities. New money accounts for \$105 million of the deal.

Barclays and Jefferies are underwriting the issue and independent advisor Anne Donahoe is working with OSF, which carries single-A ratings from Fitch and Standard & Poor’s and an A3 from Moody’s.

OSF is headquartered in Peoria. Ten of the corporation’s hospitals are in Illinois. One hospital is in Michigan.

The authority board also gave final approval to the Field Museum of Natural History’s plans to convert \$89 million of floating-rate debt now backed by a letter of credit. The museum will directly place the debt with Northern Trust, JPMorgan Chase Bank subsidiary DNT Asset Trust, and Wintrust Bank. A general pledge from the museum will continue to secure the debt which will not be rated.

The museum carries ratings of A2 from Moody’s and A from Standard & Poor’s.

“The rating reflects our view of the Field’s consistent operating performance, adequate balance sheet measures for the rating, good fundraising, and progress against its long-range financial planning model,” said Standard & Poor’s analyst Jessica Matsumori in a report last year. “The aforementioned strengths somewhat offsets some of the credit risks regarding the size and repayment structure of the museum’s overall debt profile.”

The refunding would reduce letter of credit pricing risk and to reduce variable interest rate risk on the existing series of bonds to be refunded, IFA documents said.

The museum is working with counsel Quarles & Brady LLP, bond counsel Chapman and Cutler LLP.

The Field Museum is one of the world’s largest natural history museums, providing collection-based research, exhibits, and public education with a focus on diversity in the world’s physical environments and cultures. Its collections are composed of over 25 million professionally maintained natural objects and man-made artifacts. The museum and its collections originated and were an outgrowth from the World’s Columbian Exposition held in Chicago in 1893.

The board also signed off on the Shedd Aquarium Society’s proposed \$23 million refunding of insured debt that will also be directly placed with a bank – JPMorgan Chase Bank’s DNT subsidiary.

Shedd carries an A1 rating and stable outlook from Moody’s which was last affirmed in 2013. The refunding bonds will be secured by a pledge from the aquarium and not assets. “The proposed refunding will reduce annual debt service expense thereby providing surplus cash flow for program costs,” IFA documents said.

The Shedd is working with Chapman and Cutler as bond counsel.

The Shedd Aquarium Society was established in 1924 to construct, maintain and establish the John G. Shedd Aquarium for educational and scientific purposes, for the collection, care, study, and exhibition of fish and other aquatic animals and plant life, and the education of the public. The aquarium offers one of the largest collections of aquatic life in the world.

## **The Bond Buyer**

by Yvette Shields

JUL 21, 2015 2:31pm ET

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## **[S&P: Court Rejects Chicago's Pension Reform; City Needs New Plan to Address Its Ongoing Structural Imbalance.](#)**

CHICAGO (Standard & Poor's) July 24, 2015—A Cook County circuit court judge today ruled against Chicago's statutory pension reform for its municipal and laborers plans, determining it is not allowable under the state's constitution. The case was brought by unions and retirees that challenged Chicago's pension reform. Standard & Poor's Ratings Services expects the city to appeal the decision to the Illinois Supreme Court.

In the short term, the amount of the city's contributions would decrease, likely reverting to the previous statutory formula. Despite a temporary budgetary reprieve, the increase in the city's pension liability is a significant credit risk, and the limitations placed on the city to fund those liabilities increases the liability's growth. The long-term impact of drawing down pension assets is not quantified at this time, and the magnitude of the financial and legal implications for the city if the municipal and laborers pension plans become insolvent are uncertain. Ultimately, the loss of this case means more hurdles for the city in its attempt to address its growing pension liabilities. We will likely lower our GO rating within the next six months if the city fails to incorporate pension contributions in a structurally balanced manner.

Pension reform has been one of the city's ongoing challenges. In our most recent outlook on the city's general obligation rating, we noted that, during the following six months, Chicago would need to address both its current structural imbalance, as well as the looming pension pressures to maintain its rating. For more information, please see the analysis published July 8, 2015 on RatingsDirect. Despite a likely appeal, which would delay a final decision, the loss at the circuit court level should spur the city to consider alternatives. In our view, the ruling forces the city to identify a solution that does not rely on pension reform to manage the budget demands of its pension liabilities in the long-run — a particular challenge given Illinois' state statutes governing pensions.

We expect that the next six months will show how serious the city is about implementing both immediate and far-reaching plans to address the structural cracks in its budget, including creating its own pension solution. Given the uncertainties surrounding an appeal, however, we expect city management to consider contingency plans for addressing its liability regardless of the ultimate outcome. Without long-term structural fixes, the rating on the city's debt will continue to be pressured.

Under Standard & Poor's policies, only a Rating Committee can determine a Credit Rating Action (including a Credit Rating change, affirmation or withdrawal, Rating Outlook change, or CreditWatch action). This commentary and its subject matter have not been the subject of Rating Committee action and should not be interpreted as a change to, or affirmation of, a Credit Rating or Rating Outlook.

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credit risk, we offer a unique combination of global coverage and local insight. Our research and opinions about relative credit risk provide market participants with information and independent benchmarks that help to support the growth of transparent, liquid debt markets worldwide.

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## **Senate Panel Passes Tax Extenders Bill with Bond, P.R. Provisions.**

WASHINGTON — The Senate Finance Committee on Tuesday approved a bipartisan, modified two-year tax extenders bill that includes several provisions relating to bonds and Puerto Rico.

The modified bill, which the Senate's Joint Committee on Taxation estimated would result in \$95.62 billion of lost revenues, was passed by a vote of 23 to 3 and is being referred to the full Senate.

Committee members proposed more than 100 amendments, but most of them were withdrawn for not being germane or after members said they would bring them up before the Senate. The vote came as several committee members complained a number of the tax provisions should be made permanent rather than extended.

"My goal is to see many of these provisions made permanent," said committee chairman Sen. Orrin Hatch, R-Utah, who explained that he postponed this issue "for the sake of making this markup less contentious." Sen. Ron Wyden, D-Ore., the panel's top Democrat, noted that the bill will extend the tax provisions "past the next election."

The modified bill "expresses the sense of the Senate that Congress should pursue comprehensive tax reform that eliminates temporary provisions from the tax code, thus making permanent those provisions that merit such treatment and allowing others to expire, and that a major focus of tax reform should be fostering economic growth and lowering tax rates by broadening the tax base."

Ahead of the vote, Hatch modified the bill to, among other things, ease restrictions on qualified zone academy bonds and enterprise zone facility bonds.

The bill would provide a \$400 million national volume limitation for qualified zone academy bonds for each of 2015 and 2016. These bonds are tax-credit bonds whose proceeds can be used to finance renovations, equipment, course materials and teacher training at public schools or in academic programs that meet certain requirements. The volume cap is allocated to states, which can carry forward unused capacity under the limitation for up to two years.

Under current law, issuers have to certify that private entities will contribute property or services to the school with a value of at least 10% of the QZAB proceeds, but the bill was modified to lower that amount to 5%.

The modified QZAB provision in the bill is estimated to lead to revenue losses of \$258 million over 10 years, according to the JCT.

The \$400 million volume cap would be the same as the caps for each year from 2011 to 2014 and less than the caps of \$1.4 billion for each of 2009 and 2010. As is the case with QZABs from allocations of the caps for 2011 and later, the QZABs from allocations of the 2015 and 2016 caps could not be issued as direct-pay bonds.

The legislation also would extend empowerment zone designations through the end of 2016. By extending the designations, certain distressed communities would remain eligible for tax incentives.

The incentives include enterprise zone facility bonds, though issuers would only be able to issue the bonds in empowerment zones if the zones have remaining volume cap. Additionally, public schools in empowerment zones could be eligible to have projects financed with QZAB proceeds.

The modified bill would ease a requirement for enterprise zone facility bonds. Under current law, after three years businesses that benefit from the proceeds of the bonds must have 35% of their employees as residents of the empowerment zone or enterprise community where the business is located. Under the bill, this requirement can be met if 35% of the employees are from an empowerment zone, enterprise community or qualified low-income community within the locality where the empowerment zone is located.

The JCT estimated that the modified empowerment zone provision would cost the federal government \$647 million over ten years.

The bill would allow taxpayers in their 2015 and 2016 tax years to deduct state and local general sales taxes instead of state and local income taxes. This is particularly beneficial for taxpayers in states without income taxes for individuals, including Texas, Florida and Washington.

The JCT estimated that extending the sales tax deduction for two years would cost about \$6.7 billion from fiscal years 2016 to 2025.

Sen. Dean Heller, R-Nev., introduced an amendment he sponsored along with Sens. Maria Cantwell, D-Wash., John Thune, R-S.D. and John Cornyn, R-Texas, that would make the deduction permanent. But he withdrew it.

Cantwell said this provision had been in the tax code for years before it was repealed and then reinstated on a temporary basis. She said Congress should make the provision permanent. The House earlier this year passed a bill to make the deduction permanent.

In addition, the extenders bill would extend through the end of 2016 two Puerto Rico-related tax provisions.

One provision would temporarily increase the limit on the amount of excise taxes on rum that are covered over to Puerto Rico and the U.S. Virgin Islands. Under the bill, the territories would be able to receive \$13.25 rather than \$10.50 per proof gallon. The JCT estimated that extending this provision would lead to federal outlays of \$336 million over ten years.

The other provision would allow a domestic production activities deduction to be applied to activities in Puerto Rico. Under current law, special domestic production activities rules for the commonwealth apply for the first nine years of a taxpayer beginning after Dec. 31, 2005 and before Jan. 1, 2015. Under the bill, the rules would apply for the first eleven years of a taxpayer beginning after Dec. 31, 2005 and before Jan. 1, 2017.

Extending this provision would cost \$234 million over ten years, the JCT estimated.

Several other bond-related amendments were offered but not discussed during the committee meeting. One by Sens. Robert Menendez, D-N.J. and Michael Crapo, D-Idaho, that would exempt water and sewer private-activity bonds from state volume caps. Another By Sen. Chuck Schumer, D-N.Y., and four colleagues, would provide disaster relief, including by reinstating and extending several provisions enacted in previous years including disaster-specific bond authority.

## **The Bond Buyer**

## **[Eight Things We Learned from the Detroit Bankruptcy: Thompson Coburn](#)**

Detroit's historic trip through Bankruptcy Court ended in December 2014 with the confirmation of the City's Plan of Adjustment, which trimmed \$7 billion in debt from the city's balance sheet and promised improved resident services. At the beginning of the case, no one predicted that the city would emerge from bankruptcy so quickly — only about 18 months — or that the final Plan of Adjustment would enjoy such widespread support among creditors and politicians. What can we learn from the largest municipal bankruptcy ever?

**1. Not all municipalities can take advantage of Chapter 9.** Detroit's very first battle after it filed for bankruptcy was whether it was even eligible to do so. This dispute underscored a little known fact: Most U.S. municipalities are unable to file for Chapter 9 bankruptcy. A Chapter 9 filing must be "specifically authorized" by the law of the state where the city is located. So, in the case of municipal bankruptcies, the states themselves control access to the bankruptcy courts. About one-half of the states do not say anything at all about Chapter 9, so the municipalities in those states lack the "specific authority" to file bankruptcy. Other states, such as Michigan, have very rigorous prerequisites that must be satisfied before filing. Missouri law specifically permits most municipalities to file Chapter 9. Incidentally, the term "municipality" is much broader than "city." Other political subdivisions, such as water, school or levy districts, are also included within the definition of "municipality." States cannot themselves file bankruptcy, so Illinois will have to find another way to solve its financial problems. Even if a municipality can file bankruptcy, however, there is another very important threshold question.

**2. Can public pension obligations be modified in Chapter 9 cases?** Private industry long ago mostly moved from defined benefit pension plans to defined contribution plans. But defined benefit plans are still popular for government employees, including many municipal employees. Many states, including Michigan, have special protections for public pensions in their statutes or even their state constitutions. For instance, Michigan's state constitution says: "The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby." Therefore, when Detroit filed its case, there was a legitimate question about whether the public pensions could be modified in the Chapter 9 case.

Michigan's Attorney General argued that Michigan's constitution absolutely prohibited any restructuring of vested pension benefits. Not surprisingly, various retiree groups also opposed the city's efforts to reduce pension benefits. The bankruptcy judge ultimately determined, however, that pension benefits were not entitled to any more protections than any other contractual benefits and permitted Detroit to propose a plan that reduced vested benefits. The judge in the Stockton, California, Chapter 9 case ruled the same way a few months later. Public retirees can no longer assume that their vested benefits are sacrosanct. A definitive trend is developing in the law that a federal bankruptcy court can modify those kinds of benefits, even though state or local law suggests that they cannot be modified.

**3. Bondholders and pensioners vs. residents.** The Detroit case was mind-numbingly complex; one observer called it the Olympics of Restructuring. But in its simplest terms, the case was all

about balancing the interests of three groups:

- Bondholders who held billions of dollars of debt issued by Detroit or its city agencies and for whom the prospect of a massive municipal default was utterly unthinkable.
- Retirees who had worked for the city for decades at below-market wages but who looked forward to a stable pension in their retirement.
- And the city's residents, who had seen city services deteriorate to a level not often seen in this country; indeed, one Forbes columnist called Detroit "America's first Third World city."

Each of the three groups had strong legal and equitable arguments that they claimed should be favored at the expense of the others. The bondholders argued that the entire municipal finance market was predicated on a municipality's solemn promise to pay the bonds, no matter what, and that the cost of municipal credit would increase all across the country if Detroit were permitted to default. The retirees argued that their pensions were not overly generous (the pensions generally ranged from \$1,500 to \$3,000 per month) and pointed out that many of the former employees were ineligible for Social Security because they did not have sufficient service time in the private sector. The residents pointed to Detroit's dramatic population decline, from 1.8 million in 1950 to less than 700,000 in 2013, as evidence that its residents were "voting with their feet" by leaving the City whenever they were able.

Of course, there were also many differences within the three major groups. Some of the bonds (but not all) were insured by large insurance companies, but the exposure of the bond insurers was so large that their own existence was threatened if they had to pay out. Some bonds were secured by income streams from specific projects, but others were not. Even the pension obligations were complicated. The police and firefighters had a separate pension plan from the other retirees, and it was in considerably better financial shape than the general plan. Moreover, the former city employees were entitled to other post-employment benefits (called "OPEB" in pension parlance) in the form of health and life insurance benefits that were not pre-funded at all. When everything was totaled up, Detroit had a staggering \$18 billion or so in liabilities.

**4. It really helps to own a \$1 billion art collection.** Along with its 78,000 abandoned buildings and 70 Superfund sites, Detroit also happened to own a world class art collection that included Van Gogh's "Self-Portrait," Rembrandt's "The Visitation," and Matisse's "The Window." Detroit's involvement in the art world dated back to 1919, when the City bailed out its then-bankrupt local art. In the 1920s, when Detroit was riding particularly high, the museum went on a buying spree and accumulated a collection that was the envy of museums in much larger cities. By 2013 when Detroit filed Chapter 9, the art collection was probably the city's most valuable asset, and the bondholders and retirees, who could agree on almost nothing else, both argued that it would be unfair for Detroit to keep its valuable artwork while asking for creditors to take deep discounts. After months of legal wrangling and public sniping, with estimates of the art collection's value ranging from \$350 million to \$2 billion, the parties reached the so-called "Grand Bargain."

This agreement, forged in dozens of court-ordered mediation sessions, formed the cornerstone of Detroit's bankruptcy plan. The deal called for the transfer of the art collection to a charitable trust in exchange for \$816 million contributed from the State of Michigan, private donors, and several large charitable foundations, including the Ford Foundation, which donated \$125 million itself. The retirees had to agree to accept relatively modest reductions in their monthly pensions (less than 5%) but future cost of living adjustments were eliminated. Also, almost all of the other post-employment benefits, such as retiree health care and life insurance, were slashed or eliminated.

**5. Retirees fared much better than bondholders.** The consensus is that the retirees fared much better than the bondholders in Detroit's case, and that the disparity in treatment was as more

because of political concerns than legal distinctions. For instance, the funders of the Grand Bargain insisted that their contributions go toward shoring up the pension plans — not into the pockets of the bondholders. As the case progressed, the judge, the court-ordered mediators, and the other parties began clearly discounting the bondholders' arguments that the entire U.S. municipal bond market would be harmed if Detroit did not pay back its bond debt in full. The city reached agreements with its other creditor groups before turning its attention to the bondholders (or more precisely, the companies that insured the bonds against a default). Faced with the prospect of being the only remaining major hold-out, the bondholders began a frantic round of last-minute deal making.

For instance, Detroit and Syncora (one of the largest bond insurers) reached a deal that will set the creativity bar very high for future settlements in other cases. Syncora just happened to own the company that operates the Detroit-Windsor tunnel, having acquired that company when it filed bankruptcy several years ago. The lease on the tunnel was set to expire in 2020. As part of its settlement with Syncora, the City of Detroit agreed to extend the tunnel lease through 2040, and to give a Syncora a long term lease on a city-owned parking lot, conditioned on Syncora's commitment to make \$13 million in improvements on the garage. The city also gave Syncora credits to purchase additional city-owned property in the future, including the old Joe Louis Arena. Similarly creative arrangements were reached with the other major bond insurer.

**6. Not all bonds are alike.** The bondholders were treated very differently, depending on the types of bonds they held. Some of the bonds that were well secured by project revenues will actually receive payment in full. Other bonds, which were secured by little or no collateral, will receive as little as 15% of their claims. This result turned the municipal bond market on its head. Historically, the bond market has considered so-called "general obligation" bonds as the safest debt that a municipality can issue because the municipality can always raise taxes to make bond payments. Special revenue bonds, on the other hand, have historically been viewed as more risky because the bond payments could come only from the collateral securing them. In the Detroit case, however, "general obligation" bonds were considered unsecured claims that are typically among the last to receive any payment in a bankruptcy case. To-date, however, the gloom and doom predictions about the future of the municipal bond market have been unfounded.

**7. Municipal reorganizations are expensive.** The total bill for Detroit's bankruptcy professionals was around \$170 million, or about \$10 million per month. Jones Day, the city's lead bankruptcy counsel, is set to collect over \$51 million in fees, which it claims equates to about \$17 million in discounts from its normal billing rates. Dentons, the lead bankruptcy counsel for the official retirees committee, made over \$14 million. Dozens of other law firms and consultants also worked on the case. A law firm was even appointed to review and monitor the other professionals' bills, and that firm has been paid over \$500,000.

**8. City services should improve.** Residents and visitors to Detroit have long endured abysmal city services. The average response time for a Detroit police call in 2013 was 58 minutes, compared to 11 minutes nationwide. Forty percent of the city's street lights were burned out in 2013. As part of the bankruptcy restructuring, Detroit plans to spend \$1.7 billion over 10 years in so-called reinvestment and restricting initiatives, including \$400 million to demolish the 78,000 or so blighted or abandoned buildings, \$91 million to replace police vehicles — more than half of which are over 10 years old — and \$152 million in IT expenditures — about 80% of the city's computers still run Windows XP.

Thankfully, Detroit is sui generis. No one expects a flood of municipal bankruptcies based on the relative success (at least insofar as we can tell at this point) of Detroit's restructuring. Missouri's large cities, however, are not immune from some of the same pressures and problems that

contributed to Detroit's financial melt-down.

## **Thompson Coburn LLP**

**Article by David A. Warfield**

**Last Updated: July 21 2015**

(This article originally appeared in Missouri Lawyers Weekly.)

*The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.*

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### **[IRS Memo: Procedures for Conducting Examinations of Direct Pay Bonds.](#)**

The IRS has issued a memo to all employees entitled, "Interim Guidance - Procedures for Conducting Examinations of Direct Pay Bonds."

The memo provides guidance to tax-exempt bond examiners and managers on conducting examinations of direct pay bonds, such as Build America, clean renewable energy, and qualified zone academy bonds.

The memo is available [here](#).

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### **[S&P Analysts Address Questions on U.S. Higher Education Challenges, Credit Trends, and Sector Outlook.](#)**

NEW YORK (Standard & Poor's) July 20, 2015—Standard & Poor's Ratings Services U.S. public finance analysts hosted an interactive webcast on July 13, 2015, to discuss credit trends and the outlook for the higher education sector. The webcast, which was held in conjunction with the publication of our annual median ratios reports on public and private institutions, featured discussion of hot-button topics such as how U.S.-based public and private colleges and universities are balancing their budgets and addressing increased competition, as well as trends in bond issuance, state appropriations, capital spending, and student demographic shifts.

More than 400 attendees including investors, issuers, and university and college administrators participated in the hour-long discussion. Here is a summary of the key takeaways from the Q&A portion of the webcast.

**General trends in fiscal 2014 medians:** Our analysis shows flat to slightly decreasing operating margins over the previous year, strong investment returns, improvement of balance sheet ratios, and a growing gap between rating categories.

**State appropriations outlook:** Most public universities have seen state appropriation reductions in recent years. While we have seen some stabilization in state appropriations in fiscal 2014, we do not expect appropriations to rebound to pre-Great Recession levels in the near term due to the slow economic recovery in many states and competing state budgetary priorities.

**Balancing budgets:** In an environment of stagnant margins, public and private universities have generally focused on “low hanging fruit” initiatives in terms of cost controls for the past several years, though cost-cutting efforts have increased for many in recent years. Many rated institutions cited a number of efforts including creating efficiencies by restructuring internal computer systems and responsibilities of staff, leaving staff vacancies open, prioritizing maintenance related to safety and holding off on other projects, limiting staff travel, and closely monitoring budgets.

**Competition for students:** Colleges and universities across the nation are facing increased competition for students, not just in areas with declining college student populations, but even in areas where the demographic trends are favorable. Students are applying to more schools, in part due to the ease of application submissions process, and also to broaden their program and financing options. This increased competition, and universities’ heightened sensitivity to affordability, has led to a number of recruitment strategies to entice students, including: new or modified financial aid packages; increased student services; flat or declining tuition rates; adjusted class or degree offerings or requirements for a degree; or expanded recruitment into new national or international markets.

**Debt issuance trends:** In the first half of calendar 2015, Standard & Poor’s saw increased activity in refundings as well as new money issuances, particularly in the higher rated categories for institutions with additional debt capacity. After several years of delayed capital projects or keeping themselves on a “debt diet,” many issuers have come to market to take advantage of a favorable interest rate environment and move forward with decisions on strategic projects. We expect to see the effect of these issuances in the fiscal 2015 ratios.

**Pension issues:** We expect GASB 68 to impact public university balance sheets since several public universities we rate participate in large defined benefit pension plans administered by their respective states and several state pension plans are unfunded. This liability recognition will, in our view, likely reduce the size of university unrestricted net assets (which is an equity-based measure) for fiscal 2015 and future years. While we have received estimates from several universities for their share of these unfunded liabilities, ultimately, this is a reporting requirement and there is no requirement to cash fund these liabilities. At this time, we do not anticipate any rating changes due to this reporting requirement, as the ultimate responsibility for these pension liabilities is not expected to change.

Standard & Poor’s private college and university median ratios report covers 263 universities from small regional colleges to large, national or international research universities. The public university median ratios report covers 163 institutions and includes standalone flagship and regional universities as well as several large systems.

Our reports reflect fiscal 2014 figures, which is the most recently available audited financial data and corresponding fall 2013 enrollment information. During the webcast, we provided an interpretation of those numbers while also projecting our expectations for this past year, fiscal 2015, based on historical trends, preliminary and draft financials, and multi-year budgets as well as what we have learned from management meetings.

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## **[NABL: Disaster Tax Relief Bills Introduced in House and Senate.](#)**

Legislation has been introduced in both the House and Senate that would provide tax relief to areas affected by disasters. The bills, which include several bond provisions, would create a new section in

the Internal Revenue Code for qualified disaster area recovery bonds (which will inevitably be referred to as QDARBs). These bonds would be treated as an exempt facility bond and would not be subject to section 146, but the maximum amount a state can issue would be \$10 billion. The bonds must be issued by a state or political subdivision that is part of the federally-declared qualified disaster area. At least 95% of the proceeds must be used for qualified project costs.

Both bills have bipartisan support. In the Senate, [S. 1795](#) has been referred to the Finance Committee. [H.R. 3110](#) has been referred to the House Committee on Ways and Means.

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## **[Webinar Replay - MCDC: What Comes Next For Muni Underwriters?](#)**

The web seminar, MCDC: What Comes Next For Muni Underwriters?, sponsored by Lumesis and brought to you by The Bond Buyer, has taken place.

**Attendees listened to an engaging panel discussion and asked our experts questions about:**

- Where the SEC is with Orders and Disqualifications.
- The role of the Independent Consultants.
- How Underwriting procedures and deal-making have been affected by MCDC.
- Resources for Post-MCDC Compliance.

[View web seminar recording on-demand.](#)

[Download slides from this web seminar.](#)

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## **[MSRB Documents System Hours in EMMA, RTRS and SHORT Information Facilities.](#)**

The Municipal Securities Rulemaking Board (MSRB) today filed with the Securities and Exchange Commission (SEC) a rule change to the MSRB's core operational hours relating to the MSRB's Electronic Municipal Market Access (EMMA®) system, Real-time Transaction Reporting System (RTRS) and Short-Term Obligation Rate Transparency (SHORT) system.

The rule change will be made operative on August 24, 2015.

[View the regulatory notice.](#)

[Read the rule filing.](#)

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## **[MSRB Announces Regulatory Topics to be Discussed at Upcoming Board Meeting.](#)**

The Board of Directors of the Municipal Securities Rulemaking Board (MSRB) will meet July 29-30, 2015 where in addition to addressing corporate issues and electing new members and officers, the Board will discuss the following rulemaking topics:

### **Best Execution Guidance**

The Board will review draft guidance for municipal securities dealers regarding [MSRB Rule G-18](#), on best execution, which is effective December 7, 2015.

### **Confirmation Disclosure**

The Board will discuss next steps on its [proposal](#) to require dealers to provide disclosure of pricing reference information on retail customer confirmations.

### **Investor Representation on the Board**

The Board will discuss comment letters received on its [proposal](#) to modify the application of the standard of independence under [MSRB Rule A-3](#) for the one public member of its Board of Directors designated to be representative of institutional or retail investors in municipal securities.

### **Uniform Practice Rule Review**

The Board will discuss a request for comment on proposed changes to [MSRB Rule G-12](#), on uniform practice, as part of the MSRB's [regulatory efficiency initiative](#).

### **Delivery of Investor Brochure**

The Board will consider changes to [MSRB Rule G-10](#), on the delivery of the investor brochure and the customer complaint process, as part of the MSRB's regulatory efficiency initiative.

### **Holistic Fee Review**

The Board will discuss the findings of a holistic review of all fees on regulated entities and consider possible changes to MSRB [Rules A-12](#) and [A-13](#).

### **Trade Settlement Cycle**

The Board will discuss the securities industry initiative to shift to a T+2 settlement cycle from the current T+3.

*This list is subject to change without notice. A summary of actions taken by the Board at the meeting will be sent to regulated entities and published on the MSRB's website following the meeting.*

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## **[P3s: Managing Risks And Rewards - Thompson Coburn](#)**

Successful P3s—Public-Private Partnerships—can be blessings for state and local governments searching for new ways to finance many types of critical “infrastructure”—roads, schools, prisons, and more—and control operating costs. In typical government contracting arrangements, the governmental entity designs and bids an infrastructure project and the successful private bidder only builds it for governmental operation. In contrast, a typical P3 involves a “design-build” or “design-build-operate” arrangement where the government cedes control of an initiative’s design, construction and/or operation to a private contractor—albeit with specified performance parameters—in exchange for reduction in construction cost, operating cost, or financing risk.

Some P3s—e.g., the Indiana toll road contract—allow the private contractor to retain revenues from an existing project over a multi-year period in exchange for a hefty up-front payment and maintenance and operational covenants. Others, like the Chatcomm arrangement spearheaded by Sandy Springs, Georgia, use private expertise primarily to provide services like emergency dispatch while the government and the private contractor share both revenue and capital costs, and the parties collaborate to expand the market for the services.

Interest in P3s is growing as governments search for ways to access expertise, deflect risk, speed up project completion, lower capital and operating costs, avoid public votes and increased taxes, and keep what might otherwise be counted against public debt limits “off the books.”

This tool is worth a hard look for any capital-strapped governmental entity in need of new infrastructure. But public officials must approach potential P3 arrangements with eyes wide open and a clear understanding of both prospective benefits and prospective risks.

Similarly, P3s can be a source of profit and accolades for private partners in a P3 venture. But private partners, too, must carefully evaluate potential benefits against a variety of risks: If a private entity accepts responsibility for long-term situations it cannot control or pledges too much of its capital and borrowing power to a single project, then the entity places its overall future at risk.

These arrangements must be carefully structured from both sides of the partnership to create the desired “win-win.” Without well-informed attention to detail and more than a modicum of foresight, a P3 can cause significant damage to both public and private reputations and balance sheets.

### **P3 Types and Considerations: A Very Wide Range**

Structuring a P3 is very challenging because P3s come in an almost unlimited variety of flavors, depending on the public entity’s goals.

Some types are familiar, like the federal low-income housing tax credit, or LIHTC. That program was intended in part to shift responsibility for providing affordable housing for the nation’s working class families from traditional “housing authorities” to the private sector. The LIHTC program shifts cost, operating, and financing risks to the private developer. It accomplishes its goal of providing affordable residential rental units by subsidizing annual debt service and operating costs with federal tax credits and limiting the rent the private developer can charge. Because this specific type of P3 has a sufficiently long history and is appropriately targeted to one particular purpose, most of the potential “bugs” have been worked out of the structure, and the program is generally considered a success.

At the other end of the spectrum, some P3s are essentially “one offs”—that is, there is no universally accepted and time-tested model for the contract arrangement. Those P3s present greater uncertainties and risks for public and private partners alike. For example, in certain P3 structures, a private company can theoretically guarantee completion. But, if the company lacks sufficient capital to cover its mistakes or has other costly commitments that eat up its capital cushion, the private company could become insolvent during construction and force the public sector to either assume responsibility (and cost!) for construction completion or face the specter of a half-completed highly visible eyesore while the default is litigated in court. Similarly, if a company charged with a project’s long-term operation experiences financial difficulty or insolvency, the public sector could be forced to assume the project’s maintenance and operational responsibility at a cost potentially far greater than what it would have paid the private company.

Conversely, a new mayor or governor may unfairly seek to void a P3 arrangement before the private partner has recouped its costs and made a reasonable return. If the public partner cannot or will not be fair and businesslike in administering its side of the arrangement, the private partner may ultimately win the legal battle but lose the war because legal fees have eaten up all its spare capital and its public adversary is effectively “judgment proof.”

### **P3 Risk Management: A Framework**

The risk that both sides may lose in a P3 deal can increase if the deal is “too good” for either side. An important key to successful P3s is responsible management of risks and benefits—that is, an allocation that is fair to both parties.

In a P3 whose structure is relatively “simple”—for example, the public sector seeks to shift only construction cost and possibly operating cost risk to the private sector—associated public sector risks can be mitigated to a significant extent by careful up front due diligence and by incorporating protections like net worth maintenance requirements or letters of credit into the construction and operating documents. Associated private sector risks can be mitigated by including clear parameters for design and construction outcomes, sharing arrangements for mitigation of unforeseen circumstances, and fair, carefully drafted cost-escalation provisions in the agreements. In long-term arrangements, both partners must recognize that the future is uncertain and that innovation or public policy changes may impact the validity of demand or cost projections.

In P3s that rely on the private sector to generate all of the income required to pay project-related debt, due diligence becomes much more complex. Both public and private sector risks grow exponentially. Future market considerations enter prominently into risk calculi. The failure of a public-private team to accurately predict the future—a nearly impossible task—or appropriately acknowledge and assign or share uncertain long-term risk can crater a project or strangle new related initiatives at any stage of the project’s development or operations. For example, few would have predicted the sustainability movement’s popularity twenty or even ten years ago. Today, sustainability-related initiatives have a conspicuous impact on both private demand and public sector appetite for parking and highway construction on the one hand and mass transit and recycling on the other.

Equally important, both private and governmental entities moving down the path toward a P3 partnership must have the courage to pull off the road when a collision of interests is imminent. That can be very hard when a company or a government has invested significant amounts of time and money in documenting a deal that has been essentially “promised” to shareholders or constituents. Deal momentum snowballs in the rush to schedule the groundbreaking, fill a gaping budget hole, or announce a big contract to shareholders and deal documentation can easily pick up unintentional debris in the dash to the finish line. If obstacles to a successful relationship seem insurmountable or the deal presents risks that have not or cannot be reasonably allocated or shared in a manner that adequately protects each party’s interests, it may be time to put on the brakes regardless of how near the finish line may seem.

But civic progress and private-sector profits cannot be forged without a willingness to take risks—only large quantities of guts can lead to glory. Less publicized P3 successes match or overshadow highly publicized P3 failures. Success or failure depends on how well each partner plans ahead and how realistic each partner can be.

### **Important P3 Precepts**

While public and private sector motivations vary in each P3, in all P3s the government partner attempts to tap private sector expertise and financial resources while the private partner hopes to make a profit. Successful and unsuccessful partnerships of the past offer valuable lessons and can help both private and public partners considering P3s negotiate deals that make sense for both.

### **Long-term implications**

Government officials and private decision-makers must carefully consider the long-term public policy implications of the deal under consideration. Will it unacceptably limit the government’s ability to

monitor and refine long-term strategies to address changing needs? If an agreement prohibits the development of new roads in an area served by a P3 toll road, citizens may be forced to endure unacceptable traffic congestion for the term of an agreement which may last many decades. If an agreement prohibits expansion of a region's mass transit system to preserve demand for a toll road, that region's sustainability efforts may be intolerably hampered—and the only remedy may be for the public sector to “buy back” the project at significant cost and re-assume the operating and maintenance burden when the public sector's primary interest in the agreement in the first place was to shed that burden. If an agreement requires a private company to operate and pay for operating a facility when that private entity cannot control the market for the facility's “outputs,” the company's assets can be decimated even to the point of bankruptcy.

As a corollary point, if the P3 contractor will be expected to generate the revenue that will pay for the project, both government and private-sector officials must each assess the long-term “market” for the improvement as accurately as possible. The operating pro forma must make sense for each party and the P3 agreement must allow for changes in that pro forma as new situations develop. It is impossible to make market predictions for two, three, or four decades into the future. New technologies are coming on the market every day and public policies change over time. Such issues can be addressed by reasonable partners: for example, instead of inking a 75-year “all or nothing” term, the partners can agree to 5-year or 10-year agreement increments where each partner may decline to renew the agreement at the end of the incremental term but once the agreement is renewed neither can terminate during the renewal period. That arrangement strikes a balance between predictability and inability to foresee what tomorrow will bring: either party can completely bow out when the agreement comes up for renewal but, if the working relationship has been a good one, it is more likely that each party will view the renewal as an opportunity to tweak the agreement and work out bugs.

### **Risk allocation**

Public officials must think carefully and be reasonable about risk allocation. Each partner must understand, empathize with, and fairly respond to the legitimate concerns of its counterpart. Risk allocation imbalance is dangerous for both sides. If the government unreasonably over-allocates risk to the private sector partner, either no one will respond to the request for proposals or those who do respond will be more likely to fail because they have little experience in evaluating and quantifying P3 types of risks. If the private partner loads too much risk on the public partner, the government will be criticized by its constituents. Appropriately balanced risk is the hallmark of a win-win deal.

A corollary here is that the private sector partner must always remember that all of the terms of a P3 deal are public. Virtually all governments are subject to some type of “Sunshine law” that enables reporters and others to access virtually all of the final documents involved in any deal. Each P3 deal must withstand public scrutiny—if a big or even medium-sized deal cannot pass a “smell test,” it is likely that some reporter will discover the deal's flaws by poring through the public record.

### **Non-compete provisions**

Each party should think hard before it agrees to overt or “disguised” non-compete provisions. For example, a trash-to-energy arrangement may require the public sector to deliver a minimum volume of trash each month to a privately owned incinerator at a set price for a multi-decade term. Prospectively, that may look like a reasonable private sector “ask” but, in hindsight, such a provision could prevent the government from competing with the private incinerator by diverting part of its waste stream to a recycling facility. As discussed above, consider building flexibility into long-term agreements so that deal terms can change as the future changes. The public sector can be willing to pay more (or receive less on the front end) for future flexibility, or the agreement could include

provisions for renegotiation if the public sector wishes to address new policy goals that impact the P3 contractor's reasonable expectations.

### **Picking partners**

Both parties must choose their partners carefully. A government with an unstable political climate will be a bad partner for an established private company because political battles can lead to capricious reconsideration of decisions and generate bad publicity for the company as political opponents seek to discredit each other. A government with an unfriendly business climate may, wittingly or unwittingly, hamper the project's success. A private partner with little experience and a thin balance sheet may not be able to adequately evaluate risk or fulfill its commitments without significant insolvency concerns. Careful due diligence on both sides of the partnership is essential for P3 success: mistakes are inevitable and each partner must be able to responsibly and successfully shoulder its negotiated share of responsibility for those mistakes.

### **Quality assets**

Both parties must also look carefully at the quality of the public sector "assets" upon which the deal is predicated. Is there a market for the asset or service? Is that market likely to grow or decline? Will the government partner support or thwart private efforts to sustain and grow the market? Can and will the private partner invest sufficiently in the asset to fulfill the government partner's goals? What happens if the market assessment was "off"?

### **No time to experiment**

Each party should approach untested technologies with a large grain of salt. P3s should not be viewed by either party as opportunities to experiment: risks associated with experiments are difficult if not impossible to allocate and a failed experiment will inevitably generate bad press.

### **Unrealistic burdens**

Beware of projects that attempt to address too many goals by placing unrealistic burdens on the private partner. If a project is overburdened with requirements that do not relate directly to the core purpose of the project—e.g., excessive minority participation, local training, and workforce requirements—the cost of the project will escalate. The private contractor may understandably pad its budget because it lacks experience in addressing such requirements. The public sector may be accused of overpaying—or accused of failing to insist that the contractor fulfill unreasonable ancillary requirements.

### **Knowing when to fold**

To reiterate: both private and governmental entities moving down the path towards a P3 partnership must have the courage to pull the plug when goals are irreconcilable. If it becomes apparent that obstacles to a successful relationship present risks that cannot be reasonably allocated or shared in a manner that adequately protects each party's interests and gives each party a reasonable chance of success, it may be time for everyone to cut losses—or at the very least ensure that a "no fault" termination option exists at an early stage of a potentially long-term relationship.

### **Legal authorization**

Each party should make sure that federal, state and local law permit the type of P3 arrangement contemplated. While local government charters and other organizational documents are often flexible as to the types of contracts permitted, a local P3 will almost certainly require passage of a

specific law that authorizes the particular P3 agreement. On the federal and state levels, special legislation empowering agencies to enter into P3 types of arrangements is almost always required, although many states and the federal government have recently enacted legislation authorizing some types of P3s. On a related note, if federal or state funding is used even in what is essentially a local project, special federal and state requirements will likely apply. Failure to understand those requirements can significantly dampen the victory of an otherwise successful project: federal inspectors general can demand that improperly spent funds be repaid and state auditors can chastise, to the embarrassment of everyone involved.

### **Seek professional help**

Each party must be willing to invest in good professional help in structuring the P3 agreement—and must be willing to pay for that help, even if it ultimately decides to crater the prospective deal. Private parties unused to dealing with prevailing wage, public bidding, and local benefit concerns may find themselves saddled with unanticipated costs and negative media coverage. Public parties unused to negotiating with sophisticated businesspeople may lose on key points if they cannot benefit from equally sophisticated help.

A good investment in quality front-end services from professionals experienced in P3 deals can help public and private partners avoid the pitfalls and achieve the benefits that potential P3 arrangements present.

Last Updated: July 17 2015

Article by Barbara A. Geisman

Thompson Coburn LLP

This article appears in the current newsletter of the St. Louis chapter of the Association of Corporate Counsel.

*The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.*

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## **[Texas' Property Tax Infrastructure Districts: Ongoing Growth Contributes To Credit Stability Despite Concerns Over Low Oil Prices.](#)**

We recently affirmed our ratings on 116 unlimited property tax infrastructure districts in Texas. The primary purpose of these districts is utility service or infrastructure provision; they are usually created at the request of real estate developers seeking to benefit from tax-exempt financing of infrastructure improvements to serve future development. The sector has seemingly demonstrated favorable credit quality over the past four years, and we expect continued credit stability for the foreseeable future despite concerns over the impact of currently low oil prices. The energy sector, which has historically been the state's predominant industry, helped to insulate Texas from the effects of the national economic downturn and has more recently contributed to its recent growth. However, we have seen recent growth and diversification in other sectors, including Houston's medical industry and Austin's technology sector.

The full S&P report is available for purchase [here](#).

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## **S&P U.S. State and Local Government Credit Conditions Forecast: Financial Management Stands Out In an Age of Economic Limitations.**

With little fanfare, the current U.S. economic expansion marked its sixth anniversary in June. Any cause for more celebration was dampened by weaker-than-expected performance in the first quarter, when real GDP contracted by 0.2%. The dip—owing mostly to temporary factors—means state and local governments once again will likely have to settle for a year of subdued economic growth. In Standard & Poor's Ratings Services' view, the persistence of a slow recovery has increased the relative importance of financial management in terms of the strength of state and local government credit profiles. The overall positive tilt we continue to see in the balance of our rating changes, therefore, reflects that the sector as a whole has continued to embrace a certain amount of fiscal austerity. Nowhere is this more apparent than in state and local government payrolls. Whereas, by May 2014, the overall U.S. economy had recovered all 8.7 million jobs lost during the Great Recession, even as of June 2015 the state and local government sector still had replaced only 17% of the 758,000 jobs it shed.

Absent the stronger revenue trends that would likely accompany a more robust economic expansion, we've observed that many state and local governments have maintained leaner operations. Those that have done so have been able to hold the line financially and, in many cases, maintain or rebuild their reserves. But it's not universal. We've found that credit deterioration is most likely to occur where pockets of either acute or sustained economic distress couple with imprudent financial management. Recent events in Puerto Rico illustrate, albeit as a more exaggerated example, how protracted economic contraction and weak financial management practices can undermine credit quality.

### **Overview**

- Continued slow GDP growth will require state and local government financial managers to maintain and follow prudent policies.
- The aging of society, including governmental workforces, and higher pension costs are a source of fiscal pressure for some governments.
- We project that growth will accelerate somewhat in most regions in 2016.
- Growth will likely be highest in the Mountain region in 2015 and in the South Atlantic in 2016 and lowest in East South Central in 2015 and in New England in 2016.

[Continue reading.](#)

22-Jul-2015

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## **Auditor: TIFs good for Denver**

Tax-increment financing use by the Denver Urban Renewal Authority has been good overall for Denver, according to a new white paper by the Denver auditor's office.

The sometimes controversial urban-renewal tool has been used to redevelop many areas in Denver. An audit shows that 42 tax-increment financing districts in place between 2004 and 2014 showed that TIF areas and projects were generating significant revenues and that overall, 80 percent of the total TIF amount outstanding has been paid off.

Tax-increment financing defers taxes for property declared as blighted for a specified period of time, allowing developers to invest in improvements on property that otherwise wouldn't be developed. The smaller tax burden leaves more money available to finance the project and often is the difference between whether a project gets built or not.

Proponents of TIF say that it draws developers that might not otherwise be interested in a particular project or piece of property, but it hasn't been without controversy.

Opponents say such programs need more oversight and unfairly allows cities to make tax decisions that impact counties, school districts and other taxing entities.

Of the 42 projects analyzed by the auditor's office, 31 of them are still considered active. Of those, eight have generated more tax revenue than the original amount of the TIF, the report said. These projects have resulted in total tax collections of \$446 million from 2004 to 2014, exceeding the \$385 million in TIF initially awarded to them.

Another 23 TIF districts are partially repaid, ranging in percentages paid back between .02 percent and 96 percent. Eight of these fall on the very low end of the spectrum for repayment, from .02 percent to 25 percent and have an average remaining term of 17.6 years.

Seven TIF districts are between 25 percent and 75 percent paid back, according to the auditor's report. Finally, five active TIF districts have paid back 75 percent or more of their TIF.

Two TIF districts in Denver are performing "marginally," the report said.

Alameda Square, at West Alameda Boulevard and South Zuni Street received \$7.3 million in tax increment financing, of which 40 percent has been paid back. A Lowe's home improvement store that was once the anchor of the redevelopment closed, leaving the building vacant for years until it was acquired earlier this year. Costco Wholesale Corp. has plans to open a Costco Business Center there.

The Cherokee redevelopment site, formerly the Gates Rubber Plant, is also listed as a "marginally" performing TIF district, with 1.8 percent of its \$85 million in TIF paid back, with 13 years left on its TIF term. Last September, the site was acquired by Frontier Renewal which is working on plans to develop the highly anticipated site into a mixed-use, transit-oriented development.

"As this analysis shows, TIFs over the last decade have not only met their pay-off obligations, they have in some cases generated additional tax revenue prior to their pay-off dates," said the auditor's report. "More importantly, because the properties were generating limited or no tax revenue prior to TIF funding, the projects have provided additional tax revenue to help the city and county of Denver."

Other parts of the metro are beginning to raise concerns about tax-increment financing. Littleton recently passed a ballot measure that will allow residents to vote on any TIF deal by the city, and Wheat Ridge plans to vote on a similar measure this November.

Likewise, Northglenn and Glendale have recently been involved in eminent domain struggles, another component in urban-renewal law that is often contested.

Earlier this year, the state Legislature passed, and Gov. John Hickenlooper signed a controversial piece of urban-renewal law that gives non-city entities such as counties and special districts three voting seats on 13-member urban renewal authorities that have been formed by municipal officials.

Development officials and financiers said at the time of the bill's signing that it could bring high-profile projects, including the redevelopment of the Gates Rubber site, to a halt.

KATHLEEN LAVINE | DENVER BUSINESS JOURNAL

Jul 20, 2015, 2:19pm MDT

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## **[Morristown Memorial Hospital: A Tax Exemption Ruling All Nonprofit Hospitals Need to Know About.](#)**

A recent New Jersey Tax Court decision has nonprofit entities on edge. The decision may offer tax authorities the opportunity to pursue payments from nonprofit hospitals and may result in the redefining of tax exemptions by state legislators.

On June 25, 2015, the Tax Court of New Jersey held that Morristown Medical Center, a federally tax-exempt organization and New Jersey nonprofit corporation, should pay property taxes on virtually all of its 40-acre property in Morristown, New Jersey. Judge Vito Bianco ruled that the hospital failed to meet the legal test that it operated as a nonprofit, charitable organization under the state tax law for tax years 2006 through 2008. The ruling puts \$2.5 million per year in play for each year covered by the decision.

The decision is unique in that it evaluated the entangled nature of the hospital's for-profit and nonprofit affiliates as compared to the more traditional approach of counting charitable contributions as the principal indicator of nonprofit status in order to decide to eliminate the hospital's property tax exemption. The ruling was limited to the hospital's state property tax exemption and did not affect its federal tax status as a nonprofit.

The Court stated that for-profit activities carried out on tax-exempt property must be "conducted so as to be evident, readily ascertainable, and separately accountable for taxing purposes." In rendering the decision the Court focused on the "blurred lines" between the hospital's nonprofit and for-profit activities with a specific focus on several aspects of its "labyrinth" and "entangled infrastructure." Specifically, Judge Bianco focused on the hospital's executive compensation arrangements with hospital executives, compensation paid to employed physicians, and third-party arrangements with service providers.

In evaluating the hospital's executive compensation arrangements, the Court held that the hospital failed to meet its burden of proof concerning the reasonableness of the compensation paid to some of its senior executives. In certain instances, executives were paid unreasonably high salaries (e.g., \$5 million to its CEO in 2005) and received other benefits (such as automobile stipends and golf club memberships) that were unreasonable and excessive as compared to executive compensation arrangements for similarly situated executives. In making such a decision, the Court ruled that the hospital failed to convince it that the standard applied by the IRS to determine appropriate compensation should be adopted in New Jersey. The ruling also identified that productivity incentive payments contained in the hospital's contracts with its employed physicians demonstrated a "profit-making purpose" in instances in which employed physicians received additional compensation based on, in one instance, the number of new patients and number of surgeries performed.

Lastly, the hospital's management contract with a third-party service provider to manage the cafeteria was problematic for Judge Bianco since it included a split of budgetary savings and

resembled incentive compensation or profit sharing disguised as cost savings. Specifically, Judge Bianco stated that the management contract “demonstrates that both parties contemplated the generation of additional revenue in the form of reduced expenses. This additional revenue was then split between the hospital and the third party. The Court found there is no meaningful distinction whether profit comes in the form of increased revenues or decreased expenses. Only the hospital’s auditorium, fitness center and visitor’s garage were held to be exempt from property taxes.

The activities which the Court found to be evidence of a “profit-making purpose” are activities in which federally tax-exempt hospitals have routinely engaged throughout the United States. If upheld, the ruling could have significant precedential value in New Jersey and beyond. As of July 9, 2015, the hospital and the municipality announced that they were engaging in “talks in an effort to end the court case.” One possible resolution would be for the parties to enter into a PILOT program, which allows nonprofits to negotiate voluntary and arranged payments to municipalities in lieu of making payments for taxes. These types of arrangements can preempt the tax-exempt litigation on display in this case.

Regardless of the outcome, tax-exempt hospitals and nonprofit entities nationwide should be on notice. Municipalities suffering from budgetary constraints may use the ruling as the basis for additional challenges to a hospital’s tax-exempt status. Hospitals and nonprofit entities should use this decision as the catalyst to audit their internal infrastructure to ensure sufficient distinctions between their for-profit and nonprofit activities.

## **Ballard Spahr LLP**

**by Denise M. Keyser, Patricia A. Smith, John W. Devine, and Holly V. Horsley**

July 21, 2015

Attorneys in Ballard Spahr’s Health Care Group represent clients across the health care industry, including hospitals, health systems, clinical laboratories, pharmacies, long-term care facilities, insurance companies, and pharmaceutical manufacturers. Our attorneys counsel clients on regulatory, compliance, privacy and data security, transactional, financing, benefits and compensation, and labor and employment matters.

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## **Chicago's Pension Law Struck Down.**

A Cook County judge on Friday overturned the city's changes to two pension funds, declaring them "unconstitutional and void."

In her ruling, Judge Rita Novak dismissed city arguments that the changes to the two pension funds amounted to a "net benefit" for retired workers because the city was guaranteeing the funds would be there.

The state constitution, she wrote in her 35-page opinion, "removed diminishing benefits as a means of attaining pension stability." The city, under the state constitution, already is obligated to ensure pension funding because pension promises are "a contractual relationship between the employer and employee," the judge said.

Novak also rejected the city's contention that because at least 27 of 31 affected unions agreed to the changes, it was a "bargained-for" change.

"There is no evidence that, in reaching an agreement with the city, the union officials followed union rules and bylaws in such a way as to bind their members," she wrote. "Nor is there evidence that the membership voted on the agreement. ... Additionally, there is no showing that the unions could have acted as agents of retired members while at the same time acting as representatives of active employees."

The ruling represents a setback for Mayor Rahm Emanuel and could end up costing city taxpayers hundreds of millions of dollars more because government employees would get their full benefits restored in two retirement funds and have to pay less toward their retirement.

At issue is a 2014 state law Emanuel pushed through the legislature that aimed at shoring up the financially imperiled pension funds by reducing cost-of-living increases and requiring workers to kick in more money. The city also would pay more into the retirement funds, and Emanuel came up with some of that money by raising 911 phone fees by \$1.40 a month.

The worker and laborer funds are short about \$9.5 billion of what's needed to meet future obligations and are at risk of going broke within 13 years.

Retired workers and unions sued, citing a clause in the Illinois Constitution that holds that government pension membership "shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired."

In May, the Illinois Supreme Court pointed to that clause in unanimously overturning similar changes made to four state pension funds.

Anders Lindall, spokesman for the American Federation of State, County and Municipal Employees Council 31, one of the unions that sued to overturn the law, called on the city not to appeal Friday's ruling.

"We can know, as Chicagoans, that the highest law of our state, the constitution, has meaning, and its integrity has been upheld today — that a pension is a promise, that the life savings of public service workers will not be diminished," he said.

"We would urge the city not to waste further time and taxpayer dollars on an appeal," he said.

“Judge Novak was very clear and unequivocal today, and the Supreme Court was just as unequivocal in the spring, that the constitution means exactly what it says and is without exception.”

Instead, the city should come up with the money to pay full benefits, he said.

“The problem with pensions is a funding problem, it’s not a benefit problem,” Lindall said, adding that the average annual pension payment for a city worker is \$32,000. “City employees have always paid their share.”

But city officials made it clear they intend to appeal to the state Supreme Court.

“We have always recognized that this matter will ultimately be resolved by the Illinois Supreme Court,” Corporation Counsel Stephen Patton, the top city attorney, said in a statement. “We now look forward to having our arguments heard there.”

“We continue to strongly believe that the City’s pension reform legislation, unlike the State legislation held unconstitutional this past spring, does not diminish or impair pension benefits, but rather preserves and protects them. This law not only rescues the municipal and laborer pension funds from certain insolvency, but ensures that, over time, they will be fully funded and the 61,000 affected City workers and retirees will receive the pensions they were promised,” Patton said.

While Emanuel is defending the laborers and city workers case, he’s already acknowledged the new legal landscape created by the state Supreme Court ruling in his proposed fix for the police and fire pension funds. His plan would not diminish benefits for police officers and firefighters. Instead, the city would stretch out the payment schedule so that initial increases in taxpayer contributions would be reduced. Police and fire pension funds are short about \$10 billion and stand to go broke in less than a decade.

The approach also would provide the mayor with some short-term budget relief as the city considers new pension funding sources that could include a significant property tax increase. Lawmakers approved the city pension bill May 31 but have yet to send it to Republican Gov. Bruce Rauner amid the state government stalemate.

The stakes are high in all of this: The city’s overall financial woes led one debt rating agency to downgrade the city’s creditworthiness to junk status.

“It is essential that the city officials develop a comprehensive plan, both in the short term and in the long term, for the city’s finances, regardless of the circuit ruling, because the city faces an over \$1 billion budget deficit, the worst credit rating in the United States and the risk of further downgrade if they don’t develop a comprehensive plan for stabilizing finances,” said Laurence Msall, president of the Civic Federation, a nonpartisan budget watchdog group that supports the pension changes.

The court loss Friday on the laborers and municipal workers pension case actually gives Emanuel a small bit of budget breathing room heading into 2016. The city would no longer have to increase its payments into those two pension funds. That means the \$50 million freed up by the 911 phone fee hike could be spent elsewhere.

In addition, Emanuel no longer would have to find an extra \$50 million a year in each of the next four years for the two pension funds. But that would be kicking the can down the road, as the pension shortfalls would continue to grow and it would become far more costly in the long run to restore their financial health.

With the law overturned, workers and laborers, meanwhile, could see a savings. As part of the

changes, city workers and laborers this year began making increased contributions to the funds — money they could be due back with the judge’s decision.

For that reason, unions sought to block the law from being enacted pending the outcome of the case, but they were unsuccessful. “That’s why we sought to have the law enjoined, so if it were overturned, it would not be so hard to unscramble the egg,” Lindall said before Friday’s ruling.

In closing arguments two weeks ago, Patton, the city’s top attorney, contended that instead of diminishing or impairing benefits, the changes made to the worker and laborer funds ensure for the first time that the funds won’t go bust. That’s because the law guarantees adequate city funding, something that wasn’t in the previous law, he said.

“Quite the opposite of diminishing or impairing benefits, it preserves and protects them,” Patton told Novak in his closing arguments.

Patton also said at least 27 of 31 affected city unions backed the new law, showing that it was a bargained-for exchange that would abide by contract law under the theory of “consideration” that was cited by the Supreme Court in a footnote in its ruling. “There would be nothing that would justify throwing out this statute that saves these pension funds from insolvency,” he said.

Clint Krislov, a lawyer challenging the law on behalf of the retired city workers, dismissed the city’s contention that the new law was a “net benefit” to workers and retirees because it saved the funds. “This is the Chicken Little defense,” Krislov said. “It says the sky is falling, so we’re going to do what we’re going to do.”

BY TRIBUNE NEWS SERVICE | JULY 24, 2015

By Hal Dardick

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## **[NYC’s Elite-School Debt Boom Swells as Brearley Seeks to Borrow.](#)**

The Brearley School is poised to join the borrowing boom among New York City’s elite prep schools. The all-girls academy, whose alumnae include Caroline Kennedy and actress Kyra Sedgwick, won approval Tuesday from a city agency to sell \$50 million of tax-exempt bonds to help finance an expansion on Manhattan’s Upper East Side.

New York’s private schools are moving toward selling record amounts of debt this year as endowments swell and interest rates are at generational lows. They’re replacing decades-old buildings and dangling the latest amenities to draw the children of the wealthiest, mirroring what’s been happening on college campuses. Brearley’s tuition is \$43,680 a year.

“Money is available,” said Richard Anderson, president of the New York Building Congress, a construction trade group that’s been tracking spending by schools. “If Columbia and NYU can raise money, then Collegiate and Packer and Brearley and all these other places can raise money, too.”

Bond sales by New York’s private and religious schools may exceed the almost \$280 million issued in 2002, the highest on record, according to data compiled by Bloomberg.

Riverdale Country School, Saint Ann's School and La Scuola d'Italia Guglielmo Marconi have received permission to borrow a total of almost \$150 million through Build NYC Resource Corp., the economic-development unit that authorized Brearley's sale. Ethical Culture Fieldston School and Packer Collegiate Institute have already sold a combined \$71.4 million of debt this year.

### **Half-Century Low**

The schools are seizing on municipal borrowing costs holding close to a five-decade low. When Fieldston sold \$49.4 million bonds in April, it paid yields of 2.8 percent on 10-year tax-exempt debt, about 0.7 percent more than benchmark securities.

Brearley, founded in 1884, plans to spend \$107.5 million to raze three tenements and replace them with an eight-to-10 story facility. The building will house its lower school, science and music departments, an auditorium and a gym, according to its application with the city. With 700 students from kindergarten through the 12th grade, Brearley says it's outgrown its building on East 83rd Street, which was constructed in 1929 for 440.

"For the past 20 years, Brearley has been thoughtfully searching for the best way to add badly-needed educational space to accommodate its student body," Rahul Tripathi, the school's chief financial officer, said in an e-mailed response to questions.

### **Schools Repay**

The prep schools are responsible for repaying investors, who are willing to accept lower yields because the income isn't taxed. Build NYC receives fees for arranging the sales. It isn't on the hook if they default.

Like other New York private schools, Brearley has ties to Wall Street. Ellen Jewett, a former Goldman Sachs Group Inc. public finance banker, is president of the board. Other members include Samara Epstein Cohen, head of financial instruments at BlackRock Inc.

In addition to the bond money, Brearley plans to use \$37.5 million from a capital campaign and \$20 million from its \$132.5 million endowment to fund construction, which is projected to start in Feb. 2017.

The school bought three tenements a block away on East End Avenue in May 2010 and will demolish them to make room for the new facility.

In April, Brearley reached a settlement with 15 rent-stabilized tenants who agreed to leave their apartments, said David Rozenholc, a lawyer who represented them. Rozenholc declined to provide the size of the settlement, citing a confidentiality agreement.

"It involved a very substantial amount of money that they were comfortable doing, but they were fair," Rozenholc said. "The tenants can go on with the rest of their lives and the Brearley School can build the Brearley School."

### **Bloomberg**

by Martin Z Braun

July 20, 2015 — 9:01 PM PDT Updated on July 21, 2015 — 6:57 AM PDT

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## **Pennsylvania May Sue Firms Over Ex-Harrisburg Mayor's Bond Deals.**

Pennsylvania may sue the financial advisers and law firms that worked with former Harrisburg Mayor Stephen Reed as he allegedly misused proceeds from bond deals that pushed the capital city into insolvency.

The state on Monday requested proposals from lawyers interested in mounting a case, less than a week after state Attorney General Kathleen Kane charged Reed for his role in debt deals that led the city into a state receivership in 2011. Kane said Reed used bond money to buy Western memorabilia and pay those who supported his interests. Reed said he will fight the charges.

"The city of Harrisburg is experiencing financial troubles and they're experiencing these because of past indiscretions by advisers to the city," Jeffrey Sheridan, a spokesman for Governor Tom Wolf, said by telephone. Pursuing claims "is the right thing to do."

Harrisburg, a city of about 50,000, was placed under a state-appointed receiver after struggling with debt payments from a costly incinerator project. It exited receivership last year after selling the plant, leasing its parking system and raising income taxes to settle with creditors owed about \$362.5 million.

The recovery plan for the city said that state officials overseeing Harrisburg could seek "redress" from those responsible for decisions on the incinerator project. Any recoveries could go to creditors and the city.

### **Aggressive Litigation**

Sheridan wouldn't name the potential targets of the state's action. He said officials unsuccessfully tried to recoup funds from them before deciding to turn to lawyers.

The law firms hired by the state "will be expected to implement an aggressive litigation program that includes identification of any and all causes of action surrounding the legal, financial and other professional services rendered in support of the Harrisburg incinerator retrofit," according to the state's solicitation.

Reed, who as mayor for 28 years oversaw the city's growing debt burden, was the "mastermind" of a pattern of public corruption, Kane said during a briefing last week.

Reed misused money from municipal debt sold for projects including the incinerator, she said. A 2012 forensic audit cited in the state's request for attorneys said Harrisburg officials and advisers ignored financial risks posed by the project.

### **Advisers Named**

The report referred to RBC Capital Markets, Public Financial Management Inc., Investment Management Advisory Group and Milt Lopus & Associates Inc. for their financial analysis on the deals.

Elisa Barsotti, a New York spokeswoman for RBC Capital Markets, didn't immediately return a phone call and e-mail seeking comment. Sandra Sosinski, a spokeswoman for Philadelphia-based Public Financial Management Inc., had no immediate comment. A message left at Investment Management Advisory Group's Pottstown, Pennsylvania, wasn't immediately returned.

Bruce Barnes, who was president of Harrisburg-based Milt Lopus & Associates Inc., said by telephone that he didn't know about the state action and couldn't comment.

Amanda Ritchie, a spokeswoman for Pittsburgh-based Eckert Seamans Cherin & Mellott, LLC, declined to comment. The audit said the firm's attorneys were involved in several of the incinerator's financings.

## **Bloomberg**

by Romy Varghese

July 21, 2015 — 10:26 AM PDT

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### **[Puerto Rico Left Adrift by Washington as Bankruptcy Bills Stall.](#)**

As California risked being locked out of the credit markets during the recession, officials sought federal loan guarantees to avert deep spending cuts that threatened to cascade through the biggest U.S. state.

Washington turned them away.

Six years later, as a Puerto Rico agency veers toward a default as soon as Aug. 1, federal officials in the nation's capital have echoed a refrain heard during recent state and local fiscal crises: Fix the problem on your own.

President Barack Obama's administration and the Federal Reserve have said it's up to Congress to decide how to assist the island as it struggles with \$72 billion of debt. Yet on Capitol Hill, Puerto Rico's push to allow some agencies to file for bankruptcy has stalled. Efforts to find a Republican to co-sponsor the legislation haven't borne fruit.

"Federal authorities seem to be taking the position that the only possible options are the extremes of a bailout or nothing at all," said Arturo Estrella, a former Federal Reserve Bank of New York economist.

Puerto Rico has been moving toward the largest restructuring ever in the \$3.6 trillion municipal-bond market since last month, when Governor Alejandro Garcia Padilla said the commonwealth can't afford to pay its debts. The securities have tumbled amid speculation over how much investors stand to lose as his administration moves to draw up a restructuring proposal by Sept. 1.

#### **Default Probability**

The island may miss a \$36.3 million principal payment on Public Finance Corp. bonds due on Aug. 1 because the legislature didn't allocate the money. Standard & Poor's called a default on the securities a "virtual certainty," while Moody's Investors Service said the probability of a Puerto Rico default is approaching 100 percent. The Puerto Rico Electric Power Authority, the island's main power provider, is also in talks with creditors over its \$9 billion debt load.

Investors shouldn't expect any new help from Washington, said Daniel Solender, who oversees \$17 billion as head of municipal debt at Lord Abbett & Co. in Jersey City, New Jersey.

"There's no real sign of any move towards helping them other than conversations," Solender said.

“But that’s not solving the problem.”

## **Federal Help**

Puerto Rico has more debt than any state but California and New York from years of borrowing as the economy struggled to grow and residents left for the U.S. mainland. Its bonds are widely held by American investors and mutual funds because they’re exempt from income taxes and pay higher yields than other securities.

Federal intervention wouldn’t be unprecedented. Washington helped to rescue New York in the 1970s, and it put a control board in charge of the District of Columbia’s finances in the 1990s.

So far, the U.S. hasn’t taken a central role. The Treasury Department has been holding discussions with Puerto Rico for more than two years, according to Melba Acosta, president of the Government Development Bank, which works on the island’s debt sales. Treasury officials have pushed the commonwealth to come up with a long-term plan to steady its finances and back giving agencies the power to file for bankruptcy, just as U.S. cities and government-run corporations can.

## **Ignoring Pleas**

Washington has rarely shown interest in rescuing local governments.

Officials declined to provide aid to Jefferson County, Alabama, as soaring debt bills pushed it toward bankruptcy after credit markets seized up. Cities including Philadelphia unsuccessfully sought a share of the bailout money for Wall Street banks, and a 2009 request by then California Treasurer Bill Lockyer for it to backstop short-term debt was rebuffed.

When Detroit’s record bankruptcy threatened to slash workers’ retirement checks, even then U.S. Senator Carl Levin, a Michigan Democrat, said the city shouldn’t receive a bailout.

Estrella, the former New York Fed economist, said the steps Washington has taken so far have done little to help.

The advice “that the White House said the Treasury has shared with Puerto Rico officials over the last year or two has clearly been ineffectual,” he said.

There’s been no will to make helping Puerto Rico a priority in Congress, said Brandon Barford, a partner at Beacon Policy Advisors LLC. He said the Treasury can’t provide a loan guarantee through the Federal Financing Bank without approval from Congress.

## **Feeling Abandoned**

The Obama administration and key Democrats have supported extending Chapter 9 bankruptcy protection to Puerto Rico. The legislation has yet to advance, and Republicans including Representative Darrell Issa have questioned whether changing the law is fair to investors who thought their bonds were exempt from the risk of being adjusted in court.

Alberto Baco Bague, Puerto Rico’s secretary of economic development, told Spain’s El Mundo newspaper that Washington has shown little interest in helping.

“One never loses hope, but they’ve been very negative,” he said in an interview published this week.

“As U.S. citizens, we feel very abandoned by Washington,” he said. “At the highest levels, the United

States has more interest in Greece and in Cuba. And neither of those are U.S. territories.”

## **Bloomberg**

by Michelle Kaske & Kasia Klimasinska

July 21, 2015 — 9:01 PM PDT Updated on July 22, 2015 — 7:51 AM PDT

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### **Puerto Rico Default Recovery Rates as Low as 35%, Moody's Says.**

Investors may receive as little as 35 cents on the dollar under a restructuring of Puerto Rico debt if the commonwealth defaults, Moody's Investors Service said.

Debt sold by the island's Government Development Bank, Highways and Transportation Authority, Infrastructure Finance Authority and Municipal Finance Authority is among the \$26 billion with the lowest recovery rates, Moody's estimated Wednesday in a report. The debt is ranked Ca, the second-lowest rating from the New York-based company.

“We believe that the probability of default is approaching 100 percent, and that losses given default are substantial,” Moody's analysts wrote. “Bondholder recoveries will be lowest on securities lacking explicit contractual or other legal protections.”

Investors including BlackRock Inc. and Pacific Investment Management Co. have speculated about bondholder losses in Puerto Rico since Governor Alejandro Garcia Padilla last month called the island's \$72 billion of debt unpayable. Moody's said the commonwealth could support 60 percent to 65 percent of its net tax-supported debt, assuming no economic rebound.

Holders of debt with stronger safeguards, like general obligations and bonds from the commonwealth's Electric Power Authority and Aqueduct and Sewer Authority would probably fare better than others, with recoveries of 65 percent to 80 percent, Moody's said.

The credit rater said its estimates are based on cuts in principal and interest payments of about 40 percent a year through 2023, as the government decides to reduce debt service payments to avoid budget shortfalls.

Bankruptcy alone wouldn't be enough to dig Puerto Rico out from under its debt burden, Moody's said.

If Puerto Rico agencies had access to Chapter 9, island officials have said it may apply only to certain public corporations, such as the power utility, water agency and highway authority. Those entities owe about \$20 billion combined.

## **Bloomberg**

by Brian Chappatta & Michelle Kaske

July 22, 2015 — 1:33 PM PDT

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## **Chicago Worth the Risk to Pimco, Wells Capital as Deficit Swells.**

As Chicago wrestles with rising pension costs, cash-strapped schools and a swelling budget deficit, investors from Pacific Investment Management Co. to Wells Capital Management say they aren't counting the Windy City out.

Wells Capital is increasing its exposure to the junk-rated metropolis, while Pimco said this week it sees long-term value in the city's debt. A longer-term perspective may come in handy, with a judge to rule Friday on the legality of an overhaul of two of four city employee-pension programs.

"Our big point is not that the city and its finances are necessarily on a very short-term upward trajectory, but that investors are being paid to be there," said Gabe Diederich, a Menomonee Falls, Wisconsin-based portfolio manager at Wells Capital, which manages about \$39 billion of munis, including \$529 million from Chicago. "The city has options longer-term to correct their finances."

The nation's third-most populous city had to pay yields approaching 8 percent as part of a \$743 million taxable-bond offering last week, putting it in the league of junk issuers such as telephone company CenturyLink Inc. A \$346 million tax-exempt portion of the sale yielded as much as 5.7 percent.

### **Pension Turmoil**

Already the worst-rated major city except Detroit, Chicago risks being downgraded again if the pension changes are overturned. Yields on Chicago debt are close to the highs reached after Moody's Investors Service cut the city's credit rating to below investment grade in May.

"Despite the fact that we all know that they have their problems, and Chicago politics and Illinois politics are really, really difficult, it's hard to ignore that kind of embedded yields," said Jim Colby, chief municipal strategist at Van Eck Global, which bought some of Chicago's tax-exempt deal last week. "I know the risks."

Chicago and the state of Illinois are among localities that have shortchanged retirement funds for years. Pensions in the U.S. have \$1.4 trillion less than needed to cover promised benefits nationally, according to Federal Reserve figures.

The pension system in Chicago is \$20 billion short, and the state of Illinois's retirement fund has a \$111 billion shortfall. Chicago's retirement system is only 36 percent funded as of December 2014, compared to 61 percent in 2005.

### **Union Lawsuits**

A partial solution was found last year when state lawmakers approved a plan, touted by Mayor Rahm Emanuel's administration, that restructured the pensions of the laborers and municipal workers. That affects about 60,000 workers. The fix forces employees to pay more with lower benefits while also boosting the city's contribution. Some unions sued to block the law that went into effect Jan. 1.

Friday's ruling will decide whether that law is constitutional. The decision is expected to be appealed to the state Supreme Court, which in May unanimously ruled that Illinois couldn't cut retiree benefits. Four days later, Moody's cut Chicago's credit to Ba1, one step below investment grade, saying the decision increased the likelihood that the city's reform won't hold up.

"Seeing how the state supreme court ruled earlier in the spring, I don't expect the decision to go favorably for Chicago," said Joseph Gankiewicz, an analyst at Blackrock Inc. in Princeton, New

Jersey, which oversees \$116 billion in municipal debt and owns Chicago bonds. “Now with that said, it might give cover to some of the rating agencies to downgrade the city.”

## **Chicago’s Viewpoint**

If the law is overturned, Chicago’s pensions will be broke in about 10 years, the city’s lawyers have argued.

“An adverse ruling from the circuit court and from the Illinois Supreme Court is just going to make it more difficult for the city of Chicago to extricate itself from its financial difficulties,” said Sarah Wetmore, vice president of the Civic Federation, a watchdog group that has been tracking the city’s finances since 1929.

The city said it could be downgraded again if the court finds the law unconstitutional, according to bond documents for last week’s bond sale.

City officials, including Emanuel, have said the city’s plan “fully complies” with the state constitution since it protects benefits and ensures that the funds will stay solvent.

## **Payment Jumps**

Chicago’s changes didn’t affect the pensions of police officers and firefighters. The city’s payment into their funds will jump by \$550 million next year. While the Democrat-led legislature passed a plan to lower that bill, Republican Governor Bruce Rauner has yet to sign it.

Even with its retirement debt, Chicago has the capacity to raise revenue to meet those liabilities, said Matthew Sinni, New York-based vice president and municipal credit research analyst at Pimco, which manages about \$40 billion of state and local debt.

“Despite its pension overhang, Chicago remains a dynamic city with sufficient revenue capacity to meet its steep fiscal challenges in the coming years,” Sinni said in the blog post on July 20. Pimco declined to comment beyond the note.

Pressure from pensions is expected to ramp up next year as Chicago owes about \$1.1 billion to its retirement funds in 2016 if current law stands. The city is projecting a budget shortfall of \$430 million next year, up from \$297 million this year, according to bond documents.

It’s hard to believe that Chicago won’t find a solution, whether it’s cutting spending or raising taxes or fees to “rehabilitate their credit profile,” said Van Eck’s Colby, who has about \$3 billion in tax-exempt assets across six exchange-traded funds, two of which are high-yield.

## **Bloomberg**

by Elizabeth Campbell

July 22, 2015 — 9:00 PM PDT Updated on July 23, 2015 — 6:56 AM PDT

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## **[Puerto Rico Power Utility Says Debt Exchange Plan Unworkable.](#)**

The Puerto Rico Electric Power Authority said a bondholder proposal to restructure the utility’s debt isn’t achievable because it imposes disproportionate risks on ratepayers and other creditors.

A group representing owners of 40 percent of the securities unveiled a \$8.1 billion debt exchange Thursday that would delay payments for several years and give the junk-rated agency \$2.5 billion to upgrade power systems. The utility, known as Prepa, has been negotiating with creditors including mutual-fund provider OppenheimerFunds Inc. and hedge fund BlueMountain Capital Management LLC for almost a year on how to overhaul its finances.

The plan “does not provide a path for a successful restructuring,” Yohari Molina, a spokeswoman for Prepa in San Juan, said in a statement. “It does not share the burden.”

Under the plan, debt-service payments would be suspended on existing securities and interest payments reduced by selling new obligations that would be repaid from a surcharge on Prepa’s customers. Delaying principal payments would free up about \$2.5 billion through 2025 to upgrade plants and diversify fuel sources for commonwealth’s main electricity provider. A June 1 proposal from Prepa included at least \$2.3 billion to rehabilitate facilities on the island, where electricity costs are double those on the U.S. mainland.

### **LIPA Example**

“It almost creates interest-free borrowing for the island’s utility,” Tom Wagner, co-founding partner of hedge fund Knighthead Capital Management, said Thursday during a Bloomberg television interview. Knighthead owns Prepa bonds.

New York’s Long Island Power Authority used a similar financing, Wagner said. Bondholders plan to continue their “constructive” talks with Prepa on the plan, he said.

Assured Guaranty Ltd. also has concerns about the bondholder’s latest plan, although borrowing off of a new fee would help improve the utility, Ashweeta Durani, a spokeswoman for the Bermuda-based bond insurer said in an e-mailed statement.

“While we do not support the recovery plan proposal released last evening by the ad hoc bondholder group, we believe that a properly structured securitization transaction could play an important role in Prepa’s recovery plan,” Durani said.

While such a financing could be the foundation of a long-term plan, “the proposal was developed without consultation with bond insurers and disproportionately impacts our interest,” Kevin Brown, a spokesman at MBIA Inc.’s National Public Finance Guarantee Corp., based in Purchase, New York, said in an e-mail.

The two bond insurers guarantee about \$2.4 billion of Prepa debt.

### **Default Speculation**

Puerto Rico and its agencies amassed \$72 billion of debt by borrowing to fill budget gaps as the island’s economy has struggled to grow since 2006. Governor Alejandro Garcia Padilla last month said the commonwealth can’t afford to pay its debts, igniting concern it will default. Officials are set to draw up a restructuring proposal by Sept. 1.

The utility in August 2014 signed a contract with investors, banks and bond insurers that keeps negotiations out of court, called a forbearance agreement. Prepa must craft a debt-restructuring plan by Sept. 1 or that accord will expire. The utility avoided defaulting on a July 1 bond payment with the help of a loan from bond insurers.

### **Forbearance Pact**

OppenheimerFunds, the biggest holder of Puerto Rico debt among municipal mutual-fund providers, Franklin Templeton Investments, Angelo Gordon & Co., Knighthead Capital, BlueMountain Capital and units of Goldman Sachs Group Inc. have signed the forbearance pact.

The creditor's proposal would delay principal payments for an average of 7.8 years and cut the coupons on as much as \$5.7 billion to an average rate of 4.1 percent from 5.24 percent. Another \$2.4 billion of securities would be sold as capital-appreciation bonds, which would push out principal and interest costs for up to 19 years.

The first tranche of current-interest bonds would be issued at a price of about 150 basis points above benchmark tax-exempt debt and the capital-appreciation bonds would be priced at about 200 basis points above top-rated munis, according to the bondholder plan.

Prepa's customers would be charged a new fee, with that revenue stream repaying the bonds. Under the plan, Prepa clients would pay an average 24 cents per kilowatt hour compared with the utility's historical rate of 28 cents. That surcharge may prove to be a tough sell.

"It's very hard to see how the politicians can line up behind this proposal," said Daniel Hanson, an analyst at Height Securities, a Washington-based broker dealer, said in a telephone interview.

Prepa bonds maturing July 2042 traded Thursday at an average price of 56.2 cents on the dollar, the highest since June 8 and up from 49 cents Wednesday, data compiled by Bloomberg show. The average yield was 9.6 percent.

## **Bloomberg**

by Michelle Kaske

July 22, 2015 — 9:09 PM PDT Updated on July 23, 2015 — 1:58 PM PDT

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### **[Puerto Rico Fallout Seen Contained as Muni Defaults Prove Rare.](#)**

The good news for investors in the \$3.6 trillion municipal market: only one bond issuer rated by Moody's Investors Service defaulted during the past two years, the first time that's happened since the late 1990s.

The bad news: Puerto Rico is almost certain to miss payments on some of its \$72 billion of debt, which may leave investors recovering as little as 35 cents on the dollar, the New York-based credit rater said.

The stability beyond Puerto Rico helps explain why there's been few market ripples as the island careens toward a potentially record-setting default. Munis are poised for their biggest monthly returns since January, according to Bank of America Merrill Lynch data, as investors shrug off the long-building crisis brought about by the commonwealth's unique financial strains.

"Munis went through a lot of stress in the Great Recession and a lot of them did really hard work to rebalance," said Al Medioli, a Moody's analyst who worked on the annual default report the company released Friday. "This is still a very stable, high-quality sector."

States and cities that raise money in the municipal market have been steadily mending from the

worst recession since the 1930s, which forced them to cut spending when tax collections tumbled. Speculation about widespread defaults, which caused investors to flee the market in 2011, were proven off base, even as a few cities, including Detroit, stumbled into bankruptcy.

## **Market Rarity**

Defaults by borrowers rated by Moody's are rare, according to its study. Just 95 did so from 1970 to 2014. Only eight of those were general-obligation bonds, which are backed by a government's pledge to use its taxing power to repay investors.

Last year, not one of the approximately 15,400 munis that Moody's rates missed a payment, the first year without such a lapse since 1997.

This month, Dowling College in Oakdale, New York, became the first in 2015 that Moody's deemed in default. The school had seen enrollment plunge 53 percent over the past four years.

The drop in defaults may be short lived. Some localities will be forced to renege on their obligations in the years ahead as retirement costs swell and the long U.S. recovery left "more governments with less margin and weaker positions from which to weather another sharp recession," Moody's said.

"The absence of defaults in 2014 is not really a harbinger of good times; we expect defaults to occur in years to come," it said. "We see no sign that the forces pressuring the public sector have abated."

## **Junk Cities**

The share of junk-rated local governments doubled since 2011 to 0.6 percent by the end of last year, Moody's said. Atlantic City, New Jersey, Chicago and Wayne County, Michigan, are among those with speculative grades.

Puerto Rico is also on the list. Last month, Governor Alejandro Garcia Padilla said the island can't afford to repay all that it owes as the economy struggles and residents leave for the U.S. mainland. Its Public Finance Corp. may miss an Aug. 1 debt payment because the legislature didn't appropriate funds.

The median rating for an issuer the year before it defaults is Ba3, Moody's said. Puerto Rico's general-obligation bonds, its highest-rated securities, are ranked Caa3, six steps below that.

The chances of the commonwealth defaulting "is approaching 100 percent," Moody's said in a report Wednesday.

## **Guessing Game**

What sort of losses that would spell has been a matter of speculation. Moody's estimates that buyers of securities with weaker protections may get as little as 35 cents on the dollar. The recovery rate on others, such as general-obligation debt and senior sales-tax bonds, may be as much as 80 percent.

Medioli, the Moody's analyst, said such a default won't come as a shock. Puerto Rico bonds have plunged 9 percent this year, compared with a 0.5 percent gain for munis as a whole, S&P Dow Jones Indices data show.

"People were watching Puerto Rico all of last year" to see if it would miss a payment, he said. "They keep pulling rabbits out of a hat. They're able to do something to defer what increasingly seems like an inevitable situation."

## **Bloomberg**

by Brian Chappatta

July 23, 2015 — 9:01 PM PDT Updated on July 24, 2015 — 6:05 AM PDT

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### **[Bloomberg Brief Weekly Video - 7/22/15](#)**

Taylor Riggs, an editor at Bloomberg Brief, talks with Joe Mysak about this week's municipal market news.

[Watch the video.](#)

July 22, 2015

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### **[Moody's: U.S. Unlikely to Bail Out Puerto Rico; Bankruptcy Not a Viable Solution.](#)**

New York, July 22, 2015 — Moody's ratings assume no US federal payment on Puerto Rico's (Caa3 negative) debt, and any effort by the federal government on the commonwealth's behalf would have marginal near-term effects, Moody's Investors Service says in a new report.

"The federal government does not provide states or local governments with extraordinary funds to avert defaults on their debt, in part because doing so would induce other governments to take on unsustainable amounts of debt or engage in reckless fiscal practices," says Moody's VP — Senior Credit Officer Ted Hampton in "Frequently Asked Questions About Puerto Rico's Fiscal and Debt Crisis."

The FAQ also addresses the challenges Puerto Rico faces in current efforts to introduce Chapter 9 bankruptcy measures under the US bankruptcy code.

"Since Chapter 9 is unlikely to be a viable way to achieve a consolidated restructuring of all the commonwealth's debt, bankruptcy authorization would not be sufficient by itself to manage Puerto Rico's current pressures," says Hampton in the FAQ.

The very high likelihood that Puerto Rico will default and significantly restructure its obligations affecting all of its bondholders to varying degrees, provokes questions about expectations for bondholder recoveries.

"We believe bondholder recoveries will be lowest on securities lacking explicit contractual or other legal protections. These securities consist of those rated Ca, including notes issued by the Government Development Bank for Puerto Rico (GDB, Ca negative) and the commonwealth's subject-to-appropriation debt," Hampton says.

Moody's ratings below investment grade are based on both the probability of default and the expected bondholder loss given default.

The expected debt restructuring will be unusual, consistent with of Puerto Rico's status as neither

an independent nation nor a US state. While similar to US states, Puerto Rico lacks the same legal rights and does not have representation in the US Congress. Unlike Greece (Caa3 on review for downgrade) Puerto Rico cannot turn to a lender of last resort, such as the International Monetary Fund.

The FAQ also address other questions regarding the recent loan by bond insurers to the Puerto Rico Electric Power Authority (PREPA — Caa3 negative), pension assets and the ability of the commonwealth recover fast enough to support its debt.

The report is available to Moody's subscribers [here](#).

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## **Moody's: No U.S. Municipal Defaults in 2014, But Credit Quality Erodes for Some Public Finance Credits.**

New York, July 24, 2015 — There were no Moody's-rated US municipal defaults in 2014, but a deterioration in credit quality shifted a small but growing number of public finance credits deeply into speculative grade last year, according to the latest annual default study by Moody's Investors Service.

Despite the absence of municipal defaults, pressures already identified in prior Moody's default studies continue to weigh on public finance amid the expectation defaults will materialize in the future, as detailed in the report, "US Municipal Bond Defaults and Recoveries, 1970-2014."

Despite ongoing headwinds driven by long-term demographic changes and increasing balance sheet leverage from pensions and retiree health care, Moody's believes the municipal market will continue to see few defaults or bankruptcies in the near future. The median rating for all Moody's-rated public finance credits remains Aa3 and only 1.6% of Moody's 8,500 municipal credits were below investment grade at the end of 2014.

While still a low overall percentage, the number of speculative-grade local government cities and counties has more than doubled since 2011. This includes downgrades of Atlantic City (NJ), Perry County (KY) and Kankakee County (IL), and sharp downgrades of more than four notches among several credits in Puerto Rico and two school districts last year.

"Trends affecting public finance include a slow recovery and weak labor participation rate; aging demographics that affect consumer spending; and the continued growth of pension and health care entitlements that increase local government leverage and can crowd out other budgetary demands," author of the study and Moody's SVP Alfred Medioli says. Reflecting the deterioration in credit quality and as leverage increases, a very small but growing number of severely distressed municipalities are using municipal bankruptcy to adjust their liabilities.

"Municipal bankruptcy, though still rare, is becoming a more commonly considered tool to adjust liabilities in the public sector in situations of extreme stress. Jefferson County (AL), Harrisburg (PA), and Detroit all emerged from bankruptcy or receivership," Medioli says.

Moody's has also noted the growing trend of pensions being better protected in bankruptcy at the expense of debt liabilities and retiree health care benefits. This could mean larger losses to bondholders than pensioners are increasingly likely in any future Chapter 9 filings.

The study is available to Moody's subscribers [here](#).

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## **[Fitch: Rating Public-Sector Counterparty Obligations in PPP Transactions.](#)**

These criteria outline Fitch Ratings' global approach to rating the obligations of a public-sector grantor (grantor) under a concession, lease or other agreement (referred to herein as a framework agreement) used to support a public-private partnership (PPP) financing for public infrastructure assets. Such ratings are an input in the rating process for PPP transactions.

The criteria establish a globally consistent framework to:

- Determine if the PPP framework agreement qualifies for assignment of a counterparty rating.
- Establish a methodology for notching from the general credit quality of the public-sector counterparty to reflect any perceived higher risk of default under a framework agreement.
- Guide how to consider the PPP obligation in the public-sector counterparty's general credit rating (as expressed in the IDR), as well as how a late payment or rejection of an obligation under the framework agreement would be reflected in the counterparty's IDR.

Public-sector counterparties considered in these criteria include sovereign, state, provincial, regional and local governments; departments and agencies thereof; and public-sector entities. Not all rating factors outlined in this report apply to each individual rating. Each specific rating report discusses those factors most relevant to the individual rating assignment.

[Read the report.](#)

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## **[BDA Submits Comment Letter to Labor Department on Fiduciary Duty Proposal.](#)**

Today, BDA submitted a [comment letter](#) to the Labor Department (DOL) regarding its [request for comment](#) on a proposal to expand the definition of 'fiduciary' under Employee Retirement Income Security Act (ERISA). As proposed, the expansion would significantly limit the ability of dealers to provide investment advice and recommendations to retirement investors. BDA's letter focuses on issues with the rule's two main exemptions:

- [Best Interest Contract Exemption](#)
- [Exemption for Principal Transactions in Certain Debt Securities](#)

Additionally, the letter recommends the DOL to take an alternative approach and urges the DOL work with SEC to craft a rules-based uniform best interest standard of care for investors generally, not just retirement investors.

07-21-2015

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## **[BDA Submits Comment Letter to Federal Reserve on Municipal Securities as 'High Quality Liquid Assets' \(HQLA\).](#)**

Today, BDA submitted a [comment letter](#) to the Federal Reserve in response to its [proposed rule](#) to allow investment grade, general obligation U.S. state and municipal bonds to be counted as High

Quality Liquid Assets (HQLA) under the Liquidity Coverage Ratio (LCR), a new bank liquidity rule.

The proposed rule would include GO municipal securities as level 2B high quality liquid assets under the LCR, subject to significant limitations. BDA argues that the exclusion of revenue bonds is based on a mischaracterization and the proposed limits on GO bonds are unnecessary given the ability of municipal bonds to retain value under stressful market conditions relative to other level 2B assets, including corporate debt and equity.

Currently, the proposal will only apply to bank holding companies that are primarily regulated by the Federal Reserve. Therefore, BDA urges the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation to work on a comprehensive rule that will include all investment grade municipal securities and apply to all bank holding companies subject to the rule.

The BDA's previous letter on including munis as HQLA can be read [here](#).

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## **Michigan: Wayne County Designated for Financial Emergency Status.**

Gov. Rick Snyder on Wednesday declared that Wayne County, home to Detroit, is in a financial emergency, agreeing with the findings of a state-appointed review team. The review team said on Tuesday that it had concluded there was a financial emergency based on the county's out-of-balance budgets over the last four years and an estimated \$1.3 billion unfunded health care liability. The county executive, Warren Evans, requested the review last month, asking the state for a fiscal emergency declaration and a consent agreement to fix problems. Under Michigan law, local governments can choose a consent agreement, emergency manager, neutral evaluation or Chapter 9 municipal bankruptcy to deal with a financial emergency. Detroit went through a similar review process that led to the filing of the biggest-ever American municipal bankruptcy, which the city exited last December after shedding about \$7 billion of its \$8 billion of debt and obligations.

By REUTERS

JULY 22, 2015

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## **U.S. Charter School Default Rate Up, but Sector Sound: Report.**

NEW YORK — U.S. charter schools are defaulting on bonds at a rate of 3.3 percent, a level higher than that recorded three years ago but still not one which should concern investors, according to the co-publisher of a report made available on Tuesday.

Charter schools, held in a number of municipal bond funds, are public schools that operate independently and are an alternative to schools run by local school districts. They are publicly funded but use private-sector lenders to fund buildings.

Of the \$10.4 billion issued by charter schools, \$346.9 million, or 3.3 percent, has defaulted, according to the report by community financing organization the Local Initiatives Support Corporation (LISC) and Charter School Advisors. That compares to 2.7 percent recorded in a 2012 LISC report by the same author, CSA managing director Wendy Berry.

"I don't think it should be concerning to investors if they're looking at schools in the right way," said Reena Abraham, LISC's vice president of education programs.

"There is tons of growth in this sector. I think they should be asking the same questions that we have been asking around academic performance. A good school will not fail you."

The data also showed an uptick in the default rate on the basis of the number of schools issuing bonds - with 5 percent of the 818 schools defaulting according to the 2015 report versus 3.8 percent of 583 recorded in 2012.

The schools defaulted mainly because the authorizer of the school did not renew their charter due to sub-par academic performance, the report said.

Michigan's default rate of 12 percent was the highest amongst all states. Michigan was particularly active in issuing charter school bonds in the early years of charter school bond issuance - which began in 1998 - according to the report, when underwriting criteria had not evolved, it said.

The high default rate is also due to the state having mostly small, stand-alone schools that were less able to weather Michigan's economic downturn and the associated effects of reduced education funding, the report said.

The study also said that some state programs were improving charter schools' access to the bond market with state officials in Colorado, Utah and Texas developing programs to allow charter operators to get enhanced credit ratings.

By REUTERS

JULY 21, 2015, 6:58 P.M. E.D.T.

(Reporting by Megan Davies; Editing by Andrew Hay)

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## **[Getting Tested Again: Municipal Bond Funds Face More Stress.](#)**

NEW YORK — Here we go again.

One worry after another has hit the municipal bond market in recent years, from a high-profile 2010 prediction for a wave of defaults to Detroit's 2013 bankruptcy filing, the largest in U.S. history.

The latest concern is actually an old one: The governor of Puerto Rico said last month that the island, whose economy and population have been shrinking for years, may not be able to repay its \$72 billion in debt. That's significant because half of all muni-bond funds have some Puerto Rican bonds.

The market for bonds issued by local governments, water utilities and school districts is a notoriously emotional one, dominated by individual investors who have been quick to sell when anxious. That can amplify price drops, and investors have been pulling out of muni-bond funds in recent weeks.

But as with each recent challenge, managers of muni-bond funds expect the market to power through. Even though most funds own Puerto Rican bonds, the average amount is 3.4 percent of total assets, among funds with any at all. For half of those funds, it's 1.4 percent or less, according

to data from Morningstar.

It's a separate worry, which is still looming, that may lead to bigger difficulties: rising interest rates.

"Puerto Rico is a problem in and of itself," says Lyle Fitterer, who helps oversee \$39 billion in muni-bond investments at Wells Fargo Advantage Funds. "It's not going to have a spillover effect on the broader municipal market."

## PUERTO RICO PORTIONS

One of the main draws for municipal bonds is that their income is free from federal income taxes.

Puerto Rico is a special case because income from most of its bonds is also free from state and local taxes for people living California, New York and other states far from the Caribbean. Nineteen municipal-bond funds have 10 percent or more of their assets in Puerto Rican bonds, mostly ones that focus on single states or high-yield bonds.

Worries about Puerto Rico, along with other factors, drove investors to pull \$1.6 billion out of muni funds in May and June. It marked the first monthly withdrawals since 2013. Even so, muni funds have drawn \$29.7 billion in net investment over the 12 months through June, according to Morningstar.

Analysts pay close attention to these numbers because individual investors drive the market. After the much-publicized 2010 predictions for a coming wave of defaults, for example, nervous investors dumped their muni funds. Their pullout forced managers to sell bonds to raise cash to return to investors, which pushed prices lower and spurred even more investors to head for the exits.

## LITTLE SPILLOVER

But the troubles for Puerto Rico have not hurt prices of other municipal bonds much.

Even though some areas of the country are also under financial pressure, such as Chicago, tax revenues for local governments are generally improving.

"It's amazing how the market has shrugged off these problems, but there is a thirst for fixed income that seems insatiable," says Josh Gonze, portfolio manager at Thornburg Investments, which manages about \$10 billion in municipal bonds. "The market is saying, 'We'll pass on Puerto Rico and the Detroit and Chicagos, but we'll buy everything else.'"

The average intermediate-term, national municipal bond fund is down 0.4 percent over the last three months.

## RATE EFFECT

The reason for the price drops during the spring may not be what investors expect.

Although many blame the problems in Puerto Rico, Chicago and other hot spots, "it's really because interest rates are moving higher," Fitterer says.

Higher rates pull down existing bonds' prices, because their yields are suddenly less attractive than those of newly issued bonds. And muni yields are higher than at the start of the year, following the lead of Treasuries. Many economists expect the Federal Reserve to begin raising short-term rates later this year.

Warnings have been circulating for years that bond prices could be in for a sharp slide, once rates rise. Even if it shouldn't happen, muni fund managers acknowledge that some investors may react to a Fed hike by immediately selling in hopes of avoiding losses.

Some fund managers have increased the cash in their portfolios, which would enable them to take advantage and buy low during a sell-off. Gonze's Thornburg Intermediate Municipal fund has 18 percent in cash, up from about 5 percent two years ago, for example.

If a sell-off occurs, managers say it could be short and shallow. Joe Baxter, head of the municipal bond group at Delaware Investments, points to 2004, the last time the Fed began a series of rate hikes. The funds he oversees all rose in the ensuing year.

"You can sit there, waiting for an event," Baxter says, "but then you're missing a chance to keep earning income in a market that's 95 percent good."

Just don't expect the returns to be very big. Yields are low - close to 2.25 percent for a 10-year municipal bond - which means returns will likely be too.

By THE ASSOCIATED PRESS

JULY 23, 2015, 5:11 P.M. E.D.T.

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## **[Municipal Bonds Still Considered Safe, Despite Some Ailing Governments.](#)**

Puerto Rico is drowning in \$72 billion of debt it admittedly cannot pay back. Several states — Illinois, Pennsylvania, New Jersey and Kentucky among them — are facing mounting financial problems of their own, mainly because of pension promises that are not properly funded.

Those government travails come just two years after Detroit's historic bankruptcy, the largest municipal default ever.

Since individuals hold most of the \$3.7 trillion invested in municipal bonds — or about 70 percent, either directly or through mutual funds — it raises the question: Should investors be worried? After all, municipal bonds have traditionally been viewed as safe investments.

"There is more stress in the muni market today than there was 10 years ago because there are higher fixed costs like pensions and retiree health care costs, increased debt costs and more modest revenue increases," said Lisa Washburn, a managing director for Municipal Market Analytics, a research firm based in Concord, Mass. "I am more worried about credit deterioration in states with significant pension issues, but I am not at this point concerned about any risk of default at the state level."

Overall default levels remain exceedingly low and are not expected to rise meaningfully. The default rate of the S&P Municipal Bond Index, which tracks 84,000 bonds from more than 22,000 issuers, was 0.17 percent in 2014, compared with about 0.11 in 2013.

"We expect to see a small increase from the past in terms of bankruptcy or restructuring, but we have to put this in perspective," said Christopher W. Alwine, head of Vanguard's municipal bond group. "It's a few isolated events in a very large market."

Still, the pension problem isn't going away anytime soon. Cities, counties and states will continue their struggle to find the most politically palatable and financially feasible ways to shore up their finances. In some cases, governments have issued more bonds to fill in the pension shortfall, which feels a bit like resorting to a credit card to cover the daily bills.

A recent analysis by the Pew Charitable Trusts found that state and local pensions had a funding gap of \$1 trillion. The Illinois pension system, for example, was only 39 percent funded in 2013, according to the report, and the Kentucky system was just 44 percent funded.

"Some states have big pension problems, but they also have a lot of power to manage expenses and raise revenue," said Al Medioli, head of credit policy for the public finance group at Moody's Investors Service. "Some local governments are having a harder time."

The ability to raise taxes has played a large part in keeping overall municipal bond default rates so low — and has contributed to the perception that muni bonds are generally solid investments. General obligation bonds were issued by municipal governments and backed by their "full faith, credit and taxing power," and investors in such bonds had the legal standing to seek a court-ordered tax increase if that is what it would take to prevent a default. Even in the extremely rare case when a municipality filed for bankruptcy, general obligation bondholders typically recovered most or all of their money, bond analysts said.

But in Detroit's bankruptcy, that didn't happen. General obligation bondholders recovered at most only 74 cents on the dollar and in some cases less, while many so-called revenue bondholders were not hurt. Revenue bonds, like those issued by a sewer authority for a new treatment plant, are repaid with a dedicated stream of revenue generated by that authority. As result, some bond managers and investors, both large and small, are shunning general obligation issues in favor of revenue bonds.

"This is the flip of what was taught in Bonds 101," said Marilyn Cohen, president of Envision Capital Management in El Segundo, Calif., who manages bond portfolios. "Everything we have been taught about general obligation bonds, that the issuers have the unlimited ability to tax the people and pay the bonds, we learned that is false."

Peter Hayes, head of BlackRock's municipal bond group, called it the emergence of a dangerous precedent. "If you look at Detroit, it was really more about politics than the law," he added.

In the bankruptcy of Detroit, as well as with those of Stockton and San Bernardino, Calif., pensioners were widely seen as faring better than bondholders since they received smaller reductions to their benefits, though many retirees did make concessions.

Investors are often drawn to municipal bonds, which help pay for public projects, because of their favorable tax treatment: Individuals generally don't pay federal income tax on the interest they receive. And if you live in the state where the bond was issued, the interest may be exempt from state and local income taxes as well.

Given the tax advantages, munis are often associated with investors in the highest tax brackets, but financial advisers said they often made sense for people in upper-middle tax brackets as well, say, 28 percent or higher.

Wherever you fall on the tax hierarchy, however, what has emerged from the financial crises in Puerto Rico and elsewhere are some basic lessons that bear repeating: Invest only in a diversified portfolio of municipal bonds, and know what you own. Financial advisers said it might be hard to

assemble a diversified portfolio of individual bonds without \$500,000 to \$750,000, though some said it could be done with as little as \$250,000.

Many mutual funds offer far more diversification: In Vanguard's national municipal bond funds, for instance, most issuers account for less than 1 percent of a fund's overall holdings.

But that doesn't mean fund investors are fully protected, either. Puerto Rican debt, for example, shows up in about 52 percent of municipal bond mutual funds, according to Morningstar. Exposures range from less than 1 percent of the fund's assets to nearly half.

Consider the collection of municipal bond funds offered by Oppenheimer Funds that are named after individual states, which are particularly attractive to people living in those states because they do not pay tax on bond income at three levels: federal, state and local.

The Rochester Maryland Municipal Fund, for example, had about 52 percent of its holdings in Maryland bonds as of June 30, while about 48 percent was in Puerto Rico. And the Virginia fund had nearly 40 percent of its holdings in Puerto Rican bonds, according to Oppenheimer's website.

So how does a fund named after one state invest an overwhelming chunk of its assets in another locale?

It is perfectly legal, according to the Securities and Exchange Commission rules about what companies can name their investments. Yes, single-state municipal funds must invest 80 percent of their assets in investments of the named state. But an out-of-state security can be placed in the 80 percent basket if it pays interest exempt from both federal income tax and the tax of the named state — a bar that is cleared by United States territories like Puerto Rico, Guam and the Virgin Islands.

With Puerto Rico, "because of the high yield and because of its triple-exempt tax status, it made it particularly attractive to some firms and managers that run single-state muni funds," said Beth Foos, a senior analyst at Morningstar, who also noted that the single-state fund's investment universe was limited.

Puerto Rico is an unusual case. But that the small island shows up in so many portfolios should serve as a reminder to all municipal investors. "You need to know where your money is going," said Ann Rutledge, a co-founder of the ratings firm R&R Consulting, "and how you are going to get it back."

THE NEW YORK TIMES

By TARA SIEGEL BERNA

JULY 24, 2015

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## **[Chicago Public Worker Pension Reform Plan Found Illegal.](#)**

A plan to ease Chicago's \$20 billion public-worker pension deficit is illegal, an Illinois judge ruled, leaving the city vulnerable to another credit downgrade.

Immediately after the ruling, Standard & Poor's said it would probably lower the city's rating again if a solution isn't found. S&P already cut Chicago's rating earlier this month to BBB+, or three levels above junk.

The Illinois Constitution bars the diminishing of public pensions, state court judge Rita Novak ruled Friday. The Illinois Supreme Court in May killed similar changes to the state's pension funds for the same reason.

Rejection of the state plan led within a week to a downgrade of Chicago credit to junk status. Chicago's pensions will be broke in about 10 years without the plan, city lawyers argued before the ruling.

The city's pension plan and the one covering state workers both envisioned cuts in future cost-of-living increases. Chicago argued that its plan was different from the state's because it increased city funding of pension funds and the Illinois measure only reduced benefits.

Novak rejected the city's arguments.

### **General Assembly**

The state constitution "affords the participant protection against" cuts in benefits even if the general assembly changes the pension code, the judge wrote in her 35-page ruling.

The city will appeal to the state supreme court, Chicago's lawyer said after the ruling.

"We continue to strongly believe that the city's pension reform legislation, unlike the state legislation held unconstitutional this past spring, does not diminish or impair pension benefits, but rather preserves and protects them," Stephen Patton, a lawyer for the city, said in an e-mailed statement.

The American Federation of State, County and Municipal Employees Council 31, one of the plaintiffs in the suit, urged the city in an e-mailed statement "not to take up further time and expend additional taxpayer dollars on an appeal of today's decision."

### **Job Cuts**

The court fight over pension reform comes as the city and state face increasing financial pressure. Chicago's public school system is eliminating 1,400 jobs. Illinois' retirement fund has a \$111 billion shortfall. And the state is operating without a budget because of stalemate between Republican Governor Bruce Rauner and the Legislature's Democratic leadership.

The pension system in Chicago is \$20 billion short and is only 36 percent funded, compared with 61 percent in 2005.

Chicago's measure, signed into law last year, restructured the pensions of laborers and municipal workers, requiring employees and the city to pay more into the plan while benefits are reduced. The pension plans for fire and police retirees weren't affected.

The city reform was developed in negotiations with 28 of 31 affected unions, Mayor Rahm Emanuel said in May. The employees had a "full funding guarantee," the city said. Union-backed beneficiaries sued on behalf of retirees and employees to block the reform.

### **Truck Driver**

The plan didn't have the support of pensioners, Charles Lomanto, a retired truck driver for the city of Chicago, told reporters outside Novak's courtroom Friday.

Under the plan, which took effect Jan. 1, pensioners lost all but .85 percent of an expected 3 percent increase in benefits, Lomanto said. Meanwhile, Lomanto said, his health insurance premium costs rose to \$1,300 a month from \$740.

“Rahm never came to retirees and said, ‘Hey, can we talk?’” Lomanto said. “Unions can’t negotiate on behalf of retirees.”

The rejection leaves Chicago with no viable plan to solve the pension deficit, said Sarah Wetmore, vice president and research director at the Civic Federation, a Chicago nonprofit that tracks municipal finance.

“Without these reforms, the city reverts back to an inadequate funding formula that has resulted in such severe underfunding that actuaries expect the Municipal and Laborers Funds will run out of money within the next decade -- an unthinkable prospect,” she said.

### **‘Credit Neutral’**

Moody’s Investors Service called the ruling “credit neutral” for Chicago because of the expected appeal to the state supreme court.

“The ruling is one step forward in the process of resolving outstanding questions on the constitutionality of the 2014 legislation,” Matt Butler, assistant vice president and Moody’s lead analyst for Chicago, said in an e-mailed statement.

Chicago’s financial woes and credit downgrades have burdened the city with higher borrowing costs as investors demand larger yields, relative to top-rated bonds, to buy its securities.

Yields on some Chicago bonds are close to the highs reached when Moody’s Investors Service cut the city’s rating to below investment grade in May after the Illinois Supreme Court struck down the state’s pension overhaul.

The price of a taxable Chicago bond maturing in 2042, the most actively traded city security Friday, was little changed at 99.2 cents on the dollar. The securities yield 7.8 percent, almost 5 percentage points above benchmark Treasuries, according data compiled by Bloomberg.

### **Supreme Court**

“Barring a reversal at the supreme court, this puts us back to square one on pension reform in Chicago,” said Richard Ciccarone, Chicago-based chief executive of Merritt Research Services LLC, which analyzes municipal finances. “Now the pressure on the city to come up with a solution here that won’t unduly burden taxpayers, and at the same time achieve some level of reform is going to be challenging.”

The case is *Jones v. Municipal Employees Annuity and Benefit Fund of Chicago*, 2014CH20027, Circuit Court, Cook County, Illinois, Chancery Division (Chicago).

Bloomberg

by Margaret Cronin Fisk

July 24, 2015 — 8:34 AM PDT Updated on July 24, 2015 — 11:42 AM PDT

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## [Muni Funds Get First Cash Inflow Since April as Bonds Rally.](#)

Investors added money to municipal-bond mutual funds for the first time since April, snapping an 11-week streak of outflows, as state and local debt leads a rally in the fixed-income market.

Individuals poured \$125 million into muni funds in the week through Wednesday, Lipper US Fund Flows data show. The stretch of withdrawals that began May 6 had been the longest in 18 months. The last inflow was in the week ended April 29.

The \$3.6 trillion municipal market has gained 0.6 percent in July, on track for the strongest return since January, Bank of America Merrill Lynch data show. It's outpacing the rally in U.S. Treasuries and investment-grade corporate debt, which have earned 0.5 percent and 0.3 percent this month, respectively, the data show.

Bond prices have gained amid speculation that the Federal Reserve will begin to raise interest rates at a gradual pace.

Even with the gains, the 2.34 percent yield on benchmark AAA munis compares with 2.25 percent for similar-maturity Treasuries, data compiled by Bloomberg show. The ratio of the two yields, at about 104 percent, is the highest since June 1.

Investors are frequently willing to accept lower yields on municipal bonds because their interest payments are exempt from the federal income tax.

### **Bloomberg**

by Brian Chappatta

July 23, 2015 — 2:14 PM PDT Updated on July 24, 2015 — 6:06 AM PDT

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## [Municipal Bond Dealers Lobbying Congress for Tax Exemption.](#)

Municipal bond advocates are pressing lawmakers to preserve their tax exempt status.

The Municipal Bonds for America Coalition (MBFA) organized a fly-in lobbying day on Tuesday, where advocates met with congressmen and senators to “discuss the benefits of municipal bonds.”

More than 50,000 state and local governments rely on municipal bonds to finance the construction of new roads, bridges, and schools, according to MBFA.

But they are concerned that the tax exempt status of the \$3 trillion industry may be under threat.

“As conversations about tax reform continue, we want to be out in front, talking about the issue and why this exemption is important,” said Samantha DeZur, spokeswoman for MBFA.

“We want to make sure they understand how important municipal bonds are to state and local governments,” she added.

Groups participating in the lobbying day include the American Public Power, American Public

Transportation Association, Bond Dealers of America, Council of Development Finance Authorities, Investment Company Institute, Large Public Power Council, National Association of State Treasurers, National Council of State Housing Agencies, and National Development Council.

## **The Hill**

**By Tim Devaney - 07/21/15 03:57 PM EDT**

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### **[Fitch: Statutory Liens Do Not Boost U.S. Municipal Debt Ratings.](#)**

Despite its growing use in U.S. municipal debt, the presence of a statutory lien will not enhance a municipality's debt rating, according to Fitch Ratings in a new report.

The role that statutory liens play when a municipality files for bankruptcy protection has been a topic of increased attention. Perhaps the most notable example of late is California's new law (Senate Bill 222) which automatically attaches a statutory lien to all future general obligation (GO) debt issued by cities, counties, school districts and community college districts. 'While the presence of the statutory lien will enhance a creditor's post-default recovery prospects, it doesn't avoid the interruption of payment upon a bankruptcy filing by a municipality,' said Managing Director Thomas McCormick. 'The simple reason is that in a bankruptcy scenario, the pledged tax revenue could be subject to interruption and default would be likely.'

While statutory liens do not protect a creditor from payment interruption in the event of a bankruptcy, a security defined as 'special revenue' under Chapter 9 of the U.S. bankruptcy code does. The definition of special revenues in the code includes enterprise revenues and such revenues are exempt from the automatic stay in the event of bankruptcy. Fitch's ratings for Detroit's credits reflect the distinction between general and special revenues. Fitch rated Detroit's water and sewer debt distinct from the city and as high as 'BBB+' following Detroit's July 2013 bankruptcy filing despite a 'C' rating on Detroit's unsecured GO debt. Another notable example is the City of Stockton, CA's water bonds, which Fitch rated distinct from the city and as high as 'BBB' during Stockton's bankruptcy notwithstanding defaults on other bond debt by the municipality.

As a result, Fitch caps the ratings on bonds supported by non-special revenues at the unsecured GO debt rating of the municipality. A recent example of the rating cap is the City of Chicago. Like the City's GO debt, Fitch rates Chicago's sales tax bonds 'BBB+' with a Negative Outlook despite high coverage of maximum annual debt service at over 15 times. 'The revenue flows from Chicago's sales tax bonds could be subject to interruption if Chicago were to file for bankruptcy,' said McCormick. 'Additionally, because there is no statutory lien, the lien interest would end with respect to future general sales tax revenues upon a bankruptcy filing by the city and recovery prospects could be no higher than general credit quality recovery.'

July 20, 2015 10:33 AM

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### **[Sports Owners Dip Into the Public's Purse, Despite Their Billions in the Bank.](#)**

CLEVELAND — The billionaire owner of the Cleveland Cavaliers, Dan Gilbert, is a lucky man. When LeBron James, his transcendent native son, left for Miami, the owner threw an impressive tantrum,

going on about “cowardly betrayal.”

Despite that, James felt the tug of home and returned to Cleveland to revive Gilbert’s moribund franchise. In the N.B.A. finals, James resembled a Sherpa as he strapped a depleted team to his back and tried to drag it to the summit.

In the off-season, Gilbert dug his fingers into another pile of money, this one made up of taxpayer dollars. A year earlier, Gilbert and his fellow sports billionaires here — Larry Dolan, who owns the Indians, and Jimmy Haslam, who owns the Browns — had worked together to push through a referendum that extended a countywide “sin tax” on cigarettes, beer and liquor.

Over the next 20 years, taxpayers in Cleveland and Cuyahoga County will sluice \$262 million into improvements for the city’s arenas and stadiums. This straitened city has already pumped \$800 million into its sports stadiums.

Sweet deals for team owners are a distinguishing feature of pro sports capitalism. Costs are socialized, and profits remain private. Cleveland’s owners argue that this is only just: The stadium and the arena are publicly owned, and like any landlord, the city and the county should look after repairs and improvements.

Their logic does not apply more broadly. The team owners took control of the process of auctioning off naming rights for these public stadiums. The Browns sold their stadium’s rights for \$100 million to FirstEnergy Corporation; the Indians will get \$58 million over 16 years from Progressive Insurance; Gilbert’s home loan business paid a terrific sum to Gilbert’s team to name the place Quicken Loans Arena.

The owners shared not a penny with the hard-pressed city.

The Cleveland Indians have their hearts set on a new sound system. The Browns’ Haslam — whose truck-stop company, Pilot Flying J, just last year paid a \$92 million fine to avoid a federal fraud prosecution — has compiled a list of improvements to be funded out of the public purse.

That sports teams, which are active charitable givers, have an umbilical tie to civic identity is not a fanciful notion. That this means that teams are drivers of economic progress, however, is a hallucination.

When James decided to return to Cleveland, city leaders and a few journalists retailed a narrative about L’Effect LeBron. They estimated that his return would pour many tens of millions of dollars into the city and speed the “Cleveland Renaissance.”

Cleveland has charming, leafy neighborhoods, fine museums and theaters and splendid lake views. More college-educated young adults are moving downtown, and there is indisputably more investment, building cranes and vibrancy to be found in Cleveland than a decade ago. At the same time, in the last month for which figures are available, Cuyahoga County’s job growth rate was 0.0.

The city’s poverty rate hovers near 37 percent, and the infant mortality rate is 13.0 per thousand births, compared with about 4.0 in New York City, which has no shortage of poverty.

Public schools have absorbed cut after cut.

I called George Zeller, who has analyzed the economy here for decades. He declined to talk renaissance, saying no such animal existed. “The theory that all of these sports teams are producing a gigantic boom is completely false,” he said.

Yet sin-tax dollars tumble into the hands of billionaires who employ millionaires.

The day after the end of the N.B.A. finals, I walked into the Cleveland office of Peter Pattakos. An ebullient lawyer, a sports fan and an Akron native, he helped lead the battle against the sin-tax extension. Ask a question, and he's off at a sprint.

"It's outrageous that these are public entities and we let these billionaires derive untold profits," he said. "They kept saying, 'Keep Cleveland strong,' with the implied threat that they'd leave town if we didn't underwrite their stadiums."

The anti-sin-tax campaign was a peasant crusade. Pattakos's ragtag band suggested a \$3 surcharge on sports tickets. The owners rolled their collective eyes.

"Proposing to punish Cuyahoga County families and sports fans by imposing a new, large ticket tax to pay for major repairs," the owners complained in a news release, "is terribly flawed."

A surcharge, they complained, would make it even more difficult for families to buy tickets. That argument has an out-of-body quality, as the owners set the prices. (The Cavaliers will raise ticket prices 15 percent next year, the first such hike in five years.)

The teams' owners and supporters outspent opponents, \$3 million to \$30,000. The vote to extend the sin tax, however, was not a blowout. Voters in the city of Cleveland rejected it; suburban voters carried the election.

Pattakos motioned for me to follow him, and we clattered downstairs. He led a walking tour of the Warehouse District. We passed handsome restaurants and bars, and lots of for-rent signs on vacant storefronts. Job losses are like a river eroding the shore.

"You're telling me we should spend our tax money fixing up stadiums?" he asked, over his shoulder.

The Gateway Economic Development Corporation of Greater Cleveland acts as the landlord for the basketball arena and the Indians' field. (The Cavaliers and the Indians pay Gateway's operating expenses, about \$3 million per year.) I placed phone calls and sent detailed emails to its executive director, Todd Greathouse. The next peep I hear from that office will be the first.

In editorializing for the sin tax, The Cleveland Plain Dealer argued that the city had a landlord's responsibility to pay for upkeep. Left unexplained was why the landlord had never tried to renegotiate terms with ever more wealthy teams.

(Note: The Indians offer a sort of exception. They rank next to last in the American League in attendance. The night I attended a game, the crowd had the feel of an extra-large backyard barbecue, and 25 percent of the fans seemed to be rooting for the visiting Chicago Cubs.)

Over the winter, the Cavaliers' emissaries arrived with a new proposal. They wanted locals to split the cost — in addition to the sin-tax dollars — of overhauling their arena. Adam Silver, the N.B.A. commissioner, added his voice, saying that the league would love to have the All-Star Game in Cleveland, if only its burghers would ante up again for the billionaire owner.

The Cavaliers' chief executive says the overhaul would add to Cleveland's "economic momentum."

To be a wealthy sports owner is to feel no burn of embarrassment.

THE NEW YORK TIMES

JULY 21, 2015

By MICHAEL POWELL

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- [Ratings Value Questioned as More Municipal Borrowers Go Without.](#)
  - [MSRB Considers Creating Municipal Market Data Product for Academic Researchers.](#)
  - [New California Law Would Secure Local GO Holders in Bankruptcies.](#)
  - [IRS Rules Student Loan Bonds Still Tax-Exempt in PLR.](#)
  - [CDFA Intro to Public-Private Partnership \(P3\) Finance Course.](#)
  - [CDFA Intro to Tax Increment Finance Course.](#)
  - [Borough of Keyport v. International Union of Operating Engineers](#) - Supreme Court of New Jersey holds that negotiation would have significantly interfered with management determination of governmental policy, and therefore municipalities' imposition on certain units of public employees mandatory, but temporary, layoffs, in the form of a reduced number of work days over a specified period of time was non-negotiable, such that municipalities did not violate Employer-Employee Relations Act by imposing layoffs without negotiating with representatives from unions for public employees.
  - And finally, that noise you just heard is the collective sigh of relief going up from our nation's overworked/underpaid schoolteachers as they learn that they can't be fired for a [third offense of using profanity in front of their students](#). "[Bleep] Yeah!"
  - And even more finally, Happy Motoring in the Grand Canyon State is brought to you this week by [Fleming v. State Dept. of Public Safety](#), in which a police officer placed an intoxicated driver in the rear seat of his patrol car, which was immediately obliterated by yet another drunk driver, killing the poor woman in the back seat. Maybe the open bar at the midnight Mad Max screenings wasn't such a great idea after all.
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## IMMUNITY - ARIZONA

### [Fleming v. State Dept. of Public Safety](#)

**Supreme Court of Arizona - July 9, 2015 - P.3d - 2015 WL 4132665 - 716 Ariz. Adv. Rep. 17**

Conservator for minor children of deceased arrestee brought action against Department of Public Safety (DPS), seeking to recover following arrestee's death, which occurred when police cruiser in which arrestee was seated was struck by another vehicle on shoulder of interstate highway. The Superior Court entered judgment on jury verdict in favor of DPS. Conservator appealed. The Court of Appeals affirmed. Conservator petitioned for review.

After granting review in part, the Supreme Court of Arizona held that as a matter of first impression, an injury to the "driver" of a motor vehicle, for which a public entity may have qualified immunity in certain circumstances, means an injury to a person who is driving or in actual physical control of a vehicle when she is injured.

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## UTILITIES - COLORADO

### [Energy and Environment Legal Institute v. Epel](#)

**United States Court of Appeals, Tenth Circuit - July 13, 2015 - F.3d - 2015 WL 4174876**

Nonprofit energy organization brought action alleging that Colorado statute requiring that twenty percent of electricity sold to Colorado consumers come from renewable sources violated dormant Commerce Clause. After environmental groups intervened, the United States District Court entered summary judgment in state's favor, and organization appealed.

The Court of Appeals held that:

- Statute did not violate dormant Commerce Clause, and
- District court did not abuse its discretion in denying organization's request to defer ruling on state's summary judgment motion.

Colorado statute requiring electricity generators to ensure that twenty percent of electricity they sold to Colorado consumers come from renewable sources did not violate dormant Commerce Clause. Statute was not price control statute, it did not link prices paid in Colorado with those paid out of state, and it did not discriminate against out-of-staters.

District court did not abuse its discretion in denying plaintiff's request to defer ruling on defendant's summary judgment motion until additional discovery could take place, where court did not rule on motion until after discovery had closed, and plaintiff did not seek to supplement its summary judgment opposition papers with new evidence acquired from additional discovery it received, or indicate what additional discovery was still needed.

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## **EMPLOYMENT - FLORIDA**

### **[Quiller v. Duval County School Bd.](#)**

**District Court of Appeal of Florida, First District - July 15, 2015 - So.3d - 2015 WL 4256734**

Teacher who was terminated by school board for her third offense of using profanity in front of students appealed.

The District Court of Appeal held that board's rejection of ALJ's recommendation of suspension without pay was not in compliance with collective bargaining agreement.

School board's termination of teacher for her third offense of using profanity in front of students was not in compliance with collective bargaining agreement, which required progressive steps in administering discipline unless a severe act of misconduct warranted circumventing the steps, where ALJ found that using profanity in front of students was not a severe act of misconduct, the board adopted this conclusion of law, and the ALJ recommended suspension without pay.

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## **LABOR - NEW JERSEY**

### **[Borough of Keyport v. International Union of Operating Engineers](#)**

**Supreme Court of New Jersey - July 14, 2015 - A.3d - 2015 WL 4207440**

Unions for public employees brought scope-of-negotiation challenges to municipalities' layoff actions. The Public Employment Relations Commission (PERC), in three separate decisions, held that municipalities violated Employer-Employee Relations Act (EERA). Municipalities appealed and appeals were consolidated. The Superior Court, Appellate Division, reversed. Unions sought certification to appeal, which was granted.

The Supreme Court of New Jersey held that:

- Negotiation of layoffs was not preempted by civil service statutes or regulations;
- Negotiation of temporary layoffs would have significantly interfered with determination of governmental policy; and
- Negotiation of elimination of positions as part of layoff plan would have significantly interfered with determination of governmental policy.

Neither civil service regulation that had permitted temporary layoffs of employees in State or local service, nor civil service statutes, preempted negotiation of temporary layoffs of public employees or elimination of positions as part of overall layoff plan, where statute and implementing regulations that authorized a layoff of public sector employees did not require that such action affecting terms and conditions of employment be taken.

Negotiation would have significantly interfered with management determination of governmental policy, and therefore municipalities' imposition on certain units of public employees mandatory, but temporary, layoffs, in the form of a reduced number of work days over a specified period of time was non-negotiable, such that municipalities did not violate Employer-Employee Relations Act (EERA) by imposing layoffs without negotiating with representatives from unions for public employees. Actions went directly to a substantive policy determination about whether and how to deliver public services when delivery was affected by serious and pressing economic considerations.

Negotiation would have significantly interfered with management determination of governmental policy, and therefore municipality's elimination, as part of an overall layoff plan, three full-time clerical positions and replacement of them with part-time positions, resulting in the affected employees losing their eligibility for health benefits, was non-negotiable, such that municipality did not violate Employer-Employee Relations Act (EERA) by taking action without negotiating with representatives from unions for public employees. Actions went directly to a substantive policy determination about whether and how to deliver public services when delivery was affected by serious and pressing economic considerations.

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## **ZONING - NEW MEXICO**

### **[Village of Logan v. Eastern New Mexico Water Utility Authority](#)**

**Court of Appeals of New Mexico - July 6, 2015 - P.3d - 2015 WL 4112526**

This single-issue appeal concerned the clarification of the legal methodology that applies to resolve a zoning and land use conflict between a municipality and a water utility authority, both of which are political subdivisions of the state established by legislative processes.

The district court and the parties collectively identified five stand-alone tests used in varying jurisdictions to resolve disputes of this nature: (1) the statutory guidance test, (2) the balancing of interests test, (3) the eminent domain test, (4) the superior sovereign test, and (5) the governmental propriety test.

The water authority sought application of either the statutory guidance or eminent domain tests, while the municipality maintained that the balancing of interests test should be adopted in circumstances of sovereign equality.

The district court employed the statutory guidance test, which it found to be most consistent with New Mexico law, and the Court of Appeals affirmed.

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## **ZONING - NORTH CAROLINA**

### **[China Grove 152, LLC v. Town of China Grove](#)**

**Court of Appeals of North Carolina - July 7, 2015 - S.E.2d - 2015 WL 4082073**

Land developers brought action against town for declaratory judgment to secure interest on impact fees that town charged pursuant to ordinance, which town reimbursed with a letter indicating that refund, without interest, was consideration for waiver of claims under ordinance. The Superior Court denied town's motion to dismiss, granted developers' motion for judgment on the pleadings, and awarded developers interest. Town appealed.

The Court of Appeals of North Carolina held that:

- Ordinance was invalid;
- Town was required to pay interest; and
- Accord and satisfaction of claims under ordinance did not bar interest sought under state statute.

Town ordinance requiring land developers to pay impact fees as a condition precedent for development approval used to fund police force, fire departments, and parks was invalid, despite contention that ordinance was merely a subdivision control ordinance. Ordinances requiring developers to pay fee for adequate public facilities were invalid absent specific authority from General Assembly, ordinance's stated purpose was to ensure that public facilities supporting new residential development met or exceeded standards, and statute governing subdivision control ordinances did not authorize municipalities to charge fees as a condition precedent to subdivision approval.

Fact that town had voluntarily returned to developers the principal amount of illegally exacted impact fee did not bar developers from recovering interest on the returned fee pursuant to statute, even though fee was not the subject of an underlying judgment entered against town. Statute unambiguously required payment of interest on illegally exacted fee, statute did not prevent a claim for interest when a town returned the principal amount, and statute did not bar a claim for interest that arose from a separate civil action.

Doctrine of accord and satisfaction did not bar land developers from seeking interest on fee illegally exacted pursuant to invalid town ordinance, even though town returned fee principal with letter containing mutual release of obligations and liabilities under ordinance, developers initialed letter, and developers cashed the check, where letter contained no reference to a waiver of any obligations or liabilities regarding interest payments allowed under state statute.

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## **SEPARATION OF POWERS - NORTH DAKOTA**

### **[Kroschel v. Levi](#)**

**Supreme Court of North Dakota - July 7, 2015 - N.W.2d - 2015 WL 4139734 - 2015 ND 185**

Driver sought judicial review of decision by the Department of Transportation to suspend her driver's license for 180 days following arrest for driving under the influence (DUI) by state university police officer outside of university property. The District Court affirmed. Driver appealed.

The Supreme Court of North Dakota held that:

- Chief of police was not authorized to swear university officer as officer with authority throughout city;
  - State Board of Education was not authorized to permit university officer to act outside of its institution;
  - Officer was not authorized to arrest driver under statute permitting assistance and exchange of law enforcement officers; and
  - Joint powers agreement between city and university did not authorize university officer to arrest driver.
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## **ANNEXATION - TEXAS**

### **[City of Dallas v. D.R. Horton-Texas, Ltd.](#)**

**Court of Appeals of Texas, Dallas - July 10, 2015 - Not Reported in S.W.3d - 2015 WL 4162286**

In 1971, the City annexed an area of 466 acres. In 2008, D.R. Horton-Texas, Ltd. owned about 267 acres, more than 50%, of the area, which was more than fifty percent of the area.

In 2008, D.R. Horton filed a petition with the City requesting that the City disannex the area because the City had not provided services to the area that were substantially equivalent to the services the City provided to similar areas. The City did not act on the petition, and D.R. Horton took no further action at that time.

Five years later, on September 3, 2013, D.R. Horton filed a second petition for disannexation. When the City did not act on this petition within ninety days, D.R. Horton brought suit against the City on January 24, 2014, seeking disannexation of the area.

The City filed a plea to the jurisdiction asserting it was immune from suit and that the trial court lacked subject-matter jurisdiction over the suit. The trial court held a hearing on the City's plea to the jurisdiction and denied the plea. The City appealed.

The parties agreed that the Municipal Annexation Act of 1963 (Act) applied in this case because it was the statute under which the area was annexed in 1971. The Act expressly permits a petitioner seeking disannexation to file suit against a city if the city does not timely disannex the area. Therefore, in this case, the Act waived the City's governmental immunity from suit if D.R. Horton had alleged a valid claim for disannexation.

The City contended that the trial court erred by denying the plea to the jurisdiction because D.R. Horton's suit was time barred when it failed to file suit within sixty days of the City's refusal to disannex the area in 2008. The Court of Appeals disagreed, finding nothing in the applicable statute that would prohibit multiple disannexation petitions.

The Court of Appeals also held that the requirements of section 10.C that at least one voter sign the disannexation petition and that a voter sign the affidavits of posting and of voters and acreage do not apply when no voter resides in the area sought to be disannexed.

Finally, the Court was a bit baffled by the City's contention that the trial court lacked subject-matter jurisdiction over the suit because a bond-validation suit precluded D.R. Horton's challenge to the City's boundaries.

The plea to the jurisdiction was denied.

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## **Sen. Ron Wyden's Dream: Munis as Holiday Presents.**

WASHINGTON — It's Christmas morning, and little children make their way down the stairs of their home to find out what gifts they've received.

But instead of finding toys under the tree, their parents have bought them municipal bonds that will help finance the improvement of roads and other infrastructure in their community.

Can't envision this scenario? Sen. Ron Wyden acknowledges it isn't going to happen immediately. But he hopes that one day, parents will give their kids infrastructure bonds for the holidays.

"I think that it's probably a lot better for the economy and the planet than buying a kid another toy that's going to break in 20 minutes," said Wyden, an Oregon Democrat and the ranking minority member of the Senate Finance Committee.

Wyden, 66, is probably one of the most well-known senators to muni market participants. Over the years, he has introduced a number of bond-related proposals, some more liked by market participants than others. He talked about munis and other topics in a recent interview for The Bond Buyer's series of profiles of Congress members.

Wyden said his status as a Westerner has made him particularly sensitive to the importance of municipalities' ability to finance and build infrastructure.

"If you're from the West, you know that most of your state really got built with state and local infrastructure," he said. "I mean, it was just kind-of almost embedded in our chromosomes."

Wyden has held hundreds of town-hall meetings across Oregon. "Whenever you go out to counties and local municipalities, you see that their future to a great extent is about investments they make in infrastructure in states and local projects," he said. Wyden added that he's come away from his travels thinking that bond financing should be allowed as long as it's done in a responsible fashion.

### **Move America Bonds**

Wyden's latest bond bill, the Move America Act of 2015 that he co-authored with Sen. John Hoeven, R-N.D., would create a new type of private-activity bond called Move America Bonds. These bonds could finance infrastructure projects that are publicly and/or privately owned and they would not be subject to the alternative minimum tax. The bonds would be issued under new state volume caps equal to 50% of the volume caps for PABs, and these caps could be converted to allocations of tax credits.

Wyden thinks Move America Bonds are potentially much more appealing than Build America Bonds, direct-pay bonds that the Senator says he created. BABs were authorized by the American Recovery and Reinvestment Act and could be issued in 2009 and 2010.

He said that, with Move America Bonds, "I think there's something for conservatives, particularly the focus on states and on the private sector. Think there's something there for progressives, which is the public and private investment."

Muni experts in Washington praised Wyden's interest in infrastructure and said they view the Move America Act favorably.

“Sen. Wyden has been a leader in promoting infrastructure finance throughout his career. He was an active supporter of Build America Bonds, and his most recent ‘Move America’ program represents an innovative approach to addressing the country’s infrastructure investment shortfall,” said Michael Decker, managing director and co-head of municipal securities at the Securities Industry and Financial Markets Association.

Mike Nicholas, chief executive officer of the Bond Dealers of America, said his group “appreciates Senator Wyden’s efforts to improve investment in transportation, infrastructure, and other community projects. We support his recently introduced legislation to create Move America Bonds, as long as these bonds are used as a supplement to [and not as a replacement for] traditional tax-exempt bonds.”

President Obama’s fiscal 2016 budget also proposes a new type of PAB for infrastructure – qualified public infrastructure bonds — that would not be subject to the AMT. However, there are some differences between the Obama and Wyden proposals. QPIBs could only finance publicly owned projects and would not be associated with tax credits or subject to volume caps.

Wyden said his office talked to administration officials about QPIBs and worked closely with them, but that his bill is more attractive.

“I think that the capacity to be able to sell the credits and create even more motion and even more interest and more players and more private-sector involvement is very appealing to us,” he said.

Senate Finance Committee Chairman Orrin Hatch, R-Utah, is studying the Move America Act, a spokeswoman said.

While the bill hasn’t been introduced in the House yet, Wyden said there are House members on both sides of the aisle that are interested in the proposal. He thinks it will have to have bipartisan support to pass.

“My view is, neither side has enough votes to tell the other side what to do,” Wyden said, so it’s important for members of Congress to find areas of agreement.

## **Tax Reform**

As the ranking minority member, Wyden is the top Democrat on the Senate Finance Committee with jurisdiction over tax reform.

In the past, he has sponsored bipartisan tax-reform legislation that troubled the muni market. A bill he introduced with then-Sen. Judd Gregg, R-N.H., in 2010 and a similar measure he introduced with Sen. Dan Coats, R-Ind., in 2011, would have halted the issuance of tax-exempt bonds in favor of traditional tax-credit bonds that provided investors with tax credits equaling 25% of the interest costs.

Also he and Hoeven in 2011 sponsored a bill to create transportation and regional infrastructure project bonds, tax-credit bonds for infrastructure projects.

But Wyden said he isn’t wedded to the concept of replacing tax-exempts with tax credit bonds.

“This is not some ideological cause for me,” he said. “For me, it’s about trying to ream every bit of possible value out of the incentives that you end up with.”

Still, Wyden said he “will always be concerned about abuses” of munis.

“There have been some, no question about it,” Wyden said. He’s not a fan of tax-exempt bonds being used to finance professional sports stadiums.

“To me, a public project with publicly funded tax assistance needs to have a public purpose,” he said. “Quaint idea, huh?”

Wyden and finance committee chairman Hatch created bipartisan tax-reform working groups on five topic areas that released reports earlier this month. The report from the community development and infrastructure group did not recommend changes to bond provisions.

Asked about the report, Wyden said producing tax-reform legislation is “hard work.” He said his first choice would be to do comprehensive tax reform. He also said he would be sympathetic to a long-term transportation bill tied to some type of international tax reform, “but the details count, and we’ll have to have a chance to look through and see what the costs are who benefits and who doesn’t,” he said.

Wyden said he thought Congress made a “big mistake” when it didn’t pass a bill he introduced last year — the Expiring Provisions Improvement, Reform, and Efficiency (EXPIRE) Act of 2014 — that would have extended expired or expiring tax provisions through the end of 2015. That bill, which included extenders related to bonds, state and local taxes, and Puerto Rico, stalled after the Senate Finance Committee approved it.

“I think we should have passed it and used it as a two-year bridge to do tax reform,” Wyden said. “Instead, the Congress had a tax bill with a shelf life shorter than a carton of eggs.”

Congress passed legislation that only extended the provisions through the end of 2014. This year, the House has voted to make some of the provisions permanent, including the deduction for state and local sales taxes. The Senate Finance Committee is scheduled to vote on a two-year extenders bill on Tuesday.

Wyden was an author of the Internet Tax Freedom Act, which prevents state and local governments from taxing consumer Internet access and prevents “multiple or discriminatory” taxes on e-commerce. The moratorium on taxing Internet access went into effect in 1998 and has since been extended several times. The House has passed a bill to make the ITFA permanent. Wyden wants the Senate to take the same action.

Some members of Congress want to tie the ITFA to legislation that would allow states to require out-of state online retailers to collect their sales taxes. But Wyden does not support that legislation.

State and local government groups are major supporter of online sales tax legislation, saying that it would allow states to collect taxes that are already owed. While Wyden said he has “no problem” with jurisdictions collecting taxes already owed, he thinks online sales tax bills shift the burden of collecting the taxes from the states to the retailers.

“To some extent, this is transferring, or efforts to transfer, a state function to online retailer[s],” he said.

### **An Unusual Path**

Unlike many of the main sponsors of muni-related legislation in Congress, Wyden doesn’t have a background in state and local government. In fact, he had never run for any elected office before running for Congress.

"It was not the usual path," he said.

When he was younger, Wyden dreamed not about being a Senator but about being a professional basketball player. His love of the sport was evident in his Capitol Hill office, where a basketball rested on a coffee table and another was in a bookcase.

"I went to school on a basketball scholarship. All I wanted to do is play in the NBA, and that was a little delusional, 'cause I was too small and I made up for it by being slow," Wyden said. So after playing for two seasons at the University of California, Santa Barbara, he gave up his hoops dreams and transferred to Stanford University. He then went to the University of Oregon for law school and worked with the elderly, co-founding the Oregon chapter of the Gray Panthers.

In 1980, at the age of 31, Wyden was elected to the House. He defeated the incumbent, former Rep. Bob Duncan in the Democratic primary and Republican Darrell Conger in the general election. "Portland had a Congress person, not a[n] evil, horrible person, but he just wasn't involved very much," Wyden said.

In 1996, Wyden was elected to the Senate, becoming Oregon's first Democrat in that chamber in nearly 30 years. He succeeded Bob Packwood, who resigned amidst allegations of sexual misconduct.

Packwood had served as Senate Finance Committee chairman during the 1986 tax reform process, and Wyden would later hold that position for less than a year. Wyden took the helm of the committee in February 2014, after the Senate confirmed then-Sen. Max Baucus, D-Mont., as U.S. Ambassador to China, only to lose the post in 2015 when Republicans gained control of the Senate.

Wyden, who is seeking re-election in 2016, said he'll work in a bipartisan manner no matter which political party has a majority in the Senate.

"I'd obviously rather be in the majority, but I've always been attuned to trying to find common ground," he said.

Susan Collet, president of H Street Capitol Strategies, said Wyden is "someone willing to innovate and reach across the aisle to make deals." He is willing to change what he proposes to get the political support needed to move debate forward, she said.

Howard Gleckman, a fellow at the Urban Institute, said Wyden is a "throwback to an older time in the Senate" when it was better to get a good bill than to fail to get a perfect bill.

Wyden said he feels strongly about a concept he calls "principled bipartisanship."

"Principled bipartisanship is not taking each other's bad ideas. It's about taking good ideas," he said.

THE BOND BUYER

BY NAOMI JAGODA

JUL 17, 2015 11:13am ET

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## [Junk-Bond Stigma is Costing Chicago.](#)

(Bloomberg) — Chicago is paying a price for the \$20 billion pension-fund shortfall that pushed it into junk-bond territory.

The nation's third-most populous city had to pay yields approaching 8 percent as part of a \$743 million taxable-bond offering Wednesday. That puts it in the company of issuers such as telephone company CenturyLink Inc., whose \$650 million of similar-maturity securities yield 8.53 percent.

Chicago has been stung by rising borrowing costs as Mayor Rahm Emanuel refinanced floating-rate debt over the past two months, seeking to avoid as much as \$2.2 billion of penalties triggered when Moody's Investors Service cut it below investment grade. The May downgrade left the city of 2.7 million with a lower rating than any major U.S. city except for Detroit, a result of years of failing to put enough into its retirement system to cover promised benefits.

"They've taken a notch in the right direction by reducing the liquidity threat related to variable-rate debt," said Richard Ciccarone, chief executive of Chicago-based Merritt Research Services LLC, which analyzes municipal finance. "But the city will pay a price, and deservedly so."

### ADDITIONAL LIABILITIES

Chicago's pension obligations are rising, increasing pressure on officials to boost property taxes. The city owes an additional \$550 million to police and fire funds next year.

Lawmakers approved a plan to reduce that payment, but Governor Bruce Rauner has yet to sign it. Uncertainty around the city's pension liabilities worsened after the state Supreme Court ruled that Illinois can't lower retiree benefits, casting doubt on Chicago's overhaul of its pension system to stem costs.

The taxable issue and a \$344 million tax-exempt offering set for Thursday are the last in Emanuel's plan to convert variable-rate bonds to fixed-rate securities. The floating-rate debt threatened to add to Chicago's financial pressures because its tumbling credit rating allowed banks to force Chicago to pay it off early, which it couldn't afford to do.

"We expect continued positive investor feedback on the City's reform efforts," Elizabeth Langsdorf, a city spokeswoman, said in an e-mailed statement.

### COURT DECISION

The city's escalating borrowing costs are a consequence of a financial outlook that has yet to improve, said Paul Mansour, head of municipal research at Conning & Co., which oversees about \$11 billion in municipal debt, including Chicago holdings.

He said he's not going to buy any of the debt.

The Chicago bonds sold Thursday are exempt from the federal income tax, so the yields will be lower than those set Wednesday. The city's tax-exempt bonds maturing in 2035 last traded for a yield of 5.6 percent, about 2.5 percentage points more than top-rated debt, according to data compiled by Bloomberg.

The latest sale, authorized by the city council on June 17, will also allow Chicago to push some bills into the future, said Matt Fabian, a partner at Concord, Massachusetts-based Municipal Market Analytics.

Chicago's effort to close the gap in its pension funds could be dealt a setback in court as soon as next week, when a judge is to decide whether Emanuel's overhaul of the pension system is legal. The restructuring, affects about 60,000 municipal employees. Some unions sued to block its implementation.

## INVESTOR RISK

If the judge overturns the law, Chicago's credit rating may be cut further, Fabian said. Chicago could have junk ratings from all four rating companies in the next two years, he said.

"With the risk of them potentially losing more investment grade ratings, buyers can't be aggressive," Fabian said.

"There aren't many speculators who are willing to make a bet on Chicago tightening yet. This is a kind of deal that would price cheaply."

John Donaldson isn't among such speculators. Donaldson, who helps manage about \$700 million of munis, including Chicago debt, as director of fixed income at Haverford Trust Co. in Radnor, Pennsylvania, said he's steering clear of the city.

"We've shied away from it," Donaldson said. "It's all the liabilities, including the pension, current budget. Do I need that headache right now? No, I do not."

July 16, 2015

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## **[New York Bonds Headline \\$9.48 bln Muni Supply Next Week.](#)**

An abundance of New York issuance will hit the U.S. municipal bond market next week amid total supply of bonds and notes estimated at \$9.48 billion, down from about \$10.5 billion this week, according to Thomson Reuters on Friday.

New York State's Dormitory Authority will offer \$1.16 billion of state sales tax revenue bonds through Morgan Stanley. The deal is structured with serial maturities from 2016 through 2025, according to the preliminary official statement (POS). An additional \$50 million of bonds will be priced on Thursday via Raymond James & Associates.

Another New York issuer, the Metropolitan Transportation Authority, will sell \$500 million of revenue refunding bonds through Siebert Brandford Shank & Co and Morgan Stanley with a retail order period on Wednesday ahead of formal pricing on Thursday.

Moody's Investors Service last week upgraded MTA's rating to A1 from A2, citing growing passenger volume and stable finances.

The deal consists of \$500 million of fixed-rate bonds with serial and term maturities, \$50 million of mandatory tender bonds and \$50 million of LIBOR floating rate tender notes, according to the POS.

Citigroup will price \$110 million of New York State Environmental Facilities Corporation tax-exempt and taxable revolving funds revenue bonds on Tuesday.

Topping next week's competitive calendar is a \$347 million general obligation bond issue for the Metropolitan Government of Nashville and Davidson County scheduled for Tuesday.

Meanwhile, net outflows from U.S. municipal bond funds decreased to \$29.2 million in the week ended on Wednesday from \$305.7 million in the previous week, Lipper reported on Thursday. It was the eleventh-straight week of net outflows for the funds.

Flows turned positive for high-yield muni funds with net inflows of \$14.5 million posted in the latest week after two weeks of net outflows.

## **Reuters**

(Reporting by Karen Pierog, editing by G Crosse)

July 17, 2015

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### **TAX - NEBRASKA**

#### **[TJ 2010 Corporation v. Dawson County Board of Equalization](#)**

**Court of Appeals of Nebraska - June 23, 2015 - N.W.2d - 22 Neb.App. 989 - 2015 WL 3858529**

TJ 2010 Corporation (TJ) appealed the order of the Tax Equalization and Review Commission (TERC) affirming the decision of the Dawson County Board of Equalization (Board) regarding the 2013 taxable value of a hotel owned by TJ.

The Dawson County assessor had determined that the value of the property was \$4,510,230 for tax year 2013. TJ protested the assessment to the Board and requested a valuation of \$2.8 million. The Board determined that the taxable value was \$4,510,230, as originally assessed. TJ appealed the Board's decision to TERC.

At the TERC hearing, TJ asserted that the most important method for valuing hotels is the income stream approach, which is determined by using a multiplier of the property's annual gross revenue averaged over the past 3 years. TJ indicated that the appropriate multiplier for most mainstream hotels is between 2.8 and 3.

The County's appraiser testified that he used both the cost approach and the income approach to calculate the value of the property. The appraiser opined that the income approach is generally more applicable to income-producing properties, but that for newer or unique properties such as this one, the cost approach is a better indicator of actual value.

TERC concluded that TJ had provided competent evidence to rebut the presumption that the Board had faithfully performed its duties and had sufficient competent evidence to make its determination. It criticized the appraiser's valuation for using outdated costing tables in the cost approach and for using market factors derived from comparable sales without making the necessary adjustments to the comparable properties. However, it determined that TJ's valuation method was not a commonly accepted real property appraisal method and was not supported by market data. Therefore, it found that while there were concerns about the reliability of the County's appraisal, there was no market data received in evidence to support a different opinion of any of the income approach factors. Thus, it concluded that TJ failed to present clear and convincing evidence that the Board's valuation was unreasonable or arbitrary.

The Court of Appeals affirmed, finding that TJ failed to establish by clear and convincing evidence that the county's valuation was arbitrary or unreasonable.

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## **IRS Rules Student Loan Bonds still Tax-Exempt in PLR.**

A private letter ruling from the Internal Revenue Service ruled that actions taken by an issuer of student loan bonds which would cause that issuer to cease being a qualified scholarship funding corporation would not cause the interest on the bonds to fail to be excludable from gross income under § 103.

The PLR states that “[b]ecause Issuer represents it was a corporation described under § 150(d)(2) at the time the Bonds were issued, it was a corporation described under § 150(d)(2) for the entire time the Bonds were outstanding, and it remained the obligor on the Bonds the entire time they were outstanding, Issuer’s proposed actions will not cause interest on the Bonds to fail to be excludable from gross income under § 103.”

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## **New California Law Would Secure Local GO Holders in Bankruptcies.**

PHOENIX — California Gov. Jerry Brown has signed a new law securing revenues for general obligation bonds issued by local governments — a move designed to protect bondholders in a bankruptcy proceeding. But rating agencies have mixed feelings about whether it will be of much benefit to holders of local GOs in the nation’s most populous state.

The law, known as SB 222, is designed to preserve bondholder rights to the tax revenues used to back bonds, which are received by a municipality after it enters bankruptcy proceedings. The bankruptcy code defines statutory liens like those mandated under SB 222 as created by force of law, as opposed to typical consensual liens that are created by an agreement. “Secured” creditors of a bankrupt municipality are supposed to be first in line to recover their money, but California law was previously silent on whether local GOs were “secured” for that purpose. The new law removes that ambiguity.

“Many have argued that the taxes levied to pay California GO bonds are ‘special revenues’ under the bankruptcy code, but this analysis has never been certain,” said Orrick, Herrington & Sutcliffe attorney John Palmer, who drafted SB 222. “This is the first time we have been able to say that GO bondholders are secured creditors in a municipal bankruptcy. Being a secured creditor in bankruptcy dramatically decreases the risk of nonpayment. This newfound certainty should permit investors and rating agencies to focus more narrowly on the tax-base as the credit for California GO bonds, and less heavily on issuers’ general funds.”

State Sen. Mary Block, D-San Diego, introduced the bill earlier this year. It passed through both the Assembly and the Senate with strong support last month. The new law, which becomes effective on Jan. 1, is very similar to legislation enacted in Rhode Island in 2011 after Central Falls filed for Chapter 9 protection. California has been home to some high-profile bankruptcy proceedings, including the cities of Stockton, which emerged from Chapter 9 earlier this year, and San Bernardino, which has not yet completed the process.

Moody’s Investors Service was upbeat about the implications for holders of bonds sold by California issuers.

“Generally speaking, the security for California local government GO bonds is a dedicated, unlimited, voter-approved property tax levy, the proceeds of which cannot be used for any purpose

other than the bonds authorized by voters," Moody's analysts wrote. "The California Constitution makes the debt service levy separate from the property tax levied for operating purposes. State statute is nonetheless silent on whether GO investors would be secured in the event of a local government's bankruptcy filing, and case law on this matter is also very limited. The new law is positive for GO investors because it clearly establishes their secured status."

Although Moody's views the bill as a credit positive, the agency said it would not likely have a "material effect" on the ratings of California local GOs.

Fitch Ratings analysts had a conservative take on the law.

"Revenues supported by a statutory lien are not free from the automatic stay of a municipality's general revenues once bankruptcy proceedings begin," Fitch said. "Rather, the statutory lien prevents the municipality in a bankruptcy from generally diverting the revenues subject to the statutory lien. The statutory lien does not prevent use of the revenues in the bankruptcy process as long as adequate protection for recovery is offered to bondholders benefiting from the statutory lien. These protections will not guarantee full or timely repayment, only potentially higher recovery."

Palmer said that agencies no longer having to look as closely at general funds due to the assurance of a statutory lien on revenues could be a big positive for issuers paying too much because of general fund weaknesses.

"This would potentially save taxpayers billions of dollars over the time," he said.

THE BOND BUYER

BY KYLE GLAZIER

JUL 17, 2015 3:24pm ET

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## **TAX - GEORGIA**

### **[City of Atlanta v. Hotels.com, L.P.](#)**

**Court of Appeals of Georgia - July 9, 2015 - S.E.2d - 2015 WL 4114057**

City brought action against several online travel companies, asserting claims for conversion and breach of trust. The Superior Court granted summary judgment to defendants on both claims, and city appealed.

The Court of Appeals held that:

- There was no evidence that money collected by online travel companies, purportedly owned to city in the way of taxes collected by the companies from customers seeking to occupy city's hotel rooms but not remitted, comprised specific, separate, identifiable funds, as required to support city's conversion claim;
- Under the law of the case doctrine, there could be no claim by city for breach of a constructive trust; and
- The Superior Court did not abuse its discretion in denying city's motions for additional discovery.

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## **[CDFA Summer School.](#)**

**August 10-14, 2015 | St. Louis, Missouri**

CDFA Summer School is a week long series of courses presented by the CDFA Training Institute. Hosted by the St. Louis County Economic Development Partnership and the St. Louis Development Corporation, CDFA Summer School will offer five different training courses at the St. Louis Union Station hotel in downtown St. Louis, Missouri.

These courses qualify for the CDFA Training Institute's Development Finance Certified Professional (DFCP) Program. Participants may register for one, two, or three courses during CDFA Summer School. Complete three courses, and you will have fulfilled half of the requirements for the DFCP Program. Join us in St. Louis, and start down the road to personal and professional advancement today.

[Click here for more information and to register.](#)

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## **[CDFA Intro to Public-Private Partnership \(P3\) Finance Course.](#)**

**August 11-12, 2015 | St. Louis, Missouri**

The Intro Public-Private Partnership (P3) Finance Course examines this emerging development finance model with a focus on how development finance agencies can adopt P3 principles to address a variety of projects. This course will cover basic P3 concepts, key players involved in transactions, asset valuation, contract negotiation, risk assessment, revenue stream development, and feasibility analysis. In addition, several P3 projects from across the country will be presented, and P3 experts will analyze the successful elements in each deal.

Interest in P3 financing is growing as state and local governments face tough budget decisions along with declining federal investment in infrastructure. Several state and local agencies have used P3 to finance real estate developments, schools, parking garages, public transit, affordable housing, water facilities, and more. During the Intro P3 Finance Course, industry experts will discuss the common characteristics and drivers of P3 financings throughout the country and explain the various structures of these deals.

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**August 11-12, 2015 | St. Louis, Missouri**

The Intro Tax Increment Finance Course offers an in-depth look at the guiding principles and appropriate application of TIF. This course brings TIF deal-making and best practices into focus

through a two-day program targeting the entire TIF community including economic developers, public agency representatives, bond issuers, legal professionals, developers, financial advisors, and other stakeholders.

This course qualifies for the CDFA Training Institute's Development Finance Certified Professional (DFCP) Program. Start down the road to personal and professional advancement today.

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