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“Creative Economic Development Financing in a Difficult Market”

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Topics in this Discussion

- Hot Topics in Public Finance today.
- What are New Market Tax Credits (NMTCs)?
- How can I utilize NMTCs?



Hot Topics In Public Finance

- South Carolina is on the cutting edge of development.
- Need to continue to capitalize on existing momentum.
- What can I do to attract growth and new development?
- What factors are important to the market today?
- How can I improve?

DeKalb's Descent Startles Market

&P Drops Credit y Five Notches

BY SHELLY SIGO

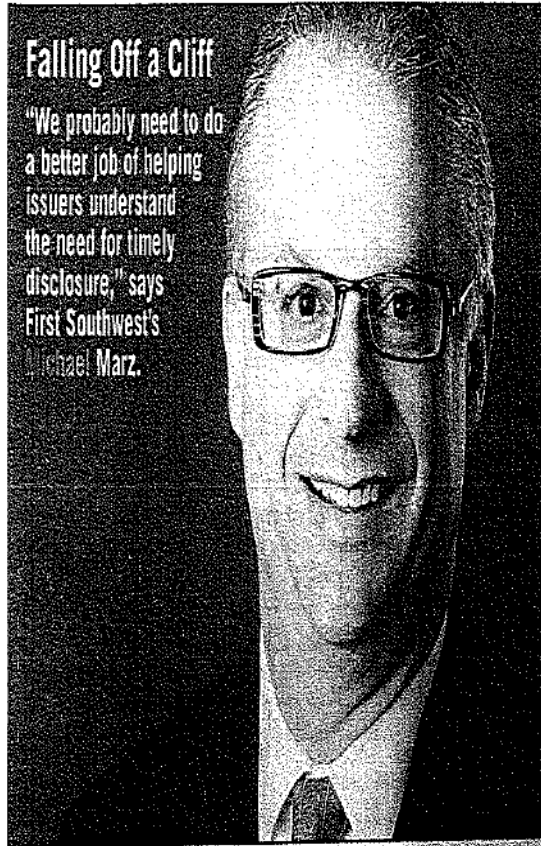
BRADENTON, Fla. — Some municipal bond market observers say last week's stunning five-notch downgrade of Georgia's third-largest county highlights the importance of disclosure — what Standard & Poor's sees as insufficient disclosure in the case of DeKalb County.

The downgrade to BBB from A-minus, and withdrawal of the county's ratings, drew swift action from market observers and forced bondholders unable to hold the debt at the lower rating to shed their investments.

Standard & Poor's had given the county a gilt-edged AAA rating as recently as January.

Some experts said the situation could send a message to issuers about the importance of disclosure, and the potential higher cost credit.

But they also rejected the idea that DeKalb's downgrade supports predictions of widespread



Falling Off a Cliff

"We probably need to do a better job of helping issuers understand the need for timely disclosure," says First Southwest's Michael Marz.

defaults by municipalities.

DeKalb has not defaulted on its debt and Standard & Poor's analysts said its action, while unusual, was indicative of a county with a rapidly deteriorating financial condition and inconsistent reporting on which to base a rating analysis.

"It was clearly the absence of information that contributed to that," Michael Marz, a vice chairman at First Southwest Co. and chairman of the Bond Dealers of America, said at the National Municipal Bond Summit in Miami Beach last week.

Marz said there is an expensive

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associated with the lack of disclosure, and without the proper continuing disclosure agreement underwriters cannot bid on an issuer's bonds.

"We probably need to do a better job of helping issuers understand the need for timely disclosure," he added.

The fundamentals of municipal credits remain very strong and very sound, Noe Hinojosa, president of Estrada Hinojosa & Co., said at the summit.

"When you are an issuer it is important to tell your story," he said. "We tell clients that never has an A [rating] mattered so much."

The steep rating downgrade took many officials in DeKalb by surprise, according to County Commissioner Jeff Rader.

Rader said that the commission erred last October when reserves were used for operational needs and that, in combination with unexplained expenses at the end of the year, pushed a negative fund balance forward.

In response to the rating downgrade, Rader said he unveiled a proposal late last week designed to stabilize the county's finances with a "modest" 3.3 millage-rate increase later this year that would restore reserves at \$45 million — one month's expenses — and provide \$17.7 million for capital and operation needs that may arise.

"All the commissioners understand that we have to increase revenues," Rader said. "I'm proposing to do it now to give a signal to the bond market and ... try to repair our credit. I hope that has a positive effect on what the market believes DeKalb is likely to do."

Standard & Poor's said several factors underpinned the county's rapid rating downfall, including multiple years of deficit operations that contributed to substantially weakened liquidity and a negative cash position at fiscal year end on Dec. 31 that necessitated internal fund borrowing to make GO debt-

service payments on Jan. 1

and failed to implement timely solutions to offset the structural budget imbalance, analysts said, noting that county commissioners rejected tax increases last year and early this year.

At the end of 2009, the county had an unreserved fund balance of negative \$34.5 million and preliminary unaudited results for fiscal 2010 indicated further deterioration of fund balance and liquidity, Standard & Poor's said.

Robin Prunty, a managing director at the agency, said analysts expected

some local governments in the years ahead.

Typically, the agency downgrades a credit incrementally before taking the step to withdraw its ratings.

"I think this was an unusual and swift financial deterioration for the county and the credit deterioration was pretty swift, too," Prunty said.

Analysts at Moody's Investors Service said they have received sufficient information from DeKalb to support a GO rating of Aa3, after a December

looked to fund balances and reserves to help bridge the budget gap, said Moody's managing director Anne Van Praagh, who stressed that the current issue deals with "revenue and spending" and is not a debt-service crisis.

"At Aa3 with a negative outlook we don't have concerns about their willingness to repay their debt," Van Praagh said. "It is not unusual for state or local governments to rely on interfund transfers to support operations. Local governments are looking at every possible fund to find interim relief."

Rader said the county's seven-member commission, composed of one Republican and six Democrats, is not against raising taxes or laying off employees if necessary.

Commissioners and the county's elected chief executive officer are struggling to structure their government to match the new realities of taxing limitations and revenue collections that are not likely to increase for years to come, he said.

"Probably the biggest mistake the commission did was pressing an agenda for restructuring and continuing to squeeze the operational budget and not being sufficiently careful about maintaining budget reserves," Rader said.

In 2008, DeKalb lost a significant portion of its tax base when the city of Dunwoody incorporated as the recession gathered force in the county of more than 700,000 people.

In recent years, the Georgia Legislature has clamped down on local spending by prohibiting increases in assessed property values if no improvements are made in the previous year, and requiring that foreclosures be considered in assessing the value of properties.

"What we're concerned about is how the administration can be structured differently so that we can withstand the expectation of the declining tax base over next couple of years," Rader said

A Stunning Descent

De Kalb County, Ga., GO bond sales

ISSUE	AMOUNT	SALE DATE
Urban redevelopment bonds, Series 2010	\$7.9M	Dec. 2010
Water & sewer bonds, Series 2010	\$28.4M	Dec. 2010
New-money bonds, Series 2006	\$230.0M	Jan. 2006
Refunding bonds, Series 2003 B	\$74.6M	Nov. 2003
Refunding bonds, Series 2003 A	\$53.3M	July 2003
New-money bonds, Series 2001	\$125.0M	Oct. 2001
Jail bonds, Series 1998	\$2.0M	Aug. 1998
Refunding bonds, Series 1993	\$81.1M	Nov. 1993
Health facility bonds, Series 1993	\$29.7M	June 1993
Refunding bonds, Series 1992	\$64.8M	Nov. 1992

Source: Thomson Reuters

to receive timely, adequate information about cash flows and how overall liquidity is being managed in order to continue evaluating DeKalb's rating.

"It was our view that was lacking and the information we were getting was not as consistent as it needed to be to make an assessment of their liquidity," she said. "It's unusual to see a transition like that, and we certainly don't have a lot of them. I think that's pretty unique to DeKalb."

The swift downgrade of a highly rated credit is not a trend Standard & Poor's expects to see going forward, Prunty said.

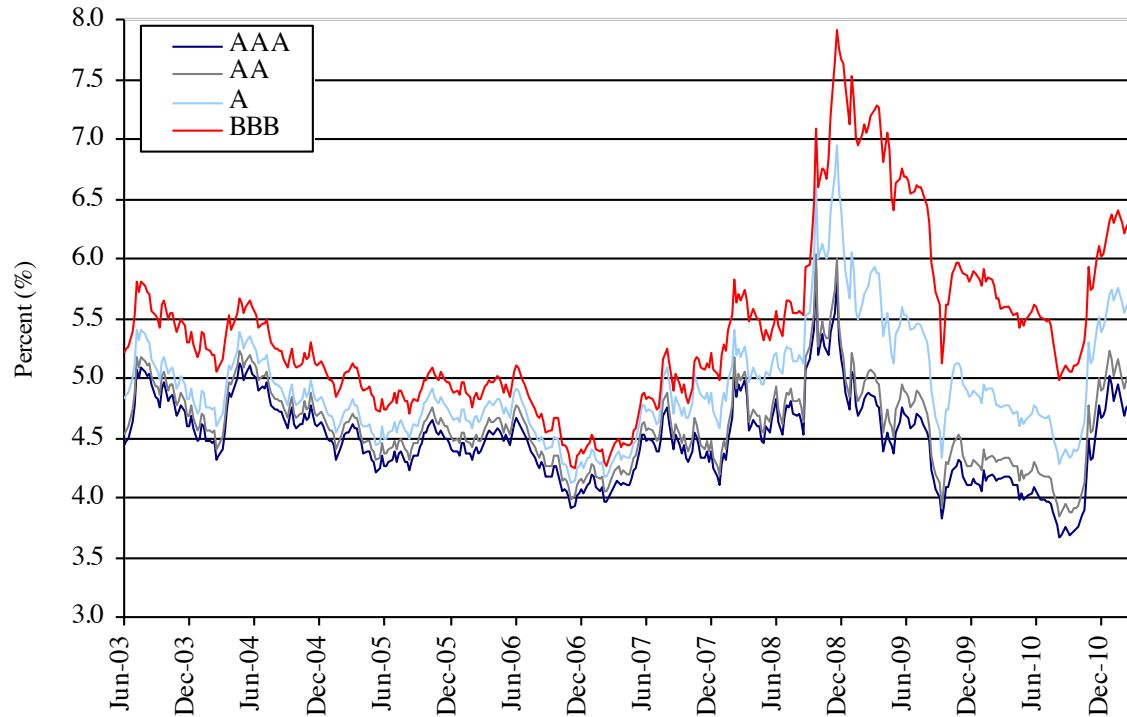
DeKalb is dealing with liquidity

downgrade from Aa1. Moody's lowered the county's rating to Aa1 from Aaa in 2009.

The rating incorporates a sizeable tax base outside Atlanta that has seen some decline, according to Moody's lead analyst Lauren Von Bargaen.

The release of audits and other financial information is typical of what Moody's see across the muni market generally, and not a concern, she said.

"When the 2010 audit comes out we'll see if it is in line with unaudited year-end results," Von Bargaen said. "We're having an ongoing dialogue with them to see if there is any new information they can provide us because it is a high-



Credit Spreads (%) off of the 30-year AAA
MMD

June 2003-Sept 2008

	<u>Average</u>
AA	0.10
A	0.28
BBB	0.55

Sept 2008 - Present

	<u>Average</u>
AA	0.18
A	0.76
BBB	1.67

Note: credit spreads compared to the 'AAA' equivalent

Source: Davenport and Co. and Thompson Financial



New Market Tax Credits (NMTCs).

- Created under the Community Renewal Tax Relief Act of 2000. A bi-partisan initiative to spur economic development in low-income areas.
- Initially authorized for 5 years and \$15B, but has been annually extended by Congress since inception. This includes the most recent budget (AMT relief too).
- Provides a 39% tax credit (dollar for dollar tax reduction) to investors over a 7 year window. 5% in years 1-3 and 6% in years 4-7.



NMTCs continued...

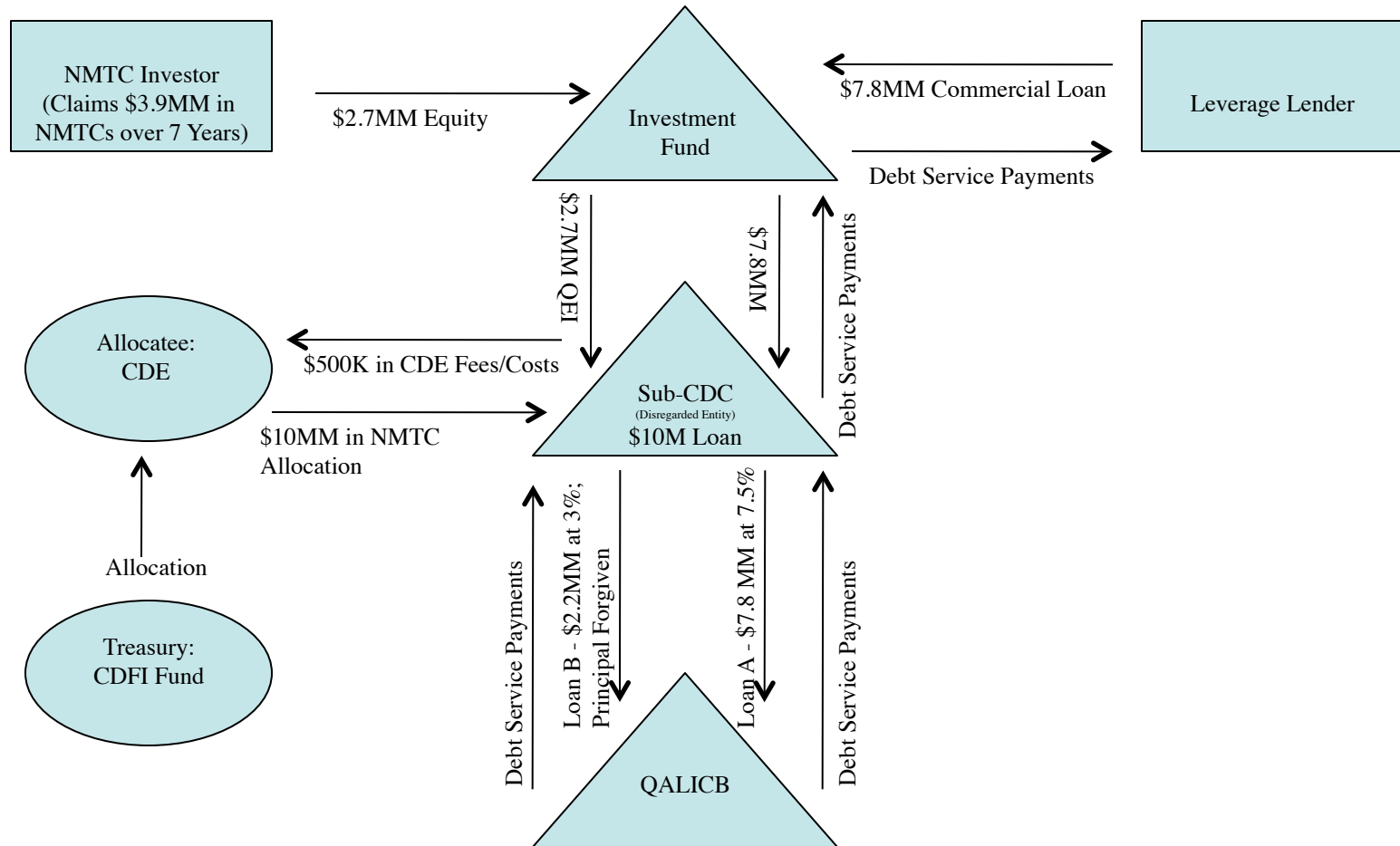
- Program overseen by U.S Department of the Treasury and Community Development Financial Institution (CDFI) Fund.
- CDFI Fund establishes Community Development Entities (CDEs) and awards allocations of NMTCs to the CDEs.
- Nutshell analysis of NMTCs:
 - CDEs must use
 - Substantially All (85%) of the proceeds from
 - Qualified Equity Investors (QEIs) to make
 - Qualified Low-Income Community Investments (QLICIs) in
 - Qualified Active Low-Income Community Businesses (QALICIs) located in
 - Low-Income Communities (LICs).



Using NMTCs.

- Does your project qualify (flexible)?
 - Office
 - Mixed-use
 - Industrial
 - Retail
 - Hospitality
 - Community Facilities (Education, Healthcare, Museums, etc...)
 - Recent focus on non-real estate investments (investment or loan not connected to real estate)
- Restrictions
 - “Sin” establishments (similar to TEB rules)
 - Residential Real Property (20% cap, but recapture severely limits)

Common Structure of NMTC Transaction





Savings

\$10MM Commercial Loan

Commercial Loan	10,000,000
Interest Only (7.5%) – 7 yrs	<u>5,250,000</u>
Total Cost	15,250,000

\$10MM NMTC Structure

A Loan – Principal	7,800,000
A Loan – Interest (7.5%) – 7 yrs	4,095,000
B Loan – Principal	2,200,000
B Loan – Interest (3%) – 7 yrs	462,000
B Loan – Forgiven Principal	<u>(2,200,000)</u>
Total Cost	12,357,000



Combinations

Recent Regulations provide that NMTCs can be blended with:

- Tax-exempt bonds
- Historic Tax Credits (Federal and State)
- Limited Mixed-use Development

Cannot be blended with Low-Income Housing Tax Credits



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