

PROVIDING DIRECTION
PRODUCING RESULTS

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Northland Securities, Inc.
45 South 7th St., Suite 2000
Minneapolis, MN 55402
Toll Free 1-800-851-2920
Main 612-851-5900
www.northlandsecurities.com
Member FINRA and SIPC

Making PACE Work

You may have already read about one of the new finance tools created by the 2010 Minnesota Legislature - voluntary energy improvements financing program for local governments. These improvements are also called PACE - Property Assessed Clean Energy. At first glance, the legislation provides the tools needed to promote cost-effective energy improvements: authority to establish a finance program, the ability to assess properties for payment of the improvements and the ability to issue revenue bonds to fund the program. What you may not know is that the statutory limitations on the revenue bonds make them unusable. The bonds are probably not marketable or, if they are, the interest rate and finance costs make traditional bank financing more affordable. There are, however, other ways to finance PACE improvements.

Creativity Required

So, what do you do with a viable source of revenue and a dysfunctional debt instrument? Find another debt instrument! The challenge to capitalizing voluntary energy improvement programs is two-

fold: (1) finding an existing debt authority that allows improvements to private property, and (2) providing the additional security to the bonds to make them marketable and to reduce the interest expense. We believe there are several intriguing options.

Special Taxing Districts

Minnesota cities have the ability to create two types of special taxing districts that can make improvements to private property. A special service district (SSD) applies to areas of commercial-industrial property. A housing improvement area (HIA) can be created to improve areas of owner-occupied housing. Voluntary energy improvements can be defined as eligible improvements under either of these tools. Improvements in a SSD or HIA can be financed with general obligation bonds.

Development Authorities

Minnesota's local government development authorities - economic development authorities, housing and redevelopment authorities and port authorities - have broad powers to promote the

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Judging the Deal

Lack of adequate funding is putting substantial pressure on local government budgets. Utilizing dollars efficiently and effectively has never been more essential. Too many local governments miss opportunities to take advantage of the ever-changing debt market.

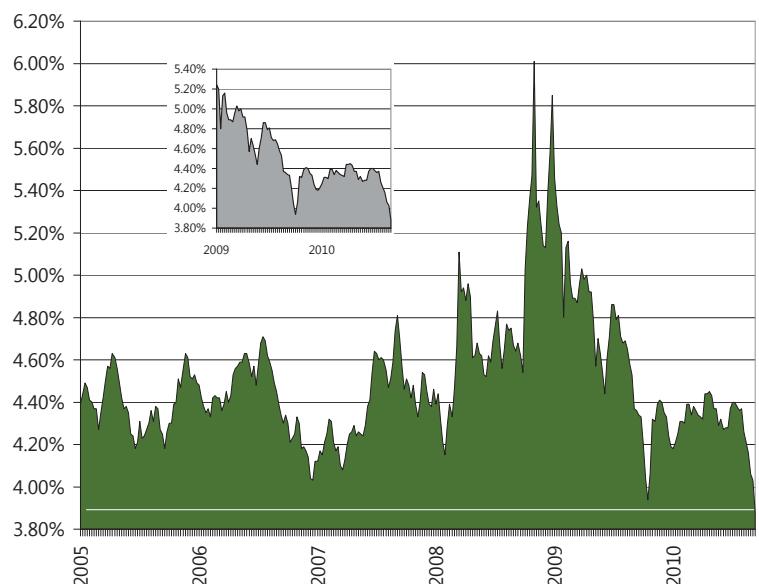
OSCBs and QZABs

Federal stimulus programs have created a variety of new bonding options. Recently, Qualified School Construction Bonds (QSCBs) and Qualified Zone Academy Bonds (QZABs) have changed from a tax credit debt to a direct payment method from the Federal government. The goal of these programs is a **0% financing**. An interest credit rate is posted daily by the IRS and anything below the daily posted rate on the pricing date is picked up by the Federal government and anything above is the local school district's obligation. Included in the daily rate posting is a permitted sinking fund yield.

The recent experiences of Minnesota school districts shows why new tools require new approaches. A case in point is a \$5,000,000 QZAB issue. The district sold the bonds with principal payments being made on an annual basis until maturity - the traditional approach for tax-

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Bond Buyer's 20-Year G.O. Index



Time Limited TIF Tools

To help stimulate new development, the Minnesota Legislature approved several important expansions in the use of tax increment financing (TIF). The 2010 Amendments (Laws 2010 Chapter 216/H.F. 2695) include:

- Ability to use TIF to stimulate construction.
- Expanded use of economic development TIF districts.
- New “compact development” TIF districts.

All of these new powers have useful applications and limited life spans. This article takes a look at the expanded TIF powers.

Temporary Pooling

Highlight: Broad, temporary authority to spend tax increments from any TIF district to assist construction or rehabilitation of private development.

The 2010 Amendments contain a broad, but temporary authorization to use TIF to stimulate construction. Prior to December 31, 2011, this new authority to *spend tax increments* may be used to:

- Provide improvements, loans, interest rate subsidies, or assistance in any form to private development consisting of the construction or substantial rehabilitation of buildings and ancillary facilities, if doing so will create or retain jobs in this state, including construction jobs, and if the construction commences before July 1, 2011, and would not have commenced before that date without the assistance.
- Make an equity or similar investment in a corporation, partnership, or limited liability company that the authority determines is necessary to make construction of a development that meets the requirements of financial feasibility stated above.

This temporary authority allows tax increments from any district to be spent to facilitate any type of development without regard to general restrictions on TIF districts, such as pooling and the five-year rule. This authority does not supersede (1) the requirement to pay bonds to which the increments are pledged, (2) the prohibition of general government use (M.S. Section 469.176, Subd. 4g) or (3) the payment of county costs (M.S. Section 469.176, Subd. 4h).

A critical limitation in the authority is the requirement that the *authority to spend tax increments* under this subdivision expires December 31, 2011. The requirement to make

expenditures by December 31, 2011 places the impetus on fund balance and revenues collected in 2010 and 2011. Bonds and other long-term obligations may not be possible.

A “written spending plan” approved by the municipality after a public hearing is required to use this authority. This provision appears to be a substitute for a TIF plan and the general requirements for contents and amendment of the TIF plan.

Economic Development Districts

Highlight: Ability to use Economic Development TIF Districts to assist any type of development that creates or retains jobs.

The 2010 Amendments create a temporary expansion of the use of economic development districts. An Economic Development District can be created for any project that the municipality finds will “create or retain jobs in this state, including construction jobs, and that construction of the project would not have commenced before July 1, 2011, without the authority providing assistance” with the TIF district. An Economic Development District can now be used to facilitate *any type* of development without regard to the existing use limitations in M.S. 469.176, Subd. 4c.

There are two important timing restrictions associated with the expanded use of Economic Development Districts:

- Construction of the project in the TIF district cannot begin later than July 1, 2011.
- Request for certification of the district cannot be made after June 30, 2011.

Interestingly, these changes apply to any Economic Development District for which the request for certification was made after June 30, 2009. TIF Plan amendments should be anticipated to authorize the new, broader use.

Compact Development District

Highlight: A new “redevelopment-like” TIF district to facilitate redevelopment of commercial-industrial property with higher density.

A “Compact Development District” is a new form of TIF district. The Compact Development District allows the creation of a TIF district in areas of existing commercial/industrial development where the redevelopment increases density. The findings required for the creation of a Compact Development District are:

- Parcels consisting of 70% of the area of the district are occupied by buildings or similar structures that are classified as Class 3a property under section 273.13, subdivision 24 (commercial and industrial property and utility real and personal property).
- Planned redevelopment or development of the district, when completed, will increase the total square footage of buildings, classified as Class 3a under section 273.13, subdivision 24, occupying the district by three times or more relative to the square footage of similar buildings occupying the district when the resolution was approved.

While the statutory criteria for a redevelopment TIF district define the means for determining if a parcel is “occupied”, no such language is in the 2010 Amendments. The House Research bill summary includes the reference to the existing test applicable to a redevelopment district. This likely means that a parcel will be deemed as occupied if at least 15% of the area of a parcel has buildings.

These findings must be made by resolution. The 2010 Amendments do not provide other requirements for making these findings.

The maximum duration of a Compact Development District is the same as redevelopment and housing districts. No tax increment shall be paid after 25 years of the date of receipt of the first tax increment (allowing for 26 years of revenues).

- The 2010 Amendments contain specific limitations on the use of Compact Development Districts. Tax increment from these districts may only be used to pay:
 - Administrative expenses (subject to overall limits of the TIF Act).
 - Cost of acquiring land located in the district or abutting the boundary of the district.
 - Demolition and removal of buildings or other improvements and other site preparation costs for lands located in the district or abutting the boundary of the district.
 - Installation of public infrastructure or public improvements serving the district, but excluding the costs of streets, roads, highways, parking, or other public improvements primarily designed to serve private passenger motor vehicles.

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Continuing Changes in Continuing Disclosure

In the past year, issuers of municipal debt have seen many changes affecting the “continuing disclosure” requirements for their bond issues. In May 2010, the Security and Exchange Commission (SEC) approved more amendments to its Rule 15c2-12 (the “Rule”), expanding the number of “material events” for which issuers must provide notification and revising the timing for providing those notices. The amendments become effective on December 1, 2010 for new issues issued on or after that date.

Events Requiring a Disclosure Notice

Previously under the Rule, there were eleven events for which notification needed to be provided “in a timely manner” if the event was deemed “material” by the issuer. The “eleven significant events” are:

1. Principal and interest payment delinquencies (**material event**);
2. Non-payment related defaults;
3. Unscheduled draws on debt service reserves reflecting financial difficulties (**material event**);
4. Unscheduled draws on credit enhancements [such as bond insurance] reflecting financial difficulties (**material event**);
5. Substitution of credit or liquidity providers, or their failure to perform (**material event**);

6. Adverse tax opinions or events affecting the tax-exempt status of the security;
 7. Modifications to rights of security holders;
 8. Bond calls;
 9. Defeasances (**material event**);
 10. Release, substitution, or sale of property securing repayment of the securities;
 11. Rating changes (**material event**).
- The amended Rule will increase that list, adding the following Events requiring disclosure notice:

1. Tender offers;
2. Bankruptcy, insolvency, receivership or similar events;
3. Consummation of a merger, consolidation, or acquisition or the sale of assets or the entry into a definitive agreement to undertake such an action or the termination of an agreement relating to any such actions;
4. Appointment of a successor or additional trustee, or the change of name of a trustee.

Events That Are Now Deemed “Material”

Previously, for most of the events listed, an issuer needed to make a determination as to whether the event was “material,” thus requiring notification to bondholders. In the amended Rule, more of the events are now deemed material from the outset, and notification will

be required within ten business days of the **occurrence** of an event. In the listing above, we have noted in bold the events that will always be considered material pursuant to the amended Rule.

Revised Deadline for Providing Notice

Effective **December 1, 2010**, notice of the events listed in the Rule must be disclosed **not more than 10 business days after the event has occurred**. Previously, the Rule simply stated that notice must be provided “in a timely manner.” The new deadline of 10 business days will require a much more heightened awareness by issuers of what the events are, so that they can “be on the lookout” for them, and it will also require prompt action, especially if that information must be communicated to an issuer’s Dissemination Agent (such as Northland), so that they can get the notice posted promptly.

Evolving Regulations

Changing material events rules is the next step in the trend of evolving disclosure regulations. Issuers should expect regulators to seek additional and more timely disclosure requirements. Since these regulations affect our ability to buy your bonds, Northland gets first notice of new and modified regulations. We use this information to keep issuers informed.

QECB Allocation Notice

Minnesota Office of Management and Budget in conjunction with Minnesota Office of Energy Security have released for allocation applications the State’s allocation of Qualified Energy Conservation Bonds (QECB’S). The QECB’s now qualify for a direct subsidy from the U.S. Treasury of 70% of the interest expense (see www.irs.gov/pub/irs-drop/n-09-29.pdf). The current term of the bonds is 17 years.

The QECB’s can be used for a variety of purposes including retrofits of existing public and private building that reduce the amount of energy consumption by 20%, rural development of renewable energy projects, and a host of other capital projects.

Of the \$54+ million allocation, approximately \$37.8 million must be used for public facilities with \$16.2 million to be allocated to private

facilities or qualifying activities. For further information contact: www.mmb.state.mn.us/fin/bonds or www.dsireusa.org or call your Northland Securities representative at 612-851-5900.

All application forms and description can be found on the Minnesota Management and Budget website or call Jacob Brown at (651) 201-8079.

TIF Tools from Page 2

It is important to understand the timing constraints associated with the 2010 Amendments. The new law applies to Compact Development Districts for which the request for certification is made after June 30, 2010. The authority to establish or approve the tax increment financing plan for a new Compact Development District expires on June 30, 2012.

Other TIF Management

Beyond the 2010 Amendments, there are a

variety of other TIF management activities to consider. Some key questions include:

- How do new property values and tax rates affect your projected flow of funds?
- Have you evaluated the ability to use “pooling” authority to facilitate development outside of TIF districts?
- Have you evaluated the ability to spend tax increments to assist eligible housing development outside of the project area?

- Do your districts qualify for the extension of the knockdown and five-year restrictions approved by the Legislature in 2009?
- How can you make most effective use of pre-1990 districts?

These are just some of the questions that guide making the most effective use of existing TIF districts.

PACE from Page 1

construction and improvement of private property. Each of these development authorities has the ability to issue revenue bonds to finance eligible projects (port authorities may also issue general obligation bonds). These bonds can be made marketable with the pledge of EDA and HRA special tax levies.

It should be noted that the powers of an EDA were expanded by the 2010 Legislature. The Legislature removed the requirement that "economic development districts" meet the requirements of redevelopment TIF districts. Many EDA powers must be used within an economic development district.

Municipal Utilities

Municipal Utilities, particularly electric and gas, may have the ability to undertake certain

types of voluntary energy improvements. The ability to use other utility revenue as additional security enhances the marketability of any bonds.

Tax Abatement

Tax abatement may provide a means of securing the debt and encouraging the improvements. Tax abatement could be used to leverage the private improvements funded by the assessments. The proceeds of tax abatement bonds may be used to reimburse property owners for the cost of improvements made to the property.

Other Challenges

Capitalizing your energy improvements may not be the only challenge of creating a viable program. Some of the other factors to consider

in designing and implementing a program for PACE improvements:

- Undertaking the energy audit or renewable energy system feasibility study needed to authorize the improvements.
- Monitoring and inspecting the improvements.
- Coordinating smaller, incremental projects into a financially viable program.
- Keeping administrative and financing costs from making the program unaffordable.

Northland is exploring joint venture and partnership opportunities. Broader service delivery systems and coordinating with existing energy improvement programs are critical factors in making use of this tool.

Good Deal from Page 1

exempt serial bonds. The bond sale effectively resulted in the majority of the interest expense paid by the federal government and meeting the 0% interest financing goal.

So what's the problem? The problem is a missed opportunity to save even more. The school district could have set aside these annual payments in a sinking fund, invested the money until final maturity and had all interest still paid by the Federal government. This alternative structure would have freed up an additional \$1,100,000 in its "operating capital" budgets.

This story has been repeated with other bonds issues using new federal stimulus tools. New tools often require new approaches to yield the best results.

Refunding Opportunities

Interest rates on municipal bonds are at historic low levels. On September 3, the Bond Buyer's 20-Year G.O. Index fell to 3.86% - **the lowest since 1967**. These historically low rates open the door to refinancing many bond issues. With increasingly limited financial resources, the savings created by refunding can be a valuable asset. A prompt and thorough review of all outstanding debt is essential. In making this review, it is important to understand the key elements of refunding bonds.

Tax-exempt, governmental purpose bonds are allowed one advance refunding (refunding prior to the call date). Make sure that the opportunity you take is the best one. This requires understanding the refunding proposal.

The majority of advance refundings are "crossovers". This means that savings are not realized until after the call date. Current interest rates produce feasible refundings with call dates three to four years into the future. Acting now locks in the savings. The benefits from the reduced debt service comes in the future.

The savings from a refunding comes from two sources - the lower interest rates and the efficiency of the escrow account established for the refunding. The proceeds of the refunding bonds are placed in an escrow account and invested. Monies in the escrow are used to pay interest on the new (crossover) refunding bonds until the call date and then to call all outstanding principal on the refunded bonds. The further away the call date, the more money required to fund the escrow and the larger the refunding bond issue.

Every refunding analysis should include a calculation of "negative arbitrage". Negative arbitrage represents lost potential savings because the escrow cannot be invested at the maximum allowable yield. This relationship may mean that a refunding closer to the call date produces more savings even if interest rates are higher. However, current low rates may also maximize savings potential even with negative arbitrage.

Savings may be the catalyst, but it may not be the only benefit of refinancing. Make sure to evaluate the bond issue and your overall debt management plans for other potential benefits. Reduced property values and limited

new development has fundamentally altered many debt plans. Debt can be restructured to better match these new realities. Also, excess monies in the debt service fund can be used to reduce the debt when refunding.

By the time you read this article, interest rates may be rising. History shows that refunding opportunities will come again. The bond market has experienced a series of dips in interest rates. These dips tend to be short-lived as issuers rush to the market and supply drives rates higher. Be prepared to catch the next window. Issuers with refundable debt should put plans in before the window opens. Waiting to evaluate a refunding until rates are falling often means that the refunding does not get scheduled until rates are rising.

Conclusion

Both new tools and time-tested refundings create important opportunities for financially challenged local governments. Making the most of these opportunities requires careful planning and capable technical guidance. The staff at Northland is always happy to help you understand and evaluate options for your financial needs.

The information in this newsletter is based on sources believed to be reliable, but does not purport to be complete and is not warranted by Northland Securities, Inc.

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