

PROVIDING DIRECTION
PRODUCING RESULTS

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Problems are only opportunities in work clothes. These words of Henry J. Kaiser are an apt description of the world we face in 2009. Most of us have never lived in more turbulent economic times. Yet, within these economic challenges are important opportunities. We need to put on the work clothes of knowledge, ingenuity and commitment to find the opportunities in your community.

The financial problems of 2009 bring us to the first issue of the Navigator. The worlds of local government and capital finance are changing. The criteria that guided yesterday's financial planning may not apply to tomorrow's projects. Information is essential as we work together to chart a course in complex times. We have prepared the Navigator to give local government officials relevant and useful information to make better use of limited financial resources.

The Navigator is an electronic newsletter. We are sensitive to adding to already crowded email

inboxes, but there are some important reasons behind this approach. An electronic newsletter is the best environmental decision. No paper is used unless you decide to print a page. An electronic newsletter makes it easier to file and save for future use. We want the Navigator to be an important tool that you refer to again.

Thank you for taking a look at the Navigator. We hope you will take away something of value.

Let's put on our work clothes and figure out how to make the best use of the tools (both old and new) we have in the toolbox. Northland Securities looks forward to helping you face the challenges and capture the opportunities that lie ahead.

Regards,

Randy Nitzsche,
Chief Executive Officer
Northland Securities, Inc.

Stimulating Public Finance

*Rusty Fifield -
Director of Northland Strategies*

Much of the news on the American Recovery and Reinvestment Act of 2009 (ARRA) focuses on the amounts and types of financial assistance available to local governments. The Act also makes some important changes to the tax provisions governing the issuance of tax-exempt bonds. Understanding the uses and implications of these legislative changes as part of your capital planning over the next two years will be critical.

What's New?

Build America Bonds

ARRA creates a new form of taxable bonds. "Build America Bonds" allow issuers of tax-

exempt bonds for governmental purposes to issue taxable tax credit bonds until December 31, 2010. Issuers of these bonds may choose to receive federal reim-bursement for 35% of the interest expense or provide a 35% tax credit to investors.

Bank-Qualified Limit Increases to \$30 million

Currently, bonds of local governments that issue less than \$10 million of tax-exempt debt during a calendar year are "bank-qualified". ARRA increases the annual limit to \$30 million for bonds issued between January 1, 2009 and December 31, 2010. Bank-qualified status makes bonds more attractive to banks by allowing them to deduct 80% of the costs of

purchasing these securities.

Expanded Bank Incentives for All Bonds

The current bond purchase cost deductions apply only to bank-qualified bonds. ARRA extends this tax treatment to all types of newly issued tax-exempt bonds. For bonds issued in 2009 and 2010 (and their subsequent refunding) banks may deduct 80% of the carrying costs of purchasing as long as investment in the bonds does not exceed 2% of the bank's total assets. This provision gives a tax treatment similar to bank-qualified bonds to all other tax-exempt bonds.

Elimination of AMT

ARRA removes the application of the alternative minimum tax (AMT) on all tax-exempt bonds

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Stimulating Public Finance continued

issued over the next two years (January 1, 2009 and December 31, 2010). This provision also applies to the refunding of bonds that were initially issued after 2003. Prior to ARRA, individuals and corporations subject to the AMT could not deduct interest on private activity bonds and certain types of governmental bonds.

What Does It Mean?

Understanding how ARRA changes the rules for tax-exempt bonds is only part of the story. You will also want to know what effects these new rules will have on the cost of debt. In the near term, clear guidance on interest rates will be elusive.

Predicting the real practical implications of this legislation is complicated by a changing and volatile bond market (see "New Market Realities" on next page). Supply and demand will greatly affect interest rates for your issue. ARRA creates the potential for a significant increase in the overall volume of bank-qualified

bonds in the market, while making all other bonds more attractive to banks. At the same time, the number of banks is contracting along with their demand for these bonds.

In general, larger issuers, that typically exceeded the \$10 million annual limit, should see lower interest rates from expanded tax benefits for banks.

Municipalities have more capacity to lend their tax-exempt status to private activity bonds without losing the bank-qualified status on their own direct debt. There will be less need for "hold harmless" payments that compensate municipalities for the loss of bank-qualified status.

Issuers of qualified private activity bonds and other conduit bonds should experience several other benefits. Removal of the AMT penalty broadens the market and allows purchasers to accept lower yields. The deductibility of

purchasing costs creates new opportunities for purchase by banks. The ability to refund bonds issued after 2003 may have limited application. Only current refundings are eligible for this provision.

The Build America Bonds offer an intriguing new tool for local governments. The combination of the 35% interest reimbursement and market demand for taxable bonds may create attractive results for some projects. An analysis of the Build America Bond option should be part of the planning for every governmental purpose project. Also recognize that the results of this analysis will vary over time with market conditions.

The American Recovery and Reinvestment Act of 2009 creates new opportunities for issuers of tax-exempt bonds. Making the most of these opportunities requires a sound understanding of changing market conditions and careful planning to tailor your capital finance needs to these conditions.

New Market Realities

*Paul Donna -
Senior Vice President (Public Finance)*

Among the things lost in 2008 was the "rule book" for local governments accessing capital markets. In moving ahead, we face new market realities for overall demand, purchaser objectives, credit enhancement, and interest rates. It is important to understand these changing realities to effectively plan for debt. Let's take a brief look at where we - were compared with now - and what we expect in the coming months.

Remember the day when...

...the municipal bond market was a relatively stable and predictable place that had lots of buyers with an insatiable appetite for any and all kinds of municipal bonds?

Today, because of the upheaval in the credit markets, our universe of bond buyers and their reduced appetite and changing investment objectives, has created one of the most volatile municipal bond markets in memory. This volatility creates challenges for structuring new debt offerings and planning to access capital markets.

...we had the ability to effectively purchase Aaa/AAA credit ratings on our \$2M+ general obligation bond issues by insuring them through companies such as AMBAC, Assured Guaranty, CIFG, FGIC, FSA, MBIA and XLCA?

Now we only have one firm (a new one) that is rated the highest quality by both rating agencies - Berkshire Hathaway (BHAC). And by the way, they are only interested in your next issue if it is at least \$100 million. We are encouraged by the direction of a number of the existing firms to re-structure and raise capital to bolster their ratings and become viable once again.

s we really needed to concern ourselves with were G.O. & IDRB?

Well, now add these to your list - BAB (Build America Bonds), CREB (Clean Renewal Energy Bonds), QECB (Qualified Energy Conservation Bonds), QSCB (Qualified School Construction Bonds), QZAB (Qualified Zone Academy Bonds), RZEDB (Recovery Zone Economic Development Bonds) and RZFB (Recovery Zone Facility Bonds)! This alphabet

soup represents special purpose bonds for everything from infrastructure to energy to schools. Each of these bonds has unique uses, processes and markets. Testing these options as part of your capital improvements planning is the best way to ensure that you do not miss an opportunity.

...the bank-qualified limit was \$10.0M?

The American Recovery and Reinvestment Act of 2009 (aka the "Stimulus Bill"), enacted this past February, increased the annual limit to \$30M. Great idea, right? Well, that depends. The new cap limit will effectively increase the supply of bank-qualified bonds in the marketplace and create more options for buyers. The impact to small issuers and lower rated bonds may be comparatively higher interest rates because of the reduced overall demand. For those of you who traditionally issued more than \$10M annually, your interest rates may be comparatively lower because you are now able to access a larger market. The overall impact of this change remains to be seen. Much will be determined by the overall supply of bank-qualified bonds and the

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New Market Realities continued

appetite of banks (and there are fewer of them now) for these investments.

...we could count on receiving at least three, five and sometimes even seven pricing proposals on our competitively sold bond sales?

Those days are gone. Today, receiving three or fewer bidders is increasingly common, particularly for lower rated and non-rated issues. With fewer bidders participating, debt planning must focus on making issues attractive to bidders without compromising issuer objectives. These conditions also require that issuers evaluate other options for accessing the lowest cost debt.

...the interest rate differential between general obligation bonds and revenue bonds for our water, sewer and city hall projects was typically .25% or less?

Today, because of the downturn in our economy, investors have flocked to high quality general obligation bonds. Revenue bonds have become a secondary choice, causing the interest rate spread to widen significantly - to a differential of .50% - .75%.

...our smaller and lower rated and even non-rated issuers could publicly issue their bonds and receive interest rates that sometimes rivaled their higher rated neighbors?

Those days may be gone as well. The change in investor objectives has placed a premium on credit ratings - particularly "AA" or better ratings.

Not since the Tax Reform Act of 1986 has the municipal bond market been faced with so many changes in law and market forces. The ability of issuers to be flexible and adaptive to the market will help provide for efficient and effective financings in the future.

Green Capital

Dan O'Neill -
Senior Vice President (Public Finance)

A new color of green now paints the bond market - not money, but energy. Municipal governments face a rapidly expanding universe of energy investments from green architecture to alternative energy projects. These green investments bring new capital finance needs and opportunities.

New feedstocks along with fuel processing and refining technologies continue to emerge even as we await the "shake out" and stabilizing of the Midwest's massive Bio-Alcohol - Bio-Oils Industry. As these businesses emerge from garages, barns and university labs across the Midwest, there appears to be many welcoming "CleanTech" venture capitalists ready to assist in taking these innovations to the next level. Five years ago gasifiers, and later plasma gasifiers, were seen as lab projects in a distant state of becoming. Today, they are converting corncobs, tires and auto fluff, municipal solid waste and wood chips into synthetic gas, natural gas equivalents, jet fuel, ammonia, hydrogen and soon the diesel fuel of tomorrow - DME (Dimethyl Ether).

Just three or four years ago, the mere suggestion to one of our utility clients that they consider adding some wind generation to their portfolio

may have drawn a puzzled look. Now, it seems everyone is joining the effort in consolidating that resource for our own needs, as opposed to exporting the income derived from that wind resource to Britain, Scotland, Spain and Denmark. It seems that almost overnight "colonies" of eighty meter towers grew out of the plains and began extracting wealth from our natural resource. Municipal utilities and local community developers continue to grow in their capacity to attract capital and to capture the remaining wind resource.



The 2008 Presidential Campaign places the terms "energy independence" and "global warming" at the center of our political dialogue - and none too soon. The developing financial crisis of 2008 and the resulting "Emergency Economic Stabilization Act of 2008" along with the "Food Conservation and Energy Act of 2008" provided a surge of new and extended tax credits for solar, wind geothermal and wave technologies along with a host of biomass feedstock and conversion technologies. The doors to the real "alternative energy candy store" opened more widely with the passage in February of the "American Recovery and Reinvestment Act of 2009". Here is an abbreviated form of the incentives embedded in the new legislation to benefit governments and their public/private partners.

New Clean Renewable Energy Bonds:

\$2.4 billion to be allocated to State and Local Governments, Public Power Providers and Electric Cooperatives for qualifying Electric Generating Projects from renewable sources such as wind, hydroelectric, biomass, landfill gas, geothermal and solar.

Qualified Energy Conservation Bonds:

\$3.2 billion to be allocated to states on a formula basis. Local Governments of 100,000 population or greater will further qualify for a set aside on a pro-rata basis of the jurisdiction's share of the State population. The proceeds of the QECB's must be dedicated to capital expenditures to implement Energy Conservation Programs and other fuels and technologies mass commuting facilities. Proceeds may further be used to provide loans and grants to make energy improvements to private buildings.

Smart Energy Grid:

\$11 billion has been appropriated to Public Utilities to bring system control, safety and reliability to the Nation's Electrical Distribution and Transmission System.

New Market Tax Credits:

\$10 billion has been allocated for 2009 and 2010 in aggregate. The New Market Tax Credits can be structured into public/private ventures, alternative energy and bio-fuels projects with the beneficial effect of reducing the required equity investment.

We are working hard to make "greener fields" for energy projects - to find the best uses for the tools and to create strategies that effectively connect energy project developers, both public and private, with providers of debt and equity.