

HARRISBURG UPDATE

JANNEY FIXED INCOME STRATEGY

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Harrisburg is working with Pennsylvania officials and other advisors to develop a plan for addressing the city's weak finances.

- Harrisburg missed a \$425,000, May 3 interest payment - Assured Guaranty came to the rescue
- The city may seek appraisals to determine asset values for potential sale or lease
- The controller released his proposal to "Pay Off Incinerator Debt"

The city of Harrisburg, whose B2 rating from Moody's was withdrawn in April 2010, continues to struggle with financial difficulties resulting primarily from the city's guarantee to make debt service payments on approximately \$287 million of bonds issued to finance the upgrade of its incinerator plant. This resource recovery project, which was shut down by regulators in 2003 because of environmental violations, has experienced cost overruns, lost battles over rate increases and failed to generate enough revenue to cover debt service. Harrisburg's guarantee should have kicked in to cover the revenue shortfall, but Harrisburg didn't have the funds and so failed to make a required interest payment of \$425,000 on May 3, 2010. Harrisburg has also missed payments on a \$25 million loan made to the city by the incinerator's operator, Covanta Energy.

The good news for bondholders is that bond insurer Assured Guaranty (Aa3/AAA) stepped in with necessary funds so bondholders received the May 3 interest payment on time. With the exception of about \$33 million of notes maturing in December 2010, which were privately placed to institutions, the incinerator debt is insured by Assured Guaranty. Additionally about half of the outstanding debt has a back up guaranty from Dauphin County, which is rated AA by S&P.

Harrisburg officials are pursuing several avenues in seeking to resolve the city's fiscal challenges, with assistance from a group of officials from the state, including Pennsylvania Housing Finance Agency's Executive Director and CEO Brian Hudson, who is working with the city and creditors to complete a forbearance agreement, which would hold off creditors for a period of time, perhaps ninety to one hundred and eighty days, and give the city time to develop and execute longer term plans. As a first step towards consideration of a sale of assets, a Request for Proposal (RFP) for Professional Appraisal Services was sent to potential bidders on June 22, with a submission deadline of July 16, 2010. Specific facilities listed in the RFP include Parking Facilities, City Island which includes a minor league baseball stadium, Broad Street Market, water and sewer utility systems, and two museums. The city is also seeking other professional advice which could include a plan for debt restructuring.

The Harrisburg city controller, Dan Miller, released a report on Wednesday, July 14 titled "Plan to Pay Off Incinerator Debt." The report is available at <http://harrisburgcitycontroller.com>. He proposes to work with involved parties to develop a plan which would include turning over the incinerator facility to Dauphin County and increasing tipping fees, the per ton fees trash haulers pay to dump trash at the incinerator. The controller's plan also includes negotiating with bondholders to reduce debt service payments. Of course Assured Guaranty, as guarantor for most of the debt, would be involved in any such discussions. Finally, as he has in earlier discussions, Mr. Miller raised the possibility of bankruptcy, which he sees as "a positive tool that could help solve Harrisburg's financial crisis." Significantly, the controller does not advocate the sale of assets.

Mayor Linda Thompson invited Pennsylvania Gov. Rendell to address a June 9 meeting with city council. The governor urged the mayor and council member to move quickly to develop a plan. When the possibility of invoking Pennsylvania's Act 47 (state oversight of distressed municipalities) was raised, the governor said it was "preferable to bankruptcy" but added "there are paths out that don't require Act 47 and don't require going into bankruptcy."

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News reports indicate that the mayor, city council and the controller may not all be on the same page with plans, but it is encouraging that the mayor is moving forward to evaluate potential asset sales or leases. The asset appraisal RFP timeline establishes July 19 through July 22 as the period for the city's review of the proposals, so further information on plans could be forthcoming in the coming weeks and months. Of course any plan will require cooperation between city council and the mayor.

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