

HARRISBURG UPDATE

JANNEY FIXED INCOME STRATEGY

APRIL 30, 2010



ON MONDAY HARRISBURG, PA WILL MISS A \$425,000 DEBT SERVICE PAYMENT IT PLEDGED TO MAKE AS PART OF ITS GUARANTEE OF BONDS ISSUED BY THE HARRISBURG AUTHORITY TO BUILD A WASTE INCINERATOR. THE BONDS ARE INSURED BY ASSURED GUARANTY (AA3/AAA) SO BONDHOLDERS WILL BE PAID ON TIME.

"AGC has consistently communicated its intention to insure that bondholders are paid on time"

In the last decade, approximately \$282 million in Harrisburg guaranteed debt was issued to finance refurbishment of and improvements to the city's resource recovery plant. The project ran into timing and cost overruns, and a request for \$100 per ton rate increase for waste hauled to the facility was denied by Dauphin County. After arbitration, the increase ended up at \$1.56 per ton, causing continuing deficit operations for the Authority.

Revenues were insufficient to cover all debt service payments in 2009, so debt service reserves and other funds were tapped to make the payments, but with these sources exhausted, there's no money for the May 1 payment of \$425,000, and Harrisburg has indicated it will not provide funds required under guaranty provisions, forcing the bond insurer, Assured Guaranty (AGC) to step in and pay bondholders. AGC has consistently communicated its intention to insure that bondholders are paid on time. The city is negotiating with AGC to structure a forbearance agreement whereby AGC would hold off on legal action against the city for some period of time, but an agreement is not finalized.

Harrisburg's financial troubles have been widely reported – Moody's lowered the rating on Harrisburg's GO debt to Ba1 rated junk status in October, and then lowered the rating again in February to B2. The City Council President held an information gathering meeting this past Monday evening to discuss the problems. Others disagreed, but the city controller suggested that bankruptcy should be considered.

Talk of bankruptcy has floated around for months, but the city is also considering other measures. Asset sales could include the city's minor league baseball stadium, an historic downtown market or some or all of the city's parking, water and sewer systems. Tax and fee increases have also been proposed, but it's questionable how much could be raised. As Moody's noted in their February 2010 report, the B2 rating "incorporates the city's highly leveraged and stagnant tax base with a notable tax exempt component [state and county governments contribute no property tax], low income and wealth levels, high poverty, and above average unemployment."

State approval, which is needed before a community can file under Chapter 9 of the federal bankruptcy code, is not a foregone conclusion. Pennsylvania does have a program to assist financially troubled communities – Act 47, also known as the Financially Distressed Municipalities Act - but thus far Harrisburg has not requested assistance. Potential resources to be accessed under Act 47 include grants, interest free loans and administrative assistance.

It's uncertain what path the city will choose going forward - we expect discussions of alternatives to continue. A bankruptcy filing should certainly be an option of last resort – the city's ability to raise capital in the future would be severely impaired if a filing was undertaken. It seems likely that some kind of state intervention – administrative or financial – is the next step, but thus far we've heard nothing about this potential course of action.

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