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Amid Pension Woes, Allentown OKs Deal

BY PAUL BURTON

ALLENTOWN, Pa. — Fittingly, the vote came as the midnight hour approached.

With Allentown facing what Mayor Ed Pawlowski has warned is a deadline to deal with its unfunded pension liability crisis, the City Council voted 6-1 Thursday in favor of a \$220 million water and sewer concession to raise money to eliminate the liability.

The Pennsylvania city intends to use part of the upfront money from the 50-year concession with the Allentown-based Lehigh County Authority public works agency to fund the pension liability, which Pawlowski has estimated is at least \$158

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Allentown aims to use part of the upfront money from the 50-year concession with the Lehigh County Authority public works agency.

Facing Midnight Deadline, Allentown, Pa., OKs Deal

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million, and apply a further \$30 million to general obligation debt. He said the next move is up to the rating agencies, which are on standby.

"We're eliminating \$158 million of debt. If that doesn't get us a better credit rating, then nothing will," he said in an interview. "The rating agencies are obviously aware of this. A lot of people are looking at us."

Pawlowski said that without this agreement, Allentown's pension liability would consume about 30% of its general-fund budget in 2015, and that the city would parallel Pennsylvania brethren Harrisburg and Scranton, and even bankrupt Stockton, Calif., in generating "ugly headlines."

Moody's Investors Service rates Allentown's GOs A3, with a negative outlook. Standard & Poor's assigns a BBB-plus rating and stable outlook.

The quasi-public Lehigh County Authority intends to finance its payment through low interest, tax-exempt bonds over the first 30 years of the agreement, according to general manager Aurel Arndt.

Workout pro John Filan finds the Allentown deal intriguing. "It's one of the few places trying to deal with the entire problem," said Filan, a vice president at Chicago turnaround firm Development Specialists Inc. "A lot of places try to cut benefits, but rarely have I seen a government try to address the revenue side. I

admire the mayor for the courage it takes to step up there and say we need to fix this problem. I can't speak for the credit rating agencies, but at a minimum, I think they'd say it's a credit positive. This is a major effort to stabilize the city's operations."

No word on any rating action came from Moody's or S&P on Friday.

Emotions percolated Thursday night as public speakers, many going beyond the council's five-minute time limit and some confrontational, debated the proposal.

Proponents cited a glaring budget problem that dates to generous pension agreements under Roy Afflerbach, who preceded Pawlowski at City Hall.

Opponents called the deal too secretive — a charge Pawlowski denies — and worried about spikes in water rates, excessive debt for the authority and loss of local control.

"This is the most gut-wrenching decision I'll ever have to make," said council member Ray O'Connell, who voted favorably. "This has pitted friend against friend, neighbor against neighbor, businessperson against businessperson and colleague against colleague."

Member Cynthia Mota participated Thursday night by phone from a hospital bed in Venezuela, where she is recovering from complications related to shingles.

The controversy pitted the authority against its bosses, members of the Lehigh County's Board of Commissioners, who in

March voted against extending the LCA's charter from 36 years to allow it to bid for the 50-year lease, but the commissioners then let the LCA bid when Allentown clarified the bid language to their liking.

"This is a bad deal for Allentown and Lehigh County," county commissioner Lisa Scheller, speaking as a resident, said Thursday. "It's a stealth tax on those who can afford it the least, the water users."

According to DSI's Filan, however, Allentown water will be in good hands," saying that LCA general manager "Aurel Arndt is well-respected in his field."

The authority has a \$24 million operating budget for 2013, and a 10-year capital plan totaling \$150 million.

According to an unaudited report from 2012, it listed \$224 million in assets, \$46 million in liabilities and has net assets of \$23 million.

Pawlowski, meanwhile, said the city is at the end of its rope. "We've done everything else," the broad-shouldered Chicago native said inside his fifth-floor office at City Hall. "We cut costs dramatically. We've reduced debt. We're at our lowest staffing level in almost 30 years. We've made systematic cuts year after year. We've pulled every rabbit out of the hat."

The city began looking at selling its assets, including its airport and golf course. "We only would have gotten \$40 million," the mayor said. He added, laughing: "Every lawyer in town lives near the golf course. They'd hate us if we sold it."

The water and sewer system was ripe for sale, according to Pawlowski, who cited a combined debt of only \$30 million and no deferred maintenance. "The area's growing. We have a lot of water capacity and sewer capacity," he said.

City officials, before setting out on a request-for-proposals process, crafted a lease agreement first, essentially flipping the process. "Nine times out of 10, a city starts with an RFP and ends with a lot less money. We wrote the agreement first. We invited companies to look at the lease and give us their feedback," Pawlowski said.

He expected \$150 million to \$200 million. "I was sweating a little bit on bidding day," he said, in part because of concern that protections built into the agreement would scare away potential suitors and reduce bids. These provisions, he said, included measures to ensure fair treatment of sewer and water employees and ratepayers, protect the city's general fund and maintain city ownership of the asset.

"The city felt many suggestions presented too much risk for the city," said Marc Feller, a Dilworth Paxson LLP lawyer advising Allentown. "What we have strikes a balance between flexible, reasonable business terms and protecting the city." Katten Muchin Rosenman LLP is also advising the city on the deal.

"There are a lot of city controls in that operating agreement," said Scott Shearer, a managing director at city consultant PFM Group Inc.

A best-and-final offer round bumped the bid up by \$15 million, to the \$220 million

Lehigh County Authority offered. LCA edged out two private firms, American Water Works Co. of Vorhees, N.J., and United Water of Harrington Park, N.J., the latter a subsidiary of GDF Suez of France.

Water leases have been controversial components of public-private partnerships, or P3, contracts. "We gleaned lessons from all the other places," said Pawlowski, who will seek a third term this year. "We'd look at one plan and say 'let's not go there.' We'd look at another one and didn't like the way it was structured."

But he acknowledged how water resonates personally. "Water we use every day. No one consumes sewage. It's dirty. You flush it. You're not consuming asphalt, either," he added.

"On the water front, you do see some national objections," said Tim Carden, also a PFM managing director. But he praised Pawlowski for confronting the pension problem. "This type of innovation would not be successful without leadership and the mayor has provided it."

Council member Jeannette Eichenwald, though, is not sold. "It's a terrible financial deal. In every way this is a bad deal. It adds \$220 million of debt while we get nothing — \$220 million is a lot for a little local authority," said Eichenwald, the council's lone dissenter.

"The mayor won't even be living in Allentown five years from now. He has higher ambitions," she said in an interview.

A Quinnipiac University poll last month, had Democrat Pawlowski ahead of Republican incumbent Tom Corbett 44% to 38%, in a head-to-head contest for governor.

Opponents have also complained that the mayor and council have denied them a referendum and even opportunities to speak at council meetings.

Pawlowski bristled. "That is absolutely, so utterly ridiculous. We held four public meetings and these people got to speak ad nauseam. We answered every message on Facebook and Twitter, every e-mail. This was probably the most transparent process the city has undertaken."

The mayor took to the streets to sell a plan about a complicated subject, pensions. "When I talk about something like MMO [minimum municipal obligation], no one knows what the heck I mean," said Pawlowski. "I did a 45-minute presentation on YouTube. How do you explain that in 45 seconds? It's not the easiest topic in the world to kick around. But I went to everybody — to the Boy Scouts, the Kiwanis, in people's backyards, it didn't matter."

DSI's Filan said Allentown's message resonates well beyond a city whose image today is a far cry from what Billy Joel portrayed in his 1983 song. Pawlowski has touted an estimated \$1 billion in proposed development downtown and along the Lehigh River, but also said his city is at a crossroads.

"Allentown's not a big city, but it's got a recognizable history to which the rest of the country can relate — places like upstate New York, Ohio and Michigan," Filan said. □

NORTHEAST INVISIBLE SUPPLY

Issuer and purpose	Amount (in millions)	Approval status	Underwriter choice	Expected sale date
MAINE				
State revenue	\$186	pending		first half 2013
State GOs	\$105	approved		2013
State GOs	\$100	pending		late 2013
State GOs	\$100	pending		late 2013
State GOs	\$76	pending		2013
NEW JERSEY				
State GOs	\$1,000	pending		2013
State GOs	\$500	pending		2013
NEW YORK				
State GOs	\$4,500	pending		TBD
NYC GOs	\$800	approved		June
NYCTFA	\$800	approved		June
NYC MWFA	\$550	approved		June
MTA revenue	\$350	approved		June
DASNY revenue	\$271	approved		spring/summer
N.Y. City TFA VRDBs	\$230	approved		April
LIPA reoffering	\$226	approved		June
NYCHDC revenue	\$110	approved		April
PENNSYLVANIA				
Philadelphia GOs	\$400	approved		June/July
PIDC (police headquarters)	\$200	approved		Jan. 2014
Water and Sewer Revenues	\$200	approved		June 2013
Water and Sewer Revenues	\$150	approved		May 2013
Philadelphia Mun. Authority	\$100	approved		Aug. 2013
PUERTO RICO				
Luis Munoz Marin airport bonds	\$350	approved		TBD