Dec. 29, 2010
TO: Chairman Mary Schapiro
FROM: Gunther Karger
RE: Bond financing recommendation

Based on what I have seen in local municipal finance and the shortfalls surfacing in many municipalities, I believe that a review of bond rating criteria could reduce forward risks in this investment sector. The most critical element in projections associated with municipal finance are the assumptions underlying the projections for three reasons:

- Political motivation
- Intermediate term revenue projections
- Inadequately experienced staff and the potential of biased staff preparing the internal analyses and projections

Specifically, projections made by local municipalities may not adequately reflect

- continued fall in home prices in many markets which leads to property appraisals getting still lower resulting in still lower ad valorem tax collctions.
- Continued weak economy for some time time leading to lower sales tax apportionments.
- Lower real estate financing documentary stamp revenues from the reduced level of mortgage financing
- Less funding becoming available from grants due to lower grant funding as grant sources have to reassess the impact of state and federal agencies dealing with continuing budget shortfalls
- Rising fixed costs associated with muni capital project infrastructure costs.
- The historic tendency to rely too heavily on "straight lining" in preparing the projections.

My recommendation is to require in bond financing a more detailed section covering assumptions underlying the projections and a statement describing more specifically the used to prepare projections and ratings and specifically how the projections rely more on forward looking factors and variables than historical "straightlining". I also recommend that municipalities should be require to certify that adequate disclosures of these matters have been made to the taxpayers asked to approve the bond issue.

Best wishes for the New Year!

Gunther