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September 13, 2012

Richard L. Sharp
President, Carmel City Council
Carmel City Hall
One Civic Square
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(rsharp@carmel.in.gov)

Re: Carmel Redevelopment Commission Refinancing – Initial Report
Our Matter No.: 0123312/0598182

Dear Mr. Sharp:

Thank you again for allowing Frost Brown Todd LLC to assist the Carmel City Council (“Council”) regarding the restructuring and refinancing of the debt of the Carmel Redevelopment Commission (“CRC”), as reflected in Ordinance D-2100-12 (the “Ordinance”). As you requested, this is an initial report regarding the transactions that form the basis of the Ordinance. To prepare this report, we have consulted the professionals hired by the CRC and the City to prepare the Ordinance, and we have reviewed the documents provided by the professionals regarding the transactions.¹

Background

As Loren Matthes, financial advisor with H.J. Umbaugh and Associates, stated at the August 16, 2012, Finance Committee meeting, the CRC’s current debt structure is “unsustainable.” Without the proposed refinancing, the CRC would be required to renegotiate some of the proposed obligations to meet its projected revenue, and possibly pay relatively high interest rates. The inability of the CRC to meet all of its debt obligations could also force the imposition of a Special Benefits Tax (“SBT”) to pay debt service on outstanding bonds. Ultimately, it may require more public money to pay all of these CRC debts proposed to be refunded as they are currently structured, than it will by refunding them with bonds secured by the SBT.

It is important to understand the structure of the debts proposed to be refinanced. The obligations proposed for refinancing fall into five (5) general categories: lines of credit

¹ We have not yet received all of the documents that we have requested, but are cooperating with the other professionals to focus our document requests and conduct our review as expeditiously as possible.

("LOCs"), land sale contracts, Installment Purchase Contracts ("IPCs"), Certificates of Participation ("COPs"), and grant obligations. These types of transactions can be defined as:

Lines of Credit: much like a personal line of credit, a financial institution agrees to provide credit to the CRC, up to a maximum amount, at an interest rate and subject to other terms; typically short term (renewals are routine, but not guaranteed), and offers flexibility.

Land Sale Contract: an agreement for the purchase of real property where the buyer (the CRC for purposes of these transactions) does not take out a mortgage, but instead agrees to buy the property by making financing payments in regular installments over time; full title does not transfer to the buyer until the final payment is made.

Installment Purchase Contract: a developer agrees to purchase assets on behalf of the CRC, which agrees to pay for the assets over time by making scheduled payments; the developer can then pledge the income stream from the installment contract to a financial institution in exchange for a loan or access to credit to purchase the asset.

Certificates of Participation: a type of security whereby the CRC pledges a share of its future income in exchange for a loan or access to credit from a sophisticated lender.

Grant Obligations: an arrangement in which the CRC agrees to make grants to an organization, and that organization then uses the grant agreement to secure credit; the organization then makes grants back to the CRC from the credit.

An executive summary of these transactions has been attached as Tab I to this report.

All of these transactions occurred in the context of pre-existing debt related to the CRC and its projects. In 2005, to finance the construction of the Performing Arts Center ("PAC"), the City issued approximately eighty million dollars (\$80,000,000) of bonds ("2005 PAC Bonds") secured by the SBT. In 2006, the City and the CRC issued approximately nine million (\$9,000,000) of bonds ("2006 COIT Bonds") for City Center construction. In April 2008, the City and CRC issued fourteen million dollars (\$14,000,000) in bonds ("2008 TIF Bonds"). The first IPC proposed for refinancing was executed by the CRC in December 2008 (Regions IPC, \$25,000,000 at the time, current par value of \$16,667,601). At that time, the CRC already had bond debt of approximately one hundred million dollars (\$100,000,000).²

To put those numbers in context, it is also helpful to understand the TIF revenues during that time period. In 2008, the CRC collected approximately ten million, seven hundred and fifty thousand dollars (\$10,750,000) of TIF revenue. In 2009, the revenue was approximately thirteen million, seven hundred and eighty thousand dollars (\$13,780,000). In 2010, the revenue was

² In November 2010, the CRC also took on sixteen million, three hundred thousand dollars (\$16,300,000) of COPs (the 2010C COPs) which are not currently proposed for refunding.

approximately fifteen million dollars (\$15,000,000). And in 2011, TIF revenue was approximately sixteen million four hundred and sixty thousand dollars (\$16,460,000).

Validity of Underlying Obligations

In order to issue bonds to refinance the current debt, an assessment must be made concerning the validity of the underlying obligations. However, we believe that, even if irregularities exist because of a past failure to obtain Council approval, the Council can now ratify the actions of the CRC and preserve the validity of the debt in the course of the refinancing. With respect to the validity of its actions without Council approval, the CRC is specifically allowed under Indiana law to purchase real estate, including by land sale contract. Ind. Code § 36-7-14-12.2(a)(1). In addition, the CRC is allowed to accept “loans, grants, and other forms of financial assistance” from any source. I.C. § 36-7-14-12.2(a)(24). The Indiana Attorney General issued an opinion that the execution of the IPCs by the CRC was valid. Several local law firms went further, issuing a memorandum that determined that such IPC arrangements were clearly not “bonds” – required to be approved by the Council – within the meaning of applicable law. That opinion and memorandum are attached as Tab 2.

Indiana law is vague as to the labels for these transactions. For political subdivisions, the definition of “bonds” includes any evidence of indebtedness payable from property taxes. I.C. § 6-1.1-20-1. But, redevelopment commissions can engage in “other methods of raising money” that do not constitute bonds. I.C. § 36-7-14-25.1. Based on the legal advice provided by its attorneys, the CRC avoided issuing “bonds” for these debts. That allowed the CRC to effectively avoid Council review and become obligated for a significant amount of debt that is now described as “unsustainable.” Also, this ambiguity in the law can result in a circular flow of money.

For instance, TIF funds cannot be used to pay operational expenses. I.C. § 36-7-14-39(b)(3)(L).³ Yet, the CRC may make payments from TIF funds on any “obligations” for the purpose of financing redevelopment within an allocation area. I.C. § 36-7-14-39(b)(3)(A). This can include grants to “neighborhood development corporations.” I.C. § 36-7-14-12.2(a)(26). And, as noted above, the CRC is also allowed to receive grants from any source. I.C. § 36-7-14-12.2(a)(24). So, the mechanism exists for the CRC to grant money to a development corporation, and then receive grants from that same organization in return.

This did, in fact, happen. In 2011, the CRC granted approximately six million (\$6,000,000) to the Carmel City Center Community Development Corporation (“4CDC”), a 501(c)(4) organization, pursuant to grant agreements. In return, the 4CDC obtained lines of credit, using the grant agreement as security, and granted approximately five million, five

³ This is also the audit position of the State Board of Accounts. See SBOA 2008 Carmel Audit.

hundred thousand (\$5,500,000) back to the CRC.⁴ Ostensibly, the grants to the 4CDC may have been TIF funds. But, once the money was returned to the CRC, it treated such funds as no longer being subject to the TIF limitations.

Propriety of Refinancing

Notwithstanding the legal questions raised by these arrangements, there are several factors that suggest it is prudent to consider restructuring or refinancing these obligations sooner rather than later. Interest rates are historically low, the City's credit rating based on its taxing power is high, and there are predictions of some potential for interest rate volatility before the end of the year. Securing a low interest rate now will maximize the savings to at least the CRC. Further, there are bond payments coming due in 2013. Packaging the proposed obligations into a single bond issue will make it more likely that the CRC can make newly refinanced bond payments without requesting assistance from the City's general fund.

But, there may likely be a future cost to providing the City's backing to these refunding bonds. Currently, none of these obligations are supported by the pledge of an SBT. But, the CRC's refunding plan asks the City to provide an SBT backup to secure the lowest interest rates. Current projections by Umbaugh provide for 1.06:1 coverage ratio of CRC income to the debt service. One problem with the coverage ratio presented to the City by Umbaugh is that it clearly assumes a significant growth in future TIF revenues – almost doubling over the next twenty five (25) years. In other words, that slim margin, which would barely be sufficient to avoid the SBT, is based on a prediction of future development in the TIF districts, not current TIF collections.

If CRC revenues are insufficient, for whatever reason, the proposed refinancing makes it very likely that the SBT will be levied. If the current obligations are not refinanced, the lenders may have recourse against the CRC and other institutions, but the SBT is not an option. But, as mentioned above, if CRC revenues are insufficient to meet the debt service on the 2005 PAC bonds, which has historically been supported by TIF revenues, then an SBT may be required.

Proposed Reforms

The Council expressed an interest in reforming the structure of the CRC to hinder additional indebtedness. Under Indiana law, redevelopment commissions have broad powers. Similarly, under Home Rule, political subdivisions have broad powers to control the mechanisms of local government.

Under Home Rule, the City can mandate reforms of the CRC to provide fiscal stability and public transparency. Some of these reforms can include: staffing the CRC with City employees, making the City Fiscal Officer the fiscal officer of the CRC, requiring compliance

⁴ In 2011, the 4CDC also granted two million, five hundred thousand dollars (\$2,500,000) to the Center for Performing Arts. Understandably, it appears that the 4CDC operates at a net loss. For 2012, this includes a redacted entry of a payment of one hundred thousand dollars (\$100,000) to an unknown payee.

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with the Access to Public Records Act for businesses that receive grants from the CRC, mandating that the CRC follow the same budget process as other City departments, and continuing the controls that were established earlier in 2012.

Conclusion

The Council has an obligation to make decisions for the benefit of the City of Carmel. This refinancing presents an opportunity to reduce the debt expenses that the CRC has incurred, establish financing that is sustainable, and implement controls on additional spending. It does, however, clearly increase the risk that the SBT will be levied in the future.

Very truly yours,

FROST BROWN TODD LLC

/s/ Thomas D. Perkins

Thomas D. Perkins

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Carmel Redevelopment Commission Debts to be Restructured - Executive Summary

#	Type	Creditor	Beneficiary or Third Party	Other Involved Entities	Collateral/Projects	CDC Authorization	Date of Transaction(s)	Par Amount	Current Interest Rate	Maturity Date	Redemption Date
1	IPC	Regions	Carmel Lofts, LLC; Carmel Lofts Garage, LLC; Carmel Theater Development Company, LLC	Keystone Group, LLC	VFW, Parcel 7C Garage, Right of Way, elevators, fire protection, interior ornamental millwork, air handler, acoustical, stage equip., lighting, signage	Res. 2008-11 (10/15/2008)	12/30/2008, 1/5/2009, 3/19/2009, 5/7/2009, 1/28/2010, 8/2/2010, 9/30/2010, 9/13/2011	\$16,667,601	4.58	1/7/2016	anytime
2	IPC	Regions			PAC equipment (i.e. risers), PAC fixed seating, PAC sound equipment	Res. 2008-11 (10/15/2008)	8/31/2009, 5/27/2011	\$9,613,041	4.75	6/1/2016	anytime
3	IPC	Mercantile	Village Financial		Components of concert hall (7A), main stage theater, black box theater, parking garage, parcel 16, streetscape and improvements	Res. 2009-10 (12/16/2009); 2010-1 (1/20/2010)	12/1/2009, 8/7/2010, 1/20/2010	\$37,905,000	7.75-8	1/15/2035	1/15/2018 @ 102%
4	COP	Oppenheimer	Carmel Theater Development Company, LLC	Wells Fargo (Trustee), CRA				\$2,510,000	9.25	1/15/2035	1/15/2018 @ 102%
5	COP	Oppenheimer			Parcel 16, limestone, red clay tile, cafe equip., lighting, seating signage, bar equip., motorcourt improvements, kitchen equip., PFE, studio & Tarkington lighting, gift shop, wood flooring, etc.	Res. 2009-10 (12/16/2009)	2/23/2010, 3/7/2010, 4/18/2010, 5/9/11, 6/7/2011, 6/24/2011, 7/13/2011, 9/13/2011	\$9,860,696	5.3	3/1/2015	anytime
6	IPC	NSI	Carmel Theater Development Company, LLC	REI Real Estate Services, LLC; Pector Residential, LLC							
7	IPC	UFB	Carmel Theater Development Company, LLC	BIS, LLC; BIS II, LLC; REI Real Estate Services, LLC; First Financial Bank; Shapiro's Carmel, Inc.	(Shapiro's) Building equipment, kitchen equipment		6/10/2010	\$2,500,000	4.75	6/30/2015	anytime

[illegible]