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Cities Deep in Red Turn to Green Deals

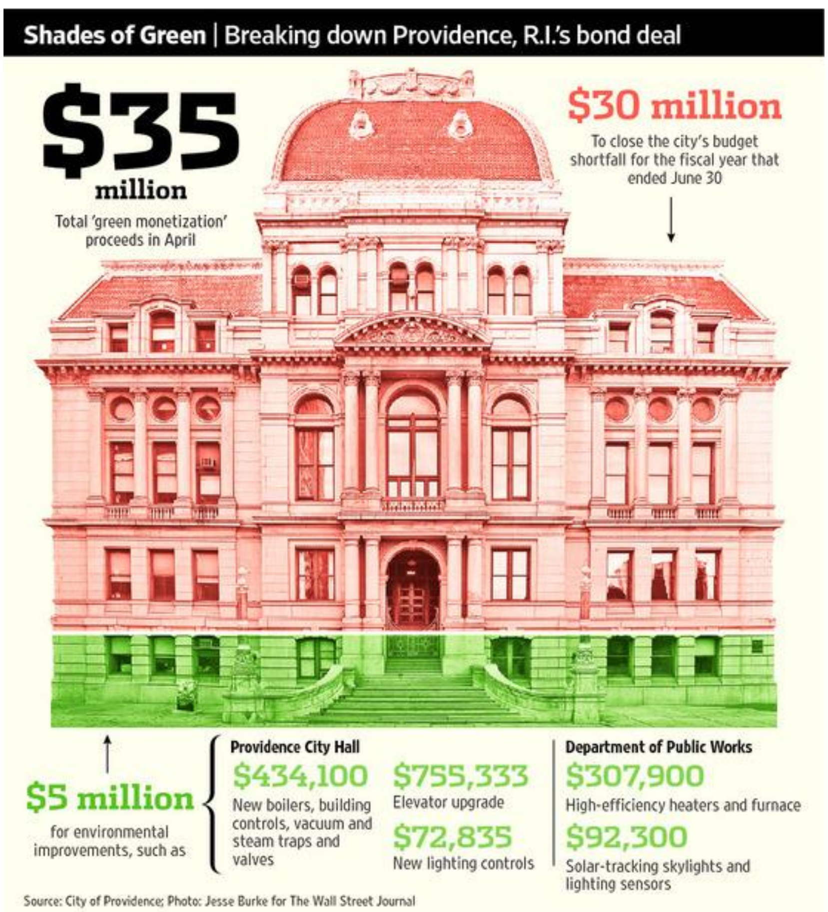
Financing Strategy Skirts Laws on Using Bonds for Deficits

By MICHAEL CORKERY

Cities and states have been firing workers and raising taxes to balance the books. But for some of the shakiest cities, those moves aren't enough.

Enter Class Green Capital Partners, a New York financial adviser to municipalities. Class Green has been helping cities to essentially take out mortgages on their public buildings and use many of the proceeds to plug their budget shortfalls.

Here is the twist: A portion of the bond proceeds go to improve energy efficiency in the buildings, which are meant to generate savings for the city.



That "green" element also helps some cities deal with state rules that restrict selling public buildings or borrowing money expressly to fill deficits.

The recession has forced many financially strapped local and state governments to turn to Wall Street for help in borrowing their way out of the mess. Officials in Harrisburg, Pa., say they are nearing a deal to obtain a $10 million loan which would allow the city to meet payroll expenses and make a bond payment next week. Earlier this year, the State of Illinois borrowed $3.7 billion to make its annual contribution to the state pension system, which has one of the lowest funding levels in the nation.

But few strategies are as unconventional as Class Green's, which has been employed in Newark, N.J. and Providence, R.I. The firm says it is in discussions with a handful of other cities about similar deals.

"We combine sustainability with municipal finance," says Class Green's cofounder and chief executive John Hirschfeld. The end result, he adds, is that "one plus one equals three."

But critics contend that the "green" element disguises the primary purpose of the deals: deficit financing.

In Providence, the chairman of the city's building authority resigned in protest over a $35 million Class Green borrowing deal. "I am not a Boy Scout, but this is just ridiculous," says Lloyd Granoff, who resigned in late March after 25 years on the board. "It has nothing to do with green energy. It is simply a way to cover up a budget deficit."

Rhode Island cities, like Providence, are required to obtain state approval to borrow money to fill budget deficits. Rosemary Booth Gallogly, the state's revenue director, said she warned Providence officials that she considered the $35 million deal a clear case of deficit financing, despite the city's claim that it was something different.

Ms. Gallogly said she didn't block the deal because she felt the city was taking other steps to stabilize its budget problems.

"We told them, 'you are not going to do any others," she says.

Providence officials say the mayor, who took office in January, had only a short time and few options to balance the budget by the end of the fiscal year.

"The fact that a portion of the proceeds were used for general budget purpose is not something anyone was hiding," says Mr. Hirschfeld.

The Providence deal was structured as a sale-leaseback: The city handed over three buildings, including City Hall, to the city's Public Building Authority, a local agency that is usually involved in school construction projects.

In April, the building authority sold a $35 million bond, using the city buildings as collateral.

For the next 15 years, the city will lease the buildings from the authority and its rent payments will go to repay bond holders. About $5 million of the bond proceeds will be used for upgrades such as "solar-tracking skylights" and efficient lighting.

The remaining $30 million went to help cover the city's budget deficit for the fiscal year ended June 30. The city also laid off certain workers and instituted a partial hiring freeze.

Class Green estimates that the upgrades will reduce annual energy costs by about 30%, which should reduce borrowing costs. After factoring in banking and bond insurance fees, the bonds carry an estimated interest cost of 6.1%.

Class Green was co-founded in July 2008 by Mr. Hirschfeld, who worked for 30 years as real estate banker, lawyer and investor. At first, Mr. Hirschfeld pitched these green, sale-leasebacks to businesses. But he couldn't find many takers because of the uncertainty in the commercial real estate market. "The private sector was putting sustainability on the back burner," he says.

The idea finally got off the ground with help from the current Connecticut governor Dannel Malloy. A senior director at Glass Green until his election as governor in November 2010, Mr. Malloy helped come up with the firm's marketing strategy to municipalities, a spokeswoman said.

Class Green aims to earn 1% of the bond proceeds, Mr. Hirschfeld says.

Some sale-lease backs around the U.S. have been controversial. California had plans to sell a group of state office buildings to private investors, generating $1.2 billion in revenue, but the deal was scuttled not long after Gov. Jerry Brown took office in January. "The sale and lease-back proposal was short-sighted," Mr. Brown said in a statement.

Mr. Hirschfeld said Class Green deals should be more politically palatable because they don't involve selling public property to private investors. "You can obtain money without transferring wealth to the private sector," he says.

Class Green advised the financially troubled city of Newark, N.J. on a $73 million bond issue in December 2010.

New Jersey has restrictions on the sale of public buildings to private buyers. So Newark enlisted the help of Essex County to do a deal. Newark handed over 16 city buildings, including the police and fire headquarters and Symphony Hall, to the Essex County Improvement Authority, which then issued the bonds. As a general rule in New Jersey, at least 20% of the debt proceeds had to go toward upgrading the buildings, Mr. Hirschfeld says.

Newark is planning to spend about $22 million of the $73 million bond proceeds to make energy improvements and other upgrades to the buildings, Mr. Hirschfeld says. The balance was used for the city operating expenses and to pay down debt. The energy improvements are expected to reduce the city's borrowing costs, including fees, to about 5.6% from 6.3%.

Mayor Cory Booker was not available for comment, a spokeswoman said.

In an April article in U.S. Mayor, the newspaper of the U.S. Conference of Mayors, Mr. Booker said the deal helped the city reduce a property tax increases and avoid additional layoffs.

"Tax increases and layoffs are often viewed as the only solution," Mr. Booker said. "It may sometimes be prudent to issue bonds or find alternative sources of capital as part of the mix."

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