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Harvey, Illinois, aiming to launch exchange on defaulted bonds next month

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Harvey, Illinois, expects to launch a long-planned tender exchange offer to general obligation bondholders next month that would shed the bonds' default status, resolve longstanding investor litigation, and give the fiscally troubled Chicago suburb more time to make good on its debts.

The city this month posted a City Council-approved ordinance, trust indenture and other documents authorizing the sale of up to $36.5 million of limited tax GO refunding bonds that would serve as an exchange of bonds sold in 2002 and 2007. The plan is to offer the exchange in a $27.6 million tax-exempt series and a $6.5 million taxable series.

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The proposed exchange — which extends the final maturity date by two decades but offers features like a tax levy with a direct intercept and trust estate — is the cornerstone of the consent agreement the city struck with a group of 2007 bondholders.

The extended repayment period is aimed at providing breathing room for Harvey to manage its mountain of bond, pension and water debts while also working to rebuild a beleaguered tax base hurt by outmigration, shuttered businesses, and an aging population. The city also has weak tax collection rates that pose a drag on its budgets.

The city hopes for full participation in the exchange, banking on institutional and retail holders looking favorably on the benefits of shedding defaulted bonds.

The consent agreement set a June 2022 deadline for a debt restructuring, but it's been an arduous process for the long fiscally troubled suburb that has faced past litigation from its pension funds and Chicago over delinquent water payments as well as past Securities and Exchange Commission sanctions.

The bondholders who sued to enforce an intercept mechanism told Cook County Circuit Court Judge Michael T. Mullen during a status hearing Wednesday that they still had some questions on the proposed exchange, but the city and bondholders are working through the various issues. A status hearing was set for June 2.

Loop Capital Markets is serving as the dealer manager for the exchange. Globic Advisors is the exchange agent. Ice Miller LLP is bond counsel and Meristem Advisors LLC is advising Harvey. The dealer's counsel is Ballard Spahr LLP.

The new bonds will provide holders with a segregated property tax levy that is "estimated, based on historical property tax collection information, to provide sufficient funds to currently pay the Series 2023 bonds through their stated maturity dates," reads bond documents posted on the Municipal Securities Rulemaking Board's EMMA website.

"Bonds that are not exchanged will remain outstanding and defaulted," the documents say. Holders will retain their rights under the original issues but "will not have any rights to receive funds from any pledged revenues under the indenture, including series 2023 property tax revenues."

Under the new bond indenture, the amount of property taxes needed for debt service will flow directly to a segregated bond fund from the county collector to provide the trustee with sufficient funds to cover debt service.

The current bonds mature in 2032. The city owes $1.9 million on its remaining 2002B bonds that mature in 2023 and pay a rate of 5.25% to 5.6%. The city owes $22 million on its 2007A bonds that mature in 2032 and pay rates of 5.5% to 5.6%. The city owes $6 million on its 2007B taxable bonds that mature in 2024 and pay rates of 7.25% to 7.75%. A 2002C series for $1 million was defeased under an insurance policy from Assured Guaranty Municipal Corp., which is seeking repayment from Harvey.

The exchange bonds tentatively contain a 2028 term for $2.3 million that pays 4%, a $25.3 million 2053 term bond that pays 4.5%, and a $6.5 million 2036 term of taxable bonds that pay 5%.

The filing lists a series of questions and answers on the exchange that address some potential investor inquiries. Assuming all outstanding bonds are exchanged, the anticipated levy to repay the bonds will rise to $4.4 million in

2025 — plus 5% to make up for non-collections — from $3.9 million in the 2023 and 2024 tax years.

The bonds will fully amortize over their life if the city's collection rates hit a low of 43.6% from the current rate of 56%, which if maintained would repay the bonds by 2043.

Assured Guaranty, which provided an insurance wrap on a portion of the defaulted 2002 bonds, is owed $731,900. The city will pay that debt off in annual installments through 2025.

In the event of a default, bondholders have the right to appointment of a receiver and holders of at least 25% of principal are needed direct the trustee to pursue other remedies.

Under the 2020 settlement agreement with bondholders, until the restructuring is complete, Harvey keeps 90% of pledged tax revenues and bondholders receive 10%.

The city began laying the groundwork for the transaction over the last two years, filing a series of long overdue audited financial statements and putting out financial updates in the absence of the most current audited results.

The city also filed default notices after years of leaving investors in the dark about its battered financial condition and status of its debts. The city also began making some debt payments while putting an experienced financing team in place. In January, it posted possible exchange terms.

The city filed its annual financial statements for 2016, 2017 and 2018 in March 2021, with the 2019 audit published in April 2021 and the 2020 audit in October 2021.

The city in April published its 2021 audit but is still finalizing the 2022 audit. The city's fiscal year ends April 30th. The latest audit underscores the city's deep fiscal scars.

The city has an accumulated unassigned deficit of $62 million in its general fund as of April 30, 2021. The city has accumulated unpaid balances due to Chicago for water purchases of more than $29 million.

"The city has defaulted on several bond payments and has experienced ongoing difficulties in meeting their financial obligations. The situation raises significant liquidity risks," the fiscal 2021 audit by John Kasperek Co. reads.

The city operates on a $31 million general fund budget and expects to close the fiscal year April 30th with a $341,000 balance. In addition to $30 million of GO debt, the city has $3 million of hotel-motel revenue-backed bonds outstanding and remains current on those payments, which mature in 2028.

The city remains in litigation with Chicago over water debts. Chicago is seeking $28 million to bring Harvey into good standing. Harvey contends the number is closer to $14 million.

In 2018, Harvey settled a dispute with its public safety pension funds that sought to garnish tax revenues to make up for overdue contributions.

The city also needs to tread cautiously with the restructuring so as to not run afoul of the Securities and Exchange Commission. Harvey's past fiscal mismanagement led to 2014 SEC sanctions on a 2008 bond sale and the bond and water payment defaults.

The SEC renewed its scrutiny and a federal judge in January 2021 ordered Harvey to rehire a consultant and prove the status of management reforms. The city and SEC resolved the latest compliance dispute at the end of January 2022. Fioretti said the city's past troubles with regulators also is a driving factor in its decision to post preliminary documents on EMMA.