

SOUTHWEST ILLINOIS FLOOD PREVENTION DISTRICT COUNCIL

2011 FINANCIAL PLAN

Prepared by

BUTCHERMARK FINANCIAL ADVISORS LLC

June 15, 2011

2010 FINANCING PLAN

The Council retained ButcherMark Financial Advisors LLC (“ButcherMark” or “Financial Advisor”) to develop a financing plan that would provide the funds necessary to pay all the expected costs to construct the repairs to the levees. It was the counties’ expectation, in forming the Council, that the incremental sales tax approved by the State of Illinois should be the primary source of payment for the costs related to completing the repairs to the levee system in order to be able to certify to the 100-year level of protection.

To meet this goal ButcherMark prepared an initial plan of finance in 2010. That plan recommended the Council leverage the three county’s sale tax income by issuing bonds in combination with surplus monies from sales tax receipts that will be used on a “pay as you go” basis. This plan for bond financing was structured with a “gross pledge” flow of funds using a “locked box” with the bond trustee to receive all sales tax receipts sent by the state on behalf of the three counties and pledging them first to pay debt service on senior bonds and second to pay debt service on subordinated (“junior” or “second lien”) bonds. The Bond Indenture, governing the terms of the bond issue, and the initial plan of finance was approved by the Council in 2010 and led to an initial issuance of three Series of bonds in November 2010 for a par amount of \$94,195,000.

This initial transaction produced \$87.4 million in Project Fund monies for levee repairs. The financing took advantage of very beneficial tax subsidies offered by the Federal government under the American Recovery and Reinvestment Act of 2009, Public Law 111-5 (the “Recovery Act”), a program which ended on December 31, 2010, by issuing Build America Bonds (“BABs”), Recovery Zone Economic Development Bonds and tax exempt bonds. It was assumed in light of very preliminary engineering cost estimates from AMEC, the Council’s design and project management engineers, that these Project Fund monies would be sufficient to complete the initial phase of the project planning and design and allow initial construction to begin once the design was completed and all permits were issued. The financing plan was also designed to delay using bond financing for certain estimated costs of levee to avoid losing a large amount of money because of negative arbitrage (meaning the rate on the investment of unused Project funds will be much less than the interest rate on the bonds) as Project Fund monies wait to be spent. Further, tax law spending requirements, monitored by the IRS, requires that the Council must reasonably expect to spend Project Fund proceeds within three years from the closing of the bond transaction. If the Council bonded for the full amount possible against the then existing sales tax revenue stream, it was uncertain that all the proceeds could be spent within the IRS time frame. ButcherMark also advised the Council that by delaying future bond issuances against sales tax revenues, the Council could maximize its leverage of those tax receipts by taking advantage of the growth in sales tax that is expected in the future.

In this initial plan, ButcherMark projected that the Council could generate a total aggregate amount of \$166.5 million by leveraging all of the sales tax monies through August of 2015. This assumed executing three bond transactions: one in 2010; another in 2012 and a final bond issuance in 2014. The plan also assumed that all accumulated surplus funds in the three county sales tax funds would only be spent on a “pay as you go” basis for levee repairs in the latter years after all bonding capacity was exhausted. The plan recommended that the first bond transactions be issued as a senior debt obligation of the Council in 2010, followed by two subordinated debt transactions in 2012 and 2014.

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In May 2011, subsequent to the first bond financing, AMEC submitted a design and cost estimate to the Council based upon a 30% design for the project. The cost of the construction based upon that level of design has now been estimated to be approximately \$150 million. Financial costs and administrative costs estimated by the Council would add an additional \$10-11 million to this cost estimate, resulting in a total estimated project cost of \$161 million.

The Council involved ButcherMark in the AMEC construction review process so that it could update its financial model based upon the most current construction cost estimates and schedule

for completing construction. ButcherMark revised its debt capacity model (see Attachment I) to include the revised project cost estimates including assumptions based upon a new projected schedule of the use of monies from the 2010 project financing (to be fully spent by the end of the first quarter of 2013), the demise of the favorable BAB program at the Federal level, the latest sales tax receipts from the State of Illinois, the use of the subordinated bond structure authorized by the Council in the Bond Indenture and the continued access to the surplus in the three county sales tax funds for “pay as you go” financial support for the levee project.

As a result, ButcherMark is recommending a financial plan to the Council in June 2011 that can generate an additional \$75.2 million on a conservative basis that will finance, together with the \$87.4 million already raised in the 2010 bond transaction, a total of approximately \$162.2 million dollars for levee reconstruction.

In preparing financial plans many judgments and estimates need to be made about components of the plan, most of which are subject to variability over time. The goal of a financial advisor is to incorporate conservative estimates for each element of the plan, track them over time and modify them as events take place during the planning horizon. ButcherMark has also prepared a sensitivity analysis (see Attachment II) for all of its variable financing assumptions in the plan to assist the Council in determining the impact of financial plan decisions today and over time.

The following conservative assumptions have been built into ButcherMark’s planning model to project out for the Council the leveraging capacity of the sales taxes to meet the cost estimates of the levee rehabilitation:

1. Sales Tax Revenues – ButcherMark noted that sales taxes increased from 2009 into 2010 and is using the total calendar year deposits from 2010 (\$11.047 million) as its starting point for revenue projections into the future. The model builds in a modest growth rate in those sales taxes of 3% per year over the life of the outstanding bonds. Sales tax revenues are the major source of revenues for leveraging debt to pay for levee reconstruction. Prudent management and rating agency criteria only allows financial plans to leverage growth in these taxes by looking backward at the actual documented historical growth pattern. Although one also would expect to stress test sales tax revenues to account for the impact of any economic downturn, we note that the historical examination of the three SW Illinois county sales taxes (adjusting for the \$0.25 sales tax increase authorized for levee reconstruction) has already been severely stress tested by the 2008 national economic downturn, so the projection has not been further stress tested. As mentioned above, we have provided a sensitivity analysis of varying growth rates in these revenues.

2. Administrative and Operating Expenditures – These are the funds that are budgeted by the Council to annually operate the Council and oversee design and construction activities. It also

includes funds to reimburse the counties for funds spent by them on the project prior to the existence of the FPD sales tax. This expenditure category is grown at a modest growth rate of 3% per year. We do not plan on providing any sensitivity analysis on this element of the plan because this is an item that is under the control of the Council and not subject to market variability.

3. Financing Assumptions – Following discussions with the Chief Supervisor and AMEC, ButcherMark made a projection of the timing of expenditures of the \$87.4 million leveraged in the Council's 2010 bond transaction. The current estimate of spending has those monies fully expended during the first quarter of 2013.

As a result, ButcherMark recommends approval by the Council of a financial plan that pays for future construction costs from April 2013 to April 2015 by using the surplus monies in the three county FPD sales tax funds, estimated to be approximately \$25.5 million during that time, supplemented by a small subordinated Council bond transaction in the first quarter of 2013 in the net amount of approximately \$8.3 million. The plan also recommends that interest earned through 4/15/2016 on the Construction Fund (\$1.9 million) and the Debt Service Reserve Fund (\$1.1 million) be used to pay project costs during this period. It should be noted that the estimate of surplus from the three county sales tax funds is based upon a calculation made about how much money will flow out of the Bond Indenture from the 2010 bond transaction as excess to the counties and assumes that those monies are modestly invested by the counties and that they are not spent for any purpose other than levee reconstruction in accordance with Council approvals and directives. It continues to be ButcherMark's recommendation that no excess monies should flow out of the Indenture to the county FPD sales tax funds, but rather they should be retained and protected under the Bond Indenture by being placed in the Project Fund, invested and then spent as "pay as you go" for levee reconstruction in accordance with the approved financial plan of the Council. This would be a credit enhancement to the bond issue structure (those monies would be available to avoid a potential bond payment default), simplify accounting and management of those monies and guarantee that they would be spent on the levee reconstruction costs in accordance with the Council approved AMEC plan.

ButcherMark's financial plan then recommends that the Council plan for a final (second) subordinated bond transaction in early 2015, which, using current conservative assumptions is projected to raise approximately \$38.4 million in net additional bond proceeds to pay for construction costs.

As mentioned above, financial plans are dynamic and adjusted periodically to take account of changes in the financial markets, construction costs, and other variables. Consequently, the two subordinated bond transactions projected to be needed in 2013 and 2015 will most likely be sized differently based on better knowledge of final construction costs and the actual revenues from

growth in the sales taxes as well as more clear information on market interest rates. The Council will also have received from the rating agencies the precise coverage and reserve requirements for the subordinated debt structure.

4. Coverage and Rating of Subordinated Debt – The most important determinant of bonding capacity for a sales tax bond will be the debt service coverage ratio necessary to achieve an “A” rating from the ratings agencies for a subordinated bond issue. This rating level is important in order to present a strong credit to bond investors and an optimal financing. The coverage ratio is the amount of revenue received annually by the issuer divided by the annual debt service amounts (principal and interest on the bonds). The coverage level we will focus on here is the additional bonds test (ABT) that will be dependent on the ratio between the previous year’s sales tax revenues and the maximum annual debt service on all bonds. This margin of safety or comfort is a variable in the plan and directly impacts the rating on the bonds. For planning purposes ButcherMark recommends that the coverage requirement be established at the lowest possible net coverage ratio to achieve a single “A” rating, which we judge is approximately 1.25, and that also achieves a reasonable cost of capital in the market. This excess coverage will also be needed to provide funds to annually fill up the Administrative Account in the Bond Indenture to permit the Council to continue to manage the overall project during construction and post-construction until the bonds are paid off. The sensitivity analysis shown in Exhibit II illustrates the impact of varying the net coverage ratio on the leveraging capacity of the sales taxes.

5. Market Interest Rates – Predicting future interest rates is a problematic but necessary exercise to arrive at a financial plan. ButcherMark approached this issue by grounding its estimated yields on tax exempt market interest rates derived from the Municipal Market Monitor Index (MMD) published for June 7, 2011. To produce a conservative future yield estimate, ButcherMark took the current MMD rate and added the actual interest rate spread from the pricing of the Council’s 2010 bond financing and the current spread difference between the yields in the single-A MMD index and the double-AA MMD index. This was done because future Council bond issues are planned to be executed as subordinated bonds with a single-A rating rather than with the double-AA on the senior bonds issued in 2010. Bonds issued under an Indenture that are called “senior” are legally first in line for repayment. Bonds issued that are subordinate in an Indenture means that they are repaid (second) from revenues left over after senior bonds are repaid. Senior bonds usually have higher coverages (more protection for bondholders) than subordinated bonds and, therefore, are rated higher than subordinated bonds. Issuers use subordinated bonds to maximize their leveraging capacity, because subordinated bonds require less coverage (see discussion above). Finally, ButcherMark added another 50 basis points (.50%) to this interest rate scale to provide a more conservative estimate. For example, the total conservative interest rate yield for a current interest bond issued by the Council maturing in 2029 (16 years after the anticipated issue date of 2013) would be 5.75%. This spread was calculated by taking the actual interest rate yield for 2029 from the MMD Index on June 7, 2011 of 3.50%, adding 95 basis points to it (which was

the 2029 spread to MMD in the 2010 bond issue), adding another 80 basis points (reflecting the current difference between the single-A index and the double-AA index) and finally adding another 50 basis points of margin because of the length of time in the future that we project issuing the next two bond issues.

ButcherMark believes that this is a very conservative projection because the bond transaction priced in November 2010 also included an “Illinois interest penalty” that added significantly to the cost of the Council’s bond transaction. Over time, as the State of Illinois failed to pass budgets on time and accumulated massive obligations to make payments to local governments and school districts, the bond market imposed a very harsh cost on all Illinois bond transactions, whether they were State issues or local issues. This increased cost became known as “the Illinois interest penalty”. More recently, the State of Illinois passed its budget and began to address their fiscal problems. Those actions were favorably viewed by the bond market and this penalty has declined by at least 25 basis points in recent Illinois financings. Since we are using the spreads from the 2010 Council bond financing that include up to a 100 basis point Illinois interest rate penalty, every reduction in that penalty going forward makes our future spread calculation in the 2011 Financing Plan even more conservative. The sensitivity analysis we prepared in Attachment II measures the impact from varying our base case interest rate assumptions.

6. Reserve Fund – A debt service reserve fund is normally required by the rating agencies and the market to ensure that there is a liquidity facility in place to meet timely principal and interest payments to bondholders. These reserve funds stay in place for the life of the debt, are normally sized at the maximum annual debt service obligation on the issued bonds, are conservatively invested and readily available and are usually scheduled to pay for the last debt service obligation of the bonds at maturity. ButcherMark’s conservative recommendation for the financial plan at this time includes a reserve fund on subordinated debt, sized at the maximum annual debt service on the respective bonds in 2013 and 2015. Again, ButcherMark’s sensitivity analysis will demonstrate the impact on the capacity of the sales taxes from varying this requirement to a lesser required amount.

POSSIBLE ADDITIONAL REVENUE SOURCES

The Council’s recommended financing plan has been designed to maximize the leveraging capacity of the FPD sales tax for levee reconstruction. However, the estimated cost of construction, including inflation and contingencies, is very close to the total amount of money that the Council can raise by leveraging the FPD sales tax. Although the plan is based upon conservative assumptions, it is not inconceivable that those assumptions might not be realized or costs may increase, resulting in the Council being unable to generate the full amount of proceeds it needs to fund total construction costs for the levee reconstruction.

Fortunately, there are other feasible alternatives that might be considered, exclusive of requesting the State of Illinois to increase in the amount of the sales tax that can be levied.

Metro East Sanitary District (MESD)

The Metro-East Sanitary District has the statutory authority to generate revenues to carry out their responsibilities and issue debt. The law sets a maximum tax rate and an overall maximum debt limit for the District. MESD has historically provided flood protection to many properties that were not included within District boundaries, and therefore not paying taxes to the District. Illinois legislation approved in 2010 and effective in 2011 (70 ILCS 2905 Sec. 2-11) provided for such areas to be annexed by the District. The increment of taxes paid by these annexed areas could be used to support the project. Current estimates suggest that the assessed value of annexed properties would be about \$208 million. Applying existing tax rates results in estimated addition annual revenue to MESD of about \$649,000.

As a Sanitary District, MESD has a maximum statutory debt limit of 5.75%. Against its 2008 assessed valuation of approximately \$730 million MESD had a debt capacity of almost \$42 million. As of its 2008's audited financials, MESD had no outstanding debt.

Based on the following assumptions MESD could generate approximately \$3.4 million through borrowing:

- 20 year term
- 2 times annual debt service coverage
- 7% average interest rate

With the approval of MESD, these funds could be used to help pay for the project.

Wood River Levee and Drainage District (WRDD)

The Wood River Levee and Drainage District has the statutory authority (70 ILCS 605/) to levy assessments on all properties within the district and to issue drainage and levee improvement bonds to finance capital projects necessary to carry out their public purpose.

The District has previously obtained judicial approval to increase assessments to generate an additional \$450,000 annually, of which approximately \$350,000 could be available to support the debt service obligations of a bond issue for levee reconstruction. As a drainage district, WRDD has no statutory debt limit. Wood River currently has issued bonds for levee work and has outstanding debt of \$436,491.

ButcherMark has made an estimate of the leveraging capacity of the incremental WRDD revenue of \$350,000 and determined that, using the assumptions below, WRDD could raise an additional \$1.9 million.

- 20 year term
- 2 times annual debt service coverage
- 7% average interest rate
- Estimated bond size: \$1,870,000

With the approval of the Board of the Wood River district, these funds could be used to support the project.

US Army Corps of Engineers

The Corps of Engineers is now authorized to spend federal funds on portions of the project and should be fully authorized to spend for eligible projects on the entire levee system by federal fiscal year 2013. However, the availability of funds is determined annually by the federal budgeting process. The outcome of that process is uncertain in the best of times. Given the stresses on the federal budget and the reluctance of Congress to earmark funds, the federal funding environment is even more difficult and unpredictable.

Once a federal project is authorized, the Corps of Engineers can undertake design and construction with the agreement of a local sponsor to provide a share of the cost and meet a number of other conditions. Typically, the federal share of project costs is 65%, but it can be greater. Certain costs, such as land acquisition or treatment and disposal of toxic and hazardous waste must be paid by the local sponsor.

While it would not be prudent for the Council to incorporate an unknown or unpredictable funding source into the financial plan, the expectation by the Corps is that over the next five year period there will be some federal appropriations for elements of the project that are coincident with the Corps projects in the American Bottom. Based on discussions with the Corps, it is reasonable to expect a minimum of \$20 million in appropriations for projects in MESD and Wood River over the next few years. If the Council and the Corps can agree on directing these funds toward high priority projects that are part of the project, it could effectively reduce the Council's costs. However, the Council would still be responsible for the local cost-share and other costs that are not eligible for federal funding.

Table 2 summarizes the latest estimates of fiscal capacity of the Council and others to pay for the project. The total estimate of fiscal capacity potentially available to the project is nearly \$188 million. However, achieving this total will require reliance on other agencies to contribute to the project, either by building components of the project or providing cash to the Council. The Council has indicated its strong preference is to build the project solely with revenues provided through the FPD sales tax. While the added fiscal capacity provided by third-parties will be useful as a backstop source of funding if the sales tax unexpectedly proves inadequate, the levee districts can make good use of the excess funds they will collect for maintenance and ongoing

capital improvements that will be needed in the future. Further, reliance on parties over which the Council has no control such as the federal government, diminishes confidence in the Council’s ability to meet its cost and schedule goals.

Table 1
Estimated Fiscal Capacity Including “Backstop” Funding

Organization	Amount
FPD Council	\$162,600,000
Metro-East Sanitary District	3,470,000
Wood River Levee and Drainage District	\$1,870,000
Corps of Engineers	\$20,000,000
Total	\$187,940,000

At this point, the financial plan concludes that with prudent decision-making by the Council and the counties, with continuing efforts to control costs, and barring unforeseen developments in the financial markets, FPD sales tax receipts should be sufficient to pay for construction of the project and ongoing Council operations.

ATTACHMENT I

		6/8/2011							
<u>Southwestern Illinois Flood Prevention District Council</u>									
<u>Capacity Analysis for Levee Construction</u>									
Results									
2010 Net Proceeds		87,409,570							
2013 Net Proceeds		8,282,700							
2015 Net Proceeds		38,447,201							
Construction Fund Earnings		1,950,359	(4/15/16)						
Reserve Fund Earnings		1,059,273	(4/15/16)						
Surplus Draws		25,492,166							
MESD & WRDD Net Proceeds		0							
Total Other than 2010 Net Proceeds		75,231,698							
Total Capital Improvement Fund Draws		162,641,267							
Maximum Semiannual Draw after 4/15/2013		14,218,211							
Projected Revenues, Debt Service, Expenses, and Surplus									
Date	Senior			Subordinate			Remaining Revenues	Administrative Expenses	Surplus
	Tax Revenues	BAB Subsidy	Debt Service	Debt Service	Remaining Revenues	Administrative Expenses			
11/23/2010									
4/15/2011	5,420,374	359,000	1,835,129		3,944,245	0	3,944,245	300,000	3,644,245
10/15/2011	5,420,374	455,070	2,326,220		3,549,224	0	3,549,224	300,000	3,249,224
4/15/2012	5,582,985	455,070	4,781,220		1,256,836	0	1,256,836	309,000	947,836
10/15/2012	5,582,985	455,070	2,301,670		3,736,386	0	3,736,386	309,000	3,427,386
4/15/2013	5,750,475	455,070	4,806,670		1,398,875	0	1,398,875	318,270	1,080,605
10/15/2013	5,750,475	455,070	2,276,620		3,928,925	229,377	3,699,549	318,270	3,381,279
4/15/2014	5,922,989	455,070	4,831,620		1,546,439	229,377	1,317,063	327,818	989,245
10/15/2014	5,922,989	455,070	2,251,070		4,126,989	229,377	3,897,613	327,818	3,569,795
4/15/2015	6,100,679	455,070	4,936,070		1,619,679	229,377	1,390,303	337,653	1,052,650
10/15/2015	6,100,679	455,070	2,210,795		4,344,954	1,425,192	2,919,762	337,653	2,582,109
4/15/2016	6,283,699	455,070	4,965,795		1,772,974	1,425,192	347,782	347,782	0
Totals	63,838,702	4,909,699	37,522,874	31,225,527	27,457,637	3,767,891	3,533,264	23,924,373	

Assumptions	2010	2013	2015
Bonds			
Tax Revenues	11,047,000	11,719,810	12,433,546
Net Coverage	1.75x	1.25x	1.25x
Gross Coverage	1.5x	1.1x	1.1x
Rating	AA-	A	A
Spread to Market (June 7, 2011)		0.50%	0.50%
2010 & Future Rev Growth		3%	3%
Surplus Fund Balance 11/23/2010 (Est.)	1,500,000		
Annual Administrative Expenditures	600,000		
Ann. Exp Growth	3.00%		
Construction Fund Earnings	0.87%		
Surplus Earnings	0.50%		
Reserve Earnings	2.32%		
Fixed Costs per Issuance	100,000		
Per bond costs of issuance	\$7		
Minimum Surplus Fund Balance	25,000		
Reserve Percentage	100%		

Projected Bond Proceeds, Construction Fund Balances, Earnings, and Draws

Date	Surplus Fund Balances		Construction Draws from Surplus	Earnings on Construction Fund	Earnings on Debt Service Reserve	Capital Improvement Plan	Construction Draws from Surplus	Construction Fund Draws	Construction Fund Balance
	Surplus Before Construction	Surplus Fund Balance							
11/23/2010		1,500,000							87,409,570
4/15/2011	5,144,245	5,147,183	0	2,938	57,442		0	0	87,764,946
10/15/2011	8,396,408	8,409,311	0	12,903	72,813	8,000,000	8,000,000	8,000,000	80,220,583
4/15/2012	9,357,146	9,378,227	0	21,081	72,813	17,000,000	17,000,000	17,000,000	63,643,311
10/15/2012	12,805,613	12,829,123	0	23,510	80,565	24,000,000	24,000,000	24,000,000	40,001,484
4/15/2013	13,909,728	13,916,713	13,916,713	31,985	80,565	28,332,000	28,332,000	28,332,000	34,122,992
10/15/2013	3,406,279	3,381,341	63	63	80,565	14,218,211	14,218,211	14,218,211	23,515,529
4/15/2014	1,014,245	989,307	62	62	80,565	14,218,211	13,228,904	13,228,904	10,469,202
10/15/2014	3,594,795	3,569,857	63	63	133,486	14,218,211	3,569,857	10,648,354	(0)
4/15/2015	1,077,650	1,052,712	62	62	133,486	14,218,211	1,052,712	13,165,499	25,415,188
10/15/2015	2,607,109	2,582,172	63	63	133,486	14,218,211	2,582,172	11,636,039	14,023,493
4/15/2016	25,000	25,000	63	63	133,486	14,218,211	63	14,218,149	0
Totals			25,492,166	92,793	1,059,273	162,641,267	25,492,166	137,149,102	
									134,139,471

ATTACHMENT II

Sensitivity to Financing Assumptions

Maximum Additional Leveraging of Sales Tax Revenue Post-2010 Bond Issue (\$millions)			
	Spread to Current Rates		
Net Coverage	+50 <u>bp</u>	0	-50 <u>bp</u>
1.40x	65.2	67.0	68.7
1.25x	75.2*	77.5	79.8
1.10x	80.0	82.6	85.4

Maximum Additional Leveraging of Sales Tax Revenue Post-2010 Bond Issue (\$millions)			
	Reserve Requirement, as Pct of Maximum "Reasonably Required"		
Tax Rev. Growth	100%	50%	0%
2%	69.3	71.3	73.5
3%	75.2*	77.6	80.0
4%	81.0	83.7	86.4

* Base Case