Request for City Council Committee Action from the Department of Finance and Property Services

Date: **June 15, 2015**

To: **Honorable John Quincy, Chair-Ways & Means**
Referral to: **None**

Subject: **Authorize Settlement with Internal Revenue Service of $135,000**

Recommendation:

Staff recommends authorizing the appropriate City staff to execute a settlement agreement with the Internal Revenue Service ("IRS") in the amount of $135,000 pursuant to examination findings regarding potential taxability of the City of Minneapolis, MN $5,390,000 Limited Tax Supported Development Revenue Bonds, Common Bond Fund Series 2006-1A (Tax Exempt) Issued June 28, 2006 ("Bonds"). Staff recommends amending 2015 General Appropriation Resolution to appropriate an additional $135,000 in the department of Community Planning and Economic Development, using reserves from the City's Common Bond Fund ("CBF").

Previous Directives:
None

Prepared by: Sandy Christensen, Deputy Finance Officer

Approved by: Kevin Carpenter, City Finance Officer

Spencer Cronk, City Coordinator

Presenters in Committee: Sandy Christensen

Financial Impact: *(delete all lines not applicable to your request)*

- Action requires an appropriation increase to the Capital Budget or Operating Budget
  Department Name: Community Planning and Economic Development
  Fund Name: Common Bond Fund
  Amount: $ 135,000
- Action requires use of contingency or reserves

Supporting Information:

The City of Minneapolis maintains an economic development financing tool known as the Common Bond Fund. The CBF bond issues are backed by a limited tax pledge upon property in the City of Minneapolis. Additionally, each bond issue in the CBF is secured by a reserve fund specific to that issue and there is also an overall reserve specific to the program. The CBF Revenue Bond Program is a loan fund for growing manufacturing companies. Most of the major manufacturing projects completed in Minneapolis since 1982 have been financed with tax-exempt or taxable revenue bonds issued through the CBF. Starting in 2004, the CBF was expanded throughout all of Hennepin County through a joint partnership between the City of Minneapolis and the Hennepin County Housing and Redevelopment Authority (HRA). Local government agencies may issue tax-exempt or taxable revenue bonds on behalf of private borrowers to provide lower interest rates on long-term financing. Revenue bonds issued for industrial/manufacturing projects are generally tax-exempt; those for commercial projects are taxable. Projects can include land acquisition, new-facility construction, additions to existing facilities, purchase and renovation of existing structures and production equipment purchase. In order for bonds to be considered tax-exempt, a number of requirements must be met as well as continually monitored for compliance with these requirements which are governed by the IRS. When tax exempt bonds are purchased by bondholders, the interest earned on the bonds is exempt from Federal income tax and Minnesota income tax (with some exemptions). Because the income derived from the interest on tax exempt bonds is not subject to income taxes, the yields are typically lower. The lower rates provide a financing benefit for the borrower in terms of lower interest costs.

In 2006, the City issued two series of bonds through the Common Bond Fund on behalf of Ambassador Press, a local printing company, to assist with facility and equipment upgrades.

Series	Amount	Taxable/Exempt
Limited Tax Supported Development Revenue Bonds – Common Bond Fund Series 2006-1A	$5,390,000	Exempt
Taxable Limited Tax Support Development Revenue Bonds – Common Bond Fund Series 2006-1B	$3,100,000	Taxable

Once bonds were issued and received, the City became owner of the facility and leased the facility pursuant to a long-term lease to Ambassador Press (“Tenant”). The Tenant’s monthly lease payments provide the revenue source for the payment of the bonds.

In February of 2014, the City was contacted by the IRS with a notice that they wished to examine the Series 2006-1A bonds as part of an on-going compliance initiative involving small issue bonds. Upon release of information and review, the IRS ultimately determined that the tenant had exceeded the mandatory small issue cap of $10,000,000 in capital improvements – a requirement of the tax exempt bond issue. Under normal circumstances, the bonds would revert to a taxable series. If this were to occur, the bondholders would be required to pay income tax on the interest income received on these bonds. At the same time, the tenant, as responsible party for maintaining the tax exempt nature of the uses of the bond proceeds could be required to pay for these costs on behalf of the bondholders, plus penalty and interest. The bonds could also be required to be called, potentially resulting in a call premium liability to the bondholders of three percent, in addition to the refinancing.

Over the course of the past year, the City has been working with the IRS and Ambassador Press to determine the validity of the IRS claim of taxability, the extent of the liability associated with the action, and the amount needed to settle the matter. In May of 2015, the City and Tenant received a settlement offer from the IRS of $135,000 which would provide a settlement of penalty and interest, as well as eliminate the need to redeem the tax exempt bonds. This settlement amount is significantly below the beginning point of negotiations with the IRS which exceeded $300,000 AND required the redemption of the tax-exempt bonds. Staff seeks authorization to notify the IRS of the City’s approval of this settlement and continue to completion. Staff continues to explore opportunities with the Tenant to participate in the settlement amount, including a short term loan to the Tenant with repayment later in 2015.