**Request for City Council Committee Action**
**From the City Attorney's Office**

Date: March 4, 2008
To: Ways & Means/Budget Committee
Referral to:

Subject: Claim of City of Minneapolis Against Kennedy & Graven, Chartered, Over Tax Dispute Involving 2003 General Obligation Tax Increment Refunding Bonds (Laurel Village)

**Recommendation:** That the City Council approve the settlement of this claim in the amount of $170,500.00 in the following fashion: (1) Kennedy & Graven shall pay $55,000.00 to the City upon execution of appropriate settlement documents; (2) that $115,500.00 shall be paid by reducing each of the future invoice amounts under Kennedy & Graven's existing bond counsel services contract by fifty percent (50%) until the outstanding obligation of $115,500.00 has been paid in full; and, (3) in the event that there is an outstanding obligation due on the expiration of the existing contract on or about June 30, 2010, that Kennedy & Graven shall pay the remainder of the obligation in cash within five business days of the date of expiration of the existing contract. Authorize the City Attorney's Office to execute any documents necessary to effectuate this settlement.

**Previous Directives:** On January 18, 2008, the City Council approved the following recommendations from the Finance Officer: (a) approved a closing agreement with the IRS regarding a tax dispute involving the City's receipt of excess private payments related to the 2003 General Obligation Tax Increment Refunding Bonds (Laurel Village); (b) increased the appropriation in the Laurel Village tax increment fund by $170,500.00 for the payment of the penalties and interest required by the proposed closing agreement; (c) authorized the issuance of a Twelve Million Nine Hundred Eighty Thousand Dollars ($2,980,000.00) General Obligation Tax Increment Taxable Refunding Bonds to refund a portion of the 2003 General Obligation Tax Increment Refunding Bonds (Laurel Village); (d) approved the terms and conditions for the issuance of the above-mentioned taxable refunding bonds; and, (e) authorized the finance officer to accept the low bid on the taxable refunding bonds based on the approved terms and conditions.

Prepared by: Peter W. Ginder, Deputy City Attorney, Civil — Phone: 673-2478

Approved by: Susan L. Segal, City Attorney

Presenter in Committee: Susan L. Segal, City Attorney

**Financial Impact** (Check those that apply)

___ No financial impact (If checked, go directly to Background/Supporting Information).
___ Action requires an appropriation increase to the _____ Capital Budget or _____ Operating Budget.
___ Action provides increased revenue for appropriation increase.
___ Action requires use of contingency or reserves.

___ Business Plan: ____ Action is within the plan. _____ Action requires a change to plan.
___ Other financial impact (Explain): Fund/Org.
___Request provided to department's finance contact when provided to the Committee Coordinator.

**Community Impact**
City Goal(s):

## Background/Supporting Information

Laurel Village was constructed in the late 1980's and is a multi-family rental housing development of approximately 1,000 units. To assist with the development, the Minneapolis Community Development Agency (MCDA) agreed to assist in the funding of several parking ramps in the project utilizing tax increment financing (TIF) revenue generated by the initially constructed buildings and ramps and a future residential tower to built later. As part of the financing plan the development agreement contained provisions for the owners of the project to semi-annually pay the City "Holding Rent" payments if TIF collections fell below prescribed levels.

Tax increment bonds in the amount of $26,000,000.00 were issued in 1986 for the Laurel Village project. These bonds were subsequently refunded in 1992 and again in 2003 to save interest costs. As a result of the second tower not being constructed and TIF changes in 2001, TIF collections fell below the prescribed levels and the provisions for collecting Holding Rent (private payments) started to come into play. The City anticipated that the Holding Rent payments would ultimately exceed the allowable federal tax limit (25%) in either 2011 or 2012. On January 29, 2003, the City issued its General Obligation Tax Increment and Funding Bonds, Series 2003 (Laurel Village) in the original aggregate principal amount of $26,350,000.00 (the "Bonds") with a call date of March 1, 2010, with the intent to issue taxable bonds when the Holding Rent payments approached the maximum allowable limit. On the date of the issuance of the Bonds, Kennedy & Graven, in its capacity as bond counsel to the City pursuant to the current bond counsel services contract, delivered its legal opinion that interest on the Bonds was not includable in gross income for federal income purposes under applicable provisions of the Internal Revenue Code of 1954. In March 2006, the IRS began an inquiry into the tax exempt status of the interest on the bonds. The IRS ultimately took the position that the bonds satisfied certain tests relating to the tax exempt status, but only as of September 1, 2006, thereby impacting the tax exempt status of the Bonds. As described in the Previous Directives section above, the City settled the determination by the IRS concerning the alleged violations of the tax exempt status of the Bonds by payment of $170,500.00 as a full and final settlement with the IRS. The City also incurred attorneys fees which were payable to Kennedy & Graven and the City's outside counsel, Nixon Peabody, with respect to defense of the IRS matter.

City staff believes that Kennedy & Graven's legal opinion regarding the tax exempt of the interest on the Bonds was in error and caused the penalty imposed by the IRS. Kennedy & Graven argues that in questioning the tax exempt status of the Bonds, that the IRS asserted the application of a regulation that to that date, was not supported by any case law, revenue ruling, revenue procedures, notice or other guidance from the IRS or the United States Treasury Department that indicated that such application by the IRS should have been foreseen by Kennedy & Graven. Notwithstanding the differences in the position of the City and Kenney & Graven, Kennedy & Graven has agreed to a full and complete resolution of any and all claims that the City may now or in the future possess against it in relation to the issuance of the Bonds by payment of the amount of $170,500.00. As part of the settlement, Kennedy & Graven agrees to pay $55,000.00 to the City upon execution and approval of the settlement agreement; that the remaining $115,500.00 shall be paid by reducing each of the future invoice amounts under Kennedy & Gravens existing bond counsel services contract by fifty percent (50%) until the outstanding obligation of $115,500.00 had been paid in full. In the event that there is an outstanding obligation due on the expiration of the existing contract on or about June 30, 2010, Kennedy & Graven shall pay the remainder in cash within five business days of the date of the expiration of the existing contact. Both the City Attorney's Office and the Finance Officer believe this resolution is fair and appropriate and request that the City Council approve this proposed settlement and authorize the City Attorney's Office to execute any documents necessary to effectuate the settlement.

M:drive/2008 Request for Council Action/Claim of City of Minneapolis against Kennedy & Graven