Request for City Council Committee Action
From the Finance Department

Date: January 14, 2008
To: Ways and Means/Budget Committee
Referral to: None

Subject: Laurel Village Tax Settlement

Recommendation
The Finance Officer recommends:

A. Approval of the proposed closing agreement (Exhibit A) 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. Increasing the appropriation in the Laurel Village tax increment fund (01CBU – 8900900 – 602004) by $170,500 for payment of the penalties and interest required by the proposed closing agreement.
C. Authorizing the issuance of $12,980,000 General Obligation Tax Increment Taxable Refunding Bonds to refund a portion of the 2003 General Obligation Tax Increment Refunding Bonds (Laurel Village) in accordance with the terms of the proposed settlement agreement between the City and the IRS.
D. Approval of the terms and conditions for the issuance of the above mentioned taxable refunding bonds as outlined in the attached Exhibit B.
E. Authorizing the Finance Officer to accept the low bid on the taxable refunding bonds based on the approved terms and conditions.

Previous Directives
None

Prepared or Submitted by Michael Abeln, Director, Capital & Debt Management, 673-3496

Approved by: Patrick Born, City Finance Officer ______________________________

Steven Bosacker, City Coordinator ______________________________

Presenters in Committee Michael Abeln, Director, Capital & Debt Management

Financial Impact (Check those that apply)

____ No financial impact - or - Action is within current department budget.
(If checked, go directly to Background/Supporting Information)

_X_ Action requires an appropriation increase to the Capital Budget
___ Action requires an appropriation increase to the Operating Budget
___ Action provides increased revenue for appropriation increase
___ Action requires use of contingency or reserves
___ Other financial impact (Explain):

___Request provided to the Budget Office when provided to the Committee Coordinator

Community Impact (use any categories that apply)

__Neighborhood Notification
__City Goals
__Comprehensive Plan
__Zoning Code
__Other

_X_Not applicable

Background/Supporting Information Attached

Laurel Village was constructed in the late 1980's and is a multifamily rental housing development of approximately 1,000 units with some units subsidized to be affordable. The development also included neighborhood retail and commercial facilities and is located in the central business district on Hennepin Avenue.

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 be built later. The second tower proved to be financially infeasible and was never constructed. 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 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 tax increment law 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 law limit (25%) in either 2011 or 2012, and therefore issued the 2003 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.

In March 2006, the IRS began an inquiry about the 2003 refunding bonds. The City fully cooperated with the IRS' inquiry. After the City answered several information document requests (IDRs), pertaining to both the 2003 refunding bonds and the earlier series of bonds, the IRS took the position that the City had met both the private use test and the private payment test in September 2006 and that the 2003 refunding bonds were taxable bonds.

The City utilized internal staff, bond counsel and outside tax dispute attorneys to reply to the IRS and to advocate the City's position that the bonds should remain tax exempt. In order to avoid the IRS declaring the 2003 refunding bonds taxable, City staff with assistance of outside counsel chose to negotiate a closing agreement with the IRS to settle this dispute.

Attached as Exhibit A is the proposed closing agreement, which contains several standard requirements included by the IRS and several covenants to protect the City against future IRS actions concerning this bond issue. The closing agreement calls for the City to pay the IRS $170,500 upon final signing of the agreement. This amount represents taxpayer exposure penalties and interest (as if the proportionate share of bonds supported by holding rents were taxable from 9/1/06 to 3/1/2010). This payment ensures the IRS will not pursue collection from the City's bondholders. In addition, the closing agreement calls for the City to issue taxable refunding bonds in the amount of $12,980,000 within 90 days of signing of the closing agreement. The agreement allows the City to keep $7,850,000 of the currently outstanding bonds in tax exempt mode (as supported by estimated future tax increments) to maturity, which is March 1, 2016.

The penalties and interest, the $12,980,000 taxable refunding bonds, the remaining 2003 refunding bonds, and legal expenses will be paid from the Laurel Village tax increment revenues. Furthermore, the holding rent payment obligation of Laurel Village's owner will remain unchanged.

The Finance Officer and City Attorney recommend acceptance of the terms of the proposed closing agreement. The IRS has approved the closing agreement on a preliminary basis, subject to final approval by senior management. The closing agreement will be executed following final approval of the City Council and the IRS. Any material changes to the closing agreement that are required for final IRS approval will require City Council approval.