Memo

To: Ben Martig, City of Northfield

From: Nick Anhut, Ehlers

Date: September 15, 2016

Subject: Financing Options for Northfield Area Fire and Rescue Service Facility

This memo has been prepared to outline the issues and options involved with the City of Northfield financing the proposed Fire Station Facility. As the project is in a preliminary planning stage, we have not included any assumptions of project cost estimates or contingencies.

The City entered into a Joint Powers Agreement ("JPA") with the City of Dundas and the Northfield Rural Fire Protection District to form the Northfield Area Fire and Rescue Service ("NAFRS") organization in 2014. The City is the current owner of a fire station which it leases to NAFRS for $20,000 per year. Maintenance and alterations are the financial responsibility of NAFRS during the lease. The City will retain ownership upon termination of the facility lease or the JPA.

NAFRS Legal Authority; Financing Options

Under terms of its JPA, the organization was granted authority to manage, own, lease and operate facilities and buildings (purchase or new construction subject to approval by all of the agreement's Parties), and further to incur debt as allowed by law payable from the revenues of the organization.

Funding consists of allocated semi-annual contributions of the total operating budget. The contributions shall be updated every two years based on market value and population estimates for each Parties share of the overall jurisdiction. The contributions for 2017 are as follows:

Northfield – 72.22%
Rural Fire – 22.41%
Dundas – 5.37%

NAFRS does not have the authority to issue a general obligation bond nor the ability to pledge a tax levy from itself or any of its members. These would reduce the bond holder's risk and enable a lowest interest cost type of financing. Financing options for NAFRS for a new facility are limited to the issuance of a special obligation payable by the revenues of the organization or entering into a lease purchase agreement. In addition to generally higher interest rates of 0.75% to 2%, the financing options available to NAFRS may also require additional covenants similar to commercial lending: mortgage interest on the property, loan to value limitations, debt service reserve, and/or rate resets.

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City of Northfield General Legal Authority; Financing Options

The ability of a City to undertake projects, issue bonds and levy taxes is governed by state law and further governed by City Charter. The Northfield City Charter, Section 9.10 identifies that:

> *the council may issue and sell obligations for any other municipal purpose in accordance with law and within the limitations prescribed by law. Except in the case of obligations for which an election is not required by this Charter or by law, no such obligations shall be issued and sold without the approval of a majority of the voters voting on the question at a general or special election.*

When a city issues bonds, the repayment is usually through user fees, property taxes, special assessments, or any combination of these. To secure the repayment, the City may choose to offer its highest security through a general obligation pledge of its full faith and credit, or restrict the source of repayment through a limited or special obligation. Backed by an unconditional tax levy, the City's general obligation pledge carries its highest credit rating (S&P "AA") and access to lower interest costs and favorable bond terms including no reserve, 100% financing, and flexible amortization structures. Even if the repayment source is strong, a limited or special obligation generally carries higher interest costs as the certainty of repayment is lower without the unconditional levy pledge to back it up.

Below is a brief outline of the typical financing options for municipal building projects like a fire facility. Like the City's general levy, the property taxes needed to support levy-based repayment for these options are based on tax capacity which includes a higher ratio of taxes per dollar of market value for commercial/industrial property.

Primary Governmental Bonding Programs

General Legal Authority; Financing All Municipal Projects

1. <u>Issuance of General Obligation Bonds pursuant to Minnesota Statutes, Chapter 475.</u> Without a determination to proceed through one of several statutory exceptions, an election is required to be held on the issuance of general obligation bonds.

    - The longest part of the election process is the allowance of a forty-nine-day notification to the County Auditor.
    - The required ballot language assumes that the entire debt service is paid from ad valorem taxes on all taxable property within the City.
    - If the City chooses on an annual basis, a portion of the bonds could be paid from other sources and the City-wide ad valorem tax levy could be reduced.
    - The bonds are subject to the statutory net debt limit, with few exceptions. Below is a calculation of the City's current *Net Debt Limit*.

City of Northfield Net Debt Limit	
Assessor's Estimated Market Value	1,230,567,100
Multiply by 3%	0.03
Statutory Debt Limit	36,917,013
Less: Debt Paid Solely from Taxes	6,690,000
Unused Debt Limit	30,227,013

- The *Net Debt Limit* generally applies solely to 100% tax supported debt of which most of the City's debt is excluded as portions of those bonds are paid by a pledge of non-property tax revenues (water fees, sewer fees, special assessments, etc.).

Specific Legal Authority; Financing Public Facilities

2. Issuance of General Obligation Capital Improvement Plan Bonds pursuant to Minnesota Statutes, Section 475.521. If the City determines to proceed under Section 475.521, an election is not required when issuing bonds under a capital improvement plan. To qualify for the referendum exemption, the following qualifications must be met:

- Approval of the bond issuance by at least a 3/5ths vote of the council membership.
- Is part of a five-year capital improvement plan.
- A public hearing is held with at least fourteen days published notice.
- Subject to thirty-day reverse referendum period to petition to place the measure on the ballot.
- Subject to net debt for municipalities with populations of 2,500 or more, with few exceptions.
- The debt service is paid from ad valorem taxes on all taxable property within the City.
- The annual levy for all GO CIP bonds debt service must not exceed .16% of estimated market value of all property in the City. Below is a calculation of the City's current *Annual CIP Levy Limit*:

Annual CIP Levy Limit	
Assessor's Estimated Market Value	1,230,567,100
Multiply by .16%	0.0016
Statutory Levy Limit	1,968,907
Less: Annual Levy under CIP	0
Unused Levy Limit	1,968,907

To provide some perspective: for a 20 year general obligation bond this annual limit could support over $29 million in project costs at today's market interest rates.

3. EDA or City lease arrangement under Minnesota Statutes, Section 465.71. If the City determines to proceed under Section 465.71, an election is not required. The City or its Economic Development Authority could provide financing through a direct lease arrangement and could issue lease-revenue bonds negotiated with a financing partner. The lease revenue bonds are not a general obligation but a special obligation payable solely from lease payments annually appropriated by the City. This means that the City has the ability to annually levy for lease payments while reserving the right to annually

terminate the lease, without penalty. Rating agencies typically rate lease revenue bonds for essential purpose municipal facilities like a fire station one notch lower than the City's general obligation rating. Because of the termination risk and rating, the City could see interest rates at least .35% to .80% above a general obligation bond rate with this type of financing. If the City determines to proceed under the direct lease financing method, the following points should be noted:

- Leases in excess of $1,000,000 are subject to the statutory net debt limit.
- A public hearing may be required for approval of a redevelopment plan.

Additional Security

As the facility is intended for use by the NAFRS organization, the City could request each member entity also include its general obligation pledge to offset the City's exclusive risk and so that the levy and debt limit requirement can be allocated amongst the participating entities. If authorized under statutes applicable to that member, each member entity could issue the City of Northfield a general obligation note commensurate with their share of the total costs. They would each individually undergo their own public process to meet the statutory requirements to issue their note. In the event the NAFRS organization discontinues or fails to make payment, the City could rely on the general obligation notes to offset its exclusive burden to levy taxes in payment of the debt.

Bonding Amount

After preliminary design, the final bonding amount will be adjusted based on construction bids and the timing of the issuance to meet the construction cash flow needs. Additional funds called capitalized interest may be necessary if initial bond interest costs are expected to come due before taxes or NAFRS contributions are collected. The City can explore using cash or levying in advance of issuance to offset this need. If an EDA lease revenue bond issue, a debt service reserve fund may be necessary to include in the initial bond proceeds as additional security for the bondholders and is held in trust and used in the event of a default.

Structure

The term of repayment cannot extend beyond the useful life of the facility or 30 years. Given the multiple users of the facility, a 15 to 20 year term structured for level annual debt service payments is recommended. After proper review of all options, the Council would select the type and term of the preferred financing method.

After satisfying the legal authority to issue bonds for the project, the City may choose to issue temporary bonds due not more than three years after issuance to provide construction financing for the project with the anticipation of replacing them with a future permanent financing. The temporary bonds would likely carry very low interest rates due to the short term in the anticipated repayment. This financing vehicle may provide the ability to initiate the project in 2017 prior to NAFRS exploring special legislation to establish a municipal fire district with the ability to acquire the newly constructed facility and issue the permanent financing.

Reimbursement Regulations

Under federal law, a municipality is allowed to use money from its general fund to pay for certain project costs before tax-exempt bonds are issued only after passing what is called a "reimbursement resolution" and then making a declaration of intent to reimburse itself from those subsequently issued bonds. The City annual addresses potential capital projects it intends to reimburse funds for, and is likely to include a declaration for the fire facility in early 2017 in anticipation of its preliminary design.

Summary

If the City wishes to proceed with consideration of this issue several decisions should be considered including the following:

1. After thorough review, determine the need and financial feasibility of a new fire facility as well as retaining ownership interest and oversight of the project.
2. If proceeding with the facility improvement, decide on a financing option as described in this memo.
3. Set the desired term of repayment for the bonds contemplating the source of repayment and desired impacts.
4. Initiate the public process to authorize the chosen finance option, including processes of the member entities if they are providing additional security to the City.
5. After final design and/or awarding of a construction contract when project costs are known, set a public meeting to receive bids on the financing.
6. Direct Ehlers, working with your bond counsel, to solicit bids for the sale of the bonds.