MEMORANDUM

TO: Ben Martig, City of Northfield

FROM: Nick Anhut, Ehlers

DATE: April 17, 2024

SUBJECT: EDA and HRA Public Project Revenue Bonds (Lease Revenue Bonds)

This memo has been prepared to discuss in general terms the issues involved with various types of bonds used to finance a new ice arena facility within the City of Northfield.

General Legal Authority; Financing Options for a Public Recreational Facility

The ability to undertake projects, issue bonds and levy taxes is governed by state law. The City of Northfield is exploring building a new ice arena facility within the community. Although user fees will be used to support operations of the arena, they are not expected to generate sufficient revenue necessary to finance the cost of the new facility's construction. The City will plan to rely on property taxes to provide the primary source of repayment.

A city debt obligation for public recreational facilities supported primarily by property taxes may be issued after approval of the majority of electors voting on the question of each project. However, cities have additional options within the state statutes to issue debt outside of holding a referendum. These options are discussed below.

Lease Revenue Bonds

An option under consideration is the issuance of revenue bonds through an Economic Development Authority (EDA) or Housing and Redevelopment Authority (HRA) pursuant to their statutory powers in Minnesota Statutes, Chapter 469 and the city's ability to enter into a lease purchase agreement pursuant to Minnesota Statutes, Section 465.71.

The concept behind lease revenue bonds, also referred to as public project revenue bonds, is that the EDA (or HRA) would exercise its statutory and local enabling powers to acquire real property and issue revenue bonds to renovate and equip a proposed facility for lease to a user. As issuer, the EDA would own the proposed facility for the term of the bonds and pledge to the bondholders the revenues made available by the facility project. The EDA and city would enter into a corresponding long-term lease purchase agreement relating to the facility and payment of debt service on the bonds. The lease will require the city make rental payments that cover the full debt service costs on the Bonds. The lease would allow the city to operate the facility, including the cost of maintenance, insurance, and all other expenses. The EDA may also designate the City as its agent to oversee construction, thereby alleviating the EDA of any associated costs, time and effort. Once all payments on the bonds have been made and the bondholders interests released, the city would then gain title to the facility.

As revenue bonds, only specific revenues of the facility are pledged toward the repayment. This limited revenue pledge allows that the EDA will not be required to contribute any funds or its levy authority to provide for the bonds' repayment, nor any liability for operations. The bondholders interests are typically managed within a Trust Indenture with a designated trustee establishing the account for the project and debt service on their behalf. The EDA would be a party to the indenture assigning all of its rights to the city lease agreement and ownership of the facility to the Trustee as security for the bonds. In some instances, lease revenue bonds also include a set-aside debt service reserve fund pledged as a back-stop in case of insufficient funds.

Northfield EDA Public Project Revenue Bonds, Series 2006A

The City of Northfield and the EDA have utilized this bonding approach for the original construction of the Memorial Pool in 2006. Through a cooperative agreement, the EDA issued $3,210,000 Public Project Revenue Bonds, Series 2006A. The 2006A Bonds were successfully sold and the swimming facility constructed. The City operates the swimming pool and made all ongoing payments on the 2006A bonds until the City exercised its purchase option to acquire the facility and terminate the lease through a refinancing in 2014.

Lease Revenue Bonds - Considerations

The city, in any one year, could technically choose to not continue the facility lease, leaving bond holders Trustee the choice to foreclose on the mortgage against the facility. The Trustee could then choose to operate the facility or sell it in order to recover the outstanding bond amount. In this unlikely event, the city would relinquish all purchase rights and built up equity from its payments, and the EDA would not be obligated to step in to remedy. This very event did occur in the City of Vadnais Heights in 2012, who chose to non-appropriate the general tax funds necessary to cover user fee revenue shortfalls it was depending on. The resulting bond default caused the City's own credit rating to be downgraded dramatically, twelve notches from "AA" to "B." The rating did not recover and the facility was ultimately sold by the bondholders to Ramsey County who operates it to this day.

Due to the annual appropriation risk, Lease Revenue Bonds typically carry a lower bond rating and higher interest cost than a general obligation bond. However, the impact generally only carries an impact on the interest rates of 30 to 50 basis points (0.30-0.50%) and the rating agencies usually give a bond rating which is one or two steps lower than the G.O. rating ("AA-" or "A+" instead of the city's "AA" G.O. rating). At the end of this memo, we have included an estimate of the pricing and debt service associated with a 20-year generic $10,000,000 Public Project Revenue Bond in today's market.

General Obligation Tax Abatement Bonds

Tax abatement is a tool a local government can use to finance public improvements or public facilities, as well as a form of assistance for new development or redevelopment. An abatement allocates the city's taxes derived from specified property toward certain public purposes like financing public facilities. The City can issue bonds without a referendum if a tax abatement is established in an amount to cover at least the principal amount required. As far as limitations, repayment of the bonds is limited to 20-years, and the sum total of all existing abatements granted within the city for any year is limited to 10% of its current net tax capacity. For the pay 2024 tax year the City of Northfield's annual abatement levy limit is $2,431,860, of which approximately $360,307 has been pledged or planned for other existing Abatement Obligations. It is anticipated that a significant portion of the remaining capacity would need to be set aside for the Ice Arena if abatement bonds are considered.

The city has used tax abatement bonds to finance street improvements, trails, and recreational facilities. It is expected to rely on abatement bonds for future park and infrastructure needs as well. As mentioned, tax abatement bonds can carry the City's General Obligation pledge and "AA" credit rating. For interest cost comparison purposes, at the end of this memo we have also included an estimate of the pricing and debt service associated with a 20-year $10,000,000 General Obligation Tax Abatement Bond in today's market.

Conclusion

While this list of financing tools is not exhaustive, they (and any combination thereof) are meant to provide the groundwork for current discussions as the city's ice arena project needs are refined. Ultimately, Lease Revenue Bonds should be expected to carry a higher interest and transactional cost when compared to a similarly sized General Obligation Bond. However, we believe that either approach would prove suitable to meet the project's funding needs. The city should weigh the anticipated cost differences against the General Obligation capacity limitations to determine its preferred fit. We at Ehlers look forward to continuing to help the city review its financing options and agreements for this important objective.

Bond Interest Comparison:

	Election – G.O. Bond	Tax Abatement – G.O. Bond	Lease Revenue Bond
Repayment Source:	City Tax Levy	City Tax Levy	City Tax Levy
Rating:	AA	AA	AA-
Principal Amount:	$10,000,000	$10,000,000	$10,000,000*
Term of Debt:	20 years	20 years	20 years
Estimated Interest Rate:	4.0269%	4.0269%	4.5531%
Average Annual Payment:	$733,139	$733,139	$763,111*
Cumulative Interest Expense:	$4,662,778	$4,662,778	$5,262,213*

* For interest cost comparison purposes, the sizing and payment estimates do not contemplate potential additional $30,000 to $50,000 in transactional costs, nor debt service reserve requirements that can vary widely based on the nature of the Lease Revenue terms and bond placement.