RELEVANT LINKS:

Note that bond investors have very little interest in how the proceeds are used, if the bonds are general obligations. Therefore, the classification by use of proceeds is mostly relevant from a standpoint of city policy and financial management.

IV. Bonds by user

The most commonly-issued bonds represent borrowing by a city to finance public assets—the city itself is the "user" of the proceeds. But Minnesota law authorizes cities to issue bonds where the proceeds are actually used by private parties. These bonds are referred to in most cases as "private activity bonds"—a name derived from federal tax law. Private activity bonds fall into two major categories, discussed in turn below.

See Section VIII-B *Governmental versus private activity.*

A. Conduit bonds

Minn. Stat. §§ 469.152 to 469.1651.
Minn. Stat. ch. 462C.

Unlike almost all other bonds, "conduit bonds" are initiated by and issued for the benefit of private entities. Under the state statutes that authorize these bonds, the city issues the bonds and loans the proceeds to the private entity. That private entity repays the loan in an amount sufficient to pay principal and interest on the bonds. As a practical matter, the loan is (normally) handled entirely by a separate bond trustee (usually the trust division of a bank). After the bonds are issued, the city has almost no role in payment or administration of the bonds.

The bonds are revenue bonds—the city does not pay debt service or any other cost related to the transaction. As such, the bonds have no effect on the issuing city's credit rating and are not counted against any statutory limitations on borrowing. When the bonds are sold, investors look only to the credit of the private borrower (and any related private security, such as mortgages and guarantees). While the city council must approve issuance of the bonds and all the bond documents, the transaction is largely handled by the private borrower and the underwriter that usually serves as the initial purchaser of the bonds. The bond counsel for conduit bonds may be the city's regular bond counsel, or may be retained by the private entity (this is a matter of city policy and practice).

See Section X *Participants in a bond sale.*

The types of private activity bonds are governed primarily by federal tax law. Congress in effect created this kind of bond to provide tax-exempt (and therefore lower cost) borrowing to certain favored activities carried out by private entities.

Much of today's tax law regarding these bonds originated with the Tax Reform Act of 1986, which sharply narrowed the scope of permissible private activity bonds (previously known as "industrial development revenue bonds" or "IDR bonds").

RELEVANT LINKS:

The three most common conduit bonds in Minnesota are:

- *Qualified 501(c)(3) bonds*, where the user of bond proceeds is a nonprofit 501(c)(3) entity. Typical examples include nonprofits that own nursing homes, hospitals, senior and other affordable housing, and schools (from K-12 to college). But any nonprofit with 501(c)(3) status is eligible for this type of financing, so bonds have been issued for entities as diverse as the YMCA to Minnesota Public Radio.
- *Housing revenue bonds (exempt facilities)*, where the user of bond proceeds is a private for-profit entity that builds housing intended for occupancy by persons or families who meet specified low-income guidelines.
- *Small issue manufacturing bonds,* where the user of the proceeds is a manufacturing business that constructs manufacturing facilities that meet certain federal requirements.

There are other less common conduit bonds that cities may occasionally encounter, but the three listed above represent the bulk of this bond type.

B. Tax increment and abatement private activity bonds

Minn. Stat. § 469.178. Minn. Stat. § 469.1814.

See Handbook, *Community Development and Redevelopment.*

The other category of common private activity bonds are those issued in the context of economic development and redevelopment. Cities may issue bonds secured by tax increments (all the increased taxes in a TIF district or portion thereof) or abatements (the taxes imposed by a participating taxing jurisdiction, usually just the issuing city).

The city *may* be the "user" of these bonds, for example, when proceeds finance public streets or other public infrastructure needed for a private development project. But bond proceeds may be delivered to a private developer to finance aspects of the private development permitted under law—such as land acquisition, excavation, and other eligible private improvements. In those cases, the private developer becomes the "user."

In most cases, where the private developer is the user, the issuing city will also require the developer to provide additional security, such as an agreement to maintain a minimum value, or a guarantee to cover debt service if tax increments or abatements fall short of expectations. The result is that these bonds are treated as "private activity bonds," and must be issued as taxable bonds.

By contrast, conduit bonds are tax exempt despite the fact that they are issued for the benefit of, and secured by, a private entity—but only because the private entity accomplishes some public purpose identified by Congress in federal tax law.