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July 9, 2012

City of Northfield
Housing and Redevelopment Authority of the City of Northfield
801 Washington Street
Northfield, MN 55057-2565

Dear Councilmembers and Commissioners:

The purpose of this letter is to summarize a proposed financing structure being considered for the construction of a public safety building, and to provide an opinion on the authority for, and legality of, the City and the Housing and Redevelopment Authority (the "HRA") entering into the transaction.

The proposal is that the HRA will issue its Lease Revenue Bonds (the "Bonds") to provide funds to acquire and construct a public safety building for use by the City (the "Project"). The HRA will enter into a Lease Purchase Agreement (the "Lease") with the City pursuant to which the HRA will provide for the construction of the Project from proceeds of its Bonds, and the City will construct and operate the Project for the term of the Lease. The City will be required under the Lease to make rent payments to the HRA sufficient to pay the principal of and interest on the Bonds. However, the Lease will be an annual appropriation obligation of the City, which means that in each year the City Council will make an annual determination whether to appropriate funds in its budget to make the next year's lease payment.

If at anytime during the Lease term, the City Council decides not to appropriate funds for the next year's lease payments, the HRA will terminate the Lease and attempt to re-lease the Project to another entity. Non-appropriation is rare for essential government facilities but the City must legally have the option. The Bonds of the HRA are payable solely from the lease payments made by the City to the HRA, and the HRA will not be legally or morally obligated to make any other funds available for payment of the Bonds in the event the City non-appropriates under the Lease.

If the City makes all of the payments under the Lease for the term of the Bonds, the HRA will convey the Project to the City for \$1.00 at the end of the Lease term.

The remainder of this letter will address certain legal issues that have been raised about this proposed financing transaction.

1. Does the HRA have the legal authority to enter into this transaction?

Housing and Redevelopment Authorities have been granted very broad powers by the legislature under Minnesota Statutes, Section 469.001 to 469.047 (the "HRA Act"). Section 469.001 of the HRA Act outlines five purposes of the HRA Act. One of those purposes is "to clear and redevelop blighted areas". Section 469.012, subdivision 1g, authorizes an HRA to acquire real or personal property to, among other things, carry out a redevelopment project. A redevelopment project is defined in Section 469.002, subd 14, as any work or undertaking to "acquire blighted areas and other real property for the purpose of removing, preventing or reducing blight, blighting factors or the causes of blight". This section also authorizes the HRA to sell or lease land so acquired for use in accordance with a redevelopment plan, and to prepare a redevelopment plan and technical and financial plans and arrangements for buildings, structures, and improvements and all other work in connection therewith.

Consequently, the HRA has the authority under the HRA Act to undertake a project pursuant to a redevelopment plan and to acquire property and lease the same as long as the HRA has determined that the project will reduce, prevent, or remove blight. A Blighted Area is defined in Section 469.002, subd 11, as "any area with buildings or improvements which, by reason of dilapidation, obsolescence, overcrowding, faulty arrangement or design, lack of ventilation, light, and sanitary facilities, excessive land coverage, deleterious land use, or obsolete layout, or any combination thereof or other factors, are detrimental to the safety, health, morals, or welfare of the community."

Pursuant to Section 469.028, subd. 3 of the HRA Act, a redevelopment project may include any work or undertaking to acquire open or undeveloped land determined to be blighted by virtue of unusual and difficult physical characteristics of the ground; the existence of faulty planning characterized by the subdivision or sale of lots laid out in disregard of the contours or of irregular form and shape or of inadequate size; or a combination of these or other conditions which have prevented normal development of the land by private enterprise and have resulted in a stagnant and unproductive condition of land potentially useful and valuable for contributing to the public health, safety, and welfare and acquisition of such land will eliminate these conditions, thereby making the land useful and valuable for contributing to the public health, safety, and welfare.

In addition, as provided in Section 469.028, subd. 4 of the HRA Act, a redevelopment project may include any work or undertaking to acquire land or space that is vacant, unused, underused or inappropriately used, including land which is occupied by functionally obsolete nonresidential buildings, or is used for low utility purposes if the authority determines such land may be developed at a cost reasonably related to the

public purpose to be served without major residential clearance activities, and with full consideration of the preservation of beneficial aspects of the urban and natural environment, for uses that are consistent with emphasis on housing for low and moderate income families. These uses include the provision of *schools, hospitals, parks and other essential public facilities*.

In order to proceed under this authority, the HRA will need to adopt a redevelopment plan pursuant to Section 469.027, submit the plan to the planning commission of the City for its opinion that it conforms with the general plan for development of the City. Section 469.028 also requires the approval of the City Council of the redevelopment plan and requires a public hearing. In approving the HRA's adoption of the redevelopment plan, the City Council is required to make the following findings:

(a) the land in the project area would not be made available for redevelopment without the financial aid to be sought;

(b) the redevelopment plan for the redevelopment area in the locality will afford maximum opportunity, consistent with the needs of the locality as a whole, for the redevelopment of the area by private enterprise; and

(c) the redevelopment plan conforms to the general plan for the development of the locality as a whole.

Lastly, the HRA has the authority under Section 469.034 to issue its revenue bonds for any of its corporate purposes, which bonds may be payable solely from the revenues of the project financed by the bonds. In the case of the HRA issuing its Lease Revenue Bonds for this Project, an election is not required since the Bonds will recite that they are payable solely from the revenues of the Project, and the full faith and taxing powers of the City will not be pledged to the payment of the Bonds, nor will any other funds of the HRA except for the lease payments made by the City.

In summary, the HRA has adequate legal authority to issue its Lease Revenue Bonds to finance the Project and to lease the same to the City as long as the HRA and the City follow the procedures in the HRA Act to adopt a redevelopment plan and make the required findings that the project will reduce, prevent, or remove blight. Historically, the courts have been very reluctant to overturn a finding of blight once made by a public body.

2. Does the City have the authority to enter into the Lease without an election?

Section 465.71 authorizes a city, among other things, to lease real or personal property with an option to purchase under a lease purchase agreement. This section goes on to provide that no election is required in connection with the execution of a lease purchase

agreement; however, the City must have the right to terminate the lease purchase agreement at the end of any fiscal year during the lease term.

Consequently, as long as the City has the right, in each year, to not appropriate funds in its budget to make the lease payments, the City may enter into lease purchase agreement with the HRA without an election.

Lease purchase financing has been used by cities for many years for a multitude of types of public buildings, including city halls, fire and police stations, public works buildings, and ice arenas. To our knowledge, these financings have never been successfully challenged in court, nor has the legislature seen the need to repeal or significantly amend the right of municipalities to use lease purchase financing. The legislature is aware of and has in the past addressed the use of lease purchase financing. Prior to 1997, there were no limits on the amount of lease purchase financing a local government could undertake. In 1997, the legislature modified Section 465.71 to require a lease purchase financing of \$1,000,000 or more to be subject to the net debt limit of 3% of market value as a way to partially limit the use of this type of financing (currently, the City has over \$30,000,000 of remaining debt limit).

The Office of the State Auditor has also reviewed the legality of a similar lease financing project in at least one other city and did not find any violation of state law. Our office and other bond counsel firms in the State of Minnesota have opined on the validity and legality of many of these financings over the past several years.

3. How will a non-appropriation affect the HRA or City?

The only asset the HRA will pledge to the bond holders will be the lease payments to the City. Consequently, there is no reason to expect any financial impact on the HRA's existing assets or current or future HRA tax levies if a future City Council decides not to appropriate.

According to the City's financial advisor, Ehlers, the main impact on the City in the event of a non-appropriation would be a significant downgrade in the bond rating for the City. A lower bond rating would therefore increase borrowing costs for future debt for other projects in the City (the existing debt for the City is fixed rate and would not be affected). Currently, the City's bond rating for its general obligation (G.O.) debt is "AA", two steps lower than "AAA", the highest possible rating.

Ehlers indicates that rating agencies expect the City will continue to support an "essential function" facility like a public safety building. Therefore, even though the lease financing is not a G.O., the rating is expected to be only one notch lower than the G.O., or "AA-".

July 9, 2012


Page 5

Standard and Poor's, the rating agency currently used by the City, has published draft criteria that indicates that a non-appropriation would immediately drop the G.O. rating to a "BBB-", which would be a seven notch drop in the rating, to the lowest investment grade rating. The rating on the annual appropriation debt would be lowered even further, potentially to junk bond status.

In conclusion, assuming the requisite findings, public hearings, and approvals are made by the City and HRA as outlined above, and the Lease and Bonds contain the required provisions as outlined above, Kennedy and Graven will render a bond counsel opinion that the Bonds have been validly issued and are payable solely from the Lease payments made by the City under the Lease. It is implicit in our bond counsel opinion that the City has the authority to enter into the Lease and that no election is required by either the City or the HRA.

I hope this addresses the questions and concerns that have arisen on this financing proposal. If you have any questions or additional concerns, please feel free to contact me.

Very truly yours,


Jenny Boulton