BEMIDJI CITY COUNCIL
Special Work Session Agenda
Monday, November 27, 2017

City Hall
Conference Room
5:30 P.M.

Bemidji
First City On The Mississippi

1. CALL TO ORDER / ROLL CALL

2. CARNEGIE PROJECT UPDATE

3. ADJOURNMENT

NOTE: *All cellular devices are to be switched to a non-audible function during Council and Committee meetings.*

HANFT FRIDE
A PROFESSIONAL ASSOCIATION

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☐ REPLY TO CLOQUET OFFICE

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November 27, 2017

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Via Email Only

Mr. Alan Felix
Bemidji City Attorney
317 – 4th Street NW
Bemidji, MN 56601

Mr. Nate Mathews
Bemidji City Manager
317 – 4th Street NW
Bemidji, MN 56601

Re: City of Bemidji/Carnegie Library/Preliminary Report
Our File No.: 32624.000

Dear Al and Nate:

John Ries, of Mahoney Ulbrich (CPA's in St. Paul) and Hanft Fride, P.A. were engaged by the City of Bemidji to analyze issues relating to the Carnegie Library and a potential historic renovation. We are focusing specifically on the issue of whether this facilities historic designation by the Department of Interior and the State Historic Preservation Office (SHPO) of the State of Minnesota creates an opportunity to utilize historic tax credits for part of its funding. This is our preliminary report.

There continue to be significant unanswered questions, as we work through this, due to several factors most specifically whether these credits will be available under possible potential tax reform in the works in Washington pursuant to Trump Administration and congressional proposals. There are several versions of a bill to deal with "saving money" to fund "tax reform" and a part of one of them is elimination of historic tax credits. While these credits have been popular due to their influence in saving buildings with historic value to communities, and making such projects feasible, they are for now, potentially on the chopping block.

One recent version of a tax bill suggests that, if a facility completes Part 1 and Part 2 of the Historic Building Tax Credit process by June 29, 2018, it will still have the credits available, notwithstanding the legislation. There is some clarification of new legislation in the enclosed email from John, who notes that he received it as a member of the Historic Tax Credit Coalition. What the summary ultimately illustrates, however, is the uncertainty of any process, given the state of the Carnegie Library project, that purports to design, market and proceed with an historic tax credit transaction. We see this as a continuing issue until there are solid and final decisions made.

In a recent communication by one of the experts on credits, we were advised that the House Bill might also require determination of ownership before December 31, 2017 as well as having investors in place. This does not appear to be feasible within the context of this project, which has a plethora of items which must be accomplished before it can responsibly be the subject of a tax credit investment.

This same expert communication advises that it is extremely unlikely that this rule will actually go into effect and suggests that the credits are likely to continue in much the same form that they are now. That, however, is speculation and, more than anything, it tells us of the uncertainty which currently marks this area of the law.

There are many other issues present here. They include:

1. <u>Market for Tax Credits</u>. The market for both federal and state tax credits has changed quite dramatically since the change in administrations due to the possibility/likelihood of tax reform and tax reduction. While tax credits will continue to have a significant value (remember, they are credits, not deductions), lowering of rates lowers tax burdens, certainly does free capital, and may (and historically has) tended to make tax advantaged investments less attractive to people. As a result of this situation, we have seen a softening in the market.

   While neither John nor I have seen any current (as in the last 60 days) quotes on historic tax credits, we see the market, generally, on projects that are "in place" in the \$.80 to \$.90 per dollar of credit. As to projects that are not far along, however, institutional investors appear to be "on the sidelines" during this period of time when the future of these credits and the timing is being discussed.

2. <u>Historic Consultant Expense</u>. Based on the status of the project and her review, and my discussion with Charlene Roise of Hess Roise, the historic tax consultant piece here will run in the \$25,000 to \$30,000 range. That is due to the specific requirements of dealing with state SHPO, the federal side (not necessarily an issue, since they usually simply agree with the state recommendation) and whatever interface is necessary between the consultant and the investor. While this project obviously already has a Part 1 and the difficult issue of moving the building apparently has been addressed successfully, there still is a significant amount of work to do.

3. <u>Documentation</u>. The documentation of these transactions is an expensive and complex process involving the creation of projections and proformas that can be utilized by investors converting that to a "business deal" and then documenting all of this in a limited partnership or LLC framework. There are a fair number of attorneys in Minnesota who, working with CPA's like John Ries, can prepare the documentation necessary. It is not an inexpensive process, and based on experience, we believe that an additional perhaps \$35,000 would need to be budgeted for ongoing legal and CPA work through the completion and financial tax credit certification for the investor.

   Changes in the law may require or initiate further changes in the documentation used in these historic tax credit transactions. It is unlikely that these changes in the law will produce significant changes in the costs, however, so the issue here again becomes uncertainty.

4. <u>Investor Availability</u>. By tax credit standards, this is a small project and, therefore, finding a tax credit buyer may be difficult. We recommend that, once the uncertainty is removed, an intensive search should begin for a local or regional investor or investors. Ideally, this would be a person or entity (or several of them) to which the state and federal tax credits are attractive, although it is worthy of note that, over the last five to seven years, in most cases, because of differences in the way the federal and state historic tax credit laws are structured, there are often separate investors in a single transaction for the state and federal credits. Right now, of course, we do not have a project or projections to show investors that can be relied on due to uncertainty.

5. <u>Construction Costs and General Feasibility</u>. Lawyers and accountants can write and pontificate about issues and issue identification, make suggestions about what may be occurring in the market place and otherwise provide observations and analysis, but we have no control over the costs of construction and know from experience that historic renovation projects can often be replete with "unknowns." In addition, we don't know what the potential market is for space in this building. From an investor standpoint, an investor is going to want to be assured that the project stays "alive" through the five-year from completion tax credit period, where the investor "owns" by far 99% plus of the project. This may require a Master Lease from the City, or some other viable person or entity who, in turn, could sublet. An alternative would be a pre-leasing operation which provides sufficient support to cover the operating expenses.

   The possibility of renting the facility to the City, in a lease that supported the transaction, and the City then becoming a tenant/landlord and subletting space to others might be explored here, however, there are specific rules that limit the term and nature of these leases. That is another issue that will need to be looked at once the applicable law becomes more certain.

6. <u>Indebtedness</u>. It is our assumption that the project is not likely to feasibly carry "real debt" and, therefore, commercial financing would not be sought. Interim financing, however, to make available, during construction, the money which will be coming in from a tax credit purchaser (almost always) funds that come in at the end upon issuance of a Certificate of Occupancy, will be necessary and a cost for this will need to be identified. We would suggest that this be projected at a 5 to 6 percent interest rate and be available for a total of a year. As it might very well be advanced periodically as needed, the cost here, while it would need to be put into a pro forma, is likely not terribly significant. For example, a $1 million construction loan, at 5% or 6%, would be $60,000 in interest over an entire year, but if funds were disbursed periodically, it might be less than half of that.

7. <u>Converting Grants to Loans</u>. Money that is provided to the ownership entity as a grant is not basis for calculation of tax credits. Accordingly, $1,000,000 of "grant" generates zero potential for tax credits, where $1,000,000 of "loan" generates, with a 20% federal and state credit available, $400,000 of tax credit potential, less costs, etc. The standard procedure here is to convert these grants to loans, payable long-term and payable to a "friendly" lender, where the possibility of long-term extension and even forgiveness (which cannot be committed to in the front end) is a real one.

SUMMARY OF PRELIMINARY FINDINGS

A summary of the above includes:

- It is difficult to see the way ahead and to make a commitment to the tax credit process without a little more information regarding the costs, comfort that the costs are attainable and an understanding as to where any additional gap can be filled.
- Uncertainty in the tax law casts a shadow over any "new" tax credit project. While this is not a new project, because the designation already exists, it is somewhat of an "infant" in terms of timing and, while it is possible to get to a finish line in five to seven months (if you know what the finish line is and that it will be a real finish line when you get there), it is very difficult to move forward in this current uncertain climate and to make an ongoing investment in a tax credit process. This fact may call for putting a 30 to 90 day hold on the process.
- The relatively small size of the project does present a potential barrier to the success of a tax credit transaction here, due to the high costs incumbent in such a transaction and a narrow group of investors who might purchase the federal and state credits. Assuming the decision is made to go ahead, our recommendation here is that we continue to work with the persons interested in this historic renovation to see if an investor can be identified. This would need to be a "real estate professional," a local real estate developer, contractor, or a C corporation with a number of shareholders, perhaps a bank. The larger tax credit purchasers, as mentioned, are unlikely to have a real interest in this project due to their appetites being focused on larger investments which justify their usual deep engagement and extensive due diligence.

After laboring hard on the issues and with every desire to assist the community in moving the Carnegie Library project forward, it is our conclusion and preliminary recommendation that, even though there is grave uncertainty as to when it will occur in terms of utilization of state and federal historic tax credits, the project be put on hold for a period of 60 days, to be reexamined at the end of that term based on how the law evolves.

One thing certain about the future and present in these unusual times is that there will be change and things that appear one way now will appear another way in the future.

We look forward to discussing this with you.

Very truly yours,

William M. Burns

WMB/dac
Enclosure

717064.v1

William Burns

From: John Ries <jries@mucr.com>
Sent: Monday, November 27, 2017 1:45 PM
To: William Burns
Subject: Impact of the recent House tax reform bill on the Historic Tax Credit

Bill -

According to members of the Historic Tax Credit Coalition (HTCC) who receive regular updates on the state of the Federal HTC's.

Here is a brief run-down on the potential impact of the proposed Tax Reform Bill to HTC's.

The House Ways and Means Committee released its tax reform bill on November 2, 2017 and it repeals the HTC, as we expected.
The full bill text is here — https://waysandmeansforms.house.gov/uploadedfiles/bill_text.pdf (HTC begins at p. 251)
The Section by Section is here —
https://waysandmeansforms.house.gov/uploadedfiles/tax_cuts_and_jobs_act_section_by_section.pd

The relevant summary language on the HTC is:

Sec. 3403. Repeal of rehabilitation credit.

Current law: *Under current law, a taxpayer may claim a credit for expenses incurred to rehabilitate old and/or historic buildings. A 20-percent credit is allowed for qualified rehabilitation expenditures with respect to a certified historic structure, while a 10-percent credit is allowed for qualified rehabilitation expenditures with respect to a qualified rehabilitated building. To qualify for the 10-percent credit, the rehabilitation expenditures during the 24- month period selected by the taxpayer and ending within the tax year must exceed the greater of the adjusted basis of the building (and its structural components) or $5,000.*

Provision: *Under the provision, the rehabilitation credit would be repealed* (a nicer word for eliminated). *Under a transition rule, the credit would continue to apply to expenditures incurred through the end of a 24-month period of qualified expenditures, which would have to begin within 180 days after January 1, 2018.*

"Provision" is our first look at potential termination rules. Termination rules are put in place to address pending or active projects and give projects time to complete their work.
Interpretation of provisions:
1. All projects must begin expending QRE's within 180 days of January 1, 2018. (It is unknown if "expending" is defined as any expenditures or a % of total project QRE's). Failure to expend QRE's may result in NPS closing the open HTC project.
2. 180 days (if calendar days) is June 29th, 2018. (We are assuming calendar days rather than "working days.")
3. All QRE expenditures should be spent with 24 months consecutive to that 180 day window.
3. The 180 day buffer allows time for projects to get NPS applications in, approved, bid the work, and mobilize the project.
4. After June 29th, 2018 there is 24 months within which to expend all QRE's, essentially finish a project. After that time all remaining QRE's are forfeit.

This change has a tremendous impact on projects currently with approved part 2's and those nearly ready to submit. We are trying to chase down more detail on the transition rules as we have several large-scale projects that simply cannot be compete within that timeframe. This "provisions" language is too vague to touch on the nuances of project variations.

To directly answer the question of Part 2 timing, your Federal NPS Part 2 application technically would need to be in and approved by June 29th, 2018. However, that only leaves you 24 months to completely finish the project. If that is not possible, the timeframe would need to move up. Also remember that with the new per project on the State HTC, we are recommending that all State HTC applications be in by March/April of 2018 to be the State change as they will be very busy processing new applications.

John M. Ries | Shareholder | Mahoney, Ulbrich, Christiansen & Russ, P.A.
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Friends of the Bemidji Carnegie Library Financial Summary

November 24, 2017

Contributions & Pledges

Community Donations	$178,805	
George W. Neilson Foundation Grant 2012	150,000	
Andreas & Marilyn Kuhn	150,000	
Anonymous	200,000	
Carolyn F. Jacobs Fund	55,000	
Community Grants*	20,000	
City of Bemidji	100,000	
MN Capital Grant-in-Aid 2015	58,280	
Minnesota State Legacy Grant 2014	50,000	
Minnesota State Legacy Grant 2017	345,960	
G. W. Neilson Foundation Challenge Grant 2017**	94,816	(To date)
Pledges	121,500	
Total	**$1,524,361**	

* Beltrami County, MN Energy Resources, Carl and Verna Schmidt Foundation, Archeology & Historic Preservation Fund

** 50% Matching Grant for all donations between Jan 1, 2017 and Dec 31, 2018 (up to a maximum of $100,000 from GWN)

Expenditures

Architectural Planning & Design	$112,026	(Architects Widseth Smith Nolting)
Fundraising events & expenses*	31,304	
Archeological Study	20,000	(106 Group)
Condition Assessment	11,000	(MJ Burns)
Accounts Interest & Fees	(13,335)	
Total	**$163,195**	

* Graphic design & printing, T-shirts, postage, web site, account management fees, fundraiser salary (2014 only), miscellaneous

Volunteer Hours – 5,864

Community Businesses – Value of Donated Goods & Services - $32,400

FIGURE 1

HISTORIC CARNEGIE LIBRARY RESTORATION PROJECT
PROJECT FUNDING ANALYSIS - NOVEMBER 2017