
Local Governments Cry Foul Over Feds' Move to Limit Tax-Free Municipal Bonds.

Public officials in Minnesota and across the nation are scrambling to head off a proposal they say would deliver a devastating blow to their ability to fund infrastructure and economic development projects.

Affordable housing in Albertville, a community gym in Edina, a fire station in Pelican Rapids: These and other projects could become tougher to build and pay for if the IRS succeeds in clamping down on the use of tax-exempt municipal bonds.

"It affects everything in the country that has bonding," said Lori Economy-Scholler, Bloomington's chief financial officer. "It could affect every piece of public financing as it pertains to port authorities and economic development agencies."

The IRS, she added, "is really overstepping their bounds."

IRS officials did not respond to requests for comment on the proposal. The open period for comments on the proposed rules ended May 23, and a hearing is scheduled June 6 in Washington.

The agency is proposing strict new limits on municipal bonding — so strict, critics say, that they would virtually end the use of tax-exempt bonds by port authorities, housing authorities and other economic development agencies.

Some cities might no longer be able to issue tax-exempt bonds for schools, hospitals and other infrastructure.

The regulations would rewrite the rules for bond issuers, including a new requirement that elected officials must exercise significant control over the agency issuing bonds. That would restrict or eliminate the ability of appointed or semi-independent economic development authorities to issue bonds.

Another change would allow the use of tax-exempt bonds only if the project provides no more than "an incidental benefit" to a private entity. That could rule out using tax-exempt bonds to finance items such as parking decks at the Mall of America.

Schane Rudlang, administrator of the Bloomington Port Authority, said the IRS is concerned about the misuse of tax-exempt bonds in some areas of the country. But the severe limits the agency is proposing, he said, "is like using a sledgehammer to kill a mosquito."

Drawing the line

Last year alone, economic development authorities in Minnesota issued more than $275 million worth of bonds, according to Springsted Inc., a financial adviser to municipal governments. That figure doesn't include bonds issued by cities themselves.

Nationally, more than $3.7 trillion in municipal bonds of all types are in force, according to the Municipal Securities Rulemaking Board.

Tax-exempt bonds allow cities and development agencies to borrow money for development projects at below-market interest rates. If taxes were assessed on the bonds, the interest rates would go up a percentage point or more. That doesn't sound like a lot, but it could amount to extra payments totaling hundreds of thousands or even millions of dollars over the life of a bond.

To make up the difference, cities would have to either assess local taxpayers more or scale back their projects.

That might not be a bad thing, said Jay Kiedrowski, a senior fellow at the Humphrey School of Public Affairs and state commissioner of finance under Gov. Rudy Perpich from 1985 to 1987.

"There have been many critics of states and cities who say that tax-exempt debt has been overused as an economic development tool," Kiedrowski said. "Tax-exempt debt makes sense for streets, water projects, sewers, parks, schools. But when tax-exempt debt is used for economic development, it's always been fuzzy as to where that line should be drawn to prevent bad projects vs. good projects."

Minnesota cities overall have a track record of using bonding for worthwhile projects, local officials said.

"Our housing and port authorities have existed for a long time and have done a lot of good work," said Tom Grundhoefer, general counsel for the League of Minnesota Cities. "And that's why we're concerned about these proposals."

Rudlang said the IRS proposal would endanger public infrastructure improvements planned over the next few years in Bloomington's South Loop district, which the city planned to finance with tax-exempt bonds of up to $100 million. The South Loop includes the Mall of America.

State Auditor Rebecca Otto called tax-exempt bonding "an extraordinary tool for local governments. We have 853 cities in Minnesota, and this tool is very important to make sure we can maintain and replace our infrastructure."

The Star Tribune

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May 31, 2016 — 8:07PM