



ARNE H. CARLSON  
STATE AUDITOR

# STATE OF MINNESOTA

OFFICE OF THE STATE AUDITOR  
SUITE 400  
555 PARK STREET  
SAINT PAUL 55103

861312

296-2551

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Members of the Commission  
Port Authority of the City of Saint Paul  
Saint Paul, Minnesota

Last spring, the Office of the State Auditor was given audit jurisdiction by the Minnesota Legislature over all port authorities in the state, including the Saint Paul Port Authority. Prior to the passage of that legislation, this office received several complaints relative to the financial activities of the Saint Paul Port Authority.

During the final days of the legislative session, we received more complaints and allegations ranging from charges of favoritism to expense account violations.

At the outset, we reviewed the financial audit prepared by Ernst and Whinney, and accepted the financial representations made in that audit.

In embarking on the audit, we found state law on port authorities vague. We discovered that laws which apply to other local units of government do not apply to port authorities. We found a minimum of oversight in the system. For these reasons, we conducted a broad examination and divided it into a compliance audit and a supplementary report.

Essentially, we found a development agency that has made a significant impact on the City of St. Paul. It has claimed, and rightly so, that it has transformed vacant land into skyscrapers, generated economic activity, created jobs and put a new face on Saint Paul. Port Authority activity has made Downtown Saint Paul more attractive and vital.

The Port Authority has also evolved into a major financial institution. As of December 31, 1985, it held assets of \$647 million. If the Port were a bank, it would be the fifth largest in Minnesota and the second largest in Saint Paul.

The Port Authority financed 34 percent of all construction in Saint Paul in 1985. It holds a financial interest in every Downtown hotel but one. It has accumulated reserves of \$46 million to prevent defaults on its bonds.

But our audit also found a series of highly disturbing patterns that lead us to a conclusion that the Saint Paul Port Authority has become a government outside of a government. It appears that the agency sees itself outside the scope of government, and acts as if it were above the scrutiny of government.

It handles public money generously when it comes to entertainment and travel. Even when confronted, the Executive Vice-President defended rather untenable positions on his expense reports.

First class travel, local lunches at Port Authority expense, and various fishing trips have become a normal pattern of behavior for Port Authority employees.

We also found that the Port Authority allowed employees to use the agency's status in order to obtain a 40 percent discount on fishing equipment and to avoid state sales tax payments.

Port Authority management, in four instances we reviewed, tolerated cost overruns that totalled more than \$1 million.

The Port Authority has had an exclusive underwriting agreement with Miller & Schroeder Financial, Inc. That firm has been the Port Authority's lead underwriter almost since the agency's inception. Miller & Schroeder's fee has almost always been three percent, regardless of the size or complexity of the bond issue.

Our best estimate is that since 1974, the exclusive underwriting arrangement has cost about \$5 million more than competitive underwriting. The comparison in the compliance audit may not be perfect; we made other comparisons and they vary. There is no doubt, however, that the extra cost has been in the millions of dollars.

This fee has not been subject to scrutiny. It has simply continued, year after year, without review and without a hint of competition.

The underwriting arrangement should be seen in the context of other Port Authority actions. The theme that ties these actions together is the Authority's apparent belief that the agency has enough money to solve any problem.

We wish to emphasize that a well-financed public agency has a duty to spend its money as wisely as a public agency that is under-financed.

Every bit as disturbing as the indifference to money was the finding that the Port Authority lacks a specific plan or a meaningful set of goals. It lacks a system of providing meaningful public input. Technical requirements for public notice have been fulfilled, but genuine public dialogue has been consistently absent.

In interviews with the Executive Vice-President of the Port Authority, it became clear that a number of decisions were made by business leaders he refers to as "the hierarchy."

We expect the business community to make plans for Downtown development and to push for the goals they have set. But we expect the Saint Paul Port Authority to represent the taxpayer and the public point of view on development.

The public interest requires that the Port Authority abandon its secretive style. When business leaders and Port Authority staff discuss multi-million dollar projects, the public ought to be listening and contributing.

The Port Authority recently classified appraisals of the Saint Paul Hotel under the state Data Practices Act. We cannot imagine the public purpose that is served by this secrecy.

During audit interviews, the Executive Vice-President stated that the appraised value of the Saint Paul Hotel is well below the amount of debt attached to the property. Embarrassing as this situation may be, it is a problem that deserves the broadest possible public examination.

The involvement of the Port Authority in the hotel business deserves not only local review but also review by the Legislature. Nothing in the law prohibits domination of markets by port authorities, nor does anything in the law authorize such domination. The Legislature must ask itself if this is the reason it created port authorities.

The Port Authority cannot even demonstrate that its activity has always been necessary. The Executive Vice-President, in a 1984 address before the Citizens League, quoted impressive job creation and development statistics. He informed

the group that at least 40 percent of that activity would not have taken place without Port Authority involvement.

A 1981 report for the Port Authority by Midwest Research Institute stated: "A key issue is whether revenue bonds are really necessary for development to occur. The answer is that it all depends."

That 1981 report went on to state: "It is important to make careful distinctions in each development case and to carefully consider whether a revenue bond should be used."

We could not find that degree of care. We anticipate that more than \$7 million of taxpayers' money could be lost in Galtier Plaza and the Saint Paul Hotel, projects for which the city loaned federal Urban Development Action Grants to developers as supplements to Port Authority financing.

In addition, we question that careful distinctions were made when the Port Authority commissioners voted on two separate projects to subsidize luxury condominiums. There is something fundamentally wrong with a system that uses \$1 million of city money and \$1 million of Port Authority money to subsidize interest rates for condominiums in Galtier Plaza while declaring it has insufficient funds to house the homeless.

Cities have been built without subsidies before, and they will continue to be built without subsidies. Resourceful and intelligent people can find a multitude of positive ways to get the job done.

Revenue bonds should be a surgical tool. Employed carefully, they can mean the difference between success and failure for vital projects of benefit to all society.

When revenue bonds flood the market, as they have in recent years, they may detract from the ability of local governments to carry out basic public projects. Public borrowing for commercial projects often raises the cost of public borrowing for things like sewers, water treatment, bridges and schools. Bond issues are an expression of priorities, and as such they deserve public examination.

The ill effects of inadequate planning and evaluation are best illustrated in the Port Authority's deep involvement in the complex business of hotels. Instead of stimulating private investment in the market, the Port Authority has become the market.

Two hotel operators have defaulted this year. The agency is seeking repossession and a new lessee for the Center City Inn, and is trying to sell the Saint Paul Hotel.

The Port Authority Commissioners last month approved a sale-and-leaseback transaction for the Saint Paul Radisson.

As the supplementary report indicates, the Executive Vice-President spoke of orchestrating room rate increases with hotel operators. The compliance audit recommends a re-examination of the Saint Paul Radisson transactions.

We are fearful that this same kind of anti-competitive behavior will take place in office building and commercial space projects as the Port Authority continues to increase its presence in these markets.

We are also fearful that state government will be under pressure to expand and fill the office space that the Port Authority has financed. Marlin Gilhousen, who keeps development records for the Metropolitan Council, said Saint Paul

would be better able to absorb surplus office space than other communities because, "State government will swell up."

If state government is to swell up, it should do so only at the direction of the public, and not for the purpose of bringing equilibrium to the office market.

The Executive Vice-President stated during an interview that the Port Authority was "not dependent upon tax dollars to support any of it." At the end of the interview, he said: "...none of this, none of this, I want to repeat this, is tax dollars."

The myth that a local government's tax-exempt bond is strictly a local concern has gained some currency. It should be remembered that a tax-exempt bond enjoys a lower rate of interest because the purchaser of the bond is excused from paying state or federal income taxes on the interest earned from the bond.

This loss of revenue, called a tax expenditure, affects the budgets of the governmental systems that rely on the income tax. The state government of Minnesota is directly affected, and its local subdivisions are affected through the impact on state aids. The federal government is also affected, as Congress is recognizing in its revision of the federal tax code.

We found a House Research estimate that tax-exempt bonds had cost the state treasury \$77 million in 1985. The Port Authority's share of the total volume of outstanding bonds in Minnesota was about one sixteenth that year, so we estimated that the Port Authority's activity had cost about \$5 million.

We later received Department of Revenue assumptions that yielded an estimated annual loss of about \$30 million statewide and about \$2 million from Port Authority activity.

Either estimate shows a significant negative impact on state revenues. The gap between the estimates shows the futility of trying to measure the cost of tax-exempt financing. Without knowing the true cost, we can never compare the benefits to the cost.

This tax expenditure does not compete with other appropriated expenditures of government. It does not go before the Legislature, nor is it submitted to the Governor for inclusion in his budget, nor are there any public hearings. It amounts to a simple withdrawal from the income tax revenue system.

The use of tax-exempt financing has become so vast that there is very little major activity in Downtown Saint Paul that does not involve taxpayer subsidy. Simply put, all taxpayers pay for public subsidies.

The more direct impact of Port Authority activity is the agency's property tax levy.

Over the years, the Port Authority has issued \$26,750,000 in general obligation bonds. Of that total, \$12,816,000 remained outstanding as of December 31, 1985. By statute and bond resolution, the Port Authority must annually levy an amount to pay principal and interest on these bonds.

The Port Authority may reduce its annual levy by certifying and setting aside an amount from its other earnings to pay principal and interest. In 1984 and 1985, the Port Authority did that for the full amount of the tax levy.

On September 17, 1985, the Commissioners voted to certify and set aside \$1 million for retirement of the bonds, leaving in place a levy of \$884,942.

Although this levy was included in the city's public budget documents, we found no mention of it in City Council minutes.



The Port Authority reinvests its net income, which is profit. That profit should be shared with the taxpayers.

The Executive Vice-President stated that income for 1986 would be about \$8 million.

Based on our analysis, we recommend that the Port Authority refund to Saint Paul taxpayers the amount levied and collected for 1986 and that the proposed levy for 1987 be waived in full.

We direct the attention of the Commissioners to recommendations contained in the compliance audit.

In addition, we make the following recommendations:

We recommend that the Saint Paul City Council:

- Exercise its statutory power to place all employees of the Saint Paul Port Authority under the direction of the mayor or a city department head. We recommend that the Port Authority Commission become an advisory board to the City Council.
- Adopt an economic development plan with specific, measurable, long-term goals established through extensive public discussion.
- Adopt a system of evaluation for proposed and completed developments. The Port Authority's abstract claims of job creation and tax base improvement wither under scrutiny. The City Council could borrow the format of the Minneapolis Community Development Agency's very sensible and thorough evaluation worksheet. Not all jobs are equal, and the Council has a duty to see that development translates into acceptable wages and benefits.

- Set limits, or "caps," on Port Authority activity. The Council should limit the amount of net income created by the Port Authority that is retained for its own use. Any excess net income could be used by the City as the Council considered appropriate. This limit should be set at an amount that would enable the Port Authority to maintain the level of reinvested income required by its bond indentures. The Council should also consider limiting the growth of Port Authority debt.
  
- Evaluate the management of the Port Authority. Our audit findings suggest that the staff was better at building the agency than they have been at sustaining it. The City Council must make sure that the Port Authority can handle the risks to which it is exposed.
  
- Improve the Port Authority's information system. Our request for underwriting data from the Minnesota Housing Finance Agency was answered in hours; comparable Port Authority data were not provided for a week. We were unable to find answers for questions about developer equity and the ratio of private investment to public investment in Port Authority projects.

We recommend that the Minnesota Legislature:

- Review the statutes covering port authorities. The statutes presently allow for flexibility not given to other Minnesota units of government, and there is a lack of accountability for these authorities. In effect, the Legislature has created an agency that is allowed to grow with few restrictions and little responsibility for its actions. Many of the laws covering port authorities have been passed as special laws

and given little scrutiny by the Legislature. The time has come for the Legislature to set limits on port authorities consistent with those for other local units of government.

- Clarify the public purpose of port authorities, while retaining the critical declaration of present law that, "Port authority money is public money."
- Require that the tax committees of both houses of the Legislature review the estimated tax expenditure involved in tax-exempt financing. Reasonable people can decide how to measure the tax expenditure, and a range of estimates might be sufficient. State leaders should regularly analyze the cost of the state's role in subsidized development.
- Devise a form of tax relief for Minnesota taxpayers who share in the cost of subsidized development to a greater degree than they share in its benefits.

We recommend that the Commissioners of the Saint Paul Port Authority:

- Discontinue the exclusive underwriting agreement with Miller & Schroeder Financial, Inc., and institute a plan for competitive underwriting.
- Include public membership on the Port Authority loan committee. This committee, now made up only of staff persons, holds the central role in the Port Authority's decision-making process.

Finally, we found no apparent public purpose for trips related to fishing, as listed in the compliance audit. We asked the Executive Vice-President for the

public purpose served by these trips and were told they were promotional in nature, to provide "leads" for the Port Authority.

We consider that to be a rationalization to justify personal recreational activities, and we recommend that all monies paid by the Port Authority for these trips be reimbursed to the Port Authority.

A handwritten signature in dark ink, appearing to read "Arne H. Carlson". The signature is written in a cursive style with a large initial "A".

ARNE H. CARLSON  
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