Institute for Local Self-Reliance
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April 5, 2008

Shelley Roe
Greg Goeke
Steven Kotke
City of Minneapolis
Minneapolis, Minnesota

Dear Ms. Roe and Mr. Goeke and Mr. Kotke,

On behalf of the Institute for Local Self-Reliance, I am writing to ask that the City Council not sell the city property at 2850 20th Avenue S, which now operates as a solid waste transfer station. The city negotiated an option with Kandiyohi to purchase the site in August 2006, with a deadline for the exercise of that option of December 31, 2006. It then extended the time that Kandiyohi could exercise that option to March 30, 2007. At that time the city extended the option an additional year to March 30, 2008. We are a week beyond March 30th. Which means the option is no longer in force.

Which reverts the situation back to 2006, when the city council, with little public notice, issued an RFP for the sale of the land for a single purpose, a wood fueled power plant. Kandiyohi was the single bidder. The city council should now reissue the RFP, but this time expand it to solicit proposals for all possible uses of the land.

With the passage of the deadline for exercising the option, Minneapolis for the first time has the legal opportunity to review <u>all</u> the aspects of the Kandiyohi project, with the information made public and open to public debate, and come to a considered decision.

This would be a refreshing change from what has occurred to date. This project was born in secrecy and to this date largely operates out of the public eye. There are a sufficient number of questions the project's history raises that should be addressed.

As described by Steve Brandt in a March 21, 2008 Star Tribune article, the genesis of the project occurred after Michael Krause left the Green Institute under a cloud. "By the time he quit in 2005 after nine years, his financial stewardship was under board scrutiny. In March that year, the board was told that the institute's finance chief lacked the cash to pay bills, leading to what minutes called 'a heated and somewhat emotional discussion.' The next month, the board was told that an eviction notice for unpaid rent had been filed against the institute's ReUse Center in the nearby Hi-Lake shopping center. After Krause left, an audit reported the institute had accumulated a $452,000 negative net worth."

That weakness in financial administrative competency should be taken into account by the city council.

Mr. Krause then created a development company. Two other investors have been publicly identified: Kim Havey, former head of the city's Empowerment Zone and Lisa Goodman, current city councilmember. Reporter Steve Brandt notes that in Havey's five year tenure at the Empowerment Zone, he did not propose to utilize any of its $130 million in tax exempt EZ bonding authority, even though nine other Empowerment Zones around the country did so. However, as a partner in Kandiyohi, he quickly applied for and the city council as quickly awarded EZ bonding authority of $78 million to Kandiyohi, two thirds of all the Empowerment Zone's existing capacity.

Lisa Goodman's investment in the project was not made public until about 2 years after the company was founded. It appears she has been actively involved in promoting the project, which certainly seems to constitute a conflict of interest.

In mid - 2006, with virtually no notice, the city council issued an RFP for the sale of the old transfer station land, but the RFP restricted bidders to only a single possible use of the land, a wood fueled power plant. The RFP drew a single response, Kandiyohi.

On June 30, the full city council approved the sale of the property to Kandiyohi.

In late October 2006, the Community Development Committee gave preliminary approval of $78 million in Empowerment Zone (EZ) Tax Exempt Revenue Bonding Authority for the Midtown Eco Energy Project. This was apparently done without formal approval by the Empowerment Zone governance structure, public debate or perhaps even serious internal consideration. For example, the pro forma contains a line item of $21,943,000 for "fees and other issuance costs". No one with whom I've spoken in the financial community thinks that is a reasonable figure and may be off by factor of 5 or even 10.

At the time, Kandiyohi promised the bond would be backed by a 25-year power purchase agreement with Great River Energy. It is unlikely there were ever serious negotiations with GRE. In 2007, Kandiyohi turned its attention to NSP. A March 22, 2008 letter from the developers indicates that they had a term sheet with Xcel as early as March 2007. During the next 13 months little if any progress seems to have been made.

As the recent March 30th deadline approached there was a flurry of activity, most of it outside of public scrutiny. Indeed, many people from the affected neighborhoods came to a city council meeting on March 28th with the expectation that the option agreement would be discussed. Not until the end of the meeting were many made aware that the developers had decided not to ask for an extension at the public City Council meeting, but changed their strategy and worked behind the scenes that same day to exercise their option.

It is hard to understand why this occurred at the very last minute, but one might surmise that the developers did not want the strong opposition to the project revealed to the full city council. In any event, exercising the option cost only $50,000 and if it had been approved would have given the developers another 7 months to actually purchase the property. That is a minor sum in a project of over $90 million.

Two weeks before the March 30th deadline, Piper Jaffray submitted a letter to the city, revealing that the pro forma had changed, with debt declining by some $13 million and syndicated tax credits increasing by an equal amount. The project essentially has become a tax shelter, with a very small percentage of the costs (3% or less) in equity coming from Kandiyohi itself.

Although as indicated above, the option has lapsed and therefore the conditions attendant to the option are no longer in force, much of the discussion in the last few days centers on Section 4.2.4, which requires the developer to “demonstrate that Buyer has financing commitments for debt and equity sufficient to undertake the Project, which commitments may be reasonably conditioned, as well as a commitment to enter in a power purchase agreement subject also to reasonable conditions.”

However, a March 17, 2008 letter from NSP only states that the company is “considering entering into a power purchase agreement” and appears to warn that one or more additional decision processes would be required, with other management structures of the company, before a phase was reached where a commitment to enter into a power purchase agreement could occur. (“Following the completion of such negotiations, if NSP and midtown reach a tentative agreement, NSP will then present the negotiated agreement to its internal management committees for review and approvals. If such approvals are received, NSP will enter into the power purchase agreement.”)

As lengthy and involved as those hurdles would be, thereby disqualifying the letter as meeting the Option requirements, the letter actually goes on to deliver an even more fatal blow. The letter concludes by categorically stating, “This letter is provided solely as an accommodation to Midtown with respect to the Option Agreement and does not create any obligation on the part of NSP”.

The city has found problems with Kandiyohi’s financing too. Burl Gilyard, writing in Finance and Commerce on March 28, 2008, wrote: “A separate, internal city memo noted that the city does not believe that Kandiyohi has secured financing for the project.” Unfortunately, that memo has not been made public.

In recent days, as neighborhood groups have been scrambling to find out what was actually going on between Kandiyohi and City officials, they were forced to file a formal Data Practices Act request with the city (similar to a freedom of information request). That information confirmed that yet another meeting had taken place between Kandiyohi and the City on Thursday, March 27, just one business day before the end of the city work week and just several days before the official March 30 Option expiration. It is also probable that they continued to talk to the city after the option period had ended. None of this has been made part of the public record.

Although no written records of the meeting were made available to the neighborhoods, the City provided a follow- up letter from Kim Havey to Greg Goeke after the meeting.

The three key components of the project’s economics include: a power purchase agreement at a high price, project financing, and a contract for sufficient feedstock. The city did not make as a condition of exercising the purchase agreement identification of sufficient feedstock. I served on a Green Institute task force before the project was taken by Michael Krause to Kandiyohi, and on other task forces focusing on the same feedstock issue. Three separate studies concluded there is insufficient biomass feedstock in the Twin Cities to fuel the proposed project. This is another item the city council should examine.

On the personal level, I have been involved in biomass energy for more than 25 years. From 1999-2005 I served on a congressionally created advisory committee to the Departments of Energy and Agriculture specifically on biomass energy. I am considered a national expert on the issue. I was not involved in the Kandiyohi project development until 2007, when I was made aware of an email Michael Krause had sent out to neighborhood residents and others that said I had written a letter in support of the project. That was not true, and Michael later withdrew the statement. But it galvanized me to pay closer attention to the project and the closer the examination, the more questions arose.

Sincerely,

David Morris
Vice President