



July 28, 2006

To: Holders of Bonds Issued by the Saint Paul Port Authority under Its Basic Resolution 876

On June 30, 2006, the Port Authority of the City of Saint Paul filed a Petition for Instructions with the Ramsey County District Court. The court will hold a hearing on the Port Authority's Petition for Instructions at 1:30 p.m., August 30, 2006, in the Ramsey County Courthouse in Saint Paul, Minnesota. A copy of the Notice of Hearing was published in the *Saint Paul Legal Ledger* and other newspapers and is also enclosed with this letter.

In its Petition for Instructions, the Port Authority seeks an order from the district court allowing the Port Authority to terminate the fund out of which principal and interest payments are made to holders of bonds issued under Basic Resolution 876 (the "876 Fund"). The assets pledged to the 876 Fund will be sold and the proceeds of the sale will be distributed to holders of bonds issued under Basic Resolution 876 ("876 Bondholders") in exchange for the cancellation of all outstanding 876 bonds. Termination of the 876 Fund at this time is designed to benefit 876 Bondholders. Among other things, substantial ongoing administrative expenses will be eliminated and those monies redirected to pay 876 Bondholders. In addition, termination will allow bondholders to recognize for tax purposes any capital loss they may have on their 876 bonds.

The decision to seek to terminate the 876 Fund comes only after many other efforts to avoid or forestall the situation currently confronting the fund. This letter provides additional explanation why the Port Authority is seeking to end the 876 program.

Background Information

From February 1974 through May 31, 1991, the Port Authority issued \$428,825,000 in industrial and commercial development bonds under its Basic Resolution 876. These bonds funded 139 projects in and around the City of Saint Paul, Minnesota. As of June 30, 2006, \$51,670,882 of these bonds remained outstanding.

Bonds issued under Basic Resolution 876 are revenue bonds and are not backed by any tax revenues of the Port Authority, the City of Saint Paul or any other governmental source. Instead, 876 bonds are secured by and payable only from revenue streams defined in Basic Resolution 876.

These revenue streams are current payments from borrowers whose properties were financed by 876 bonds, proceeds derived from the sale of real estate that the Port Authority has repossessed when borrowers have defaulted and revenues from land and fleeting and tonnage leases.

The 876 Fund also included a number of reserves to secure payment of principal and interest to 876 Bondholders. In 1991, the Port Authority told 876 Bondholders that because of borrower defaults and a downturn in the Saint Paul real estate market, the Port Authority expected that these reserves would eventually be depleted. In an effort to continue paying principal and interest in full through 2022, when the last-issued 876 bonds will mature, the Port Authority undertook a number of efforts to restructure the 876 Fund. The Port Authority spent over \$2 million of its own funds in these unsuccessful efforts. The Port Authority has also undertaken three tender offers for 876 bonds that have retired over \$123,765,000 in principal. The associated savings in interest payments benefited the remaining 876 Bondholders.

As predicted, reserve funds were depleted and the 876 Fund has been unable to pay interest and principal in full to 876 Bondholders. For example: on December 1, 2004, 100% of interest was paid, but only 55.38% of principal; on June 1, 2005, 87% of interest was paid and 0% principal. Following the sale of the Sheraton Midway hotel, on December 1, 2005, holders received 100% of their interest then due, but again none of the principal due. Proceeds of the sale of the Sheraton Midway were subsequently available to pay principal, however, and on June 1, 2006, bondholders received interest in full and 50.65% of principal. Nevertheless, the Port Authority does not anticipate the 876 Fund will ever be able to pay principal in full at any point in the future through the final maturity date in 2022 of the last issued 876 bonds.

When individual series of 876 bonds were issued, the benefit of ownership of an 876 bond was expected to end at the latest when the bond matured, ordinarily when its 20 to 30 year term ran. It was also the expectation of the parties – both the Port Authority as issuer as well as 876 Bondholders – that the 876 fund would end at the latest when the last 876 bond matured in 2022.

Tax Issues for Bondholders

There is no established liquidation date on the outstanding 876 bonds because there is no direct mechanism to accelerate maturity when interest and principal cannot be paid in full. No provision in Basic Resolution 876 or any other related document confers any individual or collective rights or remedies in the event that the 876 Fund fails to pay interest or principal in full when due. Consequently, the 876 bonds will never “liquidate” on their own terms even though 876 Bondholders’ right to 876 Fund payments will become minimal after the final lease agreements terminate.

These facts are critical under a private letter ruling the Port Authority obtained from the IRS in 2000 relating to the tax treatment of payments received by holders of 876 bonds after the date in which the reserves had been depleted and available net revenues were no longer sufficient to pay the principal and interest in full. The IRS indicated that, for federal tax reporting purposes, the Port Authority must treat all payments to 876 Bondholders after the date on which holders are no longer paid in full as payment first of interest outstanding and then to payment of principal. Hence, if payments are insufficient to pay interest in full, as is now the case, none of the payments can be deemed a return of principal. The IRS also indicated that a liquidation event as defined by state law is needed for payments to bondholders to be deemed a return of principal.

Cost Savings from Termination

Another significant consideration is the continuing expense to 876 Bondholders of operating the 876 Fund. Currently, the 876 Fund incurs approximately \$185,000 annually for administrative expenses like the annual audit, paying agent fees and the annual report. These expenses are paid out of 876 Fund income. In addition, for its work in administering the 876 Fund and the supporting real estate portfolio, the Port Authority also receives fees from borrowers under existing lease agreements that are currently nearly \$200,000 annually. Those fees are not pledged or payable to the 876 Fund but continue through the life of the leases. If the fund is terminated, the approximately \$385,000 per year that would have been spent on administrative costs and portfolio management fees will become another revenue stream sold for the benefit of 876 Bondholders.

The Proposal now before the Court

In its Petition for Instructions, the Port Authority proposes to obtain permission to solicit bids for the revenue streams that are currently the source of payments to 876 Bondholders (including the nearly \$200,000 of annual fee income that is not now pledged to the 876 Fund). This process will be managed by an independent investment firm which will package the revenue streams in a way intended to maximize the potential value of those assets. The Port Authority envisions returning to Ramsey County District Court after this marketing process is completed to confirm that the process was open and fair. Holders are invited to participate in this bidding process or to secure participation of others who might be interested in purchasing the revenue streams that are part of the 876 program. The Port Authority, however, will not purchase any of these revenue streams and will not receive any of the proceeds from their sale.

Purchasers of the revenue streams pledged to the 876 Fund would be expected to pay the present value of the future income stream generated by those assets. The elimination of the approximately \$385,000 in annual administrative costs and fees is a savings that can translate into enhanced value to the 876 Bondholders. In addition, the Port Authority believes the termination of the 876 program and cancellation of all outstanding bonds would be a liquidating event for federal tax purposes entitling eligible holders to realize potential capital loss on their 876 holdings.

If the court authorizes the Port Authority to proceed further and confirms the result of that process, the funds obtained will be distributed to 876 Bondholders and the 876 bonds cancelled. After that exchange, the 876 program will be terminated. Under the provisions of the 2000 private letter ruling, the funds distributed will be allocated to interest and principal in proportion to the amounts of interest and principal then outstanding.

Holdings are invited to attend the hearing on August 30, 2006. They may also make their views known by writing directly to the Ramsey County Court at Court Administrator, Ramsey County District Court, Room 650, 15 West Kellogg Boulevard, Saint Paul, Minnesota 55101, Court File No. C5-06-200031. Bondholders communicating directly to the court should do so by August 23, 2006, or they may appear at the hearing in person on August 30. Holders may also communicate with the Port Authority by contacting Mr. Thomas Collins at (651) 224-5686 or (800)-328-8417. Selected documents, including the Port Authority's Petition for Instructions in this matter, can be found at the 876 Fund website, www.876fund.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Kenneth R. Johnson", written in a cursive style.

Kenneth R. Johnson