

REVISE DEFINITION OF "QUALIFIED REFUNDING OBLIGATION"

Mitchell Bean, Director
Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bill 5634 without amendment
Sponsor: Rep. Judy Emmons
Committee: Intergovernmental, Urban, and Regional Affairs

First Analysis (1-24-08)

BRIEF SUMMARY: House Bill 5634 would amend the Downtown Development Authority Act to revise the definition of "qualified refunding obligation," allowing the City of Ionia to extend the period of time during which its city officials can repay its DDA's bonded indebtedness.

FISCAL IMPACT: The bill would not appear to have a significant fiscal impact on state or local revenues. (See also [Background Information](#).)

THE APPARENT PROBLEM:

The City of Ionia created a Downtown Development Authority in the 1980s in order to capture the growth, or increment, from the property taxes collected within the authority's designated boundaries. The tax increment revenue was earmarked for downtown improvements within the development district. The improvements were funded when the authority sold its debt in two bond issues. The size of the bonds (that is, their total amount, repayment duration or life, and the level of principal and interest payment) was based on the projected tax increment revenue the authority expected to collect within the development district. Using that tax increment revenue stream, the authority borrowed millions of dollars (incurred in bonded indebtedness) which it planned to pay back in annual installments, with interest, over a period of 12 years. Beginning in 1997 when interest rates were low, the City of Ionia refinanced its bonds to take advantage of the lower interest rate, and to extend their repayment schedule. One bond was refinanced on May 15, 1997, in order to extend its retirement date to May 1, 2010. (The second bond, issued on November 24, 1998, is scheduled to be retired on November 1, 2014.)

Before school finance reform was adopted by the voters in 1994 via Proposal A, cities were able to capture the incremental growth of the property tax earmarked for K-12 education, and the state then reimbursed the local school district for the lost revenue. After Proposal A, the capture of education taxes was prohibited. However, when a bond that was originally issued before Proposal A is refinanced, school taxes may continue to be captured. For example, the May 1997 bond issued by the Ionia DDA is a refinanced bond originally issued before Proposal A was adopted. Each year, the DDA captures about \$218,000 in school property tax, and the state reimburses the local school district for the lost revenue.

In Ionia, fully 60 percent of the annual tax growth within the Downtown Development District came from a single business—Meridian Automotive, an auto parts manufacturing company with more than 700 employees. (According to committee testimony, the Meridian plant based in Ionia is one of four in Michigan, although one of those, located in Kentwood, is reported to be closing.) With the downturn in the manufacturing economy, Meridian disputed its local property tax assessment and planned to request a valuation hearing by the Michigan Tax Tribunal. To settle the dispute, the City of Ionia reappraised Meridian Automotive's one-million-square-foot facility, and lowered its valuation. The lower valuation, embodied in a step-down agreement, decreases the square-foot assessment from \$17.50 to \$12 over three years.

The lower assessment for Meridian Automotive significantly reduces the amount of incremental tax growth revenue the Downtown Development Authority can collect. Indeed, the lower assessed property values have reduced tax increment revenues captured by the DDA to a level where the DDA can no longer make the existing debt service payments. The city's bond counsel (Miller, Canfield, Paddock, and Stone) has advised the DDA to restructure the debt so that existing revenues are sufficient to repay it.

Legislation has been introduced that would allow the City of Ionia to refinance its May 15, 1997 bond (originally issued before Proposal A), and extend its retirement six years, from May 1, 2010 to May 1, 2016. A similar accommodation was granted to the City of Battle Creek in 2004. (See Background Information.)

THE CONTENT OF THE BILL:

House Bill 5634 would amend the Downtown Development Authority Act to revise the definition of "qualified refunding obligation."

Public Act 196 of 2004 allowed a DDA to refund its debt without meeting certain statutory "net present value" requirements in specified narrow circumstances, namely if the refunding obligation was issued to refund a qualified refunding obligation issued in November of 1997. House Bill 5634 would extend this exception so that it would also apply to the refunding of debt issued on May 15, 1997 (and would allow subsequent refundings issued before January 1, 2010).

Typically the act requires a qualified refunding obligation to meet both of the following requirements: 1) the net present value of the principal and interest on the refunding obligation, including the cost of issuance, must be less than the net present value of the principal and interest on the debt being refunded; and 2) the net present value of the sum of tax increment finance revenues and the distributions to repay the refunding obligation must not be greater than the net present value of the revenues and distributions to repay the obligation being refunded. (In brief, there must be a financial advantage to the refunding.) As mentioned above, these requirements do not apply to the refunding of certain debt issued in November 1997 and, under the bill, would not apply to the refunding of debt issued on May 15, 1997.

Further, the bill specifies that qualified refunding obligations that need not meet those "net present value" requirements also would not be subject to the requirements of Section 611 of the Revised Municipal Finance Act, if issued before January 1, 2010. [Section 611 also imposes "net present value" requirements on refunding securities.] The bill also specifies that the duration of the development program described in the tax increment financing plan related to these qualified refunding obligations would be extended to one year after the final date of maturity of the qualified refunding obligations.

[Downtown Development Authorities can, if authorized to do so by local ordinance, designate all or parts of specially designated districts for economic development, capture the incremental growth in the assessed property tax within the designated district, and apply the revenue toward improvement projects described in a development plan. In doing this, the board members of an authority typically incur *obligations*: written promises to pay, whether evidenced by contract, agreement, lease, sublease, bond, note, or a requirement to pay imposed by law.]

MCL 125.1651

BACKGROUND INFORMATION:

Historical Background

In 2004, the Michigan legislature enacted Public Act 196 (Enrolled Senate Bill 1240) to enable the Battle Creek Downtown Development Authority to refund its bonded indebtedness, extending a bond's repayment schedule. In an analysis dated 10-7-04, the Senate Fiscal Agency notes that "An economic development measure used in Battle Creek to entice the Kellogg Corporation to locate a division headquarters there evidently would have resulted in a revenue shortfall for the city's DDA."

An earlier analysis issued by the House Fiscal Agency dated 6-16-05, notes: "In a unique situation...the DDA in Battle Creek seeks to restructure its debt in order to avoid a shortfall that otherwise would occur due to the creation of a new agricultural enterprise zone used to successfully entice the headquarters of a division of the Kellogg Corporation to Battle Creek from Illinois. The new economic development measure will result in two years of reduced revenue that will not allow the DDA to meet its obligations. The DDA does not meet the current requirements in the act on refunding debt (in part because of a successful refunding in 1997 and a rise in interest rates since then)."

To read these analyses in their entirety, visit the legislature's website at <http://www.michiganlegislature.org> and retrieve information from the bill archives for Senate Bill 1240 of 2004.

Fiscal Background

Because the Ionia Downtown Development Authority originally issued the original bond it proposes to refinance before 1994 when voters adopted School Finance Reform via

Proposal A, the Ionia Downtown Development Authority is permitted to capture about \$218,000 each year in property tax growth, an increment that is earmarked for K-12 education. The loss in revenue is reimbursed by the State School Aid Fund. (The capture of school taxes increments was, generally speaking, prohibited after Proposal A.) House Bill 5634 would extend the life of the Ionia DDA bond six years (from May 2010 to May 2016). According to committee testimony, during that six-year extension, the local DDA will recapture incremental growth that will amount to about \$1.3 million in school revenue. (During that same period, total expenditures of the State School Aid Fund will be about \$68.4 billion based on current levels.)

ARGUMENTS:

For:

This legislation allows the City of Ionia Downtown Development Authority to pay back a bond through refinancing, thereby affording the authority more time to repay its debt. Currently, the authority is unable to meet its debt service obligations on a bond issued in May 1997 because a single business whose captured taxes constituted fully 60 percent of the DDA's annual budget has cut its operations by half.

A major employer in Ionia, Meridian Automotive, has seen its operations curtailed dramatically during the current Michigan economic downturn. Once employing over 1,300 people in the late 1990's, the company now has a workforce that has been reduced by half. When the auto parts manufacturer cut back its operations, its officials successfully appealed to the State Tax Tribunal to get the assessed value of their one-million-square-foot plant facility substantially reduced. As a result of a reappraisal that lowers the square-foot assessment by about 30 percent, the property tax growth increment collected by the DDA has also substantially declined. According to committee testimony, the reduction in taxable value and tax collections leaves the DDA about \$250,000 short each year, on its bond repayment.

Without this legislation allowing the DDA bonds to be restructured and the payment scheduled lengthened, the Ionia would be forced to use its general fund to meet the DDA's debt obligations.

Against:

This bill will extend the time during which the Ionia Downtown Development Authority can capture the incremental growth in property taxes that are earmarked for K-12 education. If the bill is enacted into law, and the Ionia DDA debt is restructured over another six years, the State School Aid Fund will be required to make up the revenue shortfall—an estimated \$1.3 million.

The shortfall in tax collections in the City of Ionia's DDA District should not be borne by the state's School Aid Fund. Although the SAF is sometimes used, legitimately, to spur economic development, it should not be used to reimburse a shortfall that comes when the state Tax Tribunal reduces a corporation's property tax valuation.

POSITIONS:

The Michigan Municipal League supports the bill. (1-23-08)

The City of Ionia supports the bill. (1-23-08)

The Ionia Downtown Development Authority supports the bill (1-23-08)

The Department of Treasury opposes the bill. (1-23-08)

Legislative Analyst: J. Hunault
Fiscal Analyst: Jim Stansell

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.