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BILL ANALYSIS

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Senate Bills 582 and 583 (as passed by the Senate)
Sponsor: Senator Jack Brandenburg
Committee: Finance

Date Completed: 12-23-15

RATIONALE

Some counties in Michigan, such as Wayne, are experiencing serious financial difficulties that might have a negative impact on the local tax collecting units within the counties. As explained below, this relates to the ability of a local unit to "borrow" money from a county's delinquent tax revolving fund.

The General Property Tax Act allows the county board of commissioners of any county to create a delinquent tax revolving fund. The county-operated fund is used to pay a local tax collecting unit the amount of delinquent taxes that are owed to the local unit. In exchange, all delinquent taxes, including interest, are payable to the county. The county is protected from losses because the local tax units remain obligated to repay the money borrowed from the fund to the county treasurer if the delinquent taxes are totally uncollectable.

A county is allowed to issue bonds to keep its delinquent tax fund healthy. If a situation jeopardized the soundness of the fund and investors would not buy bonds, however, the fund could become insolvent and, consequently, leave local units without the capacity to borrow from the county. This is of particular concern if a county is in financial distress and considered a potential candidate for bankruptcy, even if that is an unlikely possibility. To address these concerns, some have proposed permitting counties to sell notes under the Revenue Bond Act, and revising the procedures and processes for counties to borrow money, issue notes, and administer a delinquent tax revolving fund.

CONTENT

Senate Bill 582 would amend the General Property Tax Act to do the following:

- **Require a county treasurer to keep any money or assets in a delinquent tax revolving fund separate from any other money, property, or assets in the custody of the county treasurer.**
- **Prohibit the county from using the money in the fund for any purpose except paying specific local units, as outlined in the Act.**
- **Provide that payment from the fund surplus to the county treasurer could not commence until after payment of the principal of and interest on issued notes and the expenses of borrowing to establish or continue the fund.**
- **Provide that notes issued and sold would be secured by a statutory lien on the delinquent taxes.**
- **Create a new Section 87f under which counties could, for six years, continue a delinquent tax revolving fund created under the existing provisions, and issue delinquent tax revolving notes under the Revenue Bond Act.**

Senate Bill 583 would amend the Revenue Bond Act to address the process and procedures for borrowing money and issuing notes secured by delinquent tax revenue to be collected in connection with a delinquent tax system (a delinquent tax revolving

fund continued under proposed Section 87f of the General Property Tax Act). The bill also would regulate the organization of accounts of a delinquent tax system.

The bills are described in detail below.

Senate Bill 582

Delinquent Tax Revolving Fund Creation & Administration

Section 87b of the General Property Tax Act allows a county board of commissioners to create a delinquent tax revolving fund. When the fund is established, all delinquent taxes, except taxes on personal property, due and payable to the taxing units in the county, except those that collect their own delinquent taxes after March 1, are due and payable to the county. The local taxing units are obligated to pay to the county the amount of taxes and the interest on them, and the State is obligated to pay the State Education Tax to the county. If the county does not receive the delinquent taxes for any reason, it has full right of recourse against the taxing unit or the State, as applicable, to recover the amount of the taxes and interest. After sufficient funds have been deposited into the delinquent tax revolving fund, the county treasurer is required to pay from the fund any or all delinquent taxes that are due to the county and any school district, intermediate school district, community college district, city, township, or special assessment district, the State, or any other political unit for which delinquent tax payments are due, within the time frame specified in the Act.

Any amount that is due from a local taxing unit or the State for a prior year's uncollected delinquent tax is a lien against future delinquent tax payments that may be payable to a local taxing unit or the State. The lien must be satisfied by offsetting the amount due to the county from the local taxing unit or the State when the county makes distributions from the delinquent tax revolving fund to the local taxing unit or the State in a subsequent year.

The bill specifies that a county could establish a tax delinquent revolving fund "on behalf of the taxing units in the county and, for purposes of the state education tax under the state education tax act…, the state".

The bill would require money and other property and assets held in a delinquent tax revolving fund to be kept separate from and not be commingled with any other money, property, or assets in the custody of the county treasurer. All money, property, and assets acquired by the county treasurer, whether as revenue or otherwise, would have to be held by it in trust for the taxing units in the county for which the taxes were levied. The county would have no right, title, or interest in the delinquent tax revolving fund except for the right to payment to the local units listed above. If the county determined to borrow as outlined in the Act, that borrowing would have to be done on behalf of the county and its taxing units.

(Section 87b allows a county to borrow money to create a tax delinquent revolving fund under Section 87c or 87d. Section 87c is discussed below. Section 87d allows a county to submit to its voters the question of establishing a tax delinquent revolving fund and issuing revolving fund notes.)

The Act requires a tax delinquent revolving fund to be segregated into separate funds or accounts for each year's delinquent taxes. The bill also would require a separate tax delinquent tax revolving fund to be established for each year's delinquent taxes.

The bill provides that Section 87b could be superseded by Section 87f (which the bill would create, as described below).

Borrowing & Issuance of Notes

Section 87c allows a county that has created a delinquent tax revolving fund to borrow money and issue notes to establish or continue the fund and to pay the expenses of the borrowing. If provided by separate resolution of the county board of commissioners for any year in which the county opts to borrow, there is payable from the fund surplus to the county treasurer an amount equal to the following for delinquent tax administration expenses:

-- For any delinquent tax on which the interest rate before sale exceeds 1% per month, 1/27 of the monthly interest.
-- For any delinquent tax on which the interest rate before sale is 1% per month or less, 3/64 of the monthly interest.

Under the bill, payment from the fund surplus to the county treasurer would have to follow payment of the principal of and interest on the notes and the expenses of the borrowing.

Additionally, the Act states that in the resolution authorizing the borrowing and issuance of notes, the delinquent taxes from which the borrowing is to be repaid must be pledged to the payment of the principal and interest of the notes, and the proceeds of the collection of the delinquent taxes pledged and the interest on the proceeds must be placed in a segregated fund or account and may not be used for any other purpose until the notes are paid in full, including interest.

The bill would delete that provision. Instead, if a county determined to borrow under Section 87c, the delinquent taxes from which the borrowing was to be repaid and any money and other property and assets received in connection with those delinquent taxes and revenue derived from the delinquent taxes and money and other property and assets, including any money in a note reserve fund, would have to be pledged as security for, and used for the payment of, the principal and interest of the notes and for no other purpose until the notes were paid in full, including interest. Money and other property held in the delinquent tax revolving fund would have to be kept separate from and could not be commingled with any other money in the custody of the county treasurer.

The bill would require notes issued and sold pursuant to Section 87c to be secured by a statutory lien on the delinquent taxes from which the borrowing would be repaid and all other property and assets and any revenue derived from the delinquent taxes and other property and assets. The lien would automatically attach without further action or authorization by the county. The lien on the delinquent taxes and all other property and assets and any revenue derived from those sources would be valid and binding from the time the notes were executed and delivered. The lien would automatically attach and be effective, binding, and enforceable against the county, its successors, transferees, and creditors, and all others asserting rights, regardless of whether those parties had notice of the lien and without the need for any physical delivery, recordation, filing, or further act. In addition, the amounts collected that would be subject to the lien would have to be held in trust for the owners of the notes authorized by these provisions.

The bill provides that Section 87c could be superseded Section 87f.

<u>Optional Administration & Regulation of Fund</u>

The bill would add Section 87f to allow the county board of commissions located in any county that had created a delinquent tax revolving fund under Section 87b, by resolution, to elect to continue the delinquent tax revolving fund under Section 87f. This section would supersede Sections 87b and 87c as to a delinquent tax revolving fund continued under Section 87f. A resolution passed under these provisions would have to authorize the county treasurer to do the following:

-- Operate the delinquent tax revolving fund for the next six years in accordance with Section 87f.
-- Issue the county's delinquent tax revenue notes during the six-year period pursuant to the Revenue Bond Act in an amount not to exceed that described below.

The county's delinquent tax revenue notes issued during the six-year period could not exceed the aggregate amount of the following:

-- The delinquent taxes pledged to secure each borrowing.

-- At the option of the county treasurer, a note reserve fund in an amount not exceeding more than 15% of each borrowing.
-- The cost of issuance.

Upon the board of commissioners' passage of the resolution, the delinquent tax revolving fund would be continued, and the fund could be designated by the county treasurer as the "100% tax payment fund". Subsequently, all delinquent taxes, except taxes on personal property, due and payable to the taxing units in the county, except those units that collect their own delinquent taxes after March 1 by charter or otherwise, would be due and payable to the county treasurer, on behalf of the taxing units in the county and the State. Money and other property and assets held in the delinquent tax revolving fund would have to be kept separate from and not be commingled with any other money, property, or assets in the custody of the county treasurer. All money, property, and assets acquired by the county treasurer, whether as revenue or otherwise, would have to be held by it in trust for the taxing units in the county for which the taxes were levied. The county would have no right, title, or interest in the delinquent tax revolving fund except for the right to payment provided for in Section 87c(3). (Under that section, a fraction of the interest collected is payable to the county for delinquent tax administration expenses, if the county has borrowed for the purpose of Section 87c.)

If the county determined to borrow pursuant to Section 87c or 87d, the borrowing would have to be done on behalf of the county and its taxing units, and the primary obligation to pay to the county treasurer the amount of taxes and the interest on the taxes would rest with the local taxing units and the State for the State Education Tax. If, for any reason, the county treasurer did not receive the delinquent taxes that were due and payable to the county treasurer on behalf of the taxing units in the county and the State, the county treasurer would have full right of recourse against the taxing unit or the State for the State Education Tax to recover the amount of the delinquent taxes and interest at the rate of 1% per month, or fraction of a month, or a lower rate as established by resolution of the board of commissioners until repaid to the county treasurer by the taxing unit.

If the county treasurer borrowed to provide funds for those payments, however, the interest rate could not exceed the highest interest rate paid on that borrowing. If the board of commissioners reduced the interest rate on the recovery of uncollected delinquent taxes as provided above, that decrease would not apply to any year's delinquent taxes when borrowing against that year's delinquent taxes occurred before the board of commissioners adopted the resolution. Any amount that was due from a local taxing unit or the State for a prior year's uncollected delinquent tax would be a lien against any future delinquent tax payments that could be payable to a local taxing unit or the State. The lien would have to be satisfied by offsetting the amount due to the county from the local taxing unit or the State when distributions from the delinquent tax revolving fund were made by the county treasurer to the local taxing unit or the State in a subsequent year. A resolution or agreement previously executed or adopted to that effect would be validated and confirmed. For delinquent State Education Taxes, the county could offset uncollectible delinquent taxes against collection of the State Education Tax received by the county and owed to the State under the Act. The fund would have to be segregated into separate funds or accounts for each year's delinquent taxes.

The delinquent taxes returned to the county treasurer would remain the property of the local units of government, and the county treasurer would serve solely as a collection agent for those delinquent taxes. All of the taxes, interest, fees, and charges required to be collected by the county treasurer by the Act related to delinquent taxes would remain in full force and effect in the event Section 87f applied. While Section 87f was in effect, the county treasurer would have the power to borrow money and issue delinquent tax revenue notes as permitted by the Revenue Bond Act, for the purpose of continuing the delinquent tax revolving fund.

Senate Bill 583

Borrowing, Sale, & Administration of Notes

The Revenue Bond Act allows a public corporation to issue bonds or notes for public improvements.

The bill specifies that a county treasurer in any county that had continued a delinquent tax revolving fund under Section 87b of the General Property Tax Act, could by order of the county treasurer and without a vote of the electors, borrow money and issue its revenue notes on behalf of itself and the local units of government secured by delinquent tax revenue from the county's delinquent tax revolving fund. ("Delinquent tax revenues" would mean the delinquent taxes, interest, penalties and fees, and chargebacks of uncollected delinquent taxes due or to become due to local units of government to be collected by a county treasurer as agent for the local unit of government in connection with a delinquent tax system and pledged to any borrowing by a county treasurer under the Revenue Bond Act. The term would not include fees, charges, and other amounts due and payable to the county treasurer under Section 87c of the General Property Tax Act.

"Delinquent tax system" would mean the delinquent tax revolving fund in any county created and designated under Section 87b of the General Property Tax Act, and continued under 87f of that Act.)

In the order authorizing the borrowing and issuance of notes, the delinquent tax revenue from which the borrowing was to be repaid would have to be pledged as security for the payment of the principal and interest on the notes and for no other purpose, and these amounts could not be used for any other purpose until the notes were paid in full, including interest. Money and other property held in the delinquent tax revolving fund, including collections on the delinquent tax revenue, would have to be kept separate from and could not be commingled with any other money in the custody of the county treasurer. The segregated fund or account would have to be established as a part of the delinquent tax revolving fund and be accounted for separately on the books of the county treasurer.

The proceeds of the notes would have to be placed in and used as the whole or part of the delinquent tax revolving fund established under Section 87b of the General Property Tax Act after the expenses of borrowing had been deducted. The notes issued pursuant under these provisions would have to be in an aggregate principal amount not exceeding the aggregate amount of all of the following:

-- The delinquent tax revenue pledged, exclusive of interest.
-- At the option of the county treasurer, a note reserve fund in an amount not to exceed 15% of each borrowing.
-- The cost of issuance.

The notes would have to bear interest not exceeding 14.5% per annum; and be in those denominations, and mature on the date not exceeding six years after their date of issue, as the county treasurer by order determined. ("Order" would mean the legislative enactment of a county treasurer's powers under the Act.)

The sale and award of notes would have to be conducted and made by the county treasurer at a public or private sale, as described in the bill.

If the county board of commissioners provided by resolution, the notes could also be limited tax full-faith and credit obligations of the county subject to the State Constitution as to the levying of any taxes not authorized by the voters or by law unless the county had held an election pursuant to Section 87d of the General Property Tax Act, permitting the county to pledge its unlimited taxing power for the purpose of providing money for the delinquent tax revolving fund. If the proceeds of the taxes pledged were not sufficient to pay the principal and interest of the notes when due, the county would have to impose a general ad valorem tax without limitations as to rate or amount on all taxable property in the county to pay the principal and interest and could reimburse itself from delinquent taxes collected.

The notes could be secured additionally by a pledge of the county's general fund if the county board of commissioners provided by resolution. Interest on the notes could be payable at any time provided in the order, and could be set, reset or calculated as provided in the order.

If the treasurer so authorized in the order authorizing the notes, any notes issued could be secured in whole or in part under a trust or escrow agreement. That agreement could authorize the trustee or escrow agent to make investments of any type authorized in the agreement.

Notes issued under the Revenue Bond Act would be exempt from the Revised Municipal Finance Act.

<u>Delinquent Tax Revenue</u>

The bill would require delinquent tax revenue to be fixed before the issuance of the notes. The revenue would have to be sufficient to provide for all of the following:

-- The payment of the expenses of collection of delinquent taxes, the administration and operation of the delinquent tax system, and the payment of costs of issuance for the notes.
-- The payment of the interest on and the principal of notes payable from the delinquent tax revenue when the notes became due and payable.
-- The creation of any reserve for the notes as required in the order authorizing their issuance.
-- Other expenditures and funds for the delinquent tax system as the order required.

<u>Statutory Lien</u>

Notes secured and sold under these provisions would be secured by a statutory lien on the delinquent taxes and on all other property and assets and any revenue derived from the delinquent taxes and other property or assets. The lien would automatically attach without further action or authorization by the county treasurer. The lien on the delinquent taxes and all other property and assets and any revenue derived from the delinquent taxes and other property or assets would be valid and binding from the time the notes were executed and delivered. The lien would automatically attach and be effective, binding, and enforceable against the county, the county treasurer, its successors, transferees, and creditors, and all others asserting rights in the secured property, irrespective of whether those parties had notice of the lien and without the need for any physical delivery, recordation, filing, or further act. In addition, the amounts collected that were subject to the lien would have to be held in trust for the owners of the notes.

<u>Order of Payment of Delinquent Tax Revenue</u>

In the authorizing order, the county treasurer would have to provide that all of the delinquent tax revenue of the delinquent tax system was subject to a statutory lien and would have to be kept separate from and not be commingled with any other money in the custody of the county treasurer. The delinquent tax revenue of the delinquent tax system would have to be paid in an order of recorded priority specified in the bill.

Any revenue remaining after the priorities were satisfied at the end of any operating year would be considered surplus and would have to be disposed of by the county treasurer as provided in Section 87b of the General Property Tax Act.

<u>Regulation of Accounts</u>

Money in the several accounts of a county's delinquent tax system would have to be deposited as designated by the county treasurer of the county. Except money in the note and interest redemption account and money derived from the proceeds of sale of the notes each of which would have to be kept in a separate deposit account, money in the accounts of the delinquent tax system could be kept in one deposit account, provided, however, that only delinquent tax revenue of the delinquent tax system could be held in or credited to that deposit account and those funds and other property could not be commingled with any other money of or in the custody of the county treasurer. In that case, the money in the combined deposit accounts would have to be allocated on the books and records of the county treasurer to the various accounts in the manner provided in the authorizing order. The county treasurer could provide that the money in the accounts of the delinquent tax system be kept in separate depository accounts. The money in the note and interest redemption account would have to be accounted for separately.

MCL 211.87b et al. (S.B. 582)
141.103 et al. (S.B. 583)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Recovering delinquent taxes can sometimes take a long time, assuming the taxes can be collected at all. A delinquent fund is beneficial to local tax collecting units because it allows them to continue receiving money on a regular schedule through the use of the fund. However, the fund must remain healthy to support local units and continue lending to them. To achieve this, a county is allowed to borrow money through the sale of bonds.

Potential buyers of bonds and notes often analyze and speculate on the worst possible scenarios before investing. General obligation bonds, which are backed by the full-faith and credit of the county, are usually considered very safe investments. General obligation bonds, however, would not be attractive to buyers if the county were in a financial crisis. The bonds are not secured by or tied to any property interest that could constitute a secured claim in bankruptcy.

Instead, revenue bonds, or notes, become the favorable purchase for buyers if bankruptcy is a possibility or occurs. Revenue obligation notes are protected and secured by collateral in a particular income source. Issuing these notes would allow a troubled county, such as Wayne County, to continue receiving funds to support local units if the county were in bankruptcy.

Many local units in Wayne County depend on its delinquent tax revolving fund, and might not have enough money to meet their needs without receiving assistance from the fund. The bills would give counties more options to keep a delinquent tax revolving fund healthy even during a financial crisis or bankruptcy.

In addition, other provisions of the bills, such as those creating a statutory lien on delinquent tax collections, would enhance the security of investors. This could lessen any reluctance to buy counties' bonds or notes and potentially would reduce the counties' interest rates.

Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

The bills would tend to result in lower debt service costs for county delinquent tax systems. The proposed establishment of a statutory lien on delinquent tax collections pledged to repay delinquent tax anticipation notes issued under current borrowing authority would increase the security of those debt instruments and tend to reduce borrowing costs for a county delinquent tax revolving fund. The proposed optional method of issuing delinquent tax anticipation notes under the Revenue Bond Act could lower costs for a county with some conditions of financial distress. Typically, revenue bonds have higher interest rates than general obligation bonds or notes; however, when credit market participants perceive a risk of municipal bankruptcy, revenue bonds may carry lower interest rates because the revenue stream dedicated to repay the revenue bonds (in this case, delinquent tax collections) is less likely to be impaired in a bankruptcy proceeding. The decision to issue notes under this proposed method would rest with the county treasurer. The amount of savings would depend on market conditions at the time of debt issuance and the volume and frequency of borrowing.

Fiscal Analyst: Elizabeth Pratt