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TIFAS: REFUNDING OBLIGATIONS

House Bill 5072 as enrolled
Public Act 271 of 1996
Sponsor: Rep. Gregory E.Pitoniak
House Committee:Local Government
Senate Committee: Economic Development, International Trade, and Regulatory Affairs

Senate Bill 992 as enrolled
Public Act 269 of 1996
Sponsor: Sen. Mat J. Dunaskiss

Senate Bill 993 as enrolled
Public Act 270 of 1996
Sponsor: Sen. Leon Stille

Senate Committee: Economic Development, International Trade, and Regulatory Affairs
House Committee: Local Government

Second Analysis (10-23-96)

THE APPARENT PROBLEM:

The new school finance/property tax system put in place following the passage of Proposal A on March 15, 1994, significantly reduced school taxes for many property owners. The reduction in local school tax revenue had an adverse effect on tax increment finance authorities (or TIFAs). These authorities are permitted by statute to capture the growth in tax revenue in a designated development area for use in financing a wide variety of public improvements (e.g., sidewalks, lighting, parking, beautification, recreation). Typically, the improvements are funded by bond issues that are paid off out of the tax revenue growth (the tax "increment"). Recognizing the effect that the new tax system would have on existing TIFA bond issues and projects then in the "pipeline," the legislature permitted the capture of state and local school taxes in the amount needed to cover those bond issues and also required state reimbursement in cases where the payment of existing obligations could not be met due to property tax reductions. The capture of school tax revenue would not be permitted once those bond issues are retired. Generally speaking, the protected bond issues were those issued before August 19, 1993 (known as "eligible obligations") and those issued after that date but before December 31, 1994 and stemming from TIFA plans approved before August 19, 1993 (known as "other protected obligations"). The legislation also allowed an "eligible obligation" to be refunded, but in that case the refunding bonds would fall into the category of "other protected obligation." (Refunding refers to issuing new bonds to pay off older bonds.)

A complication has arisen. The decline in interest rates has made it attractive to refund bond issues. Municipalities are able to issue refunding bonds to retire existing bonds, with the refunding bonds carrying a lower interest rate than the bonds they are replacing, thus saving money. As the TIFA statutes are currently written, however, if an "other protected obligation" was refunded, the authority could no longer capture school taxes to pay for the new bonds. If an "eligible obligation" was refunded, the authority or municipality would no longer be eligible for state appropriations where needed. Thus, the issuing of new bonds, which would otherwise make good sense fiscally, has been rendered impractical. Legislation has been introduced to address this problem.

THE CONTENT OF THE BILLS:

The three bills would amend three tax increment financing statutes so that TIFAs could refund obligations (e.g., bonds, notes, and various contracts) for which state and local state tax revenues can be captured without losing those revenues and could refund obligations that are eligible for "hold harmless" appropriations from the state without losing those appropriations. These obligations would be known in the three acts as "a qualified refunding obligation." Under the bills, a qualified refunding obligation would be permitted only if it would have the effect of reducing the amount of principal and interest and would have the effect of not increasing the amount of captured school tax revenues and any "hold harmless" payments from the state needed to repay the obligations.

Specifically, the bills require (1) that the net present value of the principal and interest to be paid on the refunding obligation, including the cost of issuance, be less than the net present value of the principal and interest to be paid on the obligation being refunded, as calculated using a method approved by the Department of Treasury; and (2) that the net present value of the sum of the tax increment revenues from state and local school taxes and distributions from the state to repay the refunding obligation not be greater than the net present value of those revenues and distributions to repay the obligation being refunded, as calculated using a method approved by the Department of Treasury.

To achieve their ends, the bills would amend the definitions of "eligible obligation," "obligation," and "other protected obligation," and would define a new term, "qualified refunding obligation." The bills also would specify that the term "obligation" in the acts would not refer to those bonds that had been "economically defeased" by refunding bonds issued under the act. (This is said to cover cases in which refunding bonds have been issued but the bonds being refunded are not yet eligible to be paid off. In such a case, revenue from the refunding bonds is set aside until such a time as the original bonds can be paid off. The provision would prevent both sets of bonds from being counted as obligations.)

The bills also would permit the state treasurer to reduce distributions from the state or to require a reduction in the capture of state and local school revenues if the treasurer determined that a TIFA or municipality could issue a qualified refunding obligation but had not made a good faith effort to do so. The reductions permitted would be in an amount equal to the net present value saving that would have been realized if the authority or municipality had refunded the obligation.

The bills would provide a new definition of "assessed value" that reflects the new cap on assessments in the state constitution that was part of Proposal A. The term would refer to state equalized value for valuations made before January 1, 1995 and to taxable value for valuations made after December 31, 1994.

The bills also would add to the definition of "other protected obligation" to include an ongoing management or professional services contract with the governing body of a county that was entered into before March 1, 1994, and that was preceded by a series of limited term management or professional services contracts with the governing body of the county, the last of which was entered into before August 19, 1993. House Bill 5072 would also include under that definition an obligation to implement a project described in plan approved by a municipality before August 19, 1993, located on land owned by a public university on the date of approval and for which a contract for final design was entered into before December 31, 1993.

Senate Bill 992 alone contains a provision that would amend the definition of "initial assessed value." The provision would apply to a municipality with a population less than 35,000 that established an authority prior to 1985, created a downtown development district or districts, and approved a development plan or tax increment financing plan or amendments to a plan, and which plan expired by its terms December 31, 1991. For that instance, the initial assessed value for the purpose of any plan or plan amendment adopted as an extension of the expired plan would be determined as if the plan had not expired.

House Bill 5072 would amend the Tax Increment Finance Authority Act (MCL 125.1801 et al.). Senate Bill 992 would amend the downtown development authority act (MCL 125.651 et al.). Senate Bill 993 would amend the Local Development Finance Authority Act (MCL 125.2152 et al.).

BACKGROUND INFORMATION:

Current TIFA provisions. The tax increment finance statutes currently permit the capture of school taxes only to repay eligible advances, eligible obligations, and other protected obligations. The term "eligible advance" refers to an advance made before August 19, 1993. The term "eligible obligation" refers to an obligation issued or incurred by an authority or a municipality on behalf of an authority before August 19, 1993. The term "other protected obligation" applies to 1) an obligation to refund a bond or note that was an eligible obligation; 2) an obligation issued or incurred after August 19, 1993 but before December 31, 1994 to finance a project described in a plan approved before August 19, 1993 (or before December 31, 1993 for a downtown development authority) and for which a contract for final design had been entered into before March 1, 1994; and 3) an obligation incurred after August 19, 1993 to reimburse a party to a development agreement entered into before that date for a project described in a plan approved before August 19, 1993 and undertaken and installed by that party in accordance with the development agreement. In the downtown development authority act, the term "other protected obligation" also refers to an obligation incurred by the authority evidenced by or to finance a contract to purchase real property if 1) the authority purchased the property in 1993; 2) before June 30, 1995, the authority entered into a contract for the development of the contract; and 3) in 1993, the municipality received approval for a grant from the Department of Natural Resources and the Department of Commerce. The provision that requires the legislature to hold a TIFA harmless when it has insufficient revenues due to a reduction in school property taxes applies to the repayment of eligible advances and eligible obligations.

FISCAL IMPLICATIONS:

The bills are designed so that there would be no revenue loss to the state, according to the Department of Treasury. (3-20-96)

ARGUMENTS:

For:

The principal purpose of these bills is to allow the financially advantageous refunding of certain TIFA bond issues and other obligations. They would permit the continued capture of school tax revenues to pay for the new (refunding) obligations, and would continue to allow municipalities to receive "hold harmless" distributions from the state to help pay off the obligations where needed. The bills require that the cost of paying off the refunding obligations be less than the cost of paying off the bonds being refunded. The bills also contain a provision needed to preserve certain management service contracts entered into under the acts by Ingham County and some local units of government. The bill dealing with downtown development authorities contains a provision that would allow for the uninterrupted operation of an authority in Garden City that is said to have expired inadvertently (in 1991) before being renewed. The bill would permit the authority to conduct its business as if the unintended expiration had not occurred and, thus, to base its incremental value on the initial assessed value that existed when the authority was first created (and not when it was re-instituted). There is precedent for this, according to a representative of municipalities.

Response:

A representative of the Michigan Association of Counties raised objections to the provision affecting Garden City's downtown development authority, fearing that it will set a precedent that local units will use to seek legislation that will allow them to escape obtaining the approval of the county for the capture of county tax revenue. Such approval has been required since 1994.

Analyst: C. Couch

■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.