



**House
Legislative
Analysis
Section**

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TIFAS: REFUNDING BONDS

**House Bill 5071 (Substitute H-3)
Sponsor: Rep. David Anthony**

**House Bill 5072 (Substitute H-3)
Sponsor: Rep. Gregory E. Pitoniak**

**House Bill 5073 (Substitute H-3)
Sponsor: Rep. James Agee**

**Committee: Local Government
First Analysis (3-21-96)**

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 a wide variety of improvements to public facilities (e.g., sidewalks, lighting, parking, beautification, recreation). Typically, the improvements are paid for through 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 can continue only until those bond issues are retired. School taxes are not available for recapture for TIFA projects that come after those specified existing and pipeline projects. 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."

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, the refunding of an "other protected obligation" would result in the authority no longer being able to capture school taxes to pay for the bonds. If an "eligible obligation" was refunded, the authority or municipality would no longer be eligible for state appropriations where needed. Legislation has been introduced to address this problem.

THE CONTENT OF THE BILLS:

The bills would amend three tax increment financing statutes, generally speaking, so that TIFAs could refund bonds for which state and local state tax revenues can be captured without losing that revenue as a result of the refunding and to refund bonds which are eligible for "hold harmless" appropriations from the state without losing that eligibility. These bonds would be known in the three acts as "a qualified refunding obligation." Under the bills, a qualified refunding bond issue would be permitted only if, generally speaking, it would have the effect of reducing the amount of principal and interest and it would have the effect of reducing the amount of captured school tax revenues and any "hold harmless" payments from the state needed to repay the bonds.

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

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refunding obligation be less 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 achieve a net present value savings by refunding a bond or note 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 bond or note.

House Bill 5071 would amend the downtown development authority act (MCL 125.651 et al.). House Bill 5072 would amend the Tax Increment Finance Authority Act (MCL 125.1801 et al.). House Bill 5073 would amend the Local Development Finance Authority Act (MCL 125.2152 et al.).

BACKGROUND INFORMATION:

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 purpose of these bills is to allow the financially advantageous refunding of certain TIFA bond issues. They would permit the continued capture of school tax revenues to pay for the new (refunding) bonds, and would continue to allow municipalities to receive "hold harmless" distributions from the state to help pay off the bonds where needed. The bills require that the cost of paying off the refunding bonds be less than the cost of paying off the bonds being refunded.

POSITIONS:

The Department of Treasury supports the bills. (3-20-96)

The Michigan Municipal League supports the bills. (3-20-96)

The Michigan Townships Association has no position at this time. (3-20-96)

■ 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.