Legislative Analysis

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

FISCAL STABILIZATION ACT: LIFT $125 MILLION BOND CAP

House Bill 5626
Sponsor: Rep. George Cushingberry, Jr.
Committee: Appropriations

Complete to 12-09-09

A SUMMARY OF HOUSE BILL 5626 AS INTRODUCED 12-1-09

The bill would amend the Fiscal Stabilization Act (FSA), 1981 PA 80, which provides cities and counties with the authority to issue "fiscal stabilization bonds",[1] subject to the approval of the State Administrative Board, to fund an operating deficit for a past fiscal year or a projected operating deficit in the current fiscal year. Generally, the amount of the bonds is limited to 3% of the state equalized value (SEV) of real and personal property within the city or county, with a limit on the principal of $125 million.[2]

Under the act, to issue fiscal stabilization bonds, a city must determine the following, in a resolution submitted to the State Administrative Board[3]:

1. The city had an accumulated deficit as of the end of the last completed fiscal year, or is projected to have an accumulated operating deficit at the end of the current fiscal year, determined in accordance with generally accepted accounting principles (GAAPs).

2. The amount of the deficit exceeds the amount that the city may borrow under the Emergency Municipal Loan Act, 1980 PA 243.

3. The amount of the deficit is more than the amount the city can fund by issuing tax anticipation notes under the Revised Municipal Finance Act, 2001 PA 34.

Under Section 5 of the act, the amount of bonds issued may include the amount necessary to fund the accumulated deficit, a reserve to principal and interest payments, a discount of not more than 10%, and the issuance costs (legal, financial, accounting, election, printing, and other expenses).

Section 4(b): The bill eliminates the $125 million limit on the principal, leaving in place the 3% SEV cap, and the exceptions cited in the footnote.

[1] The bill notes that a city or county may issue "bonds or obligations". For the sake of this summary, any debt issued under the act is referred to as "bonds".
[2] This $125 million limit does not apply to bonds issued to pay (1) any amounts set aside for a reserve for the payment of principal, interest, and redemption payments; (2) the expected issuance costs; (3) the amount of any discount; or (4) bonds issued to refund (refinance) outstanding bonds. Given these exceptions, this $125 million cap, in municipal finance parlance, is said to be a cap on "new money" bonds.
[3] Additionally, the resolution must also state the maximum amount of bonds or obligations necessary to fund the deficit and provide funds for the reserve, discount, debt service payments, and issuance costs.

Section 9(3): Currently, the FSA provides that the city's or county's authorizing resolution may pledge and create a lien on any unencumbered revenues or taxes. The bill provides for a further protection to bondholders by changing the permissive language (a "consensual lien") to a mandatory lien that, under the bill as introduced, "is a statutory lien paramount and superior to all other liens and interests of any kind for the sole purpose of paying the principal and interest on the bonds."[4]

The bill further provides that funds held for the payment of the principal and interest is exempt from being levied upon, taken, sequestered, or applied toward paying the debts or liabilities of the city or county other than for the debt service payments to which they apply. Additionally, bondholders would have a first priority lien "paramount and superior" to and all other liens and interests on the funds held for the payment of principal and interest.

Section 9(4): Currently, the FSA generally provides that the city or county may further pledge, for the payment of the bonds, money received (or to be received) by the city or county "derived from the imposition of taxes by the state or to be returned to the city or county as provided by law." The bill, instead, provides that a city or county may pledge "distributable aid". Incorporating the definition of "distributable aid" under the Michigan Municipal Distributable Aid Bond Act, 1981 PA 97, the bill, in Section 9(7), defines "distributable aid" to mean, revenue sharing payments under the Glenn Steil State Revenue Sharing Act, 1971 PA 140, shared revenue under any other law providing for the distribution of state shared revenues that are derived from the same taxes distributed under 1971 PA 140, and shared revenue under any law providing reimbursement to a municipality under the State Constitution as reimbursement for revenue that would otherwise be collected from taxes imposed by the municipality.[5]

The bill continues, with some revisions, existing language that permits a city or county to enter into an agreement with the State Treasurer to directly pay (bypassing the city or county) distributable aid to the paying agent, trustee, escrow agent, or other person for the sole purpose of making principal and interest payments. The bill further provides that under such an agreement, the state treasurer would hold the distributable aid in trust for the sole benefit of the bond holders. Again, as provided above, distributable aid held for principal and interest payments would be subject to a lien that is paramount and superior to all other interests and trusts of any kind, for the sole purpose of making principal and interest payments. Also, distributable aid would be exempt from being levied upon, taken, sequestered, or applied toward paying the debts or liabilities of the city or county other than debt service payments to which the distributable aid applies.

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[4] The bill applies to funds paid to a paying agent, trustee, escrow agent, the state treasurer, or other person, for the payment of principal and interest.

[5] The Michigan Municipal Distributable Aid Bond Act was enacted along with the Fiscal Stabilization Act in 1981, and generally authorized local units to issue bonds - including fiscal stabilization bonds - backed by "distributable aid", which included revenue sharing payments, payments made available under the Single Business Tax Act and other reimbursement payments. Public Act 300 of 2002, enacted along with a number of other "clean up" bills following enactment of the Revised Municipal Finance Act, prohibited local units from issuing debt under 1981 PA 97 after March 1, 2002, and repealed the act effective January 1, 2010.

Section 9(5): The bill also carries forward into the FSA, Section 7 of the Michigan Municipal Distributable Aid Bond Act, MCL 141.1027, which provides that the state covenants with the purchasers, holders, owners, and their assigns, beneficiaries, executors, and administrators of bonds secured by distributable aid that it will not repeal, revoke, rescind, modify or amend Section 9 so as to create a lien or charge on or pledge, assignment, diversion, withholding, payment, or other use or deduction from any distributable aid or other amounts securing bonds under the act that is prior in time or superior in right to the payment required by Section 9.

Continuing law provides that Section 9 is not to be construed to (1) create or constitute state indebtedness, (2) require the state continue to impose and collect taxes from which distributable aid is paid or to make payments of distributable aid; (3) limit or prohibit the state from repealing or amending a law imposing taxes from which distributable aid is paid, providing for the payment of distributable aid, or providing for the manner, time, or amount of distributable aid.

FISCAL IMPACT:

The bill would appear to have no direct fiscal impact on the state. As noted above, continuing law provides that the fiscal stabilization bonds issued by a city or county do not create or constitute state indebtedness; require the state continue to impose and collect taxes from which distributable aid is paid or to make payments of distributable aid; or limit or prohibit the state from repealing or amending a law imposing taxes from which distributable aid is paid, providing for the payment of distributable aid, or providing for the manner, time, or amount of distributable aid.

The bill would, however, have potentially significant fiscal impacts on the local units (cities and counties) issuing bonds under the Fiscal Stabilization Act. This would occur, primarily, through lifting the $125 million (par amount) cap on the principal amount (although the 3% SEV cap would remain in place under the bill) and by providing greater security for such bonds by pledging "distributable aid" (revenue sharing) to make the required debt service payments, as previously allowed under the Michigan Municipal Distributable Aid Bond Act, 1981 PA 97, and strengthening the lien position of bondholders.

The City of Detroit, under a deficit elimination plan proposed by Mayor Bing, is proposing to issue up to $250 million in fiscal stabilization bonds – which is above the statutory limit – as a means of addressing its accumulated deficit.[6] The city currently meets the criteria set forth in Section 4(1) of the act in order to apply to the State

[6] According to a November 20, 2009 memorandum from the Detroit City Council, Fiscal Analysis Division, to the City Council, the city's accumulated deficit as of the end of FY 2007-08 (June 30, 2008) was $220 million, with the deficit growing to a projected $326 million as of the end of FY 2008-09. See, [http://www.ci.detroit.mi.us/legislative/CouncilDivisions/FiscalAnalysis/Reports%202009/Fiscal%20Stabilization%20Bonds%2011-20-2009.pdf]. The resolution required under the Fiscal Stabilization Act approved by the city council further notes that projected deficit will reach $368.0 million at the end of FY 2009-10. The Fiscal Analysis Division memorandum, citing city administration officials, notes that under the 3% SEV cap on the principal, the city could, under the FSA, as amended by the bill, issue up to $375 million in fiscal stabilization bonds.

Administrative Board to issue bonds under the act. The city's resolution notes, "The City Council determines that the aggregate amount of its accumulated operating deficit and additional projected accumulated operating deficit excceds the amount which the City may borrow from the Emergency Municipal Loan Fund pursuant to Act No. 243, and also exceeds the amount that the City can fund by issuing tax anticipation notes pursuant to Act No. 34."

The resolution further notes, "the City Council hereby determines that it is necessary to issue its bonds…pursuant to Act No. 80 in the principal amount not to exceed $250,000,000, for the purpose of providing funds to fund (i) all or a portion of the accumulated operating deficit for the fiscal year ended June 30, 2009 and the additional projected accumulated operating deficit for the fiscal year ending June 30, 2010, (ii) an amount necessary to prepay all or a portion of the principal of and interest on the 2009 [Revenue Anticipation Notes], and such other obligations or bonds of the City as determined by the City Council in the Bond Authorizing Resolution, if outstanding when the Bonds are issued and so determined by the Finance Director at the time of the sale of the Bonds, (iii) a reserve to secure payment of principal of or interest on the Bonds in an amount not exceeding the maximum amount of principal and interest coming due on the Bonds in any fiscal year, if necessary, (iv) a discount not to exceed 10% of the principal amount of the Bonds, and (v) an amount sufficient to pay all legal, financial, accounting, printing, and other expenses related to the issuance of the Bonds."

It is anticipated that the fiscal stabilization bonds would be secured by the city's revenue sharing payments, in a manner similar to security provided under the Michigan Municipal Distributable Aid Bond Act, 1981 PA 97. On this point, the resolution notes, "[t]he Bonds shall be secured by the limited tax full faith and credit of the City and may be payable from money received or to be received by the City derived from the imposition of taxes by the State of Michigan and returned to or to be returned to the City as provided by law…as finally determined in the bond authorizing resolution." The chart below shows the recent revenue sharing payments to the city.

Fiscal Year	Constitutional	Statutory	Total
2003-04	$62,591,249	$224,777,839	$287,369,088
2004-05	$64,084,958	$220,151,807	$284,236,765
2005-06	$65,176,004	$215,989,144	$281,165,148
2006-07	$63,821,736	$208,882,024	$272,703,760
2007-08	$65,952,570	$206,751,190	$272,703,760
2008-09	$62,201,208	$206,751,190	$268,952,398
2009-10	$59,620,573	$179,585,690	**$239,206,263**

Source: Department of Treasury. FY 2009-10 figures are projects amounts subject to reduction.

The actual debt services costs to Detroit, or any other city or county issuing bonds under the Fiscal Stabilization Act, depends on the terms of the bonds sold (maturity dates, interest rates, security, etc).[7] The City of Detroit most recently issued fiscal stabilization

[7] Section 6 of the FSA provides that the bonds may be serial bonds (several maturity dates) or term bonds (a single maturity date), shall mature in not more than 30 years, may bear interest, may be subject to redemption prior to

bonds in 2004, with a principal amount of $61.1 million, interest rates of 3.0%-5.0%, and maturity dates of 2006-2009. According to the official statement accompanying the bond issue, interest payments totaled $12.6 million.[8] Additionally, in April 2009, the city issued $127.4 million in Revenue Anticipation Notes, secured by the city's revenue sharing payments, with an interest rate of 5.0%. The (short-term) notes are to be paid off before March 1, 2010, but could be refinanced ("refunded") as part of the fiscal stabilization bonds, consistent with continuing law. A November 20, 2009 memorandum from the City Council's Fiscal Analysis Division states, "[t]he administration currently estimates that the City would pay interest on these bonds based on an interest rate of around 6.0%. The bonds would amortize over a 20-year period." Annual debt service (principal and interest) payments would range from $20 million-$30 million depending on how the bond sale is structured, which is well below the city's constitutional revenue sharing payments.

Fiscal Analyst: Mark Wolf
Benjamin Gielcyzk

maturity with or without a premium, and may be Regarding the proposed $250 million in fiscal stabilization bonds, a recent article appearing in *Bond Buyer* noted that "Bond documents provided to the City Council show that mandatory redemption is triggered if Detroit does not have a deficit ay any point in the 20-year life of the debt, noted council member Sheila Cockrel…" See, Caitlin Devitt, "Detroit Planning $250M Sale", *Bond Buyer* (on-line), 23 November 2009,
[http://www.bondbuyer.com/issues/118_225/detroit-fiscal-bonds-1004172-1.html. According to the Official Statement of the 2004 fiscal stabilization bonds, redemption was not a feature of those bonds.

[8] Official statements are available through a number of websites including, [http://www.munios.com] and [http://emma.msrb.org/]; registration is required for both web sites. The official statement typically includes information on pricing and security of the bonds, as well as other pertinent economic, legal, and financial information related to the bond issue.