Legislative Analysis

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FISCAL STABILIZATION ACT: TEMPORARILY INCREASE AUTHORIZED BOND CAP TO $250 MILLION

House Bill 5626 as enacted
Public Act 4 of 2010
Sponsor: Rep. George Cushingberry, Jr.
House Committee: Appropriations
Senate Committee: Local, Urban and State Affairs

Complete to 4-15-10

A SUMMARY OF HOUSE BILL 5626 (2010 PA 4) AS ENACTED 2-5-10

Public Act 4 of 2010 ("Act") amended the Fiscal Stabilization Act to temporarily increase the bond cap from $125 million to $250, in order to increase the amount of fiscal stabilization bonds the City of Detroit can issue as part of its deficit elimination plan.

The Fiscal Stabilization Act (FSA), 1981 PA 80, 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 amount of the bonds of $125 million.[2]

Under the FSA, 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.

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.

[1] The Act notes that a city or county may issue "bonds or obligations." Throughout this summary, any debt issued is referred to as "bonds". 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 maturity with or without a premium, and may be may be sold in 1 or more series at public or private sale at a discount of not to exceed 10% of the principal amount of the bonds or obligations.
[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.

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

Section 3 [MCL 141.1003]: The FSA provides that a city or county that meets certain criteria may issue general obligation bonds for the purpose of financing past and current year deficits. The new Act specifies that the bonds may be issued as general obligation (GO) bonds, as bonds payable solely from a specified source of revenue lawfully available to the city or county, or as some combination of the two.

Section 4 [MCL 141.1004]: The Act temporarily increases the $125 million limit on the principal of the bonds to $250 million, leaving in place the 3% SEV cap, and the exceptions cited in footnote 2. The increased bond cap applies to bonds issued by a city between January 1, 2010, and September 1, 2010.

Section 8 [MCL 141.1008]: The Act clarifies that the bonds or obligations may be issued as limited tax bonds or obligations with the voter approval and publication requirements under the Home Rule City Act, 1909 PA 279, MCL 117.1 et seq.

Section 9(4) [MCL 141.1009]: 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." As provided above, the Act also permits the city or county to pledge "distributable aid."

The Act continues, with some revisions, existing language that permits a city or county to enter into an agreement with the State Treasurer allowing 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.[4]

The Act provides that for bonds issued after the Act's effective date [February 5, 2010], a statutory lien and trust is created applicable to the distributable aid received, after funding for distributable aid has been appropriated and subject to any reduction in the amount appropriated. This lien is "paramount and superior to all other liens and interests of any kind" for the purpose of making the required debt service payments and would be perfected without delivery, recording, or notice.

The Act further provides for fiscal stabilization bonds issued under the Act between the Act's effective date [February 5, 2010] and September 1, 2010 (e.g. the Detroit fiscal stabilization bonds), distributable aid held by the paying agent, trustee, escrow agent, or other person would be held for the sole benefit of the bondholders, and would be exempt from being levied upon, taken, sequestered, or applied toward paying the debts or liabilities of the city or county, other than making the debt service payments to which the distributable aid applies and paying the bond holders. The lien would have first priority

[4] The FSA currently provides that the funds may be paid to a trustee. To this the Act adds paying agent, escrow agent, or other person. A paying agent, escrow agent, or trustee is typically the bank that receives or hold funds used to pay the bondholders.

and would be paramount and superior to all other liens and interests that are created after the Act's effective date [February 5, 2010] and after the bonds subject to the statutory lien are issued [March 12, 2010].

The Act further provides that nothing in the Act would abridge or reduce the ability of the state to withhold revenue sharing payments, as provided under the Glenn Steil State Revenue Sharing Act. 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; or (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. The Act also provides that for bonds issued between January 1, 2010, and September 1, 2010, the maximum debt service payments due in any fiscal year can not exceed the amount of revenue sharing payments received by the city in state FY 2009.

Section 9(7): Incorporating the definition of "distributable aid" under the Michigan Municipal Distributable Aid Bond Act, 1981 PA 97, the Act, 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]

FISCAL IMPACT:

Local Fiscal Impact: The issuance of fiscal stabilization bonds under the FSA, as amended by the Act, is part of a deficit elimination plan proposed by Detroit Mayor Dave Bing.[6] In addition to the bonds, the proposed deficit elimination plan includes[7]: (1)

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[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.

[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 (June 30, 2009). 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.

[7] See Appendix E of the Official Statement accompanying the 2010 fiscal stabilization bonds. See, also, a February 23, 2010 memorandum from the Detroit City Council Fiscal Analysis Division to the Detroit City Council, [http://www.detroitmi.gov/legislative/CouncilDivisions/FiscalAnalysis/Reports%202010/Fiscal%20Stabilization%20Bonds%202-23-10.pdf]. For a review of the city's finances see, *The Fiscal Condition of the City of Detroit*, Citizens Research Council, Report 361, April 2010, [http://www.crcmich.org/PUBLICAT/2010s/2010/rpt361.pdf].

workforce reductions; (2) regionalization of Cobo Hall; (3) enhanced collection of delinquent receivables; (4) Greater Detroit Resource Recovery Authority (GRDDA) escrow payment; (5) employee furlough days; (6) Greektown Casino settlement payment; (7) DDOT grant funding; and (8) receipt of withheld revenue sharing.

The city met the criteria set forth in Section 4 of the FSA in order to apply to the State Administrative Board to issue bonds under the FSA. On this point, the city's authorizing resolution notes, "The City Council determines that the aggregate amount of its accumulated operating deficit and additional projected accumulated operating deficit exceeds 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 authorizing 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."

On February 16, 2010, the State Administrative Board approved the issuance of up to $250 million in fiscal stabilization bonds. Subsequently, on March 12, 2010, the city issued $249,790,000 in bonds, with net proceeds of $249.2 million.[8]

Sources of Funds	
Principal Amount	$249,790,000.00
Net Original Issue Premium[1]	$1,873,224.70
Total	**$251,663,224.70**
Uses of Funds	
Deposit to Fiscal Stabilization Fund	$249,176,031.25
Issuance Costs[2]	$2,487,193.45
Total	**$251,663,224.70**

Source: Official Statement of the City of Detroit Distributable State Aid General Obligation (Limited Tax) Bonds, Series 2010. **Note 1:** The original issue premium is the amount bonds are sold above the face (par) value. This amount is treated as part of the proceeds of the bond sale. **Note 2:** Issuance costs include those costs for the bond counsel, financial advisor, the underwriters' discount, the underwriters' counsel fee, Trustee fee, and other expenses.

[8] According to several news accounts, the bonds sold quickly. Reportedly, there were twice as many investors than necessary. See, Suzette Hackney, "Sale of $250 million in bonds successful", *Detroit Free Press*, March 12, 2010 and Nancy Kaffer, "Bond sale keeps Bing deficit plan on track", *Crain's Detroit Business*, March 22, 2010.

The 2010 Fiscal Stabilization Bonds are secured by the city's revenue sharing payments. 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." Further, the Official Statement notes, "[t]o the extent that Distributable State Aid payments to the City are insufficient to pay principal and interest on the Series 2010 bonds when due, the Series 2010 Bonds are payable as to principal and interest from any funds legally available to the City, as a first budget obligation, including, the proceeds of annual ad valorem property taxes, which must, to the extent necessary, be levied on all taxable property within the boundaries of the City, subject to charter, statutory and constitutional tax rate limitations." 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 projected amounts.

According to the Official Statement accompanying the city's bond issue, the annual debt service requirements range between $12.6 million and $18.9 million, which is well below the city's annual revenue sharing payments. The debt service schedule is shown below.

City FY	Principal	Interest	Debt Service	City FY	Principal	Interest	Debt Service
2011	$0	$14,067,093	$14,067,093	2024	$9,965,000	$8,883,375	$18,848,375
2012	$0	$12,566,138	$12,566,138	2025	$10,465,000	$8,384,456	$18,849,456
2013	$0	$12,566,138	$12,566,138	2026	$11,015,000	$7,834,375	$18,849,375
2014	$0	$12,566,138	$12,566,138	2027	$11,580,000	$7,269,500	$18,849,500
2015	$6,445,000	$12,405,013	$18,850,013	2028	$12,170,000	$6,675,750	$18,845,750
2016	$6,775,000	$12,074,513	$18,849,513	2029	$12,795,000	$6,051,625	$18,846,625
2017	$7,120,000	$11,727,138	$18,847,138	2030	$13,450,000	$5,395,500	$18,845,500
2018	$7,485,000	$11,362,013	$18,847,013	2031	$14,140,000	$4,705,750	$18,845,750
2019	$7,870,000	$10,978,138	$18,848,138	2032	$14,885,000	$3,961,519	$18,846,519
2020	$8,275,000	$10,574,513	$18,849,513	2033	$15,690,000	$3,158,925	$18,848,925
2021	$8,700,000	$10,150,138	$18,850,138	2034	$16,535,000	$2,313,019	$18,848,019
2022	$9,115,000	$9,734,425	$18,849,425	2035	$17,425,000	$1,421,569	$18,846,569
2023	$9,525,000	$9,321,900	$18,846,900	2036	$18,365,000	$482,081	$18,847,081
2024	$9,965,000	$8,883,375	$18,848,375	**Total**	**$249,790,000**	**$216,630,737**	**$466,420,737**

Source: Official Statement of the City of Detroit Distributable State Aid General Obligation (Limited Tax) Bonds, Series 2010. **Note:** Totals may not add due to rounding. Principal payments are due each November 1st, beginning in 2010. Interest payments are made on May 1st and November 1st each year, starting in 2010. The "City FY" is the city's fiscal year which runs from July 1 - June 30th. The first year of debt service payments, FY 2011, runs from July 1, 2010 – June 30, 2011. The Official Statement of the 2010 bond issue is available through, [http://www.munios.com], registration is required.

State Fiscal Impact: As written, the Public Act 4 has 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; do not require the state continue to impose and collect taxes from which distributable aid is paid or to make payments of distributable aid; and do not 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.

Continuing law (with some clarifying revisions) provides that the city or county may also enter into an agreement with the State Treasurer whereby the State Treasurer agrees to pay the trustee, paying agent, or escrow agent directly (thereby by-passing the city or county).

On this point, the bond issue provides, "[p]ursuant to the Agreement to Deposit Distributable State Aid, the State Treasurer has agree to send 100% of the Distributable State Aid due the City to the Trustee for deposit under the Trust Indenture for as long as the Series 2010 Bonds are outstanding. Nothing in the Agreement to Deposit Distributable Aid abridges or reduces the ability of the State Treasurer to withhold Distributable State Aid from the City as proved by law under Act 140 or other applicable law. However, pursuant to the terms of the Agreement to Deposit Distributable State Aid, the State Treasurer has agreed that so long as the Series 2010 Bonds are outstanding, if future installments of Distributable State Aid due the city are delayed or withheld, the State Treasurer shall not delay or withhold deposit with the Trustee of any portions of the city's Distributable State Aid necessary to meet the City's set-aside obligations on debt service for the Series 2010 Bonds to the extent such Distributable State Aid is due and owing to the City and unless required to do so by applicable law."[9]

As noted above, the indenture and deposit agreements provided for as part of the bond sale do have a fiscal impact the state. This is through the state's agreement to not withhold funds necessary for debt service payments, even where revenue sharing payments to the city would be withheld, and the agreement to make advance payments if necessary to meet the debt service requirements. (In the past, the state has withheld revenue sharing payments payable to the city due to the city's failure to submit financial reports as required by law.) This impacts the state's cash flow, but does not impact the amount paid by the state. These payments would be made eventually; it is a matter of timing.

Fiscal Analyst: Mark Wolf

[9] After allocating the amount required to meet the debt service requirements, the amount of distributable state aid remaining is then distributed to the city for deposit into its General Fund. Additionally, if the amount held by the Trustee is not sufficient to meet the debt service requirements, the City may request the State Treasurer to advance all or a portion of the distributable state aid due to the city.