Legislative Analysis

HOUSE FISCAL AGENCY

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FINANCIAL RECOVERY BONDS FOR ECORSE

Senate Bill 318 (Substitute H-1)
Sponsor: Sen. Hoon-Yung Hopgood
House Committee: Local, Intergovernmental, and Regional Affairs
Senate Committee: Education

First Analysis (5-5-11)

BRIEF SUMMARY: The bill would provide for the issuance of financial recovery bonds by the City of Ecorse to pay court-ordered judgments against the city, and to provide for the deposit of tax revenue into an escrow account for the payment of the bonds

FISCAL IMPACT: As written, the bill would have no impact on state revenue or expenditures, but would increase costs for local units of government by allowing them to issue bonds as a method of fulfilling a court judgment. The additional costs would be the amount of interest necessary to finance the bonds.

THE APPARENT PROBLEM:

On October 9, 2009, Governor Jennifer Granholm confirmed a financial emergency in the City of Ecorse, Michigan--a first-ring Downriver suburban community outside of Detroit with about 10,000 residents. This following a preliminary investigation by a financial review team (comprising seven financial management experts from the public and private sectors) of the city's finances which began in March 2009. The city's finances were audited by Martin, Arrington, Desai & Meyers PC, which filed a report on June 30, 2009, giving the city an adverse audit opinion.

The governor's review of the City of Ecorse financial situation was *triggered following a written request from the Ecorse Board of Education which was owed nearly $2.5 million in property taxes collected by the city*. After the financial emergency was declared, the Local Emergency Financial Assistance Loan Board--operating under Public Act 72 of 1990 (recently repealed by the new Emergency Manager laws)--named Joyce A. Parker as emergency financial manager. This is the second time the City of Ecorse has operated with an emergency financial manager. See ***Background Information***.

On December 15, 2009, Parker filed a City of Ecorse Financial Recovery Plan with the Michigan Department of Treasury. In it, she says: "For the past five years, the City has spent $3-5 million more than revenue received for the general fund. Given that revenues were less than expenses, the City made up the shortfall by spending money from other restricted funds and spending money that was collected on behalf of other taxing units in Wayne County." Parker noted further: "As of June 30, 2009, the city's current liabilities exceeded its current assets by $13,067,467. *Approximately $8.3 million was owed the Current Tax Collection Fund (CTCF) by the General Fund. The CTCF is a fiduciary fund used to collect and remit property taxes on behalf of the city, school districts and Wayne County.* The General Fund also owes approximately $5 million to the Water Fund for cash flow subsidies. In addition, the City has collected approximately $3.3 million of property taxes levied for police and fire pension by judgment of the Court that it has not remitted to the pension system." Parker's 11-page report then lays-out a plan to find revenue enhancements, reorganize city operations, and eliminate the city's deficit.

According to committee testimony, in December 2010, a Wayne County Circuit Court ordered the City of Ecorse to make the $6.6 million in tax payments it owed to the Ecorse Public Schools ($2.4 million) and to Wayne County ($4.2 million).

In order to make these payments, the City of Ecorse proposes to sell $8.5 million in financial recovery bonds to cover the court-ordered judgments to the schools, the county, and for other necessary litigation-related payments. Under the Home Rule City Act, the Ecorse has the authority to issue financial recovery bonds without the approval of the legislature. However, because of the city's financial emergency, the city's bond agency and bond counsel--R. W. Baird Company and the Miller Canfield law firm--have advised that legislation be passed to give greater assurance of repayment to those who will buy Ecorse bond debt. Consequently, legislation has been introduced, customized to address the financial emergency in Ecorse, allowing the emergency financial manager to sell financial recovery bonds following certain conditions.

THE CONTENT OF THE BILL:

Senate Bill 318 (H-1) would amend the Home Rule City Act (MCL 117.36a) to provide for the issuance of financial recovery bonds by the City of Ecorse to pay court-ordered judgments against the city, and to provide for the deposit of tax revenue into an escrow account for the payment of the bonds

Under Section 36a of the act, city can issue financial recovery bonds in amounts greater than the limitations established by the city charter or the act if a financial emergency exists under the Local Government and School District Fiscal Accountability Act.

The bill would apply to a city that has a population under 10,000 according to the latest federal decennial census, and is located in a charter county. The City of Ecorse meets both of these criteria, and a financial emergency has been found to exist in the city. Financial recovery bonds issued under the bill would be limited to the total amount necessary to pay court-ordered judgments against the city that exist on the bill's effective date.

In the order that authorizes the issuing of bonds, city officials could provide for the deposit of revenue generated from taxes levied by the city (including a tax levied to pay a judgment or comply with a court order) into an escrow account to be used to pay the principal, the interest, and the administrative costs associated with issuing the bonds, and then pledge the tax revenue for the payment of the bonds.

If the city entered into an agreement with a third-party tax collector for the collection of taxes that the city treasurer otherwise would collect, the agreement would have to provide for the direct payment of all tax revenue pledged for the payment of financial recovery bonds collected by the third-party tax collector to a trustee to be deposited into an escrow account and used for the sole purpose of paying the principal of and interest on the bonds.

The tax revenue paid to the trustee would be subject to a lien and trust, which would be a statutory lien and trust superior to all other liens and interests of any kind, for the sole purpose of paying the principal and interest on the financial recovery bonds and any other bonds subsequently issued by the city sharing a parity or subordinate pledge of that tax revenue. The tax revenue would have to be held in trust 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 other than for payment of debt service on the bonds subject to the lien.

Section 36a provides that the net indebtedness of a city, reduced by amounts excluded under Section 4a, may not exceed 20 percent of the city's assessed value. Notwithstanding this provision, if Ecorse issued financial recovery bonds under the bill, its net indebtedness, reduced by the excluded amounts, could not exceed 12 percent of the city's assessed value. (Section 4a sets limits on a city's net indebtedness incurred for all public purposes, and excludes certain bonds and obligations from the computation of net indebtedness.)

HOUSE COMMITTEE ACTION:

The members of the House Committee on Local, Intergovernmental, and Regional Affairs passed one amendment to the Senate-passed version of Senate Bill 318.

The Senate-passed version of the bill caps the net indebtedness of a city that issues financial recovery bonds at 10 percent of the assessed value of the city. In contrast, the House committee amendment raises that cap, so that the net indebtedness of a city that issues financial recovery bonds is set at 12 percent of the assessed value of the city.

BACKGROUND INFORMATION:

The City of Ecorse is the only Michigan city ever to be placed in receivership by the courts. On December 3, 1986, Chief Wayne County Circuit Court Judge Richard Dunn appointed the city's first emergency financial manager, Louis Schimmel. The court's action prompted the Michigan legislature to pass its first Local Government Fiscal Responsibility Act, Public Act 72 of 1990, the act that was repealed on March 16, 2011, when the legislature replaced that law with six new emergency manager laws--Public Acts 4, 5, 6, 7, 8, and 9 of 2011 (House Bills 4214, 4216, 4217, and 4218, as well as Senate Bills 157 and 158).

In its first experience with receivership, the City of Ecorse became a "grand experiment," featured in a noteworthy June 1989 case study about the merits of municipal privatization published by the Mackinac Center, (The Midland-based public policy think tank). An accompanying paper, entitled "Privatization Brought Ecorse, Michigan Back from Bankruptcy," indicates that "in 1986, before Schimmel took charge, the bloated payroll of Ecorse boasted 200 employees. This year (in 1999) that number is just 82." The case study itself notes that "Ecorse provides *empirical* evidence of the potential benefits of privatization in the Downriver region." It further notes: "Few, if any, communities nationwide have experience privatization to such a degree as in Ecorse. Indeed, Ecorse is evidence of a private sector economic experiment unique in recent American history.

'We have created a model city that nobody else in the country has,' explains Schimmel. 'Some communities have privatized certain functions. I've privatized just about everything. Everything that I could legally.'" According to the case study, Schimmel reduced the city's then $6-million budget deficit to $1 million, largely through privatization. To read the case study in its entirety, visit http://www.mackiinac.org/2103 and http://www.mackinac.org/6249 and http://www.mackinac.org/article.aspx?ID=5583

ARGUMENTS:

For:

The City of Ecorse has had its current emergency financial manager since October 2009. In December 2010, the Wayne County Circuit court ordered the City of Ecorse to pay its debts to the Ecorse Public Schools and the County of Wayne. Together with the Michigan Department of Treasury, the emergency manager has decided to sell bonds to cover the court-ordered judgment. That way, citizens and businesses will not face a one-time tax levy that could increase their tax bills ten-fold, after a required doubling of the millage rate to 80 mills--an amount that few in the community can afford. For example, U.S. Steel, the city's largest employer with 1,800 workers (and which makes up 40 percent of the tax base in the city) would see its tax bill jump from about $400,000 to $4.2 million.

This bill will allow the City of Ecorse to sell bonds in order to raise money to pay-off debts totaling $8.5 million, including $6.6 million that it owes to the Ecorse Public Schools and the County of Wayne. The city's preference is to issue recovery bonds to be paid back over a number of years, in order to avoid the punishing effect of a one-time tax hike. Quick action is needed on the bill, because the court-ordered judgments are due in the summer of 2011.

The section labeled ***The Apparent Problem***, at the beginning of the document, contains additional information and justification.

POSITIONS:

The City of Ecorse supports the bill. (5-5-11)

R.W. Baird Company (representing the City of Ecorse) supports the bill. (5-5-11)

Miller Canfield (representing the City of Ecorse) supports the bill. (5-5-11)

United States Steel supports the bill. (5-5-11)

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