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REVISED MUNICIPAL FINANCE ACT

Senate Bill 29 (Substitute H-1)
First Analysis (6-5-01)

Sponsor: Sen. Joanne G. Emmons
House Committee: Tax Policy
Senate Committee: Finance

THE APPARENT PROBLEM:

The Municipal Finance Act, Public Act 202 of 1943, is the act that establishes the rules for municipalities to use in borrowing and issuing debt. Tax specialists have been working on a revision of the act for several years. Their goals have included making the rules that municipalities must follow clearer, eliminating obsolete and unnecessary provisions in the current law, providing additional tools to municipalities that will reduce costs to taxpayers and ratepayers, and establishing more efficient and effective oversight of municipal debt issues by the Department of Treasury. Legislation has been developed that would create a Revised Municipal Finance Act in order to achieve these goals.

THE CONTENT OF THE BILL:

The bill would create the Revised Municipal Finance Act with an effective date of March 1, 2002. Most of the current Municipal Finance Act, and its associated administrative rules, would be repealed on that date. The bill contains a number of provisions designed to make the transition from the old act to the new act. The new act would retain many of the provisions of the current act, although in a rewritten form. Any security (bond, note, etc.) that is exempt from the current act by virtue of the terms of the act under which it was authorized would also be exempt from the new act.

A "municipality" would be defined to mean a county, township, city, village, school district, intermediate school district, community college district, metropolitan district, port district, drainage district, district library, or another governmental authority or agency that has the power to issue a security. The term would not include the state or any authority, agency, fund, commission, board, or department of the state.

Among the key new provisions of the new act (as identified by tax specialists) are the following.

• Municipalities would be able to issue bonds without the approval of the Department of Treasury under a newly established set of procedures. Each year, a municipality would have to file an audit report with the department within six months from the end of its fiscal year (or as otherwise provided in the Uniform Budgeting and Accounting Act), along with a "qualifying statement" certified by the municipality's chief administrative officer. The department would have 30 days to determine if the municipality complied with a list of requirements set forth in the bill. If so, the municipality could proceed to issue municipal securities without further approval from the department until 30 days after the next qualifying statement was due or until a new determination was made by the department, whichever occurred first. Such a municipality would be said to have achieved "qualified status". A municipality denied qualified status could correct the noncompliant requirements and request reconsideration. If a municipality was denied qualified status, it would need the prior written approval of the department to issue a municipal security.

• A municipality would be able to sell an authorized municipal security at either a competitive sale or a negotiated sale, as determined in the authorizing resolution. Currently, the law only allows negotiated sales for issues less than $100,000 or issues of $12 million or more. Otherwise they must be sold at public sale. Under the bill, if a municipality decided to sell a municipal security at a negotiated sale, the local governing body would have to expressly state the method and reasons for choosing such a sale instead of a competitive sale in the resolution or ordinance authorizing the issue or sale.

• Municipalities can currently issue short-term securities in anticipation of the collection of taxes. This power would be continued. Additionally, the new act would permit the issuance of short-term securities in two other instances: 1) in anticipation of

the proceeds of a long-term municipal security that a municipality proposes to issue or that will be issued on its behalf (called by tax specialists "bond anticipation notes"); and 2) in anticipation of the receipt of grants from the state or federal government (sometimes called "grant anticipation notes"). In each case, the proceeds from the short-term security could only be used for the purpose that the proceeds from either the long-term security or the grant could be used.

• The new act would also allow for the issuance of so-called budget bonds, a new kind of long-term security that allows a local unit to pay for securities out of its operating budget. A county, city, village, or township could by resolution of its governing body, and without a vote of its electors, issue a municipal security to pay the cost of any capital improvement items, provided the amount of taxes necessary to pay the principal and interest on that security, together with the taxes levied for the same year, did not exceed authorized limits. Such securities could not exceed five percent of the state equalized valuation (SEV) of the property assessed within the county, city, village, or township. A local unit would have to publish a notice of intent to issue such a security, and it would be subject to referendum upon the petitioning of registered electors.

• The bill would define several new key terms, notably "security", "municipal security", and "refunding security". These terms would replace a number of terms in the current act, including "obligations", "bonds", "notes", and "funded indebtedness". The new term "security" would be defined to mean an evidence of debt such as a bond, note, contract, obligation, refunding obligation, certificate of indebtedness, or other similar instrument issued by a municipality, which pledges payment of the debt by the municipality from an identified source of revenue. A "municipal security" would be defined to mean a security that when issued was not exempt from the Revised Municipal Finance Act, the prior Municipal Finance Act, or the law authorizing its issue and that was payable from 1) ad valorem real and personal property taxes; 2) special assessments; 3) the limited or unlimited full faith and credit pledge of the municipality; or 4) other sources of revenue described in the act for debt or securities authorized by the act. A "refunding security" would be a municipal security issued to refund an outstanding security.

• A municipality would not be allowed to issue a refunding security unless the net present value of the principal and interest to be paid on the refunding security, including the cost of issuance, was less than the net present value of the principal and interest to be paid on the outstanding security being refunded, as calculated using a method approved by the Department of Treasury. An exception from this requirement could be obtained from the department if it determined 1) the refunding was required by a state or federal agency; 2) the refunding was necessary to reduce or eliminate requirements of ordinances or covenants applicable to the existing outstanding security; 3) the refunding was necessary to avoid a potential default on an outstanding security; or 4) the refunding was of a short-term security issued in anticipation of a long-term security.

• The new act would prohibit what tax specialists have referred to as capital appreciation bonds (CABs or zero coupon bonds), except in specified circumstances. The bill would provide that a municipal security issued under the act could not be sold at a discount exceeding ten percent of the principal amount of the security. The exception would apply only if one or more of the following conditions applied, as determined by the Department of Treasury: 1) the sale would result in the more even distribution for the municipality of total debt service on proposed and outstanding municipal securities; 2) the sale would result in an interest cost savings when compared to the best available alternative that did not include such a security; 3) the issuance was based on the availability of specific revenues previously pledged for another purpose and lawfully available for this purpose; and 4) the security was issued to the state or the federal government to secure a loan or agreement. Moreover, such a municipal security would have to be rated investment grade by a nationally recognized rating agency or have insurance for the payment of the principal and interest on the security to the holders of the security. Also, no more than 25 percent of the total principal amount of any authorized issue of a municipal security could be in this kind of security. (Generally speaking, these kinds of securities are bought at a large discount from the face value and do not have regular interest payouts. Instead, the interest accumulates, and at maturity the security is redeemed for the face value.)

• The bill would put in place a new fee structure. Within 15 business days of completing the issuance of any municipal security, a municipality with qualified status would be required to pay to the Department of Treasury a filing fee equaling .02 percent of the principal amount of the municipal security issued, but in an amount not less than $100 or more than $1,000, as determined by the

department. For a municipality that had not been granted qualified status, the filing fee would be .03 percent of the principal amount of the municipal security to be issued, but not less than $800 or more than $2,000. This fee would accompany the application to the department for approval for the issue of a municipal security. (Currently, the act requires fees to accompany applications to the department for exemptions from prior approval. This application process has been superseded by the provisions of the new act.)

• The Department of Treasury would have the ability to issue bulletins or adopt rules to carry out the purposes of the new act. A bulletin would have to include a statement of the department's specific statutory authority for any substantive requirement contained in the bulletin. Rules would have to be adopted following the Administrative Procedures Act.

• The bill contains a number of transition-related provisions. Two sections of the existing Municipal Finance Act, Sections 10 and 11 of Chapter III, dealing with obligations not requiring prior approval, would be repealed on April 30, 2002. Beginning March 1, 2002 and ending April 30, 2002, a municipality planning to issue a municipal security could either 1) seek approval or an exception from prior approval from the Department of Treasury in accordance with Sections 10 and 11 of Chapter III of the old act; or 2) seek qualified status under the new act by filing a qualified statement that references the most recent audit report previously filed with the department or by attaching a copy of the most recently completed audit report to the qualified statement. Further, the terms of the existing act, and the administrative rules of the municipal finance division would apply with respect to any security issued under an order of the department that was issued before May 1, 2002. All orders approving the issuance of securities by the department would continue in force until October 31, 2002. The terms of the existing act would apply with respect to any security issued pursuant to an order of the department issued before May 1, 2002.

HOUSE COMMITTEE ACTION:

The House Committee on Tax Policy reported a substitute H-1 that changes the Senate-passed version in only a few ways. One amendment removed public school academies (or charter schools) from the definition of "municipality". The Senate-passed version said that, except for certain capital appreciation bonds, a rating would not be required for a municipal security that could be issued without the prior approval of the Department of Treasury. The committee removed this provision and amended the bill so that it now provides that the department can require a rating for a municipal security issued without prior approval if the principal amount exceeded $5 million. Other amendments adopted are technical in nature.

FISCAL IMPLICATIONS:

The Senate Fiscal Agency has reported that the fiscal impact to the state and local units is indeterminate. The bill would put in place new filing requirements and filing fees. Currently, the Department of Treasury receives $250,000 per year in fees from local units to review and approve the issuance of debt or obligations. But how the collection of the new fees would compare with current fees has not been determined. (SFA Floor Analysis dated 4-16-01)

ARGUMENTS:

For:

The bill would revise the law that governs municipal borrowing and the issuance of debt. The existing law was first enacted in 1943. One aim of the new bill is to provide more clearly written rules. There appears widespread agreement that the current law is unnecessarily difficult to understand. The bill would update and clarify the language of the act, while retaining a great many of the current requirements. It would make borrowing easier for municipalities while maintaining effective oversight by the state. A new bond approval process would be put in place whereby municipalities could qualify annually with the Department of Treasury and then could issue securities throughout the year without prior departmental approval. Municipalities would have to file extensive amounts of information about each security issue with the department. This should provide more efficient and effective oversight. Further, municipalities would be granted some additional powers to issue short-term securities in anticipation of future revenues, either from promised state and federal grants or from the proceeds of future long-term borrowing. They also would be allowed to issue "budget bonds", which would allow them to finance capital improvements from their operating budgets without creating special financing authorities. As with other kinds of debt, voters could force a referendum to prevent such borrowing. The bill will allow local units the choice of a competitive sale of securities or a negotiated sale. If the municipality chooses a negotiated sale, the local

legislative body would have to explain why as part of the resolution or ordinance approving the sale.

Response:

Some people would prefer that municipalities continue to be required to issue securities by competitive sale. At present, negotiated sales are only permitted for issues below $100,000 and for issues of $12 million or more. There are concerns that allowing negotiated sales in all cases could lead to abuses. While there may be good reasons for negotiated sales, generally competitive sales should produce lower interest rates.

POSITIONS:

The Department of Treasury supports the bill. (5-30-01)

The Michigan Municipal League supports the bill. (5-30-01)

The Michigan Townships Association supports the bill. (5-30-01)

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.