Peter,

Hope all is well. I recently read that the City Center construction bond is in danger of default if it is not refinanced by Dec. 1.

If accurate, this is quite puzzling. The provisions of every document executed in the project relating to a potential default, make clear that the bond is to be paid by Incremental taxes received from the project. Prior to my leaving Council, I was advised that the assessment of the project was higher than expected and in excess of the projected revenues. The applicable documents also make clear that any shortfall is to be provided by the developer.

If the potential default is truthfully being reported, this means that the developer does not have the resources necessary to make up the shortfall. And, that poses a much, much larger concern regarding the health of this project.

In this instance a default makes for an even more curious situation since the funder is a company controlled by the parent of one of the partners in the project. If a default occurs, and the funder pursues foreclosure of the project, the foreclosing entity would simply step into the shoes of the existing developer. In any event, neither the BRA nor the City would be liable in any way for a shortfall. In the event of foreclosure, the funder, like the current developer, recaptures (according to our agreements) the shortfall paid by the funder (or developer) once the original debt is paid off, with interest. In this case that seems likely since the assessment on the property is substantially higher than expected. The simple math is that if the 100% TIF the Council approved pays off principal and interest earlier, the difference between the payoff and the maximum capture established by Council is available to reimburse the Developer.

The BRA is an agency of the City which City Council established by authorizing Resolution in 2000. That resolution adopts by reference the enabling statute and in paragraph 4 authorizes the Authority to prepare Brownfield Plans and “submit them to the City Council for consideration pursuant to Section 14 of the Act.” It goes on to provide, in paragraph 6, “…approvals by the City Council of all matters pertaining to the Authority or its Board shall be by resolution.” Section 14 of the statute, MCL 125.2664 provides that a Brownfield plan is established by City Council approval.

Among other things, the enabling statute provides that the approved Brownfield Plan must provide “the maximum amount of note or bonded indebtedness to be incurred…” MCL 125.2663(2)(e). In this matter that amount is $24,389,518 plus interest (total of $50,217,825). The statute also requires the Plan to provide “…the costs of the plan intended to be paid for with the tax increment revenues…” MCL 125.2663(2)(a). In this matter those costs are set out on Exhibit N, Scenario A, Column 2 of the Development Agreement. The Authority does have the ability to bond as an activity of the Authority. MCL 125.2657(1)(m) provides that the Authority can “Borrow money and issue its bonds and notes…in anticipation of collection of tax increment revenues.” The tax increment revenues, however, must be “…received under a brownfield plan established under Sections 13 and 14.” That is the method authorized by Brownfield Plan #24.
MCL 125.2663b sets out things Tax Increment Revenues cannot be used for. Subsection (6) provides: “An authority shall not do any of the following: (a) Use taxes captured from eligible property to pay for eligible activities conducted before approval of the brownfield plan.” This prohibition is tempered by a provision of subsection (9)(b) allowing for the use of local incremental revenue to pay for: “... any eligible activities conducted on eligible property or prospective eligible properties prior to approval of the brownfield plan, if those costs and the eligible property are subsequently included in a brownfield plan approved by the authority.”

You probably recall, vividly by now since it has become a centerpiece in the discussion of the refinancing bonds, that City Council unanimously approved Brownfield Plan #24 as amended by the Council. It took that action on June 20, 2017. That vote changed the plan by limiting the permissible eligible activities to be compensated by tax increment revenues to those on an exhibit to the Development Agreement and the entire amount of incremental taxes permitted to pay off that amount of bond debt (principal and interest) to about $50+Million. The resolution and other executed documents incorporated by reference the Development Agreement’s Exhibit N, Scenario A, Column 2 as the limit of bonding and of use of tax increment revenues. That exhibit set forth the approved eligible activities, the approved costs associated with those activities and the maximum tax capture to pay for approved eligible costs plus interest.

I have been advised that bond counsel has pointed to language in the Development Agreement, which was also passed on June 20, 2017, as somehow allowing greater use of tax increment financing than was established in the resolution approving the Brownfield Plan. That is an interesting proposition since the Council was very clear on its intent with the resolution. Since our bond counsel was in the room when the Council decision was announced, it would seem that he would have had a duty to advise the Council that there was conflicting language in the Development Agreement at that time. He did not so advise.

The Development Agreement provides that the BRA bond is “…subject to BRA Plan #24 as approved by City Council resolution…” Section I.8. The agreement goes on to provide in that same section “The bond proceeds will be used to pay for the costs of eligible activities which are set forth in Column 2, Scenario A of Exhibit N...The net proceeds of the bonds shall not exceed $24,389,518.” The section goes on to define net proceeds and provides for its computation: “plus any original issue premium, less any original issue discount, less costs of issuance...less any bond proceeds allocated to capitalized interest...and less any bond proceeds deposited into a debt service fund...” Notably, the defined net proceeds are exactly the amount which Council authorized the use of tax increment revenues to pay for. The other items mentioned, cannot be paid for using tax increment revenues.

As I am also advised, bond counsel now argues that the Development Agreement alters the limitations placed on the financing of this project by the Council resolution approving Brownfield Plan #24 through the following language, also from Section I.8. of the Development Agreement: “Notwithstanding any provision to the contrary in this Agreement or in Brownfield Plan #24, the maximum amount of tax increment revenue that may be captured is $55,952,038.” The Development Agreement also provides context for this amount: “…payment
of debt service on the Bonds and, to the extent not needed to pay debt service on the Bonds to reimburse the Developer for the cost of City Approved Eligible Activities, subject to the maximum amount of tax increment revenue that may be captured of $55,952,038.”

Putting aside the dynamics of the actual approval of the Development Agreement and the Brownfield Plan authorizing resolution, the proposed interpretation of this language would require the Council to be depicted as setting a limitation publicly and emphatically which it then negated a few minutes later, also knowingly. The Council has been accused of many things, but this kind of duplicity has not occurred in the 30 years I have been associated with the City.

The language of the phrase seized upon by bond counsel does not support a finding of any conflict with the limitations placed on the project and its bonding by the Council. The phrase does not say “shall be captured”, it says “may” be captured. It is not a “minimum” amount of tax capture, it is a “maximum amount.” You may recall that I made the motion to approve the Bonding and Reimbursement Agreement in this matter, which I discuss later in this communication.

But there is more. The setting of a maximum amount of tax increment revenues that can be captured, and which is in excess of the limitation placed by Council, does not change the definition of eligible activities that can be paid for with tax increment financing. So, even if a bond is issued in excess of the limit placed by Council, the captured revenue can only be used for the eligible activities established by Council. The $55,952,038 provides a cushion and that is all it provides unless the BRA, with Council approval, amends Brownfield Plan #24. I don’t believe that has happened but if you feel that tax increment revenues should be used to pay for items not authorized by the Council in the Brownfield Plan, as amended by Council, I recommend you suggest an amendment, get it approved by the BRA and City Council. That procedure is authorized by statute.

I have also read that there has been argument that the Council authorized the payment of “costs of issuance”. That is simply untrue. In fact, as I pointed out above, payment of those costs, insofar as they represent costs incurred prior to June 20, 2017 cannot be paid by tax increment revenues. Further, the provision which can alter that conclusion for some costs incurred prior to plan approval is limited to costs incurred “on” an eligible property, not costs “associated with” an eligible property, which is what the “costs of issuance” are. To the best of my knowledge, even if the Council had approved payment for “costs of issuance” there has been no audit of those costs to determine what portion precedes June 20, 2017. Given that I was involved in meetings after that date, it is impossible that the amounts attributed to “costs of issuance”, even with the most expensive professionals, could add up to what was charged against that fund. Most of these costs had to relate to the year-long negotiations that preceded June 20, 2017 and the documents prepared during those negotiations.

I have also read that City staff opted to take $335,000 of the interest earned in the bond fund and use that to pay the Developer for City approved cost overruns on the public infrastructure. I want to caution you regarding this just in case the use of these funds was authorized by the BRA. The Development Agreement provides that payment for cost overruns are to be made after “Payment of debt service on the Bonds” and after “Transfer for any deficits in the Debt
Service Reserve Funds under the Indenture” and after “reimbursement to the Developer for any debt service payments previously made by the Developer on the Bonds without interest.” Only after all that, can any remaining dollars be used to pay for cost overruns. And, the money to pay for this comes only from “Captured tax increment revenues that are not needed to pay debt service on the bonds.” See Section I.b. Given the projected shortfall, it seems that these earnings would have been properly utilized to pay “debt service on the Bonds.”

Using the earnings for that purpose would also lessen the burden on the Developer since the Development Agreement, as I mentioned above, provides: “It is also anticipated that as a second level of security for the Bonds the Indenture will provide for the Developer, if necessary, to make certain payments to the Trustee, to pay debt service on the Bonds, in the event that the ELBRA tax increment revenues, together with any debt service reserve funds and other such security under the Indenture and approved by the ELBRA are not sufficient to pay debt service on the Bonds.” As you know, the Indenture you executed, provides exactly for that responsibility.

The Indenture also refers specifically to a “Developer Debt Service Guaranty” which is defined as being “the guaranty of the Developer to make certain payments to the Trustee in order to pay debt service on the Bonds in the event the Tax Increment Revenues, together with any other security under this Indenture, are not sufficient to pay debt service on the Bonds, all as described in Section I.8 of the Development Agreement.” This is the language that makes the predicted default unlikely; unless the Developer does not have the resources to make up the shortfall. In which case the foreclosing entity or its successor would have to do so.

I think it might be useful to discuss a few of the many documents associated with this development and the negotiations surrounding its approval. A “City Center Term Sheet” dated May 17, 2017 and prepared by representatives of the Developer provides for “Total Capture of approximately $55 million ($26,939,437 of Eligible Activities plus interest) to be considered for approval by the East Lansing City Council, as stated in Column 1 of TIF Eligible Expense Scope Description.” By June 1, 2017, the deal had been further negotiated and a “Term Sheet” provided “Proceeds of the approved Brownfield Plan/381 Work Plan will be used to only reimburse a maximum Non-Recourse Bond of $24,389,518 (Net Proceeds) plus interest and associated issuance costs.” Negotiations continued and by June 6, 2017, Lori Mullins advised George Lahanas: “The Brownfield Redevelopment Authority will be asked to issue non-recourse bonds that will be payable only by the tax increment revenue derived from the City Center Brownfield Plan #24. The amount of the bonds will not exceed $24,389,518 which is the total amount of eligible costs associated with public improvements in the plan. These bonds are necessary to finance the public portions of the project.” On June 14, 2017 Laurie advised George: “It is anticipated that there would be a nonrecourse brownfield revenue bond that would be used to finance the public improvements which are brownfield eligible expenses, estimated at $24,389,518. The bonds would be payable from the tax increment revenue from the redevelopment project. Any shortfall in bond payments would be covered by the developer. It is also anticipated that the Development Agreement will limit the reimbursement of Brownfield tax increment revenue to only pay for the debt service on the bonds, thus limiting the reimbursement to only pay for the cost of the public improvements.”
In July of 2017, City staff prepared a “Brownfield Bonding and Reimbursement Agreement” which provided “Eligible activities and the costs of any activity may be adjusted after the date the plan is approved by the ELBRA and the City of East Lansing, so long as the reimbursement does not exceed the combined total of all eligible activity costs to Owner in the amount of $50,217,825.” Also contained in the document is a chart identifying the allowable use of tax revenues as established by Council on June 20, 2017: “total cost of eligible expenses and interest as detailed in the MDA Exhibit N $50,217,825.00” plus “BRA Administration $450,000.00” plus “State Revolving Loan Fund $1,959,935.00”. The total is $52,627,760.00. It should be noted that this amount is the maximum tax capture. Of that amount, the maximum capture for the eligible expenses is the $50 million figure.

That is the limit on the use of tax increment revenues. When that amount is reached, no tax increment revenues can be used to pay any cost associated with this project. Further, the only authorized use of tax increment revenue is for the three items identified by Laurie.

You may recall that Laurie left for greener fields shortly after. By September 2017, a different version of this document was prepared by bond counsel for the developer. It removed the chart prepared by Laurie and eliminated reference to the specific content of the resolution approving Brownfield Plan #24. It added language indicating that the Brownfield Bonding and Reimbursement agreement controls as to any conflict with Brownfield Plan #24, as amended by Council. I moved approval of this version after assurance by staff that the additional items which were included (“costs of issuance”) were the responsibility of the developer and could not be paid for by tax increment revenues.

Peter, the version approved was signed only by you (not approved by Council) and to the extent it purports to be more authoritative than the resolution adopted by Council, is void. The permissible extent of the BRA authority in this matter is as set forth in Laurie’s July version of the Bonding and Reimbursement Agreement, which recites the limitations and authorizations established by Council. The total tax increment revenue that may be authorized is $52,627,760. The maximum tax increment revenue that can be utilized for the eligible expenses of the project is $50,217,525. No expenses other than those set forth in Laurie’s version were ever authorized by Council.

I understand that you and Jim have been authorized to proceed by the BRA. Please consider the above in executing that authority. If the refinancing bond goes out without an explanation of the limitations I have mentioned above, you and the BRA (thus the City) may be found liable notwithstanding the nonrecourse nature of the bonds. That protection would not apply in this instance. Please make sure applicable limitations on reimbursement of the bonds is clearly and prominently stated with regard to them.

I am sharing this communication with Jim, the Mayor, and the City Manager.

Mark