The Case for Rejecting the Core Spaces Proposal

Introduction

The best use of Ann Arbor’s public land is a serious concern for citizens and Council alike. Should the most central parcel remaining in public ownership be sold to a private developer? If so, what is a fair price, and more importantly what is the collective community vision for what should be built? Is there a community consensus for how this central parcel will interact with its neighbors and the rest of downtown? What are the possible legal pitfalls? What are the alternatives, and are they being seriously considered?

We all want the best use of public land that benefits the city for the long term. Our city has grown significantly in the past five years with many new developments on private land. Therefore it is incumbent on citizens and Council to take a fresh look at the proposal for the Library Lot, taking into consideration Ann Arbor’s growing population density and demands for parking, open space and social housing equality issues.

When considering sale of this most central plot of public land, we should be extremely careful to ensure a sale meets both public needs and legal requirements if the parcel is encumbered. Our goal for use must be to enhance the vitality of downtown, offer more (rather than fewer) amenities to residents and visitors to our downtown area, incorporate and show sensitivity to surrounding historic uses, and create a destination that all can be proud of. The Core Spaces proposal raises many legal and financial questions and should be rejected. Council has no obligation to accept this proposal, and has the power to reject it, as specified in the first of the “Additional Provisions” of the Offering Memorandum.” (See full text in Section 6.)

The following is a list of critical issues surrounding the current proposal and decision-making process. They must be adequately addressed prior to the current Core Spaces or any other future private development on this unique piece of public land.

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1. **Legal Overview**

If the City of Ann Arbor finalizes its agreement to sell development rights for the Library Lot to Core Spaces, it may be violating the provision of the Build America Bonds that funded the underground parking lot. Any such violation would result in loss of the Federal subsidy, and could cost the City up to $40 million dollars of interest penalty. The concern, in short, is that the City is selling equity to the private sector from a public project financed by a federally subsidized low interest loan. In addition, for many other reasons this sale is not “in the best interest of the City.” (Offering Memorandum, (Additional Provisions, 1. No Obligation to Proceed, page 24)

2. **The Library Lot Parking Facility**

On November 5, 2007, City Council affirmed in R-07-517 “Resolution Requesting that the Downtown Development Authority Prepare a Written Recommendation for the Construction of an Underground Parking Garage on the City-Owned South Fifth Avenue Parking Lot.”

Following several years of planning, lawsuits, and other negotiations, the underground 5th Avenue parking structure opened in September, 2012. The garage has 738 spaces, many reserved for permit parking. The structure was funded by Build America Bonds; of the approximately $50 million cost, it is estimated that $5 million was allocated to reinforcements to allow building a large structure on top of the lot. However, the project engineer (from Carl Walker Inc.) estimated that 30% of the total project cost, or approximately $15 million, were elements unneeded by the parking structure.

3. **Build America Bonds**

Build America Bonds (BABs) are governmental bonds eligible for certain tax advantages under the Internal Revenue Code (IRC Section 54AA). These BABs were issued in 2009 and 2010 for the creation of the Library Lane structure. They may be used for governmental purposes only, i.e., public use and not more than 10% private use. BABs
provide a Federal subsidy through Federal tax credits to investors equal to 35% of the total interest payable by the issuer to investors.

The bond issuance by the City of Ann Arbor for $49,420,000.00 was prepared by Dykema Gossett PLLC, acting as bond counsel. In their August 19, 2009 letter to the City of Ann Arbor, they wrote:

“…we are of the opinion that the Bonds are “build America bonds” and are “qualified bonds” under section 54AA of the Code. Failure of the City to comply with such requirements could result in the Bonds failing to be “build America Bonds” under section 54AA(d) or “qualified bonds” under section 54AA(g) retroactively to the date of issuance of the Bonds.”

4. Public vs. Private Use of Build America Bonds

There are two private activity bond tests under section 141 of the Internal Revenue Code; failure of either will result in the bonds being classified as private activity bonds, and the tax benefits will be cancelled retroactively.

The first private business test is if more than 10% of the proceeds are used for any private business use. The second private use test is if more than 10% of the bonds are either secured by any interest in property used for a private business use, or derived from payments for property used for a private business use.

5. A Cautionary Tale

It is relevant to note that on November 6, 2014, the Securities and Exchange Commission announced fraud charges against the City of Allen Park, Michigan and two former city leaders in connection with a municipal bond offering. There is a parallel to Ann Arbor: in both cases the initial proposal was for a different project than the final one. For Allen Park, the initial project was a movie studio, but it changed to a vocational school. For Ann Arbor, the original project was a publicly owned “building authority” to be created by City Council to own a hotel/convention center, but it changed to selling the development rights to a private developer.

6. Ann Arbor Offering Memorandum

The February 2015 Offering Memorandum by the City of Ann Arbor, managed by CBRE Group, Inc., was “to acquire and develop the surface of the “Library Lot” parcel totaling approximately 35,112 square feet in downtown Ann Arbor at 319 S. Fifth Avenue. The property sits upon a 711 space, City-owned four-level underground parking garage that
has been constructed to allow for high density development. The City will retain control of the underground parking garage.” “The City’s goal is to provide for a disposition of the property to a private developer or development team for a high density, modern, sustainable urban redevelopment that contributes to the fabric and livability of downtown Ann Arbor.”

In the “Additional Provisions” of the City’s Offering Memorandum, the first one, “No Obligation to Proceed,” is especially relevant to any Council vote on the Core Spaces proposal:

1. No Obligation to Proceed – The city is under no obligation to proceed with this project or any subsequent project, and may cancel this OM at any time without the substitution of another if such cancelation is deemed in the best interest of the City. Furthermore, the City may reject any and all proposals, to waive any irregularities or informalities in a proposal, and to issue a new or modified OM, if it is found to be in the best interest of the City.”

7. Selection of Core Spaces

Following a process in which multiple proposals were reviewed, on January 19, 2016, City Council passed a “Resolution to Affirm and Approve CORE as the selected developer of 319 South Fifth and Authorize the City Administrator and City Attorney to Begin the Negotiation Process for Sale of the Property.” (File ID: 16-0025) Core Spaces is an Illinois-based real estate firm.

8. The Core Spaces Proposal

The Core Spaces proposal, for a 17-story building, includes ground floor retail, office, residential and a boutique hotel. It includes a 12,000 square foot plaza, designed to satisfy the requirement for public space. In exchange for development rights, Core proposes paying the City $10 million (less normal fees and closing costs), and intends to utilize, on a long-term exclusive basis, 200 parking spaces in the underground garage, either purchasing them for $5 million, or leasing them at market rates.

9. Additional Community Benefits

In the approval resolution (File 16-0025), Council authorized the City Administrator and City Attorney to negotiate for the following community benefits as part of a proposed Sale Agreement:
A. Including 10% of all housing units as workforce housing (affordable housing for lower income households).
B. A higher level of LEED Certification than the proposed LEED Silver, with a preference of LEED Platinum.
C. Building and site design that provides improved pedestrian connectivity from Fifth Avenue to Liberty Plaza park, as well as from Blake Transit Center to the site.

Note that these are desired, not required, benefits, and it is up to Core Spaces to agree.

10. Citizen Issues with Core Proposal

Members of Council, the Mayor and the City Administrator have all stressed the importance of public input in this process. Reviewing that input identifies numerous, serious concerns with the CORE proposal that have yet to be addressed.

On October 22, 2015, the City of Ann Arbor presented two “Public Input Meetings” with the development teams from CORE and CA Ventures to present their proposals, as well as the opportunity for the public to comment, ask questions and voice concerns. Both sessions were well attended.

The public gave input orally, electronically (with hand-held response clickers) as well as written on 3 x 5 cards; however, almost none of the public’s questions, comments or concerns were addressed at the meeting. While we were assured that this input would be addressed at a later date, that never happened.

The results were eventually posted online: [http://bit.ly/2dP0i8i](http://bit.ly/2dP0i8i) They indicated serious concerns about the CORE proposal that need to be addressed. Public input in the oral and written phases included serious concerns regarding:

- lack of respect for clearly expressed citizen preference for public use of this space
- the closed nature of the selecting process
- lack of open green space and trees
- lack of meaningful connectivity to Liberty Plaza
- lack of context with the surrounding buildings
- excessive density in limited space
- absence of a more public-friendly option
- inadequate parking
- availability of privately owned land better suitable for this type of development
- $10 million payment for development rights is inadequate.
The most easily quantifiable public input came from the electronic input section. It showed that:

A. A majority Disagreed or Strongly Disagreed that the CORE proposal "has an attractive, aesthetically-pleasing design and/or conveys an iconic image suitable for a site that is in the core of downtown."

B. An overwhelming majority Disagreed or Disagreed Strongly that the CORE design "is in context with its setting, appealing from all four sides and compatible with the character of the district."

In short, the people of the City of Ann Arbor found the CORE proposal unattractive and inappropriate for this important tract of public land.

In addition to the Public Input Sessions of October 22, over 5,000 citizens have signed a petition to have the property “designated, in perpetuity, as an urban park and civic center commons.”

Similarly, the Ann Arbor Democratic Party has passed two resolutions advising the City against commercial development of the lot and directing the City to submit any proposal to approval by the voters.

In short, the public has given much valuable and valid input through organized channels (Library Green Conservancy, The A2 Committee for the Community Commons, A2 Dems), through the City sanctioned Public Input Sessions, and by speaking at numerous City Council Meetings. The public has raised many serious concerns, and has acted in good faith while doing so.

All this focused commentary supports invoking the key statement in the Offering Memorandum: that “the City may reject any and all proposals ... if it is found to be in the best interest of the City.” (Additional Provisions, 1. No Obligation to Proceed, OM, page 24)

City Council needs to show that it, too, has been acting in good faith by publicly addressing the public’s many serious concerns and by rejecting the CORE proposal as inadequate and not in the best interest of the City.

11. Concerns About the “Urban Public Park” on the Library Lot

City of Ann Arbor documents concerning establishing an “Urban Public Park” on the Library Lot contain a number of recommendations and requirements (City of Ann Arbor Text File Numbers 14-0334, 14-0470, and 14-1326 – see links in Section 16 below).
In the “Resolution Designating an Urban Public Park Location on the Library Lot Site,” April 7, 2014, “The fourth resolved clause acknowledges the necessity for the City to work with all the neighboring property owners on the Library Block in order to achieve the pedestrian connectivity that will result in vital, attractive public spaces.”

Possible goals of this collaboration include:

- Reorientation of the physical design and uses of these adjacent properties so that they help to create pedestrian interaction with the public park on the Library Lot Structure,
- Creation of pedestrian walkways that connect the Library Lane Structure and public park to Liberty Plaza Liberty Street and William Street;

To date, neither the City nor Core Spaces has adequately addressed the details and schedule for fulfilling these goals. In its public presentations, Core Spaces has deferred dealing with these questions until its deal with the city is finalized. We believe the City should require a plan with specific objectives and a timetable for fulfilling them before approving any agreement with Core Spaces.

The second resolution, “Encouragement of Creative Public Programming,” lists specific goals for the Library Lot as a public space:

“Whereas, The City Council also approved the PAC recommendations including, but not limited to, the importance of “placemaking” principles and the “activation” of urban public spaces through: pedestrian traffic, relationship to adjacent properties, activities desired by the community, and funding for maintenance and security, as well as close consultation with the Ann Arbor District Library (AADL), and further public input regarding the design and uses of downtown public open spaces; . . .

Again, Core Spaces has not addressed these recommendations, while at a meeting at the downtown library a Core Spaces representative suggested erecting a masonry wall separating their site from the adjacent properties to the north, completely in contradiction to the City’s goals.

12. Financial Concerns About the Core Spaces Agreement

Those advocating on behalf of the CORE proposal argue that the revenue from the new development is the real benefit to the City. This is the implicit argument for building the Library Lane structure to support a tall building: that the City and DDA needed to invest public resources to encourage the private development that would pay taxes to the City during a difficult time. But that argument is disproved by the level of development that has occurred since the Library Lane project was launched. Since 2009 ten large residential developments have been built in or near our downtown, adding 3,117
bedrooms to our housing stock. At least four more already-approved large developments will add another 1,363 bedrooms in the next two years. (These figures do not include many smaller apartment and condo developments already built or in progress.)

The resulting increase in property tax revenue flowing to the City and the DDA from these developments is dramatic. One example: In 2014 Foundry Lofts at 413 E. Huron paid $94,802 in property tax, and in 2016 it paid $963,618 -- a 900% increase in revenue.

If there was ever any need for the City to take a risk with public resources to "prime the pump" for private developers, that need is long gone. The real need is for the City to step up to the reality of more than 5,000 additional residents within the DDA boundaries. The DDA is fighting the wrong battle by working to encourage more big buildings. Instead, the City and the DDA should be working to make the central part of Ann Arbor more habitable for all of the new inhabitants. The glaring absence of public open space in the downtown is becoming more obvious with each additional hundred of new residential units.

As for the need to add new, taxable property, the City Assessor’s published figures show that Ann Arbor’s taxable value is at an all time high. This is a wealthy community. We should not be trading away valuable public assets for short-term, quick cash. Creating more luxury hotel rooms and market rate housing for upper-income residents is not a government priority nor is it a necessary trade-off to address an emergency.

It is questionable whether $10 million is adequate for development rights for a property that required a $50 million loan, especially when the additional costs of interest on the loan are included. First, the property, undeveloped, is worth $6 million (c.f. prospective Dahlmann purchase agreement for former YMCA site). Second, there was $5 million worth of extra cement and steel to create a foundation for a large building on top of the garage site. Third, interest on the $50 million loan will amount to nearly $40 million. Fourth, the cost of each parking space in the underground lot was approximately $70,000; selling 200 for $5 million vastly underestimates both their cost and value ($70,000 X 200 = $14 million).

All these costs should have been considered when Ann Arbor identified a fair cost for developing this central city parcel.

13. Concerns About the Core Spaces Parking Agreement

A September 21, 2016 letter from Tom E. Harrington, Jr., the Core Spaces Director of Acquisitions, to Susan Pollay, Executive Director, Ann Arbor Downtown Development Authority (DDA), identifies the “long term parking agreement to facilitate the development of The Collective on 5th Project.” This letter, and the accompanying Library
Lane Shared Parking Study prepared by DESMAN, raises significant concerns about the negative impact the Core Spaces project will have on downtown businesses and parking access for Ann Arbor’s citizens and visitors.

In this letter, Core Spaces requests the following:

- 196 24-hour equivalent spaces in the underground garage
- 85 standard permit spaces in the 4th & William garage
- 80 additional off peak permits in the 4th & William garage
- Core Spaces will pay DDA’s current monthly rental rate
- "rates shall not increase more than 3% in any given year."
- 20 year term, with 3 renewals = 80 years total
- Core Spaces can sub-lease parking spaces, and "will have complete and sole discretion as to the rate it charges its sub-lessee."

Here are just some of the concerns raised by these demands, quite aside from the question of whether receiving 194 underground spaces violates the provisions of the Build America Bonds (see section 4 above).

A. Are these terms the best deal for the city?
B. Has any other development received an 80-year lease option? Isn’t there a limit on the duration of any deal the City can make with a private entity? Is this negotiation setting a bad precedent?
C. Will allocating an additional 165 parking spaces in the 4th and William garage worsen the already limited parking situation for downtown?
D. Will removing 165 parking spaces in the 4th and William garage discourage people from coming downtown, thereby driving away potential clients and harming Main Street businesses and restaurants?
E. Is this agreement fair to other developers who also seek dedicated parking spaces?
F. Is this agreement fair to all the individuals now on waiting lists for a monthly parking permit? Is the city picking winners and losers with this deal?
G. Are the assumptions made in the DESMAN Parking Study, about which residents and visitors to the building will use cars, valid?
H. Are the conclusions drawn from their assumptions, about peak demand and shared parking spaces, realistic?

In addition to these questions about the potential negative impacts of granting so many additional parking spaces, and the validity of their assumptions, there are other substantial issues that must be addressed.
1. How can the city possibly allow a developer to dictate parking rates in a city-owned public facility? ("rates shall not increase more than 3% in any given year.")

2. By reserving parking spaces in the 4th and William lot for their use, shouldn’t Core Spaces also become responsible for a proportionate share of the facility upkeep, maintenance, insurance, and other operating expenses?

3. Core Spaces is reserving the right to profit from sub-leasing parking spaces that the city paid to have constructed. ("Core Spaces will have complete and sole discretion as to the rate it charges its sub-lessee.")

4. Why is Core Spaces negotiating parking matters with the DDA, without any input from City Council, the City Manager, or the public?

The material in this September 21, 2016 letter adds to all the other evidence presented here arguing that the Core Spaces proposal is not in the best interests of the city, and should not be allowed to move forward.

14. Legal Concerns About the Core Spaces Agreement

A fundamental concern is that the City of Ann Arbor’s agreement with Core Spaces will violate the provisions of the Build America Bonds, and result in revocation of the 35% interest rebate retroactively. At the heart of this concern is whether the proposed deal with Core Spaces will exceed the 10% private use allowed by the Build America Bonds. One issue is that the $5 million cost of reinforcements to the parking structure, only there to support a large building, is already 10% of the total bond. When additional costs are added for infrastructure improvements necessary for a large building, especially on Library Lane, and making parking spaces available for private exclusive use on a long term basis, the Core Spaces project may exceed the 10% private use limit.

The City will claim that the costs allocated for supporting the future building site and infrastructure needs were funded by City Equity, and therefore did not come from the Build America Bonds. This is a rather complex and confusing matter, and how the City has allocated bond funds and juggled monies between public and private benefits is not clear. In any case, the sale or rental of parking spaces in the garage points to another area of concern.

The City of Ann Arbor is fully aware of potential issues with the proposed sale, specifically in an April 14, 2010 letter to the then mayor John Hieftje, City Council members, and Susan Pollay (Ann Arbor DDA) from Noah Hall, of the Great Lakes Environmental Law Center. In the letter he addresses restrictions on the use of Build America Bonds relating to the parking structure project, and discusses the two private use tests. His conclusion follows:
“...there is a legal risk that the bonds used to construct the parking structure and other infrastructure at the site will violate the private activity test, risking millions of dollars in federal subsidy for the City, if the parking structure spaces are contracted to or if special parking entitlements are provided to a private facility. Further, given statements made by the Downtown Development Authority regarding the significant portion of bond proceeds being used for site infrastructure to benefit a future developer including the private development’s share of costs for Library Lane, the service alley, the 12” water main, site work, and building structural support (which appears to solely benefit the private building), even a limited allocation of parking spaces for a private hotel could put the city at risk of losing millions of dollars in federal subsidies.”

From an IRS report (Number: 20044125) released October 8, 2004, Index Number: 141.01-01, “Section 1.141-3(g)(4)(iii) provides, in general, . . . for a facility in which government use and private business use occur simultaneously. . . .” “The average amount of private business use of a garage with unassigned spaces that is used for government use and private business use is generally based on the number of spaces used for private business use as a percentage of the total number of spaces.” This IRS language suggests that the city’s proposal to allocate almost 200 of 711 underground spaces to private use** would mean that approximately 25% of the garage cost should be assigned to private use. This is two and a half times more private use than is allowed in Build America Bond-financed projects. (** “The City is entitled to exclusively transfer up to 200 parking permits in the underground garage for the exclusive use of a developer.” Offering Memo p. 20)

Stephen Kunselman, in a January 19, 2016 letter to City Council, referred to the SEC charges against Allen Park for violating the terms of their bonds; attached the Noah Hall letter; argued for a higher price for development rights; and asked whether any letter has been received from Bond Counsel affirming that the proposed sale conforms to SEC provisions. To date he has received no response about Bond Counsel ruling.

15. Concerns About How Floor Area Ratio (FAR) is Calculated

On page 19 of the Offering Memo, the following statement occurs: “For purposes of the Property’s FAR, Respondents may utilize the total Library Lane parcels consisting of ±1.56 acres.” This has allowed Core Spaces to increase the lot size on which their FAR is calculated from 35,112 square feet to 67,953 sf. This larger base allows Core Space to build a much bigger building than would be allowed if restricted to just the Library Lot footprint. In addition, the inflated site size also allows Core Spaces to escape other requirements that are based upon FAR. For example, in order to build such a large building, a developer who was complying with an accurate (smaller) base measure of the site would be required to meet a more stringent LEED level of energy efficiency, required to provide more affordable housing, and required to provide more
parking spaces. It is not normal to include public right of ways in calculating FAR - in effect saying that part of the street can be included in the site so as to permit development of a larger building.

The legal and financial issues arising from this FAR recalculation are troubling. Since the Offering Memo includes the total Library Lane parcels as part of the private development calculations, the additional infrastructure costs allocated to the Library Lane parcels should also be allocated to private use. On page 20 of the Offering Memo, the city writes the parking structure “was designed and constructed for future high density development. . . . The site was constructed to be ‘development ready’, including such utilities as water mains and electricity.” The consequence of this recalculation will be a determination that more than 10% of the Build America Bond is going to private use, making Ann Arbor vulnerable to forfeiture of the 35% interest rebate, again at a cost of $40 million over the life of the bonds.

16. Conclusion

The Ann Arbor City Council has often expressed its fear of litigation and financial damages while voting for projects that many find inappropriate for the city. This concern for the city’s financial health and fear of litigation is admirable, and should now be extended to further evaluation of the Core Spaces agreement. As outlined above, there is a real danger that the proposed agreement with Core Spaces, for its development and long-term access to parking spaces in the underground lot, will violate the public use provisions of the Build America Bonds. Any such violation could result in loss of favorable interest terms, retroactively and into the future, and cost the city up to $40 million dollars of interest penalty.

The collective impact of (a) discounted sale of the Library Lot, (b) concessions on FAR by including other publicly owned land (i.e., Library Lane), (c) proposed parking agreement at the expense of numerous other parking patrons, (d) detrimental effect of parking concessions on citizens and visitors’ ability to park for access to downtown businesses and restaurants, with negative effect on these businesses -- all equal an enormous public subsidy to a private developer. The City’s net gain will be less than $5 million (after set-aside for affordable housing and closing and legal fees), and a huge building that citizens of Ann Arbor have continually said they do not want.
Furthermore, the Core Spaces proposal also falls short of meeting the City’s defined needs for pedestrian connectivity and activation of the public plaza element. When this is added to the significant legal and financial issues identified above, and the negative impact on public parking availability, we believe Council’s best response will be to thank Core Spaces, reject their proposal, and revisit this central site with fresh eyes. The new perspective must be based on full input from citizens, nearby property owners, area businesses, and developers who understand the best interests of Ann Arbor and join us in planning for the city’s future.

17. Relevant links

Library Lot Development Proposals Public Engagement Summary:

City of Ann Arbor site for Library Lot RFP Responses:
http://www.a2gov.org/departments/city-administrator/Pages/Library-Lot-RFP-Responses.aspx

Ann Arbor Chronicle Articles:
http://annarborchronicle.com/search-results/?cx=003083320230527424487%3Aaqygadm22aik&cof=FORID%3A11&ie=UTF-8&q=parking+garage&sa=Search&siteurl=annarborchronicle.com%2Farchives%2Findex.html&ref=annarborchronicle.com%2Fsearch-results%2F%3Fcx%3D003083320230527424487%253Aaqygadm22aik%26cof%3DFORID%253A11%26ie%3DUTF-8%26q%3DLibrary%2BLot%2Bparking%2Bcosts%26sa%3DSearch%26siteurl%3Dannarborchronicle.com%252F%26cof%3D%253D%26ss%3D6431j1749835j34%2526ss%3D2584j546290j14

Letter from Susan Pollay, DDA Director, to Steve Powers, City Administrator, November 22, 2013, about the Library Lane Parking Structure Design:

Park Advisory Commission (PAC) Recommendation for Redevelopment of Liberty Plaza and Development of the Library Lot (File Number: 14-1326):
Resolution to Direct the City Administrator to List for Sale 319 South Fifth and to Retain Real Estate Brokerage Services (File Number: 14-0470):

Resolution Designating an Urban Public Park Location on the Library Lot Site (File Number: 14-0334):

18. Attachments

Noah Hall letter of April 14, 2010

Contact person for Library Green Conservancy: Peter Nagourney
(nagourney@gmail.com)
The Great Lakes
Environmental Law Center

Protecting the world’s greatest freshwater resource
and the communities that depend upon it

440 Burroughs Street, Suite 111, Box 70
Detroit, Michigan 48202
www.glelc.org

April 14, 2010

Mayor John Hieftje and City Council Members
City of Ann Arbor
Guy C. Larcom, Jr. Municipal Building
100 N. Fifth Avenue
Ann Arbor, MI 48104

CC: Susan Pollay, Ann Arbor Downtown Development Authority

Re: Restrictions on Use of Build America Bonds Relating to
S. Fifth Avenue Parking Structure Project

Dear Mayor and City Council:

The Great Lakes Environmental Law Center offers the following information regarding
restrictions on use of Build America Bonds relating to the S. Fifth Avenue parking
structure project. Given our prior litigation and settlement with the city, we wish to make
explicitly clear that we do not intend to pursue any further legal action on this matter,
either as a party or as attorneys for another party. We are simply providing this
information to assist the city in avoiding any potential liabilities resulting from violations
of the terms and restrictions of Build America Bonds. As stated in the bond offering,
failure to comply with the Build America Bond requirements “may cause loss of the
Refundable Credit to be retroactive to the date of issuance of the Bonds.”

In February and July of 2009, the city of Ann Arbor approved a total of $49,420,000
worth of Capital Improvement Bonds to construct a 677 space, 4 story, underground
parking structure in the city. The bonds are general obligation bonds and were
designated as “Build America Bonds” under section 54AA of the Internal Revenue Code.
More specifically, the bonds are classified as Direct Payment Build America Bonds.
There are three types of Build America Bonds and the particular type issued for the
parking structure provides the issuer, in this case the city, with a Federal subsidy through
a tax credit paid by the Treasury Department and the Internal Revenue Service (“IRS”) in
an amount equal to 35 percent of the total coupon interest payable to investors in these
taxable bonds.¹ Direct Payment Build America Bonds “may be issued to finance

¹ IRS Notice 2009-26, at 1-2.
governmental purposes for which tax-exempt governmental bonds (excluding private activity bonds under §141) could be issued under §103” of the Internal Revenue Code. Therefore, sections 103 and 141 of the Internal Revenue Code govern the use of proceeds from Build America Bonds. If the bonds issued for the parking structure would be considered “private activity bonds” under §141, then that particular use for the bonds is impermissible. Just like tax-exempt bonds, proceeds from Build America Bonds must be used for public and not private use.

A bond is a private activity bond if it meets the (A) private business use test and (B) private security or payment test. These are known as the private business tests. If the Build America Bonds are used to finance parking for a private facility such as a hotel, as the city may be considering, there is a risk that the terms of the Build America Bonds will be violated and the City will lose millions of dollars in federal subsidy.

The purpose of the private activity bond tests of section 141 is to “limit the volume of tax-exempt bonds that finance the activities of nongovernmental persons, without regard to whether a financing actually transfers benefits of tax-exempt financing to a nongovernmental person.” According to the IRS regulations regarding section 141, that section “may not be applied in a manner that is inconsistent with these purposes.” Additionally, these tests may be met even if at the exact time of issuance of the bonds the proceeds were planned to be used for not more than 10% private use. If the issuer of the bonds “reasonably expects,” as of the issue date, that the issue will meet either of the private activity bonds tests of section 141, then those bonds are private activity bonds. Further, if the issuer takes any “deliberate action, subsequent to the issue date, that causes the conditions of either” of the tests to be met, those bonds are also classified as private activity bonds. A deliberate action is any action that is within the issuer’s control. Intent to violate section 141 is not necessary for an action to be considered deliberate. The only reason an action would not be considered deliberate is if it is an involuntary or compulsory conversion or it is taken in response to a directive action made by the federal government.

An issue meets the private business use test if more than 10% of the proceeds are to be used for any private business use. Presumably, the parking structure does not itself cause this test to be met, although there is still some uncertainty regarding the amount of bond proceeds being used to support future private development at the site rather than construction of public parking spaces. However, if the parking spaces are used for private facility parking in the future, that could cause the bonds to be classified as private activity bonds. If more than 10% of the proceeds of an issue are used in a business of a

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2 Id. at 4.
3 26 CFR 1.141-2(a).
4 Id.
5 26 CFR 1.141-2(d)(1).
6 Id.
7 26 CFR 1.14102(d)(3).
8 Id.
10 Id.
nongovernmental person or a combination of nongovernmental persons then the private business use test is met. Generally, the private use test is met if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. However, a special economic benefit to a private party may also be sufficient. There are many arrangements that would cause the private use test to be met. For example, if the infrastructure built with the proceeds of the Build America Bonds (such as the parking spaces) are contracted to a private person or entity or if that private person or entity has a special entitlement or priority to use the spaces, rather than being solely available for use by the public, the private use test will be met. It does not matter if this arrangement is fashioned after the issuance of the bonds, or even after construction of the structure. Entering into an arrangement that would provide a special entitlement to a person in a private business, or more simply, to a nongovernmental person, would no doubt be a deliberate action within the control of the city and therefore the bonds would become classified as private activity bonds.

The second private use test is met if the payment of the principal (or the interest on the principal) of more than 10 percent of the proceeds of the issue is either:

(A) secured by any interest in

(i) property used or to be used for a private business use, or

(ii) payments in respect of such property, or

(B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

The payment of, or security for, debt service is determined from both the terms of the bond documents and any underlying arrangements. Underlying arrangements may be the result of separate agreements between parties or may be determined by all the facts and circumstances surrounding the issuance of the bonds.

If a nongovernmental person engaged in a private trade or business makes a payment to the city, directly or indirectly, for use of parking spaces in the new structure, that would be a private payment for use under section 141. Whether a private payment for use of property is made under an arrangement that is entered into in connection with the issuance of an issue is determined on the basis of all of the facts and circumstances, but is treated as such if: (A) the issuer enters into an arrangement during the three year period beginning 18 months before the issue date; and (B) the amount of payments reflects all or a portion of debt service on the issue. If the City enters into an arrangement within 18 months of the issue date whereby the private owners of a future facility will pay the city an amount at least equal to 10 percent of the proceeds from the bonds used to finance the parking structure, the private payment test will be met. If the arrangement is made after

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11 26 CFR 1.141-3(a)(1).
12 26 CFR 1.141-3(b).
13 26 CFR 1.141-3(b)(2).
16 Id.
18 months have passed, all of the facts and circumstances will be considered to determine if the arrangement was entered into in connection with the issuance of the bonds.

As described above, there is a legal risk that the bonds used to construct the parking structure and other infrastructure at the site will violate the private activity test, risking millions of dollars in federal subsidy for the City, if the parking structure spaces are contracted to or if special parking entitlements are provided to a private facility. Further, given statements made by the Downtown Development Authority regarding the significant portion of bond proceeds being used for site infrastructure to benefit a future developer including the private development’s share of costs for Library Lane, the service alley, the 12” water main, site work, and building structural support (which appears to solely benefit the private building), even a limited allocation of parking spaces for a private hotel could put the city at risk of losing millions of dollars in federal subsidies. We urge the City to consider these risks in making decisions about future development arrangements at this site.

Respectfully Submitted,

[Signature]

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On Tuesday, January 19, 2016 5:11 PM, Stephen Kunselman <stephenkunselman@yahoo.com> wrote:

Dear City Council,
I am hoping during your discussion of the Library Lot development rights sale, that the importance of ensuring the sale complies with the SEC requirements for the original bond sale will be discussed openly. I've attached the link to the SEC judgement against Allen Park that illustrates the importance of abiding by the law SEC.gov | SEC Charges Allen Park, Mich. and Two Former City Leaders in Fraudulent Muni Bond Offering for Movie Studio Project

SEC.gov | SEC Charges Allen Park, Mich. and Two Former
FOR IMMEDIATE RELEASE 2014-249
Washington D.C., Nov. 6, 2014 —
View on www.sec.gov Preview by Yahoo

There is much to be concerned about with the direction this proposed sale is going:

A). The original Library Lot proposal was for a publicly owned "building authority" to be created by City Council to own a hotel/convention center with the backing of the full faith and credit of the City. Hence the Bond sale may have been premised on this scenario, but that is no longer the proposal - similar to the Allen Park case.

B). The $10 million purchase price offer is less than what the value of the development rights are when one includes the interest charged to the $50 million loan. The property is easily worth $5 million (Y-lot sold for about as much), and there is $5 million worth of extra cement for the foundation according to a number of public statements - but there's no inclusion of any amount of the $30 million of interest from the government subsidized low interest loan. It's as if the City is cashing out it's equity from a Federal low interest loan with private use restrictions and in turn subsidizing private development by not charging for the interest accrued on the $5 million used for the extra cement. It's also interesting to note that the $5 million in cement is 10% of the $50 million loan, which I believe is the threshold for the private use restrictions of the Build America Bonds. If there's more than $5 million attributed to private use, than it seems the sale would violate the threshold.

C. The 2010 letter from Noah Hall (attached) details a number of concerns about the parking arrangements that have been proposed back when the proposal was a public project. With the proposed sale to a private purchaser, he states, "Presumably, the parking structure does not itself cause this test to be met, although there is still some uncertainty regarding the amount of bond proceeds being used to support future private development at the site rather than construction of public parking spaces."

Clearly, unless you have received a letter from Bond Counsel (which I asked for many times, even having met with Bond Counsel) that this sale is legit with the SEC, this sale could be a problem. Considering the SEC judgments against the Mayor and Administrator of Allen Park, I implore you to not jeopardize the career of Tom Crawford, City of Ann Arbor Interim Administrator, in this effort.