



CHALLENGING TIMES CALL FOR LAYERED INCENTIVES FOR DISTRESSED PROPERTIES

by Richard A. Barr* and Megan C. McCulloch**



Introduction

Distressed properties present unique redevelopment challenges even in the best of economic times. With the change in the economic landscape, making redevelopment projects feasible (or projects feasible, for that matter) has become even more challenging. During tough economic times, creative blending, combining, or layering of various property redevelopment incentives is a key to increasing the viability of a project. Unfortunately, some incentive programs cannot be used together, so an early evaluation of which combination of incentives will maximize the benefits for a proposed project is imperative. As project conditions and assumptions change, this evaluation may need to be revisited.

To illustrate the benefits of leveraging, several of Michigan's strong distressed property redevelopment incentives are highlighted, which include a suite of tax abatements, tax exemptions, tax credits, tax increment financing, and other sources of funds, such as grants and revolving loan programs. General incentives principles that require consideration are also discussed.

Major Michigan Incentives to Consider for Distressed Properties

Two key questions to ask before evaluating which incentives are available for distressed property are:

1. Is the distressed property in a qualified local unit of government (also known as a "Core Community") or a "Distressed Area"? Several incentives are reserved for distressed properties in these Core Communities¹ or Distressed Areas.²
2. What was the former use of the property, what is the current use of the property, and what is the future use of the property? Property use affects the availability of various incentives. For example, tax abatements under Public Act 198 of 1974 (PA 198)³ generally are available for

- 1 List of Qualified Local Units of Government (Core Communities): http://www.michigan.gov/documents/deq/deq-rrd-Qualified-LJGs-3-23-09_272341_7.pdf
- 2 List of Eligible Distressed Areas: <http://www.michigan.gov/mshda/0,1607,7-141-181277-,00.html>
- 3 MCL § 207.551 *et seq.*

* RICHARD A. BARR is a partner in the Detroit office of Honigman Miller Schwartz and Cohn LLP and is the co-chair of its Investment Incentives and Tax Savings Group and a member of the Environmental Law Department. His practice focuses on brownfield redevelopment and the creative use of economic development and incentive programs. Richard is involved with legislative, stakeholder and policy groups, including the Michigan Department of Environmental Quality's Part 201 Advisory Group and its recent Part 201 Discussion Group.

** MEGAN C. McCULLOCH is an associate in the Detroit office of Honigman Miller Schwartz and Cohn LLP and is a member of its Environmental Law Department and its Investment Incentives and Tax Savings Group. Megan focuses on brownfield redevelopment and incentive programs as well as environmental enforcement, remediation, and contaminated sediment management.

manufacturing businesses that are expanding/building new facilities or are rehabilitating existing facilities, and the scope of other eligible projects under this 35 year old law has been expanded in recent years.

These key questions go to the heart of a proposed project's eligibility for certain incentives and help define the universe of potentially available incentives. Many of the key Michigan incentives available for distressed properties are discussed below.

A. Tax Abatements and Exemptions

Tax abatements and exemptions often provide very favorable benefits to owners of distressed property. Several of the most common tax abatements and exemptions that are applied to distressed properties are discussed below.

1. Obsolete Property Rehabilitation Act

The Obsolete Property Rehabilitation Act (OPRA)⁴ offers a partial property tax "freeze" for certain rehabilitated housing and commercial facilities in Core Communities. Upon issuance of an OPRA exemption certificate by the State Tax Commission, the taxable value added to the property's building and improvements as a result of the rehabilitation project is not added to the taxable value prior to the addition or rehabilitation for the purpose of most property taxes for up to 12 years. The partial "tax freeze" generally does not affect school operating taxes or the state education tax. However, the State Treasurer may exempt one-half of those taxes for a period of up to 6 years, but only 25 such additional exemptions may be approved per year by the State Treasurer. Land and personal property continue to be fully taxed.

To qualify for this program, the aggregate cost of improvements must equal at least 10% of the property's value at the time the rehabilitation project commenced. Additionally, to obtain an OPRA exemption certificate, the local unit of government must first approve an OPRA district and an OPRA exemption certificate for the project. The local unit of government has discretion over the duration of the OPRA. Please note that under current law, no new OPRA exemption certificates may be issued after December 31, 2010.

⁴ Obsolete Property Rehabilitation Act, Public Act 146 of 2000, MCL § 125.2781 *et seq.*

2. Commercial Rehabilitation

The Commercial Rehabilitation Act (CRA)⁵ is similar to the OPRA with a few important exceptions. First, the program is not limited to Core Communities. Second, the county government where the property is located must approve the CRA exemption. Third, the exemption may only be approved for up to 10 years (as opposed to up to 12 years under OPRA). Fourth, the building must be at least 15 years old or have been allocated New Markets Tax Credits or the property must be intended for use primarily as a retail supermarket, grocery store, or produce market (referred to as a "qualified retail food establishment"). Fifth, the property comprising the commercial rehabilitation district must meet certain size requirements unless it is located in a downtown or business area or unless it contains a qualified retail food establishment. Finally, the State Treasurer does not have the authority to exempt a share of school operating taxes or state education taxes. Thus, because of the significant differences between OPRA and CRA, the OPRA abatement is a more valuable abatement. Note that no new exemption certificates may be issued by the State Tax Commission under the CRA after December 31, 2015. The CRA and the OPRA are two of the few programs that provide a real property tax freeze or exemption for retail, mixed-use, and commercial redevelopment projects.

3. Commercial Redevelopment

The Commercial Redevelopment Act⁶, restored in 2008 after expiring in the 1980s, allows *cities or villages* to offer a 50% property tax abatement for new commercial facilities and a frozen tax base for rehabilitation projects. All commercial property qualifies except for some bank properties and apartments/housing, and property owned by public utilities. The abatement may be granted for up to 12 years and the State Treasurer may exempt one-half of the state education tax for up to 6 years, but only 25 such additional exemptions may be approved per year by the State Treasurer.

4. Industrial Property Tax Abatement ("Act 198")

Any local government in Michigan may offer 50% property tax abatements for new construction and equipment related to manufacturing, high-technology,

⁵ Commercial Rehabilitation Act, Public Act 210 of 2005, MCL § 207.841 *et seq.*

⁶ MCL § 207.651 *et seq.*

and certain other activities for up to 12 years.⁷ The State Treasurer may exempt real property from one-half or all of the number of mills levied under the state education tax. (Industrial personal property may already be exempt from the state education tax.⁸) For rehabilitated or replacement facilities, a freeze of the taxable value of the property for up to 12 years may be approved. A construction period of typically up to 2 years may be added to the abatement term. A written agreement with the local governmental unit is required in connection with the approval of abatements under Act 198; communities often seek claw-back provisions or other penalties if a company does not complete and operate the promised project for the entire abatement period.

5. Neighborhood Enterprise Zones

The Neighborhood Enterprise Zone (NEZ) Act⁹ allows Core Communities to offer a tax reduction in the form of a reduced tax millage rate for owner-occupied new residential construction, rental units in a mixed-use building located in a qualified downtown revitalization district, the rehabilitation of existing structures for residential uses, and owner-occupied units in neighborhoods that were platted before 1968. A certificate may last between 6 and 15 years, as determined by the local unit of government. In the case of rehabilitation projects in qualified historic buildings, the certificate may last for up to 17 years.

The tax reduction differs depending on the type of unit. A newly constructed unit will be taxed at a rate equal to one-half of the statewide average property tax rate, which in Detroit results in an approximate 70% property tax reduction. The tax on a rehabilitated unit will include all current taxes that apply in the local municipality, but will be applied against the pre-rehabilitation value of the unit for the duration of the certificate. A homestead facility will be taxed at a rate equal to one-half of the applicable city and county operating millages plus the full rate of the other taxing entities. A "phase-out" provision is included in the law, providing that the abatement is reduced incrementally during the last three years of the certificate.

6. Wayne County TURBO

To facilitate investment in Wayne County, this innovative program uses the Wayne County Land Bank

⁷ Plant Rehabilitation and Industrial Development Districts Act, Public Act 198 of 1974, MCL § 207.551 *et seq.*

⁸ The Revised School Code, MCL § 380.1211.

⁹ Neighborhood Enterprise Zone Act, Public Act 147 of 1992, MCL § 207.771 *et seq.*

to provide benefits of up to a 100% real property tax exemption in the first year, followed by up to 5 years of reimbursement of the equivalent of 50% of the total real property taxes. If the 100% real property tax exemption is sought, concurrence by the local unit of government usually is required. To utilize this program, title must be transferred to the Wayne County Land Bank and a development agreement must be executed with the Wayne County Land Bank. The program was developed under the Land Bank Fast Track Act.¹⁰

7. Public Act 328 Personal Property Exemption

Under Public Act 328 of 1998,¹¹ local governments with eligible "distressed areas" can offer a 100% property tax exemption for all new personal property acquired by businesses that are engaged primarily in manufacturing, mining, research and development, wholesale trade, or office operations, and are located within one of several different types of zones or districts within the local unit.¹² Retail is not an eligible activity. If the business is not located within one of the zones, the local unit must create a district before the exemption may be approved. The exemption must be approved by the State Tax Commission to become effective. The exemption is available for all newly purchased or leased personal property, as well as any used property that will be moved to Michigan for the first time from another state or otherwise initially becomes subject to property tax in Michigan. The local unit may set the duration of the exemption; there is no statutory limit to the duration of the exemption. Some local units have granted exemptions for as long as 50 years under this program.

8. Renaissance Zones

One program that is exclusively targeted to economically distressed or disadvantaged areas is the Renaissance Zone program.¹³ Renaissance Zones are

¹⁰ Public Act 258 of 2003, MCL § 124.751 *et seq.*

¹¹ Public Act 328 of 1998, MCL § 211.9f.

¹² "Eligible districts" mean industrial development districts (Public Act 198 of 1974, MCL § 207.551 *et seq.*), renaissance zones (Public Act 376 of 1996, MCL § 125.2681 *et seq.*), enterprise zones (Public Act 224 of 1985), brownfield redevelopment zones (Public Act 381 of 1996, MCL § 125.2651 *et seq.*), empowerment zones (subchapter U of chapter 1 of the Internal Revenue Code of 1986, 26 USC § 1391 *et seq.*), authority districts or development areas from the Tax Increment Finance Authority Act (Public Act 450 of 1980, MCL § 125.1801 *et seq.*), authority districts from the Local Development Financing Act (Public Act 281 of 1986, MCL § 125.2151 *et seq.*), or downtown districts or development areas from the Downtown Development Authority Act (Public Act 197 of 1975, MCL § 125.1681 *et seq.*), MCL § 211.9f(7)(e).

¹³ Michigan Renaissance Zone Act, Public Act 376 of 1996, MCL § 125.2681 *et seq.*

state designated zones scattered across approximately 152 locations in 38 counties in Michigan¹⁴ in which businesses are exempt from virtually all state and local taxes attributable to its activity within the zone. Taxes that are subject to the exemption include the personal income tax (for residents of the zone), Michigan Business Tax, property taxes imposed for operating purposes and the utility users tax.¹⁵ Property taxes levied for non-operating purposes (e.g., debt millages) and state sales tax are not exempted in the zones. Eligibility for exemption is not restricted with respect to type of business activity, and existing facilities qualify as well as new ones. Several special Renaissance Zones to promote particular activities include: Tool and Die Recovery Zones,¹⁶ Agricultural Processing Facilities,¹⁷ Renewable Energy Facilities,¹⁸ Forest Products Processing Facilities,¹⁹ Pharmaceutical Recovery Zones,²⁰ and Alternative Energy Zones.²¹

Benefits for the first zones established begin to expire in 2008; however, recently enacted legislation allows for the extension of many of the existing zones and permitted local jurisdictions that already have zones to create new ones. Taxpayers who are delinquent in any state or local tax are disqualified from the exemptions.

B. Brownfield Redevelopment Incentives

In addition to traditional brownfields created by past releases of hazardous substances, many brownfields now exist in Michigan not because of contamination, but because they are "functionally obsolete" or "blighted" properties. Functionally obsolete properties include those that are unable to be used to adequately perform the function for which it was intended due to a substantial loss in value resulting from factors such as overcapacity, changes in technology, deficiencies or superadequacies in design, or other similar factors that affect the property itself or the property's relationship with other surrounding property.²² Blighted properties include those that are (1) declared a public nuisance in accordance with a municipality's code or ordinance, (2) an attractive nuisance to children, (3) are a fire hazard or otherwise dangerous to public safety, (4) have had the utilities, plumbing, heating, or sewerage permanently

disconnected, destroyed, removed, or rendered ineffective so that the property is unfit for its intended use, (5) are tax reverted, (6) are owned by a land bank fast track authority, or (7) have substantial subsurface debris rendering the site unfit for its intended use.²³ Thus, there are many ways for properties to qualify as brownfields even if they are not environmentally contaminated.

1. Brownfield Redevelopment Tax Increment Financing

Brownfield tax increment financing (TIF) is the core brownfield redevelopment incentive in Michigan. Under a "Brownfield Plan," which must be approved by a local governmental unit, a developer may receive dollar-for-dollar reimbursement of certain eligible brownfield redevelopment expenses. In general, TIF incentives are available for "eligible activities" on "eligible property." The scope of these terms differs depending whether the property is located in a Core Community or a non-Core Community or whether the property is owned by a land bank fast track authority.²⁴

Eligible activities in all communities include site investigation, baseline environmental assessments, due care activities, demolition, additional environmental response activities, lead and asbestos abatement,²⁵ and the cost of preparing a Brownfield Plan and related work plans.²⁶ In the 104 "Core Communities" (which typically are Michigan's more urbanized or economically impaired communities), the eligible activities also include site preparation, relocation of public buildings, public infrastructure improvements, and the acquisition of property by a public "land bank."

Under the TIF process, a "Brownfield Redevelopment Authority" (BRA) captures tax increment revenues generated by the redevelopment of eligible property and applies those revenues to reimburse a developer for the cost of eligible activities on the property, and also may fund a local site remediation revolving fund for use at other eligible properties in the community. In some circumstances, a BRA can fund a project through the issuance of bonds, or by using TIF revenues generated by other projects. State approval is required for some of the eligible activity costs if tax increment revenues

14 For a list of Renaissance Zones, see: <http://ref.michigan.org/medc/services/sitedevelopment/renzone/>

15 The exemption may be provided in the form of a tax credit. See MCL § 125.2689.

16 MCL § 125.2688d.

17 MCL § 125.2688c.

18 MCL § 125.2688e.

19 MCL § 125.2688f.

20 MCL § 125.2688a.

21 MCL § 125.2688a.

22 MCL § 125.2652(r).

23 MCL § 125.2652(e).

24 MCL § 125.2652(m).

25 Under Part 201 of the Natural Resources and Environmental Protection Act, MCL § 324.20101 *et seq.*, a property is not considered contaminated solely because of the presence of lead or asbestos in buildings.

26 MCL § 125.2652(m) (definition of eligible activities); MCL § 125.2652(n) (definition of eligible property).

from school operating taxes or the state education tax (SET) will be captured by a BRA.²⁷

2. MBT Brownfield Redevelopment Tax Credits

A Michigan Business Tax (MBT) Brownfield Redevelopment Credit²⁸ of up to 20% of eligible investment for a project can be obtained by an owner or lessee of a property that is the subject of a Brownfield Plan. The credit can be approved at a rate of up to 12.5% for most projects, and up to 20% (15% after December 31, 2010) for urban development area projects (defined generally to include Core Community downtowns, central business districts, and traditional commercial corridors). The credit can be as high as \$30 million (12.5% of a \$240 million eligible investment or 20% of a \$150 million eligible investment).²⁹ The credit can be carried forward for up to 10 years and can be assigned, or can be claimed as a discounted refundable credit at the rate of 85% of the face amount of the approved credit.³⁰ The project expenses eligible for calculation of the credit include most "hard" and some "soft" costs expended on the development (excluding acquisition costs and those costs covered by TIF), including demolition of existing structures; construction, restoration, alteration, renovation, or improvements to buildings; and additions of machinery, equipment, or fixtures to the property. This program has been an effective tool to offset potential cost differentials between developing in urban areas and "green space" (a rural or previously undeveloped area). The number of credits that may be awarded in any one year is limited, and various policies are employed by the State to allocate credits to the projects that best fit those policies.

C. Other Tax Increment Financing Authorities

Other tax increment financing authorities (TIFAs) that may be available to provide support for a redevelopment project include Local Development Finance Authorities,³¹ Downtown Development Authorities,³² Corridor Improvement Authorities,³³ and SmartZones.³⁴ These TIFAs may provide funding for site costs and infrastructure, including roads, sewers, and utilities.

²⁷ MCL § 125.2665.

²⁸ MCL § 208.1437.

²⁹ MCL § 208.1437(1)-(4).

³⁰ MCL § 208.1437(18).

³¹ Local Development Financing Act, Public Act 281 of 1986, MCL § 125.2151 *et seq.*

³² Downtown Development Authority Act, Public Act 197 of 1975, MCL § 125.1651 *et seq.*

³³ Corridor Improvement Authority Act, Public Act 210 of 2005, MCL § 125.2871 *et seq.*

³⁴ SmartZones are created under the Local Development Financing Authority Act.

D. Other Tax Credits

Other tax credits that may be available include Historic Preservation Credits (State and Federal), New Markets Tax Credits, MEGA Job Credits, Federal Job Credits, Low Income Housing Tax Credits, Film Incentives, Alternative Energy, and Advanced Battery Credits. Eligibility for these credits is highly fact-specific.

E. Other Sources of Funding

For environmentally contaminated properties, site assessment and/or cleanup assistance may be available through the local unit of government or other public bodies in the form of revolving loan programs (e.g., revolving fund capitalized by United States Environmental Protection Agency (U.S. EPA) revolving loan fund, Clean Michigan Initiative Brownfield Redevelopment Loan Program, Michigan's Revitalizing Revolving Loan Program, local site remediation revolving fund), site assessment grants (e.g., funds from U.S. EPA's site assessment grant program, Clean Michigan Initiative Brownfield Redevelopment Grant Program, Michigan's Site Assessment Fund Grants³⁵), and site remediation grants (e.g., U.S. EPA's cleanup grant program, Clean Michigan Initiative Brownfield Redevelopment Grant Program, Michigan Site Reclamation Grants). The availability of these types of funds should be evaluated as early as possible in a project because they have their own eligibility requirements and timelines as well as limited funding or appropriations.

General Incentive Principles

A. "But For" Principle

Many incentives programs subscribe to the "but for" principle: "But for" the taxpayer receiving the incentive, the project would not move forward in the proposed location. For those incentives programs that do not explicitly apply the "but for" principle, the "but for" principle often creeps into discussions with incentives managers and is important for bargaining leverage. Thus, it is key to avoid commitments to a location, making announcements about the proposed project, signing leases, or commencing construction prior to discussing, applying for, and receiving the desired incentives.

³⁵ Funding for Michigan's Site Assessment Fund Grants has been exhausted and no additional funding rounds are anticipated. Michigan Department of Environmental Quality Grants and Loans Catalog, available at http://www.michigan.gov/documents/deq/deq-essd-grantsloans-catalog_210643_7.pdf

B. Location and Timing

Location, location, location. Some incentives programs are only available in certain areas of the State (e.g., "eligible distressed areas," "Core Communities," Renaissance Zones). Evaluating whether the property of interest is within these areas is an important first step in determining which incentives are appropriate for the proposed project.

Timing, like location, is critical. In addition to the "but for" principle, which adds an element of timing into a project, many incentives programs have statutory requirements regarding deadlines and the sequence of approvals and other events. Some of these deadlines and sequences of approvals and events can be time consuming and lengthy and because they are required by statute, cannot be waived or "speeded up." Thus, incentives and their timing should be evaluated as early as possible in the life of a proposed project to increase the opportunities to obtain incentives and to minimize the potential disruption to the proposed project's schedule (financing and construction schedules).

C. Turning Incentives Into Equity

Some incentives may be turned into sources of equity for the redevelopment project. For example, MBT Brownfield Redevelopment Credits³⁶ may be sold by developers, who typically lack significant tax liability under the MBT Act,³⁷ to entities that have significant tax liability under the MBT Act. Or, for developers who do not opt to sell their MBT Brownfield Redevelopment Credits, recent changes to the law allows them to claim the credit as a refundable tax credit calculated at 85% of their value.³⁸ These tax credits may plug gaps in financing or, depending on their size, be a significant source of equity for a project.

Principles of Leveraging

A. Understanding How the Current Taxable Value and Anticipated Future Taxable Value of The Property Affects the Value of the Incentives

The current taxable value and the anticipated taxable value of the property when the project is complete strongly influences the value of the incentives and

³⁶ MCL § 208.1437.

³⁷ Michigan Business Tax Act, Public Act 36 of 2007, MCL § 208.1101 *et seq.*

³⁸ MCL § 208.1437(18).

which mix of incentives is appropriate for a particular redevelopment project. For example, the greater the difference between the initial or current taxable value and the anticipated taxable value (e.g., the "delta"), the more valuable an OPRA freeze on the real property becomes compared to a 5 year-50% rebate under Wayne County's TURBO program. The timing/staging of the construction also influences the value of the incentives because it directly affects how the annual taxable value of the property increases. The expected delta along with the timing/staging of the construction should be evaluated to determine which mix of incentives is most valuable for the project.

B. Specific Taxes Versus Ad Valorem Taxes

Some tax abatements and tax exemptions are actually specific taxes as opposed to general ad valorem taxes. These specific taxes are, for the most part, capturable by tax increment financing authorities (e.g., brownfield redevelopment authorities), which makes leveraging these incentives as part of a brownfield redevelopment project possible. However, it is important to carefully evaluate each incentive tool and confirm which, if any, of the incentives can be combined with other incentives under consideration for a project.

C. Knowing When to Say "When" and Not to Ask For More (aka "Politics")

Often the decision about which combination of incentives to pursue involves an evaluation of the politics of "asking for more." Understanding the political dynamics at both the state and local levels is imperative because asking and pushing for "too much" may lead a state or local governmental body or agency to turn down the request for incentives either in its entirety or to approve a much narrower incentives package than it would have had the initial request from the developer been perceived as reasonable. At the same time, creatively finding ways for the developer, the municipality, and the state to each "win" may result in greater incentives for the proposed project. Thus, in determining what package of incentives will yield the greatest benefit for the proposed project, politics and perceptions of fairness cannot be ignored.

Hypothetical Case Study

A large, functionally obsolete building in Detroit will be redeveloped into a modern mixed-use, commercial/office building. The current taxable value of the property is roughly \$1,000,000. The redevelopment is expected to increase the taxable value to approximately \$4,400,000 over the course of four years. The capital investment



in the project is anticipated to be \$8,900,000 and the brownfield tax credit eligible investment is anticipated to be \$7,600,000. The following incentives may be available for the project:

- 20% MBT Brownfield Redevelopment Credit of \$1,520,000
- Brownfield Tax Increment Financing of \$1,300,000 (possibly plus interest)
- OPRA property tax savings of \$2,600,000 over 12 years

Thus, approximately \$5,420,000 in incentives (possibly plus interest) may be leveraged for the project.³⁹

³⁹ Additional incentives may be available through other programs, such as Wayne County's TURBO Program.

Conclusion

Leveraging redevelopment incentives with other incentives can make projects feasible. Michigan has a broad range of incentives available for redevelopment projects. To maximize the benefits from incentives programs, the range of potential incentives should be evaluated early in the life of a proposed project because many incentives programs have eligibility requirements and statutory timelines for application and approval that can affect how the project is structured. Additionally, some incentives programs cannot be combined, so the early evaluation of the range of incentives available should also include an analysis of which combination of incentives will provide the maximum benefit. Thus, when it comes to incentives, the earlier they are considered in the life of a project, the greater the likelihood of maximizing their benefit.