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City Council  
City of Rochester Hills  
1000 Rochester Hills Drive  
Rochester Hills, MI 48309

Re: *P.A.C.E.*

Dear City Council:

City Council's discussion, last month, over establishment of a Property Assessed Clean Energy district and program spawned a number of questions, many of which have been addressed by City staff and Levin Energy Partners through supplemental information. Additionally, there were legal questions relating to the City's risk or exposure in the event of the energy project owner's bankruptcy.

Generally, a municipality will be able to recover the property taxes owed to it even though the debtor has filed for bankruptcy. What the municipality can do to collect the tax may be restricted by the bankruptcy and the automatic stay provisions under the bankruptcy code, but the taxes would not be extinguished or forgiven by the bankruptcy. That is because under state law, MCL 211.40, property taxes are given a first priority lien. Bankruptcy Code Sec. 362(b)(18) further permits property taxes to become liens even after bankruptcy is filed. The City's property tax lien ordinarily will survive the bankruptcy and will be given priority for payment upon the sale of the property to which the lien is attached, so the tax claim should be paid in full either through a reorganization or liquidation plan, a sale in the bankruptcy, or through lifting of the automatic stay and a tax sale.

Ordinarily, payment of a debt to a secured private lender would have a lower priority than the City's property tax lien. But the PACE law potentially affects that. Under the PACE program, the funding for the energy project would come from owner-arranged financing from a commercial lender, but the financing would be paid back through a voluntary special assessment imposed by the City. The special assessments can be paid to the City for forwarding to the commercial lender, or may be paid directly to the commercial lender. Under the PACE law, MCL 460.943, the PACE assessment will constitute a lien against the property which will run with the property and have the same priority and status as other property tax and assessment liens. Consequently, the obligation in the form of special assessments will constitute a lien having the same priority status as the City's property taxes.

Concern was expressed at the last City Council meeting that the elevation in priority status of the PACE assessment to the same level as the City's property taxes potentially places the City's tax recovery at risk. Ordinarily, in a bankruptcy situation, the City's taxes, having a higher priority, would get paid fully before the bankrupt's assets would be applied toward repayment of secured and unsecured creditors, including a commercial lender. But, in a scenario where the commercial loan is secured by a PACE assessment lien, the PACE lien will have the same priority as the City's property tax lien and will be paid proportionately with the property taxes, rather than after the property taxes. Thus, in a scenario where the bankrupt's liquid assets are less than the property tax and PACE assessment debt, there is risk that the City's taxes won't get fully paid first, but rather, will be paid proportionately along with the commercial loan secured by the PACE assessment lien. That is a risk that has to be weighed against the potential benefits to be realized through establishment of a PACE program.

Also, the issue or concern may be more one of timing than whether the City's taxes will go unpaid. That is because even if the bankrupt's liquid assets are insufficient to fully pay the taxes owing, the City property tax lien (as well as the PACE assessment lien) against the property will survive bankruptcy and run with the land. Therefore, so long as the value of the property remains sufficient to pay the amount of the tax and the PACE lien, the tax should eventually be fully paid through a bankruptcy plan, a sale of the property, or lifting of the stay and a tax sale.

We have also considered whether through the special assessment agreement and related agreements the commercial lender can perhaps agree that in the event of default or bankruptcy, the property taxes will get fully paid before repayment of the commercial loan. We have not found a definitive answer to this question and believe although it is possible to write this into the agreement, a court might refuse to uphold such a provision if the court believes it is inconsistent with, and trumped by, the statute which gives the PACE assessment lien the same priority and status as property taxes.

Very truly yours,



John D. Staran

JDS/ijd

cc: Mayor Bryan K. Barnett  
Mr. James Breuckman, Planning & Economic Development