

Bulletin 5
Public Act 34 of 2001, Revised Municipal Finance Act

Net Present Value Exceptions
Clarification of the Term “Covenant”

Issued By: Local Audit and Finance Division, Bureau of Local Government Services

Effective Date: June 24, 2009

Under Section 611 of Public Act 34 of 2001, the Revised Municipal Finance Act, an issuer may only issue a refunding security when the net present value of the principal and interest to be paid on the refunding security, including the cost of issuance, is less than the net present value of the principal and interest to be paid on the outstanding security being refunded. A municipality may obtain an exception from the net present value savings requirement if the Department of Treasury determines a reasonable basis for that exception exists. A reasonable basis, for purposes of Section 611 includes situations where the refunding is necessary to reduce or eliminate requirements of ordinances or covenants applicable to the existing outstanding security. MCL 141.2611(2)(b).

A covenant is an enforceable promise to do, or refrain from doing, some act, generally intended to maintain the level of risk assumed at the time of issuance, and to provide assurances that are legally enforceable. Generally, with respect to municipal bonds, covenants may be found explicitly stated in the bond contract, resolution, or indenture. Typical bond covenants include covenants to maintain casualty insurance on the financed project; to complete, maintain, and operate the project in a manner to ensure revenue to meet the bond obligations; not to encumber or sell the project; not to issue parity bonds unless certain earnings tests are met; or not to violate Internal Revenue Service regulations or take other actions that would cause the bonds to become arbitrage bonds.

Although the maturity date is an essential term of an ordinance, resolution, indenture, loan contract agreement, or other evidence of indebtedness, this Department has determined that the maturity date is not considered to be a "covenant" for the purposes of Section 611(2)(b), and the modification or extension of a maturity date does not constitute a reduction or elimination of requirements of ordinances or covenants applicable to the existing outstanding security with respect to Section 611(2)(b). The Department expresses no opinion as to whether the maturity date is a covenant for purposes other than MCL 141.2611(2).

This bulletin is issued pursuant to Section 201(b) of the Revised Municipal Finance Act which authorizes this Department to issue bulletins to carry out the purposes of the Act.