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March 8, 2011

Members of the RFP #743 (Library Lot
Redevelopment) Advisory Committee
City of Ann Arbor
100 N. Fifth Ave.
P.O. Box 8647
Ann Arbor, MI 48107

Subject: **Ann Arbor Library Lot**
City of Ann Arbor RFP No. 743
Our File Number 1132-000

Dear Committee Members:

Our firm represents Mary Hathaway, a resident of Ann Arbor. This letter presents to the Committee certain concerns on behalf of our client regarding the Committee's anticipated consideration on March 8, 2011 of a proposed Letter of Intent for redevelopment of the Library Lot with Valiant Partners LLC ("Valiant"), the City of Ann Arbor and Ann Arbor DDA as signatories. The proposed Letter of Intent is based on a recommendation of The Roxbury Group, a consultant hired by the DDA, which issued its report dated November 23, 2010 ("Roxbury Report").

On behalf of our client, and for reasons which include those addressed in this letter, we request that the Committee recommend that the City reject the proposal submitted by Valiant Partners in response to RFP #743.

According to the Roxbury Report, Valiant amended its initial submission, although the exact financing details are not provided. Valiant now proposes a conference center to be owned by the City on the lower three floors of a building to be constructed by Valiant, with Valiant obtaining a ground lease for the rest of the 14 story building consisting primarily of a hotel above the conference center, plus retail space, office space and luxury condominiums. Valiant apparently proposes obtaining EDC bonds in the amount of $6.9 million to finance construction of the conference center, to be operated by a 501(c)(3) entity, with payment of the bonds to come from revenue from the private hotel/ retail/office/ luxury condominium development. The portions of the structure other than the conference center are to be privately

financed. Valiant's Proposal dated January 28, 2010 states at page 33: "In order to assure financability [sic] of the hotel the purchase price and/or Ground Rent will be subordinated to the first mortgage financing, which will be no more than 65% of Project Costs."[emphasis added]

A. The Valiant Proposal to Subordinate the City's Lease Payments to its Private Construction Mortgage Would Violate Article 7, Section 26 of the Michigan Constitution.

Article 7, Sec. 26 of the Michigan Constitution provides:

> "Except as otherwise provided in this constitution, no city or village shall have the power to loan its credit for any private purpose or, except as provided by law, for any public purpose".

What constitutes a "loan of credit" can take different forms. For example, in the case of Skutt v. City of Grand Rapids, 275 Mich. 258, 266 (1936), the Michigan Supreme Court found that "[c]ontracts involving use of public money to further private enterprise are void." In the case of Kaplan v. City of Huntington Woods, 357 Mich. 612 (1959), the Court found that a City entering into an agreement with other property owners to restrict the use of certain city lots to single dwelling purposes, which disposed of a valuable property right of the City without consideration, violated the constitutional provision forbidding a City to loan its credit to private parties.

A situation similar to that proposed in the present matter was discussed in an opinion of the Office of the Florida Attorney General, Op. Att'y Gen. Fla. 1992-71. That opinion addressed the question of whether a Florida constitutional provision[1] comparable to Article 7, Sec. 26 of the Michigan constitution quoted above would preclude a Florida municipality from subordinating its mortgage (securing the payment of the balance of the purchase price for surplus property) to the construction mortgage of the private for-profit corporate buyer of the property. The Florida Attorney General opined:

> "Your inquiry, however, concerns not only the granting of a mortgage but the subordination of that mortgage to the lien of any mortgage obtained by the buyer for the construction of improvements on the property. As you note, the municipality is not directly liable on the construction loan. [citation omitted]. However, in the event of a default on such loan, the municipality would be forced to assume the debt of the purchaser in order to prevent the loss of the property. Thus, the arrangement would appear to place the municipality's interests in the property in jeopardy and would appear to be an indirect obligation on the part of the municipality to pay off the construction loan in order to protect its interest in the property. [citation omitted]. Such subordination, therefore, would appear to implicate the provisions of s. 10, Art. VII, State Const. . . . . .

[1] The Florida constitution provision at issue, Section 10, Art. VII, State Const., provides in pertinent part:
Neither the state nor any . . . municipality . . . or agency of any of them, shall become a joint owner with, or stockholder of, or give, lend or use its taxing power or credit to aid any corporation, association, partnership or person.

> Therefore, while a municipality is not precluded from taking back a mortgage on the surplus property it sells, I am of the opinion that the subordination of that mortgage to that of a private lender where the primarily [sic] beneficiary of such an arrangement is the private for profit corporation purchasing the property is impermissible".

Since the Michigan constitution provision precluding the loaning of credit to a private entity is substantially similar to the Florida provision, comparable reasoning would apply to the present situation.

Thus, the Valiant proposal to subordinate the City's right to receive rent payments to the developer's construction mortgage is not only a financial risk, but also would be impermissible under Article 7, Sec. 26 of the Michigan Constitution.

B. <u>The Private Development Portion of the Valiant Proposal Would Cause the City to be Engaged in a "Business Enterprise" Requiring Voter Approval Under the Home Rule City Act</u>.

The Home Rule City Act includes the following prohibition on city powers at MCL 117.5(e):

> "117.5 Prohibited powers.
> A city does not have power:
> * * * * *
> (e) . . . to engage in a business enterprise requiring an investment of money in excess of 10 cents per capita. . . . unless approved by a majority of the electors voting on the question at a general or special election. . . . ."

The definition of the term "business enterprise" is set forth in the case of <u>Gregory Marina, Inc. v. City of Detroit</u>, 378 Mich 364 (1966) as follows:

> "'Business Enterprise: Investment of capital, labor or management in an undertaking for profit; . . . .'"

The <u>Gregory Marina</u> case held that the operation of a marina, "a parking facility for boats," was not a "business enterprise" requiring voter approval within the meaning of MCL 117.5(e) -- the City was simply "discharging its obligation to provide adequate, safe recreational facilities for its population." <u>Id</u>. at 402 -403.

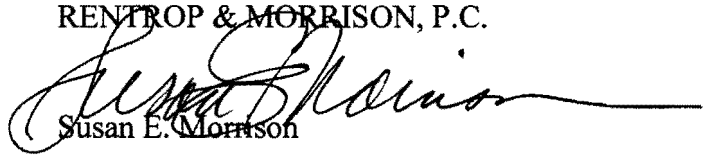
However, in contrast to the public recreational purpose being pursued by the City of Detroit in the <u>Gregory Marina</u> case, the major portion of the 14-story development proposed by Valiant for the Library Lot is for non-public hotel, retail, office and luxury condo uses. Valiant includes as part of the proposal that the City share in the speculative risk of developing luxury condos, with the City receiving a percentage of the sale price only when those condos sell (which might not occur). This venture also will necessarily require the City to undertake the function of being a commercial landlord and managing the ground lease on its property, as well as other aspects of the joint project. Whether performed by City staff or contract labor, the City's

managing of the property and lease as a commercial landlord for the private (non-conference center) portion of the Valiant project can be considered a "business enterprise" within the meaning of MCL 117.5(e). At a minimum, the City will be investing costs in labor in this undertaking. The City anticipates a profit from this venture (indeed the RFP itself requires at page 4 that "[t]he proposal must provide a positive financial return to the City"). The anticipated cost of the labor alone to be invested by the City over the years in managing the ground lease as a commercial landlord would almost certainly exceed the ten cents per capita threshold in MCL 117.5(e) (With a population of approximately 114,000, ten cents per capita would be the sum of $11,400).

Under MCL 117.5(e), approval by Ann Arbor voters of this proposed "business enterprise" at a general or special election would be needed before the City entered into an agreement with the developer.

On behalf of our client, and for the reasons stated above, we respectfully request that the Committee recommend that the City reject the proposal of Valiant Partners LLC submitted in response to RFP No. 743.

Respectfully submitted,
RENTROP & MORRISON, P.C.



Susan E. Morrison

cc: Mary Hathaway