Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

SFA BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 142 (Substitute S-2 as reported by the Committee of the Whole)
Senate Bill 1137 (Substitute S-3 as reported by the Committee of the Whole)
Sponsor: Senator Leon Stille
Committee: Education

Date Completed: 5-30-02

RATIONALE

In 1994, the passage of Proposal A significantly altered the way public schools were funded. Before 1994, school funding was largely a local matter; residents paid a majority of their local school's expenses through their property taxes. When the district needed money above and beyond what the current property tax could provide, it went to the voters to ask for a milage increase. After Proposal A was approved, local property taxes ceased to be the major revenue source for schools. Now, the per-pupil foundation allowance that schools receive from the State (generated from a combination of sales and use taxes, State education property taxes, the State income tax, and other sources) is their main source of funding. The allowance is to be used for operating expenses such as salaries, textbooks, playground and library equipment, and technology. New construction or remodeling projects are still funded by local property taxes, which can be increased only if the voters approve a bond issue in a milage election. As before, wealthier districts are better able to raise money for school facilities while poorer districts must forgo improvements or carry a heavier tax burden. Furthermore, Proposal A significantly limited the ability of districts to raise their milage. Because of this, some people believe that the State should provide some assistance to needy districts borrowing money for infrastructure improvements.

CONTENT

Senate Bill 1137 (S-3) would create the "Michigan School Infrastructure Improvement Bond Authorization Act" to require the State to issue up to $1 billion of general obligation bonds to finance infrastructure improvements at Michigan public schools, subject to voter approval.

Senate Bill 142 (S-2) would add Part 17a to the Revised School Code to provide for the State's issuance of the bonds and to create the "Michigan School Infrastructure Improvement Bond Fund", which would have to be used to make interest-free loans to school districts and public school academies (PSAs) for the acquisition, construction, or major renovation of school buildings, and to finance the construction of school buildings. The bill also would require the Department of Management and Budget to create an information network linking all school districts, higher educational institutions, and libraries. The bills are tie-barred to each other and could not take effect unless the voters approved the proposed bond issue.

Senate Bill 1137 (S-3)

General Obligation Bond

The State would be required to borrow up to $1 billion and issue general obligation bonds, pledging the State's full faith and credit for the payment of principal and interest on the bonds, to finance public school infrastructure. The bonds would have to be issued in accordance with conditions, methods, and procedures established by law.

Bond Proceeds

The proceeds of the sale of the bonds, premium and accrued interest on the delivery of the bonds, and any earned interest on the bonds' proceeds would have to be deposited in the State Treasury and credited to the "Michigan School Infrastructure Fund" (proposed by Senate Bill 142). Money from the Fund could be disbursed only for the

purposes for which the bonds were authorized, including the expense of issuing the bonds. The proceeds of the sale of the bonds, and any premium and accrued interest received on the delivery of or on the proceeds of the bonds, would have to be spent for the purposes set forth in the bill, in a manner provided by law.

Vote

The question of borrowing up to $1 billion and issuing general obligation bonds would have to be submitted to a vote of the State's qualified electors. The Secretary of State would have to perform all acts necessary to submit the question properly to the electors qualified to vote on the question at the next general election. The proposed bonds could not be issued unless a majority of the qualified voters voting approved the question.

Appropriation

The bill would require that, after the bonds were issued, a sufficient amount be appropriated from the State's General Fund each fiscal year to pay promptly the principal of and interest on all outstanding bonds and costs incidental to their payment. The Governor would have to include the appropriation in his or her annual budget recommendation to the Legislature.

Senate Bill 142 (S-2)

Declaration

The bill states that the Legislature "finds and declares that the school infrastructure improvement programs implemented under this part are a public purpose and of paramount public concern in the interest of the health, safety, and general welfare of the citizens of this state".

Creation of Fund

The bill would create the Michigan School Infrastructure Improvement Bond Fund in the State Treasury. The Fund would consist of all of the following: the proceeds of sales of the infrastructure bonds sold at public or private sale, and any premium and accrued interest received on the delivery of the bonds; any interest or earnings generated by the proceeds of the sale of the bonds; and repayments of loans to school districts and public school academies, as well as repayments of State financing of school construction projects for districts, under the bill. The Department of Treasury could establish restricted subaccounts within the Fund as necessary to administer it.

Fund Purposes

Money in the Fund could be used only for the following purposes: to pay for the cost of issuing infrastructure bonds and the costs incurred by the Administrative Board to authorize transactions necessary to provide security to assure timely payment or purchase of the bonds; to make interest-free loans to school districts to pay for infrastructure improvements; to make interest-free loans to public school academies (PSAs) for infrastructure improvements; and to finance the construction of school buildings for districts whose taxable value per pupil was among the lowest 1% in the State.

The bill specifies that, for the first year after money was available in the Fund, 20% of the money could be used only for loans to districts whose taxable value per pupil was in the lowest 20% among districts in the State. Also, the maximum percentage of the money in the Fund that could be used for a particular district would be 10%.

Fund Proceeds

The total proceeds of all infrastructure bonds sold at public or private sale would have to be deposited into the Fund, and the State Treasurer would have to direct its investment. Further, the infrastructure bond proceeds would have to be spent in an appropriate manner that maintained the tax-exempt status of any infrastructure bonds issued as tax exempt bonds. The unencumbered balance in the Fund at the close of the fiscal year would have to remain in the Fund, and could not lapse to the General Fund.

The Department of Treasury would have to submit an annual accounting of infrastructure bond proceeds spending on a cash basis to the Governor, the standing committees of the House of Representatives and the Senate that primarily address issues pertaining to education, and the House and Senate Appropriations Committees.

Interest-Free Loans

The money in the Fund would have to be used to make interest-free loans to school districts. To qualify for a loan, a district would have to meet all of the following:

- The district would have to borrow money and issue bonds for the acquisition, construction, or major renovation of one or more school buildings of the district.
- The bonds borrowed for the acquisition, construction, or major renovation would have to be approved by the school electors of the district at an election held after June 1, 2002.
- Of the bonds borrowed for the construction or renovation of a school building, the district would have to sell to the State the same percentage of the bond issue as the percentage amount the district could borrow from the Fund based on the district's taxable value per pupil and, in some cases, the percentage of students qualifying for Federal free or reduced-price lunch.

(The bill would define "acquisition, construction, or major renovation of school buildings" as purchasing, erecting, completing, or equipping or reequipping school buildings or parts of or additions to school buildings, or a renovation of an existing school building that affected at least 50% of the building's square footage.

"Taxable value per pupil" would mean a school district's taxable value, as certified by the Department of Treasury, for the calendar year ending in the most recent State fiscal year for which an audited membership count was available, divided by the district's membership for the school year ending in the most recent State fiscal year for which an audited membership count was available, as determined under the State School Aid Act (MCL 388.1606).)

The amount of interest-free money a school district could borrow from the Fund would be based on the district's taxable value per pupil. Districts whose taxable value per pupil was in the lowest 20% in the State could borrow 100% of the amount of the bond issue. Districts in the lowest 40% but not in the lowest 20% could borrow 75% of the amount of the bond issue from the Fund. Those in the lowest 60% but not in the lowest 40% could borrow 50% of the bond issue from the Fund. Districts in the lowest 80% but not the lowest 60% could borrow 25% of the bond issue. Those districts whose taxable value per pupil was in the highest 20% could borrow 10% of the bond issue from the Fund. The amount a district could borrow would be increased by 10 percentage points if that district were not in the highest 20%, and if at least half of the students in the district met the Federal eligibility criteria for free or reduced-price lunch in the fiscal year in which the loan application was made.

To obtain a loan from the Fund, a district would have to apply to the Department of Treasury, in a form and manner prescribed by the Department. Before releasing a loan, the Department would have to enter into a loan agreement with the loan recipient. The loan agreement would have to specify at least the term of the loan and manner of repayment, and would have to provide for full repayment of the total amount of the loan within 20 years. The State Treasurer would have to deposit all money received for the repayment of a loan into the proposed Fund.

Loans to Public School Academies

Public school academies could receive up to $40 million in interest-free loans from the Fund to finance the acquisition, construction, or major renovation of school buildings owned by an academy. The maximum amount a PSA could borrow would be $581 per pupil for the most recent State fiscal year for which an audited membership count was available.

To qualify for a loan, a PSA would have to submit an application to the Department of Treasury, in a form and manner prescribed by the Department. The application would have to include at least a resolution of the PSA's board of directors requesting the loan and documentation satisfactory to the Department demonstrating the PSA's ownership of the building.

Before releasing a loan, the Department would have to enter into a loan agreement with the loan recipient. The agreement would have to specify at least the term of the loan and manner of repayment. The State Treasurer would have to deposit all money received for the repayment of a loan into the Fund.

State Financing for Poorest 1%

If a school district's taxable value per pupil were in the lowest 1% among districts in the State, the district could apply for State financing of a school building. To qualify, the district would have to borrow money and issue its bonds for the construction of the building. The bonds would have to be approved by voters in that school district at an election held after June 1, 2001. The board of the district would have to apply to the Department of Treasury and supply necessary information in a form and manner prescribed by the Department.

If the State financed the construction of a school building under these provisions, all of the following would apply:

-- The school building would have to be jointly owned by the district and the State until the district repaid the costs of construction to the Fund. After the full amount was repaid, the State would have to transfer full ownership of the building to the district without additional payment by the district.
-- The terms and schedule of repayment would have to be prescribed by the Department and agreed to by the district before the application was approved. The repayment term and payments would have to structured so that the payments made by the district were sufficient to pay all of the construction costs for the school building, without the assessment of any interest charge, within a reasonable number of years set by the Department, considering the district's financial circumstances and agreed to by the district before the approval of the application.
-- All maintenance costs on the building would have to be borne by the school district.
-- The school district would have to sell the bonds to the State in a manner prescribed by the Department.

The State Treasurer would have to deposit all money received from repayments into the Fund.

Bond Issuance

The bill would require that the first bond issuance be structured in such a manner that debt payments did not begin before October 1, 2003. The bill would require the infrastructure bonds to be in a form and executed in a manner, and be subject to or granting those covenants, directions, restrictions, or rights specified by resolution to be adopted by the State Administrative Board as necessary to ensure the marketability, insurability, or tax-exempt status of the infrastructure bonds.
The Board could refund the infrastructure bonds issued under the bill by the issuance of new infrastructure bonds, whether or not the bonds to be refunded had matured or were subject to prior redemption. The Board could issue infrastructure bonds partly to refund infrastructure bonds and partly for any other purpose provided under the bill. The principal amount of any refunding bonds issued under the bill could not be counted against the limitation on principal amount provided in the proposed Michigan School Infrastructure Improvement Bond Authorization Act.

The Board could authorize the State Treasurer, within limitations contained in the authorizing resolution of the Board, to do one or more of the following:

-- Sell, deliver, and receive payment for the infrastructure bonds.
-- Deliver infrastructure bonds partly to refund infrastructure bonds and partly for other authorized purposes.
-- Select which outstanding infrastructure bonds would be refunded, if any, by the new issue of infrastructure bonds.
-- Buy issued infrastructure bonds.
-- Approve interest rates or methods for determining interest rates, prices, dates, denominations, redemption rights, the place and time of delivery and payment, and other matters and procedures necessary to complete the authorized transactions.
-- Execute, deliver, and pay the cost of remarketing agreements, issuance contracts, agreements for lines of credit, letters of credit, commitments to purchase infrastructure bonds or notes, and any other transaction to provide security to assure timely payments or purchase of any infrastructure bond issued under the bill.

The infrastructure bonds, or any series of the bonds, would have to be sold at public or private sale at a price determined by or pursuant to a resolution of the Board. The bonds and their interest would be exempt from all State taxes.

The infrastructure bonds would not be subject to the Revised Municipal Finance Act, but issuance of the bonds would be subject to the Agency Financing Reporting Act (proposed by Senate Bill 1201). Further, the bonds would have to fully negotiable under the Uniform Commercial Code.

The bill specifies that the infrastructure bonds would be securities in which financial institutions, State authorities, investment companies, all insurance companies, and all administrators, executers, guardians, trustees, and other fiduciaries could properly and legally invest funds, including capital, belonging to them or within their control.

Information Network

The bill would require the Department of Management and Budget to prepare and implement a State plan for the creation of a Michigan information network linking each local school district, intermediate school district, PSA, community college, independent nonprofit college or university located in the State, State public university, and each State, local, or regional library on an equal basis by fiber optic or coaxial cable or other comparable system, allowing a world-class Statewide interactive video and data access and exchange system. Further, all educational entities would be encouraged to participate in this Michigan information network and in similar networks or systems, and would be encouraged to use computer, telecommunications, and other interactive technology to develop and use distance learning for educational purposes.

Repealer

The bill would repeal Section 1291(1) of the Code, which required the Department of Management and Budget, by June 30, 1995, to prepare a State plan for the creation of a Michigan information network linking all schools on an equal basis by fiber optic or coaxial cable or other comparable system.

The bill also would repeal Section 1615 of the Code, which required, for the 1983 tax year only, a summer property tax levy of a district to be in compliance with other sections of the Code.

MCL 380.1272d et al. (S.B. 142)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Families with school-aged children continue to migrate to the suburbs outside of Michigan's city centers. As a result, most suburban districts have experienced a glut of students who have quickly crowded the school buildings. In response, the districts have asked their residents for a millage increase to build new schools. Most of the time, the voters have supported the measure, the property taxes are raised, and the district builds a brand new, state-of-the-art school.

City and rural schools are not as fortunate. The migration to the suburbs has left these districts with fewer students, which results in a smaller amount of funding from the State. In addition, because property values are lower inside cities and in rural areas, a milage increase in the city would have to be far greater than a milage increase in a suburb to raise an equivalent amount of money to build a new school. (A mill is a $1 tax on every $1,000 of taxable value on a home.)

The disparity that exists in two contiguous school districts is startling. In a comparison of taxable values per pupil in contiguous districts conducted by the School Equity Caucus, the suburban districts often had a taxable value worth three times that of their neighbors'. The Bangor district, for example, had a taxable value of about $52,000 per pupil, while its neighbor, the Covert district, had a taxable value of almost $400,000.

Students who live in districts with low taxable values often attend school in buildings constructed in 1920 or earlier. These buildings lack proper heating systems, adequate lighting, science labs, and leak-proof roofs. According to the School Equity Caucus, research studies from Syracuse, Virginia,

Alberta, and the Carnegie Foundation all link student achievement and behavior to the physical building condition. Student achievement lags in shabby school buildings.

Passage of the two bills is necessary to ensure that the education and physical well-being of all students in Michigan are treated to an equal amount of respect. Poorer districts deserve to receive greater debt relief so that they may build schools worthy of their students.

Opposing Argument

According to the Department of Treasury, a $1 billion bond would double this kind of State debt. While equalizing educational opportunities is undoubtably a worthy measure, increasing the State's bonded indebtedness during these tight budgetary times could be unwise.

Legislative Analyst: Claire Layman

FISCAL IMPACT

Senate Bill 142 (S-2)

State: For an explanation of the proposed school infrastructure loan provisions, please see the **FISCAL IMPACT** on Senate Bill 1137 (S-3).

Local: Local school districts and public school academies that used the proposed loan program would experience cost savings. Since the State would provide interest-free loans in varying amounts to participating entities, the savings to the local districts would reflect the interest they otherwise would pay on portions of successful bond issues.

The savings to local districts would vary by the percentage of a bond issue the district would be eligible to borrow from the State interest-free. For example, a district whose taxable value per pupil ranked in the third quintile would be eligible to borrow 50% of the principal on a successful construction bond issue from the State interest-free (up to $100 million). Therefore, the savings to this district would equate to the interest cost on 50% of the bond issue. (The district would have to use "normal" bonding procedures for the remaining 50% of its bond issue.)

Charter schools (PSAs) could borrow up to $581 per pupil interest-free for acquisition and construction purposes. Therefore, savings to participating academies would reflect the interest they otherwise would pay if they borrowed $581 per pupil in the "normal" financial market.

Michigan Information Network

The cost of implementing the provision in the bill requiring the Department of Management and Budget to develop and implement a State plan for interactive video and data access and exchange system for schools and libraries at multiple levels and jurisdictions, would depend highly on the existing infrastructure in the individual facilities. Buildings that currently do not have sufficient technology and cable connections would require a greater investment by the Department for implementation of the plan. (It may be more appropriate for the Department of Information Technology to originate this plan.)

Senate Bill 1137 (S-3)

The cost to sell and repay general obligation bonds would depend on how long the bonds were issued for, the annual interest rate that would have to be paid on the bonds, and the characteristics of the program to be funded with the bond proceeds. Assuming 20-year bonds issued at a constant interest rate of 5%, the debt service on the bonds would be approximately an average of $30 million per year over the course of 20 years. The total interest costs (under these assumptions) would be $584 million; the total cost of the bonds therefore would be $1.584 billion. Under the provisions of Senate Bill 142, districts and public school academies would repay the principal on the $1 billion. Therefore, the cost to the State would simply be the interest cost of the general obligation bonds, which would average $30 million a year in General Fund/General Purpose revenue using the assumptions stated above.

Fiscal Analyst: Kathryn Summers-Coty
Jessica Runnels

A0102\s142a

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.