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SFA BILL ANALYSIS

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Senate Bill 1313 (as enrolled) **PUBLIC ACT 450 of 2002**
Senate Bill 1314 (as enrolled) **PUBLIC ACT 500 of 2002**
Sponsor: Senator Joanne G. Emmons
Senate Committee: Finance
House Committee: Tax Policy

Date Completed: 1-17-03

CONTENT

Senate Bill 1314 amended the Revised Municipal Finance Act to regulate interest rate agreements entered into in connection with the issuance or proposed issuance of debt, or in connection with outstanding debt. Senate Bill 1313 amended Public Act 108 of 1961, which allows and regulates State loans to school districts for the payment of their bonds, to specify that interest on bonds includes a district's "net interest obligation" under an interest rate agreement entered into under the Revised Municipal Finance Act.

Senate Bill 1314

The Revised Municipal Finance Act allows a municipality to enter into an interest rate exchange or swap, hedge, or similar agreement in connection with the issuance of debt or outstanding debt. The bill also allows a municipality to enter into an interest rate agreement for the proposed issuance of debt.

Previously, any interest rate agreement under the Act had to be payable as a limited tax full faith and credit pledge from general funds of the municipality or, subject to any existing contracts, from any available money or revenue sources, including revenues specified by the agreement, securing the municipal security in connection with which the agreement was entered into. Under the bill, this applies to an interest rate exchange or swap, hedge, or similar agreement entered into by a municipality in connection with debt that was not approved by the voters of the municipality, or in connection with a refunding of debt not originally approved by the voters of the municipality.

The bill provides that if a municipality enters into an interest rate exchange or swap, hedge, or similar agreement in connection with debt that was approved by the voters of the municipality, or in connection with a refunding of debt originally approved by the voters, the municipality's interest payment obligation is considered to be additional interest on the debt, and constitutes an unlimited tax full faith and credit pledge of the municipality. The municipality must levy the full amount of taxes required or, in the case of a variable rate obligation, the amount reasonably estimated to be required, for the payment of: 1) principal and interest on the municipal securities without limitation as to rate or amount and in addition to other taxes that the municipality may be authorized to levy; and 2) the municipality's net interest obligation under the interest rate exchange or swap, hedge, or similar agreement. The amount levied must be reduced by any surplus funds on hand in the debt retirement fund in excess of a reasonable reserve as determined by the municipality's chief financial officer.

Under the bill, "net interest obligation" means the amount of interest payable by a municipality in a given year under an interest rate agreement minus any interest payment received by a municipality from the other party to the agreement in the same period under the agreement, but not less than zero. Termination payments constitute interest to the extent that the treatment does not cause the interest rate on the debt to exceed the limits established under the Act.

The bill prohibits a municipality from entering into an agreement unless the governing body of the municipality has, by resolution or ordinance, expressly approved the agreement and acknowledged the potential risks associated with it; the counterparty to the agreement has been assigned a rating of "A" or better, or other rating as the Department of Treasury determines, by a nationally recognized rating agency at the time the agreement is entered into; and the length of the agreement does not extend beyond the final maturity date of the debt issued in connection with it. Further, a municipality may not enter into an agreement unless it has created a debt management plan and a swap management plan; and has not waived its right to a jury trial. The agreement must be described in the municipality's annual audit report.

Under the bill, a "debt management plan" is a municipality's written plan that includes the total amounts of the municipality's debt and variable rate debt; an analysis of the effect of rising interest rates on the municipality's variable rate holdings; and an analysis of risk in maintaining variable risk holdings. "Swap management plan" means a written management plan that includes an analysis of the benefits and costs of, and risk associated with entering into swap agreements; an analysis of early termination, involuntary termination, default, and cost considerations associated with swap agreements; and a system in place to monitor the status of all outstanding swap agreements.

The Act authorizes municipalities to issue a municipal security in anticipation of the collection of taxes for the following fiscal year; this is referred to as a short-term municipal security. A municipality may issue a short-term municipal security to pay for certain operating expenditures, or to pay for capital improvements budgeted in the fiscal year in which the municipality issues the security. The bill also allows a municipality to issue a short-term municipal security to pay debt service charges or obligations on municipal securities or agreements entered into in connection with voter-approved debt or a refunding of voter-approved debt.

Under Section 701 of the Act, if a municipality has municipal securities outstanding, or with the approval of its electors has authorized the issuance of municipal securities to be paid from collections of its next tax levy, an officer or official body responsible for determining the amount of the next taxes to be raised or levying the next taxes, must include certain amounts in the taxes levied each year. The bill added to these amounts an amount necessary to pay debt service charges or obligations on municipal securities or agreements described in the bill (for voter-approved debt) falling due in the immediately preceding fiscal year, to the extent that the tax levy in that fiscal year is inadequate to pay, when due, those debt service charges or obligations. The municipality must do one or more of the following with the proceeds of this tax levy: 1) deposit the proceeds in the debt retirement fund established for the municipal securities and used to pay debt service charges or obligations on the municipal securities or agreements; 2) pay debt service on short-term municipal securities; or 3) reimburse the municipality for any advances of funds used for either of those purposes.

Further, the bill specifies that, as used in Section 701, a "tax levy" includes special assessments.

Senate Bill 1313

The bill provides that interest on qualified bonds includes the amount required for the payment of a school district's net interest obligation under an interest rate exchange or swap, hedge, or other agreement entered into under the Revised Municipal Finance Act.

(Under Public Act 108, qualified bonds are general obligation bonds of school districts issued for capital expenditures, including refunding bonds.)

MCL 388.963a (S.B. 1313)
141.2317 et al. (S.B. 1314)

Legislative Analyst: George Towne

FISCAL IMPACT

The bills will have no fiscal impact on State or local government.

Fiscal Analyst: David Zin

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