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 Bills 1313 and 1314 (as introduced 5-9-02)
Sponsor: Senator Joanne G. Emmons
Committee: Finance

Date Completed: 5-14-02

CONTENT

Senate Bill 1314 would amend 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 would amend Public Act 108 of 1961, which allows and regulates State loans to school districts for the payment of school districts' bonds, to specify that interest on bonds would include a district's "new 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 would allow a municipality to enter into an interest rate agreement for the proposed issuance of debt.

Currently, an interest rate agreement must 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 that must be specified by the agreement, securing the municipal security in connection with which the agreement is entered into. Under the bill, this would apply 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.

If a municipality entered 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 would be considered to be additional interest on the debt, and would constitute an unlimited tax full faith and credit pledge of the municipality. The municipality would have to 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 could 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 would have to 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" would mean 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 would constitute interest to the extent that the treatment did not cause the interest rate on the debt to exceed the limits established under the Act.

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

Under the bill, a "debt management plan" would be a municipality's written plan that included the total amount 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" would mean a written management plan that included 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 bill also would allow a municipality to issue short-term municipal securities, in anticipation of tax collections for the next fiscal year, 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 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 would add 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 was inadequate to pay, when due, those debt service charges or obligations. The municipality would have to 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.

Senate Bill 1313

The bill provides that interest on qualified bonds would include 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.)

Proposed MCL 388.963a (S.B. 1313)
MCL 141.2317 (S.B. 1314)

Legislative Analyst: George Towne

FISCAL IMPACT

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

Fiscal Analyst: David Zin

S0102\s1313sa