Legislative Analysis

HOUSE FISCAL AGENCY
Mitchell Bean, Director
Phone: (517) 373-8080
http://www.house.mi.gov/hfa

CREATE SCHOOL BOND LOAN REVOLVING FUND

Senate Bill 406 (H-1)
Sponsor: Sen. Clark-Coleman

Senate Bill 407 (S-2)
Sponsor: Sen. Switalski

Senate Bill 408
Sponsor: Sen. Clarke

Senate Bill 410 (S-1)
Sponsor: Sen. Leland

Senate Bill 411 (S-1)
Sponsor: Sen. Cherry

Committee: As Passed Appropriations

Complete to 6-28-05

SUMMARY:

In general this package of bills would do the following:

** Repeal Public Act 108 of 1961 and replace it with a new School Bond Qualification, Approval, and Loan Act with the same basic purpose of implementing Article IX, Section 16 of the State Constitution and providing for loans to school districts to pay debt service on bonds the districts have issued. The new Act would contain, among other things, more extensive application and approval criteria.

** Create a School Bond Loan Revolving Fund (SBLRF) to be operated by the Michigan Municipal Bond Authority and require that money repaid by school districts on loans made by the SBLRF be deposited back into the fund (rather than go into the General Fund, as is the case currently with the existing program). The State Treasurer could assign repayments of old loans made prior to the effective date of the new revolving fund system to the SBLRF.

** Specify that the State Treasurer would be required to prequalify new bonds of a school district if the issuance of new bonds would not prevent the district from repaying its outstanding qualified loans on schedule. The new Act would authorize the State Treasurer to establish payment dates for school districts with qualified loans outstanding as of the new Act's effective date (and for new bonds issued later).

** Authorize qualified bonds of the kind districts issue currently (meaning they still require the levying of between 7 and 13 debt mills to receive state loan support, and require voter approval). Graph 1 shows a typical district's borrowing and debt service under the current SBLF program.

** Require ballot questions on unlimited tax general obligations that will be guaranteed by the state to inform voters that the district borrowing from the state may be required to continue to levy mills beyond the term of the bonds in order to repay the state.

THE APPARENT PROBLEM:

Article IX, Section 16 of the State Constitution requires the state to provide loans to school districts under certain circumstances. The School Bond Loan Fund (SBLF) is the mechanism used to do this. The SBLF receives state funding through proceeds from the sale of general obligation bonds and uses those proceeds to make loans to school districts for capital construction projects. The SBLF makes loans to school districts for the difference between the debt service payment required on the district's bonds issued and the actual millage collected. Over time, taxable values in school districts typically grow, and the millage collected eventually meets, and then exceeds the debt service payment required. At that point, the excess millage collected (above the amount required to make the debt service payment) is used to repay the state for any loans. (See graph 1, which shows a district's typical SBLF borrowing. In the first years, the seven-mill levy does not generate enough to pay the debt service on the bonds issued; therefore the school district borrows until the seven-mill levy exceeds the debt service, wherein the school district begins to repay the state.)

As of May 2005, the amount of loans the state has made to school districts exceeds $704.0 million. Because the state must borrow (via the sale of bonds) in order to make loans, the state also incurs debt service costs. These costs have grown over time because the rate at which the state pays back its own debt is faster than the rate at which school districts repay the state. Under current law, a school district may postpone repayment of its loan from the state under the SBLF by issuing another bond for a second construction project prior to repaying the state for the borrowing from the first project. Graph 2 illustrates the repayment schedule change when a second bond is issued by a school district. The Department of Treasury has expressed concern that if there is no change in the current SBLF the estimated state debt service for the SBLF (currently funded in the School Aid budget) will reach $200 million by 2021, falling to $165.0 million annually beginning in 2026 (using current assumptions.)

By requiring school districts to repay existing loans from the state before being approved to issue new qualified bonds, the state is able to transform a previously inconsistent revenue stream into an asset, the value of which can be borrowed against and turned into a self-sustaining revolving fund. Creation of the SBLRF would lead to a phase-out of state debt service and elimination of the drain on the School Aid budget (which pays the SBLF debt service) by an estimated 2024. Graph 3 shows the estimated debt service the state will have to pay under the new SBLRF (blue bars) and the estimated debt service without reform to the SBLF (gold bars).

THE CONTENT OF THE BILLS:

Senate Bill 406 (H-1) would repeal Public Act 108 of 1961 and replace it with the "School Bond Qualification, Approval, and Loan Act." Districts that are currently in the SBLF would maintain the current terms and conditions of their outstanding qualified bonds issued under Public Act 108 of 1961.

The new Act would require school districts to apply to the State Treasurer for preliminary qualification on proposed school bonds to be issued by filling out an application that includes the following:

- Proposed ballot language (as in current law).
- A description of the proposed project(s) (as in current law).
- Debt service projection showing the estimated mills the school district must levy to pay for the qualified bonds (as in current law).
- Evidence that the rate of utilization will be at least 85% for new buildings (as in current law).
- Evidence that the cost per square foot will be reasonable (as in current law).
- Evidence that the school district will repay all outstanding qualified loans on time to the state (new to the act).
- Weighted average age of all school buildings in the district based on square footage (new to the act).
- Overall utilization rate of all school buildings in the school district (as in current law).
- The taxable value per pupil (new to the act).
- Total bonded debt outstanding and total taxable value of property of the district (as in current law).
- A statement describing any environmental or usability problems (new to the act).
- An architect's analysis of the overall condition of the proposed project (new to the act).
- An amortization schedule demonstrating that the weighted average maturity of the qualified bond issue does not exceed 120% of the average reasonable expected useful life of the facilities (new to the act).

The Act would require the State Treasurer to prequalify new bonds of a school district only if the State Treasurer determined that issuing of additional qualified bonds would not prevent the school district from repaying its outstanding qualified loans on time and that the ballot conformed to the requirements in the Act. However, for school districts that submitted a prequalification to the State Treasurer by May 25, 2005, the State Treasurer would be required to prequalify bonds for elections held in 2005 even if the school district did not provide evidence that its outstanding loans would be repaid on time. School districts with fall 2005 elections would be exempt from new ballot language requirements.

The bill would require the State Treasurer to qualify bonds if the following conditions are met:

- Electors of a school district have approved the issuance of bonds.
- The terms of the bond issuance comply with the Revised School Code.
- The school district is in compliance with the Revised Municipal Finance Act.
- The weighted average maturity of the qualified bond issue does not exceed 120% of the average reasonable expected useful life of the facilities.
- The school district has filed any information necessary to update the original application.
- The school district has paid a qualification fee of at least $3,000 for the estimated administrative expenses.

SB 406 (H-1) also requires the following:

1. The order which qualifies bonds must specify various principal and interest payment dates and maximum amounts, computed millage (if any), final repayment dates and other matters determined by the State Treasurer;
2. If borrowing from the SBLRF is expected, the State Treasurer and the school district would have to enter into a loan agreement setting forth the terms of the agreement;
3. If a school district does not issue its qualified bonds within 180 days after the date of the order qualifying the bonds, the school district may reapply for qualification and update the original application for any changes.

A ballot submitted to the electors after November 8, 2005, would have to inform electors that if the school district borrowed from the SBLRF to pay debt service on bonds, the school district may be required to levy mills beyond the term of the bonds to repay the state.

The proposed legislation also changes the school district's repayment schedules for outstanding qualified loans owed to the state. For school districts that currently have qualified loans under the SBLF, the State Treasurer would have to review the taxable value and debt service information for each district. Within 90 days, the State Treasurer will issue an order establishing the payment date for all outstanding qualified loans and any additional qualified loans expected to be incurred before the SB 406 (H-1) effective date. The date of repayment shall be not later than six years after the date on which the qualified bonds were due to be paid off.

For new qualified loans under the SBLRF, the loans would be due not later than six years after the date on which the qualified bonds were due to be paid off. A new provision in the Act would allow school districts to roll old loans from the state into the new qualified bond request, thereby ensuring payoff of the old debt "on-time."

If a school district does not apply to the State Treasurer for qualification of a bond issuance before the bonds are issued, the State Treasurer shall not approve the bonds as qualified bonds under this Act.

Under this bill, when revenue from the school district's debt millage exceeds the debt service payment for the qualified bond, the school district shall notify the State Treasurer and provide any relevant information to this effect. The State Treasurer will then send an invoice to the school district for the amount of repayment due by the school district for that year for payback on its qualified loan from the state. School districts would have 30 days to make payment on the invoice.

If a school district that owes the State for loans from the SBLRF and fails to levy its computed millage for repayment of its qualified bonds and is in default or the loan is unpaid, the State Treasurer shall have the school district's State School Aid payment withheld until the school district makes satisfactory arrangements with the State Treasurer.

If a school district fails to process any report, application, confirmation, or repayment under this Act, the State Treasurer may withhold a school district's state aid funds until the school district complies with the requirements under this Act.

A school district may use any remaining funds from the proceeds after completion of the voter approved project(s) in one of three ways: 1) to pay for enhancement to the projects approved by the electors; 2) to pay debt service on the qualified bonds; or 3) to repay the state for any outstanding loans.

Senate Bill 407 (S-2) would amend the Shared Credit Rating Act to create the new School Bond Loan Revolving Fund (SBLRF). The fund would be assigned the proceeds of bonds or notes issued by the Michigan Municipal Bond Authority (MMBA), revenue from MMBA, contributions from the state, or repayments of loans from the SBLRF. Funds in the SBLRF may be used only to make qualified loans to school districts, establish a reserve fund, secure bonds or notes issued by MMBA to provide funds for the SBLRF, act as a surety, and pay the costs of the MMBA to administer the fund.

Senate Bill 408 would amend Public Act 112 of 1961 to specify that loan repayments would go back to the new revolving fund.

Senate Bill 410 (S-1) would amend the State School Aid Act to allow the State Treasurer to withhold all or part of a School Aid payment to a school district if the school district defaulted on its repayment to the state and failed to make satisfactory arrangements with the Treasurer for the repayment of the amount in default.

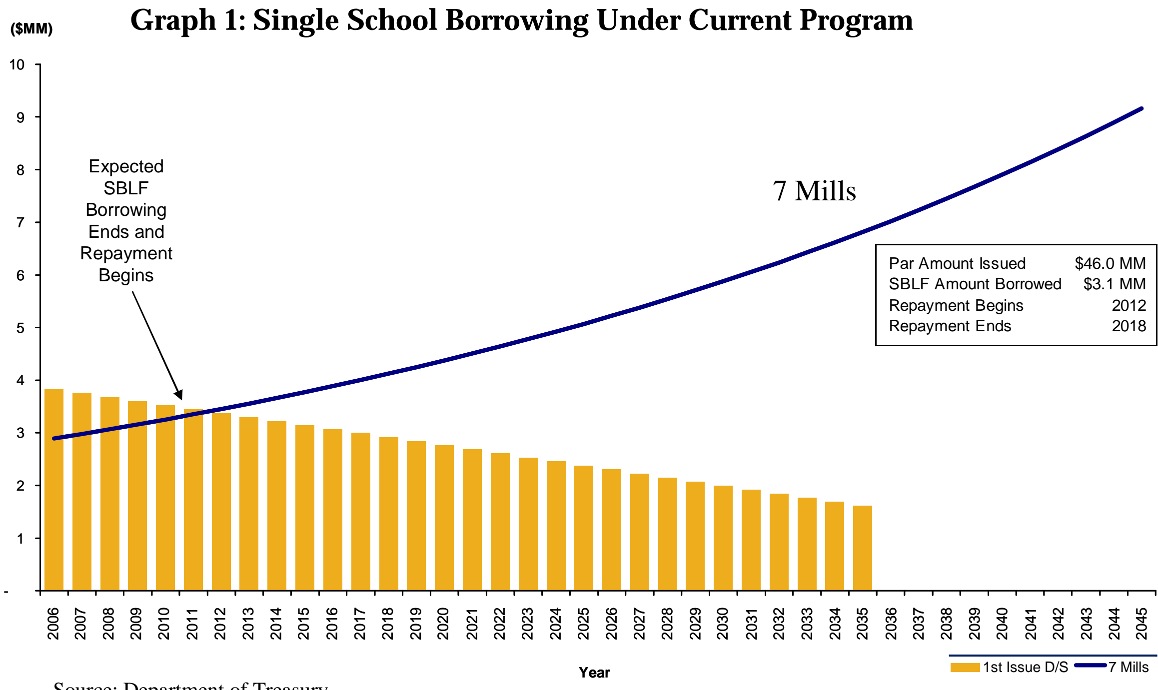
Senate Bill 411 (S-1) would amend the Code of Criminal Procedure to establish a sentencing guideline for the crimes of making a false statement or concealing information to obtain qualification of a school bond and improperly using bond proceeds. The offense would be a Class F felony against the public trust with a maximum term of imprisonment of four years.

The bills are tie-barred together.

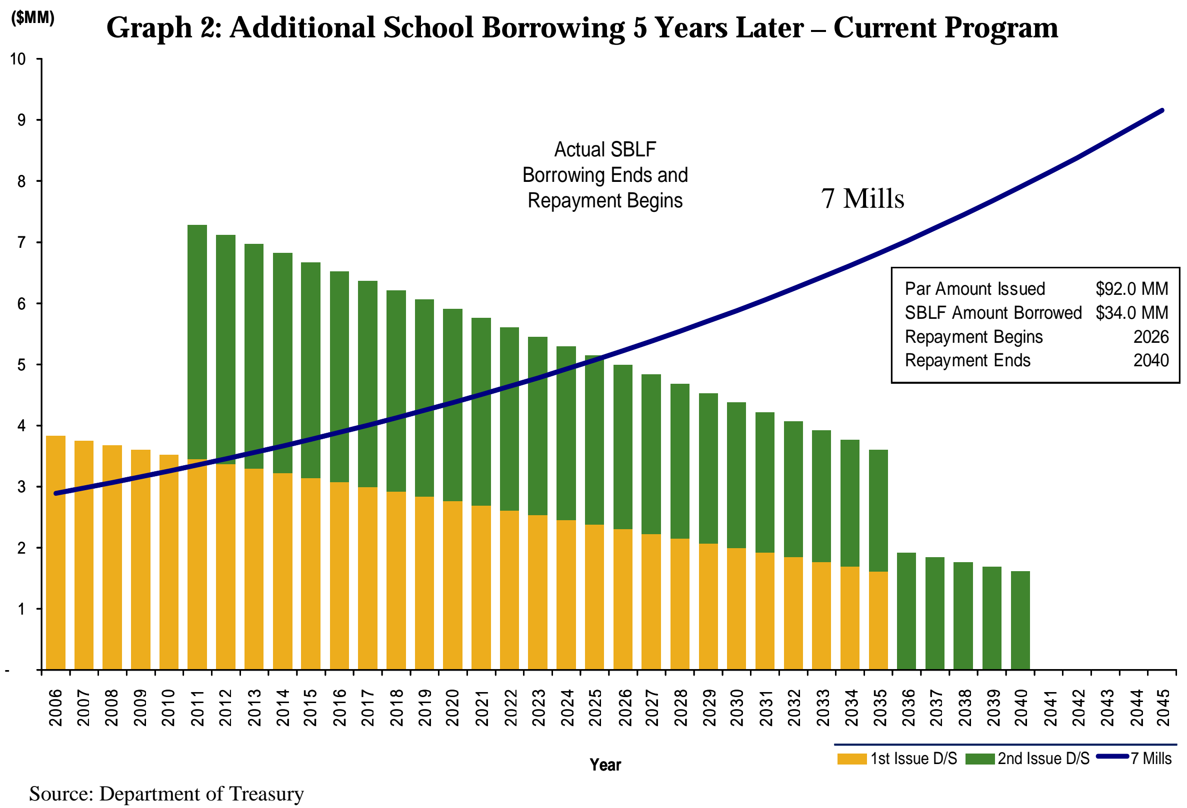
FISCAL IMPACT:

The School Aid Act appropriates the funding for debt service for the School Bond Loan Program. The debt service for FY 2004-05 is $41.1 million and the estimate for FY 2005-06 is $44.5 million. The Executive/Senate/House proposals for the School Aid budget use a portion of the new School Bond Loan Revolving Fund funding to pay the debt service for FY 2004-05 and FY 2005-06, thus saving school aid funds of $85.6 million.

The bill would require that repayments for the school districts be deposited into the SBLRF instead of the General Fund. However, this would not have a fiscal impact on the General Fund revenue used for budget purposes because these deposits are not included in the consensus revenue figures and are not available for general purpose expenditures. In addition, the SBLRF would incur issuance costs (underwriter, bond counsel, and rating agencies) to change from the current school bond loan program to a revolving fund.

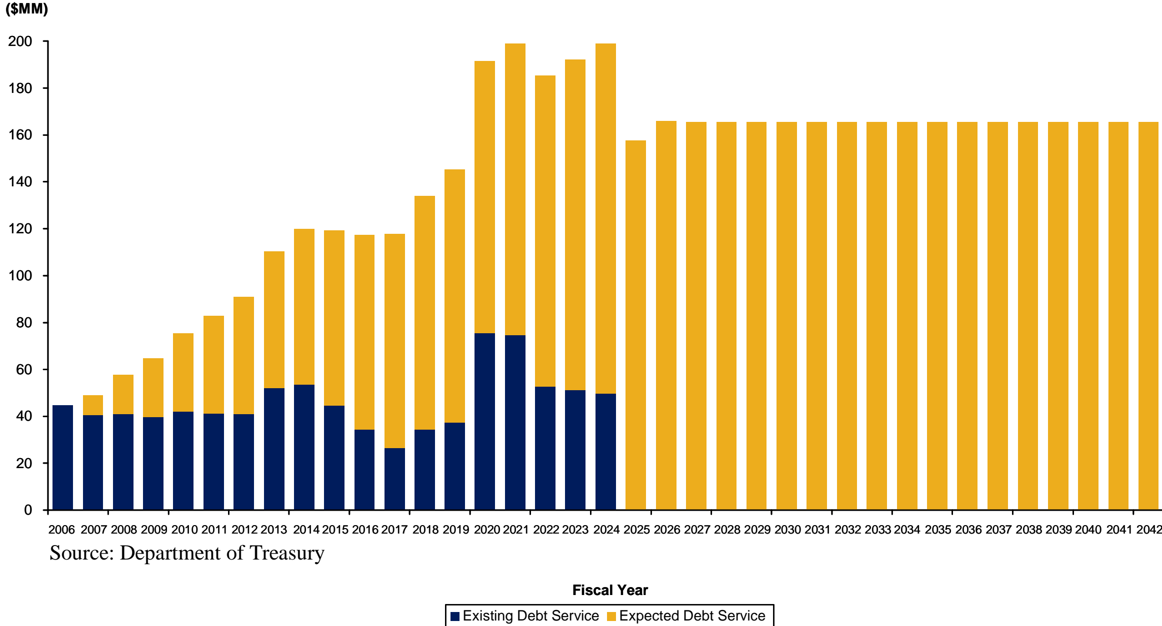


Source: Department of Treasury



Source: Department of Treasury

Graph 3: Existing and Expected GO Bond Debt Service for SBLF



Source: Department of Treasury

(1) Assumes $100 million total new loans made annually including existing commitments.

Analysts: Mary Ann Cleary
Chris Couch
Rebecca Ross

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.