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BILL ANALYSIS

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Senate Bills 406, 407, and 408 (as enrolled) **PUBLIC ACTS 92, 93, & 94 of 2005**
Senate Bills 410 and 411 (as enrolled) **PUBLIC ACTS 95 & 96 of 2005**
Sponsor: Senator Irma Clark-Coleman (S.B. 406)
Senator Michael Switalski (S.B. 407)
Senator Hansen Clarke (S.B. 408)
Senator Burton Leland (S.B. 410)
Senator Deborah Cherry (S.B. 411)
Senate Committee: Appropriations
House Committee: Appropriations

Date Completed: 1-23-07

CONTENT

Senate Bill 406 repealed Public Act (P.A.) 108 of 1961 and replaced it with the "School Bond Qualification, Approval, and Loan Act". The new Act retains much of the previous law while also codifying various standard practices. The bill does not alter the terms and conditions of any outstanding qualified bonds issued in accordance with P.A. 108 of 1961 and the loans associated with those qualified bonds.

The bill retains provisions that allow a school district to apply to the State Treasurer for preliminary qualification of a proposed school bond issue by filing an application that includes the following information:

a) the proposed ballot language
b) a description of the project
c) a debt service projection showing the estimated mills the district will levy to pay the qualified bonds
d) evidence that the rate of utilization will be at least 85% for new buildings
e) evidence that the cost per square foot will be reasonable
f) overall utilization rate of all school buildings in the district
g) total bonded debt outstanding and total taxable value of property of the district.

New items to be included on the preliminary qualification application under S.B. 406 include:

a) an application fee of at least $500 to fund the costs of processing the application
b) evidence that the rate of utilization will be at least 60% (rather than 85%) for renovated buildings
c) evidence that the district will repay all outstanding qualified loans at the times described in the Act (a requirement that is at the heart of the reform)
d) the weighted average age of all school buildings in the district
e) the taxable value per pupil
f) a statement describing any environmental or usability problems to be addressed by the project
g) an architect's analysis of the overall condition of the facilities to be renovated or replaced as a part of the project
h) an amortization schedule demonstrating that the weighted average maturity of the qualified bond issue will not exceed 120% of the average reasonably expected useful life of the facilities.

The crux of the reform is found in the area of the Act that allows the State Treasurer to prequalify new bonds of a school district only if the Treasurer determines that the issuance of additional qualified bonds will not prevent the school district from repaying its outstanding qualified loans on time, and that the form of the ballot conforms with the requirements of the Act. However, a new qualified bond may include a bond issued to refund loans owed to the State. Thus, districts have the means to combine old loans (associated with previous bond issues) with the new bond issue, thereby repaying outstanding qualified loans on time. Also, for those districts that submitted prequalification applications by May 25, 2005, the Treasurer could prequalify bonds for elections held in 2005 even if the district could not provide evidence that its outstanding loans would be repaid on time. Districts with elections in the fall of 2006 were exempt from the new ballot language requirements.

The bill retains existing provisions under which the State Treasurer may qualify bonds if the following conditions are met:

a) a majority of the school district electors have approved the bonds
b) the terms of the bonds comply with the Revised School Code
c) the district is in compliance with the Revised Municipal Finance Act
d) the district has filed any information necessary to update the original application
e) the district has paid a qualification fee of at least $3,000 to cover administrative expenses.

Under a new provision for the final qualification of bonds, the weighted average maturity of the qualified bond issue may not exceed 120% of the average reasonably expected useful life of the facilities.

The legislation contains three more new aspects for the final qualification of bonds: a) The order qualifying the bonds must specify various principal and interest payment dates and maximum amounts, computed millage (if any), final repayment dates, and other matters; b) if borrowing from the revolving fund is anticipated, the State Treasurer and school district must enter into a loan agreement setting forth the terms; and, c) if a district does not issue its qualified bonds within 190 days after the date of the order qualifying the bonds, the district may reapply for qualification by filing an application, paying a fee of at least $500, and updating any necessary information.

A new requirement under S.B. 406 provides that a ballot submitted to the school electors must inform the electors that if the district borrows from the State via the revolving fund to pay debt service on the bonds, then the district may be required to continue to levy mills beyond when the bonds are paid off in order to repay the State.

Under the bill, districts that previously could refund (i.e., refinance) nonqualified bonds and turn them into qualified bonds under limited certain circumstances may no longer do so. However, a district still may refund qualified bonds if the State Treasurer finds that the refunding bonds comply with the Revised Municipal Finance Act. Also, a district with nonqualified bonds may continue to refund them privately as nonqualified bonds.

Again, the crux of the reform lies in the changes in schedules for the repayment of outstanding qualified loans the districts owe to the State. For school districts having existing qualified loans issued under the School Bond Loan Fund, the State Treasurer must review taxable value and debt service information for each district and, within 90 days, issue an order establishing the payment date for all those outstanding qualified loans and any additional qualified loans expected to be incurred by those districts related to qualified bonds issued before the bill's effective date. The payment date will be not later than six years after the date on which the qualified bonds are due to be paid off.

A new provision allows for a district, with voter approval, to "roll-in" any loans owed to the State on top of the new bond issue. For example, if a district owed the State $2.0 million in loans, and the new bond project were $20.0 million, then the district could request qualification for a bond in the amount of $22.0 million. In this manner, the State will be repaid what it is owed if the voters approve the "rollover" of the old debt combined with the new project.

For new qualified loans from the revolving fund related to qualified bonds issued after the enactment of the bill, the loans will be due not later than six years after the date on which the qualified bonds are due to be paid off.

Under the bill, when revenue from a district's debt millage levy exceeds the debt service payment for the qualified bonds, the district must notify the Department of

Treasury and provide relevant information. Then, twice a year, the State Treasurer will send an invoice to the district for the amount of repayment the school district owes on its qualified State loans, which will be the difference between the revenue raised from the debt millage levied and the amount of debt service owed on the qualified bonds. Districts must pay the amount specified in the invoice within 30 days after the date on the invoice.

Under the bill, the interest rate that will be charged to school districts for loans from the revolving fund changes from the State's average cost of funds rounded to the nearest one-eighth of 1%, to the average cost of funds plus one-eighth of 1%.

New fees will be imposed on school districts that failed to process reports or applications on time and as required under the Act. For the first occurrence of a failure, a $500 special handling fee will be imposed, and for each subsequent occurrence, a fee of $1,000 will be assessed. All fees collected under the Act will be deposited into a new fund established solely for the purpose of administration and enforcement of the Act.

One final change from current law is found in S.B. 406. Previously, a school district could petition the Department of Treasury to use any residual funds left over after all the qualified bond projects were completed to address health and safety issues in the district. The bill removed this application and instead allows districts to use residual funds in one of three ways: 1) to pay for enhancements to the projects approved by the school electors as described in the ballot; 2) to pay debt service on the qualified bonds; or 3) to repay the State for any outstanding loans.

<u>Senate Bill 407</u> amended the Shared Credit Rating Act, with the primary purpose of establishing the School Loan Revolving Fund (referred to below as "revolving fund"). This fund is assigned the proceeds of bonds or notes issued by the Michigan Municipal Bond Authority (MMBA), revenue of the MMBA, contributions from the State including dollars resulting from the assignment of the right to receive loan repayments on qualified loans made or authorized under a school loan act, or repayments from the revolving fund. Funds residing in the revolving fund may be used only for making qualified loans to school districts, establishing a reserve fund, securing bonds or notes issued by the MMBA to provide funds in the revolving fund, acting as a surety, and paying the costs of the MMBA to administer the fund.

Using the fixed repayment schedule for school districts' existing and future qualified loans from the State (under S.B. 406), the MMBA under S.B. 407 may borrow against the repayment stream asset and receive funds to establish the revolving fund.

<u>Senate Bill 408</u> amended Public Act 112 of 1961 (the SBLF financing act) to require repayments on loans made from the new revolving fund to be deposited back into the revolving fund. In addition, the State Treasurer may assign repayments on loans previously made from the SBLF to the revolving fund, rather than the General Fund.

<u>Senate Bill 410</u> amended the State School Aid Act to allow the State Treasurer to withhold all or part of a district's State Aid payment if the district defaults on its repayment of a qualified loan from the State and fails to make satisfactory arrangements with the Treasurer for the payment of the amount in default.

<u>Senate Bill 411</u> amended the Code of Criminal Procedure to include a violation of Section 17 of S.B. 406 in the sentencing guidelines. Making a false statement or concealing material information to obtain qualification of a school bond issue or improperly using proceeds of a school bond is a Class F felony against the public trust punishable by a maximum of four years' imprisonment.

The bills were tie-barred together.

<u>BACKGROUND</u>

Public Act 108 of 1961 implemented Article IX, Section 16 of the Michigan Constitution of 1963, which requires the State to make loans to school districts for qualified capital construction projects under certain conditions. This Act was commonly referred to as the School Bond Loan Fund (SBLF) Act. Over the last four decades, the amount of loans the State made to districts grew, and stood at more than $704.0 million as of June 2005. Because the State had to borrow in order to have money to lend, the State incurred debt service costs. These costs grew over time because the rate at which the districts repaid the State was slower than the rate at which the State paid back its own debt. This occurred because, under previous law, districts could postpone repayment of their SBLF debt by obtaining qualification and issuing new bonds on a second construction project before repaying the State for the first project's borrowing. Therefore, the State repaid its debt more rapidly than it received payments from districts.

School districts may seek qualification of bond projects from the State in order to accomplish three objectives: 1) The bonds are guaranteed by the State; 2) the district is able to use the State's credit rating when selling its qualified bonds, thereby obtaining a lower interest rate; and 3) if the district's millage levy in any given year is insufficient to pay the principal and interest, the district may borrow the difference from the SBLF.

FISCAL IMPACT

The reform of the SBLF from its former state to a revolving fund will, by enabling the MMBA to borrow against the newly formed asset (resulting from the fixed repayment schedule), yield revenue of $41.1 million in fiscal year (FY) 2004-05 and $44.5 million in FY 2005-06, along with "seed money" to begin the revolving fund. Aside from the "seed money", the dollars were proposed by the Administration to be appropriated in the School Aid Act for both fiscal years to pay the existing SBLF debt service, and were in fact assumed in the Governor's recommended budgets for K-12. Without the reform or exponentially increased repayments from school districts on loans owed to the State, the FY 2004-05 School Aid budget would, all else being equal, have been in deficit by $41.1 million. In addition, the Governor's recommended budget for FY 2005-06 would have been out of balance by $44.5 million.

In the long run and without a reform in the SBLF system, projections by the Department of Treasury indicate that State debt service costs would grow from $44.5 million estimated in FY 2005-06 to $200.0 million in FY 2020-21, falling to a yearly cost of $165.0 million beginning in FY 2025-2026. However, under the reform, the State will no longer have to issue additional General Obligation bonds to provide the money to lend to school districts, and therefore the State's debt service costs on existing General Obligation debt will have a finite end date estimated to be FY 2023-24.

While repayments from districts on funds borrowed from the SBLF were deposited into the General Fund, there is no General Fund impact. This is due to the fact that the consensus revenue estimates (and subsequent budget appropriations) do not include any estimated repayments.

Each school district will experience a different impact under the SBLF reform package. Variables affecting districts and their ability to be prequalified for new bonds under the reform include current bonded indebtedness (or lack thereof), existing taxable value, taxable value growth, and future construction needs. Local school districts applying for prequalification, qualification, or loans from the revolving fund will see changes in the fee structure as outlined above, but fiscal impacts will vary according to activities.

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