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BILL ANALYSIS

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Senate Bill 406 (Substitute S-3 as reported by the Committee of the Whole)
Senate Bill 407 (Substitute S-2 as reported without amendment)
Senate Bill 408 (as reported by the Committee of the Whole)
Senate Bill 410 (Substitute S-1 as reported without amendment)
Senate Bill 411 (Substitute S-1 as reported without amendment)
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)
Committee: Appropriations

BACKGROUND

Public Act 108 of 1961 currently implements 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 is commonly referred to as the School Bond Loan Fund (SBLF) Act. Over the last four decades, the amount of loans the State has made to districts has grown, and now stands at more than $704.0 million. Because the State must borrow in order to have money to lend, the State incurs debt service costs. These costs grow over time because the rate at which the districts repay the State is slower than the rate at which the State pays back its own debt. This occurs because, under current law, districts may 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 repays its debt more rapidly than it receives 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.

CONTENT

Senate Bill 406 (S-3) would repeal Public Act (P.A.) 108 of 1961 and replace it with the "School Bond Qualification, Approval, and Loan Act". The proposed Act would retain much of current law while also codifying various standard practices. The bill would 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 would retain current 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 proposed in S.B. 406 (S-3) include:

a) an application fee of at least $500 to fund the costs of processing the application
b) evidence that the rate of utilization would be at least 60% (rather than the current 85%) for renovated buildings
c) evidence that the district would 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 would 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 proposed Act that would allow the State Treasurer to prequalify new bonds of a school district only if the Treasurer determined that the issuance of additional qualified bonds would not prevent the school district from repaying its outstanding qualified loans on time, and that the form of the ballot conformed with the requirements of the Act. However, 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 this fall also would be exempt from the new ballot language requirements.

The bill would retain current 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 could not exceed 120% of the average reasonably expected useful life of the facilities.

The legislation proposes three more new aspects for the final qualification of bonds: a) The order qualifying the bonds would have to 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 were anticipated, the State Treasurer and school district would have to enter into a loan agreement setting forth the terms; and, c) if a district did not issue its qualified bonds within 190 days after the date of the order

qualifying the bonds, the district could 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 (S-3) provides that a ballot submitted to the school electors would have to inform the electors that if the district borrowed from the State via the revolving fund to pay debt service on the bonds, then the district could be required to continue to levy mills beyond when the bonds were paid off in order to repay the State.

Under the proposal, districts that currently may refund (i.e., refinance) nonqualified bonds and turn them into qualified bonds under limited certain circumstances would not be able to do so in the future. However, a district still could refund qualified bonds if the State Treasurer found that the refunding bonds complied with the Revised Municipal Finance Act. Also, a district with nonqualified bonds could continue to refund them privately as nonqualified bonds.

Again, the crux of the reform lies in the proposed changes in schedules for the repayment of outstanding qualified loans the districts owe to the State. For school districts having qualified loans issued under the current School Bond Loan Fund (i.e., existing loans today), the State Treasurer would have to 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 would be not later than six years after the date on which the qualified bonds were due to be paid off.

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

Under the bill, when revenue from a district's debt millage levy exceeded the debt service payment for the qualified bonds, the district would have to notify the Department of Treasury and provide relevant information. Then, twice a year, the State Treasurer would send an invoice to the district for the amount of repayment the school district owed on its qualified State loans, which would be the difference between the revenue raised from the debt millage levied and the amount of debt service owed on the qualified bonds. Districts would have to pay the amount specified in the invoice within 30 days after the date on the invoice.

Under the proposal, the interest rate that would be charged to school districts for loans from the revolving fund would change 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 would 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 would be imposed, and for each subsequent occurrence, a fee of $1,000 would be assessed. All fees collected under the Act would 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 (S-3). At present, a school district may petition the Department of Treasury to use any residual funds left over after all the qualified bond projects are completed to address health and safety issues in the district. The proposal would remove this application and instead allow 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.

Senate Bill 407 (S-2) would amend the Shared Credit Rating Act, with the primary purpose of establishing the School Loan Revolving Fund (referred to below as "revolving fund"). This fund would be 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 could 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 (proposed in S.B. 406 (S-3)), the MMBA under S.B. 407 (S-2) could borrow against the repayment stream asset and receive funds to establish the revolving fund.

Senate Bill 408 would amend Public Act 112 of 1961 (the SBLF financing act) to require repayments on loans made from the proposed revolving fund to be deposited back into the revolving fund. In addition, the State Treasurer could assign repayments on loans previously made from the SBLF to the revolving fund, rather than the General 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 district's State Aid payment if the district defaulted on its repayment of a qualified loan from the State and failed to make satisfactory arrangements with the Treasurer for the payment of the amount in default.

Senate Bill 411 (S-1) would amend the Code of Criminal Procedure to include a violation of Section 17 of S.B. 406 (S-3) 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 would be a Class F felony against the public trust punishable by a maximum of four years' imprisonment.

The bills are tie-barred together.

FISCAL IMPACT

If enacted, the reform of the SBLF from its current state to a revolving fund would, 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 are proposed by the Administration to be appropriated in the School Aid Act for both fiscal years to pay the existing SBLF debt service, and are 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 will, all else being equal, be in deficit by $41.1 million. In addition, the Governor's recommended budget for FY 2005-06 would be 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 will 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, if the reform were to occur as proposed, the State would 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 would have a finite end date estimated to be FY 2023-24.

While current repayments from districts on funds borrowed from the SBLF are deposited into the General Fund, there would be 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 would experience a different impact if the SBLF reform package were enacted. 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 would see changes in the fee structure as outlined above, but fiscal impacts would vary according to activities.

Date Completed: 6-7-05 Fiscal Analyst: Kathryn Summers-Coty

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