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BILL ANALYSIS

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House Bill 5384 (Substitute H-1 as passed by the House)
Sponsor: Representative Daniela Garcia
House Committee: Appropriations
Senate Committee: Committee of the Whole

CONTENT

The bill would amend the Revised School Code to provide for the transfer of a "qualifying school district" (Detroit Public Schools) to a proposed "community district" on July 1, 2016 (the "transfer date"), and provide that the qualifying school district would retain a limited separate identity and its territory would continue as a separate taxing unit for the purpose of repaying outstanding debt until the debt was retired.

With respect to the creation, organization, and operation of the district, the bill would do the following:

-- Provide for an initial appointed school board for the community district consisting of seven school electors of the district, including two appointed by the mayor, three appointed by the Governor, one appointed by the Governor from nominees submitted by the Senate Majority Leader, and one appointed by the Governor from nominees submitted by the Speaker of the House.
-- Require the board, within 60 days after the community district was created, to appoint a superintendent, subject to the approval of the Financial Review Commission in place for the City of Detroit.
-- Require the appointed board to serve until the election of the initial elected board, which would have to consist of seven school electors of the district elected on a districtwide basis.
-- Require the board to be elected at the first regular August election occurring at least 180 days after the transfer date (i.e., in August 2017).
-- Provide that the board of the qualifying district would continue for limited purposes related to the repayment of debt and dissolution of the district, until the members of the board of the community district were elected and took office.
-- Provide that the community district would be subject to the financial oversight of the Financial Review Commission in place for the City of Detroit.
-- Require the board of the community district to assign an official or administrator to coordinate and oversee all funding received by the district from a foundation, corporation, or other private source to ensure that the funding was used for its intended purpose; and, unless the funding was restricted for another purpose, require it to be used only for academic programs or "wraparound services".
-- Prohibit the community district from spending more than 6.3% of its current operating expenditures for administrative expenditures.
-- Require the community district board to ensure that it did not reimburse a school board member, official, or employee of the district from public funds for out-of-State travel.
-- Extend borrowing authority to the community district.

The bill also would appropriate $250,000 from the General Fund to the Department of Treasury for fiscal year 2015-16 for the purpose of providing financial support for the organization and administration of the community district during that fiscal year. The State Treasurer would have to ensure that a portion of the money was allocated to provide school board training to the initial elected members of the community district board.

With respect to school closures and the opening of new schools, the bill would do the following:

-- Provide that a school within the community district that had operated for at least four years and was on the list of the lowest-achieving 5% of public schools in the State for three out of the previous five years would have to be included on a list of public schools subject to closure; and require the State School Reform/Redesign Office (SRRO) to prepare and publish that list by October 1 each year.
-- Require the SRRO to issue an order subjecting each public school on the list to closure as of the end of the current school year, but allow the SRRO to rescind that order if the closure of a school would result in unreasonable hardship to pupils because there were insufficient other public school options reasonably available.
-- Prohibit the community district, within three years after a public school was ordered to close, from opening a new school at the same location unless the new school had a substantially different leadership structure and substantially different curricular offerings and was approved by the SRRO.
-- Prohibit the board of the community district from opening a new school if it would operate at the same location as a school that was currently on the list of the lowest-achieving 5% of public schools in the State or had been on that last during the preceding three years, and the proposed school would have substantially the same leadership and curricular offerings as the school that previously operated at that location.

Regarding personnel of the community district, the bill would:

-- Provide that an individual who was entitled to employment by the qualifying district on the transfer date would be entitled to employment by the community district, but the terms and conditions of a collective bargaining agreement applicable to school employees of the qualifying district on the transfer date would not be the terms and conditions applicable to employees of the community district.
-- Allow the district to engage a full- or part-time noncertificated, nonendorsed teacher to teach in its schools if the appropriate official of the district determined that, due to the individual's education and experience, it would be appropriate and in the best interests of the pupils of the district.
-- Provide that, for teachers and administrators hired by the community district after the bill's effective date, the district would have to implement and maintain a method of compensation that included job performance and job accomplishments as the primary factor in determining compensation and additional compensation.
-- Provide that the district could not use length of service or achievement of an advanced degree as a factor in compensation levels, except as otherwise provided.

With respect to a public school academy (PSA) to be located within the community district, the bill would prohibit an authorizing body from issuing a contract to organize and operate a new PSA unless the Superintendent of Public Instruction determined that the authorizing body had been accredited by a national recognized accrediting organization specializing in the accreditation of charter school authorizing bodies. The bill also would prohibit an authorizing body from issuing a contract for a new PSA to be located in the community district under substantially the same circumstances under which the district board would be prohibited from opening a new school. In addition, a public school academy would be subject to the proposed requirements for the closure of a school by the SRRO.

In addition, the bill would allow the qualifying district, with the approval of the State Treasurer, to issue "school financing stability bonds" for the purpose of eliminating an operating or projected operating deficit or refunding or refinancing outstanding State aid anticipation notes issued through the Michigan Finance Authority. The qualifying district could pledge as security for repayment State school aid payment, school operating tax revenue, and other revenue; and could enter into an agreement with the Department of Treasury or the Michigan Finance Authority for direct payment of school aid to the Authority or a designated trustee.

The bill also would do the following:

- -- Allow the board of a school district, rather than a school district that operates grades K-12, to be an authorizing body for a public school academy.
- -- Revise the conditions under which an authorizing body must be notified and take action when a site is among the 5% lowest-performing schools in the State.
- -- Expand provisions under which a school district is not required to employ a superintendent.
- -- Require a constituent district to transfer regional enhancement property tax revenue to another school district or public entity that operated a public school for the constituent district.
- -- Allow a district to provide public education services through an agreement, contract, or other cooperative arrangement with another public entity, including another school district or an intermediate school district.

The bill would repeal Part 5A of the Code, which provides for the appointment of a school reform board to govern Detroit Public Schools, and other sections of the Code related to a vote on the question of reapportioning the district.

MCL 380.3 et al. Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

State: The fiscal impact of House Bill 5384 (H-1) would depend, in part, on whether Senate Bill 819, or similar legislation, is enacted. If Senate Bill 819, or a similar bill, is enacted to provide for the financing of the Detroit Public Schools (DPS) debt to be paid by allowing the "old" district (the "qualifying district") to retain its identity as a taxing authority, while the "new" district (the "community district") would not levy basic operating millage to finance its foundation allowance (requiring the State to pay 100% of the community district's per-pupil funding), then the cost to the State of House Bill 5384 (H-1) would be roughly $71.0 million per year until the qualifying district's debt was repaid. (That time frame is estimated at eight years under this bill due to the more restricted definition of transitional operating costs compared to the Senate package of bills on DPS, although it could be longer if significant interest costs accrued when financing DPS' debt.)

The existing debt is estimated by the Department of Treasury to total $467.0 million (down from the earlier estimate of $515.0 million due to supplemental funding under Public Act 54 of 2016 equal to $48.7 million), and repayments against the debt from the district's 18-mill operating levy would roll in at roughly $65.0 million to $70.0 million per year. The bill would allow for transitional operating costs, defined as costs relating to changes in timing for grant funding or reimbursements or costs incurred in meeting cash flow needs, to be included in school financing stability bonds. While the House has referred to cash flow needs of $33.0 million, there is no dollar cap on transitional costs in the bill, with the exception of a prohibition that they not exceed 3% of the taxable value of the qualifying district, which would be roughly $202.0 million. However, as mentioned above, the definition of transitional operating costs is narrower than in the legislation passed by the Senate, and therefore transitional operating costs under the definition in this bill likely would mean a cost less than the $202.0 million cap.

However, the debt financing proposal described above would be only partially covered by House Bill 5384 (H-1); in fact, Senate Bill 819 includes amendments to the State School Aid Act (SAA) to first provide the "new" district with a foundation allowance and then provide that the State would pay 100% funding of that foundation allowance. Currently, the SAA requires local districts to levy operational mills in partial support of the cost of a district's foundation allowance. In the current year, DPS levies 18 operational mills, bringing in an assumed $71.3 million yearly. This equates to $1,687 per general education pupil, which is applied toward DPS' $7,434 per-pupil foundation allowance, and the State makes up the difference of $5,747 per general education pupil. (This is the same formula calculation for all districts: Local districts are required to levy mills for basic operations, and the State pays the difference between what is received in local revenue and the district's foundation allowance, capped at the basic foundation allowance. Foundation allowances for public school academies, or charter schools, are 100% State funded because charters do not levy mills.)

The enactment of House Bill 5384 (H-1) with the concurrent enactment of Senate Bill 819, or similar legislation, would trigger the fiscal impact on the State, estimated at $71.0 million per year, which is equal to the diversion of the operating taxes to pay off debt. Again, this has been estimated by the Department of Treasury to total $467.0 million in existing debt, plus transitional operating costs allowed under the House bill. If the total cost of the debt, transitional operating costs, and any interest accrued in financing the debt exceeded $500.0 million, then the additional cost would be borne by the School Aid Fund, since House Bill 5387 would earmark a maximum of $500.0 million from Tobacco Settlement revenue to the Community District Education Trust Fund for the purpose of backfilling the hole left by diverting the 18-mill revenue to pay debt.

There are other provisions of House Bill 5384 (H-1) that could or would have fiscal impacts on the State. First, and most straightforward, the bill would appropriate $250,000 from the General Fund to the Department of Treasury, which would be a cost increase to the State. Second, as mentioned above, the bill would allow for transitional operating costs to be included in school financing stability bonds, and ultimately considered part of the qualifying district's debt. Third, the bill would allow school districts to "cause education to be provided" for pupils through an agreement with another public entity, and if the other public entity were not part of the retirement system, it is possible that higher stranded retirement costs could occur, again paid by the School Aid Fund (SAF). Related to the previous point, if the community district employed a substantial number of noncertificated, nonendorsed teachers as allowed under the bill, and if those teachers were not part of the retirement system, that would lead to increased stranded costs paid for by the SAF. Fourth, the additional requirement for the State Reform/Redesign Office to assess whether schools on the closure list would result in an unreasonable hardship to pupils could require additional resources; since the SRRO is funded under the Department of Technology, Management, and Budget, this could be an additional State cost.

<u>Local (DPS)</u>: As noted above, amendments to the School Aid Act under Senate Bill 819 would provide the community district established under House Bill 5384 (H-1) with a foundation allowance and allow for that foundation allowance to be fully funded by the State, instead of being partially funded with local revenue. The bill would provide "transitional operating cost" revenue to pay for the cost of cash flow incurred by a community district as a result of the transfer of functions and responsibilities from a qualifying district. Another local fiscal impact would be the costs to provide an annual evaluation and report on academic performance (if not already done by DPS), and the cost of a financial audit, if necessary to arrive at a conclusive determination of the amount of a deficit. The bill also would allow the community district to borrow money and issue bonds for capital improvements. Other provisions that would affect the new community district include a requirement that the district not spend more than 6.3% of its current operating expenditures for administration (in FY 2014-15, DPS spent 8.7%); a prohibition against using any public funds to reimburse for out-of-State travel expenses; and a requirement that the community district prioritize a portion of its funding to pay for facility-related improvements, such as costs associated with deferred maintenance, space consolidation, and school closure or other building closures. Finally, the community district could face different costs if employing a noncertificated, nonendorsed teacher when compared to the costs of employing a certificated, endorsed teacher, and likely would face

different cost structures based on paying for job performance and job accomplishments rather than based on seniority or achievement of an advanced degree, but those impacts are indeterminate.

Local (All Districts): It is anticipated that the bill would have fiscal impacts on all districts, not just DPS, as follows: The bill would allow districts to "cause education to be provided" through a contract or cooperative agreement, instead of directly employing staff to provide education, which could have fiscal impacts on the districts. Also, the requirements for some schools to close if underperforming (instead of being subject to one of four intervention models) could have an impact on the affected district's finances, if the children from a closed school chose to attend a different district than the district in which they had been attending previously.

In addition, the bill's restrictions on new public school academies operating in a community district, or on new schools operated by the community district, in situations where the new school would operate where an underperforming school had operated previously, could affect the resulting locations of new schools, which also likely could affect which districts pupils enrolled in. If pupils changed where they intended to enroll based on the requirements for opening new schools, this could shift funding among the districts and public school academies in ways different than under current law. While there should be little State impact (since the pupils would be enrolled and counted for foundation allowance funding in one place or another), there could be fiscal impacts on the community district, surrounding local districts, or public school academies based on these requirements.

Date Completed: 5-11-16 Fiscal Analyst: Kathryn Summers