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BILL ANALYSIS

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Senate Bill 770 (Substitute S-3 as passed by the Senate)
Senate Bill 771 (Substitute S-1 as passed by the Senate)
Senate Bill 772 (Substitute S-1 as passed by the Senate)
Sponsor: Senator John Pappageorge (S.B. 770)
Senator Phillip Pavlov (S.B. 771)
Senator Howard Walker (S.B. 772)
Committee: Appropriations

Date Completed: 6-14-12

CONTENT

Senate Bill 770 (S-3) would amend the School Bond Qualification, Approval, and Loan Act to do the following:

-- Provide that, in order to prequalify a proposed bond issue that would result in additional qualified loans, the Treasurer would have to determine that the outstanding balance of all qualified loans, including principal and interest, did not exceed $1.8 billion as of the previous May 1 or November 1. School districts already participating in the qualified loan program at the time the cap was reached would still be able to borrow.
-- Set a "final mandatory repayment date". That date would apply to all qualified bonds and loans of a school district, and would be a single date for each school district set at 72 months after the qualified bonds were due. An order qualifying bonds would include the final mandatory repayment date. This would apply until 30 days after the date that the district had no outstanding qualified bonds or qualified loans. The State Treasurer would be authorized to set a later mandatory repayment date if a school district agreed to levy a millage higher than its existing computed millage, but not more than 13 mills.
-- Provide that, in order to prequalify a proposed bond issue, a district would have to provide evidence that existing qualified bonds and loans and any proposed qualified bonds and loans would all be repaid by the final mandatory repayment date. Prequalification of bonds also would require a determination by the State Treasurer that the issuance of more qualified bonds would not have an adverse impact on the finances of the school district, the State, or the School Loan Revolving Fund. The State Treasurer would be required to consider relevant economic factors, including whether the total bonds and qualified loans outstanding for a district would exceed 25% of the district's taxable value at the time of issuing additional bonds.
-- Require all school districts with outstanding qualified bonds or qualified loans to recalculate at least annually the millage rate required to pay the principal and interest on the qualified bonds and qualified loans by the final mandatory repayment date; and, to levy the higher or lower computed millage rate, up to a maximum of 13 mills and not less than the computed millage established when the bonds were qualified and not less than 7 mills. The requirement to recalculate the millage and levy the computed millage rate would be effective on October 1, 2012. The State Treasurer would be authorized to redetermine the millage rate if the Treasurer found a district's calculations to be in error. The district would be required to levy the redetermined rate.
-- Change the taxable value assumptions used to estimate repayment schedules at the time of bond prequalification. Taxable value for the first five years after the application date would be estimated using the average rate of growth or decline in taxable value

over the previous five years. For the remaining term of the bond, the taxable value would be assumed to change based on the average growth rate for the 20 years preceding the date of application, but not more than 3.0% or less than 0.0%.

-- Permit school districts to request the State Treasurer to approve use of a period for considering changes in taxable value other than the average growth for the preceding five years.
-- Change the requirements for State Treasurer qualification of refunding bonds to include a determination that a school district would repay all outstanding qualified and proposed qualified bonds and loans by the final mandatory repayment date and that the refunding would be financially beneficial to the State.
-- Require ballot language presented to voters for approval of bonds for which a district expected to borrow from the State to pay debt service, to include the total principal and the interest to be paid on that loan, the estimated millage rate for that levy, and a statement that the millage rate could be changed during the duration of the levy.
-- Authorize the State Treasurer to charge fees for prequalification applications, qualification applications, and annual loan activity. The State Treasurer could set the fees at levels that would pay the estimated administrative costs of the program in that fiscal year.
-- Modify the interest rate required on qualified loans. The interest rate could not be less than the cost of the bonds or notes issued by the Michigan Finance Authority to finance the loans. Also, the State Treasurer could set a higher interest rate if necessary to prevent the impairment of any contract of the State or the Michigan Finance Authority existing on the bill's effective date.
-- Simplify the process for school districts to notify Treasury when they do not need to borrow for paying principal and interest on bonds.
-- Limit the use of bond proceeds remaining after approved projects are completed. Bond proceeds could be used for enhancements to the voter-approved projects only if the school district's bond counsel determined that using the proceeds for paying debt service on the bonds or repaying State loans would have an adverse effect on the Federal tax treatment of the interest on the qualified bonds.
-- Require school districts to maintain detailed records of the investment and spending of the proceeds of qualified bonds. Districts would be required to provide these data to the State Treasurer upon request and on a date specified by the State Treasurer that would allow a district at least five business days to provide the detailed information.

Senate Bill 771 (S-1) would amend Public Act 112 of 1961 (the School Bond Loan Fund financing act) to:

-- Authorize the State Treasurer to accept the assignment of loans or repayments on loans made from or payable to the School Loan Revolving Fund.
-- Specify that the proceeds of the sale of bonds, notes, or commercial paper issued to reimburse the State or the Michigan Finance Authority would have to be applied as determined by the State Administrative Board.

Senate Bill 772 (S-1) would amend the Shared Credit Rating Act to:

-- Authorize the board of the Michigan Municipal Bond Authority (whose functions are now carried out by the Michigan Finance Authority) to assign to the State loans and loan repayments made from or payable to the School Loan Revolving Fund.
-- Remove the limit on the principal amount of qualified bonds that may be purchased in a year from school districts by the Authority. Currently, that principal amount may not exceed 7.5% of the principal amount of qualified bonds issued by school districts in the prior year.

The bills are tie-barred.

MCL 388.1923 et al. (S.B. 770)
MCL 388.981 et al. (S.B. 771)
MCL 141.1057 & 141.1058 (S.B. 772)

BACKGROUND

Article IX, Section 16 of the Michigan Constitution provides for State loans to school districts that issue State-qualified general obligation bonds for capital expenditures. Under the Constitution, the loans are available according to the terms and procedures established by the Legislature. The Constitution provides that for a bond that is "qualified" by the State, if the mills that a district would need to levy to repay the principal and interest on those qualified bonds "…exceed 13 mills…or such lower millage as the legislature may prescribe, then the school district may elect to borrow all or any part of the excess from the state. In that event the state shall lend the excess amount to the school district for the payment of principal and interest." These loans, known as qualified loans, also are available to a school district with a qualified bond if the school district is unable to pay the principal and interest on its qualified bonds when due.

Districts seek to qualify bonds in order to sell their bonds using the State's credit rating and to have access to qualified loans if needed. To take out a qualified loan, a school district must levy at least seven mills and not more than 13 mills; the seven-mill minimum is set by statute and the 13-mill maximum is established in the Constitution. Loans are supposed to be repaid within six years after the bond principal is paid off, but current law allows existing loans to be refunded by a new bond issue. Although the loans to the State are repaid, the district may continue to borrow from the SBLF on existing or new bonds. Under the current act, with a loan balance of zero the district would receive a new, later final mandatory repayment date when additional bonds were issued for new projects. Potentially, the district would still be repaying the refunding bonds, previously issued bonds, and the new issue, all of which if qualified bonds, could require additional qualified loans from the State. Many districts with qualified bonds may never take out qualified loans. Other districts use qualified loans from the State to make bond debt service payments to smooth the millage rate over time, perhaps borrowing from the State in the early years that the bonds are outstanding and repaying loans later in the life of the bond or after the bonds are repaid. Some districts continue to issue bonds and accumulate additional qualified loans. This increases their outstanding qualified loan balance and delays repayment of the loans to the State for many years.

FISCAL IMPACT

State: Under the School Bond Loan Fund (SBLF) program, the State is required to make loans available to school districts in order to "smooth out" the repayment of a district's bonds, if those bonds are first qualified, the loan is necessary to repay the principal and interest on the bonds (due to taxable value and/or market conditions), and the school district levies at least seven mills, but not more than 13 mills. The State incurs costs to operate this program because it has to borrow in order to make money available for these loans to districts. The State's costs (which are actually debt service costs on General Obligation (GO) bonds sold to make money available for loans) are paid in the School Aid budget, out of School Aid Fund revenue. A School Loan Revolving Fund (SLRF), established in 2005, also has been making loans to districts, using district repayments in order to make new loans, but due to uncertainty in repayments, the SLRF is not able to continue operating as a self-sufficient revolving fund at this time, and the State has had to sell more GO bonds and incur higher debt service costs.

This package of bills would reduce the State's costs by making several key changes: 1) providing that, if the total amount of qualified loans, including principal and interest, outstanding to districts were at or above $1.8 billion, a district's proposed bond issue would not be "qualified" if it were expected that the district would need to borrow from the State in order to meet its debt service payments on the new bond issue; 2) requiring that a school district recalculate its millage rate at least annually to determine the millage necessary to repay the principal and interest on qualified loans and qualified bonds by the final mandatory repayment date and levy the higher or lower computed millage or 13 mills, whichever was less but not less than seven mills or the original computed millage; and, 3) requiring a district to pay off all outstanding qualified bonds and qualified loans, and any proposed bond issue and anticipated loans, by a singular, final mandatory repayment date. Establishing a single final repayment date for all outstanding qualified bonds and loans would result, in many cases, in a district's repaying a previous bond issue and associated loans before being qualified for a new bond issue, unless the district could afford to pay for the new bond issue by the repayment date established for the first bond issue. As a district's final mandatory repayment date approached, the district would have its ability to borrow with qualified bonds constrained by the requirement to repay any new debt by the existing final mandatory repayment date. This may mean that a district would have to reduce the size of the bond issue or increase its computed millage rate to pay for the new bond issue. School districts demonstrating that borrowing from the State was not anticipated would still be able to have their bonds qualified.

The Department of Treasury estimates that the changes described above would lead to reduced State debt service costs. Table 1 illustrates three items: 1) the known, committed State debt service costs as of August 2011; 2) the State's additional debt service based on estimates of cost of projected qualified loans on existing qualified bonds already approved (the lightest area on the chart); and, 3) the additional debt service that the State expects to incur on new qualified loans for additional qualified bonds if there are no changes to the current system (the darkest topmost bars on the chart). Over the next 35 years, the debt service without any change in the current system is estimated to total $6.4 billion, while the estimated debt service as a result of the changes in this legislation is $4.1 billion, for State savings estimated at $2.2 billion over the next 35 years (as shown by the darkest topmost bars on the chart). The requirement to recompute local debt service millage annually would result in additional State savings of an unknown amount.

If the bills were enacted, the amount of future debt issued by the State would be significantly reduced, and the loan repayments would become more certain. This would allow the SLRF to operate as a self-sustaining revolving fund, where the required repayments by districts in the system are used to make qualified loans for qualified bonds. The purpose of the 2005 revisions to the system was to create a self-sustaining revolving fund, but because districts currently do not have to repay existing debt before being qualified for new debt, and because of the significant declines in local property tax revenue resulting in a spike in demands for new State qualified loans, the SLRF has not had sufficient revenue to operate as an independent revolving fund.

It is anticipated that the proposed cap of $1.8 billion on all outstanding loans (applicable when districts sought to qualify bonds and anticipated the need for qualified loans) would be reached by October 2014. After that date, no new bonds would be qualified if it were anticipated that the bond issue would require loans from the State. Based on current projections, the level of outstanding loans will not fall below $1.8 billion until 2040, meaning that districts would be able to qualify their bonds during that 26-year period only if they did not anticipate a need for qualified loans. Alternatively, districts could issue unqualified bonds at their own credit rating. School districts that are already participating in the qualified loan program would continue to receive loans; however, they also would be required to recompute their millage rates annually and increase their millage levy if necessary to repay the qualified loans by the final mandatory repayment date.

The Department of Treasury would likely see increased fee revenue under the legislation in the near term, with the fee structure designed to offset the administrative costs of the qualified bond and qualified loan programs; however, the constraints on local district borrowing would tend to reduce qualified bond and loan activity and Treasury costs over time.

Local: Annual recomputation of the millage rate necessary to ensure that qualified bonds and loans would be paid off by the mandatory repayment date would increase local millage levies above the seven-mill statutory minimum for some districts, increasing local tax revenue and, with debt repaid sooner, reducing long-term debt service costs to the district. Depending on local taxable value and debt service requirements, other districts would remain at seven mills. The millage recomputation and the requirement that all outstanding bonds and loans be consolidated in terms of meeting one repayment date could result in greater variations in local millage rates paid by taxpayers within a school district than under current practice. The system as it operates today allows a district to levy a minimum of seven mills and borrow the difference from the State if the levy does not produce sufficient revenue to meet the bond's debt service. That loan can be "rolled over" into a new qualified bond issue with a later repayment date, but the district is required to continue levying only a minimum of seven mills while the district's debt increases. The changes under this legislation would require the millage rate on the original bond issue to be recomputed every year to ensure that the original bond and associated loans, and any new bonds and loans qualified after the original loan, would be repaid within the mandatory repayment time frame, which could mean millage increases above the original levels. However, while the millage rate could fluctuate, the prohibition against "rolling over" previous loans would restrict a district's ability to issue additional qualified bonds to the amount that could be repaid by the final mandatory repayment date. Particularly in the years immediately preceding the final mandatory repayment date, only relatively small new bond issues could be repaid by the mandatory date. This should lead to lower debt service costs in the long run.

School districts likely would see administrative cost increases as a result of the requirements of this legislation, including the maintenance of detailed records on the investment and expenditure of the proceeds of qualified bonds and making those records available to the State Treasurer five business days after the request; and, paying new or revised fees for prequalification, qualification, and annual loan activity, and also on any loans taken out under either the SBLF or the SLRF. However, the legislation does propose a somewhat simpler process for notifying Treasury in the event a loan is not needed for a particular year.

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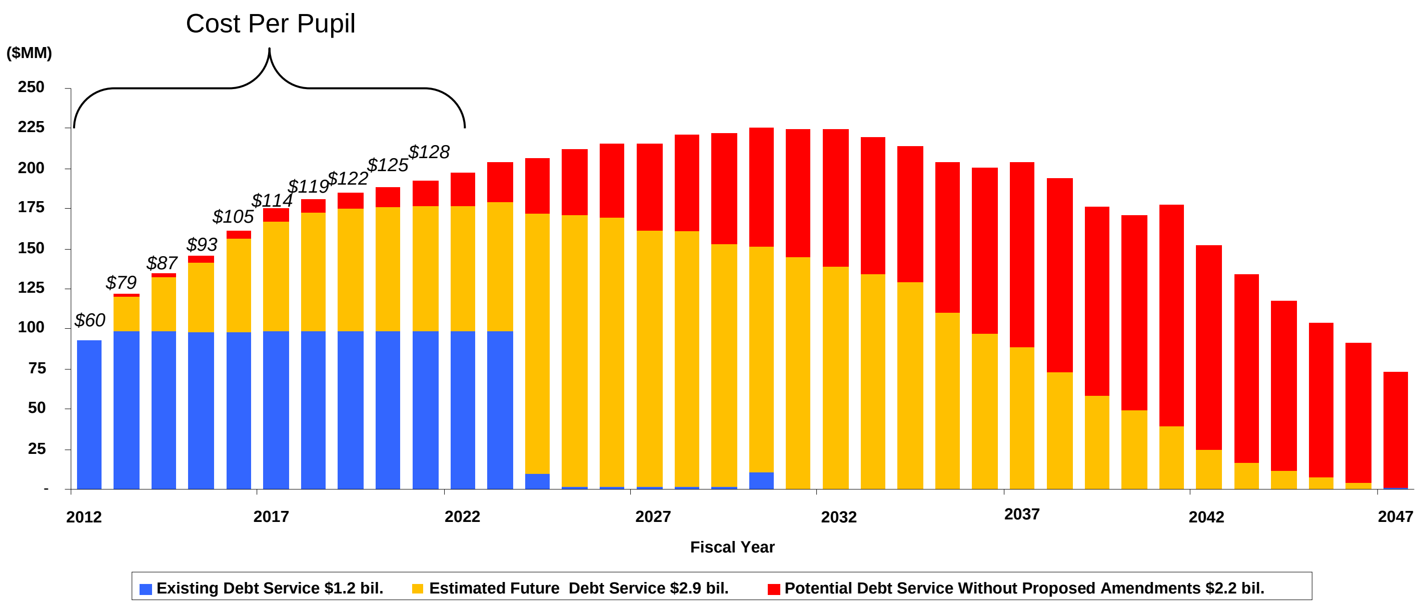
Table 1
Projected School Bond Loan GO Debt Service
(Current and Projected Future Participants
Without Proposed Amendments Enacted)



Debt service based on estimated future loan needs of both current and projected future borrowers funded with General Obligation bonds. Loan needs based on taxable value growth at the five-year average rate for the next five years and 3% thereafter.

Estimated cost per pupil based on Senate Fiscal Agency student count projections and existing and estimated future debt service on General Obligation bonds issued to fund loans for current and projected future participants.

Assumes debt service will continue to be paid from the School Aid Fund.

The $2.9 billion Estimated Future Debt Service and $2.2 billion Potential Debt Service Without Proposed Amendments are cumulative to the Existing Debt Service.

Source: Department of Treasury