



# Capital Improvement Financing for Michigan Public Schools

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## At a Glance

Michigan law provides several options for public schools to finance capital improvements. While demand for capital improvements remains strong, declining statewide enrollment has shifted the focus from constructing new spaces to replacing or renovating existing spaces, security, energy conservation, and technology. The COVID-19 pandemic is increasing demand for technology for delivery of remote and hybrid instruction models as well as additional health safety features in school buildings.

**M**ichigan law provides several options for public schools to finance capital improvements. Unlike private sector entities, public schools must have express statutory authority or power necessarily implied from express powers to undertake a public improvement, finance that improvement, and use a particular method of financing.<sup>1</sup> While demand for capital improvements remains strong, declining enrollment has shifted focus from construction of new space to replacement or renovation of existing spaces, security, energy conservation, and technology. The COVID-19 pandemic has increased demand for technology and technology systems for delivery of remote/hybrid instruction models and additional safety features in school buildings (e.g., air purification and touchless technology).

Interest rates remain at historically low levels, reducing the costs of available financing options.<sup>2</sup> Financing options for traditional school districts and public school academies

(PSAs) vary significantly; particularly, PSAs do not have geography or taxing power which precludes voter approval for issuance of capital improvement bonds or the levy of a sinking fund millage. All public schools must provide an independent audit of the expenditure of bond proceeds to the state<sup>3</sup> and all capital bonds issued by districts and PSAs (other than PSA bonds secured by mortgage) are subject to the requirements of the Revised Municipal Finance Act.<sup>4</sup>

Public schools typically issue debt on a tax-exempt basis to reduce debt service cost. To achieve tax-exempt status, they must satisfy federal tax requirements for the debt.

### Voted capital improvement bonds

Sections 1351 and 1351a of the Revised School Code permit districts to issue “unlimited tax” bonds with voter approval, meaning that districts become obligated to levy a debt millage



on all taxable property in the district at a rate necessary to pay debt service on the bonds.<sup>5</sup> There are limitations that are described below. A district's outstanding voted bonds may not exceed 15 percent of the state equalized value of properties in the district unless the bonds are qualified under the Michigan School Bond Qualification and Loan Program (SBQLP), in which case the SBQLP limitations apply.<sup>6</sup>

Voted bonds can only be used to finance capital improvements and purchases. Allowable uses include acquisition of land and buildings; construction of or additions to school buildings; site improvements; remodeling of existing buildings; and acquisition of furnishings, equipment, technology, and school buses.<sup>7</sup> "Technology" is defined as hardware and communication devices that transmit, receive, or compute information for pupil instructional purposes and includes the initial purchase of operating software or customized application software.<sup>8</sup> Prohibited uses include repairs; maintenance; supplies; salaries; automobiles, trucks, and vans; uniforms; textbooks; upgrades to existing operating software; off-the-shelf application software; training; and consulting or maintenance contracts.<sup>9</sup>

### Michigan school bond qualification and loan program

Districts may qualify voted school bonds through the SBQLP, established by the Michigan Constitution<sup>10</sup> and implemented

Some districts are combining traditional energy conservation programs with solar projects through public-private partnerships to obtain savings while making long-term commitments to renewable energy for their buildings.

under the School Bond Qualification, Approval, and Loan Act.<sup>11</sup> Designed to increase market access and reduce borrowing cost, the SBQLP requires districts to complete a preliminary qualification process prior to submitting bond proposals to voters and obtain final qualification prior to issuing bonds after voter approval.<sup>12</sup>

The SBQLP provides loans to districts with respect to qualified bonds in two situations:

**State credit enhancement:** Loans are available to prevent default on qualified bonds. If for any reason a district lacks sufficient debt millage revenue to pay debt service on the bonds when due, the state must loan the shortfall to the district. Rating agencies treat the availability of this loan as credit enhancement and assign qualified bonds the state's credit rating, usually reducing debt service on the bonds.<sup>13</sup>

**Debt millage cap:** This allows many districts to levy a lower, more stable debt millage rate than their tax bases would otherwise support. Generally, a district with outstanding qualified bonds may borrow an amount equal to the revenue the district would otherwise have to raise by levying a higher debt millage in excess of its computed millage rate (which ranges between seven and 13 debt mills).<sup>14</sup>

For a typical district with qualified bonds, the annual debt millage levy is capped at seven mills if it can project repayment of its qualified bonds and loans by the mandatory repayment date. If not, it must levy that number of debt mills between seven and 13 which the state projects will satisfy the deadline.<sup>15</sup>

The district must levy the computed millage rate until both its qualified school bonds and state loans are repaid. The SBQLP requires repayment of loans no later than 72 months following the final maturity of the qualified bonds. The SBQLP provides for recalculation of the computed millage based on changes in taxable values and other circumstances.<sup>16</sup>

## Non-voted capital improvement bonds

School Code Sections 1351 and 1351a also permit districts to issue capital improvement bonds without voter approval.<sup>17</sup> Non-voted bonds must be repaid from the district's general fund or other revenue sources as opposed to a dedicated debt millage.<sup>18</sup> In most circumstances, a district may only issue non-voted bonds if the proposed bonds and all currently outstanding *voted and non-voted bonds* do not exceed five percent of the district's state equalized value.<sup>19</sup>

Non-voted bonds cannot be qualified under the SBQLP.<sup>20</sup> The proceeds may be used for the same purposes as voted bond proceeds.

Sections 504a(g) and 1351a also permit PSAs to issue non-voted bonds. The bonds are repaid from the PSA's general fund or other revenue sources. A PSA may mortgage its school facility to secure bonds.<sup>21</sup>

## Building and site sinking fund

School Code Section 1212 permits districts to seek voter approval to impose a sinking fund millage of up to three mills for up to 10 years to pay the cost of acquiring land and buildings; constructing, repairing, or remodeling buildings; site improvements; school security improvements; and technology acquisitions or upgrades.<sup>22</sup> Purchases of furnishings and other types of equipment are not permitted.

Sinking funds may be used for capital improvements and repairs, but not for maintenance. Repairs are curative, i.e., restoring assets to good condition, and maintenance generally prevents deterioration. In 2016, districts received authority to use sinking fund proceeds to purchase security and technology equipment.<sup>23</sup> The Section 1212 amendments apply to sinking

fund millages authorized by voters after 2016. Many districts have sought voter approval for the expanded authority to replace unexpired, pre-2017 sinking fund millage authority.

Districts may also issue non-voted bonds as described above in anticipation of future sinking fund tax levies if the proceeds are used only for sinking fund-eligible capital projects (not repairs). The bonds are payable from the sinking fund, backed by the general fund, and can provide significant construction savings if one year's sinking fund revenue is insufficient for a larger project.

## Energy conservation bonds and installment contracts

School Code Section 1274a permits districts to finance energy conservation, asbestos removal, or other capital improvements (as opposed to training, repairs and maintenance) to achieve operational efficiencies through energy conservation bonds and installment contracts without regard to debt limits.<sup>24</sup> Lighting, roofs, HVAC systems and controls, and water conservation are popular improvements. These obligations are payable from the district's general fund, usually structured to match annual debt service to projected savings.<sup>25</sup> Districts typically obtain a performance contract guaranteeing a certain level of savings for a specified period of time.

School Code Section 380.504a provides similar authorization for PSAs to finance energy improvements.<sup>26</sup>

Some districts are combining traditional energy conservation programs with solar projects through public-private partnerships to obtain savings while making long-term commitments to renewable energy for their buildings. Under the partnership, the power company designs, builds, finances, operates, and maintains roof and/or ground-mounted solar arrays at district sites and the district purchases the energy generated on-site at a reduced rate from the company.

1933 PA 99, as amended, permits districts to use installment contracts or leases to acquire equipment, furnishings, buses and other vehicles, buildings and building additions, and land.<sup>27</sup> The principal amount of all outstanding district Act 99 contracts may not exceed 1.25 percent of the taxable value of the property located within the district. The contract term may not exceed the lesser of 15 years or the useful life of the asset being financed (e.g., six years for buses).<sup>28</sup>

School Code Section 380.504a provides a similar authorization for PSAs.<sup>29</sup>

## Refunding bonds

State and federal law allows public schools to refinance outstanding bonds or SBQLP loans subject to certain restrictions.<sup>30</sup> Typically, refunding bonds are issued for savings but in limited circumstances a refunding can be used to avoid default or eliminate restrictive covenants.<sup>31</sup>

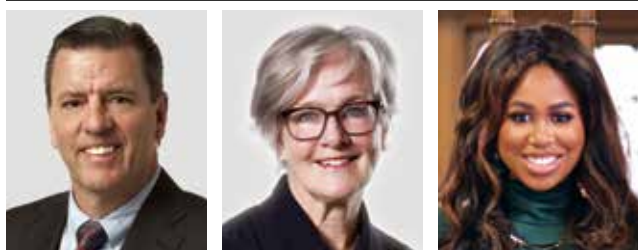


## Special circumstances and a look forward

While the SBQLP has provided market access at more affordable debt millage rates for many districts across the state, it has not solved every problem. There are a number of districts—urban, rural, and in between—where the existing debt millage rate is at or near 13 mills or where the tax base will not support additional debt meeting state requirements despite demand for modest capital improvements to provide a safe learning environment and support educational programming. This often occurs in areas with lower property values and higher poverty levels. The pandemic has exacerbated these circumstances and diminished the ability of these districts to compete with their wealthier neighbors.

Districts with declining tax bases may no longer meet mandatory repayment dates for existing loans or qualify for new debt to upgrade or restore existing facilities. While the new Detroit Public Schools Community District is debt free and could seek voter approval for bonds for the more than \$1 billion in capital improvements identified in a recent independent facilities assessment,<sup>32</sup> it shares a geography and tax base with Detroit Public Schools, which exists solely to retire legacy liabilities. These liabilities include voted bonds and related loans for which the old district is forecast to continue levying 13 debt mills for the next few decades.

No single tool described in this article will solve these problems, underscoring the need to develop new tools to assure equitable access to safe, comfortable, and healthy learning environments. Such tools could include modification of the SBQLP loan structure, subsidies, or capital grants to level the playing field. ■



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## ENDNOTES

1. As Michigan courts have consistently held, “local authorities can exercise only those powers which are expressly or impliedly conferred, and subject to such regulations or restrictions as are annexed to the grant.” *City of Taylor v. Detroit Edison*, 475 Mich 109, 115; 715 NW2d 28 (2006) (citing *City of Kalamazoo v. Titus*, 208 Mich 252, 262; 175 NW 480 (1919)).
2. E.g., *Rates Over Time—Interest Rate Trends*, WM Financial Strategies (updated weekly) <[www.munibondadvisor.com/resources.htm](http://www.munibondadvisor.com/resources.htm)> [<https://perma.cc/F25J-DTVD>].
3. MCL 380.1351a(2) and MCL 380.504a(g).
4. MCL 141.2101 *et seq.*
5. MCL 380.1351(2), MCL 380.1351a, and Const 1963, art. 9, § 16. See also MCL 141.2701.
6. MCL 380.1351(3). SEV equals 50 percent of the assessor’s determination of true cash value under MCL 380.1212(6).
7. MCL 380.1351a(1).
8. MCL 380.1351a(5).
9. MCL 380.1351a(1).
10. Const 1963, art. 9, § 16.
11. MCL 388.1921 *et seq.*
12. MCL 388.1932.
13. Const 1963, art 9, § 16 and MCL 388.1934.
14. MCL 388.1929.
15. *Id.*
16. MCL 388.1929.
17. MCL 380.1351(2) and MCL 380.1351a.
18. MCL 380.1351(4).
19. MCL 380.1351(2). SEV and TV are calculated pursuant to Const 1963, art 9, § 3, and implementing legislation.
20. MCL 388.1927 and MCL 388.1932.
21. MCL 380.504a(g) and MCL 380.1351a.
22. MCL 380.1212.
23. MCL 380.1212(6).
24. MCL 380.1274a.
25. MCL 380.1351(2) and MCL 380.1351(4).
26. MCL 380.504a.
27. MCL 123.721 *et seq.*
28. MCL 123.721(1).
29. MCL 380.504a.
30. E.g., MCL 141.2601 and MCL 388.1927.
31. MCL 141.2611.
32. Detroit Public Schools Community District is a community district under MCL 380.1351a.