

**NOTE 12 – BONDS AND NOTES PAYABLE – PRIMARY GOVERNMENT**

**General Information**

**General Obligation Bonds and Notes**

Article 9, Section 15, of the State Constitution authorizes general obligation long-term borrowing, subject to approval by the Legislature and a majority of voters at a general election. In addition, debt may be incurred without voter approval for the purpose of providing loans to school districts. General obligation notes to provide temporary financing for such loans are recorded as liabilities in the School Bond Loan Fund, a special revenue fund. General Fund appropriations are made to finance debt principal and interest requirements for all general obligation issues. General obligation bonds are backed by the full faith and credit of the State.

The State Constitution provides that the Legislature may also authorize the issuance of general obligation short-term notes, the principal amount of which may not exceed 15% of undedicated revenues received in the preceding year. The State Constitution also provides that such notes must be repaid within the fiscal year of the borrowing. In fiscal year 2007, the State issued general obligation notes to meet cash flow requirements of the General Fund.

Short-term debt activity for the fiscal year ended September 30, 2007, was as follows (in billions):

	<u>Beginning Balance</u>	<u>Draws</u>	<u>Repayments</u>	<u>Ending Balance</u>
General Obligation Notes	\$ -	\$1.3	\$1.3	\$ -

**Revenue Dedicated Bonds and Notes**

Long-term bonds have been issued periodically for specific purposes, with the stipulation that financing of debt requirements is to come strictly from designated revenue sources. The transportation related debt is payable solely out of funds restricted for transportation purposes by Article 9, Section 9, of the State Constitution. The State's general credit does not support such issues.

In previous years, the Department of Transportation issued grant anticipation notes. The notes have variable rates that may bear interest at a daily interest rate, a weekly rate, note interest term rate, long-term interest rate, or an ARS interest rate.

The notes are issued in accordance with the authorization provided in MCL Section 247.668b. The proceeds of the sale of the notes, together with investment earnings on the proceeds and other available monies, will be used to pay a portion of the costs to complete the Build Michigan II highway program, to pay capitalized interest on the notes, and to pay note issuance costs.

The principal and interest on the notes are payable solely from and are secured by an irrevocable pledge of the State share of all federal grants received each year under the Federal-Aid Highway Program. Payment of the principal and interest on the notes from the State share shall be subject to an appropriation each year by the Legislature in an amount sufficient to make the payments. As of September 30, 2007, principal payments of \$568.0 million have been made on the notes. The amount outstanding at September 30, 2007, \$32.0 million, is not disclosed in the table below.

Revenue bonds have been issued by the State Building Authority (SBA) to acquire and/or construct various facilities for use by the State or institutions of higher education. Revenue bonds have also been issued to finance equipment capital lease refinancings and acquisitions. In addition, the SBA issues commercial paper notes to fund capital projects prior to bonding. Short-term debt activity for the fiscal year ended September 30, 2007, follows (in millions):

	<u>Beginning Balance</u>	<u>Draws</u>	<u>Repayments</u>	<u>Ending Balance</u>
Commercial Paper Notes	\$57.0	\$89.7	\$ -	\$146.7

Note 13 provides disclosures regarding the bonds and notes payable of the discretely presented component units.

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**Bonds Issued and Outstanding**

General obligation and revenue dedicated bonds issued and outstanding (excluding defeased bonds) at September 30 (in millions) are as follows:

	Amounts Issued	Outstanding 9/30/2007	Fiscal Year Maturities		Average Interest Rate Percentage
			First Year	Last Year	
<b>General Obligation Bonded Debt</b>					
General Obligation Refunding Debt:					
Series 2001 (Refunding)	\$ 183.3	\$ 145.1	2002	2016	4.76
Series 2002 (Refunding)	300.7	284.0	2004	2017	4.41
Series 2005 A (Refunding) (3)	86.8	86.8	2017	2021	5.00
Series 2005 B (Refunding) (3)	82.8	82.8	2013	2021	5.00
Series 2005 C (Refunding) (3)	21.1	21.1	2008	2013	4.17
Recreation and Environmental Protection:					
Series 1989 (1)	75.0	14.6	1991	2012	6.81
Series 1992 (1)	246.3	81.9	1994	2013	5.50
College Savings Bonds - Series 1992 Mini-bonds (1)	.5	1.3	2012	2012	5.86
Series 1992 A (1)(2)	13.9	5.0	1995	2013	6.17
Series 1993 (1)(2)	16.7	7.3	1996	2014	5.00
Series 1995 (1)	234.3	10.8	1997	2010	5.28
Series 1998 (1)	90.0	8.5	1999	2009	4.87
Series 1999 A (3)	81.8	12.0	2004	2010	5.47
Series 2000 (1)	60.0	10.4	2002	2011	5.24
Series 2001 (3)	56.8	26.2	2004	2012	4.82
Series 2003 (5)	10.0	6.0	2054	2054	0.00
Series 2003 A (1)(3)	200.0	190.6	2007	2021	5.00
Series 2006 A (1)(3)	105.0	105.0	2014	2026	4.58
Series 2006 B (5)	47.0	46.7	2007	2009	5.19
School Loan Bonds:					
Series 1998	160.0	35.9	2001	2012	4.80
Series 2005 B (4)	362.5	192.6	2008	2022	Variable
Series 2005 C (4)	113.1	113.1	2020	2024	Variable
Total General Obligation Bonded Debt	2,547.5	1,487.5			
<b>Revenue Dedicated Bonded Debt</b>					
<u>State Park Related:</u>					
2002 – Gross Revenue Bonds	15.5	13.4	2004	2023	3.58
Total Revenue Dedicated Bonded Debt – State Park Related	15.5	13.4			
<u>Transportation Related:</u>					
Tax Dedicated Bonds:					
Michigan Comprehensive Transportation:					
Series 1998 (Series A Refunding)	38.6	29.7	2005	2011	4.81
Series 2001 (Series A Refunding)	27.8	27.8	2008	2022	5.01
Series 2002 (Series A Refunding)	89.6	36.1	2003	2011	5.07
Series 2002 (Series B)	82.3	17.9	2004	2012	5.13
Series 2003	35.0	19.7	2004	2023	3.61
Series 2005 (Refunding)	62.2	62.2	2009	2023	5.15
Series 2006 (Refunding)	53.7	52.3	2007	2031	4.54
State Trunkline Fund Bonds:					
Series 1989 (Series A)	135.8	10.8	1994	2009	6.75
Series 1992 (Series A Refunding)	253.6	56.7	2000	2013	5.76
Series 1992 (Series B Refunding)	99.6	8.3	2000	2013	5.68
Series 1998 (Series A Refunding)	377.9	374.4	2006	2027	5.03
Series 2001 (Series A)	308.2	32.7	2003	2012	4.96
Series 2002 (Refunding)	97.9	68.6	2004	2022	4.71
Series 2004 (Refunding)	103.5	99.7	2006	2022	4.13
Series 2004	185.7	100.5	2008	2019	4.36
Series 2005 (Refunding)	223.0	223.0	2010	2023	5.10
Series 2005 B (Refunding)	378.3	378.3	2010	2019	4.81
Series 2006	244.5	244.5	2008	2022	4.74
Series 2007	485.1	485.1	2009	2027	4.85
Total Revenue Dedicated Bonded Debt –Transportation Related	3,282.2	2,328.3			

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	Amounts Issued	Outstanding 9/30/2007	Maturities		Average Interest Rate Percentage
			First Year	Last Year	
<u>State Building Authority:</u>					
1998 Series I Bonds (Refunding)	330.4	248.6	1999	2022	4.75
2001 Series I Bonds (Refunding)	419.7	363.1	2003	2026	5.26
2003 Series I (Refunding)	659.4	527.0	2004	2018	3.64
2003 Series II (Refunding)	392.6	174.5	2005	2030	4.42
2004 Series I	155.4	131.5	2005	2020	4.08
2005 Series I (Refunding)	293.4	285.3	2006	2034	4.84
2005 Series II (Refunding)	242.8	241.9	2007	2037	4.66
2005 Series II A Multi-modal (7)	343.6	40.1	2018	2018	Variable
2005 Series II B Multi-modal (7)	9.9	9.9	2007	2017	Variable
2006 Series I A Serial	438.3	438.3	2014	2037	4.80
2006 Series I A Capital Appreciation	891.8	891.8	2014	2037	4.80
2006 Series I B	13.7	13.7	2009	2014	4.80
Total State Building Authority Bonded Debt	4,191.0	3,365.7			
<u>Tobacco Settlement Finance Authority:</u>					
Series 2006 A (6)	363.1	363.1	2008	2034	7.31
Series 2006 B (6)	72.6	72.6	2008	2034	7.85
Series 2006 C (6)	54.8	59.7	2046	2046	8.50
Series 2007 A (6)	480.1	480.1	2010	2047	5.86
Series 2007 B (6)	35.6	35.6	2052	2052	7.25
Series 2007 C (6)	7.2	7.2	2052	2052	7.50
Total Tobacco Settlement Finance Authority	1,013.5	1,018.4			
Total Revenue Dedicated Bonded Debt	8,502.2	6,725.9			
Total General Obligation and Revenue Dedicated Bonded Debt	<u>\$ 11,049.7</u>	<u>\$ 8,213.3</u>			

- (1) Michigan Compiled Laws Sections 324.19301 and 324.71301 authorized the issuance of bonds totaling \$800.0 million. As of September 30, 2007, \$791.5 million of such bond proceeds had been received, leaving remaining authorization of \$8.5 million. Sum of amounts issued in table differs by amount of bonds refunded or redeemed, premiums and discounts, and other issuance costs.
- (2) The \$13.9 million Series 1992A and the \$16.7 million Series 1993, Recreation and Environmental Protection General Obligation Bonds, were used to provide a contribution of capital to the Michigan Municipal Bond Authority (a discretely presented component unit). An outside trustee for the Authority is holding the bonds as an investment of the Authority; no immediate cash proceeds were provided. The trustee receives the debt service payments on the bonds, which are negotiable instruments held to subsidize water pollution control financing provided by the Authority.
- (3) Michigan Compiled Laws Section 324.95102 authorized the issuance of bonds totaling \$675.0 million. As of September 30, 2007, \$495.1 million of such bond proceeds had been received, leaving remaining authorization of \$179.9 million. Sum of amounts issued in table differs by amount of bonds refunded or redeemed, premiums and discounts, and other issuance costs.
- (4) The Multi-Modal School Loan Bond Series, currently bear interest at a commercial paper rate and are remarketed at each maturity. For the future debt service requirements, interest was estimated at the interest rate in effect at September 30, 2007.
- (5) November 2002, voters approved a ballot proposal in which the State would issue \$1.0 billion in general obligations bonds to provide capital, which is then loaned to local units of government for water quality improvement projects. As of September 30, 2007, \$143.2 million of such bond proceeds had been recognized as received, leaving remaining authorization of \$856.8 million. Included in the amount recognized as received is \$100.0 million in bonds issued to a discretely presented component unit, the Michigan Municipal Bond Authority (MMBA). Although no cash traded hands, MMBA (the registered owner of the bonds) is holding the bond document as collateral and issuing their own revenue bonds to generate the capital. This transaction allows the State's General Fund to defer principal and interest costs until future years when the bond is repurchased/redeemed. MMBA will fund the principal and interest costs of the revenue bonds until such time that they request the State to honor the general obligation bond document.

On December 18, 2003, the State issued \$100.0 million in bonds (\$10.0 million relating to Strategic Water Quality and \$90.0 million relating to the previously existing State Water Quality Revolving Fund). The \$10.0 million bond relating to Strategic Water Quality includes a repurchase provision that requires the State to repurchase all or any portion of this bond upon 10 days prior written notice from the registered owner, MMBA. The State anticipates at this time that if the bond repurchase was acted on, the State would issue long-term debt to finance the repurchase. This bond is being used as collateral by MMBA for

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the Strategic Water Quality bonds being issued by MMBA to local governments. The \$10.0 million bond was reduced to a net obligation of \$6.0 million when \$4.0 million of the proceeds from General Obligation Recreation and Environmental Protection Series 2006B were used to refund a portion of the original obligation. For these reasons, the State has recognized the \$6.0 million bond related to Strategic Water Quality as a liability in the entity-wide statements. The \$90.0 million "bond" document issued for the State Water Quality Revolving Fund does not contain the 10 day repurchase provision that the \$6.0 million bond does. Nor is the \$90.0 million "bond" document being used as collateral by MMBA. For these reasons, the State has not recognized a liability for the \$90.0 million "bond" document related to the existing State Water Quality Revolving Fund.

- (6) The Michigan Tobacco Settlement Finance Authority (MTSFA) issued taxable Tobacco Settlement Asset-Backed Bonds as follows: \$363.1 million Series 2006A Fixed Rate Turbo Bonds; \$72.6 million Series 2006B Indexed Floating Rate Turbo Term Bonds; \$54.8 million Series 2006C Capital Appreciation Turbo Term Bonds; \$480.1 million Series 2007A Senior Current Interest Bonds; \$35.6 million Series 2007B First Subordinate Capital Appreciation Bonds; and \$7.2 million Series 2007C Second Subordinate Capital Appreciation Bonds.

MTSFA was created by MCL Section 129.264, the Michigan Tobacco Settlement Finance Authority Act. As a public body corporate and politic within the Department of Treasury, it is a separate legal entity with separate corporate purposes, exercising public and essential governmental functions. The MTSFA is authorized to issue bonds as needed to provide sufficient funds to purchase all or a portion of the State's Tobacco Settlement Revenues (TSRs) payable to the State under the Master Settlement Agreement (MSA) entered into by participating cigarette manufacturers in 1998. Refunding bonds may also be issued. Net proceeds of the sale of TSRs are deposited in the Michigan 21<sup>st</sup> Century Jobs Trust Fund the School Aid Fund, the General Fund, and in a reserve fund.

The bonds were issued in accordance with the Purchase and Sale Agreement (the Agreement), dated May 1, 2006, between the State and MTSFA. Pursuant to the Agreement, MTSFA is purchasing the right, title, and interest in and to 13.3% of all the State's future TSRs payable to the State on or after April 1, 2008, as required under the terms of the MSA. In 2007, an additional 10.77% of future tobacco settlement revenue was purchased by MTSFA on amounts payable on or after May 15, 2009. Every issue of bonds shall be special revenue obligations payable from and secured by a pledge of TSRs and other assets, including without limitation the proceeds of the bonds deposited in a reserve fund for the benefit of the owners of the bonds, earnings on funds of the authority and other funds as may become available, upon the terms and conditions as specified by the authority in the authority resolution under which the bonds are issued or in a related trust agreement of trust indenture.

The issuance of bonds under the provisions of this law shall not directly, indirectly, or contingently obligate the State or any political subdivision of this State to pay any amounts to the MTSFA or owners of bonds or benefited parties, or levy or pledge any form of taxation whatsoever for the bonds. The bonds are not a debt or liability of the State or any agency or instrumentality of the State, other than MTSFA. The MTSFA is not authorized to incur any indebtedness on behalf of or in any way obligate the State or any political subdivision of the State.

- (7) The State Building Authority Multi-Modal bears interest at a remarketed weekly rate.

**Capital Appreciation Bonds**

Capital appreciation and convertible capital appreciation bonds are recorded in the Bonds Issued and Outstanding table and the Changes In Bonds and Notes Payable Table at their accreted year-end book value. The table that follows summarizes capital appreciation bonds (in millions):

	Accreted Book Value	Ultimate Maturity Value	Fiscal Year Maturities	
			First Year	Last Year
<b>General Obligation Bonds:</b>				
Series 1989	\$14.6	\$16.9	1999	2012
Series 1992	12.1	14.6	2000	2012
College Savings Bonds - Series 1992 Mini-bonds	1.3	1.8	2012	2012
Series 1995	10.8	12.2	2001	2010
<b>Revenue Dedicated – Transportation Related:</b>				
State Trunkline – Series 1989 A	10.8	11.9	2004	2009
State Trunkline – Series 1992 A	56.7	66.7	2006	2013
State Trunkline – Series 1992 B	8.3	9.6	2006	2013
<b>Revenue Dedicated – State Building Authority:</b>				
2006 Series I A	415.7	891.8	2017	2030
<b>Revenue Dedicated – Tobacco Settlement Finance Authority</b>				
Series 2006 C	59.7	1,534.9	2046	2046
Series 2007 B	35.6	865.3	2052	2052
Series 2007 C	7.2	195.1	2052	2052

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**Advance Refundings and Defeasances**

The State has defeased certain bonds through advance refundings by placing the proceeds of new bonds (i.e., the “refunding” bonds in the table of bonds issued and outstanding) in irrevocable trust to provide for all future debt service on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not recorded as assets or liabilities in these statements and are not included in the other debt tables in this note.

The State has defeased certain bonds through current refundings in which the proceeds of the refunding debt are applied immediately to redeem the debt to be refunded.

The State has defeased certain bonds by placing cash with an escrow agent in a trust to be used for future payment on the debt. The following table summarizes the defeased bonds outstanding at September 30 (in millions):

	Amounts Outstanding
Recreation and Environmental Protection:	
Series 1998	\$ 50.4
Series 1999 A	56.1
Series 2000 (partial)	37.4
Series 2001	22.3
Series 2001 (Refunding)	.1
Series 2002 (Refunding)	8.5
Series 2003	4.0
Total Recreation and Environmental	\$ 178.8
School Loan Bonds:	
Series 1998	\$ 77.0
Series 2005 B	156.9
Series 2006 A	66.8
Total School Loan Bonds	\$ 300.7
Comprehensive Transportation Fund Bonds:	
Series 2002 B (partial)	\$ 52.9
Series 2003	9.9
	\$ 62.8
State Trunkline Fund Bonds:	
Series 2001 A (partial)	\$ 245.8
Series 2004 (partial)	85.2
	331.1
Total Transportation Related	\$ 393.9
State Building Authority:	
1994 Series II	\$ 7.0
1997 Series I	47.2
1997 Series II	196.0
1998 Series I	62.8
2000 (MSP Phase II)	22.5
2001 (MSP Phase III)	32.8
2002 (MSP Phase IV)	24.0
1999 Series I	50.7
2001 Series I	87.4
2001 Series II	131.0
2000 Series 1	113.7
2002 Series III (Refunding)	190.4
2003 Series II (Refunding)	194.9
Total State Building Authority	\$ 1,160.2

**General Obligation**

In fiscal year 2007, the Michigan Municipal Bond Authority (MMBA), a discretely presented component unit of the State, placed funds with an escrow agent to refund a total of \$240.3 million in State general obligation debt for the following:

General Obligation Debt	Refunded Amount
Recreation and Environmental Protection Series 2001	\$ .1
Recreation and Environmental Protection Series 2002	8.5
School Loan Bonds Series 1998	8.0
School Loan Bonds series 2005B	156.9
School Loan Bonds series 2006A	66.8

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The State assigned a total of \$171.5 million in loan repayments to the MMBA in consideration for the funds placed by MMBA with the escrow agent, resulting in a net subsidy of \$68.7 million from MMBA to the State.

**Debt Service Requirements**

The following table summarizes debt service requirements for outstanding bonds (in millions):

Fiscal Years Ending	General Obligation			State Park, and Transportation Related		State Building Authority		Michigan Tobacco Settlement Finance Authority		Total Principal And Interest
	Principal	Fixed Interest	*Estimated Interest	Principal	Fixed Interest	Principal	Interest	Principal	Interest	
2008	\$ 59.9	\$ 47.3	\$ -	\$ 76.2	\$ 114.3	\$ 87.1	\$ 123.1	\$ 1.8	\$ 54.1	\$ 563.7
2009	125.0	54.8	14.5	82.5	110.4	92.2	118.8	3.7	60.1	661.9
2010	84.1	48.9	14.5	119.4	107.0	97.4	114.0	7.1	59.9	652.4
2011	88.3	44.8	14.5	124.7	101.8	103.0	108.9	8.3	59.5	653.8
2012	92.6	40.4	14.5	116.5	96.5	109.0	103.5	9.6	59.0	641.6
2013-2017	480.4	123.2	72.5	657.3	393.0	620.8	426.0	70.6	284.3	3,128.0
2018-2022	472.2	36.1	47.6	768.6	211.2	679.4	296.7	106.3	256.6	2,874.6
2023-2027	85.6	4.7	2.4	396.1	56.9	571.7	219.0	129.1	217.8	1,683.4
2028-2032	-	-	-	12.6	1.5	554.2	154.3	190.4	163.9	1,076.9
2033-2037	-	-	-	-	-	450.9	49.6	148.4	94.7	743.5
2038-2042	-	-	-	-	-	-	-	105.4	60.3	165.7
2043-2047	-	-	-	-	-	-	-	1,670.0	24.9	1,694.9
2048-2052	-	-	-	-	-	-	-	1,060.4	-	1,060.4
Thereafter	6.0	-	-	-	-	-	-	-	-	6.0
<b>Total</b>	<b>\$ 1,494.0</b>	<b>\$ 400.1</b>	<b>\$ 180.5</b>	<b>\$ 2,354.1</b>	<b>\$ 1,192.4</b>	<b>\$ 3,365.7</b>	<b>\$ 1,713.8</b>	<b>\$ 3,511.2</b>	<b>\$ 1,395.0</b>	<b>\$ 15,606.8</b>

\*Interest for Multi-Modal Bonds future debt service requirements was estimated at the rate in effect at September 30, 2007.

Interest to maturity for the State Building Authority may be significantly smaller than the amount shown in the above table because many of the bonds will be called prior to the final scheduled maturity date. The retirement of these bonds varies from project to project, as each bond issue is related to specific projects and any excess borrowing and accrued investment earnings are restricted to projects and debt service on the related bonds.

**Changes in Bonds and Notes Payable**

Changes in bonds and notes payable for the year ended September 30, 2007, was as follows (in millions):

<b>Governmental Activities</b>	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due Thereafter
<b>Bonds Payable:</b>						
General obligation debt	\$ 1,793.5	\$ 2.8	\$ 308.8	\$ 1,487.5	\$ 59.9	\$ 1,427.6
Revenue bonds	1,902.8	490.1	51.2	2,341.7	76.2	2,265.5
State Building Authority	3,449.3	-	83.6	3,365.7	87.1	3,278.6
Tobacco Settlement Finance Authority	490.5	527.9	-	1,018.4	1.8	1,016.7
<b>Notes Payable:</b>						
Transportation related	84.0	-	52.0	32.0	-	32.0
<b>Deferred Loss on Refundings:</b>						
General obligation debt	(33.3)	-	4.0	(29.3)	-	(29.3)
Revenue dedicated debt	(31.1)	-	2.4	(28.8)	-	(28.8)
State Building Authority	(33.9)	-	5.1	(28.8)	-	(28.8)
<b>Unamortized Discounts:</b>						
State Building Authority	(496.4)	-	20.4	(476.1)	-	(476.1)
Tobacco Settlement Finance Authority	-	(15.2)	-	(15.2)	-	(15.2)
<b>Unamortized Premiums:</b>						
General obligation debt	61.3	-	5.2	56.1	-	56.1
Revenue dedicated debt	106.4	18.7	7.4	117.6	-	117.6
State Building Authority	116.9	-	7.3	109.5	-	109.5
<b>Total bonds and notes payable</b>	<b>\$ 7,409.9</b>	<b>\$ 1,024.2</b>	<b>\$ 464.1</b>	<b>\$ 7,950.4</b>	<b>\$ 225.0</b>	<b>\$ 7,725.5</b>
Plus State Building Authority commercial paper notes reported as "Current Liabilities: Bonds and Notes Payable" on the Statement of Net Assets				146.7	146.7	-
As reported on the Statement of Net Assets				<b>\$ 8,097.1</b>	<b>\$ 371.7</b>	<b>\$ 7,725.5</b>