

# STATE OF MICHIGAN

## Bond Qualification Process Overview

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## **Introduction**

This bulletin is designed to assist superintendents and school board members in planning facility programs funded by state qualified bonds. Bond qualification is granted through the Michigan School Bond Qualification and Loan Program (SBQLP). As authorized in the State's Constitution, and by statute, the SBQLP provides a state credit enhancement and loan mechanism for school district bond issues. Bond issues that are qualified by the state have at least two important aspects that are advantageous to school districts. First, a district that receives qualification will get a rating on the bonds equal to the State's credit rating, which will usually result in a lower interest rate and cost. Second, a district may borrow from the State an amount sufficient to enable the district to pay principal and interest requirements on its outstanding qualified bonds. A minimum debt millage must be levied before a district can borrow from the state.

Unlimited qualified bonds may be issued by a school district for a period of up to 30 years. Qualified bonds require approval by the State Treasurer and an affirmative vote from the electors to authorize the district to issue the bonds.

State qualification is based on an extensive preliminary qualification review process, which must be completed prior to the district calling for the bond election. A final qualification process is also required upon approval of the bonding proposition by the district's voters.

Since qualified bonds are unlimited, the local board of education has the authority and the obligation to set the necessary tax rate for debt retirement annually, but has the option under certain circumstances to borrow funds necessary to meet annual principal and interest payments from the State's School Loan Revolving Fund (SLRF). A district may request state qualification of its bonds even though the district has no need or intention of borrowing from the SLRF.

It is a local decision whether to apply for qualification of a bond issue. The Department of Treasury acts only on the request of a local board of education. If qualification is to be obtained, a local school district must meet the necessary requirements as defined in Public Act 92 of 2005, as amended and follow the procedures as prescribed by the Department of Treasury.

This bulletin should be used in conjunction with the services of independent legal, architectural, financial and educational consultants, as appropriate to the project scope. While it is important to acquire competent professional services, final responsibility lies with the local board of education to ensure that education needs are met in a fiscally responsible manner. Long-term financing typically involves expenditures of millions of dollars. It is important for local school boards to understand the commitment necessary before and after the election to assure projects are completed in accordance with intended scope.

## **Qualification Process**

State qualified bonds must be approved by the State Treasurer and bond proceeds must be used for capital expenditure purposes. The bond qualification process involves the following steps:

1. Strategic Planning and Defining Project Scope
2. Preliminary Qualification Approval
3. Election
4. Final Qualification Approval and Issuance of Bonds
5. Construction
6. Audit of Bonded Construction Funds

## **Strategic Planning & Defining Scope**

Planning for a bond issue may begin a year or more before the intended election date. The school district begins by identifying its desired goals for the bond issue. Once these goals are clearly defined, it moves on to a series of analyses and assessments of educational, facility and program needs which provide a context for defining the project scope. Project scope is the boundary that shows where projects begin and end. Developing a solid project scope is critical and helps to focus on what the projects aim to achieve.

The strategic planning process should include the following:

- Conduct a thorough study at the local level to determine current and future school capital expenditure needs and develop a long-term master plan. Involve board members, citizen committees, staff members, etc. Use consulting services, if necessary.
- Secure long range enrollment projections from a Treasury-approved enrollment service provider. Use current enrollment and future enrollment projections to determine the number of classrooms needed as well as required space for other needs.
- Determine classroom needs based on the following teaching station utilization standards:
  - Lower Elementary = 20 students per teaching station
  - Upper Elementary = 25 students per teaching station
  - Middle School = 22.5 students per teaching station
  - High School = 21.25 students per teaching stationDistrict wide utilization should be no less than 85% for new buildings no less than 60% for remodeled buildings.
- Determine construction priorities. Obtain the services of an architect, financial consultant, bond attorney, and construction manager, if deemed necessary.
- Identify potential new/additional sites where project development may occur and secure options on proposed property if acquiring new/additional sites.
- Determine whether an impact study is necessary on new or existing sites to address environmental issues such as underground storage tanks, wetlands, groundwater, etc.
- Consult local government officials/boards regarding requirements and restrictions that may exist on the proposed property including: zoning, cost of roadway additions or improvements, driveway access, sewage, drainage, water access, etc.
- Consult utility providers regarding services, easements, availability and costs.
- Instruct the architect or construction manager to prepare preliminary plans, cost estimates and a detailed budget.
- Instruct the financial advisor to develop financing plans. Consider any special circumstances such as tax appeals or a plant closing that could affect the district's tax base or growth projections.
- Decide if state qualified bonds should be issued. If so, the bond attorney should contact the School Bond Qualification and Loan Program to schedule a preliminary qualification meeting. If not, see the "Other Funding Sources for School Improvements Projects" section on page 5. Schedule a preliminary qualification meeting approximately six months prior to the election date. Consult with district legal counsel regarding election requirements and establish time lines for all activities that must be completed.

## **Regular and Special Election Dates**

School district bond elections must be held on one of three regular election dates or a limited number of "floater dates" (if certain requirements are met). The three regular election dates are as follows:

- 1<sup>st</sup> Tuesday after the 1<sup>st</sup> Monday in May
- 1<sup>st</sup> Tuesday after the 1<sup>st</sup> Monday in August
- 1<sup>st</sup> Tuesday after the 1<sup>st</sup> Monday in November

More information on these standard election dates or the requirements for holding a special election on a "floater" date can be obtained from the school district's legal counsel.

## **Preliminary Qualification**

Preliminary qualification enables the district to proceed with calling for an election and presenting the bonding proposition to the district's citizens. The application process must be initiated in sufficient time to meet all statutory requirements and to allow the SBQLP staff to thoroughly review the application. The preliminary qualification approval process involves the following steps:

- Obtain approval of preliminary plans, estimates and budget from the local board of education.
- Download the preliminary qualification application, instructions and worksheets from the School Bond Loan website at [www.michigan.gov/sblf](http://www.michigan.gov/sblf) and complete the required forms and supporting documents, including project component cost breakdowns, architect sketches of buildings identifying teaching stations, site plans, enrollment projections compiled by an independent source and financial data completed by a qualified financial advisor.
- Participate in a preliminary qualification meeting with the Michigan Department of Treasury. All significant participants in the project development should be available for this meeting including: bond counsel, financial advisor, architect, construction manager, school superintendent, school board representative(s), citizens committee representative(s), etc. During the meeting, Treasury representatives will conduct a detailed review of the application and supporting documents to ensure compliance with qualification requirements and determine if any revisions or clarifications are required.
- Complete any required revisions to the preliminary qualification application and any required supporting documents for presentation to the board of education. Conduct a review of the finalized application at a board meeting and adopt a board resolution to apply for preliminary qualification. Submit a certified application to the SBQLP at least 30 days prior to the last day to call for an election.
- Adopt an official resolution calling for the election after a letter of preliminary qualification is received from the State Treasurer.
- Participate in a site visit of existing facilities conducted by Treasury officials to review conditions and plans.
- Hold a local election and notify Treasury of the election results.

## **Final Qualification**

If a majority of the district's citizens votes in favor of the proposition, the district applies for final qualification of the bonds, which requires the following actions:

- Complete the Form 3451, Application for Final Qualification of Bonds, which can be downloaded from the Treasury website at [www.michigan.gov/sblf](http://www.michigan.gov/sblf).
- Conduct a review of the final application at a board meeting and adopt appropriate board resolutions to apply for final qualification. Submit a certified application and supporting documentation to the School Bond Qualification and Loan Program.
- Receive Treasury's Order Qualifying Bonds with qualification fee billing.
- Remit qualification fee within 30 days of receiving bond proceeds.

## **Construction Period**

Bond proceeds are used to complete construction projects approved in the preliminary qualification application and the ballot proposal(s). Construction must be completed in accordance with certain State regulations. The use of bond proceeds by public schools is defined in The Revised School Code Part 17, Sections 1351 – 1372 (MCL 380.1351 – 1380.1372). Allowable and unallowable uses of bond proceeds are as follows:

Allowable use of bond proceeds:

- Constructing new school buildings
- Constructing additions to existing school buildings
- Remodeling existing school buildings
- Energy conservation improvements
- Asbestos abatement
- Land purchases
- Site development and improvements
- Athletic and physical education facility development and improvements
- Playground development and improvements
- Refunding debt (if new present value savings can be demonstrated)
- Direct bond program costs such as: professional fees, election fees, issuance costs, qualification fees, insurance fees, final audit costs
- School bus purchases
- Loose furnishings and equipment purchasing
- Technology purchases limited to hardware and communication devices that transmit, receive or compute information for pupil instructional purposes only. The initial purchase of operating system and customized application software is allowed if purchased with the initial hardware.

Unallowable uses of bond proceeds:

- Repairs, maintenance, or maintenance agreements
- Supplies, salaries, service contracts, lease payments, installment purchase contracts
- Automobiles, trucks, or vans
- Portable classrooms purchased for temporary use
- Uniforms
- Textbooks
- Upgrades to an existing computer operating system or application software
- Computer training, computer consulting, or computer maintenance contracts

Bond proceeds must be expended in accordance with competitive bidding requirements described under Sections 1267 and 1274 of the Revised School Code.

Public school construction projects must comply with all applicable State site plan review and inspection requirements. More information on these requirements may be obtained from the Department of Licensing and Regulatory Affairs, Bureau of Construction Codes and Fire Safety.

During the construction period, appropriate accounts must be maintained to segregate bond proceeds and debt service funds. Complete transactions to properly account for bond sale, project expenditures, interest income and debt service. If funds remain after completion of all approved projects, the district may use these funds to pay for enhancements to the projects approved by the electors, to pay debt service on the qualified bonds or to repay the state.

### **Audit of Bonded Construction Funds**

Once all projects are completed, the school district must arrange to have an independent audit performed of all bonding activities. This audit must be completed within 120 days after all projects are complete. File the audit report with Local Audit and Finance Division, Department of Treasury. More information on the audit requirements can be found in the "Bulletin for School District Audits of Bonded Construction Funds and of Sinking Funds in Michigan" which is available from the Local Audit and Finance Division website.

### **School Loan Revolving Fund (SLRF)**

The SLRF is a self-sustaining fund that makes loans to school districts to assist with making debt service payments on state qualified bonds. Any money repaid on loans by the school districts to the SLRF is deposited back into the fund for future use. In order to borrow from the State for debt service needs the district must levy a minimum of 7 debt mills and

may be required to levy additional millage up to a maximum of 13 mills to ensure complete repayment to the SLRF within six years of the final bond maturity.

This borrowing process continues until the required debt millage levy yields more revenue than the amount needed to pay debt service. At this point, the district will begin to use the surplus to repay the loan principal and accrued interest.

Borrowing from the SLRF, in many ways, is similar to obtaining a loan from a bank. Prior to obtaining the loan, information must be submitted for review and approval. When a school district issues bonds with the intention of borrowing from the SLRF, it is important to understand the ongoing commitment involved with obtaining the loans and accounting for borrowing and repaying. More information on the SLRF loan process can be found in the "School Loan Revolving Fund Loan Process" bulletin available on Treasury's website at [www.michigan.gov/sblf](http://www.michigan.gov/sblf).

## **Other Funding Sources for School Improvement Projects**

Other funding options exist when planning for school improvement projects. A school district may choose to explore the following other options to fund its capital improvements:

Resolution Bonds: By board resolution and without a vote of the electorate, the board of education may issue bonds that together with the district's outstanding bonded indebtedness do not exceed 5% of the state equalized valuation of the district. Such bonds are not qualified by the State Treasurer and do not go through the State qualified bond approval process. Annual principal and interest payments are financed from existing funding sources. Districts may not levy a specific debt millage for this type of issue. See MCL 380.1351(2).

Non-qualified Bonds: Unlimited non-qualified bonds may be issued by a school district for a period of one to 30 years. Such issues require an affirmative vote of the electors to authorize the district to issue the specific amount of bonds. Since these are unlimited tax obligations, the local board of education has the authority and obligation to set the necessary tax rate for annual principal and interest payments.

Unlimited non-qualified bonds may not exceed a debt to assessed valuation ratio of 15% and do not go through the State qualified bond approval process. See MCL 380.1351(3).

Sinking fund: A district may establish a sinking fund to provide funding on a pay as you go basis. Such a fund must be approved through a school election and a district may levy not more than 5 mills for a period of not more than 20 years. A sinking fund may only be used for purposes defined in MCL 380.1212 and as limited by the ballot language. Briefly, these purposes are the same as described earlier under "Allowable use of bond proceeds" with the following exceptions: A sinking fund may be used for repairs costing more than the amount defined in MCL 380.1267, but must be completed by contracted sources. A sinking fund may not be used for maintenance. A sinking fund may be used for technology, but is limited to wiring or materials for installing technology; this does not include equipment or software.

Shared savings energy programs: A district may complete energy conservation improvements to school facilities and pay for the improvements from operating funds, bond proceeds, or may enter into contracts in which the cost of improvements are paid from the subsequent savings. (See MCL 380.1274a)

Annual state aid percentage: A district may use a percentage of the annual state aid received for operations from the current year or unencumbered funds from a previous year that had been transferred to the Capital Projects Fund. (Review current year's state aid act provisions for current percentage.)

Other sources: A district may use proceeds from the sale of land or buildings, monetary gifts received by the district, other non-taxable funds (e.g. athletic fund), Federal assistance programs (if available), etc.

## **Conclusion**

The intent of the bulletin is to provide interested parties with information regarding the bonding process. It is not intended to be all inclusive or ensure that all legal and other requirements are identified. This bulletin should be used in conjunction with the services of independent architectural, construction managerial, educational, financial and legal consultants as appropriate to the project scope.

## Legal References

The following represent some of the current applicable state legal requirements that school districts should be aware of when consideration bonding.

Public Act 34 of 2001 (as amended) – Revised Municipal Finance Act

MCL 141.2101 to 141.2821

Requires that all school district borrowing be approved by the Department of Treasury, Municipal Finance Section

Public Act 92 of 2005 (as amended) – School Bond Qualification, Approval, and Loan Act

MCL 388.1921 to 388.1939

Establishes requirements for obtaining qualification of school bonds and for obtaining state loans from the School Loan Revolving Fund

Public Act 112 of 1961 (as amended) – School Bond Loan Financing Act

MCL 388.981 to 388.985

Establishes authority for the state to issue bonds and notes in order to provide funds for making loans to schools

Public Act 451 of 1976 (as amended) – The Revised School Code

MCL 380.1212 – Sinking fund

MCL 380.1267 – Competitive bidding requirements for school building construction

MCL 380.1274 – Competitive bidding requirements for purchasing equipment

MCL 380.1274a – Energy conservation programs

MCL 380.1351 to 380.1372 – Borrowing money and issuing bonds

Public Act 388 of 1976 (as amended) – Campaign Finance Act

MCL 169.257

Establishes regulations regarding political activity, contributions and expenditures by public officials to influence passage or defeat of a ballot questions

Public Act 116 of 1954 – Michigan Election Law

MCL 168.641 – Regular and special election dates.

Public Act 227 of 1985 – Shared Credit Rating Act

MCL 141.1066c

Establishes a School Loan Revolving Fund