CITIZENS RESEARCH COUNCIL OF MICHIGAN

"The right to criticize government is also an obligation to know what you're talking about."

Lent Upson, First Director of the Citizens Research Council

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State Steps in with Debt Relief for School Districts, Despite Lack of Cohesive Policy

In a Nutshell

- Michigan lawmakers recently approved $114 million from the state School Aid Fund to pay off the legacy debts of several local school systems that previously faced serious financial distress.
- While this is welcomed news for both students and taxpayers of the affected school systems, these funds were not part of a cohesive state policy on school debt relief.
- The lack of a cohesive state policy for dealing with school legacy debts represents a moral hazard, signaling to other districts that they will not be fully responsible for solving their future financial problems and taking care of their legacy debts, should they arise.

As part of a $276 million supplemental appropriation bill for the 2023-24 fiscal year, Lansing lawmakers earmarked $114 million of surplus state School Aid Fund dollars to liquidate outstanding debts held by several local public school districts that previously faced serious fiscal challenges and needed state intervention of some sort. This includes several districts that are currently in operation and servicing their legacy debts from their operating budgets. Also, the state is providing debt relief to two districts that have been shuttered and no longer provide services to K-12 students. These systems have remained in existence to collect voter-approved property taxes dedicated to repaying those districts' legacy debts. Instead of waiting for future local tax dollars to be collected to repay these debts, School Aid Fund dollars will be used to eliminate the debts of closed districts immediately.

State assumption of these repayment obligations will have differing impacts on each district's finances and local tax levies. For those school systems still in operation, the state's assistance will free up current school operating dollars previously earmarked for debt relief and make them available for classroom expenses. In contrast, the taxpayers in the closed districts will be the chief beneficiaries of the state's debt relief funding because the School Aid Fund is now going to pay off bonded debts that were backed by local millages. Taxpayers in those communities will see reductions in their school debt millage rates as a result.

Debt Relief to Free-Up Dollars for the Classroom

Of the total $114 million state appropriation, nearly half ($55 million) will be used to eliminate the outstanding balances of state emergency loans and other state-backed operating loans provided to school districts in Benton Harbor, Muskegon Heights, Pontiac, and Ypsilanti. In each case, the loans originally were provided to cover the substantial accumulated operating deficits these school systems amassed from chronic budget overspending and mismanagement. As of June 30, 2023, the outstanding loan balances for these districts totaled $10.3 million, $21.4 million, $18.2 million, and $5.5 million respectively.

When issued, the state emergency loans effectively allowed school districts to alleviate their short-term budget deficits by converting them into long-term debts repayable to the State of Michigan. But, it should be noted, that the state assistance did nothing to address the underlying fiscal challenges these districts faced at the time. They were not required to make operational changes or budget reductions as a condition of receiving a state loan, nor did they receive supplemental state funding or additional taxing authority to cover loan repayment.

These state loans were a stop-gap intervention. They provided additional time for districts to pay down their accumulated operating deficits. While each loan was structured differently, the expectation was that repayment would come from each district's flow of future operating funds rather than requiring debt repayment all at once. To minimize the negative impacts that these repayment obligations would have on the amount of annual funding for current classroom instruction and other operating expenses, repayment schedules were stretched out over decades and the state provided other favorable terms to the loans (e.g., below-market interest rates, interest-only payments).

For example, Pontiac restructured its loans in 2021 to lower the interest rate, extend the term from 20 to 30 years, and require interest-only repayments for several years. It is scheduled to spend just $345,000 from its operating budget to service its loans in 2024, equivalent to $100 per student. However, because the district is making interest-only payments currently, future annual per-student servicing costs will be much higher to repay the district's $18 million outstanding principal balance.

Similarly, the much smaller Benton Harbor district with a $10 million outstanding loan balance is scheduled to make a $360,000 installment repayment in 2024, equating to $314 per-student. Again, Benton Harbor's future per-student repayment amounts will increase because it is making interest-only payments currently.

The same situation applies in Ypsilanti where the district has been paying off an $18.7 million state-backed operating loan with a portion of its operating funds since 2013. The original loan was provided to give the district a debt-free "fresh start" by eliminating the combined accumulated operating deficits of two school systems (Ypsilanti and Willow Run) following their consolidation in the summer of 2013. The newly formed district was given 13 years to repay its state loan, requiring $2 million annually (over $500 per student) from its operating budget.

With School Aid Fund dollars covering the outstanding loan balances of these districts, school operating dollars that would have gone towards annual principal and interest obligations can be redirected to provide services to current students. And while the amount of redirected funds may be small today, they would have been substantially greater in the future under current repayment schedules.

Debt Relief for Shuttered Districts

The School Aid Fund also will be used to eliminate the outstanding balances of certain bonded debts held by two shuttered school districts, Muskegon Heights and Inkster. Currently, these districts don't provide any K-12 educational services, instead, students residing within their boundaries attend schools in neighboring districts or a charter school. While the circumstances and specific details behind the closure of each school system are unique, Muskegon Heights and Inkster share one thing in common; they exist for the sole purpose of collecting locally-approved taxes earmarked for debt repayment.

Paying off the bonded debts of these systems will not result in more operating dollars being available for classroom instruction, as is the case with the School Aid Fund dollars used for operating loan relief. Rather, taxpayers living in these districts will benefit from the state's debt-relief appropriation in the form of lower taxes because the dedicated taxes they pay to finance bonded school debts will decrease.

For example, after the state-mandated dissolution of the Inkster School District in 2013, students attending Inkster schools were assigned to the four neighboring districts for the start of the 2013-14 school year. While the district no longer was responsible for providing K-12 education services, it remained intact for taxing purposes to pay the annual debt service on voter-approved bonds that the district sold to construct and improve buildings and other infrastructure. The district continued to levy the state maximum millage rate (13 mills) on its qualified bonds to cover annual principal and interest. (Note: A mill equals $1 of tax for every $1,000 of taxable property.)

With those debts now paid by the School Aid Fund, going forward Inkster taxpayers will be responsible for the debt millage of the school district to which they were assigned following dissolution. All have debt millages considerably lower than 13 mills – Romulus (8.25 mills), Taylor (2.35 mills), or Wayne-Westland (4.48 mills). (Note: A portion of the former Inkster district was apportioned to Westwood, but it does not levy any debt mills.) Further, taxpayers in the receiving districts will benefit from the School Aid Fund picking up Inkster's debt because the tax base in these jurisdictions will grow with the addition of a portion of Inkster's tax base.

Lack of a Cohesive Policy

This was not the first time that the State of Michigan has stepped in to settle the legacy debts of local school districts. It did something very similar in 2016 for the former Buena Vista School District in Saginaw County and again in 2021 to cover $25 million of Inkster's debts following the dissolution of both systems. While the recent $114 million state appropriation for school debt relief is welcomed news for both students and taxpayers of the affected school systems, these funds, just like those from prior years, were not part of a cohesive state policy. If the state funding was tied to such a policy, then similarly situated school systems would have had their legacy debts picked up by the State of Michigan. But they were not.

Notably, the Highland Park school system went through the same state intervention process in 2012 as Muskegon Heights when it was dealing with fiscal distress and fell under the control of a state-appointed emergency manager. While the state has committed to wiping away all of Muskegon Heights' legacy debts, it will not do the same for Highland Park's. The district still owes $5.4 million on the state emergency loans it received. This is unfair to both students and taxpayers in Highland Park.

Moreover, the lack of a cohesive state policy for dealing with school legacy debts represents a moral hazard of sorts. It signals to other school districts that they will not be fully responsible for solving their future financial problems and taking care of their legacy debts, should they arise. That is because state policymakers, over the years, have demonstrated their willingness to step in and provide state assistance to select school districts. But, it needs to be clarified how those districts were selected for debt relief.

ABOUT THE AUTHOR

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Craig is the Research Council's Research Director and primary researcher of education and school finance issues. Prior to becoming Research Director, Craig served as the Director of State Affairs and as a Senior Research Associate. During his graduate school studies, he worked for the Council as a Lent Upson-Loren Miller Fellow from 1993 to 1995. Before joining the Council in 2006, Craig worked for ten years as a fiscal analyst at both the Senate Fiscal Agency and the House Fiscal Agency. He previously worked for the Michigan Department of State, Office of Policy and Planning and the United States Environmental Protection Agency in Chicago.

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