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"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 Nears Key Milestone to Repay Detroit Schools Legacy Debts

In a Nutshell

- A key milestone in the State of Michigan's 2016 plan to address the financial crisis in the Detroit Public Schools is just around the corner.
- With the repayment of the operating portion of its legacy debts on the horizon, DPS officials have approached state policymakers during the current lame duck legislative session with a proposal that would allow the district to continue to use the proceeds from its school operating property tax to help repay its $1.4 billion of outstanding capital debt and related state borrowings.
- As lawmakers consider the DPS proposal, they should note the fact that specific proposal is proof that Michigan lacks a clear and cohesive policy surrounding public school debt relief.

A key milestone in the State of Michigan's 2016 plan to address the financial crisis in the Detroit Public Schools is just around the corner. The now-defunct Detroit Public School district (DPS) is on track to repay a major component of the nearly $2 billion in legacy debts it was saddled with in 2016 when state law shifted responsibility for the education of Detroit school children to the new Detroit Public Schools Community District (DPSCD).

Last month, DPS officials shared news with Lansing lawmakers that the final payment toward a $150 million state emergency loan will be made in early 2025, two years earlier than was originally planned. This will end one chapter in the extremely contentious state-imposed restructuring plan for Detroit schools and end the state's direct financial commitment to DPS legacy debt retirement. Since the state plan was put in motion nearly nine years ago, the state has committed a total of $760 million towards settling these debts.

With the repayment of the operating portion of its legacy debts on the horizon, DPS officials have approached state policymakers during the current lame duck legislative session with a proposal that would allow DPS to continue to use the proceeds from its school operating property tax to help repay its $1.4 billion of outstanding capital debt and related state borrowings. Under the 2016 restructuring plan, this school "operating tax" can only be used to repay the district's outstanding "operating obligations." The current proposal seeks to change state law by expanding the definition of DPS legacy "operating obligations" to allow district to use the operating tax dollars to payoff all state loans associated with its bonded capital debt incurred for building construction and renovation.

If enacted, the proposal would continue the diversion of the operating tax toward DPS legacy debt repayment. However, it would require an annual General Fund appropriation of at least $120 million in the Fiscal Year (FY)2026 state budget to ensure DPSCD receives the full amount of its state-guaranteed per-pupil funding. The state's General Fund obligation would grow in future years with the growth of Detroit property tax base.

This article examines the financial implications for the state budget, the "old" DPS, the "new" DPSCD, as well as taxpayers, of the state's 2016 debt repayment plan. It also explores the likely impacts to these entities should Michigan policymakers allow DPS to continue to use its local operating tax towards "capital debt" repayment.

Anatomy of the State's Debt Repayment Plan for Detroit Schools

After multiple failed attempts by state-appointed emergency managers to bring financial stability to Detroit Public Schools, state lawmakers in 2016 enacted a suite of bills to completely restructure DPS. Most notably, the package included ending state control and emergency management by returning the district to local control, creating a separate accountability system for all Detroit schools (traditional public and charter), placing the district under oversight of the Detroit Financial Review Commission, and splitting the district into two separate entities – the "new" DPSCD charged with educating students and the "old" DPS that would be responsible for collecting all authorized property taxes to pay off several types of legacy debts (both operating and capital).

Two key parts of the financial reform involved the authorization for the district to re-purpose its existing school operating property tax to repay the operating debts (delinquent contributions to state pension system, operating loans, etc.) and the commitment of $617 million in state tobacco settlement funds to finance a portion of the DPS operating costs that would normally come from the school operating property tax. Per the restructuring plan, the proceeds from the district's 18-mill non-homestead tax (levied only on industrial, commercial, rental, and vacation properties) are redirected to repayment of DPS operating debts, as defined in the 2016 state legislation.

Under the state's per-pupil funding mechanism these dollars would normally be used to finance the local portion of a district's per-pupil foundation grant, the primary funding sources for Michigan schools. With the local taxes re-directed to DPS debt repayments, state law required the state to backfill, dollar for dollar, the local portion of the per-pupil foundation allowance for DPSCD students. Absent this funding structure, DPS' efforts to repay its operating debts would have to come at the expense of operating funds needed to educate students. In 2015-16, DPS was paying an estimated $1,100 of its $7,400 per-pupil foundation towards paying off previous budget deficits and operating liabilities.

Beginning with the FY2017 School Aid budget, the state has effectively reimbursed DPSCD for the full amount of the re-directed local tax dollars. The annual state reimbursement increased from $67 million in FY2017 to an estimated $120 million for FY2025 according to state reports, The reimbursement equates to about $2,400 per-pupil for the 48,500-student district in FY2025.

From a school funding perspective, the practical effect of the tax-capture/state-reimbursement mechanism results in state funds, rather than a combination of local/state funds, contributing 100 percent to DPSCD's foundation allowance while DPS pays off its operating obligations. This state-funded debt-relief financing mechanism was first employed in 2012 when the state dissolved two much smaller districts – Muskegon Heights and Highland Park. The funding for debt relief in those instances, as well as others since, came from the School Aid Fund. Notably, the 2016 DPS reform legislation relies on non-School Aid funds to provide debt-relief.

To date, the state has contributed a total of $760 million towards this arrangement. This includes the original $617 million tobacco settlement funds pledged and an additional $143 million in state General Fund appropriations. The current state budget includes $69 million from the General Fund towards the total estimated $110 million reimbursement to DPSCD this year, with the remainder coming from what is left from the $617 million commitment of tobacco settlement funds. Notably, the 2016 restructuring plan requires the General Fund to cover the full DPSCD reimbursement amount once the tobacco settlement funds are depleted.

Detroit's post-bankruptcy rebounding real estate market has fueled strong growth in property values in the city and, therefore, the tax receipts pledged to DPS debt repayment. This, in turn, has helped speed up the repayment of DPS legacy operating debts. As of June 30, 2024, the district's audited financials show just $70 million in outstanding operating obligations – this represents the principal balance remaining on a $150 million state emergency loan issued to the district in 2016. Although the final principal and interest payment on the state loan is currently scheduled for 2027, Detroit school officials have publicly shared that the district will be able to pay off the loan in early 2025, two years earlier than planned.

Repayment of Operating Debt Achieves Key Milestones of State Plan

This final pay-off achieves a key objective of the state's 2016 restructuring plan. Under the provisions of the plan, after all "operating obligations" have been repaid and verified by the state treasurer, the local tax-capture/state-reimbursement mechanism must end and the authority/responsibility for levying the local 18-mill school operating property tax shifts from the "old" DPS to the "new" DPSCD. This transition will not occur automatically because DPSCD will need to gain voter approval to levy the operating tax – current taxing authority that only the "old" DPS holds.

Under the 2016 legislation, the district has been prohibited from levying the operating tax while DPS levies the tax for debt repayment. This provision ensured that the State of Michigan, not Detroiters, was fully responsible for liquidating all operating debts. Again, with state reimbursement complete, DPSCD will need this taxing authority to generate the local funds to ensure it receives its full foundation allowance.

Notably, the operating debt pay-off also ends the state's direct financial commitment to DPS under the 2016 legislation, as it will no longer have to provide reimbursement to DPSCD. As noted above, this is currently costing the state budget $110 million in FY2025, an amount that will likely rise above $120 million in FY2026 with the expected growth of Detroit taxable values. Because the state's original $617 million commitment will be exhausted in FY2025, any future state budget exposure would have to come entirely from General Fund dollars.

From a Detroit taxpayer perspective, and assuming the transfer of taxing authority to DPSCD gains voter approval, the amount of annual school operating taxes paid by non-homestead property owners will not change. Rather, the entity collecting the taxes will change (i.e., DPSCD), as well as the use of the tax receipts (i.e., DPSCD foundation allowance). At this point, DPSCD's foundation funding will operate like other Michigan districts with a combination of local and state funds.

Full repayment of DPS legacy "operating obligations", combined with the transfer of taxing authority to DPSCD, will achieve two milestones in the state's 2016 restructuring plan. The next major financial milestone of the plan will come after DPS makes its last payment towards is capital debt and state officials confirm that the district's operating debt is fully repaid. At that point, state law provides for the full dissolution of the "old" DPS, the final milestone of the state's plan. Absent any changes to the statutory provisions regarding debt repayment, full dissolution of DPS will occur no sooner than 2040 based on the current capital debt repayment schedule.

Proposal to Extend State Payments for Detroit Schools Capital Debt

With its legacy operating debts repaid, Detroit school officials have approached the Michigan Legislature with a proposal to extend the current tax-capture/state-reimbursement mechanism to allow DPS to begin using the tax proceeds for capital debt repayment. As of June 2024, DPS had $1.1 billion of capital debt outstanding, down from $1.5 billion at the end of June 2016 when the state restructuring plan was put in motion. Final repayment is scheduled for 2040.

The legislation under consideration (House Bill 6255) would change the definition of "operating obligation" in state law to include loans taken by DPS under the state's School Loan Revolving Fund. This change would allow these long-term loans to be eligible for repayment from the 18-mill property tax and effectively require the state budget to assume responsibility for financing a portion of the district's capital debts into the future. Beyond the state budget impact, the proposal has other financial tradeoffs with implications for Detroit taxpayers, as well as the future of DPSCD.

Several school districts across Michigan take loans from the School Loan Revolving Fund annually as part of the overall financing structure they employ to repay voter-approved capital bonds issued for building construction and renovation. The program, with its origins in the state constitution, is designed to assist districts with coming up with the funding necessary for required annual debt service payments on state-qualified bonds. The loans allow districts to cap the annual millage rate levied on taxpayers (13 mills) to raise funds for principal and interest payments on bonds; any obligations that cannot be met with revenue from the 13 mills can come from a revolving fund loan. This feature is intended to protect taxpayers from spiking school-related taxes when districts borrow for capital improvements. Borrowing from the revolving fund effectively extends the term of the voter-approved bonds because districts are required to continue levying a minimum debt service millage (7 mills) after the original bonds are completely repaid.

Detroit Public Schools has been actively borrowing from the revolving fund for the past 14 years. The district's outstanding loan balance grew from $184 million in June 2022 to $348 million as of June 2024. Additional borrowing is expected in the coming years to meet the debt service requirements on its outstanding capital bonds.

Under the proposal, the current $348 million loan balance, plus all future loans, will be repaid with a portion of the 18-mill school operating tax. To ensure Detroit students receive full funding, this will require the state General Fund to continue making reimbursements of at least $120 million to DPSCD towards its per-pupil foundation funding. This represents a new long-term obligation for the state's General Fund budget.

The primary beneficiaries of this proposal will be Detroit taxpayers. That is because state dollars will pick up a portion of the annual costs associated with financing DPS capital debts. DPS will be able to repay its current $1.1 billion of outstanding capital debt, plus its state School Loan Revolving Fund loans, much sooner than planned. By reducing the length of time to repay these obligations, DPS will reduce the amount of interest taxpayers have to pay. If approved, Detroit officials estimate that these obligations would be repaid in 2033, instead of 2040, and result in total interest savings of $326 million.

Progress Despite a Cohesive Statewide Policy

The state's 2016 plan to address the financial crisis in Detroit public schools is proceeding according to plan and yielding success. This is something previous state-level interventions, including several emergency managers, were unable to achieve.

As documented here, DPS is on track to fully repay its legacy operating debts by early 2025, two years ahead of schedule. Importantly, the full repayment of $760 million of legacy operating debts used state funds to avoid burdening current funding for Detroit school children or jeopardizing the financial health of the "new" DPSCD. As our previous research has documented, the state plan has succeeded here too. The legislation enacted eight years ago provided DPSCD with a "debt-free" fresh start and the district has been on a solid financial footing since with regularly balanced annual budgets, growing budget reserves, and stable student enrollment. All key metrics of schools' financial health. According to current state law, however, the state's direct involvement with settling DPS legacy debts effectively ends when the operating portion of those debts is retired next year.

With the state's involvement soon ending, Detroit officials are pushing for a state law change that would effectively extend the state's responsibility for DPS debt repayment. The proposal would lower the total amount of school property taxes Detroiters pay over the next seven to eight years, but also comes at a substantial annual cost to the state budget. Approval of the proposal would require at least $120 million per year from the General Fund. Last week our blog noted the potential future budget impacts of a major new proposal to reallocate revenue to address the state's crumbling road infrastructure.

As debate on the proposal moves forward in the waning days of the current lame-duck session, these various fiscal costs and tradeoffs will have to be explored and debated by lawmakers. At the same time, lawmakers should note the fact that this specific proposal is proof that Michigan lacks a clear and cohesive policy surrounding public school debt relief. Without such a policy, several important questions go unanswered – which districts are eligible for debt relief, the type of debts covered, who is responsible for repayment, and what resources should be used for relief. While there may be little time to broach this policy subject before the current legislative sessions adjourns at the end of the month, but it should be an agenda item for the next session.

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.

Craig holds a B.A. in Economics and Political Science from Kalamazoo College and a Masters in Public Administration from Wayne State University. He holds positions on various professional, nonprofit, and local government boards/associations.

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