Chippewa Valley Schools taps taxable market to pay back Michigan — New Coverage
By Gunjan Banerji
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Chippewa Valley Schools' refunding of its loan balance exemplifies the State of Michigan's school finance gone awry, said two credit analysts.

"It appears that once [SLRF] balances get too high, school districts are taking on debt to repay the loan fund, which is not how the fund was originally expected to work," said Tamara Lowin of Belle Haven Investments.

The highly-indebted Chippewa School District tapped the market to pay back the state this summer. Chippewa issued USD 200m of taxable debt this summer to refund its outstanding USD 185m School Loan Revolving Fund (SLRF) balance with the state.

Loan repayment to the state starts not with a new bond issuance, but when the debt millage a district is required to levy yields more than the amount that is required to pay its debt service obligations, according to an SBQLP report.

Last year, the district levied 8.64 mills. Rather than naturally paying off the debt with its property tax revenue, Chippewa transferred the loan balance to taxable general obligation debt – thus never delevering. Money repaid by school districts on loans made by the SLRF is deposited back into the fund for future use, so at least the fund is happy.

The non-deleveraging

This is a highly-indebted district, said a municipal credit analyst.

After the taxable issuance, Chippewa's general obligation (GO) debt load increased by 54% to USD 492m this year from USD 319m in FY14. This pegs it at USD 29,872 of GO debt per student based on 16,470 enrolled students.

Previously, the district had USD 319m of GO debt and an outstanding USD 183.7m in loans to Michigan – which meant GO debt per pupil was much lower at roughly USD 19,000. Debt per pupil is a calculation to consider when evaluating Michigan school districts due to the per-pupil funding formula, which follows students if they choose to go to another district.

"If a district receives USD 8,000 per student, I wouldn't be comfortable with it having more than USD 16,000 in debt per student," said a second municipal credit analyst. The district is projected to receive a per pupil foundation allowance of USD 7,126, according to its recent offering statement.

Meanwhile, its deficit widened by 10% to USD 82m in FY14 from USD 74m in FY13, according to its FY14 CAFR. This was partially attributable to an "unrestricted" line item on its financial statements that accounts for USD 38.2m in accrued interest owed to the state.

"It is my understanding that the district realized net present value savings when it refunded the SLRF loans with taxable bonds. The current low interest rate environment makes that possible," said Terry Stanton of the Michigan Treasury.

Managing state exposure

As the state and its individual municipalities struggle with unfavorable demographics, more and more school districts turn to Michigan for financing help. Michigan's approach to school districts is different than other states; it adds risk to both the state and its locals, the municipal credit analyst said.

The School Bond Qualification and Loan Program (SBQLP) is a credit enhancement mechanism, and the accompanying SLRF lends to districts so they can pay debt service on state-backed bonds. The Chippewa School district carries an Aa3 underlying rating by Moody's and an Aa2 enhanced rating as of 7 May 2015 – thanks to the SBQLP.

Michigan's SLRF balance is projected to double over the next decade, according to a Michigan Treasury report.

"Taxable values have decreased significantly in Michigan, pushing out the repayment expectations. The school districts' paying off their balances through a new issuance is the best way for the state to stop the loan fund from drying up," Lowin said.

There was concern that a district would take on a debt that it either couldn't pay off, or would have to be paid off via a judge's order, said Douglas Roberts, director of the Institute for Public Policy and Social Research at Michigan State University. Roberts was the treasurer for Michigan from 1991 to 1998 and served as deputy superintendent of the Department of Education.

Demographics are the primary driver of distressed school districts, Roberts said. Michigan was the only state in the union that lost population as of the 2010 census, Roberts said. Losing population, combined with an aging population, is not good for a school district or a city, Roberts said. The district's enrollment has been relatively flat since FY13, according to its recent offering documents.

The irony, Roberts points out, is that rejecting a district that wants to tap the SLRF is like saying that "it's too poor" to use a system that's designed to help such poor districts.

Chippewa plans to continue borrowing through the SLRF to assist with annual debt service payments on qualified GOULT bonds. The new bonds are qualified by the state of Michigan -- which means the district can borrow from the state if it is unable to pay principal or interest on the bonds.

A tranche of Series 2013 bonds maturing in 2034 last traded on 8 July 2015 at 98.8 yielding 3.7%, according to Electronic Municipal Market Access. The USD 195m Series 2015B taxable bonds sold at yields between 1.18% for a two year maturity and 2.98% for the longest dated bond, due in 2022.

Chippewa Valley Schools did not respond to calls for comment.