CHAPTER 12 – AUTHORIZED BORROWING FOR SCHOOL DISTRICTS

INTRODUCTION

This chapter can assist district personnel in understanding the legal requirements of borrowing funds. It does not contain all the legal and financial information a school district may need to borrow funds nor does it replace the possible need for legal assistance or the services of a financial advisor. Section One provides a description of the various types and conditions of borrowing. Section Two provides detail on the Credit Enhancement Program.

Section One: Authorized Borrowing Conditions and Types

School districts do not have the authority to borrow funds unless that authority is specifically provided in statute. Minnesota Statutes provide for two types of borrowing: (1) Cash Management and Short-Term Debt, and (2) Long-Term Debt. School districts are not allowed to enter into any other forms of borrowing, including common private sector forms such as mortgages, cash advances, and commercial paper.

School districts are also limited to an amount of net long-term debt of 15 percent of actual market value of all taxable property situated within its corporate limits (Minn. Stat. § 475.53, Subd. 4). Net debt generally means the amount remaining after deducting from its gross debt the amount of current revenues which are applicable within the current fiscal year to the payment of any debt, and also after deducting any other debt which authorizing legislation has specified to not be included as part of net debt. Certain exceptions to the above debt limits exist for districts located within a city of the first class (Minn. Stat. § 475.51, Subd. 4). Finally, there is no limit on the rate of interest that a school district obligation can carry (Minn. Stat. § 475.55, subd. 2 (2006)).

Cash Management and Short-Term Debt

Each fiscal year, a school district should analyze its cash flow by estimating cash receipts and disbursements to determine if a cash flow deficit is projected at any time during any month of the year. There are five authorized methods to eliminate a cash flow deficit.

1. **Borrowing to cover insufficient funds to pay orders** – In the event that a district has insufficient funds to pay its usual lawful current obligations, the board may enter into agreements with banks or any person to take its orders (warrants) (Minn. Stat. § 123B.12a). A district may also enter into a line of credit agreement with a financial institution (Minn. Stat. § 123B.12b).

   Proceeds from either of the above are not revenue but would increase the amount of cash (General Ledger Asset Account Number 101) and increase the amount recorded in short-term indebtedness (General Ledger Liability Account Number 202). Warrants can only be issued to pay for current lawful obligations. They cannot be used to circumvent the restrictions on borrowing. For example, a district cannot issue warrants for the sole purpose of investing the proceeds.

2. **Tax Settlement Advance** – A district, upon written request to the county treasurer, may possibly receive advances from tax collections prior to the next settlement and distribution (Minn. Stat. § 276.11).

3. **Emergency State Aid** – A district may appeal to the commissioner to revise the state aid payment dates and percentages prescribed in statute if there is an emergency or there are serious cash flow problems that cannot be resolved by issuing warrants or other forms of indebtedness (Minn. Stat. § 127A.45, Subd. 4). A cash flow waiver to minimize a district's need for short-term borrowing may be negotiated with the commissioner if the district is exceeding its expenditure limitations. (Minn. Stat. § 127A.45, Subd. 6).

4. **Certificates of Indebtedness** – A school district may issue certificates of indebtedness. These certificates are intended to provide cash needed in the short-term by borrowing against either property taxes or state aids receivable (Minn. Stat. § 126C.50 to 126C.56).

   a. **Tax Anticipation Certificates** are issued in the calendar year in which the taxes are due and payable. They must mature by the earlier of the anticipated date of payment in full of the taxes anticipated, or three months after the end of the calendar year in which the certificates are issued. The aggregate borrowing must not exceed 75 percent of the current taxes that are due and payable in the calendar year when the certificates are issued.

   b. **Aid Anticipation Certificates** are issued in the fiscal year (July 1 to June 30) in which the aids are receivable. They must mature no later than 13 months after issuance, but in no event later than three months after the end of the school year (June 30). The Minnesota Department of Education (MDE) supplies a certificate of aids receivable through June 30. They are limited to 75 percent of aids that are receivable in the fiscal year issued.

These two certificates can be in the Credit Enhancement Program which was established to allow Minnesota school districts (with levy authority) to borrow funds at a lower interest rate by extending the state's credit rating to the districts. See Section Two for details.

5. **Reverse Repurchase Agreements** help a district to receive additional cash when it sells a security it has purchased with an agreement to repurchase at a fixed future date and price. (Minn. Stat. § 475.51, Subd. 12). This reverse repurchase agreement allows a school district to borrow money over an extended period of time at tax-exempt interest rates. In this respect, the reverse repurchase agreement is similar to a general obligation bond. However, payments are based upon an annual expenditure appropriation and the school district is not obligated to payments for more than one year at a time. In addition, the reverse repurchase agreement does not require voter approval and does not affect any general obligation debt limitations. Default on lease payments results in asset repossession by the Lessor.

Long-Term Debt

A school district may issue bonds for the **acquisition or betterment of school facilities**, including gymnasiums, athletic fields, stadia, teacherages, school garages, school buses, and all other facilities for administration, academic instruction, and physical and vocational education according to Minnesota Statutes, section 475.52, Subdivision 5. In general, voter approval is required prior to any bond issue. However, statutes do authorize certain bonds to be issued without an election. Refer to Minnesota Statutes, sections 123B.59 to 123B.62 for special authorities that do not require an election (Facility Bonds, Calamity Bonds, and Alternative Facility Bonds). Because of the election requirements and other complexities, general obligation bonds should only be undertaken with the assistance of a qualified financial advisor and proper legal advice.

School districts are also permitted by Minnesota Statutes, section 123B.63, to establish a **capital project referendum account** funded by an annual tax levy to finance capital projects. As with a bond issue, establishment of the annual levy must be approved by voters. However, this type of election does not result in the issuance of bonds and does not create long-term debt. This statute is intended to give districts the ability to save funds for a building project over a period of years which reduces the amount a district would need to borrow and the interest costs it would pay. A capital project referendum can also be used when there is no issuance of bonds at a future date.

The only other authorized debt is to **purchase certain capital equipment**. The board of a school district may issue certificates of indebtedness or capital notes, subject to the school district debt limits, to purchase vehicles, computers, telephone systems, cable equipment, photocopy and office equipment, technological equipment for instruction, and other capital equipment having an expected useful life at least as long as the terms of the certificates or notes. The certificates or notes must be payable in not more than five years (Minn. Stat. § 123B.61).

Alternative to Long-Term

Some lending institutions have set up **Tax-Exempt Lease Purchase Programs** for school districts as an alternative to issuing long-term indebtedness. A lease purchase may be arranged for a wide variety of essential equipment such as energy improvements, vehicles, food service equipment, computers, gym and playground equipment, and modular classrooms. These obligations are not included in net debt since the district must have the right to terminate a lease purchase agreement at the end of any fiscal year during its term (Minn. Stat. § 465.71).

Section Two: Credit Enhancement Program

The Credit Enhancement Program (CEP) was established to allow Minnesota school districts (with levy authority) to borrow funds at a lower interest rate than the current rate of an individual district by extending the state's credit rating to districts. This program was authorized in Minnesota Statutes, sections 126C.50 to 126C.56. A school district must covenant and obligate itself to be bound by this statute prior to the issuance of debt obligations in order to ensure participation in this program.

The state promises to pay from available cash balances on any obligation (both short- and long-term) of the debt service when a district is unable to pay. Payments may be available from the state for debt issued prior to the beginning of the program or otherwise not included in the program. The availability of payments for debt not included in the program will be dependent on the determined effect on the state's credit rating.

General Instructions for Inclusion in the Program

The **School District Credit Enhancement Application for Program Participation (ED-02110-07)** form comprises the application, paying agent acknowledgment, record of financial advisor (or attorney) and certification of participation from MDE. This form must be completed and signed by all parties before a district is included in the program. A separate form is required for each new debt obligation to be included in the program. An application to participate in the Credit Enhancement Program is available from the local financial advisor or the Financial Management website.

The general steps to complete an application are:

1. The school district contacts its financial advisor with a potential need to participate in the program. The financial advisor will provide the district with borrowing limits and assist it in moving the issue through the bidding and/or quoting procedures.

2. The Board of Education will pass a required resolution that covenants and obligates itself to the conditions of the program. The minutes of the meeting at which the resolution was passed and the resolution itself are retained in the files at the school district. **These items are not sent to the state.**

3. The school district completes its portion of the application form and forwards it to the paying agent.

4. When the application is forwarded to the paying agent, the paying agent affixes proper signatures to acknowledge its responsibility in the process. The rating agencies have requested the requirement that the paying agent be separate and independent of the school district. They also requested that MDE have the documentation (application with all signatures) on file by the paying agent prior to issuance of the certificate.

5. The application is forwarded to the district's financial advisor (or attorney) who completes the financial advisor portion of the application prior to forwarding the application to MDE for certification of participation.

6. A copy of the application will be retained at MDE and also copied for Minnesota Management and Budget. The original will be returned to the financial advisors for inclusion in their documentation.

The financial advisors may file the original with the district or at least provide the district with a copy of the application that has all signatures affixed.

7. For general obligation bonds, the financial advisor sends the **final** maturity and interest schedule to MDE and to Minnesota Management and Budget.

8. For refunding bonds:

    a. The financial advisor sends the final maturity schedule and interest to MDE and to Minnesota Management and Budget.

    b. There is an indication of when payment on new refunding bonds will change from escrow to tax levies.

    c. There is an indication as to whether the bond that is being refunded was part of the CEP.

    d. There is an indication of the amount of debt service from the original bond issue that the school district will remain responsible to pay each six months after the refunding.

    e. There is an indication where the money for the refunding is held in an escrow account.

9. The expected savings by using the CEP is calculated on each issue by the financial advisor and sent to MDE with the debt service schedule.

Financial advisors have been requested to send three copies of the certificate with all signatures affixed to MDE for processing. The advisors enclose a self-addressed stamped envelope to facilitate the return of the original to them.

Financial advisors have also been requested to send copies of the payment schedules, ratings and savings to MDE and Minnesota Management and Budget in electronic format.

General Instruction in the Event of a Default

The **Notification of Potential Default (ED-02111-05)** is the form used to notify MDE of potential default on a debt obligation. This form is available from MDE or from the financial advisor of record. This form may be submitted to request payment in the event of a default, whether or not the issue is included in the program. Essential steps and conditions of the notification include:

- The district will notify the commissioner of education not less than 15 working days before payment is due if the district believes it may be unable to make payment of principal or interest on any debt obligation.

- If the state has paid all or part of a school district's debt obligation, the pledge of full faith and credit and unlimited taxing powers of the school district to repay the principal and interest due on the debt obligations shall also, without an election, become a pledge of the full faith and credit and unlimited taxing powers of the school district to repay to the state the amount paid, plus interest.

- The amount paid by the state, plus interest, shall be reduced from state aid payable to the district, except that if a total reduction of the aids would cause an undue hardship, the commissioner may establish a different schedule for reduction of aids.

- With approval of the commissioner, a school district may levy in the year the state makes a payment an amount up to the amount necessary to repay the state.

- If the state is not repaid in full by November 30 of the calendar year following the year in which the state makes the payment, the commissioner will require the school district to certify a property tax in the amount necessary to repay the state. To prevent undue hardship, the commissioner may allow the district to certify the levy over a five-year period.

- The district will include a provision in its agreement with the paying agent that requires the paying agent to inform the commissioner if it becomes aware of a potential default on the day three business days prior to the date a payment is due on the issue.

A separate and detailed set of instructions is available for use by MDE, Minnesota Management and Budget and financial advisors in the potential or actual event of default. Those instructions and the default form can be obtained by contacting the financial advisor or e-mailing mde.ufars-accounting@state.mn.us.

Credit Enhancement Program Activity

The Credit Enhancement Program continues to be utilized by the majority of districts in the state of Minnesota. See **Table One: Credit Enhancement Summary Report – FY 2010 through 2014.**

TABLE ONE

CREDIT ENHANCEMENT SUMMARY REPORT - FY 2010 through FY 2014

Issue Type	FY 2014	FY 2013	FY 2012	FY 2011	FY 2010
General Obligation (G.O.) Bonds	56	48	46	41	78
G.O. Refunding	45	67	77	38	64
Aid Anticipation	41	112	166	150	155
Tax Anticipation	0	1	16	4	4
Capital Equipment	1	2	1	2	17
Certificate of Participation (COP)	1	2	1	1	8
Total Number of Issues	144	232	307	236	326
Total Amount Issued	$1,300,377,058	$1,626,740,838	$1,981,261,645	$1,082,893,674	$1,751,824,856
Net Change in Program	-20.06%	-17.89%	82.96%	-38.18%	24.05%
Approximate Savings on Program	$9,622,680	$13,457,881	$22,325,935	$7,444,419	$18,479,049

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