

Summary and Analysis

There is legislation before the Michigan Legislature [House Bill (HB) 4824 and Senate Bill (SB) 688] that would allow the proceeds from sinking fund millages to be used by Michigan School Districts for the same purposes for which unlimited tax general obligation bonds may be used under current law. Sinking funds are presently permitted for slightly more limited purposes. The legislation initially had broad support, but following release of a report by the Anderson Economic Group, there has been considerable confusion and a negative reaction by some media outlets. The following paper provides a factual explanation for understanding the issues surrounding use of sinking funds by school districts, and the extension of those uses for certain, limited purposes.

Under current law, a sinking fund is a voted millage of up to 5 mills that may be used for the purchase of real estate sites, the construction or repair of school buildings and facilities, and acquiring or installing technology. The Michigan Department of Treasury has defined technology in this case to mean wiring or materials for installing technology but NOT equipment (e.g., computers) or software.

Schools are, however, permitted more latitude in the use of the proceeds of unlimited tax general obligation bonds for bonded indebtedness. Under Section 1351a of the Revised School Code, a district may borrow funds by issuing unlimited tax general obligation bonds, the proceeds of which may be used to purchase a number of items specified by law, including: acquiring, installing or re-equipping school buildings for technology; purchasing, erecting, remodeling, furnishing, or re-furnishing a site or facility; or purchasing school buses.

Thus, the main difference between permissible uses of general obligation bond proceeds and sinking fund proceeds is that currently sinking fund proceeds may not be used for purchasing technology equipment, general office or classroom equipment, furnishings, and school buses. The passage of HB 4824 and SB 688 would allow the use of sinking fund proceeds for these purposes.

Why should schools be permitted to use sinking funds for these purposes? Because it makes economic sense. When bonds are issued by a school district, taxpayers are responsible for paying interest charges and legal costs. With sinking funds there are no interest payments or associated borrowing costs. Schools cannot establish a sinking fund without voter approval. The approved amount of up to 5 mills may be used for only the purposes specified in the ballot question. The district then creates a type of savings account, using the proceeds from the millage to pay for the allowed purchase without bonding and borrowing. Taxpayers have control and sinking funds save taxpayer dollars.

As cited in the following paper, 98 districts currently have sinking funds, generating a total of \$56.8 million in 2002. Assuming a five percent interest rate and 20-year term, this translates to the equivalent of the annual payment on a \$1.288 billion bond. If those districts were paying interest on such a bond, it would cost taxpayers \$35.8 million dollars a year. This equates to the salary and fringe benefit costs for about 800 first-year teachers.

Why not give local taxpayers the choice to either incur bonded debt that requires the payment of interest, or create a sinking fund? Why should sinking funds be limited to more narrow purposes than bonded debt?

The Anderson report makes the argument that permitting the use of sinking funds for the same purposes as bonded debt is backtracking on the tax limits contained in Proposal A. This is a patently absurd. Proposal A did not freeze all tax laws in place at the time of its passage. Certain Constitutional limitations were imposed, but none of those would be affected by this legislation.

Would the opponents of HB 4824 and SB 688 accept the proposition that there could be no additional tax *cuts* after Proposal A because a promise had been made to fund public education from particular sources? Of course not. There have been several tax cuts since the passage of Proposal A that have negatively impacted school funding. Likewise, there have been tax increases at the state level approved by the legislature and at the local level voted by local taxpayers. As times and situations change, the legislature *should* review and modify tax policy and law to respond to existing circumstances.

But the fact remains, ***passage of this legislation allowing voters the option of using sinking funds for the same purposes as bonded debt does not increase taxes*** - it gives taxpayers a choice of incurring debt and paying interest, or, in limited situations, using a sinking fund and avoiding interest and borrowing costs. Local taxpayers have an additional option and voting no still remains a choice.

The Anderson report admits that, Bond, building and site and sinking fund millages can be prudent vehicles to raise funds for capital projects. Then an argument is made against their use because, Short-lived assets like school buses and technology have a useful life of three to seven years —imprudent expenditures for debts repaid over ten or twenty years. The point made in the Anderson report is wrong; under current law and regulation schools cannot bond or use the proceeds of sinking funds to pay for something beyond its useful life. *The Michigan Department of Treasury limits the duration of the payback period for the use of funds for qualified bonds as follows: furnishings and equipment - 10 years; school buses - 6 years; and technology equipment - 5 years.*

Additionally, the School Code contains a limitation that schools may not pay for an item over a period exceeding its useful life. This imposes a limitation on items not purchased through the use of qualified bonds. The Anderson report is incorrect in asserting that school buses and technology purchases can be repaid over a period of ten or twenty years.

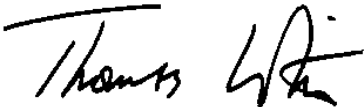
Another misleading assertion in the Anderson report bears clarification. The paper states, By authorizing 5 additional mills to be levied for such purposes, the legislature would effectively increase the maximum school property tax for operating purposes by 5 mills a 5-mill increase would represent more than a 20% tax increase. To say the least, this statement stretches reality. Sinking funds are an *alternative* to issuing general obligation bonds. Districts that have sinking funds have less debt levy. Under current law a district could seek approval for general obligation bonds for the same purposes as this legislation would allow for sinking funds. In either case, voters have the choice of saying no. Passage of HB 4824 and SB 688 would not increase taxes by 20%.

The core points in support of approving HB 4824 and SB 688 are:

- Sinking funds permit schools to save taxpayer dollars over alternative forms of bonding and borrowing.
- No taxes would increase by virtue of passage of this legislation. The Constitutional protections against property tax increases put in place with the passage of Proposal A would stay intact.
- Local taxpayers are sufficiently informed and sophisticated to make a decision as to whether their local school should utilize a sinking fund, operational sources, or a bond.

HB 4824 and SB 688 propose a minimal change in state law, allowing the proceeds of sinking funds to be used for the same purposes as proceeds from general obligation bonds. This modestly expands the current permissible use of sinking funds to allow the purchase of technology, equipment (e.g., copiers, audio visual), furnishings (e.g., classroom furniture, replacement light fixtures), and buses. Existing rules from the Michigan Department of Treasury require that each of these items be paid within its useful life so schools will not be making inappropriate purchases with these funds. There are no interest charges or borrowing costs associated with sinking funds so there is a lower cost to taxpayers compared with general obligation bonds. Taxpayers maintain control because sinking funds must be approved by local voters. Sinking funds are a responsible, viable method of public financing.

We offer the following paper as clarification and an alternative view to the Anderson Economic Group Report. To discuss the contents of this paper and the general issue of the use of sinking funds, please contact me at the Michigan School Business Officials at 517.327-2580 or e-mail me at twhite@msbo.org.



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The following report was authored by Robert Kleine, MBA. Mr. Kleine is currently a private consultant. He was employed for 16 years as vice president and senior economist at Public Sector Consultants (PSC), a leading think tank for public policy analysis. He has extensive experience in analyzing public policy issues, state and local government budgets, economic forecasting, tax policy analysis, and school organization and finance. Mr. Kleine was employed by the State of Michigan for 17 years, the last ten years as Director of the Office of Revenue and Tax Analysis, where he was responsible for state economic and revenue forecasts and development of state tax policy. He was employed for 2_ years as a Senior Analyst by the Advisory Commission on Intergovernmental Relations, where he conducted studies on such state and local finance issues as cigarette smuggling, state tax comparisons, value-added taxation, and state and local tax policy. He also served as an adjunct professor at Michigan State University, teaching public finance from 1998 to 2000.

Summary

One method of financing available to school districts for capital improvements is the levying, with voter approval, of up to 5 mills to establish a Sinking Fund. This is a prudent way for a district to pay for improvements without issuing bonded debt. A major advantage of a sinking fund is that it can reduce the district's need to bond or borrow, overall. This can reduce interest costs associated with bonded or borrowed debt. The 98 districts that levy sinking fund millage generated \$56.8 million in revenue in 2002. This amount of revenue would support a bond issue of \$1,288,000,000, assuming a 5 percent interest rate and a 20-year term. The total interest on this bond issue would be about \$717 million, or \$35.8 million annually. By using sinking funds, the 98 school districts are realizing a substantial savings that can be used to provide a better education for their students.

"In many cases, the most cost effective mechanism would be a 'pay as you go' sinking fund levy as opposed to a bond issue because interest costs would be avoided."

Under current law sinking funds can be used only for the purchase of real estate for sites, for the construction or repair of school buildings, acquiring or installing technology infrastructure, and the retirement of bonded debt. It would be good public policy to have consistent criteria for the acquisition of capital assets so that school districts could choose the most cost efficient mechanism for their given circumstance. In many cases, the most cost effective mechanism would be a "pay as you go" sinking fund levy as opposed to a bond issue because interest costs would be avoided. Proposed legislation (HB 4824 and SB 688) would amend the Revised School Code to allow electors and school district officials to create sinking funds for any purpose for which money can be borrowed and bonds can be issued under section 1351a of the code while retaining current uses.

Critics argue that such an expansion is likely to lead to a significant increase in sinking fund millage rates. In FY 2002, the average sinking fund millage rate (across all districts) was .289 mills. A recent report by the Anderson Economic Group projected that the average millage rate would increase by 2.5 mills over the next decade if the purposes for which sinking funds can be used are expanded.¹ According to the report, from 1994 to 2000, the statewide average millage for debt, sinking fund and building and site taxes increased .25 mills a year. The report uses questionable assumptions in reaching its conclusions, as it assumes this rate of increase will continue for the next decade if legislation to expand the purposes for which sinking funds can be used is passed. This projection is overstated based on recent history as sinking fund millages combined increased from 4.11 mills in 2000 (1999 rates) to 4.49 mills in 2002 (2001 rates), an increase of .38 mills. Using this rate, total debt and sinking fund millage would increase by only 1.9 mills over the next decade. Most of this increase (84 percent) is due to the increase in debt retirement millage, which has little to do with sinking funds and is more a function of the reduction in, and limitation on, operating millage as a result of Proposal A.

1. *Expanded School Sinking Fund Taxes: Infrastructure Investment, or Backtracking on Proposal A*, Anderson Economic Group, Prepared for State Chamber Foundation, June 26, 2002.

The report also argues that to allow sinking funds to be used as a supplement to operating millage is imprudent, if not reckless, as bonds that will take 20 years to repay should not be used to pay for services, nor for short-lived assets. A district can request a sinking fund millage for a period of up to 20 years. However, for those sinking funds approved from 1994 to 1999, the average request was 6.3 years. Only 3 districts requested a period of 20 years and two of those requests were defeated. It appears that districts are conservative in matching the life of the sinking fund millage to the life of the projects being financed.

“Voters deserve the opportunity to have the most cost effective means available for financing the necessary capital improvements.”

Based upon current utilization, there is no evidence to support arguments that expanding the potential use of sinking funds will result in irresponsible expenditure. It must be kept in mind that millage rates cannot increase without voter approval. Voters are astute and responsible enough to recognize whether millage increases, in general or for a specific project, are a good idea or a bad idea for the district. Voters deserve the opportunity to have the most cost effective means available for financing the necessary capital improvements.

Background

Under current law school districts are authorized, with voter approval, to levy millage for a number of purposes. These include:

- ↳ Eighteen mills for operating purposes on all property except homesteads.
- ↳ Up to three enhancement mills for operating purposes on an ISD-wide basis, if approved by a majority of the voters in the ISD. This millage is currently levied in only Monroe County.
- ↳ The number of mills necessary to hold harmless spending, for operational purposes, at the FY 1993-94 level, for those districts spending more than \$6,500 per pupil in FY 1994-95.
- ↳ Unlimited mills to pay the principal and interest on bonds. Districts that qualify to borrow from the School Bond Loan Fund need levy no more than seven mills.
- ↳ Building & Site mills, which allows segregated millage for the construction of buildings and other major capital expenditures. This is actually a sinking fund under another name.
- ↳ Up to 5 mills for a period of no more than 20 years to establish a Sinking Fund. Under current law sinking fund money can only be used for major building renovations and repairs according to Michigan law. The monies can also be used to purchase land and to pay down bonded debt. The purpose of such a fund is to set aside money each year to be used to pay for capital expenditures without issuing bonded debt.
- ↳ Intermediate School districts also levy millage for operations, special education, and vocational-technical education.
- ↳ A state education property tax of 6 mills is levied on all property.

Prior to the passage of Proposal A in 1994, all districts were able to ask the voters to approve operating mills subject only to the 50-mill limit in the state constitution. (The limit applied to school operating millage and some general government and authority millages.). The average school operating millage in 1994 was 33.4 mills.

Although Proposal A made major changes in the system used to finance schools, it made no significant changes in the methods used to finance capital improvements.

Those involved in the Proposal A debate knew that there were inequities in the funding of capital expenditures equal to those on the operating side. Most participants recognized that the capital issue would have to be revisited at some future date. Many hoped that the dramatic reduction in property tax rates for operations would allow for easier local approval of debt millages for capital in many districts, and this did occur to a limited extent as discussed below.

While it still doesn't address the basic question of adequacy and equity for K-12 capital financing, schools districts are now proposing that they should be able to use sinking fund millage for the same, or similar, purposes for which the proceeds of bond issues can be used. HB 4824 and HB 688 would expand the purposes for which sinking funds can be used. Opponents argue that the result will be a significant increase in school millage rates and it will break faith with voters who approved Proposal A with the understanding that the ability of voters to approve millage increases would be largely limited to debt retirement millage for the payment of principal and interest on bonds. Supporters argue that sinking funds are a more cost efficient method of financing capital improvements.

History of Sinking Funds

The sinking fund millage option is available under current state law as a vehicle for school districts to raise revenue for acquisition, improvement, and development of sites and the construction or repair of school buildings.

The sinking fund tax levy has its legislative roots in several Michigan Compiled Laws and public acts dating back to 1941. Sections 211.201 and 211.117A of the Michigan Compiled Laws and Act 312 of the Public Acts of 1993 included an amendment to section 1212 of the School Code, allowing school districts to create a sinking fund to be used for the purchase of real estate, as well as the construction or repair of school buildings.

At the same time Proposal A was introduced in 1993, the Legislature continued to amend this law. The intent was to update 211.201 as a continued law, allowing school districts to approach the public through a millage procedure to assist districts in sustaining a quality infrastructure as buildings grew old and needed serious repairs or replacement of equipment, remodeling, improving or repairing sites. There was no intention by the Legislature for Proposal A to replace sections 211.201 and 211.117A of the Michigan Compiled Laws.

In 1996, the Legislature approved significant revisions to the entire School Code and left the sinking fund untouched. This decision clearly indicated the intention of the Legislature to continue to provide schools with the use of a sinking fund for building and site improvements. Items on which the district could spend such funds include replacing windows, roofs, boilers, science laboratory tables and sinks, and light fixtures, and wiring the district buildings for installation of new technologies.

Current Use of Sinking Funds

There are 98 school districts in Michigan (out of 554) that currently levy a sinking fund millage. Since 1997, 105 districts have levied a sinking fund millage. The average number of mills levied in 2002 (2001 tax year) was 1.63 mills. The number of mills levied ranges from almost 5 mills in Bellevue, Highland Park, Union City, and Dearborn Heights SD #7 to .25 mills in Lamphere. The average number of mills averaged across all districts is .289. The total revenue raised for the sinking funds is \$56.8 million. The 98 districts that levy sinking fund millage account for 17.4 percent of taxable value statewide.

On average, the school districts that currently levy sinking fund millage are slightly less wealthy than the average district. The average revenue per pupil for sinking fund districts is \$7,526, or about 2.3 percent below the state average (excluding charter schools) of \$7,702. Of the 98 districts using sinking funds, 33 have per pupil revenue above the state average. The average taxable value per pupil of sinking fund districts is \$157,319, or about 11 percent below the state average of \$176,837.

Districts that levy sinking fund millage also levy an average of 3.1 mills of debt retirement millage compared to an average of 4.2 mills for all districts. Although the combined debt and sinking fund millage rates are higher in districts that use sinking funds than in districts that do not, it is clear that many of these districts use the sinking fund at least as a partial alternative to debt.

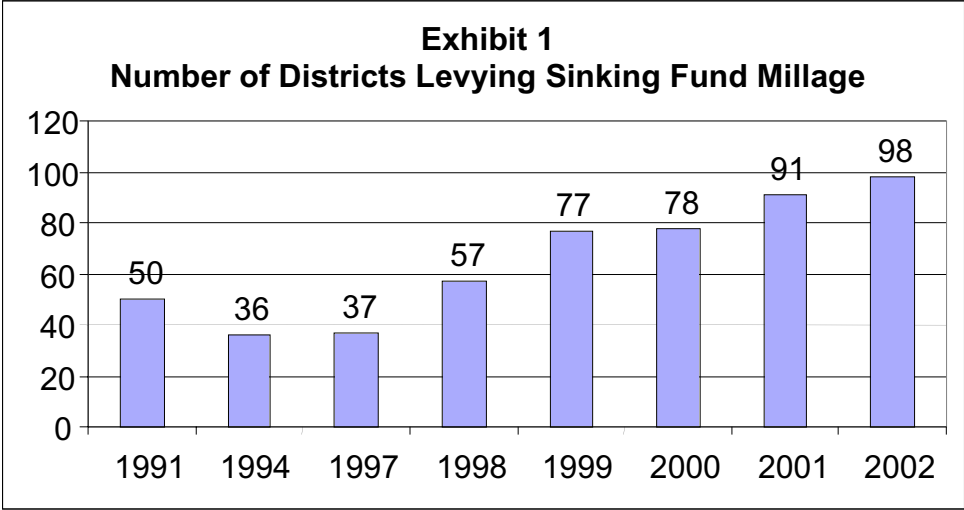
Of the 98 districts that levied sinking fund millage in 2002, 30 (30.6 percent) levy no debt retirement millage. Among all districts, only 89 (16.1 percent) do not levy debt millage. For districts that do not levy sinking fund millage only 13.6 percent do not levy debt retirement millage.

The use of sinking funds is largely concentrated in districts located in urban counties. The largest numbers of school districts using sinking funds are located in Genesee County (13), Kent County (9), Wayne County (9), and Oakland County (8). These four counties account for about 40 percent of the districts levying sinking fund millages.

Growth in Use of Sinking Fund Millage

In 1997 only 37 school districts levied sinking fund millage. The average number of mills levied by those districts using sinking funds was 1.67. The average

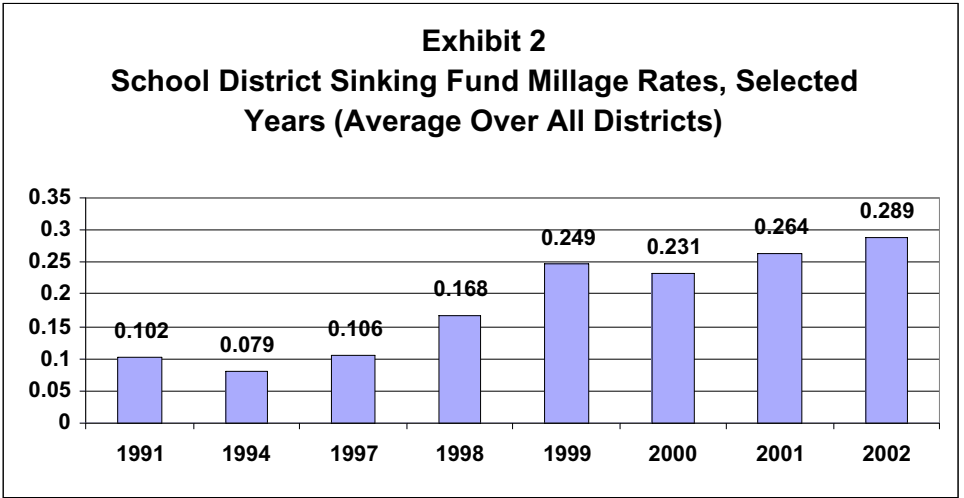
number of mills spread across all districts was 0.1. The number of districts levying this millage increased to 78 in 2000 and 98 in 2002 (see Exhibit 1). As noted above, the average sinking fund millage rate in 2002 for those districts using sinking funds was 1.63 mills, or .289 mills averaged across all districts.



In 1994, the last year before Proposal A took effect, the average school operating millage was 33.4 mills, the average debt millage was 2.47, and the average sinking fund millage was 0.08 mill for all districts.

Debt millage rates were about unchanged from 1991 (the earliest year for which data is available) to 1994. The average debt millage rate in 1991 was 2.49 mills and the average sinking fund millage was .10 mills.

Exhibit 3 shows sinking fund millage rates for selected years since 1991.



Proposed Legislation

Two bills have been introduced in the legislature that will expand the purposes for which sinking funds can be used -- HB 4824, which has passed the House, and SB 688, which is still in committee.

HB 4824 and SB 688 would amend the Revised School Code to allow electors and school district officials to create sinking funds for any purpose for which money can be borrowed and bonds can be issued under section 1351a of the code while retaining current uses of the funds.

Sinking funds are to be used only for the purchase of real estate for sites for, and the construction or repair of, school buildings. However, under Section 1351a of the Code a district may borrow money and issue bonds to defray all or part of the cost of any of the following:

- Purchasing, erecting, completing, remodeling, or equipping or reequipping (except for equipping or reequipping technology) school buildings, including library buildings, structures, athletic fields, playgrounds, or other facilities, or parts of or additions to those facilities.
- Furnishing or refurnishing new or remodeled school buildings.
- Acquiring, preparing, developing, or improving sites, or parts of or additions to sites, for school buildings, including library buildings, structures, athletic fields, playgrounds, or other facilities.
- Purchasing school buses.
- Acquiring, installing, or equipping or reequipping school buildings for technology.
- Refunding all or part of existing bonded indebtedness under limited circumstances.
- Accomplishing a combination of the above purposes.

“If school electors decide to create sinking funds for these purposes, they could reduce the district’s overall need to bond or borrow. This reduces interest costs associated with bonded or borrowed debt.”

The arguments for the bill are:

- School officials should have greater flexibility to use sinking fund revenue for the same purposes as currently permitted under Section 1351a of the School Code in order to improve their programs by preserving capital assets.
- If school electors decide to create sinking funds for these purposes, they could reduce the district’s overall need to bond or borrow. This reduces interest costs associated with bonded or borrowed debt (see discussion below).
- If school electors authorize new sinking funds for these purposes, they can increase their capital investment in their local schools and substantially improve the facilities that sustain their academic and athletic programs.

The arguments against the bill are:

- The legislation thwarts the intent of Proposal A (Michigan’s school reform ballot proposal), the primary aims of which are to reduce the reliance on the property tax overall, and to close the spending gap between high- and low-value school districts. A sinking fund levies authorized mills against the

- property value of a district. The higher the property value, the more revenue a district can raise at low millage rates, without inflicting hardship on taxpayers.
- ↳ This legislation likely will enable wealthier districts to expand their programs by supplanting some spending now financed from general operating funds with sinking fund revenue, thereby widening the gap with poorer districts. This would inevitably insure that wealthier districts would gain some advantage over poorer districts that may not be able to pass a sinking fund millage, and would realize less revenue per mill. (As noted above, districts with below average wealth make more use of sinking funds than do wealthier districts).

Voter Behavior

One point of interest is whether sinking fund millages are more likely to pass than other types of millages. The evidence suggests that they are, by a small margin.

Until 2000, the Department of Education kept track of all millage votes in school districts. Due to budget reductions and reorganization, this information is no longer collected; however, the information is available for the 1994-1999 period. After the passage of Proposal A in 1994 through 1999 there were 98 votes on sinking fund millages. Of these 60, or 61.2, percent were approved. The average number of mills approved was 1.397, while the average number of mills requested but not approved was 1.435. This suggests that the size of the millage request was not a factor in its failure or success. During the same time period there were only 32 votes on debt millage to support a bond issue. Of these 18, or 56.3 percent, were approved. The average number of mills approved was 3.856. The average number of mills for the failed requests was 3.901.

A district can request sinking fund millage for a period of up to 20 years. For those sinking funds approved from 1994 to 1999, the average request was 6.3 years. Only three districts requested a period of 20 years and two of those were defeated.

Anderson Consulting Study

On June 26, 2002 the Michigan Chamber of Commerce issued a report on sinking funds prepared by Anderson Economic Group.² The report was highly critical of allowing school districts more flexibility in the use of sinking funds, as provided for in SB 688 and HB 4824. The report reaches four main conclusions.

1. The new sinking fund legislation will result in a *dramatic* increase in the number of districts using sinking funds and, therefore, an increase in the average millage rate. The report notes that from 1994 to 2000 the statewide average millage for debt, sinking fund, and building and site taxes increased .25 mills per year. Based on this, the report assumes that

2. *Expanded School Sinking Fund Taxes: Infrastructure Investment, or Backtracking on Proposal A*, Anderson Economic Group, Prepared for State Chamber Foundation, June 26, 2002.

the average sinking fund millage rate will increase by 2.5 mills over the next 10 years. According to the Anderson Report, this 2.5 mill increase would result in additional property taxes over the 10-year period of \$5.43 billion, of which \$ 3.37 billion would be paid on residential property. (The report also uses alternate scenarios assuming a 1.5 mill increase and a 3.5 mill increase.)

2. To allow an expansion of the use of sinking funds would strike many voters as reneging on the taxation limitation commitment implicit in their approval of Proposal A.
3. Passage of SB 688 or HB 4824 would allow districts to use sinking funds to pay costs that go well beyond the proper use of sinking funds, which is to repay the principal owed on a debt. Passage of such a law would effectively allow schools to increase their operating tax revenue, by using sinking funds revenue to cover repair, maintenance, refurbishing, technology , and furnishing costs that would normally be paid out of operating funds.
4. To quote the report,

“There is little evidence to support the Anderson Report projection of a 10-fold increase in sinking fund millage rate.”

Bond, building & site, and sinking fund millages can be prudent vehicles to raise funds for capital projects However, to allow them to be used as a supplement to operating millage is imprudent, if not reckless. Bonds that will take 20 years to repay should not be used to pay for services, nor for short-lived assets. Short-lived assets like school buses and technology have a useful life of three to seven years- imprudent expenditures for debts repaid over twenty years.

Response to Anderson Report

The most critical question is whether an expansion of the purposes for which sinking funds can be used will dramatically increase their use . The Anderson Report assumes that 50 percent of the districts (in terms of taxable value) will levy the maximum allowable 5 mills.

“The state-wide average for sinking fund millage increased from .231 mills to .289 mills over the past two years. At this rate, the average sinking fund millage rate in 10 years would be only .58 mills.”

The use of debt millage has increased since the passage of Proposal A in 1994. (It reduced operating millage rates from average of 33.4 mills to 6 mills on homestead property and 18 mills on non-homestead property in most districts.) The average number of debt mills increased from 2.47 mills in 1994 to 4.2 mills in 2002, and the average number of sinking fund and building and site mills increased from about 0.08 mills in 1994 to .29 mills in 2002. However, there is little evidence to support the Anderson Report projection of a 10-fold increase in sinking fund millage rate. According to the report, from 1994 to 2000, the statewide average millage for debt, sinking fund and building and site taxes increased .25 mills a year. The report assumes this will continue for the next decade if legislation to expand the purposes for which sinking funds can be used is passed. This projection is already overstated as these millages combined increased from 4.11 mills in 2000 (1999 rates) to 4.49 mills in 2002 (2001 rates), an increase of only .38 mills. At this rate total debt and sinking fund millage would increase by only 1.9 mills over the next decade.

The statewide average for sinking fund millage increased from .231 mills to .289 mills over the past two years. At this rate, the average sinking fund millage rate in 10 years would be only .58 mills.

Also, only six districts currently levy more than 4 mills for sinking funds. It is highly unlikely that, no matter how much the purpose are expanded; half the districts would levy the full five mills.

Even, if the average millage rate did increase 2.5 mills over the next 10 years, the Anderson Report exaggerates the impact on the taxpayer. In 2001, taxable property value in Michigan was \$258 billion. An increase of .25 mills would generate about \$64 million in taxes in 2001. If the entire 2.5 mills were levied in the first year, property taxes would increase by \$645 million. Residential taxes would increase by \$400 million. The cost to the average homeowner would be about \$140. The Anderson analysis estimates that in 2013, when the full 2.5 mills is assumed to be levied, property taxes would be higher by \$1.13 billion. However, \$1.13 billion in 2013 is worth only \$770 million in 2001 dollars (assuming 3 percent inflation), or \$477 million for residential taxes.

“There is nothing in the legislation to expand the use of sinking funds that violates any of the property tax restrictions added to the constitution by Proposal A.”

The assertion that expanding the use of sinking funds would renege on the voter approved provisions of Proposal A has little validity. Proposal A restricted school districts ability to raise operating millage rates but left unchanged district s ability to increase, with voter approval, debt millage. Sinking funds are used for capital purposes, not operating, and even if the purposes for which sinking funds can be used are expanded, they would still be restricted to capital items with longer term purposes. The report seems to imply that the voters were well aware of the restrictions that would be imposed if Proposal A passed, and that now school officials and others are trying to get around these restrictions. This is completely untrue. There is nothing in the legislation to expand the use of sinking funds that violates any of the property tax restrictions added to the constitution by Proposal A.

It must be kept in mind that millage rates cannot increase without voter approval. Voters are sophisticated enough to recognize whether millage increases in general or for a specific project are a good idea or a bad idea for the district. It is interesting that those who normally support local control are worried about passing legislation that would allow voters to consider a millage increase to provide the kind of education they want for their children. The deck is certainly not stacked in favor of passing a Millage. Less than 25 percent of Michigan households contain children of K-12 school age. There is a large built-in no vote that assures that that the district must be able to make a strong case for a millage increase to be successful.

The fourth conclusion of the Anderson report (that districts will borrow long-term for short-term obligations) has little validity. As noted above, a district can request sinking funds millage for a period of up to 20 years. However, for those sinking funds approved from 1994 to 1999, the average request was 6.3 years. Only three districts requested a period of 20 years and two of those requests were defeated. It appears that districts already use good judgment in matching the life of the sinking fund millage to the life of the projects being financed.

A major advantage of sinking funds that critics fail to acknowledge is how much money they can save school districts. The 98 districts that levy sinking fund millage generated \$56.8 million in revenue in 2002. This amount of revenue would support a bond issue of \$1,228,000,000, assuming a 5 percent interest rate and a 20-year term. The total interest on this bond issue would be about \$717 million, or \$35.8 million annually. By using sinking funds, the 98 school districts are realizing a substantial savings that can be used to provide a better education for their students.

“Those who criticize schools for not being fiscally responsible should applaud districts that choose to set up sinking funds to pay as they go for capital improvements, rather than borrowing through other available methods and saddling taxpayers with large interest costs for 20 to 30 years.”

Those who criticize schools for not being fiscally responsible should applaud districts that choose to set up sinking funds to pay as they go for capital improvements, rather than borrowing through other available methods and saddling taxpayers with large interest costs for 20 to 30 years.

As noted above, the districts that use sinking funds are less wealthy than the average district. This suggests that an expansion of the purposes for which sinking funds can be used would provide more equity in financing capital improvements. Many of the districts that use sinking funds could pass bond millages. However, this puts the poorer districts at a disadvantage as they cannot raise as much revenue per mill as wealthier districts. The evidence also suggests that sinking funds are a partial replacement for bonded debt as the average debt mills levied for districts using sinking funds is only 3.1 mills compared with 4.1 mills for all districts. Expanding the purposes for which sinking funds can be used will provide a fairer financing alternative for less wealthy districts.