Detroit Public Schools' restructuring will require USD 214m refinancing of state aid notes

By Gunjan Banerji
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Detroit Public Schools' USD 214m in Series 2011 and Series 2012 state aid notes will be refinanced as the distressed district splits into an "old" district and "new" district, Jeremy Sampson, a spokesperson for the Michigan Treasury, told *Debtwire Municipals*.

The Michigan legislature approved a restructuring package for the school this week, which addresses a series of financial and organizational changes for the state's largest district. If Governor Rick Snyder (R) signs the legislation, on 1 July 2016 the Michigan state superintendent of public instruction will transfer grants and federal funds from an "old" DPS to a "new" DPS, while the freshly minted educational entity will acquire, succeed, and assume school buildings and facilities, according to legislation.

Under the plan, debt will remain with the old district, which includes USD 214m in refinanced state aid notes, USD 1.5bn in long-term bonds, and a USD 245m balance with the School Loan Revolving Fund, which it taps to pay debt service on School Bond Qualification and Loan Program bonds.

The refinanced notes will have a first lien on an 18-mill non-homestead tax, Sampson said. For DPS, the 18-mill tax yielded USD 72m in FY15, according to a Citizens Research Council Report.

Refinancing is necessary because the notes are currently secured by state aid, which the old district will not receive, Sampson told *Debtwire Municipals*. The state aid notes are currently backed by money that Michigan funnels to school districts on a per-pupil basis—these funds would stay with the "new" district, which would educate students, requiring another source of revenue to back the refinanced debt.

Because the 18-mill tax will be diverted toward the old district, the state will funnel USD 72m per year from the state's Tobacco Settlement Revenue to compensate for this hole at the new district. The state currently receives around USD 250m in tobacco settlement revenue per year, according to the analysis. It will need to appropriate the funds in order to backfill the revenue.

A Series 2015E USD 52m outstanding short-term state aid note will be paid back with FY16 state aid received in July and August, Sampson said. This provided DPS with the liquidity to meet cash flow requirements in FY16, according to its FY15 CAFR.

More debt

The overhaul could avert a Chapter 9 bankruptcy, but could also cost the district more in terms of capital, according to an analysis of the bill by the Michigan House Fiscal Agency.

The state is trying to buy more time to pay off the short-term debt, but the refinancing appears to cost DPS more, said Pat O'Keefe, founder and CEO of O'Keefe. The district has issued debt to trim operating deficits in the past, as reported.

Interest and bond costs associated with a refinancing could add an estimated USD 140m to the total debt costs, according to a House Fiscal Agency analysis. The debt will likely take at least 10 years to be paid off, assuming that voters reauthorize the “old district’s” 18-mill levy in 2022, when the existing authorization expires, according to the analysis. Repayment is expected by 2022, Sampson said.

Snyder applauded the Michigan legislature’s approval of the bill package. HB 5384 includes USD 150m to finance start-up costs and cash flow issues for the new district, according to the bill analysis.

"This is a new Detroit Public School district. The debt will be gone. The emergency managers will no longer be needed. Local control will be restored, so that new leaders for the district can be chosen this fall by Detroit voters. The same financial review commission that works with the city will assist with making strong investments as the school board stands up the new district,” according to a statement from Snyder.

Other controls

HB 5384 provides for an appointed transition manager who will oversee the dissolution of the old district and creation of the new district.

The transition manager will levy taxes for the old district’s old debt, and manage the repayment of outstanding debt for the old district, such as borrowing from the revolving loan fund for debt service on qualified bonds, or refunding or refinancing debt at a lower rate, according to an HB 5384 analysis.

The legislation puts forth academic and financial controls to ensure an overhaul. However, if the district continues to lose enrollment, the new district could accumulate deficits, O’Keefe said. DPS’ enrollment declined by 64% to 47,160 students in 2015 from 130,718 in 2006, according to offering documents.

The Michigan-based restructuring expert estimates that a 15% decline in enrollment per year would burn a USD 150m deficit in the new district over the next five years.

The new district would be able to borrow and obtain lines of credit, while the old district would not, according to the legislation.

The new district’s school board will be elected in November 2016 and take office in January 2017, according to the legislation. There will also be controls in place for public schools and charter schools through an A-F grading system.

The School Reform Office will be required to close traditional schools and notify authorizing charter bodies to revoke charters when a school is in the lowest 5% of Michigan schools, or has received an “F” grade under the new grading system, for the preceding three years.

The Education Achievement Authority will be dissolved, while an advisory council for the new district will be created. The council will provide reports on the distribution of students, school locations, and recommendations on best addressing their needs.

Once all DPS debts and obligations have been discharged, the old district will be fully dissolved, according to the HB 5384 analysis.

Moody's rates DPS Caa1/negative. A USD 13.2m tranche of Series 2015A bonds issued by the **Michigan Finance Authority** for DPS last traded on 1 June at 121 yielding 2.37%, according to *Electronic Municipal Market Access*.