CITIZENS LEAGUE REPORT

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Borrowing Policy for the City and School District of Minneapolis

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TO: Board of Directors

FROM: Taxation and Finance Committee

FUNDAMENTAL CONSIDERATIONS IN SETTING A BORROWING POLICY FOR THE CITY AND SCHOOL DISTRICT OF MINNEAPOLIS

PREFACE

The Citizens League first made suggestions for an outline of a borrowing policy for the City of Minneapolis in a 1954 report, Taxation and Borrowing Policy in the City of Minneapolis. In 1958 the League revised portions of the suggested policy in the course of framing answers to four questions on borrowing posed by the Board of Estimate and Taxation.

With the approval of a special independent school district for Minneapolis by the voters in June 1959, there was a shift in borrowing authority and procedure for school purposes. Whereas up till then borrowing for school purposes had been subject to review and recommendation by the City Council, and final determination by the Board of Estimate and Taxation, in the same way as all general obligation borrowing in Minneapolis, thereafter school borrowing became subject to action by the Board of Education and the voters. Specifically, the Board of Education may now issue bonds each year in an amount not to exceed one-half of one percent of the School District's assessed value (currently equal to about $1,960,000). The Board may issue bonds in excess of this amount in any year provided that such issues are authorized by vote of the people. Total school bonds outstanding may not exceed 10% of assessed value - about $39,200,000 at present.

City borrowing for non-school purposes continues as before, subject to determination by the City Council and Board of Estimate and Taxation, and issuance by vote of two-thirds of the Board. There is no limit on yearly issues. Total outstanding net debt may not exceed 10% of true and full value, or about $114,000,000 at present.

In view of the fundamental change in local borrowing authority and procedure, the Taxation and Finance Committee has reexamined the Citizens League's previous position on borrowing. The following report is the result.

PAY-AS-YOU-GO VS. BORROWING

If borrowing for capital improvements is avoided, interest will be saved. It thus appears that it would be more economical to finance these improvements on a pay-as-you-go basis. However, from a practical point of view, the present financial status of the City and School District makes it appear that in the foreseeable future capital improvements will in most cases be financed by borrowing. The limits on current property tax levies for operating and capital improvements expenditures are too low to permit financing the City's needs for such expenditures entirely from these levies. The School District, although not bound by the strict limitations governing the City, could not go to a pay-as-you-go basis initially without an unacceptably large increase in the current mill rate.

This also points up one important advantage of borrowing: Capital improvements can be built as needed with enough flexibility in financing to insure that the property tax level will not be seriously disrupted on a short term basis.

DESIRABLE PURPOSES OF BORROWING

In connection with the nature of items to be financed through borrowing, the following principles should apply:

Bonds should be issued only for capital improvements, not for current operating expenses, except in case of serious emergencies declared by 3/4 vote of the Council or the School Board. In some cases there is a fine distinction between ordinary repairs and capital improvements. Both the City and the School District should follow a definite and articulated policy on where the distinction should be drawn. This problem comes to mind particularly in connection with the financing of the rehabilitation of school buildings. The need for rehabilitation is a cumulative need resulting from the failure to make ordinary repairs and improvements over an extended period of time. This need has arisen in many school buildings as a result of a depression followed by a war. It is legitimate to handle proper rehabilitation needs by borrowing for them. The School District should set a definite policy, acceptable to bond experts, indicating which items are rehabilitation, (which should be financed by borrowing) and which are repairs (which should be financed by current levies.).

As a general rule existing bonded indebtedness should not be refunded. The planning of capital improvements should be efficient enough to insure that they willbe paid for over the period originally estimated. This rule should be adhered to unless there is clearly a financial advantage to be gained by refunding.

The question arises whether or not borrowing for capital expenditures should be used as an economic device to help offset deflationary or inflationary tendencies in the economy. Here it should be emphasized that borrowing decisions are complex ones which must weigh the factors of community need, available financing and public opinion. To further complicate the situation by injecting nebulous economic theory bearing no relationship to the purpose of the improvements seems unwise.

PROPERTY TAX LEVY FOR DEBT SERVICE

For 1960 Minneapolis has a total property tax rate of 18.79 mills for the payment of bond principal and interest - 12.72 mills for city purposes, and 6.07 mills for school purposes. Of the school portion, 5.48 mills were levied for bonds issued prior to the School District's fiscal independence.

These property tax levies are the major revenue source available for financing capital improvements at present. Supplemental available sources are state aid for roads, a limited current property levy, special assessments and revenue bonds.

As the Citizens League has pointed out before, every effort should be made to prevent the property tax from increasing above its present high level. Therefore, except in case of serious emergency declared by 3/4 vote of the Council or School Board, no borrowing program should be followed which would cause the present property levy for debt service to increase. If this policy begins to force the postponement of necessary or highly desirable improvements the situation can be remedied by the adoption of a substantial non-property tax revenue source, to be used either directly for capital expenditures or for debt service.

Since the School District's borrowing is now legally independent of the rest of the City government, holding the line on the property tax for debt purposes requires coordinated action by the Board of Estimate and Taxation and City Council, on one hand, and the School Board on the other

This raises the question of how the 18.79 mills should be divided between the two. A logical division would be on the basis of the relative quantity and urgency of capital needs of the School Board and the City. However, while the City has gone a long way toward developing an inventory of its capital needs through CLIC, the School District is now only starting to do this, because of the fact it only recently achieved fiscal independence.

Until such time as the School Board has developed a long range capital improvement program which can be balanced in the program of total City needs, it seems reasonable in the interim to follow recent practice in allocating the debt service levy between the City and schools.

In the five years prior to the separation of the School District, property taxes allocated to debt service for school purposes ranged from about 25 to 40% of the total for City and Schools together, with an average of about 33%. For 1960 the division is almost exactly 33%-67%.

Until such time as the School Board has developed a long range capital improvement program, therefore, we suggest that the Board of Estimate and Taxation and City Council do their share of maintaining the present 18.79 mills overall debt service rate by adjusting their future bond issues and maturities to require no more than 67% of the total 18.79 mills, or 12.50 mills.

The bond policy which the City Council recently adopted and also recommended to the Board of Estimate and Taxation for adoption seems to be consistent with this overall limit on the debt levy for City purposes. This Council policy, proposed in its essentials by the Capital Long Range Improvements Committee (CLIC) for the five year period 1960-64, calls for (1) total bond issues for City purposes of $25,000,000 with not more than $5,000,000 to be spent in any one year, except when less than $5,000,000 has been allocated, the difference may be added to a later year's program, (2) maturity of bonds not to exceed ten years, and (3) maximum City debt of $30,000,000.

The School Board's share of the predent 18.79 mills total levy would be restricted by two factors: the legal limit of 1/2% of assessed value on the amount of bonds it may issue any year on its own action (about $1,960,000 at present), and the requirement that any bond issues beyond this amount in any year must be submitted to a vote of the people.

In any case, the School Board should schedule its bond issues so as to require a debt levy of not to exceed 6.29 mills, so that the overall total of mills required for city and school purposes would not exceed the present level of 18.79 mills.

After the School Board's long range capital needs are determined, the Citizens League will reexamine the approximate 33% - 67% sharing and the total limit of 18.79 mills, in the light of total School and City capital needs.

LEVELS VS. FLUCTUATING ANNUAL BORROWING

The question also arises whether annual borrowing by the City and the School District should be at a level amount each year, or whether it should vary. As previously pointed out, one advantage of debt financing is its flexibility. A policy which requires capital spending at a fixed rate each year does not take advantage of this feature.

It is possible, by regulating the maturities of bonds, to spend large amounts in a short time without increasing the debt service levy above the amount required under a level annual program. Of course, this is true on a long term basis only if, in some years, few or no bonds are issued. It is not the purpose of this statement to advocate or oppose such a "crash program". It is suggested, however, that no strict policy should require the issuance of the same amount of bonds each year if it can be satisfactorily shown to the community that a more flexible program can better furnish needed facilities with no sacrifice of the principle of sound financing.

CITY AND SCHOOL DISTRICT COORDINATION

The recently achieved fiscal independence of the School District would be of little value if the School District were to be strictly limited in its borrowing because of an overall plan encompassing all groups in the city. Yet the School District should work closely with the City government to schedule borrowing to the best financial advantage of both the School District and the City.

A policy should be instituted immediately whereby the School District will make known its borrowing plans as early as possible to CLIC, the City Council, and the Board of Estimate and Taxation, and will work closely with these bodies in planning its borrowing. Such coordination is particularly important in relation to the scheduling of bond sales of the two units. A coordinated policy should be formalized by the School District and the City in the near future.

DEBT ADMINISTRATION

Long or Short Term Bonds. It is obvious that the longer that the term of a bond issue is extended, the greater will be the interest cost to the City, since the unpaid principal balance on which interest accrues will extend over a greater period of years. For a number of recent years, market conditions were also such that the bonds maturing more than ten years from date of issue carried a substantially higher interest rate than the bonds maturing in ten years or less.

However, it is not possible to recommend categorically any policy in favor of either long or short term bonds. For instance, market conditions have recently changed so that the interest rate on long term bonds is quite often very close to, or even lower than, that on short term bonds. It is obvious also that the logical extreme of short term borrowing is pay-as-you-go, or in other words, no borrowing at all, which has been stated earlier not to be practical under current conditions. Finally, if a crash bond program is approved, it would seem to require long term borrowing, as otherwise the millage for debt retirement would have to be unduly increased.

Advance Planning of Borrowing. The present program of planning capital improvements and bond issues five years ahead is very beneficial and should be continued. It makes sufficient time available for adequate consideration of the needs of the City for capital improvements, the determination of priority among them, the general plan for meeting the needs and the preparation of specific plans.

Marketing of Bonds. The City and School District should at least once a year check with bond dealers and rating agancies, particularly Moody's Investors Service and Standard & Poors Corp., to determine whether they are doing all they can to sell their bonds at the best times and in the best amounts, and to provide adequate information to bidders. The City and School District should also check at least once a year with the rating agencies to determine if they are doing all they can to obtain the best possible credit rating.