Oxford Area Community School District (Michigan)

Organization Size: 8 schools (4,600 students in K-12)
Project Scope: New boilers, new chiller, lighting upgrades, and other energy conservation measures
Project Cost: $2.9 million
Type of Financing: Limited tax general obligation bonds
Simple Payback Period: 8.5 years (net project cost / savings per year)
Key Benefits: Energy savings, replacement of aging equipment, improved lighting and comfort

In 2007, Michigan's Oxford Area Community School District (OACSD) entered into an energy savings performance contract (ESPC) and issued limited tax general obligation bonds to fund the up-front costs of almost $3 million of energy-related improvements. The school district partnered with an energy services company (ESCO) to complete the project and has realized significant annual savings – approximately $70,000 of positive cash flow ($340,000 gross savings) annually.

Efficiency Enables the Replacement of Aging Equipment

The school district's administrators were motivated to pursue energy efficiency primarily by their need to replace aging infrastructure, including two boilers and a chiller that was a significant gas user. Assistant Superintendent Timothy Loock noted that, "Our summer gas bills looked like winter gas bills. We were re-heating air in the middle of the summer to run the chiller, which was an original from the early 1980s. "[1] In addition to new equipment, OACSD recognized that energy efficiency offered an opportunity to reduce operating costs in an era of strained budgets and achieve classroom benefits in the form of improved lighting and comfort.

Limited Tax Bonds Provide the Financing without Requiring Voter Approval

The school district opted to finance the up-front costs of the improvements through a limited tax general obligation bond, primarily because this approach did not require a vote among area residents. In Michigan, schools have access to a limited amount of pre-approved taxing authority. A limited tax general obligation bond is secured by this existing authority, and those

[1] In some large buildings, constant-volume chillers serve spaces with varying heating and cooling requirements and must reheat cooled air just before it enters building zones without cooling needs.

Case study excerpted from: Borgeson, Merrian, and Zimring, Mark. *Financing Energy Upgrades for K-12 School Districts: A Guide to Tapping into Funding for Energy Efficiency and Renewable Energy Improvements*, 2013.
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taxes are only collected if the school is unable to cover debt service payments to bondholders.[2]

While general obligation bonds require a vote of the electorate in Michigan, limited tax general obligation bonds can be issued without a vote. This feature was important as it allowed OACSD to achieve the benefits of energy efficiency without asking voters to approve a bond, which can be a slow and sometimes unsuccessful process. Like many other communities around the country, property values have fallen, and with a lower overall tax base, OACSD leaders were not confident that the community would support a new taxpayer-funded bond for the project (they were also reluctant to ask for a vote on a relatively small bond issuance).[3] While the bonds were ultimately secured by a limited amount of pre-authorized tax revenues, the school district signed a performance contract so that it would have a high degree of confidence that project operating savings would be sufficient to cover the bond's interest and principal payments, and using tax revenue would not be required.

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- Timothy Loock, Assistant Superintendent of Oxford Area Community School District

Trade-offs Required Given Funding Limitations

There are trade-offs that school districts must grapple with in choosing financing tools and contracting types. For OACSD, getting voter approval for a general obligation bond would have been ideal, if it was possible – because tax payers would have repaid the bond holders (instead of OACSD) and the school district could have directed all of its energy savings to other needs such as school supplies and teachers' salaries rather than using those savings to make debt principal and interest payments. It also would not have necessitated that OACSD sign an energy savings performance contract (ESPC), which is an additional expense for the school district because it means paying the energy service company (ESCO) to take on the performance risk of the energy-related improvements. Loock acknowledged this, "Had we been able to pass a taxpayer bond, we wouldn't have needed performance contracting and we could have gotten more bang for our buck. But there was no community appetite for new debt and we felt we needed a performance contract to issue the limited tax general obligation bond."

Despite having to pay for the 15 year ESPC, OACSD was ultimately pleased by the flexibility that

[2] While state law in Michigan enables government entities to issue a limited amount of debt without a vote, other states require that all debt secured by taxpayer revenue be approved by voters.
[3] In 2009, the school district did request – and receive – taxpayer support for a much larger ~$35 million school facilities bond.

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the ESPC afforded. After the contract was signed, several problems were identified in existing buildings (e.g. improperly installed insulation, need for air conditioning in part of one building) and additional energy conservation measures were added to the work scope to address these issues without the ESCO requiring a change in the ESPC terms.

District Considers Seeking a Parcel Tax to Fund Ongoing Improvements

As OACSD continues to seek operating savings, OACSD administrators are considering proposing to the community a sinking fund that would be capitalized with an annual parcel tax.[4] The sinking fund would be available to pay for school maintenance, repair, and construction projects on an ongoing basis, as needs arise. Sinking funds typically have strict limits on eligible projects – for example, school districts are often prohibited from using sinking fund monies for technology upgrades such as new computers. These funds accrue the parcel tax levy until the school district draws down capital for an eligible project. There are several advantages to sinking funds relative to general obligation debt: 1) because they are not debt obligations, sinking funds do not require interest payments and do not count against a jurisdiction's debt limits,[5] 2) school districts have increased flexibility to fund improvements as needs arise, rather than as they are able to gain taxpayer support for additional expenditures.

Resources

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[4] Sinking funds are typically limited in both maximum annual tax rate and tax lifetime – that is, how much (as a percentage of property value) and for how long funds can be raised before taxpayer reauthorization is required.
[5] In some states, schools sinking funds have a different approval threshold than general obligation bonds. For example, in California, a two-thirds vote majority is required to pass all property taxes including a parcel tax to create a sinking fund except those used to repay bonds for schools, which must achieve only fifty-five percent voter support.

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