

An Audit Report on

Higher Education Authorities Established by Westlake and Cameron

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Higher Education Authorities Established by Westlake and Cameron

Rider 6 in the State Auditor's portion of the General Appropriations Act (page X-6, 77th Legislature) directs the State Auditor to "audit the Higher Education Authorities created under Chapter 53 of the Education Code by the cities of Cameron and Westlake." Objectives of this audit were to gain an understanding of the authorities and related entities, review their expenses, and determine the value of scholarships they awarded to students.

Overall Conclusion

The entities established by the Town of Westlake (Westlake) and the City of Cameron (Cameron) appear to be operating within the provisions of Chapter 53 of the Texas Education Code and of the Texas Non-Profit Corporation Act. We found no evidence of improper payments in our review of expenses.

Both Westlake and Cameron have issued tax-exempt revenue bonds to be used for educational or student housing facilities.

Westlake and Cameron's higher education authorities and corporations have borrowed a combined total of \$153 million through bond issues and installment sale agreements. Proceeds from the borrowings, less issuance and closing costs of more than \$4.9 million, were used to acquire \$113 million in properties. Annual costs to manage the properties exceed \$900,000. In addition, from 1995 through 2002, the Westlake entities awarded student scholarships valued at \$664,000.

The costs associated with issuing the bonds for both Westlake and Cameron are significantly higher than the average cost paid by state entities, municipal entities, and other nonprofit education entities. These costs do not represent expense to the State. In addition and in what appears to be common practice, the same firms provide bond counsel, financial advisor, finance counsel, and underwriter services on most Westlake bond issues.

Provisions in the Texas Education Code provide certain advantages to higher education entities in return for educational benefits. In general, higher education authorities and corporations that acquire properties have several advantages over student housing competitors. The higher education entities can secure less expensive financing by issuing tax-exempt bonds. As nonprofit corporations, they are also exempt from federal income and state franchise taxes. Furthermore, current properties are exempt from local property taxes. As a result, local governments will forgo revenues exceeding \$2.1 million for the 2001 and 2002 tax years. On the other hand, higher education entities are restricted to leasing only to university students, faculty, and staff, and they fund student scholarships.

A higher education authority, or a nonprofit corporation established in lieu of an authority, is an entity created by a city to purchase, lease, construct, or improve educational or housing facilities. An authority may also acquire land and issue tax-exempt revenue bonds.

A board of directors appointed by the city governs an authority. Chapter 53 also provides that directors serve without pay and that private persons may not share in any of an authority's earnings.

Source: Chapter 53 of the Texas Education Code



In some cases, Westlake entities have entered into agreements that provide specific benefits to the state universities involved. The universities obtain student housing without issuing debt and therefore preserve bond capacity. The universities also receive at least 95 percent of any net cash flow from the projects, and on two projects the universities are relieved of the liability and administrative burden of operating student housing facilities. The universities will also own the properties years from now after all debt is paid. In two of the projects, the universities received monies (\$100,000 and \$50,000) when the bonds were issued.

Key Points

Town of Westlake

- Westlake creates entities that purchase student housing properties in Texas cities with universities. The entities also provide scholarships to students in school districts near Westlake. As of August 2002, Westlake had borrowed more than \$142 million to acquire or construct student housing properties and had awarded scholarships valued at \$664,000. Bond issuance and closing costs on five projects exceed \$4.5 million to date.
- Since 1995, Westlake has created six entities (one authority and five corporations). The entities currently own properties in Austin, San Marcos, and Denton that are not assessed property taxes and that therefore represent a loss of local tax revenue. Properties in Bryan and College Station have been foreclosed, and one property in Austin was sold. The other property in Wichita Falls is on the campus of Midwestern State University. The Town of Westlake does not receive financial benefit from the entities or the properties.
- Current properties were purchased from and are subsequently managed by companies that are affiliated partnerships. Annual costs to manage three current properties and projects exceed \$900,000. These costs include program administration services contracted to another company that also provides management services to the town. We reviewed expenses of the Westlake corporations and the property management firms and did not identify any payments that appeared inappropriate or unusual.

City of Cameron

- Cameron has created one entity, the City of Cameron Education Corporation (Corporation), which provides borrowers access to the tax-exempt bond market. In contrast to the Westlake entities, the Corporation has not acquired properties or granted scholarships. It has paid \$34,900 to the City of Cameron.
- To date, the Corporation has issued three series of conduit debt, totaling \$30.6 million. (In a conduit debt transaction, the entity that issues the bonds assumes no responsibility for their repayment. The borrower for whom the bonds were issued assumes all responsibility for repayment.) The Corporation loaned the proceeds of two bond issues (\$10.7 million) to faith-based organizations in Dallas. Issuance costs on these two issues exceeded \$440,000.
- The Corporation loaned the proceeds from the other issue (\$19.9 million) to one of the Westlake corporations. In addition, borrowers paid issuance fees totaling \$45,900 to the Corporation. The Corporation also receives a \$10,000 annual sponsorship fee from the Westlake corporation.

Summary of Audit Objectives, Scope, and Methodology

To satisfy the requirement of Rider 6, page X-6, in the General Appropriations Act (77th Legislature), our objectives included gaining an understanding of the financial activities of the authority and corporations, as well as reviewing expenses and scholarships to students. The audit scope included available financial records and scholarship files of the higher education entities created by the Town of Westlake and the City of Cameron.

We interviewed representatives of the entities and reviewed available financial records, including bank and trustee statements. We also reviewed checks and payroll records of the property management contractor and various other documents, including bond transcript files, board minutes, scholarship records, project reports, governing statutes, and other items of correspondence.

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Detailed Results

Chapter 1

Town of Westlake Higher Education Entities

The Town of Westlake (Westlake) has created six entities (one authority and five corporations) that either issue bonds or borrow funds to finance the purchases of student housing properties. The entities currently own properties in Austin, Denton, and San Marcos.

The stated intent of these entities is to use profits from the properties to fund student scholarships. From 1996 to 2002, the entities awarded a total of 118 annual room-and-board or room-only scholarships to 49 students. The market value of these scholarships is estimated at \$446,600. For the 2002–2003 academic year, the entities awarded 39 scholarships with an estimated total value of \$217,400.

In addition to student scholarship benefits, agreements on two of the projects (San Marcos and Denton) provide that the universities (Southwest Texas State University and the University of North Texas) will receive 95 percent of the net cash flow from the projects. On the Midwestern State University project, the university will receive all of the net cash flow. The properties also will belong to the universities once the bond debt is paid.

Table 1 and the text that follows it provide more information about the entities created by the Town of Westlake.

Table 1

Entities Created by the Town of Westlake					
Entity Name and Property Acquired	Bonds Issued (in millions)	Issuance or Closing Costs ^a	Purchase Price	Property Tax Exempt	Scholarship Values (Est.)
Texas Student Housing Corporation (1995) Madison House (Austin)	\$0	\$72,000	\$4.6 million	No	\$43,000
	Purchased in 1996. Financed by installment sale agreement. Sold soon after acquisition.				
The Colony (200-unit apartment complex) 10 residential properties (College Station)	\$0	\$301,000	\$5 million	No	\$494,000
	Purchased in December 1995. Financed by installment sale agreement. Foreclosed in October 2001.				
University Tower (843-unit apartment complex) Forum (236-unit apartment complex) 5 residential properties (Bryan and College Station)	\$0	(Included with Colony closing costs)	\$24 million	No	(Included with Colony scholarships)
	Purchased in January 1996. Financed by installment sale agreement. Foreclosed in October 2001.				
Texas Student Housing Corporation—College Station (2000)	No property purchased. Project cancelled due to questions about property tax exemption.				

^aLimited to those costs identified

Table 1

Entities Created by the Town of Westlake					
Entity Name and Property Acquired	Bonds Issued (in millions)	Issuance or Closing Costs ^a	Purchase Price	Property Tax Exempt	Scholarship Values (Est.)
Texas Student Housing Corporation—San Marcos Project Jefferson Commons at San Marcos (173-unit apartment complex)	\$0	\$891,000	\$17.2 million	Yes	\$10,800
	Purchased in 2000. Financed with proceeds from a bond issue of the City of Cameron Education Corporation. Annual management costs: property management, \$175,800; asset management, \$42,000; program administration, \$10,000.				
Texas Student Housing Corporation—Denton Project Jefferson Commons at Denton (288-unit apartment complex)	\$34.4 million	\$1.6 million	\$28.8 million	Not determined	\$17,400
	Purchased in 2001. Financed with bond proceeds. Annual management costs: property management, \$244,200; asset management, \$57,000; program administration, \$10,000.				
Texas Student Housing Authority Jefferson Commons at the Ballpark (283-unit apartment complex in Austin)	\$39.6 million	\$1.6 million	\$33.1 million	Yes	\$99,200
	Purchased in 2001. Financed with bond proceeds. Annual management costs: property management, \$286,800; asset management, \$78,000; program administration, \$15,000.				
Texas Student Housing Corporation—MSU Project (2002) To be constructed	\$14.5 million	Not determined	Not determined	Yes	N/A
	Issued bonds to finance the construction of a student housing facility on the campus of Midwestern State University in Wichita Falls.				

^aLimited to those costs identified

Chapter 1-A

Texas Student Housing Corporation

The Texas Student Housing Corporation (TSHC) was chartered in February 1995. According to Westlake officials, TSHC acquired a student housing property in Austin (the Madison House) in 1996 for \$4.6 million. The purchase was financed through an installment sale agreement.

The property was sold later that same year at a reported profit of \$225,000. That profit continues to fund scholarships for several students attending The University of Texas at Austin and for students attending Texas A&M University from 2001 through 2003.

In December 1995, TSHC acquired the Colony, a 200-unit apartment complex in College Station, and 10 residential properties for \$5 million. In January 1996, TSHC purchased the University Tower (843 units), the Forum (236 units), and five other residential properties in Bryan and College Station for \$24 million.

The Bryan/College Station property acquisitions were financed by installment sale agreements at 12 percent interest per year and were secured by the facilities, properties, and net revenues of the student housing projects. Audited financial statements on the projects for 1996 to 2000 reveal losses in each year of operation. The financial statements also indicate that these properties were not exempt from property taxes.

The properties were subsequently foreclosed in October 2001. Parties to the installment sale agreements are currently in litigation concerning the ownership and distribution of remaining funds.

After the foreclosures, TSHC continued to honor scholarships for 22 students attending Texas A&M University by transferring the students to another apartment complex. TSHC also renewed 18 scholarships for the 2002–2003 academic year.

Since 1996, TSHC has awarded 136 scholarships to 49 students attending either Texas A&M University or The University of Texas at Austin. The estimated total value of these scholarships is \$537,000.

TSHC currently owns no properties.

Chapter 1-B

Texas Student Housing Corporation—College Station

In December 2000, the Town of Westlake formed the Texas Student Housing Corporation—College Station in anticipation of constructing a student apartment complex near Texas A&M University in College Station. The project was canceled prior to construction after questions arose regarding property tax exemption. The Texas Student Housing Corporation—College Station currently owns no properties.

Chapter 1-C

Texas Student Housing Corporation—San Marcos Project

In December 2000, Westlake chartered the Texas Student Housing Corporation—San Marcos Project (San Marcos Project). The San Marcos Project immediately borrowed \$19.9 million from the City of Cameron Education Corporation to acquire a student housing property, the Jefferson Commons. The source of the loan was the “City of Cameron Education Corporation Student Housing Revenue Bonds (Southwest Texas State University Project) Series 2000.” The San Marcos Project paid \$29,850 to the City of Cameron Education Corporation as an issuance fee at the closing and will continue to pay it \$10,000 per year as a sponsor fee until the bonds are paid off.

The property was purchased in December 2000 for \$17.2 million. At closing, the Southwest Texas Development Corporation received \$50,000, and the San Marcos Project received \$50,000 to fund scholarships for students attending Southwest Texas State University (University). An agreement between the San Marcos Project and the University provides for the University to receive 95 percent of the excess net cash

flow from the project. The University will also own the property once all bonds are paid.

The San Marcos Project awarded two scholarships for lodging for the 2002–2003 academic year. The total value of these scholarships is estimated at \$10,800.

Property management, asset management, and program administration services are contracted. Costs of these services totaled \$227,800 in the initial year of operation.

Chapter 1-D

Texas Student Housing Corporation–Denton Project

The Town of Westlake chartered the Texas Student Housing Corporation–Denton Project (Denton Project) in May 2001. The Denton Project issued \$34.4 million in revenue bonds in July 2001 and acquired the Jefferson Commons at Denton, a student housing property. The price was \$28.8 million.

An agreement between the Denton Project and the University of North Texas (University) provides for the University to receive \$100,000 at closing, \$475,000 annually from the net cash flow of the project, and 95 percent of the annual excess net cash flow. The University will also own the property once all bonds are paid.

The tax appraisal review board denied tax-exempt status on the Jefferson Commons at Denton property. However, that status was litigated, and the property is now assessed as tax-exempt.

The Denton Project plans to fund scholarships with the first \$25,000 of annual net cash flow. It has awarded three scholarships for lodging for the 2002–2003 academic year. The value of these scholarships is estimated at \$17,400.

Property management, asset management, and program administration services are contracted. Costs of these services totaled \$311,200 in the initial year of operation.

Chapter 1-E

Texas Student Housing Authority

Westlake's Board of Aldermen (Board) initially created the Texas Student Housing Authority (TSHA) in January 1995. According to Westlake officials, no business was conducted until the Board reconfirmed TSHA in May 2001.

In December 2001, TSHA issued \$39.6 million in revenue bonds to acquire Jefferson Commons at the Ballpark, a housing property in Austin. The purchase price was \$33.1 million.

For the 2002–2003 academic year, TSHA awarded 16 scholarships valued at an estimated total of \$99,200. These lodging scholarships were reportedly funded with \$100,000 that was escrowed in an education account with the trustee at closing. TSHA plans to fund future scholarships from deposits to that education account.

Property management, asset management, and program administration services are contracted. Costs of these services totaled \$379,800 in the initial year of operation.

Other Observations Regarding Westlake Entities

Advantages over Competitors

In general, higher education authorities and corporations that acquire properties have several advantages over student housing competitors. The higher education entities can secure less expensive financing by issuing tax-exempt bonds. As nonprofit corporations, they are also exempt from federal income and state franchise taxes. In addition, the properties they own are not always assessed property taxes, which causes some local governments to forgo revenues. One disadvantage is that the entities are restricted to leasing only to university students, faculty, and staff, thereby limiting the market for tenants and potentially affecting occupancy rates. Higher education entities also provide student housing scholarships.

Affiliated Partnerships

We also noted that the properties in San Marcos, Denton, and Austin were purchased from partnerships affiliated with one another. Property and asset management services for the three properties are also contracted with entities related to these partnerships.

Bond Issuance Costs

We noted substantial bond issuance costs (see text box) for the Westlake entities. We compared those costs with bond issue data obtained from the State's Bond Review Board, including costs for fiscal year 2001 state issues, costs of municipal revenue issues in 2000, and costs of several education entity issues for housing facilities from 1995 to 2001. Although lower state costs are to be expected, we noted that the entities' issuance costs were significantly higher:

Bond Issuance Costs

Bond issuance costs cover services provided by the underwriter, bond counsel, financial advisor, rating agency, and printer, as well as other services.

- Issuance costs for the Westlake entities averaged \$43.84 for every \$1,000 of debt issued.
- Issuance costs for the State averaged \$7.92 per \$1,000 and ranged from \$1.14 per \$1,000 to \$45.15 per \$1,000.
- Issuance costs for municipal revenue bonds valued between \$3 million and \$40 million averaged \$20.25 per \$1,000.
- Issuance costs for several housing issues by nonprofit education entities ranged from \$3.72 per \$1,000 to \$34.10 per \$1,000.

We also noted that the average cost for bond counsel services alone on state bonds was \$0.80 per \$1,000, and the costs ranged from \$0.10 per \$1,000 to \$7.90 per \$1,000. The Westlake average was \$10.82 per \$1,000. The cost of bond counsel on the Denton Project issue was highest at \$560,000, or \$16.30 per \$1,000.

Review of Expenses

In addition to bond issuance costs, we reviewed expenses of the corporations and authority established by Westlake. We also reviewed bank and payroll records of the property management contractor. We did not identify any payments in these records that appeared inappropriate or unusual in nature. All expenses appear typical for student housing operations.

Chapter 2

City of Cameron Education Corporation

The City of Cameron chartered the City of Cameron Education Corporation (Corporation) in July 2000. The Corporation was created to aid nonprofit institutions of higher education, accredited primary or secondary schools, and authorized charter schools in providing educational and housing facilities.

In contrast to entities created by the Town of Westlake, the Corporation has not acquired properties or awarded scholarships. The Corporation provides borrowers with access to the tax-exempt bond market and issues conduit, or “no commitment,” debt. The Corporation loans the proceeds of the bond issue to a borrower, who assumes all obligations for repayment of the debt.

Bylaws of the Corporation stipulate a \$1,000 application fee from each potential borrower. In 2000, borrowers also paid issuance fees totaling \$45,900 to the Corporation. In addition, the Corporation receives \$10,000 per year from the Texas Student Housing Corporation–San Marcos Project for its sponsorship.

In 2000, the Corporation issued and loaned the proceeds from the following three bond series, totaling \$30.6 million:

- The Corporation loaned \$19.9 million to the Texas Student Housing Corporation–San Marcos Project (one of the corporations created by the Town of Westlake). The source of the loan was a bond issue titled “City of Cameron Education Corporation Student Housing Revenue Bonds (Southwest Texas State University Project) Series 2000.”

The borrower used the money to purchase a student housing development in San Marcos, to pay all costs associated with the debt issue, and to pay \$29,850 to the Corporation as an issuance fee.

- The Corporation loaned \$7.7 million to the Dallas Jewish Community Foundation, which in turn made a loan to the Conservative Jewish Day School of Dallas, Inc. The source of the loans was a debt issue titled “City of Cameron Education Corporation Variable Rate Demand Revenue Bonds (Dallas Jewish Community Foundation Project) Series 2000.”

The Conservative Jewish Day School of Dallas, Inc., owns and operates a private school for students in pre-kindergarten through eighth grade. The purpose of the loan was to use the funds to build new facilities and improve existing ones.

- The Corporation loaned \$3 million directly to the Conservative Jewish Day School of Dallas for the purpose of building new facilities and improving existing ones. The source of the loan was a bond issue titled “City of Cameron Education Corporation Variable Rate Demand Educational Facilities Revenue Bonds (Solomon Schechter Academy of Dallas Project) Series 2001.”

Other Observations Regarding the City of Cameron Education Corporation

Bond issuance costs associated with the loan to the Texas Student Housing Corporation–San Marcos Project are included in the observations for Westlake entities. Although we were unable to identify all expenses of the other two bond issues, we compared the costs we could identify with bond issue data obtained from the Bond Review Board:

- Total bond issuance costs on the \$3 million issue exceeded \$61.08 per \$1,000.
- Cost of bond counsel alone on the \$3 million issue was \$60,000, or \$20.00 per \$1,000, as compared with the State’s average of \$0.80 per \$1,000.
- State issue costs averaged \$7.92 per \$1,000 in fiscal year 2001 and ranged from \$1.14 per \$1,000 to \$45.15 per \$1,000.
- Municipal revenue bond costs on issues from \$3 million to \$8 million averaged \$22.45 per \$1,000 in fiscal year 2000.
- Issuance costs on several housing issues made by nonprofit education entities between 1995 and 2001 ranged from \$3.72 per \$1,000 to \$34.10 per \$1,000.

In January 2001, the Corporation paid \$34,900 to the City of Cameron. Other expenses of the Corporation since its inception total only \$66,000.

Other Information

Objectives, Scope, and Methodology

Objectives

To satisfy the requirement of Rider 6, page X-6, in the General Appropriations Act (77th Legislature), our objectives were to report:

- An understanding of the purpose(s) and financial activities of the higher education authorities (Authorities) of Cameron and Westlake and their related entities.
- The results of our audit of the propriety of expenditures of the Authorities and the related entities.
- The number and valuation of scholarships and any other benefits awarded to students by the Authorities and related entities.

Scope

The scope of this audit included financial records and student scholarship files of the higher education authority and corporations created by the Town of Westlake and the City of Cameron. We also reviewed pertinent bank and payroll records of the Westlake property management contractor.

In addition, some of the financial transactions of the Texas Student Housing Corporation date to 1995. As a result, records pertaining to property in Austin formerly owned by the Texas Student Housing Corporation and bank records for the period during which the Corporation entered into agreements to acquire various properties in Bryan and College Station were not readily available. Therefore, we were unable to identify and evaluate all financial transactions relating to those activities.

Methodology

To achieve the audit objectives, we interviewed representatives of the entities and reviewed available financial records, including bank and trustee statements. We also reviewed various other documents, including audited financial statements where available, bond transcript files, board minutes, scholarship records, project reports, governing statutes, memoranda, and other items of correspondence.

Project Information

Fieldwork was conducted from April 2002 to June 2002. The following members of the State Auditor's staff performed the work:

- Kelton Green, CPA, CFE (Project Manager)
- Rob Bollinger, CPA
- Patricia Pratt
- Worth S. Ferguson, CPA (Quality Control Reviewer)
- Susan A. Riley, CPA (Audit Manager)
- Frank Vito, CPA (Audit Director)

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City of Cameron Education Corporation

Mr. William C. Meacham, President

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Texas Student Housing Authority

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