Key Points of Report

A Briefing Report on School District Debt

February 1998

Overall Conclusion

The magnitude of tax-supported, long-term school district debt may have implications to the State and to school districts. It is imperative that interested parties have complete and accurate information on school district debt and management and monitoring practices.

Texas independent school districts throughout the State are experiencing rapid growth in student enrollment. To meet the demands of the increasing student population, these school districts are financing facility renovations and building new facilities by issuing debt. During our research of school district long-term debt we found issues that legislative leaders, the Texas Education Agency, and school district administrators and board members should consider.

Issues for Further Consideration

- The Texas Education Agency should develop guidelines for school districts to use when reporting accretion on capital appreciation bonds in the independent school districts' annual financial reports. Long-term debt is understated in school districts' annual financial reports due in part to a lack of specific guidance on the treatment of capital appreciation bond accretion.
- The Permanent School Fund's insurance capacity should be increased. Without an increase in the amount of bonds the Fund can insure it will reach capacity by 2002. As a result, school districts may be forced to purchase insurance from private companies at an increased cost. As of August 31, 1996, 84 percent of school district bonds were insured through the Fund.
- The $300 fee charged by the Texas Education Agency to participate in the Permanent School Fund insurance program should be adjusted to reflect the costs of the program.
- Texas should consider formulating a statewide policy on school district long-term debt management. School district debt is a local issue, controlled by local school boards. While complete state oversight of school district debt is not appropriate, the long-range impact of increasing school debt could have statewide implications.

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THE STATE OF TEXAS STATE AUDITOR

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This audit was conducted in accordance with Government Code, Section 321.0131.

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Overview

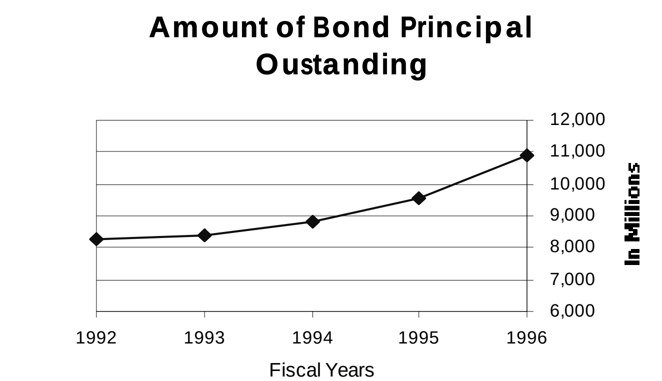
Overall Conclusion

Texas independent school districts throughout the State are experiencing rapid growth in student enrollment. To meet the demands of the increasing student population, these school districts are financing facilities renovations and building new facilities by issuing debt. This report explores numerous issues concerning the use of these debt instruments and the results on school district long-term debt.

Background

School district outstanding debt has increased steadily since 1992. At the end of fiscal year 1996, the amount of bond principal outstanding was $10.9 billion compared to $8.3 billion at the end of fiscal year 1992 (Figure 1).

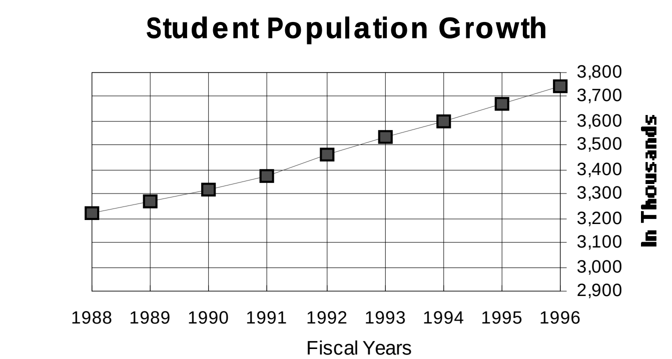
Figure 1



Source: Bond Review Board

The percentage of increase between fiscal years 1995 and 1996 was 14.58 percent, the largest annual percentage increase since 1992. Texas school districts issued $2.15 billion in new-money bonds in fiscal year 1996. This is 55 percent of all bonds issued by Texas governments during the fiscal year. The amount of bonds issued has increased steadily since fiscal year 1993. In 1996, school districts issued $2 billion in bonds compared to $650 million in fiscal year 1993. The percentage of increase between fiscal years 1995 and 1996 was 49 percent.

Figure 2



Source: Texas Education Agency

The student population in Texas has increased from 3.2 million to 3.7 million since 1988 (Figure 2), a 15.97 percent increase, according to information obtained from Snapshots published by the Texas Education Agency. The annual growth has averaged 1.87 percent. Since fiscal year 1994, when the Texas Education Agency began to keep this particular data, the number of total schools has increased at an annual rate of 2.42 percent. The number of high schools, however, increased by 13.44 percent from 1,228 to 1,393 between fiscal year 1995 and 1996.

Recently passed legislation will also contribute to the increase in construction. The 75th Legislature passed the Facilities Allotment Program (FAP) effective September 1, 1997.

The FAP provides assistance to school districts in making debt service payments on qualifying bonds and lease purchase agreements. The FAP will allow school

Overview

districts that could not previously support new debt to do so. The Legislature appropriated $200 million for the FAP, authorizing the distribution of $100 million during each of the next two years.

Since enactment of the FAP, school districts have rushed to hold bond elections to qualify for the program. On September 27, 1997 San Antonio ISD voters passed a record $483 million bond issue to renovate and build new facilities. The bond package was presented to the voters as a win-win situation.

The district showed how the new Homestead Exemption and the FAP would save the majority of homeowner's money, even if the bonds passed.

Summary of Objectives and Scope

The objectives of this project were to (1) analyze the increase in new debt; (2) determine types of alternative debt, implications for future school district solvency, and the amount of debt associated with each type; and (3) review the roles of the Texas Education Agency, the Attorney General's Office, and the Texas Bond Review Board to determine the extent of oversight and to identify gaps in oversight responsibilities.

The scope of this project included (1) all school district long-term debt; (2) the roles of the Attorney General's Office and the Texas Education Agency in the issuance of long-term debt by the school districts; (3) the role of the Bond Review Board in collecting, compiling, and reporting information on school district long-term debt; and (4) statutes and regulations related to the issuance of school district debt.

Section 1:

School District Long-Term Debit Is Understated

> **What are Capital Appreciation Bonds?**
>
> Capital appreciation bonds are deep discounted debt instruments. When a CAB is issued or sold, the issuer sells the bond and promises to pay the bondholder the principal and interest at a future date. There no regular interest payments associated with CABs.
>
> During the time the bond is outstanding, the CAB "accretes" interest until the bond matures. The accretion is the difference between the face value of the bond and the price of the bond bought at an original discount. The accretion remains a liability of the school district until the CAB matures or is extinguished through a refunding.

School district long-term debt is understated in the annual financial reports of the school districts. In our review of 34 school district annual financial reports (AFRs) with a total of $1 billion of bonds outstanding, we found 20 districts with capital appreciation bonds (CABs) with a face value of $71 million. Of the 20 school districts, 18 did not disclose $67 million (94 percent) in liability associated with the CABs in their financial statements. Without an accurate and total reporting of the accretion of the CABs, the total amount of outstanding long-term liability is unknown.

School districts have not been consistent in reporting CAB accretion in the financial statements because of a lack of specific guidance from the Government Accounting Standards Board and the Texas Education Agency on the treatment of CAB accretion.

School districts report bonds payable in the General Long Term Debt Account Group (GLTDAG) in accordance with generally accepted government accounting principles. Additional information, such as description of new issues and refundings, are disclosed in the Notes to the Financial Statements (Notes). Debt service payments are also disclosed in the Notes in the form of a Debt Service Schedule.

School districts can:

- Report the annual CAB accretion in the GLTDAG.
- Disclose the accretion in the Notes to the Financial Statements.
- Not report or disclose the accretion at all. (Most school districts have chosen not to report or disclose the accretion, with a few disclosing the accretion in the Notes and even fewer reporting the accretion on their balance sheet.)

Although most school districts have not recognized their future liability on the balance sheet, they have not totally ignored it either. Future CAB principal and interest payments are included in the debt service schedules in the Notes to the AFRs. To pay for the CABs as they mature, school districts normally include the maturity amount in the school district's budget in the year of maturity.

The exact amount of school district long-term debt can only be determined when the school districts report the liability associated with the CABs. According to information from the Municipal Advisory Council of Texas, Texas school districts have 575 bond issues outstanding that are all CABs or a mixture of term or serial bonds with CABs.

According to the Municipal Advisory Council, as of November 1997, school districts had $1 billion of CABs outstanding (principal only). The amount of unreported accretion was not computed for this report because it would have required the individual computation of each bond issue with CABs.

Issue for Further Consideration:

The Texas Education Agency Should Develop Reporting Guidelines for Reporting CAB Accretion

The Texas Education Agency should develop reporting guidelines for reporting CAB accretion. School districts should report the annual accretion of capital appreciation bonds in the GLTDAG. The recording of the accretion in the GLTDAG is not without precedent. All state agencies and institutions of higher education that issue debt and have CABs outstanding record the annual accretion as an increase in bonds payable in compliance with instructions from the Comptroller of Public Accounts.

Section 2:

The Permanent School Fund Insures School District Bonds

The Permanent School Fund (Fund) was created with a $2 million appropriation by the Texas Constitution of 1854 for the benefit of the Texas public schools. In 1983, voters approved a constitutional amendment providing for the insurance of school district bonds by the Fund. The Fund insures only voter-approved, long-term bonds issued by accredited schools.

The requirements to obtain bond insurance through the Fund are minimal. The minimum requirements are:

- A school district must be fully accredited.[1]
- The school district must submit an application along with audited financial statements.

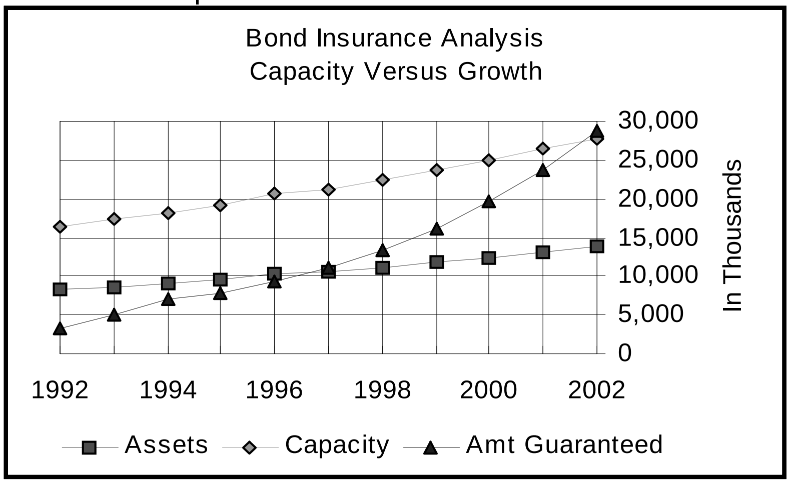
The applications are reviewed by the Texas Education Agency's administrative group and approved by the state Commissioner of Education. In line with the Fund's public purpose, nearly all applications are accepted.

[1] To be fully accredited, a school district must maintain minimum academic standards and submit annual audited financial statements. If a school district is below full accreditation, it may still get Fund insurance on its bonds if its financial position is sound.

Section 2-A:

The Fund Bond Insurance Program Will Reach Capacity in 2002

Figure 3



Source: Texas Education Agency

The bond insurance program supported by the Fund will reach capacity by the year 2002 unless action is taken to increase its capacity (Figure 3). The Fund can not insure more than 200 percent of its asset value according to the guidelines that govern the Fund's bond insurance program. The continuing increase in the issuance of school district bonds and the increasing use of the Fund to insure those district bonds are factors that will cause the Fund to reach capacity in the next four years.

As of August 1996, 84.3 percent of the outstanding voter-approved debt was insured by the Fund. Since 1990 the amount of bonds insured has increased 1,065 percent, from $789,821,329 to $9,203,776,599. At the end of fiscal year 1997, the Fund was at 52.14 percent of its capacity.

Issue for Further Consideration:

The Fund's Insurance Capacity Should Be Increased

In anticipation of the Fund insurance program reaching capacity by the year 2002, consideration should be given to increasing the 200 percent cap on the amount of bonds the Fund may insure. According to Fitch Investors Services, one of the national rating services, the 200 percent ratio is very conservative. In addition, the Fund's ability to intercept state money to reimburse draws for potential claims provides further protection to the Fund's capital. A two-thirds vote by both houses of the Legislature is required to raise the ceiling on the amount of bonds the Fund can insure. The Commissioner of Education has the authority to limit the amount of bonds insured by the Fund. However, school districts unable to insure their bonds with the Fund could be forced to acquire private insurance at a greater cost.

Section 2-B:

The Fund's Bond Insurance Fee Is A Bargain

Compared to other governmental entities, the $300 bond insurance premium charged by the Texas Education Agency is a bargain. According to the Bond Review Board, school districts in Texas paid $240,879 in bond insurance premiums for 147 transactions and $2.5 billion in bonds issued. Cities, on the other hand, paid $8,789,670 in bond insurance premiums for 146 transactions and $2.18 billion in bonds issued.

In addition, school districts obtain better bond ratings from the rating agencies because of the Fund insurance. Rating agencies (such as Moody's Investor Services, Fitch Investor Services, or Standard & Poor's Corporation) assign a rating to the bonds, which serves as a guide to investors as to the creditworthiness of the issue. Ratings are based on the issuer's ability and willingness to meet future debt service requirements. The higher the rating, the lower the interest rate the school district is likely to obtain on its bonds. The lower the interest rate, the lower the debt service costs to the school district.

There are two ratings normally assigned to each bond issue: the issue rating and the underlying rating. The underlying rating is the bond rating that credit rating agencies would give the bonds if they were not insured by the Fund. Although unusual, some bond issues are issued without a bond rating or insurance.

Rating agencies will assign the highest ratings to bonds insured by the Fund, regardless of the underlying rating. For example, in fiscal year 1996, the Bond Review Board listed 33 school districts as having significant debt ratios that point to having a high debt burden. (See Section 6 for more information on debt ratios.) However, because of the Fund insurance, these school districts can receive the highest ratings for the nominal fee of $300.

Issue for Further Consideration:

The $300 Fee Should Be Reassessed

The Texas Education Agency should perform an activity-based cost analysis of the administrative process to determine the true costs associated with the bond insurance program and adjust the fee structure accordingly. The $300 fee assessed for bond insurance helps defray the costs of administering the insurance program. The fee structure was established in 1983 to be affordable and accessible to all school districts. Since its inception the fee has never been adjusted to compensate for increasing operational costs. According to Section 33.65 of the Texas Education Code the commissioner of the Texas Education Agency sets the fee with the approval of the State Board of Education.

Section 3:

There Is Limited State Oversight of School District Debt

“Oversight” is generally defined as “watchful and responsible care.” As such, there is limited state oversight of independent school district long-term debt. School districts are required to submit most bond proposals and lease purchase agreements to the Attorney General's Office for approval. However, as long as the bond proposals and lease purchase agreements meet the statutory requirements, the school districts are free to issue bonds and enter into lease purchase agreements.

The Bond Review Board is charged with the responsibility of reporting state and local government debt to the Legislature on an annual basis. However, the Bond Review Board is not responsible for the issuance of long-term debt by the school districts.

The Bond Review Board does monitor school district debt, as well as debt of other local governmental entities.

To assist the Bond Review Board in monitoring school district debt, Article 717k-8 V.T.C.S. requires the Attorney General's Office to collect, in the form required by the Bond Review Board, information on bonds issued by the school districts. The article also requires the Attorney General's Office to send the information to the Bond Review Board.

The Texas Education Agency also provides some limited monitoring through the Division of School District Audits (Division). The Division is charged with performing desk reviews of all school district audit reports. However, long-term debt oversight is not independent within the Division's scope. The Texas Education Agency's responsibility with regard to long-term debt is to ensure that the proper disclosures are made in the annual financial reports.

Section 3-A:

Bond Review Board Assesses School Districts on Their Debt Management Practices

The Bond Review Board has adopted industry standards to assess the school districts on their debt management practices. The Bond Review Board compiles and reports on school district debt, as well as on the debt of other government organizations such as municipalities and water districts, to comply with a statutory requirement passed by the 72nd Legislature in 1991. Over the years, the Bond Review Board has developed a sophisticated database with information on the amount of school district long-term debt, tax rates, debt service payments, and other information related to debt management. The Bond Review Board has also refined the collection and evaluation process and expanded the scope of the information it maintains. The Bond Review Board regularly reports its information to the Legislature.

The Texas Education Agency and the State Auditor's Office also maintain databases on school district long-term debt. Major differences, however, exist among the three databases because the overall objectives of each are different:

- The Bond Review Board's data focuses mainly on long-term debt, evaluating trends and debt management practices.

- The information developed by the Texas Education Agency is primarily financial and is used in-house to (1) evaluate the accuracy of the annual financial reports of the school districts and (2) identify school districts in financial difficulty.

- The State Auditor's Office uses financial and performance data in its database to develop an overall assessment of school district risk.

Issue for Further Consideration:

Texas Should Consider Formulating a Statewide Policy on School District Debt Management

Texas should consider formulating a statewide policy on school district long-term debt management. School district debt is a local issue, controlled by local school boards. While complete state oversight of school district debt is not appropriate, the long-range impact of increasing school debt could have statewide implications.

The State Auditor's Office identified opportunities to enhance the State's debt management in the December 1992 report *Debt Management - Securing Texas' Future* (SAO Report No. 93-026). The State Auditor's Office recognized that addressing debt management solely at the state level did not provide planning, control, and monitoring for the largest percentage of total debt outstanding. As of August 31, 1996, the $11.28 billion in school district tax-supported debt represented 34 percent of all state and local government tax-supported debt outstanding.

The State should reconsider the following recommendations from the State Auditor's Office:

- Form a joint debt advisory committee to assist in the development of a comprehensive debt management plan.
- Expand the authority of the Bond Review Board to enhance its oversight role and facilitate state and local partnerships in debt management.
- Reduce local government debt by developing state assistance programs.

The report's recommendations support the development of a comprehensive debt management plan that includes state and local government debt without eliminating local control.

Section 3-B:

School Districts Do Not Have Specific Debt Management Policies

School districts do not have specific debt management policies to guide them in formulating a debt management plan. Of the 28 school districts that responded to our survey, 19 said that they had debt management policies. However, further investigation revealed that the debt management policies of the school districts were generic and were not tailored to the needs and environment of the individual districts.

Debt management policies should provide a framework, establish parameters, and provide general direction for debt issuance. In addition, formal debt policies should be used as tools to evaluate the impact of bond issues on the school district's overall financial position. Well thought out debt policies describe fiscal management practices that seek to integrate long-range project needs with available financial resources.

The majority of school districts use professional services to formulate their policies. As of April 1997, all but 41 of Texas' 1,043 school districts subscribe to the Texas Association of School Boards' (TASB) Policy Service. The Policy Service provides Texas' school districts with guidance, maintenance, and development of a uniform policy manual.

The debt policies formulated by the TASB's Policy Service do not go far enough to accomplish the goals of adequate debt management policies. For those school districts that issue debt and subscribe to the TASB's policy service, the policy guidelines generally outline statutory regulations and requirements. The guidelines provided by the TASB are excellent tools that can be used by the school districts to mold their own specific policies. However, they are not a substitute for a well thought out financial plan that corresponds to the school district's vision, mission, goals, objectives, and unique operating environments.

When formulating a debt management policy, school districts should have a clear understanding of the types and timing of the projects to be financed. The school district should monitor trends in average daily attendance, population demographics, tax roles, the economic environment, and other indicators that could affect the school district's ability to repay its debt and impact its financial position.

Issue for Further Consideration:

Essential Elements of a Debt Management Policy

A debt management policy should encompass several elements. At a minimum, the following should be considered:

- Acceptable levels of both short- and long-term debt
- The purposes for which debt will be issued
- The use of tax-supported, general obligation bonds
- The mix of pay-as-you-go and debt financing
- The use of variable rate debt
- Structuring debt maturities
- Acceptable financing costs and risks

A formal debt policy should be used as a tool to evaluate the impact of individual bond issues on the entity's overall financial position so as to avoid exceeding acceptable levels of indebtedness.

While debt policies are beneficial in establishing a framework for debt issuance, they should be sufficiently flexible. Debt management policies should be reviewed by the school board at explicit, predetermined time intervals. Changes in policy may arise from these periodic reviews. In addition, current events will require amendment and adjustment of the policy from time to time to take advantage of market opportunities or to respond to changing conditions without jeopardizing an entity's mission, goals, and objectives.

Section 4:

School Board Members Need More Training in Debt Management

School board members need more training in debt management issues. Nearly half (46 percent) of the 28 respondents to our survey marked "yes" to the question of whether additional training is needed. Four others suggested that more training and continuing education are needed in the recommendations and comment section of the survey.

School board members or trustees, elected by local voters, set district policy and oversee both the fiscal and operational aspects of the school district. Fiscal operations include adopting a budget and a tax rate. Operational aspects include monitoring district administration and educational performance.

School board members' understanding of debt management is becoming a critical factor affecting future district performance. Texas has one of the fastest growing public school systems in the country. With an expected enrollment growth of 70,000 students this year, it is estimated that school districts will need up to $4 billion of new building construction.

Board Member Training - According to Section 11.159 of the Texas Education Code, the State Board of Education must provide a training course to school district board members. In addition, the Regional Education Service Centers are charged with the responsibility of administering the courses. In compliance with the Texas Education Code, a three-hour introductory course is offered to new board members. The course gives a very brief survey on school district management themes delineated in the Texas Education Code. The introductory course, however, does not address issues regarding debt management in detail.

Framework for School Board Development

- Vision
- Structure
- Accountability
- Advocacy
- Unity

Board members must also receive continuing education on an annual basis. First-year board members must receive 10 hours of instruction and board members with more than one year of service must receive at least five hours of continuing education. All continuing education must be based on the assessed needs of the district and fall within the Framework of School Board Development. Each of the five critical areas contains additional descriptive statements outlining the board's responsibilities.

Aside from formal training in debt management and the debt issuance process, there is also an informal training option for board members. According to an executive director of an education service center and responses from board members, training is also received internally. It is not uncommon for school district superintendents, school district staff members, and financial advisors to provide the board members the information they need on the debt issuance process and the different debt instruments. However, the information the board members receive from internal sources is only as good as the expertise of the school district's staff.

Financial Advisors Becoming More Significant - Dependence on financial advisors is becoming more significant because expertise at the school-district level is varied and financing issues are complicated. Although the results of our survey can not be judged as conclusive evidence, we noted developing trends relating to the role of the financial advisor and training. For example, we noted that respondents to our survey, who indicated a need for more training, were more likely to respond that they relied heavily on their financial advisor.

Issue for Further Consideration:

Suggestions to Improve Board Member Training

The mandatory training offered to new board members may not provide them with a thorough understanding of the difficult and complicated issues surrounding debt management. The following should be considered:

- The State Board of Education should consider amending the Framework for School Board Development to include the following statement under Structure:

  > The board develops and adopts debt management policies that ensure the financial stability of the district as it strives to achieve its vision, mission, and goals.

  Incorporating the above statement in the Framework for School board Development should ensure that board members receive the appropriate training in matters related to debt management.

- The Regional Education Service Centers should review their board member training curriculums. Consideration should be given to more in-depth debt management training, especially "just-in-time" training for school districts considering issuing long-term debt.

- Board members should be encouraged to obtain debt management training from other sources.

The Texas Association of School Business Officials holds four, one-day seminars on issues related to debt management for their members. Although designed for school business officials, these courses could prove beneficial to school board members as well.

Texas Association of School Business Officials Seminars

- Management 304: Real Estate Management
- Management 310: Long Range Planning
- Management 311: Administering School Elections
- Management 314: Managing the Authorization, Sale, and Retirement of School Bonds
- Management 315: Planning and Administering School Construction

Bond Review Board's
Proposed Debt Management Training
for Elected/Appointed Officials

- Rules and Understanding Your Responsibilities
- Effective Oversight and Planning
- Introduction to the Tax-Exempt Bond Market
- Investors
- Issuing Debt and the Bond Sale Process

The Bond Review Board is currently developing a one-day seminar on debt management for elected and/or appointed officials. The objective of the seminars is to provide specific, detailed information to the participants so that they can actively participate in the debt financing process. This information can help board members address the questions necessary to facilitate decision making at the district level. Negotiations with the vendor are currently in progress.

Section 5:

Texas School Districts Refunded Bonds to Restructure Debt and Extend Payments

Definition of Terms

Cash saving (loss) - This is a direct comparison between the total debt service on the bonds refunded and the total debt service on the new refunding bonds.

Present value saving (loss) - This is an analysis of the cash savings that takes into account the time value of money. The present value saving (loss) is obtained from discounting the value of the saving (loss) in the year it is generated.

According to the Bond Review Board, Texas school districts as a whole restructured debt and extended payments on the refunding bonds beyond the maturity period of the old debt in fiscal year 1996. These refundings resulted in cash losses of $170.2 million and present value savings of $9.8 million.

Although the school refundings resulted in present value savings for fiscal year 1996, the amount of savings has decreased steadily from 1993. In 1993, school districts issued $2 billion in refunding bonds and had $59 million in present value savings.

By 1996, the face value of refunding bonds had decreased to $553 million and present value savings decreased to $9.8 million, and 83 percent decrease.

School district refundings do not compare favorably when compared to other governmental entities in fiscal year 1996. School districts had the largest cash losses, $170 million, and the smallest percentage of present value savings, 1.77 percent. They also had the lowest percentage of bond issues refunded for cash savings, 36 percent.

The effect of the increased use of refundings to extend debt is that the repayment of the debt is being postponed. Further evidence of this is the deterioration in the percentage of debt being paid off by the districts within five and ten years. According to the Bond Review Board, in 1991 school districts repaid 38.7 percent of their debt in five years and 73.8 percent of their debt in ten years. In 1996, only 27.8 percent of the debt was repaid in 5 years and 54.2 percent of the debt was repaid in 10 years.

Section 6:

Key Debt Management Ratios Continue to Deteriorate

Associated with the increase in bonds issued by the school districts and the increases in the amount of debt outstanding is a continued deterioration of school district overall debt ratios.

The Bond Review Board has identified four key debt-burden ratios in its fiscal year 1996 report. In 1996 the Bond Review Board identified 32 school districts with significant debt ratios, the same number as in fiscal year 1995. A difference is a decrease in the number of the largest districts and an increase in the number of districts with student populations of 5,000 or less.

The following is a summary of the four key ratios extracted from the Bond Review Board's fiscal year 1996 debt report. School districts with ratios greater than the median, based on Moody's Investor Service 1996 Medians, are considered to have significant debt ratios and are considered to have high debt burdens.

Table 1

Four Key Ratios From the Bond Review Board's Fiscal Year 1996 Debt Report

Ratio	Benchmark	Comment
Debt to Assessed Valuation (AV)	According to Moody's Investor Services (Moody's) direct ratios for school districts should be watched once they exceed 1.5 to 2.7 percent.	At the end of fiscal year 1996 there were 141 school districts with AV ratios of 3 percent or more, an increase of 18 over the prior year.
Debt Repayment	Repayment of 25 percent of principal in five years and 50 percent in ten years is considered average. Standard and Poor's further defines repayments as low when 15 percent or less is repaid at five years and 25 percent or less at ten years. School districts with low principal-repayment schedules could be faced with future economic stress.	Since 1991 the percentage of debt repaid in five years has declined from 38.65 percent to 27.83 percent. The percentage of debt repaid in ten years has declined from 73.79 percent to 54.23 percent. At the end of fiscal year 1996 there were 162 school districts with below average five- and ten-year repayment schedules. This is an increase of 41 schools over 1995 and 117 since fiscal year 1991.
Debt Per Capita	Standard and Poor's suggests that overall debt per capita of $0-$400-$800 is moderate and over $800 is high. Analysts at Moody's further caution that direct tax debt per capita should be watched once the ratio exceeds the median for the type of government and population size. For this analysis, $1,700 was used as the benchmark for overall debt per capita for all resident populations.	At the end of fiscal year 1996 there were 173 school districts with direct debt per capita over $800. This is 48 more than the prior year. The Bond Review Board identified 29 school districts with ratios above the $1,700 median in fiscal year 1996.

Table 1 (concluded)

Four Key Ratios From the Bond Review Board's Fiscal Year 1996 Debt Report		
Ratio	**Benchmark**	**Comment**
Debt Service to Expenditures	Standard and Poor's establishes a benchmark of 10 percent. Should debt service costs represent more than 10 percent of total expenditures, such costs should be noted and watched.	For fiscal year 1996, there were 110 school districts with fiscal year 1997 debt service to fiscal year 1996 expenditure ratios greater than 10 percent. This is 11 school districts fewer than last year. This improvement in this ratio is offset by the decrease in the repayment schedules. School districts may have refunded some debt, lowering their debt service payments and improving the debt-service-to- expenditure ratio.

Appendix 1:

Objectives, Scope, and Methodology

Objectives

The objectives of this project were to:

- Analyze the increase in new debt ($2 billion between fiscal year 1995 and fiscal year 1996).
- Determine types of alternative debt, implications for future school district solvency, and the amount of debt associated with each type.
- Review the roles of the Texas Education Agency, the Attorney General's Office, and the Texas Bond Review Board to determine the extent of oversight and to identify gaps in oversight responsibilities.

Scope

The scope of this project included:

- All school district long-term debt
- The roles of the Attorney General's Office and the Texas Education Agency in the issuance of long-term debt by the school districts
- The role of the Bond Review Board in collecting, compiling, and reporting information on school district long-term debt
- Statutes and regulations related to the issuance of school district debt

Methodology

In performing this project we collected information from:

- Profession literature
- The Internet
- Government codes, statutes, and regulations
- Surveys
- Various state agencies knowledgeable about the school debt management process

We also performed the following procedures:

- Analyzed the information in the reports prepared by the Bond Review Board
- Interviewed appropriate staff at the Attorney General's Office, the Texas Education Agency, the Bond Review Board, and a sample of school districts
- Surveyed 100 school districts

Other Information

We conducted our fieldwork from September 1997 through December 1997. The project was authorized by Government Code, Section 321.0131.

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Appendix 2:

Definition of Terms

Accretion	The incremental adjustment of the difference between the face value of the bond and price of the bond bought at a discount.
Bond	A written promise to pay the face amount at the maturity date. Periodic interest payments are required except for capital appreciation bonds (see below).
Capital Appreciation Bond	A long-term security sold at a discount. The yield, or accretion, is reinvested at a stated rate until maturity at which time the investor receives total payment. There are no period interest payments made during the life of the bond.
Debt to Assessed Valuation	This is the ratio of the total school district voter-approved debt outstanding (principal only) as of August 31, 1996, to the 1994-1995 effective assessed valuation of the school district.
Debt Per Capita	This ratio represents total school district voter-approved debt outstanding as of August 31, 1996, divided by estimated residential population of the school district.
Debt Repayment	This ratio represents the percentage of total principal outstanding as of August 31, 1996, retires within five- and ten-year periods.
Debt Service to Expenditures	For debt issued through August 31, 1996, the ratio of school district voter-approved debt service (principal and interest) due in fiscal year 1997 to fiscal 1996 budgeted school district expenditures.
Face Value	Par value or maturity amount on the face of the bond certificate
Fiscal Year	Information based on the fiscal year of the State, from September 1 through August 31

Tax Debt Limitations on School Districts

- Unlimited for voter-approved bonds for most districts; however, subject to Texas Education Code, Section 45.003 (e)

- Maintenance tax rate of $1.50 for most districts; Attorney General's Office requires a showing of coverage for contractual obligations.

Appendix 3:

The Debt Issuance Process

School Districts Explore Alternative Financing

School districts are also exploring alternative methods of financing operational and capital needs. Two alternatives are the use of Tax Increment Zones and Public Facility Corporations.

Tax Increment Zones freeze taxes at certain levels within the designed area. As development occurs and assessments increase, the tax revenue is captured and reinvested within the zone.

To spur development within the Zone, the governmental entity will build an educational facility and rent it to the school district. An advantage to the school district is that as property assessments increase, there will not be a corresponding decrease in the district's share of state funding. According to the Attorney General's Office, the legal authority for tax increment financing of public schools is uncertain.

A **Public Facilities Corporation** (PFC) issues revenue bonds to build an educational facility. The PFC then enters into a lease-purchase agreement with the district to rent the facility. At the end of the lease-purchase agreement, the PFC will sell the facility to the school district for a bargain purchase price. Lease purchase payments for school buildings can only be paid from state aid or surplus maintenance funds. Also, this type of financing is generally more costly than voted general obligation bonds.

State statutes and regulations govern the debt issuance process. The process originates at the local school district level with the school board establishing the needs of the district. The next step is developing a plan of action to raise the monies necessary to fulfill the needs of the district. The school board will then set an election date if required. The financial advisor, the underwriter, and the bond counsel are brought into the process as needed by the school district. Before the bonds are sold, the school board will contract with a rating agency such as Fitch Investor Services, Moody's Investor Services, or Standard and Poor's Corporation for a bond rating. The Attorney General must approve most debt issuance transactions to ensure compliance with the state statutes and regulations. If the school district wants the bonds insured by the Permanent School Fund, the package must be submitted to the Texas Education Agency for approval. Finally, the Office of the Comptroller of Public Accounts records the bonds before they are issued.

Voter Approval Is Not Required For All Debt Instruments

Voter approval is not required for all debt instruments. School boards can by pass the voters and raise money through a variety of debt instruments (Appendix 4). However, the majority of debt is voter-approved, general obligation debt. According to the Bond Review Board, as of August 31, 1996, of the $11.28 billion in public school debt, $10.92 billion (97 percent) was voter-approved debt.

Refunding Bonds

A refunding bond is a common type of bond that can be issued without voter approval. Refundings allow the school districts the flexibility to change their debt structure and save money by lowering their total debt service payments. Proceeds from the new (refunding) bonds are used to retire or defease previously issued (refunded) bonds. A school district will normally issue a refunding bond to take advantage of reduced interest rates, to restructure its debt, or to remove restrictive covenants.

A bond issuer may issue a refunding bond under the provisions of the Texas Education Code, Sections 45.004 or 46.007. In addition, the issuer may also cite Article 717k V.T.C.S. Although each citation provides school districts with flexibility and financing options, there are considerable differences in the three sections:

- Texas Education Code, Section 45.004 allows refundings only when the total amount of the debt service payments of the refunding bonds is less than the debt service of the refunded bonds.

- Texas Education Code, Section 46.007 allows the use of state funds to pay the principal and interest of refunding bonds if they are issued to refund bonds eligible under Section 46.003 (Instructional Allotment Program) and result in present value savings.

- Article 717k allows refundings with minimum restrictions.

Appendix 4:

Debt Instruments

Table 2

Type of Bond	Code Section	Board Approval	Voter Approval	Description
General Obligation	Texas Education Code 45.003	X	X	General Obligation Bonds are negotiable coupon bonds for the construction and equipping of school buildings and the acquisition of land that pledge the full faith and credit of the school district. Such bonds may be issued in various series or issues with a maturity not to exceed 40 years. General obligation bonds are usually term bonds or serial bonds.
Revenue	Texas Education Code 45.032	X	X	Revenue bonds are generally issued to acquire, purchase, construct, and improve or equip athletic or recreational facilities. Bonds may be issued serially not to exceed 50 years. Such bonds are to be paid with revenues generated by the facilities or the activities supporting the facilities.
Refunding/ Advance Refunding	Texas Education Code 45.004	X	X	Refunding bonds provide funds to retire the principal of outstanding bonds. Proceeds may be used to redeem outstanding bonds, or the refunding bond may be exchanged for the outstanding bonds. An advance refunding occurs before the maturity or call date of the outstanding debt. Proceeds are deposited in escrow with a trustee and are used to pay the principal of any bond at maturity or call date, pay interest on bonds being refunded, or to pay interest on the advance refunding bonds.
Tax Anticipation	Texas Education Code 45.108	X		Tax Anticipation Bonds are short-term notes issued for the purpose of paying current maintenance expenses. At no time will the note balance exceed 75 percent of the previous year's income. Such notes shall be payable from any legally available funds of the school district.
Loans Secured by Delinquent Taxes	Texas Education Code 45.104	X		Loans Secured by Delinquent Taxes may be used for any legal maintenance expenditure or purpose.
Loans	Texas Education Code 45.103	X		Loans may be used for any legitimate school purpose. Such loans are not to exceed five years or $500,000.

Table 2 (concluded)

Type of Bond	Code Section	Board Approval	Voter Approval	Description
School Bus Purchases	Texas Education Code 34.005	X		Shall not exceed five years and can be used to purchase any approved school bus or motor vehicle
School Bus Lease-Purchase	Texas Education Code 34.009	X		May not be for fewer than two years or more than ten years.
Asbestos/ Environmental	Texas Education Code 45.108	X		All notes issued pursuant to environmental/asbestos clean up and removal programs may be issued to mature in not more than 15 years from the date of issuance.
Personal Property Contractual Obligation	Local Government Code 271	X		The contract may be in the form of a lease, a lease-purchase, or purchase of personal property. Contractual obligations greater than $100,000 may be submitted to the Attorney General of the State of Texas and must be submitted to the Board. The terms of the contract may not exceed 25 years. The Attorney General must approve the contracts under certain circumstances.

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