Vol. 28, No. 3

EQUITY CENTER

April 2009

News & Notes

Advocating School Finance Equity and Adequacy in Texas

HB 3697 Proposes Much Needed Changes in the "50-Cent Debt Test"

The proposed "50-Cent Debt Test" amendment (HB3697/Aycock) would provide the following benefits to school districts:

- **On a local option basis, provides flexibility to reduce the interest cost of school districts and taxpayers by millions of dollars, as bond repayments are reduced.**
- **Generates future capacity within the Permanent School Fund guarantee Program.**
- **Additional debt capacity is created for school districts to meet future facility needs at a lower I&S tax rate.**
- **Provides school districts the flexibility to meet recommended "bond repayment" guidelines of bond rating agencies, thereby potentially enhancing the bond ratings of Texas school districts.**

In 1991, the Texas Legislature enacted Senate Bill 351 which introduced the "50-Cent Debt Test." This was one of the identified problems that needed to be changed to comply with the Texas Supreme Court in Edgewood I and II. The "50-Cent Debt Test" can be found in Section 45.0031 of the Texas Education Code. The test requires that each school district demonstrate to the Attorney General that they could pay any new issue of bonds and all existing debt with an Interest and Sinking (I&S) tax rate of 50 cents or less. The school district could also pledge additional funds, if needed to pass the test. The two sources of funds a school district can lawfully pledge to pay debt are:

- Chapter 42 – Subchapter B portion of Tier I; and
- Chapter 46 – Existing Debt Allotment (EDA) and Instructional Facilities Allotment (IFA)

Some districts may not know or remember they have previously pledged funds to pass the "50-Cent Debt Test." Why is this important? Once a school district has passed the test, a school district is obligated to set an I&S tax rate sufficient to pay its annual principal and interest requirements even if the tax rate exceeds 50 cents. Let's assume that a school district is required to adopt a tax rate greater than 50 cents in order to meet annual principal and interest requirements. In this case, a school district that has previously pledged Chapter 42 sources of funding would be required to first transfer the pledged funds and pay debt prior to increasing the I&S tax rate above 50 cents. Obviously, considering the demands on today's school district budgets, this could be stressful to school district operations.

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HB 3697 Proposes Much Needed Changes..."50-Cent Debt Test"

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With the passage of House Bill 2888 in 2001, school districts are allowed to use a projection of their future taxable assessed valuation in order to comply with the test. If a school district is required to exceed the I&S tax rate of 50 cents, the next time they issue school district bonds the test will be limited to an I&S tax rate of 45 cents.

So, what has changed that suggests school districts consider a request to amend the "50-Cent Debt Test?" The most compelling factor to consider is the cost of construction. Since 1991, construction costs have increased on average of 300%. For example, an elementary school that cost $5 million to construct in 1991 now costs $20 million. Construction materials, labor, fuel, and changes in instructional standards have compounded construction costs for school districts. A second component is the changing student demographics of Texas. If you look at the last 10 years, Texas has seen an increase of 60,000 new students per year and during the last 5 years, 79,000 new students per year. The increase in student growth for the last 5 years, in part, is displaced student populations as a result of gulf coast hurricanes. The continued movement of student populations from rural areas of the state to more urban areas has increased demand for new schools in suburban and urban areas of the state.

The legislation would provide the school district with a local *option* of shortening the repayment period of their bonds, thus reducing the interest cost borne by taxpayers by allowing the district to increase its I&S tax rate above 50 cents.

Many school districts are struggling to afford increasing student population demands. This is evidenced by increasing I&S tax rates. In 2005-06, only eight school districts had I&S tax rates above 40 cents. In just three years, that number has grown to approximately 70 school districts. Ten of these school districts are at or near a 50 cent I&S tax rate. Most of these school districts continue to experience material student growth. Further analysis shows that the majority of these school districts are Chapter 42 school districts and about half of these school districts are "Fast Growth School Districts."

So, how has the "50-Cent Debt Test" affected the way school districts manage their debt to meet demands of construction and student growth? Remember the test is used to limit the amount of debt a school district can issue. It does this by making sure that new and existing bond issues can be paid with an I&S tax rate below 50 cents. Payments are based on the annual requirements of principal and interest. Under current law, school districts have the authority to issue school bonds for 40 years. This is what some school districts have needed to do to pass the test and meet demands. What is the cost in interest with the longer bond maturities? Would it be better to provide a local option that allowed an interest savings by electing to retire debt earlier?

House Bill 3697 proposes to amend the "50-Cent Debt Test" to do just that. This amendment would still require the school district to demonstrate that it could issue bonds below an I&S tax rate of 50 cents. The legislation would provide the school district with a local *option* of shortening the repayment period of their bonds, thus reducing the interest cost borne by taxpayers by allowing the district to increase its I&S tax rate above 50 cents. The school district may only access this local option if it is able to demonstrate an actual interest savings of at least 10%.

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