April 17, 2014

Members of the Legislative Audit Committee:

The State Auditor’s Office certifies that, for the fiscal year ended August 31, 2013, the amount of school district bonds guaranteed by the Permanent School Fund’s (Fund) Bond Guarantee Program (Program) was within the limits applicable to the Program. As of August 31, 2013, the total principal of the 2,789 outstanding bond issues guaranteed by the Program was $55.2 billion (see the attachment to this letter for a summary of the Program’s activity during fiscal year 2013). In addition, as of that date, the bond guarantee capacity of the Program under the State Board of Education (Board) limit was $76.8 billion, and the Board held in reserve $3.8 billion of that capacity. The bond guarantee capacity under the Internal Revenue Service (IRS) limit was $117.3 billion.

The Board’s rules in the Texas Administrative Code set a limit on the Program’s bond guarantee capacity of three times the cost value of the Fund, as permitted by Texas Education Code, Section 45.053(d). The Board’s rules also allow the Board to hold guarantee capacity in reserve of no less than 5 percent of the Fund’s capacity, as permitted by Texas Education Code, Section 45.0531(a). The Board may use the reserve to award guarantees to school districts with unforeseen catastrophes or emergencies that require renovation or replacement of school facilities as described in Title 19, Texas Administrative Code, Section 33.65(e)(2). IRS Notice 2010-5, issued on January 11, 2010, established another limit on the bond guarantee capacity of no more than 500 percent of the total cost of the assets held by the Fund as of December 16, 2009. That federal limit is intended to provide flexibility to state and local governments to obtain credit enhancement for tax-exempt bonds.

The guarantee saves school districts money by enhancing their bond ratings to the highest possible rating. Without the Program’s guarantee, school districts would need to (1) purchase private bond insurance or (2) pay higher interest rates on the bonds they sell.
The Program’s remaining statutory capacity, net of the Board’s $3.8 billion reserve, was $17.8 billion at the end of fiscal year 2013.

The attachment to this letter provides additional information on the Program’s fiscal year 2013 activity. As of August 31, 2013, the Program could guarantee an additional $17.8 billion in bonds before reaching the limit imposed by the Board, net of its $3.8 billion reserve.

Figure 1 shows the amounts of outstanding bonds guaranteed and the statutory and IRS guarantee limits from August 31, 2004, through August 31, 2013. The Board’s additional reserve is not presented in the graph.

Figure 1

| Source: Permanent School Fund’s Bond Guarantee Program Capacity Calculations. |
Recent changes have been made to Program statutes and rules.

The 82nd Legislature passed Senate Bill 1, which contained a provision that called for the inclusion of charter schools in the Program. That provision went into effect on September 28, 2011. In October 2011, the State of Texas requested an IRS ruling on whether the inclusion of charter schools in the Program might cause the Program to violate current arbitrage laws, which could result in the loss of the Program’s tax-free status. The U.S. Treasury and IRS published proposed rules in the Federal Register for September 16, 2013\(^1\), that would extend the guarantee of tax-exempt bonds to include charter schools. Final IRS rules had not been published as of March 2014. The Fund plans to award the first bond guarantees to charter schools during fiscal year 2014, as allowed by the proposed IRS rules.

We appreciate the Texas Education Agency’s cooperation during this audit, particularly the cooperation of staff of the Permanent School Fund. If you have any questions, please contact Hillary Eckford, Audit Manager, or me at (512) 936-9500.

Sincerely,

John Keel, CPA
State Auditor

Attachment

cc: Members of the State Board of Education
    Ms. Barbara Cargill, Chair
    Mr. Thomas Ratliff, Vice Chair
    Ms. Mavis B. Knight, Secretary
    Mr. Lawrence A. Allen, Jr.
    Ms. Donna Bahorich
    Mr. David Bradley
    Mr. Ruben Cortez, Jr.
    Dr. Martha M. Dominguez
    Ms. Patricia Hardy
    Mr. Tom Maynard
    Ms. Sue Melton-Malone
    Mr. Ken Mercer
    Ms. Geraldine “Tincy” Miller
    Ms. Marisa B. Perez
    Mr. Marty Rowley
Texas Education Agency
    Mr. Michael Williams, Commissioner of Education
    Mr. Holland Timmins, CFA, Executive Administrator and Chief Investment Officer,
        Permanent School Fund

\(^1\) See Federal Register 78 (September 16, 2013), page 56847.
Bond Guarantee Program Summary

The following tables provide a summary of fiscal year 2013 activity for the Permanent School Fund’s Bond Guarantee Program (Program). Tables 1 and 2 show the changes in the number and dollar amount of outstanding bonds guaranteed by the Program.

Table 1

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance on August 31, 2012</td>
<td>2,634</td>
</tr>
<tr>
<td>Issued during fiscal year 2013</td>
<td>345</td>
</tr>
<tr>
<td>Issues that matured during fiscal year 2013</td>
<td>(134)</td>
</tr>
<tr>
<td>Issues that refunded during fiscal year 2013</td>
<td>(56)</td>
</tr>
<tr>
<td><strong>Balance on August 31, 2013</strong></td>
<td><strong>2,789</strong></td>
</tr>
</tbody>
</table>


Table 2

<table>
<thead>
<tr>
<th>Category</th>
<th>Dollar Amount of Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance on August 31, 2012</td>
<td>$ 53,634,455,141</td>
</tr>
<tr>
<td>Issued during fiscal year 2013</td>
<td>8,565,825,610</td>
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<tr>
<td>Issues that matured during fiscal year 2013</td>
<td>(1,917,815,299)</td>
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<tr>
<td>Issues that refunded during fiscal year 2013</td>
<td>(5,105,754,130)</td>
</tr>
<tr>
<td>Other adjustments</td>
<td>42,177,834</td>
</tr>
<tr>
<td><strong>Balance on August 31, 2013</strong></td>
<td><strong>$55,218,889,156</strong></td>
</tr>
</tbody>
</table>