August 6, 1998

Re: Revised Estimate of the Permanent School Fund's Capacity

Members of the Legislative Audit Committee:

In *A Briefing Report on School District Debt* (SAO Report No. 98-027, February 1998) the State Auditor's Office reported that the Permanent School Fund (Fund) would reach its capacity to guarantee school district bonds in 2002. Since then, we have worked with the Texas Education Agency and determined that the Fund might reach capacity between 2003 and 2009. However, it is most likely that the Fund will reach its Internal Revenue Service (IRS) capacity in 2005 and its statutory capacity in 2006.

To determine this most likely scenario, we used a more sophisticated model than the one used in the original analysis. This model includes the factors that we believe influence the school districts' decisions to issue debt, such as interest rates, student enrollment, and the economic environment. The model assumes that each year the amount of bonds guaranteed by the Fund will grow by 10 percent and the value of the Fund will grow by 4 percent.

The Fund's ability to guarantee school district bonds has two different capacities:

- The statutory capacity is 200 percent of the lower of cost or market value of the Fund, exclusive of real estate.

- The IRS capacity comes from an IRS Letter Ruling that outlines a complicated formula related to perpetual trust funds. This ruling states that the Fund may guarantee bonds up to 250 percent of the value of the lower of the amortized cost or market value of the Fund adjusted for additions after May 15, 1989.

It does not appear that legislative action is required at this time. However, the situation should be monitored annually and the model updated as more current information becomes available.

If you require additional information, please contact Carol Smith at 479-4700.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

SAO Report No. 98-057