LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 85TH LEGISLATIVE REGULAR SESSION

March 27, 2017

TO: Honorable Dan Huberty, Chair, House Committee on Public Education

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: **HB467** by Murphy (Relating to the guarantee of charter district bonds by the permanent school fund.), **As Introduced**

No significant fiscal implication to the State is anticipated. The bill significantly increases the capacity of charter district bonds available to be guaranteed by the PSF, and therefore **increases the risk of default. If such a default did occur, there would be a significant and ongoing negative fiscal impact as discussed below.**

The bill would amend the Education Code related to the calculation of the capacity of the bond guarantee program (BGP). The provisions of the bill would apply the available capacity for charter districts to the total capacity of the bond guarantee program based on the number of students in charter schools as a percentage of all public school students. Current law requires the subtraction of any outstanding guaranteed bonds from the total capacity before calculating the percentages available for school districts and charter districts.

The bill would take effect immediately if passed by two-thirds of each chamber of the Legislature, or otherwise on September 1, 2017.

No significant fiscal implication to the state is anticipated. This is based on an assessment of historical information and recent financial stability information reviewed by TEA as part of its charter school bond guarantee review program; and on the considerations that there has never been a default in the Texas charter school Permanent School Fund (PSF) bond guarantee program, that the bill would not change the eligibility criteria for assessing whether a charter school qualifies for a PSF guarantee, and that all charter bond holders are screened by TEA for financial stability and reliability, reducing risk to the PSF bond guarantee program.

However, a default on charter district bonds guaranteed by the Permanent School Fund could result in costs to the state. The bill would significantly increase the capacity of charter district bonds available to be guaranteed by the PSF. The bill proposes to make charter school capacity a percentage of the bond guarantee program's total capacity instead of its available capacity, which, according to information provided by the Texas Education Agency (TEA), could result in an increase of potential charter school debt from the current amount of $1.0 billion to an estimated $4.0 billion. Moody's Investors Service, in its most recent review of the Permanent School Fund in January, noted that "House Bill 467 would be a credit negative for the PSF, as it could potentially weaken the overall credit quality of the program's participants as the PSF extends its guarantee to a growing number of charter schools over time."

Assuming the entire amount available in the PSF to guarantee charter bonds was used for this purpose, assuming industry standard interest rates for guaranteed charter school bonds, and calculating against annual default rate probabilities of guaranteed charter school bonds based on historical data from Standard and Poor's (0.18% to 0.50%), TEA anticipates that the estimated potential cost to the PSF to cover defaults could range between $2.0 million and $12.0 million per year, and that such costs would continue thereafter until the bonds mature, typically at the end of a twenty-year amortization period.

In the event of default, the Permanent School Fund would pay the amount due to the bondholders or the charter district reserve fund. The PSF and the Reserve Fund would then be reimbursed with the first state money payable to the charter district. If the state money payable to the charter district is not sufficient to reimburse the PSF for the amount paid, there would be a shortfall in the reimbursement and this would expose the PSF to a loss. Because the PSF would continue to make payments until the bonds mature, it is anticipated that net potential costs to the PSF to cover defaults from fiscal years 2023 to 2032 could exceed $100 million. This estimate is based on the highest probable annual cost to the PSF associated with default, and assumes no recovery of any real estate assets owned by charter schools with guaranteed bonds.

Local Government Impact

The bill would expand the number of charter district bonds that could be guaranteed by the Permanent School Fund and, therefore, enable more charter districts bonds to be issued at lower interest rates.

However, in the event of a default of a PSF-guaranteed charter district bond, interest rates would rise for independent school districts and charter districts that were issued bonds, raising costs for a temporary period of time even if the PSF maintained the highest rating provided by the credit rating agencies.

PSF staff indicate that the additional funding costs of higher interest rates that could result from a default on charter district bonds would be approximately $14.8 million per year or $297 million over the 20-year average term of the bond district issuance, including both school district and charter district bond debt service costs. This estimate is based on the average annual bond issuance by school and charter districts during the last five years; the difference of interest rates if a default occurred (based on the differential between 20-year municipal revenue bonds of AAA at 2.95%, and AA bonds at 3.33%); and the assumption that the PSF gets downgraded only one level for one year.

Source Agencies: 701 Texas Education Agency

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