LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 85TH LEGISLATIVE REGULAR SESSION

April 20, 2017

TO: Honorable Larry Taylor, Chair, Senate Committee on Education

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: **SB1480** by Hughes (Relating to the guarantee of school district and charter district bonds by the permanent school fund.), **Committee Report 1st House, Substituted**

Estimated Two-year Net Impact to General Revenue Related Funds for SB1480, Committee Report 1st House, Substituted: an impact of $0 through the biennium ending August 31, 2019.

However, there would be a revenue gain of $13,060,190 to the Charter District Bond Guarantee Reserve Fund in the 2018-19 biennium.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2018	$0
2019	$0
2020	$0
2021	$0
2022	$0

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue Gain from *Charter District Bond Guarantee Reserve Fund* 0053
2018	$7,049,455
2019	$6,010,735
2020	$4,970,815
2021	$3,930,117
2022	$2,888,571

Fiscal Analysis

The bill would amend the Education Code related to the calculation of the capacity of the bond guarantee program (BGP). 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. The increase of charter bond guarantee capacity would be phased-in over five years, making available over each of the next four fiscal years 20 percent of the difference between the existing charter capacity as of January 1, 2017 and the new charter capacity on September 1, 2017 as specified by the provisions of the bill described above. 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 specifies that the charter district bond guarantee reserve fund would be managed by the State Board of Education (SBOE) in the same manner as the SBOE manages the Permanent School Fund to establish standards for the investment of funds and ensure that the balance is sufficient for cash-flow requirements of the fund. If the balance of the reserve fund reached at least 3.0 percent of the total amount of outstanding guaranteed charter district bonds, then the charter districts would not have to make payments into the reserve fund.

In addition, the bill establishes certain safeguards to reduce the risks of default on charter district bonds. The bill grants the board the authority to increase charter bond capacity by less than the total capacity allowed by the bill, or to decline to increase charter capacity if an increase of capacity would have a negative impact on bond ratings. The commissioner may disapprove an application for a guaranteed charter district bond if it is determined that certain bond documents do not provide a security interest in real property pledged as collateral for the bond. The commissioner may also disapprove a bond application based on any additional reasonable factor deemed necessary to protect the bond guarantee program and minimize risk to the Permanent School Fund, including considerations of average daily attendance or insufficient performance by a charter district that may adversely affect the charter district's financial performance.

The bill would take effect on September 1, 2017.

Methodology

It is estimated that the bill would result in a revenue gain to the charter district bond guarantee reserve fund of $7.0 million in fiscal year 2018 and $6.0 million in fiscal year 2019, for a biennial total of $13.1 million. The annual revenue gain would gradually decline thereafter, falling to $2.9 million in fiscal year 2022.

The declining revenue forecast results from two main opposite and offsetting factors that affect the reserve fund's revenues. The bill would increase the amount paid by charter districts to the charter district bond guarantee reserve fund from 10 percent to 20 percent of the bond interest savings that result from the charter district bonds being guaranteed. These increased payments to the charter district bond guarantee reserve fund would constitute an ongoing revenue that is anticipated to be sufficient to cover any potential losses due to charter district bond defaults. The higher revenues in fiscal years 2018 and 2019 reflect the immediate doubling of the amount remitted by both existing and anticipated new charter districts to the reserve fund based on bond interest savings that would result from the bond guarantee. At the same time, however, the incremental increase of the charter bond capacity in subsequent fiscal years would increase the probability of default over time and therefore increase the probable costs to the reserve fund in the event a default occurred, offsetting revenues over time and accounting for the declining revenue forecast.

Although the bill would increase the probability of a guaranteed charter bond default and therefore increase the anticipated costs to the reserve fund of guaranteeing charter district bonds, TEA anticipates the annual net potential loss to the Permanent School Fund (PSF) to cover defaults for fiscal years 2018 through 2022 to be zero due to higher cash balances in the reserve fund that would result from increased revenues established by the bill. Increased balances in the reserve fund are anticipated to be sufficient to eliminate exposure of the PSF to increased costs that may result from defaults on charter district bonds.

Revenue and cost projections to the reserve fund consider anticipated growth of charter district bond capacity, the total amount available in the PSF to guarantee charter bonds, industry standard interest rates for guaranteed charter school bonds, the annual default rate probabilities of guaranteed charter school bonds based on historic data, and an assessment of historical information and recent financial stability information reviewed by TEA as part of its charter school bond guarantee review program. TEA also reports 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.

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. The bill would increase the amount that charter districts remit to the reserve fund from 10 to 20 percent of the bond-interest savings that resulted from receiving a guaranteed bond at a lower interest rate.

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

LBB Staff: UP, THo, AM, TSI, SD