AN ACT

relating to the guarantee of school district and charter district
bonds by the permanent school fund.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. Section 45.0532, Education Code, is amended by
amending Subsections (a), (a-1), and (b) and adding Subsections
(b-1), (b-2), (b-3), and (b-4) to read as follows:

(a) In addition to the general limitation under Section
45.053, the commissioner may not approve charter district bonds for
guarantee under this subchapter in a total amount that exceeds the
charter capacity [percentage of the total available capacity] of
the guaranteed bond program [that is equal to the percentage of the
number of students enrolled in open enrollment charter schools in
this state compared to the total number of students enrolled in all
public schools in this state, as determined by the commissioner].

(a-1) The commissioner may not approve charter district
refunding or refinanced bonds for guarantee under this subchapter
in a total amount that exceeds one-half of the charter capacity
[tot al amount available for the guarantee of charter district bonds
under Subsection (a)].

(b) For purposes of this section [Subsection (a)], the
charter [total available] capacity of the guaranteed bond program
is the percentage of the total capacity of the guaranteed bond
program [limit] established by the board under Sections 45.053(d)
and 45.0531 that is equal to the percentage of the number of students enrolled in open-enrollment charter schools in this state compared to the total number of students enrolled in all public schools in this state, as determined by the commissioner [minus the total amount of outstanding guaranteed bonds]. Each time the board increases the limit under Section 45.053(d), the total amount of charter district bonds that may be guaranteed increases accordingly under Subsection (a).

(b-1) The charter capacity provided by Subsection (b) applies beginning with the state fiscal year that begins September 1, 2021. Subject to Subsections (b-2) and (b-3), the board shall establish a charter capacity for the preceding state fiscal years by increasing the total limitation on the amount of charter district bonds that could be guaranteed under the law in effect on January 1, 2017, by the following amount:

(1) for the state fiscal year that begins September 1, 2017, 20 percent of the difference between the charter capacity provided by Subsection (b) and the charter capacity in effect on January 1, 2017;

(2) for the state fiscal year that begins September 1, 2018, 40 percent of the difference between the charter capacity provided by Subsection (b) and the charter capacity in effect on January 1, 2017;

(3) for the state fiscal year that begins September 1, 2019, 60 percent of the difference between the charter capacity provided by Subsection (b) and the charter capacity in effect on January 1, 2017; and
(4) for the state fiscal year that begins September 1, 2020, 80 percent of the difference between the charter capacity provided by Subsection (b) and the charter capacity in effect on January 1, 2017.

(b-2) For any year, the board may increase the charter capacity by less than the amount provided by Subsection (b-1) or may decline to increase the charter capacity by any amount if:

(1) the board determines that increasing the charter capacity by the amount provided by Subsection (b-1) would likely result in a negative impact on the bond ratings provided by one or more nationally recognized investment rating firms for school district or charter district bonds for which a guarantee is requested under this subchapter; or

(2) one or more charter districts default on payment of maturing or matured principal or interest on a guaranteed bond, resulting in a negative impact on the bond ratings provided by one or more nationally recognized investment rating firms for school district or charter district bonds for which a guarantee is requested under this subchapter.

(b-3) If the board makes a determination described by Subsection (b-2) for any year and modifies the schedule provided by Subsection (b-1) for that year, the board may also make appropriate adjustments to the schedule for subsequent years to reflect the modification, provided that the charter capacity for any year may not exceed the limit provided for that year by the schedule.

(b-4) Subsections (b-1), (b-2), and (b-3) and this subsection expire September 1, 2022.
S.B. No. 1480

SECTION 2. Subchapter C, Chapter 45, Education Code, is amended by adding Section 45.0533 to read as follows:

Sec. 45.0533. COMMUNICATION WITH NATIONALLY RECOGNIZED INVESTMENT RATING FIRM. Information obtained from a nationally recognized investment rating firm relating to Section 45.053, 45.0531, or 45.0532 that concerns a hypothetical or actual scenario relating to the credit rating of the permanent school fund or the bond guarantee program of the permanent school fund, and any communications from, or information generated by, the agency, the board, the commissioner, or their employees relating to that information, is confidential and not subject to disclosure under Chapter 552, Government Code.

SECTION 3. Section 45.056, Education Code, is amended by adding Subsection (a-1) to read as follows:

(a-1) For purposes of this subsection, "bond security documents" include the resolution, trust agreement, indenture, ordinance, loan agreement, deed of trust, bond, note, and any additional document executed in connection with the issuance of a charter district bond for which a guarantee is requested under this subchapter. The commissioner's investigation of an application submitted by a charter district may include evaluation of whether the charter district bond security documents provide a security interest in real property pledged as collateral for the bond and the repayment obligation under the proposed guarantee. The commissioner may decline to approve the application if the commissioner determines that sufficient security is not provided.

SECTION 4. Subchapter C, Chapter 45, Education Code, is
amended by adding Section 45.0561 to read as follows:

Sec. 45.0561. COMMISSIONER CONSIDERATION OF ADDITIONAL FACTORS FOR CHARTER DISTRICT BONDS. (a) In addition to considering all other applicable requirements under this subchapter, in determining whether to approve charter district bonds for guarantee the commissioner may consider any additional reasonable factor that the commissioner determines necessary to protect the guarantee program or minimize risk to the permanent school fund, including:

(1) whether the charter district had an average daily attendance of more than 75 percent of its student capacity for each of the preceding three school years, or for each school year of operation if the charter district has not been in operation for the preceding three school years;

(2) the performance of the charter district under Sections 39.053 and 39.054; and

(3) any other indicator of performance that could affect the charter district's financial performance.

(b) This section expires September 1, 2019.

SECTION 5. Section 45.0571, Education Code, is amended by adding Subsections (a-1) and (a-2) and amending Subsections (b) and (c) to read as follows:

(a-1) Notwithstanding Chapter 404, Government Code, the charter district bond guarantee reserve fund is managed by the board in the same manner that the permanent school fund is managed by the board. The board may invest money in the charter district bond guarantee reserve fund in accordance with the investment
standard described by Section 404.024(j), Government Code, and the board's investment is not subject to any other limitation or requirement provided by Section 404.024, Government Code.

(a-2) The board shall adjust the investment portfolio of charter district bond guarantee reserve fund money periodically to ensure that the balance of the fund is sufficient to meet the cash flow requirements of the fund.

(b) Subject to Subsection (c), a [A] charter district that has a bond guaranteed as provided by this subchapter must annually remit to the commissioner, for deposit in the charter district bond guarantee reserve fund, an amount equal to 20 [10] percent of the savings to the charter district that is a result of the lower interest rate on the bond due to the guarantee by the permanent school fund. The amount due under this section shall be [amortized and] paid on receipt by the charter district of the bond proceeds [over the duration of the bond. Each payment is due on the anniversary of the date the bond was issued]. The commissioner shall adopt rules to determine the amount [total and annual amounts] due under this section.

(c) Subsection (b) does not apply if, at the time the charter district receives the proceeds of the bond guaranteed as provided by this subchapter, the balance of the charter district bond guarantee reserve fund is at least equal to three percent of the total amount of outstanding guaranteed bonds issued by charter districts. [The commissioner may direct the comptroller to annually withhold the amount due to the charter district bond guarantee reserve fund under Subsection (b) for that year from the...
S.B. No. 1480

1 state funds otherwise payable to the charter district.

SECTION 6. Section 45.0571, Education Code, as amended by
2 this Act, applies only to a charter district bond that is approved
3 by the commissioner of education for guarantee under Subchapter C,
4 Chapter 45, Education Code, on or after the effective date of this
5 Act. A charter district bond that is approved by the commissioner
6 of education for guarantee under Subchapter C, Chapter 45,
7 Education Code, before the effective date of this Act is governed by
8 the law in effect on the date the bond is approved for guarantee,
9 and the former law is continued in effect for that purpose.
10
11 SECTION 7. This Act takes effect September 1, 2017.
S.B. No. 1480

President of the Senate

I hereby certify that S.B. No. 1480 passed the Senate on May 1, 2017, by the following vote: Yeas 27, Nays 3, one present not voting.

Speaker of the House

I hereby certify that S.B. No. 1480 passed the House on May 23, 2017, by the following vote: Yeas 139, Nays 7, one present not voting.

Secretary of the Senate

Chief Clerk of the House

Approved:

5-31-2017

Date

Greg Abbott
Governor

FILED IN THE OFFICE OF THE SECRETARY OF STATE
11:00 AM O'CLOCK

WIN 01 2017

Secretary of State
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:

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All Funds, Five-Year Impact:

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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
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 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.

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