DAN FLYNN

★ DISTRICT 2★

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AUSTIN - The House Ways & Means Committee heard House Bill 3416, addressing Capital Appreciation Bonds (CAB), presented by State Representative Dan Flynn (R-Van) Thursday evening. Representative Flynn did present a Committee Substitute (CS) for the bill. The bill addresses the growing concern over the reliance and utilization of CABS by municipalities and school districts in Texas. CABS do not require payment on interest until the bond matures. The bonds appreciate in value as the interest accumulates until repayment is made resulting, in many cases, a type of balloon payment at the end of the term.

It is called a Capital Appreciation Bond or CAB because the bond does not pay interest until maturity – it "appreciates" in value as the interest accumulates until the bond is repaid. Their use helped create the financial problems for California. CABS have come under increased scrutiny when the deferral of bond payments to fund certain facilities increases the ultimate cost of the bond, sometimes 10 times the original amount, through long maturities and refinancing, ultimately impacting the tax burden of future generations.

It is reported over 1000 Texas municipalities and school districts have CABs within their debt portfolios. Of the 1,025 school districts within the State of Texas, 471 currently have CABs within their debt portfolios. The top 10 ISD's with CABS make up nearly 45% of the maturity value of all CABS acquired by Texas schools. Texas schools and public agencies issued more than 700 deferred interest bonds from 2007-2011. With no immediate payments required, the securities enable schools and municipalities to avoid exceeding limits on debt-service payments.

Committee Member Representative Mark Strama (D-Austin) recognized there were a few extreme examples of CAB mismanagement and agreed with Representative Flynn that HB3416 and the demand to address these imprudent financial practices is not an attempt to "single out any one school district" but rather better understand how it is that some ISD's with fast growth districts can properly manage their CABS and others, with equal growth, have acquired a seemingly insurmountable debt.

The issuance of CABS for school districts is a solution to cope with the ".50 debt test", a limitation of a schools districts maximum Interest & Sinking Fun ("I&S") tax rate. Opponents of this test argue that it does not allow districts to cope with the fast growth of their community. Prior to the test, the debt limit for schools was 10% of taxable assessed valuation. In its current form, the test equates to a debt limit of approximately 7%. Before a vote to sell voter approved bonds, the 50 cent test requires a school district to gain approval from the Attorney General, demonstrating new and existing bonds can be repaid from a maximum I&S tax rate of 50 cents or less.

"Many of these CABS appear to be used to avoid the 50 cent debt test and in some cases, to provide cash flow for the ISD's," said Representative Flynn, "We need to stop these types of actions while allowing reasonable and prudent use of these products."

"I was disappointed by the number of hostile witnesses, including bond salesmen, testifying in support of large debts of over 2 billion for some ISD's," Representative Flynn stated after the hearing. "You have to wonder what voters would say once the transparency portions of this bill are implemented and voters are notified of this massive debt placed upon them, their children, grandchildren, and future grandchildren."

A widely unknown fact is that school district bonds are guaranteed by the Permanent School Fund Bond Guarantee Program, and as of August 31, 2012 the total principal of outstanding bond issues guaranteed exceeded 53 billion. "That is principal only," Representative Flynn stated. "When you look at principal and interest to maturity, it adds almost 40 billion dollars to the cost, you are looking at massive numbers that are not transparent to us, our constituents, and perhaps even the governing bodies that approve their issue."

CABS can be a valuable debt-management tool for school districts to lower the tax impact of bond programs and manage bond payments. "My concern is not to do away with Capital Appreciation Bonds," Flynn reemphasized after the hearing, "But there is a need for transparency among ISD's and municipalities and their voters. With multiple school districts exceeding a 2 billion dollar CAB debt, there is a clear realization that the voters and taxpayers are not fully aware of the long-term implications of approving a proposed school bond. In some cases, bond maturity is delayed up to 40 years." HB3416 facilitates a safer avenue for CAB use and protection from excessive abuse.

The Senate version of HB3416, by Senator Juan "Chuy" Hinojosa (D- McAllen), was recently passed out of the Senate.

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