BILL ANALYSIS

Senate Research Center
84R30671 JTS-F

C.S.H.B. 114
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Finance
5/21/2015
Committee Report (Substituted)

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

PROBLEM

- Capital Appreciation Bonds (CABs) are a type of municipal bond that delay principal and interest payments for 25 - 40 years. There are no installment payments to bring down the debt, so compound interest keeps piling on, causing the balance to balloon.

- What's wrong with this approach?
  - The buy-now, pay-later approach can result in paying up to $10 for every $1 borrowed now.
  - Assumption that since the number of taxpayers is increasing, the anticipated larger tax base in the future will be able to repay the loan.
  - Long-term projections conclude that CABs will work out in the long-run while the much needed capital expansion and facility projects can be enjoyed in short run.
  - However, often the tax base does not expand as was originally anticipated, so there aren't enough additional taxpayers to reasonably bear the burden.
  - Other times the property values do not increase as expected, so the tax levy is not sufficient to produce the funds necessary to repay the obligation.

- In recent years, Texas school districts and local government entities have increasingly turned to CABs because our growing populations are demanding new facilities and capital development that far outpace our local wealth and resources. Usually, immediate development is needed but there are limited other financing options.

- CABS are especially used by school districts to enable them to remain under the 50-cent debt ceiling that limits the property taxed assessed for debt service costs to 50 cents per $100 of assessed value. CAB issuances by school districts are general obligation (tax) debt repaid with ad valorem taxes.

- This financing tool is very attractive as a way to enjoy the fruits of borrowed money today. However, these payments are pushed onto future taxpayers creating an expensive tab for our children.

- Between 2007 and 2011, Texas local government entities issued over 700 CABs, receiving $2.3 billion in immediate funding, but committing future repayments of over $20 billion.

- Often CABs and their consequences are not fully understood—the true long-term costs ultimately result in enormous local debt. Local governments in Texas have more than doubled their debt load in the past decade.

SOLUTION

- Transparency and accountability are the best tools we have for decreasing our local debt problem and increasing public awareness and understanding.

- H.B. 114 would prohibit school districts and all local government entities from issuing CABs unless certain conditions are met:

- The issuance of CABs that are secured by ad valorem taxes are limited to a 25 year maturity date or less and issued only if the CAB makes up less than 25 percent of total debt payments.
- Prohibits extending the maturity date of an issued CAB.

Two exceptions are included in this legislation to allow for (1) the issuance of refunding bonds; and (2) the issuance of CABs for the purpose of financing transportation projects.

C.S.H.B. 114

The committee substitute changes the maturity date of issuance for CABs from 25 years to 20 years.

C.S.H.B. 114 amends current law relating to the issuance of certain capital appreciation bonds by political subdivisions.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Subchapter B, Chapter 1201, Government Code, by adding Section 1201.0245, as follows:

Sec. 1201.0245. CAPITAL APPRECIATION BONDS BY POLITICAL SUBDIVISIONS. (a) Defines, in this section, "capital appreciation bond."

(b) Prohibits a county, municipality, special district, school district, junior college district, or other political subdivision from issuing capital appreciation bonds that are secured by ad valorem taxes unless:

(1) the bonds have a scheduled maturity date that is not later than 20 years after the date of issuance;

(2) the governing body of the political subdivision has received a written estimate of the cost of the issuance, including:

(A) the amount of principal and interest to be paid until maturity;

(B) the amount of fees to be paid to outside vendors, including vendors who sell products to be financed by the bond issuance;

(C) the amount of fees to be paid to each financing team member; and

(D) the projected tax impact of the bonds and the assumptions on which the calculation of the projected tax impact is based;

(3) the governing body of the political subdivision has determined in writing whether any personal or financial relationship exists between the members of the governing body and any financial advisor, bond counsel, bond underwriter, or other professional associated with the bond issuance; and

(4) the governing body of the political subdivision posts prominently on the political subdivision's Internet website and enters in the minutes of the governing body:

(A) the total amount of the proposed bonds;

(B) the length of maturity of the proposed bonds;

(C) the projects to be financed with bond proceeds;

(D) the intended use of bond proceeds not spent after completion of the projects identified in Paragraph (C);

(E) the total amount of the political subdivision's outstanding bonded indebtedness at the time of the election on the bonds, including the amount of principal and interest to be paid on existing bond indebtedness until maturity;

(F) the total amount of the political subdivision's outstanding bonded indebtedness, including the amount of principal and interest to be paid until maturity; and

(G) the information received under Subdivision (2) and determined under Subdivision (3).

(c) Requires the governing body of a political subdivision that makes a determination that a personal or financial relationship described by Subsection (b)(3) exists to submit the determination to the Texas Ethics Commission.

(d) Requires the governing body of a political subdivision to regularly update the debt information posted on the political subdivision's Internet website under Subsection (b)(4)(F) to ensure that the information is current and accurate.

(e) Prohibits capital appreciation bond proceeds from being used to purchase the following items, unless an item has an expected useful life, determined based on the depreciable life of the asset under the Internal Revenue Code of 1986, that exceeds the bond's maturity date: items more regularly considered maintenance items, including replacement HVAC units, upgraded plumbing, or similar items, or transportation-related items, including buses.

(f) Authorizes capital appreciation bond proceeds unspent after completion of the project identified as the proceeds' intended use to be used only for a use identified on the political subdivision's website under Subsection (b)(4)(D), unless another use is approved by the voters of the political subdivision at an election held for that purpose.

(g) Prohibits the total amount of capital appreciation bonds from exceeding 25 percent of the political subdivision's total outstanding bonded indebtedness at the time of the issuance, including the amount of principal and interest to be paid on the outstanding bonds until maturity.

(h) Prohibits a county, municipality, special district, school district, junior college district, or other political subdivision, except as provided by Subsection (i), from extending the maturity date of an issued capital appreciation bond, including through the issuance of refunding bonds that extend the maturity date.

(i) Authorizes a political subdivision to extend the maturity date of an issued capital appreciation bond only if:

(1) the extension of the maturity date will decrease the total amount of projected principal and interest to maturity; or

(2) the political subdivision is a school district and the maximum legally allowable tax rate for indebtedness has been adopted and the Texas

Education Agency certifies in writing that the solvency of the permanent school fund's bond guarantee program would be threatened without the extension.

(j) Subsection (b) does not apply to the issuance of refunding bonds under Chapter 1207 (Refunding Bonds), or capital appreciation bonds for the purpose of financing transportation projects.

SECTION 2. Provides that the change in law made by this Act does not affect the validity of capital appreciation bonds issued before the effective date of this Act.

SECTION 3. Effective date: September 1, 2015.