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Protect the work accomplished during the 2015 session regarding Capital Appreciation Bonds and oppose further restrictions.

WHAT IS THE ISSUE?

Capital Appreciation Bonds (CABs) are a type of bond used by municipalities, transportation authorities, school districts, and other governmental agencies. With these bonds, the investment return on the initial principal amount is reinvested at a stated compounded rate until the CABs maturity; at maturity the investor receives a single payment (the “maturity value”) of both the initial principal amount and the total investment return.

School districts use CABs to refinance existing debt, to smooth out tax rates and maturities, and in some cases, to finance new school facilities. For most districts, CABs represent a very small percentage of the district’s debt portfolio, but for a handful of districts, CABs have become a necessary tool due to the “50-cent debt test.”

HOW IS THE 50-CENT DEBT TEST RELATED TO THIS ISSUE?

The “50-cent test” is a legal requirement for the issuance of bonds for construction of school facilities; the 50-cent test does not apply to refunding bonds. In simplest terms, passage of the 50-cent test requires school districts to demonstrate to the Texas Attorney General that, with respect to the proposed bonds, the district has a projected ability to pay the principal of and interest on the proposed bonds and all outstanding bonds, from a tax at a rate not to exceed \$0.50.

Unfortunately, the 50-cent debt test creates an arbitrary cap for school districts at which point they cannot build any more schools, even when local voters want those schools built. Because only the initial principal amount of a CAB is counted as “principal amount” for the 50-cent test, school districts are able to issue CAB debt to help pass the 50-cent debt test. For this reason, the two issues--CABs and the 50-cent test--are intricately tied together.

BACKGROUND

- HB 114 by Flynn passed during the 2015 legislative session and includes the following:
 - CAB maturity date of no more than 20 years
 - Various notification requirements to the school board and on the district’s website
 - Items such as HVACs, buses and technology must be paid off within the useful life of the asset
 - CABs may not exceed 25% of total outstanding debt at the time of issuance
- The bill contained a minor error regarding the refunding of CABs and the Attorney General’s office worked with school districts to find a temporary workaround. This has allowed some districts to achieve significant savings on behalf of their taxpayers.
- The Texas Bond Review Board has reported that capital appreciation bond use by school districts has fallen 66% in fiscal 2016 to \$73.8 million. Additionally, “CABs only account for approximately 0.2% of the total par amount issued by Texas local governments,” the BRB wrote.

RECOMMENDATIONS

- Consider a permanent solution regarding the bill drafting issue referenced above (related to refundings).
- Oppose further restrictions on CABs and allow local government entities time to further reduce their CAB-related debt.

HELPFUL LINKS

comptroller.texas.gov/economy/fiscal-notes/2016/march/cab.php

brb.texas.gov/pub/lgs/fy2015/CABs%20Summary%202015.pdf

brb.state.tx.us/pub/lgs/fy2016/2016LocalARFinal.pdf

