SUBJECT: Making changes to various appropriations-related bills

COMMITTEE: Appropriations — favorable, without amendment

VOTE: 18 ayes — Heflin, Luna, Berman, Branch, B. Brown, F. Brown, J. Davis, Hamric, Hope, Isett, E. Jones, Kolkhorst, Pitts, Raymond, Solis, Stick, Truitt, Wohlgemuth

5 nays — Deshotel, Eiland, Hupp, Menendez, Turner

1 present, not voting — Pickett

5 absent — Crownover, Dukes, Ellis, Gutierrez, McClendon

WITNESSES: No public hearing

BACKGROUND: ***Borrowed funds from accounts outside the state treasury.*** Government Code, sec. 403.092 allows the comptroller to borrow money for short-term cash flow management purposes by transferring surplus cash from undedicated treasury funds to general revenue. The comptroller must return to the funds the same amount as was transferred, with interest. The comptroller also manages or has custody of dozens of accounts outside the treasury.

During its regular session, the 78th Legislature enacted HB 3175 by Pitts and HB 2425 by McCall, authorizing the comptroller to transfer available cash into general revenue from funds outside the treasury that are under comptroller management or in the comptroller's custody. The bills specified that the comptroller must repay the funds the same amount transferred and must maintain the funds' equity, and they precluded cash transferred into general revenue from being included in the comptroller's biennial revenue estimate for appropriation purposes. The bills also appropriated to the comptroller sufficient general revenue to repay funds with interest for any cash transfers made during fiscal 2004-05.

Gov. Rick Perry vetoed HB 3175 and the portion of HB 2425 that related to the repayment of borrowed funds. In explaining his veto, the governor stated that the bills "exceed the amount necessary at this time to reimburse anticipated borrowing." The governor's veto did not extend to the provision that allows the comptroller to borrow from funds outside the treasury that are under comptroller management or in the comptroller's custody.

Delayed payment to school districts. HB 3459 by Pitts and HB 2425 by McCall, both enacted during the regular session of the 78th Legislature, authorized the Texas Education Agency (TEA) to delay its August Foundation School Program (FSP) payment until September, the first month of the next fiscal year, resulting in a one-time savings to the state of between $800 million and $900 million in fiscal 2004-05. Because the delayed payment provision was amended to two pieces of legislation, each with a different effective date, confusion arose as to whether the delayed payment would take place immediately or at a future date. Under HB 2425, which took effect June 20, 2003, the August payment would have been delayed in 2003. Under HB 3459, which took effect September 1, 2003, the August payment would be delayed in 2004. TEA Rider 72 in HB 1 schedules the delayed payment for August 2005.

On August 6, 2003, Gov. Perry issued an executive order directing TEA to credit Texas school districts with the scheduled August 2003 payment. Comptroller Carole Keeton Strayhorn questioned whether the governor had the authority to issue such an order while the Legislature was in session. On August 14, Attorney General Greg Abbott, in a letter to the comptroller, clarified that the bill on which the Legislature took its last vote (HB 3459) prevailed. Thus, according to the attorney general, since HB 3459 did not take effect until September 1, 2003, the August 2003 payment could not be delayed, but the August 2004 FSP payment will be delayed until September 2004.

Property value study. SB 671 by Staples, enacted during the 78th regular legislative session, modified elements of the comptroller's annual property value study (PVS), which certifies estimates of appraised values for use in public school funding formulas by TEA. Beginning with the 2002 PVS, school districts whose local values set by their appraisers exceed state values determined by the PVS will have their local values certified as taxable values for formula funding purposes.

For the 2003-04 school year, TEA must calculate the impact on state funding of certifying local values higher than state values in the 2002 PVS. TEA must make a one-time distribution of the savings proportionately among school districts meeting three criteria: certified state values, additional funding under Education Code Ch. 42 (recapture), and maintenance and operations taxes at rates exceeding $1.42 per $100 of property valuation.

Vetoed funds. On June 22, Gov. Perry used his line-item veto authority to reduce spending in the fiscal 2004-05 budget by a total of $81.1 million.

Art. 9, sec. 11.15 of HB 1 by Heflin, the general appropriations act for fiscal 2004-05, authorized the comptroller to reduce appropriations on a pro-rate basis if necessary for certification. Any line-item vetoed funds were to segregated by the comptroller, and the Legislative Budget Board (LBB) and the governor were to determine the final allocations of any appropriation reductions that may be required under sec. 11.15. The comptroller did not use this authority.

Art. 9, sec. 11.28 appropriates any federal funds for the purpose for state fiscal relief, after implementation of sec. 11.15, to the comptroller for transfer to state agencies under a plan developed by the governor and the LBB and based on priorities set forth in sec. 11.28(b).

Government Code, chap. 317 authorizes the governor and the LBB to exercise budget execution authority when the Legislature is not in session to transfer appropriated funds between agencies, change the purpose of an appropriation, or prevent appropriated funds from being spent, upon the finding of an emergency.

DIGEST: HB 28 would require the comptroller, during fiscal 2004-05, to repay funds from outside the treasury in the same amount transferred, plus interest, within 14 days of borrowing the funds.

The bill would appropriate to the comptroller sufficient general revenue to repay borrowed funds, including up to $5 million for interest, for any cash transfers made during fiscal 2004-05.

HB 28 would implement an FSP payment delay to school districts beginning with fiscal year 2004 rather than fiscal year 2003.

The bill would make state values the taxable values for formula-funding purposes for the 2003-04 school year for school districts whose local values are deemed invalid by the 2002 PVS because they exceed state values. This change would expire September 30, 2004. HB 28 would repeal the one-time savings distribution by TEA.

HB 28 would amend Art. 9, sec. 11.28 of HB 1 to authorize the governor and the LBB to reappropriate general revenue and general-revenue dedicated funds that were line-item vetoed to state agencies for state fiscal relief, acting under the budget execution authority of Government Code, chap. 317 and notwithstanding the sec. 11.15 provision concerning this funds. The governor and the LBB could make a transfer, based on need, to an agency or for a purpose not described by the priority list in sec. 11.28(b).

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect on the 91st day following the last day of the third called session.

SUPPORTERS SAY:

Returning funds borrowed from accounts outside the state treasury. HB 28 would appropriate money to repay funds outside the treasury for any cash borrowed during fiscal 2004-05, enabling the comptroller to use this much-needed tool for cash management. It would limit the amount that could be borrowed by stipulating that interest could not exceed \$5 million. During its regular session, the 78th Legislature gave the comptroller the flexibility to tap into funds under the agency’s control, but the governor vetoed the funding to repay such funds. The fiscal 2004-05 budget could not be certified without the governor’s vetoes of certain legislation, including the appropriation to repay the borrowed funds.

The anticipated \$4.1 million appropriation made by HB 28 would not be likely to throw the budget out of balance. The governor vetoed HB 3175 and portions of HB 2425 because last-minute changes to the budget had pushed the appropriations over the anticipated available revenue for fiscal 2004-05. With those reductions, the comptroller’s revised revenue estimate on June 27 found that the state has \$98.6 million in unappropriated available revenue for the coming biennium. Because HB 28 would limit the repayment of interest to

$5 million and the length of the borrowing to 14 days, the budget should contain sufficient money for this measure.

The comptroller likely would use the borrowing authority near the end of fiscal 2003 to cover an anticipated cash shortfall but could not repay the borrowed funds under current law. The state pays out huge sums every August and September, mostly for public education. Cash on hand tends to decline until December, then rises as revenue from various taxes is collected and deposited. The comptroller has maintained the general revenue balance by issuing tax and revenue anticipation notes (TRANs), typically one-year tax-exempt obligations sold on the bond market. This year, the comptroller will make payments and return borrowed funds in late August but will not receive the infusion of cash until the TRANs are issued in early September. The comptroller likely will borrow from funds outside the treasury to cover the state's cash flow during that time but will not be able to repay these funds unless the Legislature appropriates the necessary amount.

Authority to borrow from outside the treasury and a clear mechanism by which to replace the funds also would serve the state's interests in obtaining short-term financing. In fiscal 2004, the comptroller intends to issue between $7 billion and $8 billion in TRANs and hopes to obtain a favorable interest rate for the borrowed funds. Factors considered when determining the state's creditworthiness and the interest rate include the amount of cash on hand, or liquidity. The comptroller's staff has identified funds totaling about $1 billion that have no constitutional or statutory prohibition against interfund transfer and that would be viewed favorably when considering the state's liquidity.

Borrowing is not unilateral or arbitrary. Decisions to transfer cash from these funds must adhere to the same guidelines that apply to treasury funds. A cash deficiency must be imminent; the fund must contain cash, not bond proceeds or stocks; the relevant agency must be able to forgo use of the money temporarily; and the transfer must be legal. The "hold harmless" provision requires the comptroller to repay borrowed funds with interest, as if the funds never had been transferred.

If a major hurricane struck the Texas coast during the period when the borrowed funds were out of the catastrophe reserve trust fund, the money would be returned in a timely manner, ensuring that the full amount of this fund would go toward claims. In such a circumstance, the Texas Windstorm Insurance Association, the residual market for windstorm and hail coverage along the Texas coast, would pay the first $100 million in claims by assessing all property insurers, and the catastrophe reserve trust fund would pay the next $100 million. After that, reinsurance and additional disbursements from the catastrophe reserve trust fund would pay up to $800 million in claims before insurers would be assessed again. The 14-day restriction on borrowing would require that the funds be returned quickly enough for any hurricane claims to be paid.

Property value study. In revamping the PVS, SB 671 reduced the amount of state aid to school districts in which the comptroller finds overappraised property values. Previously, where appraisals were deemed higher than market value, the PVS assigned school districts state values *lower* than their local values. While this quirk may have yielded relatively more formula-generated state aid plus additional local revenue from taxing against higher local values, it was beyond school districts' control. SB 671 requires TEA to use higher local values for the current fiscal year but gives adversely affected districts too little time to compensate for reduced state aid. Forty-six districts, mostly in small rural communities, stand to lose $3.4 million. This dollar amount, though relatively small, represents significant portions of some budgets; for example, one district would lose more than $650,000. Yet the proportional redistribution would average only $7,000 per recipient. The harm to the so-called "double dippers," which are appealing their assigned values administratively, outweighs the benefit to other districts. Therefore, HB 28 would suspend this provision until 2004.

School districts have little control over property values assessed by central appraisal districts (CADs). HB 28 would give these 46 districts a one-year grace period to adjust their budgets and plan accordingly. This is only fair since SB 671 provides "grace periods" for districts adversely affected when the PVS assigns them higher state values for underappraising that effectively reduces their state funding.

Delayed payments to school districts. HB 28 would fix an unintentional problem created in the 2003 regular session that could have caused the August payment delay to schools take effect this year. By pushing the effective date forward to 2004, HB 28 would not create an undue burden to districts since they would have plenty of time to plan for the delay, and it would give the state $800 million in revenue for the 2004 fiscal year. If the state's fiscal situation improves in the future, payments could be returned to their current schedule.

Granting authority to appropriate vetoed funds. The LBB and the governor need the flexibility to make budget decisions while the Legislature is not in session concerning line-item vetoed funds. Otherwise, these funds may not be available for spending until the next legislative session should special needs arise.

OPPONENTS SAY:

Returning funds borrowed from accounts outside the state treasury. The comptroller does not need additional flexibility in borrowing funds. Some of the largest funds identified in the previous legislation — the system benefit fund and the subsequent injury trust fund — were moved into the treasury by the 78th Legislature, enabling the comptroller to borrow from them without the appropriation proposed by HB 28. Other funds identified as sources of borrowing will cease to exist during fiscal 2004-05 for lack of funding, such as the Texas Excellence Fund, University Research Fund, and Smart Jobs Fund. Other funds should remain outside the treasury so that they cannot be borrowed with the ease of funds inside the treasury.

The catastrophe reserve trust fund is outside the treasury for a reason and should not be depleted during the hurricane season. As the largest fund that remains outside the treasury, the catastrophe reserve trust fund most likely would be tapped by the comptroller in August. Based on current cash-flow projections, the comptroller would borrow about $300 million from the fund for the two-week period at the end of the fiscal year. That would be at the height of the hurricane season, and the National Oceanic and Atmospheric Administration has predicted about a 50 percent probability of an above-normal hurricane season.

Borrowing that fund's current balance of $300 million would leave the state with no reserve if a major hurricane hit. Even though the first $100 million would be assessed against insurers, those companies have 30 days to pay the assessment. In case of a hurricane that was likely to cause damages in excess of $200 million, the Texas Windstorm Insurance Association would request the $100 million from the catastrophe reserve trust fund first, because the money would be available to pay for emergency shelter or temporary repairs in the wake of the storm. Without access to those funds, the people affected by the storm might have to wait 30 days until the funds from the assessment were available, or the Texas Windstorm Insurance Association might have to borrow the money from a bank, driving up the cost of a major hurricane.

When considering the legislation during the regular session, one attraction of borrowing from funds outside the treasury was that many of the funds maintained sizable and relatively stable cash balances infrequently tapped by agencies. That is no longer true, because the funds that remain outside the treasury are either too small to be a significant source of funds or they are not stable cash balances.

Delayed payments to school districts. The delayed payment idea started as a one-time accounting trick to gain the state an extra $800 million in revenue for the coming biennium. Now, it has become a permanent "fix" that would put school districts in a difficult financial position at the beginning of every school year. While school districts were relieved that the August delayed payment did not take effect this year, HB 28 provides no guarantee that the August payment, once delayed, ever will be restored to the original schedule.

Granting a one-year grace period on the terms of the property value study. Prior to SB 671, school districts whose CADs were found to be overappraising property incurred no penalty; in fact, they were rewarded. Even though their local values were found to be too high, the state funded them more generously based on lower state values, plus they obtained relatively more local revenue by taxing against an inflated base. SB 671 was designed to end this "double-dipping" boon that subsidizes a select few districts at others' expense. Some of these districts have enjoyed extra funding for years; it is time that this unfair loophole be closed.

SB 671 was debated throughout the spring while school budgets were being formulated. School officials should have been aware that changes potentially affecting their budgets might be forthcoming and planned to deal with such contingencies. State and other local governments are having to make difficult fiscal decisions; school districts getting more than their fair share of state funding should be no exception.

Granting authority to appropriate vetoed funds. Authorizing the governor and the LBB to appropriate vetoed funds would weaken the budget authority of the House Appropriations Committee and Senate Finance Committee and the House and the Senate as a whole. HB 28 would allow a small number of officials to make decisions outside the legislative process on how funds should be spent. Money that the Legislature had designated for specific purposes could be reappropriated for anything. The Legislature as a whole should be given a say in how those funds are appropriated.

The bill is unnecessary since the Legislature currently is meeting in special session and likely will meet again in a school finance special session in the spring of 2004. Thus, the Legislature has at least two more opportunities to reappropriate vetoed funds and should not give that power away to the governor and the LBB.

OTHER OPPONENTS SAY:

Granting a one-year grace period on the terms of the property value study. HB 28 should address technical problems in the PVS that undermine its credibility at the expense of school districts, their students, and employees. The state should declare a blanket amnesty and assign local values until the PVS is independently reviewed and corrected. Rather than render a second set of property values, the PVS should focus on evaluating CADs.

NOTES:

HB 2 by McCall, which passed the House during the second called session but died in the Senate when it could not be referred to committee due to the lack of a quorum, was almost identical to HB 28 except that HB 2 also contained a provision that would have created a retirement savings plan for new public education employees affected by a provision in SB 1370 by Duncan, enacted during the regular session, that created a 90-day waiting period for participation in the Teacher Retirement System.