



**MATURITY SCHEDULE**

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT  
(Fayette County, Texas)**

**\$5,574,919.80\* UNLIMITED TAX REFUNDING BONDS, SERIES 2011**

**\$5,515,000\* Current Interest Bonds**

<u>Maturity</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Initial Reoffering Yield<sup>(b)</sup></u>	<u>CUSIPS<sup>(c)</sup></u>
2/15/2012	\$ 95,000			
2/15/2013	45,000			
2/15/2015	285,000			
2/15/2016	305,000			
2/15/2017	300,000			
2/15/2018	345,000			
2/15/2019	340,000			
2/15/2020	365,000			
2/15/2021 <sup>(a)</sup>	385,000			
2/15/2022 <sup>(a)</sup>	380,000			
2/15/2023 <sup>(a)</sup>	400,000			
2/15/2024 <sup>(a)</sup>	420,000			
2/15/2025 <sup>(a)</sup>	435,000			
2/15/2026 <sup>(a)</sup>	455,000			
2/15/2027 <sup>(a)</sup>	470,000			
2/15/2028 <sup>(a)</sup>	490,000			

(Interest to accrue from Dated Date)

**\$59,919.80\* Premium Capital Appreciation Bonds<sup>(a)</sup>**

<u>Maturity</u>	<u>Principal Amount</u>	<u>Yield to Maturity<sup>(b)</sup></u>	<u>Maturity Value</u>	<u>Initial Offering Price per \$5,000 in Maturity Value</u>
2/15/2014	\$ 59,919.80			

(Interest to accrete from the Date of Delivery)

\*Preliminary, subject to change.

<sup>(a)</sup> The CIBs maturing on and after February 15, 2021, are subject to optional redemption in whole or in part on February 15, 2020, or any date thereafter, at a price equal to the principal amount thereof, plus accrued interest from the most recent interest payment date to the date of redemption. The CABs are not subject to redemption prior to maturity. (See "THE BONDS—Optional Redemption").

<sup>(b)</sup> The initial yields at which Bonds are priced are established by and are the sole responsibility of the Underwriters and may be changed at any time at the discretion of the Underwriters.

<sup>(c)</sup> CUSIP numbers have been assigned to this issue by the CUSIP Service Bureau, a division of the McGraw-Hill Companies, Inc., and are included solely for the convenience of the purchasers of the Bonds. Neither the District, the Financial Advisor, nor the Underwriters shall be responsible for the selection or correctness of the CUSIP numbers set forth herein.

**DISTRICT OFFICIALS, STAFF AND CONSULTANTS**

**Board of Trustees**

<u>Name</u>	<u>Title</u>	<u>Years of Service</u>	<u>Term Expires May</u>	<u>Occupation</u>
Norris Sternadel	President	4	2013	Mechanic
Darren Florus	Vice President	4	2013	Texas Department of Transportation Foreman
Tony Shank	Secretary	2	2012	Sales
Leon John Langhamer	Member	6	2012	Business Owner
Eugene Schrader	Member	3	2014	Maintenance
Robert Fowlkes	Member	1	2014	Business Owner
Richard Moring	Member	New	2014	Chief Appraiser

**Administrators**

<u>Name</u>	<u>Title</u>	<u>Years with District</u>
Walter Padgett	Superintendent	3
Lynne Machac	Chief Financial Officer	20

**Consultants and Advisors**

Certified Public Accountant .....	Belt, Harris, Pechacek Bellville, Texas
Bond Counsel .....	Andrews Kurth LLP Houston, Texas
Financial Advisor .....	Coastal Securities, Inc. Houston, Texas

## USE OF INFORMATION IN OFFICIAL STATEMENT

*For purposes of compliance with Rule 15c2-12 of the Securities and Exchange Commission (the “Rule”), as amended and in effect on the date hereof, this document constitutes an Official Statement of the District with respect to the Bonds that has been “deemed final” by the District as of its date except for the omission of no more than the information permitted by the Rule.*

*This Official Statement, which includes the cover page, inside cover page, schedule and the Appendices hereto, does not constitute an offer to sell or the solicitation of an offer to buy in any jurisdiction to any person to whom it is unlawful to make such offer, solicitation or sale.*

*No dealer, broker, salesperson or other person has been authorized to give information or to make any representation other than those contained in this Official Statement, and, if given or made, such other information or representations must not be relied upon.*

*The information set forth herein has been obtained from the District and other sources believed to be reliable, but such information is not guaranteed as to accuracy or completeness and is not to be construed as the promise or guarantee of the Financial Advisor or the Underwriters. This Official Statement contains, in part, estimates and matters of opinion which are not intended as statements of fact, and no representation is made as to the correctness of such estimates and opinions, or that they will be realized. See “CONTINUING DISCLOSURE OF INFORMATION” for a description of the District’s undertaking to provide certain information on a continuing basis.*

*The information and expressions of opinion contained herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the District or other matters described herein. See “CONTINUING DISCLOSURE OF INFORMATION” for a description of the District’s undertaking to provide certain information on a continuing basis.*

*THE BONDS ARE EXEMPT FROM REGISTRATION WITH THE SECURITIES AND EXCHANGE COMMISSION AND CONSEQUENTLY HAVE NOT BEEN REGISTERED THEREWITH. THE REGISTRATION, QUALIFICATION, OR EXEMPTION OF THE BONDS IN ACCORDANCE WITH APPLICABLE SECURITIES LAW PROVISIONS OF THE JURISDICTIONS IN WHICH THESE SECURITIES HAVE BEEN REGISTERED, QUALIFIED, OR EXEMPTED SHOULD NOT BE REGARDED AS A RECOMMENDATION THEREOF.*

*IN CONNECTION WITH THE OFFERING OF THE BONDS, THE UNDERWRITER MAY OVERALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.*

*The agreements of the District and others related to the Bonds are contained solely in the contracts described herein. Neither this Official Statement nor any other statement made in connection with the offer or sale of the Bonds is to be construed as constituting an agreement with the purchasers of the Bonds. INVESTORS SHOULD READ THE ENTIRE OFFICIAL STATEMENT, INCLUDING ALL APPENDICES ATTACHED HERETO, TO OBTAIN INFORMATION ESSENTIAL TO MAKING AN INFORMED INVESTMENT DECISION.*

*The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwrites have reviewed the information in this Official Statement in accordance with, and as part of, their responsibilities to investors under federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.*

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## OFFICIAL STATEMENT SUMMARY

This summary is subject in all respects to the more complete information and definitions contained or incorporated in this Official Statement. The offering of the Bonds to potential investors is made only by means of this entire Official Statement. No person is authorized to detach this summary from this Official Statement or to otherwise use it without the entire Official Statement.

- The District** ..... Schulenburg Independent School District (the “District”) operates as an independent school district under the laws of the State of Texas. It is located in Fayette County, Texas. (See “THE DISTRICT”).
- The Bonds** ..... The District’s Unlimited Tax Refunding Bonds Series 2011 (the “Bonds”) are being issued in part as current interest bonds (the “CIBs”) and in part as premium capital appreciation bonds (the “CABs”).
- The CIBs** ..... The CIBs are being issued in the principal amounts and mature on the dates set forth on the inside cover page hereof. The CIBs bear interest from the November 1, 2011, (the Dated Date”), at the rates per annum set forth on the inside cover hereof, which interest is payable each February 15 and August 15, commencing February 15, 2012, until maturity or early redemption. (See “THE BONDS—Description”).
- The CABs** ..... The CABs are being issued in Maturity Amounts (hereafter defined) and mature on the dates set forth on the inside cover page hereof. Interest on the CABs will accrete from the date of delivery, will compound February 15 and August 15 of each year, commencing February 15, 2012, and will be payable only at maturity. (See “THE BONDS – Description”).
- Authority for Issuance** ... The Bonds are being issued pursuant to an order passed by the Board of Trustees of the District and a pricing certificate executed pursuant thereto (the “Order”), and the Constitution and general laws of the State of Texas, particularly Chapter 1207, Texas Government Code, as amended. (See “THE BONDS - Authority for Issuance”).
- Security for Bonds** ..... Principal of and interest on the Bonds will be payable from the receipts of an annual ad valorem tax levied, without legal limit as to rate or amount, on all taxable property within the District. (See “THE BONDS - Security and Source of Payment” and “AD VALOREM TAX PROCEDURES – Tax Rate Limitations”).
- Permanent School Fund Guarantee** ..... The District applied to the Texas Education Agency and has received conditional approval for the Bonds to be guaranteed by the Texas Permanent School Fund. (See “THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM”).
- Optional Redemption** ..... The CIBs maturing on and after February 15, 2021, are subject to optional redemption in whole or in part on February 15, 2020, or any date thereafter, at a price equal to the principal amount thereof, plus accrued interest from the most recent interest payment date to the date of redemption. The CABs are not subject to redemption prior to maturity. (See “THE BONDS—Optional Redemption”).
- Use of Proceeds** ..... Proceeds from the sale of the Bonds will be used to (1) refund certain of the District’s outstanding bonds, as indicated in APPENDIX A – Table 11, attached hereto (the “Refunded Bonds”), and (2) pay costs of issuing the Bonds. (See “THE BONDS—Sources and Uses of Funds”).
- Tax Exemption** ..... In the opinion of Bond Counsel, interest on the Bonds is excludable from gross income for federal income tax purposes under existing law, subject to the matters described under “TAX MATTERS - Tax Exemption” herein, and is not includable in the alternative minimum taxable income of individuals. See “TAX MATTERS - Tax Exemption” for a discussion of the opinion of Bond Counsel, including the alternative minimum tax on corporations.
- Qualified Tax Exempt Obligations** ..... The Issuer designated the Bonds as qualified tax-exempt obligations. See “Qualified Tax-Exempt Obligations.”
- Ratings** ..... Moody’s Investors Service (“Moody’s”) has assigned its municipal bond ratings of “\_\_\_” to the Bonds by virtue of the guarantee of the Permanent School Fund of the State of Texas on the Bonds. Moody’s has also assigned an underlying rating of “\_\_\_” to the Bonds. (See “OTHER INFORMATION - Ratings”, and “THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM”).
- Book-Entry-Only System** ..... The definitive Bonds will be initially registered and delivered only to Cede & Co., the nominee of DTC, pursuant to the Book-Entry-Only System described herein. The Bonds will be issued in principal or Maturity Amount denominations of \$5,000, as applicable, or any integral multiple thereof. No physical delivery of the Bonds will be made to the beneficial owners thereof. Principal of, premium, if any, and interest on the Bonds will be payable by the Paying Agent/Registrar to Cede & Co., which will make distribution of the amounts so paid to the participating members of DTC for subsequent payment to the beneficial owners of the Bonds. (See “THE BONDS - Book-Entry-Only System”).
- Payment Record** ..... The District has never defaulted in the payment of its tax-supported debt.

**SELECTED FINANCIAL INFORMATION**

<b>Fiscal Year Ended 31-Aug</b>	<b>Estimated District Population<sup>(a)</sup></b>	<b>Taxable Assessed Valuation<sup>(b)</sup></b>	<b>Per Capita Taxable Assessed Valuation</b>	<b>Ad Valorem Tax-Supported Debt</b>	<b>Per Capita Tax-Supported Tax Debt</b>	<b>Ratio Tax Debt to Assessed Valuation</b>	<b>Tax Year</b>
2007	5,018	\$ 273,385,909	\$ 54,481	\$ 7,085,000	2.59%	2.59%	2006
2008	5,127	299,411,472	58,399	6,890,000	2.30%	2.30%	2007
2009	4,902	312,518,932	63,753	6,715,000	2.15%	2.15%	2008
2010	5,132	327,977,672	63,908	6,530,000	1.99%	1.99%	2009
2011	4,803	320,790,842	66,790	6,335,000	1.97%	1.97%	2010
2012	4,803	345,623,006	71,960	6,124,948 <sup>(c)</sup>	1.77%	1.77%	2011 <sup>(c)</sup>

<sup>(a)</sup> Population estimates obtained from Texas Municipal Reports.

<sup>(b)</sup> Net of exemptions. Assessed valuations do not include adjustments in supplemental rolls made after the end of each fiscal year.  
Source: Fayette County Appraisal District.

<sup>(c)</sup> Includes the Bonds and excludes the Refunded Bonds. Preliminary, subject to change.

**General Fund Consolidated Statement Summary**

	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
Beginning Balance	\$ 530,304	\$ 404,687	\$ 322,596	\$ 169,079	\$ 174,389
Adjustment to Fund Balance	-	-	-	-	-
Total Revenue	6,240,299	6,202,694	6,662,211	6,094,866	5,516,082
Total Expenditures	6,282,481	6,072,201	6,506,030	5,875,931	5,517,617
Net Other Resources (Uses)	(45,000)	(4,875)	(74,091)	(65,418)	(3,774)
Ending Balance	\$ 443,122	\$ 530,305	\$ 404,686	\$ 322,596	\$ 169,080

Source: The District's audited financial statements.

For additional information regarding the District, please contact:

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**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**  
**(Fayette County, Texas)**

**\$5,574,919.80\***  
**UNLIMITED TAX REFUNDING BONDS**  
**SERIES 2011**

**INTRODUCTION**

This Official Statement, including the Schedule and Appendices hereto, provides certain information regarding the issuance of the Schulenburg Independent School District Unlimited Tax Refunding Bonds, Series 2011 (the "Bonds"). Except as otherwise indicated herein, capitalized terms used in this Official Statement have the same meanings assigned to such terms in the order (the "Order") adopted by the Board of Trustees (the "Board of Trustees") of the Schulenburg Independent School District (the "District") authorizing the issuance of the Bonds.

There follows in this Official Statement descriptions of the Bonds and certain information regarding the District and its finances. All descriptions of documents contained herein are only summaries and are qualified in their entirety by reference to each such document. Copies of such documents may be obtained from the Financial Advisor, Coastal Securities, Inc., Houston, Texas, by electronic mail or upon payment of reasonable handling, mailing, and delivery charges.

This Official Statement speaks only as of its date, and the information contained herein is subject to change. Copies of the Final Official Statement pertaining to the Bonds will be submitted to the Municipal Securities Rulemaking Board, through its Electronic Municipal Market Access system (EMMA) at [www.emma.msrb.org](http://www.emma.msrb.org). See "CONTINUING DISCLOSURE OF INFORMATION" for a description of the District's undertaking to provide certain information on a continuing basis.

**THE BONDS**

**Description**

The following is a description of some of the terms and conditions of the Bonds, which description is qualified in its entirety by the Order which may be obtained upon request to the District.

The Bonds are being issued in part as current interest bonds (the "CIBs") and in part as premium capital appreciation bonds (the "CABs"). The Bonds are dated November 1, 2011 (the "Dated Date"), and mature on February 15, 2012, and February 15 in each of the years and in the amounts shown on the inside cover page hereof. Interest on the CIBs will accrue from the Dated Date, and will be payable each February 15 and August 15, commencing February 15, 2012, until maturity or earlier redemption. Interest on the CIBs will be calculated on the basis of a 360-day year consisting of twelve 30-day months. The CABs will mature on February 15 in each of the years and in the amounts shown on the inside cover page hereof. Interest on the CABs will accrete from the date they are initially delivered to the Underwriters, will compound semi-annually on February 15 and August 15, commencing February 15, 2012, and will be payable only upon maturity. The amount of principal, plus the initial premium, if any, and accrued interest paid at maturity with respect to the CABs is hereinafter referred to as the "Maturity Amount."

The term "Accreted Value" as used in this Official Statement and in the Order means the original principal amount of a CAB plus the initial premium, if any, paid therefor with interest thereon compounded semiannually to February 15 or August 15, as the case may be, next preceding the date of such calculation (or the date of calculation, if such calculation is made on February 15 or August 15), at the respective yields stated on the inside cover page of this Official Statement and, with respect to each \$5,000 Maturity Amount, as set forth in the Accreted Value tables attached hereto as Schedule I. For any day other than a February 15 and August 15, the Accreted Value of a CAB shall be determined by a straight line interpolation between the values for the applicable semiannual compounding dates (based on 30-day months).

The definitive Bonds will be issued only in fully registered form in any integral multiple of \$5,000 of principal amount or Maturity Amount for any one maturity and will be initially registered and delivered only to Cede & Co., the nominee of The Depository Trust Company ("DTC") pursuant to the Book-Entry-Only System described herein. **No physical delivery of the Bonds will be made to the beneficial owners thereof.** Principal of, premium, if any, and accrued interest on the CIBs and the Maturity Amount of the CABs will be payable by the Paying Agent/Registrar, initially Wells Fargo Bank, National Association, Fort Worth, Texas (the "Paying Agent/Registrar") to Cede & Co., which will make distribution of the amounts so paid to the participating members of DTC for subsequent payment to the beneficial owners of the Bonds. See "THE BONDS - Book-Entry-Only System" herein.

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\* Preliminary, subject to change.

## **Yield on CABs**

The yields of the CABs as set forth on the inside cover page of this Official Statement are the approximate yields based upon the initial offering prices therefor set forth on the inside cover page of this Official Statement. Such offering prices include the principal amount of such CABs plus premium equal to the amount by which such offering price exceeds the principal amount of such CABs. Because of such premium, the approximate offering yield on the CABs is lower than the bond interest rates thereon. The yield on the CABs to a particular purchaser may differ depending upon the price paid by the purchaser. For various reasons, securities that do not pay interest periodically, such as the CABs, have traditionally experienced greater price fluctuations in the secondary market than securities that pay interest on a periodic basis.

## **Authority for Issuance**

The Bonds are issued pursuant to the Order, a pricing certificate executed pursuant to there and by the authority conferred by the Constitution and general laws of the State of Texas, including particularly, Chapter 1207, Texas Government Code, as amended.

## **Security and Source of Payment**

The Bonds constitute direct obligations of the District, payable as to principal and interest from an annual ad valorem tax levied, without legal limit as to rate or amount, against all taxable property within the District.

## **Optional Redemption**

The District reserves the right, at its option, to redeem CIBs having stated maturities on and after February 15, 2021, in whole or in part in principal amounts of \$5,000 or any integral multiple thereof, on February 15, 2020, or any date thereafter, at the par value thereof plus accrued interest from the most recent interest payment date to the date of redemption. If a CIB (or any portion of the principal sum thereof) shall have been called for redemption and notice of such redemption shall have been given, such CIB (or the principal amount thereof to be redeemed) shall become due and payable on such redemption date and interest thereon shall cease to accrue from and after the redemption date, provided funds for the payment of the redemption price and accrued interest thereon are held by the Paying Agent/Registrar on the redemption date.

The CABs are not subject to redemption prior to maturity.

## **Defeasance**

The District reserves the right to defease the Bonds in any manner, now or hereafter permitted by law.

## **Book-Entry-Only System**

*This section describes how ownership of the Bonds is to be transferred and how the principal of, premium, if any, and interest on the Bonds are to be paid to and credited by The Depository Trust Company ("DTC"), New York, New York, while the Bonds are registered in its nominee name. The information in this section concerning DTC and the Book-Entry-Only System has been provided by DTC for use in disclosure documents such as this Official Statement. The District, the Financial Advisor and the Underwriters believe the source of such information to be reliable, but take no responsibility for the accuracy or completeness thereof.*

*The District cannot and does not give any assurance that (1) DTC will distribute payment of debt service on the Bonds, or redemption or other notices to DTC Participants, (2) DTC Participants or others will distribute debt service payments paid to DTC or its nominee (as the registered owner of the Bonds), or redemption or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or (3) DTC will serve and act in the manner described in this Official Statement. The current rules applicable to DTC are on file with the Securities and Exchange Commission, and the current procedures of DTC to be followed in dealing with DTC Participants are on file with DTC.*

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered certificate will be issued for the Bonds, in the aggregate principal amount of such issue, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is a holding company for DTC, National Securities Clearing

Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has a Standard & Poor’s rating of: “AA+.” The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive physical certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee, do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Paying Agent/Registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC’s practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Bonds unless authorized by a Direct Participant in accordance with DTC’s Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the District as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, principal, and interest payments on the CIBs and the Maturity Amount on the CABs will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC’s practice is to credit Direct Participants’ accounts upon DTC’s receipt of funds and corresponding detail information from the District or the Paying Agent/Registrar, on the payable date in accordance with their respective holdings shown on DTC’s records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in “street name,” and will be the responsibility of such Participant and not of DTC nor its nominee, the Paying Agent/Registrar, or the District, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, principal, and interest payments on the CIBs and the Maturity Amount on the CABs to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the District or the Paying Agent/Registrar. Disbursement of such payments to Direct Participants will be the responsibility of DTC, and reimbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to the District or the Paying Agent/Registrar. Under such circumstances, in the event that a successor depository is not obtained, Bond certificates are required to be printed and delivered. Discontinuance by the District of use of the system of book-entry transfers through DTC may require compliance with DTC operational arrangements.

The District may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). Discontinuance of the system of book-entry transfers by the District may require the consent of Participants under DTC’s Operational Arrangements. In that event, Bond certificates will be printed and delivered.

*Use of Certain Terms in Other Sections of this Official Statement.*

In reading this Official Statement it should be understood that while the Bonds are in the Book-Entry-Only System, references in other sections of this Official Statement to registered owners should be read to include the person for which the Participant acquires an interest in the Bonds, but (i) all rights of ownership must be exercised through DTC and the Book-Entry-Only System, and (ii) except as described above, notices that are to be given to registered owners under the Order will be given only to DTC.

### **Paying Agent/Registrar**

The initial Paying Agent/Registrar is Wells Fargo Bank, National Association, Fort Worth, Texas. In the Order, the District retains the right to replace the Paying Agent/Registrar. The District covenants to maintain and provide a Paying Agent/Registrar at all times while any Bonds are outstanding and any successor Paying Agent/Registrar shall be a commercial bank or trust company organized under the laws of the United States or any state and duly qualified and legally authorized to serve as and perform the duties and services of Paying Agent/Registrar for the Bonds. Upon any change in the Paying Agent/Registrar for the Bonds, the District agrees to promptly cause a written notice thereof to be sent to each registered owner of the Bonds by United States mail, first class, postage prepaid, which notice shall also give the address of the new Paying Agent/Registrar.

### **Transfer, Exchange and Registration**

In the event the Book-Entry-Only System should be discontinued, the Bonds may be transferred and exchanged on the registration books of the Paying Agent/Registrar only upon presentation and surrender thereof to the Paying Agent/Registrar at its designated payment office and such transfer or exchange shall be without expenses or service charge to the registered owner, except for any tax or other governmental charges required to be paid with respect to such registration, exchange and transfer. Bonds may be assigned by the execution of an assignment form on the Bonds or by another instrument of transfer and assignment acceptable to the Paying Agent/Registrar. A new Bond or Bonds will be delivered by the Paying Agent/Registrar, in lieu of the Bond or Bonds being transferred or exchanged, at the designated payment office of the Paying Agent/Registrar, or sent by United States mail, first class, postage prepaid, to the new registered owner or his designee. To the extent possible, new Bonds issued in an exchange or transfer of Bonds will be delivered to the registered owner or assignee of the registered owner in not more than three business days after the receipt of the Bonds to be canceled, and the written instrument of transfer or request for exchange duly executed by the registered owner or his duly authorized agent, in form satisfactory to the Paying Agent/Registrar. New Bonds registered and delivered in an exchange or transfer shall be in any integral multiple of \$5,000 of principal or Maturity Amount, as applicable, for any one maturity and for a like aggregate principal amount or Maturity Amount as the Bond or Bonds surrendered for exchange or transfer. See "THE BONDS - Book-Entry-Only System" herein for a description of the system to be utilized initially in regard to ownership and transferability of the Bonds.

### **Record Date for Interest Payment**

The record date ("Record Date") for the interest payable on the Bonds on any interest payment date means the close of business on the last business day of the month next preceding such interest payment date. In the event of a non-payment of interest on a scheduled payment date, and for 30 days thereafter, a new record date for such interest payment (a "Special Record Date") will be established by the Paying Agent/Registrar, if and when funds for the payment of such interest have been received from the District. Notice of the Special Record Date and of the scheduled payment date of the past due interest ("Special Payment Date," which shall be 15 days after the Special Record Date) shall be sent at least five business days prior to the Special Record Date by United States mail, first class, postage prepaid, to the address of each holder of a Bond appearing on the registration books of the Paying Agent/Registrar at the close of business on the last business day next preceding the date of mailing of such notice.

### **Bondholders' Remedies**

The Order does not establish specific events of default with respect to the Bonds. Under Texas law, there is no right to the acceleration of maturity of the Bonds upon the failure of the District to observe any covenant under the Order. Such registered owner's only practical remedy, if a default occurs, is a mandamus or mandatory injunction proceeding to compel the District to levy, assess and collect an annual ad valorem tax sufficient to pay principal of and interest on the Bonds as it becomes due. The enforcement of any such remedy may be difficult and time consuming and a registered owner could be required to enforce such remedy on a periodic basis.

On June 30, 2006, the Texas Supreme Court ruled in *Tooke v. City of Mexia*, 197 S.W.3rd 325 (Tex. 2006) ("*Tooke*") that a waiver of sovereign immunity must be provided for by statute in "clear and unambiguous" language. In so ruling, the Court declared that statutory language such as "sue and be sued", in and of itself, did not constitute a clear and unambiguous waiver of sovereign immunity. In *Tooke*, the Court noted the enactment in 2005 of sections 271.151-.160, Texas Local Government Code (the "Local Government Immunity Waiver Act"), which, according to the Court, waives "immunity from suit for contract claims against most local governmental entities in certain circumstances." The Local Government Immunity Waiver Act covers school districts and relates to contracts entered into by school districts for providing goods or services to school districts. The District is not aware of any Texas court construing the Local Government Immunity Waiver Act in the context of whether contractual undertakings of local governments that relate to their borrowing powers are contracts covered by the Act. Neither the remedy of mandamus nor any other type of injunctive relief was at issue in *Tooke*, and it is unclear whether *Tooke* will be construed to have any effect with respect to the exercise of mandamus, as such remedy has been interpreted by Texas courts. In general, Texas courts have held that a writ of mandamus may be issued to require public officials to perform ministerial acts that clearly pertain to their duties. Texas courts have held that a ministerial act is defined as a legal duty that is prescribed and defined

with a precision and certainty that leaves nothing to the exercise of discretion or judgment, though mandamus is not available to enforce purely contractual duties. However, mandamus may be used to require a public officer to perform legally-imposed ministerial duties necessary for the performance of a valid contract to which the State or a political subdivision of the State is a party (including the payment of monies due under a contract).

The Order does not provide for the appointment of a trustee to represent the interest of the bondholders upon any failure of the District to perform in accordance with the terms of the Order, or upon any other condition. The opinion of Bond Counsel will note that the rights of bondholders are subject to the applicable provisions of the federal bankruptcy laws and any other similar laws affecting the rights of creditors of political subdivisions generally, and may be limited by general principles of equity which permit the exercise of judicial discretion. See “THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM” herein for a description of the procedures to be followed for payment of the Bonds by the Permanent School Fund in the event the District fails to make a payment on the Bonds when due.

**Refunded Bonds**

The Refunded Bonds (as listed in Appendix A – Table 11) and the interest due thereon are to be paid on their scheduled interest payment and maturity dates or dates of redemption from funds to be deposited with Wells Fargo Bank, National Association, Fort Worth, Texas (the “Escrow Agent”), pursuant to an Escrow Agreement (the “Escrow Agreement”) between the District and the Escrow Agent.

The Order provides that from the proceeds of the sale of the Bonds to the Underwriters, the District will deposit with the Escrow Agent an amount, which, together with other available funds, when added to the investment earnings thereon, will be sufficient to accomplish the discharge and final payment of the Refunded Bonds. Such funds will be held by the Escrow Agent in a special escrow account (the “Escrow Fund”) and used to purchase direct obligations of the United States of America or agency securities backed by the full faith and credit of the U.S. federal government (the “Federal Securities”).

Under the Escrow Agreement, the Escrow Fund is irrevocably pledged to the payment of principal of and interest on the Refunded Bonds.

In the Order, the District will give irrevocable instructions to provide the required notice to the owners of the Refunded Bonds that the Refunded Bonds will be redeemed on the redemption date described herein, on which date money will be made available to redeem the Refunded Bonds from money held under the Escrow Agreement.

Grant Thornton LLP, Minneapolis, Minnesota, Certified Public Accountants, will verify from the information provided to them the mathematical accuracy as of the date of the closing of the Bonds of the computations contained in the provided schedules to determine that the anticipated receipts from the Federal Securities in the schedules provided by Coastal Securities, Inc. will mature and pay interest in such amounts which, together with uninvested funds, if any, in the Escrow Fund will be sufficient to pay, when due, the principal of and interest on the Refunded Bonds. **Such maturing principal of and interest on the Federal Securities will not be available to pay the debt service on the Bonds.**

By the deposit of the Federal Securities and cash with the Escrow Agent pursuant to the Escrow Agreement, the District will have effected the final payment and discharge of the Refunded Bonds pursuant to Chapter 1207, Texas Government Code. As a result of such deposit, firm banking and financial arrangements will have been made for the discharge and final payment of the Refunded Bonds, and such Refunded Bonds will be deemed to be fully paid and no longer outstanding except for the purpose of being paid from funds provided therefor, in the Escrow Agreement. Upon defeasance of the Refunded Bonds, the payment of such Refunded Bonds will no longer be guaranteed by the Permanent School Fund Guarantee Program of the State of Texas.

The District has covenanted in the Escrow Agreement to make timely deposits with the Escrow Agent from lawfully available funds of any additional amounts required to pay the principal of and interest on the Refunded Bonds, if for any reason the cash balances on deposit or scheduled to be on deposit in the Escrow Fund are insufficient to make such payment.

**Sources and Uses of Funds**

Proceeds from the sale of the Bonds will be applied in the amounts shown below.

<u>Sources of Funds</u>	
Par Amount of the CIBs	\$
Par Amount of the CABs	
Accrued Interest on the CIBs	
Net Premium	
Total	\$ _____
 <u>Uses of Funds</u>	
Deposit to Escrow Fund	\$
Costs of Issuance	
Underwriters’ Discount	
Deposit to Debt Service Fund (Additional Proceeds & Accrued Interest)	
Total	\$ _____

## THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM

*This Official Statement provides information relating to the program administered by the Texas Education Agency (the “TEA”) with respect to the Texas Permanent School Fund guarantee of Texas school district bonds, which program is referred to, and defined herein, as the Guarantee Program. The information below concerning the Texas Permanent School Fund (the “PSF” or the “Fund”) and the Guarantee Program for school district bonds has been provided by TEA and is not guaranteed as to accuracy or completeness by, and is not to be construed or a representation by the District, the Financial Advisor, or the Underwriters.*

*Some of the information contained in this Section may include projections or other forward-looking statements regarding future events or the future financial performance of the PSF. Actual results may differ materially from those contained in any such projections or forward-looking statements.*

### History and Purpose

The PSF was created with a \$2,000,000 appropriation by the Texas Legislature (the “Legislature”) in 1854 expressly for the benefit of the public schools of Texas. The Constitution of 1876 stipulated that certain lands and all proceeds from the sale of these lands should also constitute the PSF. Additional acts later gave more public domain land and rights to the PSF. In 1953, the U.S. Congress passed the Submerged Lands Act that relinquished to coastal states all rights of the U.S. navigable waters within state boundaries. If the state, by law, had set a larger boundary prior to or at the time of admission to the Union, or if the boundary had been approved by Congress, then the larger boundary applied. After three years of litigation (1957-1960), the U. S. Supreme Court on May 31, 1960, affirmed Texas’ historic three marine leagues (10.35 miles) seaward boundary. Texas proved its submerged lands property rights to three leagues into the Gulf of Mexico by citing historic laws and treaties dating back to 1836. All lands lying within that limit belong to the PSF. The proceeds from the sale and the mineral-related rental of these lands, including bonuses, delay rentals and royalty payments, become the corpus of the Fund. Prior to the approval by the voters of the State of an amendment to the constitutional provision under which the Fund is established and administered, which occurred on September 13, 2003 (the “Total Return Constitutional Amendment”), and which is further described below, the PSF had as its main sources of revenues capital gains from securities transactions and royalties from the sale of oil and natural gas. The Total Return Constitutional Amendment provides that interest and dividends produced by Fund investments will be additional revenue to the PSF. The State School Land Board (“SLB”) maintains the land endowment of the Fund on behalf of the Fund and is authorized to manage the investments of the capital gains, royalties and other investment income relating to the land endowment. The SLB is a three member board, the membership of which consists of the Commissioner of the Texas General Land Office (the “Land Commissioner”) and two citizen members, one appointed by the Governor and one by the Texas Attorney General (the “Attorney General”).

The Texas Constitution describes the PSF as “permanent” and “perpetual.” Prior to the approval by Total Return Constitutional Amendment, only the income produced by the PSF was to be used to complement taxes in financing public education.

On November 8, 1983, the voters of the State approved a constitutional amendment that provides for the guarantee of school district bonds by the PSF. On approval by the State Commissioner of Education (the “Commissioner”), bonds properly issued by a school district are fully guaranteed by the corpus of the PSF. See “The Guarantee Program.”

The sole purpose of the PSF is to assist in the funding of public education for present and future generations. Prior to the adoption of the Total Return Constitutional Amendment, all interest and dividends produced by Fund investments flowed into the Available School Fund (the “ASF”), where they are distributed to local school districts based on average daily attendance. Any net gains from investments of the Fund accrue to the corpus of the PSF. Prior to the approval by the voters of the State of the Total Return Constitutional Amendment, costs of administering the PSF were allocated to the ASF. With the approval of the Total Return Constitutional Amendment, the administrative costs of the Fund have shifted from the ASF to the PSF. In fiscal year 2010, the total amount distributed to the ASF was \$60.70 million.

Audited financial information for the PSF is provided annually through the PSF Annual Report (the “Annual Report”), which is filed with the Municipal Securities Rulemaking Board (“MSRB”). The Annual Report includes the Message of the Executive Administrator of the Fund (the “Message”) and the Management’s Discussion and Analysis (“MD&A”). Reference is made to the Annual Report for the complete Message and MD&A for the year ended August 31, 2010, and for a description of the financial results of the PSF for the year ended August 31, 2010, the most recent year for which audited financial information regarding the Fund is available. The 2010 Annual Report is incorporated herein and made a part hereof for all purposes, but the 2010 Annual Report speaks only as of its date and the TEA has not obligated itself to update the 2010 Annual Report or any other Annual Report. The TEA posts each Annual Report, which includes statistical data regarding the Fund as of the close of each fiscal year, the most recent disclosure for the Guarantee Program, the Statement of Investment Objectives, Policies and Guidelines of the Texas Permanent School Fund, which is codified at 19 Texas Administrative Code, Chapter 33 (the “Investment Policy”), monthly updates with respect to the capacity of the Guarantee Program (collectively, the “Web Site Materials”) on the TEA web site at [www.tea.state.tx.us/psf](http://www.tea.state.tx.us/psf) and with the MSRB at [www.emma.msrb.org](http://www.emma.msrb.org). Such monthly updates regarding the Guarantee Program are also incorporated herein and made a part hereof for all purposes. In addition to the Web Site Materials, the Fund is required to make quarterly filings with the Securities and Exchange Commission (“SEC”) under Section 13(f) of the Securities Exchange Act of 1934. Such filings, which consist of a list of the Fund’s holdings of securities specified in Section 13(f), including exchange-traded (e.g., NYSE) or NASDAQ-quoted stocks, equity options and warrants, shares of closed-end investment companies and certain convertible debt securities, is available from the SEC at [www.sec.gov/edgar.shtml](http://www.sec.gov/edgar.shtml). A list of the Fund’s equity and fixed income holdings as of August 31, 2010, has been posted to the TEA web site and filed with the MSRB. Such list excludes holdings in the Fund’s securities lending program. Such list is incorporated herein and made a part hereof for all purposes.

## The Total Return Constitutional Amendment

The Total Return Constitutional Amendment approved a fundamental change in the way that distributions are made to the ASF from the PSF. The Total Return Constitutional Amendment requires that PSF distributions to the ASF be determined using a total-return-based formula instead of the current-income-based formula, which was used from 1964 to the end of the 2003 fiscal year. The Total Return Constitutional Amendment provides that the total amount distributed from the Fund to the ASF: (1) in each year of a State fiscal biennium must be an amount that is not more than 6% of the average of the market value of the Fund, excluding real property (the "Distribution Rate"), on the last day of each of the sixteen State fiscal quarters preceding the Regular Session of the Legislature that begins before that State fiscal biennium (the "Distribution Measurement Period"), in accordance with the rate adopted by: (a) a vote of two-thirds of the total membership of the State Board of Trustees ("SBOE"), taken before the Regular Session of the Legislature convenes or (b) the Legislature by general law or appropriation, if the SBOE does not adopt a rate as provided by clause (a); and (2) over the ten-year period consisting of the current State fiscal year and the nine preceding state fiscal years may not exceed the total return on all investment assets of the Fund over the same ten-year period (the "Ten Year Total Return"). In April 2009, the Attorney General issued a legal opinion, Op. Tex. Att'y Gen. No. GA-0707 (2009) ("GA-0707"), at the request of the Chairman of the SBOE with regard to certain matters pertaining to the Distribution Rate and the determination of the Ten Year Total Return. In GA-0707 the Attorney General opined, among other advice, that (i) the Ten Year Total Return should be calculated on an annual basis, (ii) a contingency plan adopted by the SBOE, to permit monthly transfers equal in aggregate to the annual Distribution Rate to be halted and subsequently made up if such transfers temporarily exceed the Ten Year Total Return, is not prohibited by State law, provided that such contingency plan applies only within a fiscal year time basis, not on a biennium basis, and (iii) that the amount distributed from the Fund in a fiscal year may not exceed 6% of the average of the market value of the Fund or the Ten Year Total Return.

In determining the Distribution Rate, the SBOE has adopted the goal of maximizing the amount distributed from the Fund in a manner designed to preserve "intergenerational equity." Intergenerational equity is the maintenance of endowment purchasing power to ensure that endowment spending keeps pace with inflation, with the ultimate goal being to ensure that current and future generations are given equal levels of purchasing power. In making this determination, the SBOE takes into account various considerations, and relies particularly upon its external investment consultant, which undertakes a probability analysis for long term projection periods that includes certain assumptions. Among the assumptions used in the analysis are a projected rate of growth of the average daily scholastic attendance State-wide, the projected contributions and expenses of the Fund, projected returns in the capital markets and a projected inflation rate.

In September 2006, the SBOE established the Distribution Rate from the Fund to the ASF for fiscal years 2008 and 2009 at 3.5% of the average of the PSF market value during the Distribution Measurement Period. The decision of the SBOE regarding the Distribution Rate for 2008 and 2009 took into account a commitment by the SLB to transfer at least \$100 million per year for each year of the biennium commencing September 1, 2007. The SLB has advised the SBOE that it will make a similar \$100 million release to the PSF in the 2011 fiscal year. The SBOE set the Distribution Rate for the Fund for fiscal years 2010 and 2011 at 2.5% of the average of the PSF market value during the Distribution Measurement Period that ended in November 2008, which will produce transfers of approximately \$1.15 billion during the 2010-11 biennium. The SBOE has set the Distribution Rate for the 2012-13 biennium at 4.2%, which rate was determined after the SLB authorized the release of a total of \$500 million to the PSF in quarterly installments during the 2012-13 biennium. For a discussion of subsequent legislative developments that may affect the amount distributed from the Fund in the 2012-13 biennium, see "2011 Legislative Actions" below. Since the enactment of a prior amendment to the Texas Constitution in 1964, the investment of the Fund has been managed with the dual objectives of producing current income for transfer to the ASF and growing the Fund for the benefit of future generations. As a result of this prior constitutional framework, prior to the adoption of the 2004 Asset Allocation Policy (as defined below) the investment of the Fund historically included a significant amount of fixed income investments and dividend-yielding equity investments, to produce income for transfer to the ASF.

With respect to the management of the Fund's investment portfolio, the single most significant change made to date as a result of the Total Return Constitutional Amendment has been new asset allocation policies adopted by the SBOE in February 2004 (the "2004 Asset Allocation Policy"), in July 2006 (as subsequently reaffirmed in July 2008 such asset allocation is referred to herein as the "2008 Asset Allocation Policy") and in July 2010 (the "2010 Asset Allocation Policy"), which have significantly altered the asset allocations of the Fund. The Fund's investment policy provides for minimum and maximum ranges among the components of each of the three general asset classifications: equities, fixed income and alternative asset investments. The 2004 Asset Allocation Policy decreased the fixed income target from 45% to 25% of Fund investment assets and increased the allocation for equities from 55% to 75% of investment assets. In July 2006, the SBOE modified its asset allocation to reduce the equity allocation, including both domestic and foreign equity portfolios, to a target of 53% of Fund assets, further reduced the fixed income allocation target to 19% and added an alternative asset allocation, which included real estate, real return, absolute return and private equity components, totaling 28% of the Fund's asset target. Alternative asset classes diversify the SBOE-managed assets and are not as correlated to traditional asset classes, which is intended to increase investment returns over the long run while reducing risk and return volatility of the portfolio. In July 2010, the SBOE modified the 2008 Asset Allocation Policy by decreasing the equity allocation to 50%, and the fixed income allocation to 15%, while increasing the alternative asset allocation (which may include equity and fixed income investments as part of a variety of alternative investment strategies) to 35%. The new asset categories added by the 2010 Asset Allocation Policy are a new 7% allocation for risk parity investments, added in accordance with the recommendation of a new investment advisor, and a .5% allocation for charter school investments, both of which are categorized within the Fund's alternative asset category. Any charter school investments would be made in part for the purpose of increasing funding for charter school facilities in the State. With respect to the charter allocation, the SBOE Chair has requested an opinion of the Attorney General with respect to questions presented by that allocation, including whether investments in Texas charter school facilities must be made in a manner that is consistent with the constitutionally-established prudent person standard applicable to the Fund, or whether the

SBOE may consider other benefits to a state policy in making an investment decision with respect to the Fund. The opinion request is available on the website of the Attorney General at <https://www.oag.state.tx.us/opinions/opinions/50abbott/rq/0941GA.pdf>.

The PSF Staff and the Fund's investment advisor are tasked with advising the SBOE with respect to the implementation of the 2010 Asset Allocation Policy, including the timing and manner of the selection of any external managers and other consultants. For a variety of reasons, each change in asset allocation for the Fund, including the 2010 Asset Allocation Policy, has been, and is being, implemented in phases. At August 31, 2010, the Fund was invested as follows: 63.76% in public and private market equity investments; 25.18% in fixed income investments; 10.61% in absolute return assets, 0.33% in real estate assets; and 0.12% in cash.

In accordance with the Texas Constitution, the SBOE views the PSF as a perpetual institution, and the Fund is managed as an endowment fund with a long-term investment horizon. Under the total-return investment objective, the Investment Policy provides that the PSF shall be managed consistently with respect to the following: generating income for the benefit of the public free schools of Texas, the real growth of the corpus of the PSF, protecting capital, and balancing the needs of present and future generations of Texas school children. As described above, the Total Return Constitutional Amendment restricts the annual pay out from the Fund to the total-return on all investment assets of the Fund over a rolling ten-year period. State law provides that each transfer of funds from the PSF to the ASF is made monthly, with each transfer to be in the amount of one-twelfth of the annual distribution. The heavier weighting of equity securities relative to fixed income investments has resulted in greater volatility of the value of the Fund. Given the greater weighting in the overall portfolio of passively managed investments, it is expected that the Fund will reflect the general performance returns of the markets in which the Fund is invested.

The asset allocation of the Fund is subject to change by the SBOE from time to time based upon a number of factors, including recommendations to the SBOE made by internal investment staff and external consultants, changes made by the SBOE without regard to such recommendations and directives of the Legislature. Fund performance may also be affected by factors other than asset allocation, including, without limitation, the general performance of the securities markets in the United States and abroad; political and investment considerations including those relating to socially responsible investing; application of the prudent person investment standard, which may eliminate certain investment opportunities for the Fund; and limitations on the number and compensation of internal and external investment staff, which is subject to Legislative oversight. The Guarantee Program could also be impacted by changes in State or federal law or the implementation of new accounting standards.

### **Management and Administration of the Fund**

The Texas Constitution and applicable statutes delegate to the SBOE the authority and responsibility for investment of the PSF's financial assets. In investing the Fund, the SBOE is charged with exercising the judgment and care under the circumstances then prevailing which persons of ordinary prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital. The SBOE has adopted a "Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund," which is codified in the Texas Administrative Code beginning at 19 TAC section 33.1.

The Total Return Constitutional Amendment provides that expenses of managing the PSF are to be paid "by appropriation" from the PSF. In January 2005, at the request of the SBOE, the Attorney General issued a legal opinion, Op. Tex. Att'y Gen. No. GA-0293 (2005) ("GA-0293"), that the Total Return Constitutional Amendment requires that SBOE expenditures for managing or administering PSF investments, including payments to external investment managers, be paid from appropriations made by the Legislature, but that the Total Return Constitutional Amendment does not require the SBOE to pay from such appropriated PSF funds the indirect management costs deducted from the assets of a mutual fund or other investment company in which PSF funds have been invested.

Texas law assigns control of the Fund's land and mineral rights to the three-member SLB, which consists of the elected Commissioner of the General Land Office ("GLO"), an appointee of the Governor, and an appointee of the Attorney General. Administrative duties related to the land and mineral rights reside with the GLO, which is under the guidance of the Commissioner of the GLO. In 2007, the Legislature established the real estate special fund account of the PSF (the "Real Estate Account") consisting of the land, mineral or royalty interest, real estate investment, or other interest, including revenue received from those sources, that is set apart to the PSF under the Texas Constitution and laws, together with the mineral estate in riverbeds, channels, and the tidelands, including islands. The investment of the Real Estate Account is subject to the sole and exclusive management and control of the SLB and the Land Commissioner, who is also the head of the GLO. The 2007 legislation that established the Real Estate Account, House Bill 3699 ("HB 3699") presented constitutional questions regarding the respective roles of the SBOE and the SLB relating to the disposition of proceeds of real estate transactions to the ASF, among other questions. On April 9, 2008, the Attorney General issued a legal opinion, Op. Tex. Att'y Gen. No. GA-0617 (2008), at the request of the Chair of the SBOE advising, among other matters, that any proceeds from the sale of real estate that are not reinvested by the SLB in other real estate assets must be invested under the direction of the SBOE, and that the provisions of H.B. 3699 that permit the SLB to directly transfer real estate investment proceeds to the ASF (in lieu of transfer to the investment portfolio of the PSF under the management of the SBOE), would likely be determined by a court to be in violation of the State constitution. Amounts in the investment portfolio of the PSF are taken into account by the SBOE for purposes of determining the Distribution Rate. For a discussion of subsequent legislative developments that may affect an amendment to the Texas Constitution to permit the SLB to make transfers directly to the ASF, see "2011 Legislative Actions" below.

The SBOE contracts with its securities custodial agent to measure the performance of the total return of the Fund. A consultant is typically retained for the purpose of providing consultation with respect to strategic asset allocation decisions and to assist the SBOE in selecting external fund management advisors. The SBOE also contracts with financial institutions for custodial and securities lending services. The SBOE has established the Committee of Investment Advisors, which consists of independent investment experts each appointed by a member of the SBOE to closely advise the respective SBOE member on investment issues.

As noted above, the Texas Constitution and applicable statutes make the SBOE responsible for investment of the PSF's financial assets. By law, the Commissioner is appointed by the Governor, with Senate confirmation, and assists the SBOE, but the Commissioner can neither be hired nor dismissed by the SBOE. The Executive Administrator of the Fund is also hired by and reports to the Commissioner. Moreover, although the Fund's Executive Administrator and his staff implement the decisions of and provide information to the School Finance/PSF Committee of the SBOE and the full SBOE, the SBOE can neither select nor dismiss the Executive Administrator. TEA's General Counsel provides legal advice to the Executive Administrator and to the SBOE. The SBOE has also engaged outside counsel to advise it as to its duties over the Fund, including specific actions regarding the investment of the PSF to ensure compliance with fiduciary standards, and to provide transactional advice in connection with the investment of Fund assets in non-traditional investments.

### **The Guarantee**

The Guarantee Program for School District Bonds (the "Guarantee Program") was authorized by an amendment to the Texas Constitution in 1983 and by Subchapter C of Chapter 45 of the Texas Education Code, as amended (the "Act"). If the conditions for the Guarantee Program are satisfied, the guarantee becomes effective upon approval of the bonds by the Attorney General and remains in effect until the guaranteed bonds are paid or defeased, by a refunding or otherwise.

In the event of default, holders of guaranteed bonds will receive all payments due from the corpus of the PSF. Following a determination that a district will be or is unable to pay maturing or matured principal or interest on any guaranteed bond, the Act requires the district to notify the Commissioner not later than the fifth day before the stated maturity date of such bond or interest payment. Immediately following receipt of such notice, the Commissioner must cause to be transferred from the appropriate account in the PSF to the Paying Agent/Registrar an amount necessary to pay the maturing or matured principal and interest. Upon receipt of funds for payment of such principal or interest, the Paying Agent/Registrar must pay the amount due and forward the canceled bond or evidence of payment of the interest to the State Comptroller of Public Accounts (the "Comptroller"). The Commissioner will instruct the Comptroller to withhold the amount paid, plus interest, from the first State money payable to the district. The amount withheld will be deposited to the credit of the PSF. The Comptroller must hold such canceled bond or evidence of payment of the interest on behalf of the PSF. Following full reimbursement of such payment by the district to the PSF with interest, the Comptroller will cancel the bond or evidence of payment of the interest and forward it to the district. The Act permits the Commissioner to order a school district to set a tax rate sufficient to reimburse the Fund for any payments made with respect to guaranteed bonds, and also sufficient to pay future payments on guaranteed bonds, and provides certain enforcement mechanisms to the Commissioner, including the appointment of a board of managers or annexation of a defaulting district to another district.

If a district fails to pay principal or interest on a bond as it is stated to mature, other amounts not due and payable are not accelerated and do not become due and payable by virtue of the district's default. The Guarantee Program does not apply to the payment of principal and interest upon redemption of bonds, except upon mandatory sinking fund redemption, and does not apply to the obligation, if any, of a school district to pay a redemption premium on bonds.

In the event that two or more payments are made from the PSF on behalf of a district, the Commissioner shall request the Attorney General to institute legal action to compel the district and its officers, agents and employees to comply with the duties required of them by law in respect to the payment of guaranteed bonds.

For a discussion of legislative developments that have authorized the use of the Fund to guarantee revenue bonds issued by certain open-enrollment charter schools, see "2011 Legislative Actions" below.

### **Capacity Limits for the Guarantee Program**

The capacity of the Fund to guarantee bonds under the Guarantee Program is limited in two ways: by State law (the "State Capacity Limit") and by regulations and a notice issued by the Internal Revenue Service (the "IRS" and the "IRS Limit," respectively). Prior to May 20, 2003, the State Capacity Limit was equal to two times the lower of cost or fair market value of the Fund's assets, exclusive of real estate. During the 78th Regular Session of the Legislature in 2003, legislation was enacted that increased the State Capacity Limit by 25%, to two and one half times the lower of cost or fair market value of the Fund's assets as estimated by the SBOE and certified by the State Auditor, and eliminated the real estate exclusion from the calculation. Prior to the issuance of the IRS Notice (defined below), the capacity of the program under the IRS Limit was limited to two and one-half times the lower of cost or fair market value of the Fund's assets adjusted by a factor that excluded additions to the Fund made since May 14, 1989. During the 2007 Texas Legislature, Senate Bill 389 ("SB 389") was enacted providing for additional increases in the capacity of the Guarantee Program, and specifically providing that the SBOE may by rule increase the capacity of the Guarantee Program from two and one-half times the cost value of the PSF to an amount not to exceed five times the cost value of the PSF, provided that the increased limit does not violate federal law and regulations and does not prevent bonds guaranteed by the Guarantee Program from receiving the highest available credit rating, as determined by the SBOE. SB 389 further provides that the SBOE shall at least annually consider whether to change the capacity of the Guarantee Program. Since 2005, the Guarantee Program has twice reached capacity under the IRS Limit, and in each instance the Guarantee Program was closed to new bond

guarantee applications until relief was obtained from the IRS. The most recent closure of the Guarantee Program commenced in March 2009 and the Guarantee Program reopened in February 2010 on the basis of receipt of the IRS Notice.

On December 16, 2009, the IRS published Notice 2010-5 (the "IRS Notice") stating that the IRS will issue proposed regulations amending the existing regulations to raise the IRS limit to 500% of the total cost of the assets held by the PSF as of December 16, 2009. In accordance with the IRS Notice, the amount of any new bonds to be guaranteed by the PSF, together with the then outstanding amount of bonds previously guaranteed by the PSF, must not exceed the IRS limit on the sale date of the new bonds to be guaranteed. The IRS Notice further provides that the IRS Notice may be relied upon for bonds sold on or after December 16, 2009, and before the effective date of future regulations or other public administrative guidance affecting funds like the PSF.

The IRS Notice establishes a static capacity for the Guarantee Program based upon the cost value of Fund assets on December 16, 2009 multiplied by five. On December 16, 2009, the cost value of the Guarantee Program was \$23,463,749,653 (estimated and unaudited), thereby producing an IRS Limit of approximately \$117.3 billion. The State Capacity Limit is determined on the basis of the cost value of the Fund from time to time multiplied by the capacity multiplier determined annually by the SBOE, but not to exceed a multiplier of five. The capacity of the Guarantee Program will be limited to the lower of the State Capacity Limit and the IRS Limit. On May 21, 2010, the SBOE modified the regulations that govern the Guarantee Program (the "Guarantee Program Rules"), and increased the State Law Capacity to an amount equal to three times the cost value of the PSF. Such modified regulations, including the revised capacity rule, became effective on July 1, 2010. The Guarantee Program Rules provide that the Commissioner may reduce the multiplier to maintain the AAA credit rating of the Guarantee Program, but provide that any changes to the multiplier made by the Commissioner are to be ratified or rejected by the SBOE at the next meeting following the change. See "Valuation of the PSF and Guaranteed Bonds," below.

Since July 1991, when the SBOE amended the Guarantee Program Rules to broaden the range of bonds that are eligible for guarantee under the Guarantee Program to encompass most Texas school district bonds, the principal amount of bonds guaranteed under the Guarantee Program has increased sharply. In addition, in recent years a number of factors have caused an increase in the amount of bonds issued by school districts in the State. See the table "Permanent School Fund Guaranteed Bonds" below. The SBOE has approved and modified the Guarantee Program Rules in recent years, most recently in May 2010. Generally, the Guarantee Program Rules limit guarantees to certain types of notes and bonds, including, with respect to refunding bonds, a requirement that the bonds produce debt service savings, and that bonds issued for capital facilities must have been voted as unlimited tax debt of the issuing district. The Guarantee Program regulations include certain accreditation criteria for districts applying for a guarantee of their bonds, and limit guarantees to districts that have less than the amount of annual debt service per average daily attendance that represents the 90th percentile of annual debt service per average daily attendance for all districts, but such limitation will not apply to school districts that have enrollment growth of at least 25% over the previous five school years. Effective September 1, 2009, the Act provides that the SBOE may annually establish a percentage of the cost value of the Fund to be reserved from use in guaranteeing bonds. The capacity of the Guarantee Program in excess of any reserved portion is referred to herein as the "Capacity Reserve." The Guarantee Program Rules provide for a minimum Capacity Reserve of no less than 5%, and provide that the amount of the Capacity Reserve may be increased by a majority vote of the SBOE. The Commissioner is authorized to change the Capacity Reserve, which decision must be ratified or rejected by the SBOE at its next meeting following any change made by the Commissioner. The Guarantee Program Rules are codified in the Texas Administrative Code at 19 TAC sections 33.65 et seq., and are available on the TEA web site at [www.tea.state.tx.us/rules/tac/chapter033/index.html](http://www.tea.state.tx.us/rules/tac/chapter033/index.html). The current Capacity Reserve is noted in the monthly updates with respect to the capacity of the Guarantee Program on the TEA web site at [www.tea.state.tx.us/psf](http://www.tea.state.tx.us/psf), which are also filed with the MSRB.

Based upon historical performance of the Fund, the legal restrictions relating to the amount of bonds that may be guaranteed has generally resulted in a lower ratio of guaranteed bonds to available assets as compared to many other types of credit enhancements that may be available for Texas school district bonds. However, changes in the value of the Fund due to changes in securities markets, investment objectives of the Fund, an increase in bond issues by school districts in the State or legal restrictions on the Fund, the implementation of a guarantee program for revenue bonds issued by certain open-enrollment charter schools, or an increase in the calculation base of the Fund for purposes of making transfers to the ASF (see "2011 Legislative Actions" below), among other factors, could adversely affect the ratio of Fund assets to guaranteed bonds and the growth of the Fund in general. It is anticipated that the issuance of the IRS Notice will substantially increase the amount of bonds guaranteed under the Guarantee Program.

The Act requires that the Commissioner prepare, and the SBOE approve, an annual report on the status of the Guarantee Program (the Annual Report). The State Auditor audits the financial statements of the PSF, which are separate from other State financial statements. The TEA has filed the audited annual report of the PSF for the year ended August 31, 2010 with the MSRB. The 2009 Annual Report has also been filed with the Municipal Advisory Council of Texas and posted to the PSF web site. Such report speaks only as of the date thereof.

### **Ratings of Bonds Guaranteed Under the Guarantee Program**

Moody's Investors Service, Standard & Poor's Rating Service, a Standard & Poor's Financial Service LLC business, and Fitch Ratings rate bonds guaranteed by the PSF "Aaa," "AAA" and "AAA," respectively. Not all districts apply for multiple ratings on their bonds, however. See "Ratings" herein.

## Valuation of the PSF and Guaranteed Bonds

Permanent School Fund Valuations		
Fiscal Year Ended 8/31	Book Value <sup>(1)</sup>	Market Value <sup>(1)</sup>
2006	\$19,359,570,146	\$26,537,687,968
2007	21,234,323,093	29,251,882,931
2008	22,926,299,922	29,336,248,611
2009	23,117,052,793	25,443,104,623
2010	23,653,185,489 <sup>(2)</sup>	27,066,200,259 <sup>(2)</sup>

(1) SLB managed assets are included in the market value and book value of the Fund. In determining the market value of the PSF from time to time during a fiscal year, the TEA uses current, unaudited values for TEA managed investment portfolios and cash held by the SLB. Market values of land and mineral interests, and investments in externally managed real estate funds managed by the SLB are based upon information reported to the PSF by the SLB. Beginning in fiscal year 2009, the SLB reported that information to the PSF on a quarterly basis. The valuation of such assets at any point in time is dependent upon a variety of factors, including economic conditions in the State and nation in general, and the values of these assets, and, in particular, the valuation of mineral holdings administered by the SLB, can be volatile and subject to material changes from period to period. At August 31, 2010, land, external real estate investments, mineral assets and cash managed by the SLB had book values of approximately \$462.9 million, \$1.150 billion, \$13.39 million and \$1 billion, respectively, and unaudited market values of approximately \$827.6 million, \$749.8 million, \$2.38 billion and \$1 billion, respectively.

(2) At June 30, 2011, the PSF had a book value of \$24,648,927,086 and a market value of \$31,111,958,884 (in each case, based on unaudited data).

Permanent School Fund Guaranteed Bonds	
At 8/31	Principal Amount <sup>(1)</sup>
2006	\$37,793,429,328
2007	44,856,621,419
2008	49,860,572,025
2009	50,032,724,439
2010 <sup>(1)</sup>	49,301,683,338 <sup>(2)</sup>

(1) Represents original principal amount; does not reflect any subsequent accretions in value for compound interest bonds (zero coupon securities). The amount shown excludes bonds that have been refunded and released from the Guarantee Program. The TEA does not maintain records of the accreted value of capital appreciation bonds that are guaranteed under the Guarantee Program.

(2) As of August 31, 2010, the TEA expected that the principal and interest to be paid by school districts over the remaining life of the bonds guaranteed by the Guarantee Program is \$84.7 billion, of which \$35.4 billion represents interest to be paid. At June 30, 2011, there were \$52,386,655,418 of bonds guaranteed under the Guarantee Program and the capacity of the Guarantee Program was \$73,946,781,258 based on the three times cost value multiplier approved by the SBOE on May 21, 2010. Such capacity figures include the Reserve Capacity.

### Discussion and Analysis Pertaining to Fiscal Year Ended August 31, 2010

The following discussion is derived from the Annual Report for the year ended August 31, 2010, including the Message of the Executive Administrator of the Fund and the Management's Discussion and Analysis contained therein. Reference is made to the Annual Report for the complete Message and MD&A. Investment assets managed by the fifteen member SBOE are referred to throughout this MD&A as the PSF(SBOE) assets. As of August 31, 2010, the Fund's land, mineral rights and certain real assets are managed by the three-member SLB and these assets are referred to throughout as the PSF(SLB) assets. The 2008 Asset Allocation Policy includes an allocation for real estate investments, and as such investments are made, and become a part of the PSF investment portfolio, those investments will be managed by the SBOE and not the SLB.

At the end of fiscal 2010, the total Fund balance was \$24.4 billion. Fund balance increased \$1.80 billion from the prior year primarily attributable to the increase in the fair value of the PSF(SBOE) investments and the recovering markets. During the year, the SBOE continued implementing its revised long term strategic asset allocation to diversify and strengthen the PSF(SBOE) investment assets of the Fund. The revised allocation is projected to increase returns over the long run while reducing risk and return volatility of the portfolio. The one year, three year, five year and ten year annualized total returns for the PSF(SBOE) assets were 7.51%, -2.64%, 3.11% and 2.87% respectively (total return takes into consideration the change in the market value of the Fund during the year as well as the interest and dividend income generated by the Fund's investments). In addition, the SLB continued its shift into externally managed real asset investment funds and the one year, three year, and five year annualized total returns for the PSF (SLB) real assets, including cash, are -2.85%, -4.68%, and 2.19% respectively.

The market value of the Fund's assets is directly impacted by the performance of the various financial markets in which the assets are invested. The most important factors affecting investment performance are the asset allocation decisions made by the SBOE and SLB. The current SBOE long term asset allocation policy allows for diversification of the PSF(SBOE) portfolio into alternative asset classes whose returns are not as correlated to traditional asset classes. The implementation of the long term asset allocation will occur over several fiscal years and is expected to provide incremental total return at reduced risk. As of August 31, 2010, the PSF(SBOE) portion of the Fund had diversified into emerging market international equities, absolute return funds, real estate and private equity. Other asset classes such as risk parity and real return will be strategically added commensurate with the economic environment and the goals and objectives of the SBOE.

The PSF(SLB) portfolio is generally characterized by three broad categories: (1) discretionary real assets investments, (2) sovereign and other lands, and (3) mineral interests. Discretionary real assets investments consist of externally managed real estate, infrastructure, and energy/minerals investment funds; internally managed direct real estate investments, and cash. Sovereign and other lands consist primarily of the lands set aside to the PSF when it was created. Mineral interests consist of the minerals that are associated with PSF lands. The investment focus of PSF(SLB) discretionary real assets investments has shifted from internally managed direct real estate investments to externally managed real assets investment funds. Approximately \$230 million of capital commitments to externally managed real assets investment funds were funded during fiscal year 2010. At August 31, 2010, the SLB had approved total capital commitments, net of the original capital commitments associated with any investments that were subsequently sold or dissolved, of \$2.122 billion to thirty-four funds, and one co-investment vehicle, of which approximately \$971 million remains unfunded.

The PSF(SBOE)'s investment in equity securities experienced a return of 5.50% during the fiscal year ended August 31, 2010. The PSF(SBOE)'s investment in fixed income securities produced a return of 11.29% during the fiscal year and absolute return investments yielded a return of 7.85%. Combined, all PSF(SBOE) asset classes produced an investment return of 7.51% for the fiscal year ended August 31, 2010, outperforming the target index by approximately 84 basis points. All PSF(SLB) real assets (including cash) returned -2.85% for the fiscal year ending August 31, 2010.

For fiscal year 2010, total revenues, inclusive of unrealized gains and losses and net of security lending rebates and fees, totaled \$1.93 billion, an increase of \$3.92 billion from fiscal year 2009 negative earnings of \$1.98 billion. This increase is primarily attributable to the recovery of domestic and international securities markets in fiscal year 2010. In fiscal year 2010, revenues earned by the Fund included lease payments, bonuses and royalty income received from oil, gas and mineral leases; lease payments from commercial real estate; surface lease and easement revenues; revenues from the resale of natural and liquid gas supplies; dividends, interest, and securities lending revenues; the net change in the fair value of the investment portfolio; and, other miscellaneous fees and income.

Expenditures are paid from the Fund before distributions are made under the total return formula. Such expenditures include the costs incurred by the SLB to manage the land endowment, as well as operational costs of the Fund, including external management fees paid from appropriated funds. Total operating expenditures, net of security lending rebates and fees, decreased 41.7% for the fiscal year ending August 31, 2010. This decrease is primarily attributable to the decrease in the expenditures for gas supplies purchased for resale within the State Energy Management Program.

The Fund supports the public school system in the State by distributing a predetermined percentage of its asset value to the ASF. For fiscal years 2009 and 2010, this distribution to the ASF totaled \$716.53 million and \$60.7 million, respectively.

At the end of the 2010 fiscal year, PSF assets guaranteed \$49.3 billion in bonds issued by 776 local school districts. Since its inception in 1983, the Fund has guaranteed 4,243 school district bond issues totaling \$88.9 billion in principal amount. During the 2010 fiscal year, the number of outstanding issues guaranteed under the Guarantee Program decreased by 76, or -3.1%. The dollar amount of guaranteed school bond issues outstanding decreased by \$731.0 million or 1.5%. The guarantee capacity of the Fund increased by \$13.167 billion, or 22.8%, during fiscal year 2010 due to the change in the multiplier.

## **2011 Legislative Actions**

During the Regular Session of the 82nd Legislature, which concluded May 30, 2011, a joint resolution ("HJR 109") was enacted proposing amendments to various sections of the Texas Constitution that pertain to the PSF. HJR 109 requires that a referendum be held in the State on November 8, 2011, for the purpose of approving non-substantive changes to the Texas Constitution to clarify references to the Fund, and, in addition, other changes to Section 5, Article VII of the Texas Constitution, that would make substantive changes to that Section, which is the principal constitutional provision that pertains to the Fund. If approved by the voters, Article VII, Section 5(a)(1) of the Texas Constitution will be amended to increase the base amount used in calculating the Distribution Rate from the Fund to the ASF. The proposed increase to that base would occur by adding to the calculation base certain discretionary real assets and cash in the Fund that is managed by entities other than the SBOE (at present, by the SLB). The value of those assets are included in the value of the Fund for purposes of the Guarantee Program, but have not been included in the calculation base for purposes of making transfers from the Fund to the ASF. While HJR 109 provides for an increase in the base for the calculation, no new resources are provided for deposit to the Fund. As described under "The Total Return Constitutional Amendment" the SBOE is prevented from approving a Distribution Rate or making a pay out from the Fund if the amount distributed would exceed 6% of the average of the market value of the Fund, excluding real property, on the last day of each of the sixteen State fiscal quarters preceding the Regular Session of the Legislature that begins before that State fiscal biennium or if such pay out would exceed the Ten Year Total Return. If approved by the voters, the new calculation base is required to be used to determine all payments to the ASF from the Fund beginning September 1, 2011. As described under "The Total Return Constitutional Amendment" the SBOE approved a distribution rate of 4.2% in January 2011 based on a commitment of the SLB to transfer \$500 million to the PSF during the biennium.

HJR 109 also provides authority to the GLO or other entity other than the SBOE that has responsibility for the management of land or other properties of the Fund to determine in its sole discretion whether to transfer each year from Fund assets to the ASF revenue derived from such land or properties, an amount not to exceed \$300 million. Any such discretionary distribution to the ASF would reduce amounts administered by the SBOE or managed by the SLB as part of the Fund.

The fiscal note pertaining to HJR 109 (the "Fiscal Note"), drafted by the Texas Legislative Budget Board, states that given the 4.2% Distribution Rate approved by the SBOE for the 2012-13 biennium, the amendment would increase the total return distribution by an estimated \$75.4 million in each year of the 2012-13 biennium, and that assuming a distribution rate of 3.5% in the 2014-15 biennium and beyond, as the value of the real assets investments increase annually, distributions to the ASF would increase in the out years. The Fiscal Note further states that the increased amounts distributed from the Fund would be a loss to either the investment corpus of the PSF managed by SBOE or, should the SLB increase its transfers to the SBOE to cover this share of the distribution, to the assets managed by the SLB. In addition, the Fiscal Note states that if the amendment is approved by the voters, the PSF would not benefit from the compounding interest that would be derived from these assets remaining in the corpus of the Fund. The scenarios described in the Fiscal Note for any fiscal period after the 2012-13 biennium are dependent upon future actions of the SBOE and the SLB and may differ from the assumptions used in the Fiscal Note.

During the First Called Session of the 82nd Texas Legislature, which ended June 29, 2011, Senate Bill 1 ("SB 1") was enacted. Among other provisions, SB 1 authorizes the use of the PSF to guarantee revenue bonds issued by certain open-enrollment charter schools that are designated as "charter districts" by the Commissioner. The program authorized by SB 1 is referred to herein as the "Charter School Guarantee Program." It is anticipated that the Charter School Guarantee Program will not become effective until certain contingent requirements are satisfied, including the establishment of regulations by the Commissioner for the administration of the program. It is also expected that certain federal tax law matters concerning the Charter School Guarantee Program will be submitted to the IRS for review prior to the implementation of the program, and it is possible that a legal opinion from the Attorney General with respect to certain provisions of the law may be requested. As a result, the date of implementation and the ultimate structure of the Charter School Guarantee Program is presently unknown.

In general, the Charter School Guarantee Program has been authorized through the enactment of amendments to the Act. As amended, the Act provides that a qualified charter district may make application to the Commissioner under the Act for a guarantee of its bonds, including refunding bonds, by the PSF. The capacity of the Charter School Guarantee Program is limited to the total amount that equals the result of the percentage that is equal to the ratio of the number of students enrolled in open-enrollment charter schools in the State compared to the total number of students enrolled in all public schools in the State multiplied by the of the combined capacities of the Guarantee Program and Charter School Guarantee Program. As of October 29, 2010 (the most recent date for which data is available), the percentage of students enrolled in open-enrollment charter schools to the total State scholastic census was approximately 2.7%. For the capacity of the Guarantee Program, see "Capacity Limits for the Guarantee Program."

The amendments to the Act further provide that the Commissioner may not approve charter district bonds for guarantee if such guarantees will result in lower bond ratings for public school district bonds that are guaranteed under the Guarantee Program. To be eligible for a guarantee, the Act provides that a charter district's bonds must be approved by the Attorney General, rated without the guarantee as investment grade by a nationally recognized investment rating firm, and satisfy an investigation conducted by the TEA as to the charter district's accreditation.

The amendments to the Act further provide for the establishment of a reserve fund in the State treasury. Each charter district that has a bond guaranteed must annually remit to the Commissioner, for deposit in the charter district bond guarantee reserve fund, an amount equal to 10% (or such higher amount as may be determined by the Commissioner) of the savings to the charter district that result from the lower interest rate on the bond due to the guarantee by the PSF.

The Act provides that immediately following receipt of notice that a charter district will be or is unable to pay maturing or matured principal or interest on a guaranteed bond, the Commissioner is required to instruct the transfer from the charter district bond guarantee reserve fund to the district's paying agent an amount necessary to pay the maturing or matured principal or interest. If money in the charter district bond guarantee reserve fund is insufficient to pay the amount due on a bond for which a notice of default has been received, the Commissioner shall instruct the transfer from the PSF to the district's paying agent the amount necessary to pay the balance of the unpaid maturing or matured principal or interest. If a total of two or more payments are made under the Charter School Guarantee Program on charter district bonds and the Commissioner determines that the charter district is acting in bad faith under the program, the Commissioner may request the Attorney General to institute appropriate legal action to compel the charter district and its officers, agents, and employees to comply with the duties required of them by law in regard to the guaranteed bonds.

#### **Other Events and Disclosures**

The State Investment Ethics Code governs the ethics and disclosure requirements for financial advisors and other service providers who advise certain State governmental entities, including the PSF. In accordance with the provisions of the State Investment Ethics Code, the SBOE periodically modifies its code of ethics, which occurred most recently in May 2010. The SBOE code of ethics includes prohibitions on sharing confidential information, avoiding conflict of interests and requiring disclosure filings with respect to contributions made or received in connection with the operation or management of the Fund. The code of ethics applies to members of the SBOE as well as to persons who are responsible by contract or by virtue of being a TEA PSF staff member for managing, investing, executing brokerage

transactions, providing consultant services, or acting as a custodian of the PSF, and persons who provide investment and management advice to a member of the SBOE, with or without compensation under certain circumstances. The code of ethics is codified in the Texas Administrative Code at 19 TAC sections 33.5 et seq., and is available on the TEA web site at [www.tea.state.tx.us/rules/tac/chapter033/index.html](http://www.tea.state.tx.us/rules/tac/chapter033/index.html).

Since 2007, TEA has made supplemental appropriation requests to the Legislature for the purpose of funding the implementation of the 2008 Asset Allocation Policy, but those requests have been denied or partly funded. In the 2011 legislative session, the Legislature approved an increase of 31 positions in the full-time equivalent employees for the administration of the Fund, which was funded as part of an \$18 million appropriation for each year of the 2012-13 biennium, in addition to the operational appropriation of \$11 million for each year of the biennium.

As of August 31, 2010, certain lawsuits were pending against the State and/or the GLO, which challenge the Fund's title to certain real property and/or past or future mineral income from that property. Reference is made to the Annual Report for a description of such lawsuits that are pending, which may represent contingent liabilities of the Fund.

### **PSF Continuing Disclosure Undertaking**

The SBOE has adopted an investment policy rule (the "TEA Rule") pertaining to the PSF and the Guarantee Program. The TEA Rule is codified in Section I of the TEA Investment Procedure Manual, which relates to the Guarantee Program. The most recent amendment to the TEA Rule was adopted by the SBOE on November 19, 2010, and is summarized below. Through the adoption of the TEA Rule and its commitment to guarantee the Bonds, the SBOE has made the following agreement for the benefit of the District and holders and beneficial owners of the Bonds. The TEA (or its successor with respect to the management of the Guarantee Program) is required to observe the agreement for so long as it remains an "obligated person," within the meaning of SEC Rule 15c2-12 ("Rule 15c2-12"), with respect to the Bonds. Nothing in the TEA Rule obligates the Agency to make any filings or disclosures with respect to guaranteed bonds, as the obligations of the Agency under the TEA Rule pertain solely to the Guarantee Program. The district issuing the guaranteed bonds has assumed the applicable obligation under Rule 15c-12 to make all disclosures and filings relating directly to guaranteed bonds, and the TEA takes no responsibility with respect to such district undertakings. Under the TEA agreement, the TEA will be obligated to provide annually certain updated financial information and operating data, and timely notice of specified material events, to the MSRB.

The MSRB has established the Electronic Municipal Market Access ("EMMA") system, and the TEA is required to file its continuing disclosure information using the EMMA system. Investors may access continuing disclosure information filed with the MSRB at [www.emma.msrb.org](http://www.emma.msrb.org).

### **Annual Reports**

The TEA will annually provide certain updated financial information and operating data to the MSRB. The information to be updated includes all quantitative financial information and operating data with respect to the Guarantee Program and the PSF of the general type included in this Official Statement under the heading "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM." The information also includes the Annual Report. The TEA will update and provide this information within six months after the end of each fiscal year.

The TEA may provide updated information in full text or may incorporate by reference certain other publicly-available documents, as permitted by Rule 15c2-12. The updated information includes audited financial statements of, or relating to, the State or the PSF, when and if such audits are commissioned and available. Financial statements of the State will be prepared in accordance with generally accepted accounting principles as applied to state governments, as such principles may be changed from time to time, or such other accounting principles as the State Auditor is required to employ from time to time pursuant to State law or regulation. The financial statements of the Fund were prepared to conform to U.S. Generally Accepted Accounting Principles as established by the Governmental Accounting Standards Board.

The Fund is reported by the State of Texas as a permanent fund and accounted for on a current financial resources measurement focus and the modified accrual basis of accounting. Measurement focus refers to the definition of the resource flows measured. Under the modified accrual basis of accounting, all revenues reported are recognized based on the criteria of availability and measurability. Assets are defined as available if they are in the form of cash or can be converted into cash within 60 days to be usable for payment of current liabilities. Amounts are defined as measurable if they can be estimated or otherwise determined. Expenditures are recognized when the related fund liability is incurred.

The State's current fiscal year end is August 31. Accordingly, the TEA must provide updated information by the last day of February in each year, unless the State changes its fiscal year. If the State changes its fiscal year, the TEA will notify the MSRB of the change.

### **Material Event Notices**

The TEA will also provide timely notices of certain events to the MSRB. Such notices will be provided not more than ten business days after the occurrence of the event. The TEA will provide notice of any of the following events with respect to the Guarantee Program: (1) principal and interest payment delinquencies; (2) non-payment related defaults, if such event is material within the meaning of the federal securities laws; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit

enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions, the issuance by the IRS of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB), or other material notices or determinations with respect to the tax-exempt status of the Guarantee Program, or other material events affecting the tax status of the Guarantee Program; (7) modifications to rights of holders of bonds guaranteed by the Guarantee Program, if such event is material within the meaning of the federal securities laws; (8) bond calls, if such event is material within the meaning of the federal securities laws, and tender offers; (9) defeasances; (10) release, substitution, or sale of property securing repayment of bonds guaranteed by the Guarantee Program, if such event is material within the meaning of the federal securities laws; (11) rating changes; (12) bankruptcy, insolvency, receivership, or similar event of the Guarantee Program (which is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent, or similar officer for the Guarantee Program in a proceeding under the United States Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Guarantee Program, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement, or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the Guarantee Program); (13) the consummation of a merger, consolidation, or acquisition involving the Guarantee Program or the sale of all or substantially all of its assets, other than in the ordinary course of business, the entry into of a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (14) the appointment of a successor or additional trustee with respect to the Guarantee Program or the change of name of a trustee, if such event is material within the meaning of the federal securities laws. (Neither the Act nor any other law, regulation or instrument pertaining to the Guarantee Program make any provision with respect to the Guarantee Program for bond calls, debt service reserves, credit enhancement, liquidity enhancement, early redemption or the appointment of a trustee with respect to the Guarantee Program.) In addition, the TEA will provide timely notice of any failure by the TEA to provide information, data, or financial statements in accordance with its agreement described above under “Annual Reports.”

#### **Availability of Information**

The TEA has agreed to provide the foregoing information only to the MSRB and to transmit such information electronically to the MSRB in such format and accompanied by such identifying information as prescribed by the MSRB. The information is available from the MSRB to the public without charge at [www.emma.msrb.org](http://www.emma.msrb.org).

#### **Limitations and Amendments**

The TEA has agreed to update information and to provide notices of material events only as described above. The TEA has not agreed to provide other information that may be relevant or material to a complete presentation of its financial results of operations, condition, or prospects or agreed to update any information that is provided, except as described above. The TEA makes no representation or warranty concerning such information or concerning its usefulness to a decision to invest in or sell Bonds at any future date. The TEA disclaims any contractual or tort liability for damages resulting in whole or in part from any breach of its continuing disclosure agreement or from any statement made pursuant to its agreement, although holders of Bonds may seek a writ of mandamus to compel the TEA to comply with its agreement.

The continuing disclosure agreement of the TEA is made only with respect to the PSF and the Guarantee Program. The District may make a continuing disclosure undertaking in accordance with Rule 15c2-12 with respect to its obligations arising under Rule 15c2-12 pertaining to financial and operating data concerning the District and notices of material events relating to the Bonds. A description of the District's undertaking, if any, is included elsewhere in this Official Statement.

This continuing disclosure agreement may be amended by the TEA from time to time to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of the TEA, but only if (1) the provisions, as so amended, would have permitted an underwriter to purchase or sell guaranteed bonds in the primary offering of such bonds in compliance with Rule 15c2-12, taking into account any amendments or interpretations of Rule 15c2-12 since such offering as well as such changed circumstances and (2) either (a) the holders of a majority in aggregate principal amount of the outstanding bonds guaranteed by the Guarantee Program consent to such amendment or (b) a person that is unaffiliated with the TEA (such as nationally recognized bond counsel) determines that such amendment will not materially impair the interest of the holders and beneficial owners of the bonds guaranteed by the Guarantee Program. The TEA may also amend or repeal the provisions of its continuing disclosure agreement if the SEC amends or repeals the applicable provision of Rule 15c2-12 or a court of final jurisdiction enters judgment that such provisions of the Rule are invalid, but only if and to the extent that the provisions of this sentence would not prevent an underwriter from lawfully purchasing or selling bonds guaranteed by the Guarantee Program in the primary offering of such bonds.

#### **Compliance with Prior Undertakings**

The TEA has not previously failed to substantially comply with its previous continuing disclosure agreements in accordance with Rule 15c2-12.

## **SEC Exemptive Relief**

On February 9, 1996, the TEA received a letter from the Chief Counsel of the SEC that pertains to the availability of the "small issuer exemption" set forth in paragraph (d)(2) of Rule 15c2-12. The letter provides that Texas school districts which offer municipal securities that are guaranteed under the Guarantee Program may undertake to comply with the provisions of paragraph (d)(2) of Rule 15c2-12 if their offerings otherwise qualify for such exemption, notwithstanding the guarantee of the school district securities under the Guarantee Program. Among other requirements established by Rule 15c2-12, a school district offering may qualify for the small issuer exemption if, upon issuance of the proposed series of securities, the school district will have no more than \$10 million of outstanding municipal securities.

## **STATE AND LOCAL FUNDING OF SCHOOL DISTRICTS IN TEXAS**

### **Litigation Relating to the Texas Public School Finance System**

On April 9, 2001, four property wealthy districts filed suit in the 250th District Court of Travis County, Texas (the "District Court") against the Texas Education Agency, the Texas State Board of Education, the Texas Commissioner of Education (the "Commissioner") and the Texas Comptroller of Public Accounts in a case styled *West Orange-Cove Consolidated Independent School District, et al. v. Neeley, et al.* The plaintiffs alleged that the \$1.50 maximum maintenance and operations ("M&O") tax rate had become in effect a state property tax, in violation of Article VIII, Section 1-e of the Texas Constitution, because it precluded them and other school districts from having meaningful discretion to tax at a lower rate. Forty school districts intervened alleging that the Texas public school finance system (the "Finance System") was inefficient, inadequate, and unsuitable, in violation of Article VII, Section 1 of the Texas Constitution, because the State of Texas (the "State") did not provide adequate funding. As described below, this case has twice reached the Texas Supreme Court (the "Supreme Court"), which rendered decisions in the case on May 29, 2003 ("West Orange-Cove I"), and November 22, 2005 ("West Orange-Cove II"). After the remand by the Supreme Court back to the District Court in West Orange-Cove I, 285 other school districts were added as plaintiffs or intervenors. The plaintiffs joined the intervenors in their Article VII, Section 1 claims that the Finance System was inadequate and unsuitable, but not in their claims that the Finance System was inefficient.

On November 30, 2004, the final judgment of the District Court was released in connection with its reconsideration of the issues remanded to it by the Supreme Court in West Orange-Cove I. In that case, the District Court rendered judgment for the plaintiffs on all of their claims and for the intervenors on all but one of their claims, finding that (1) the Finance System was unconstitutional in that the Finance System violated Article VIII, Section 1-e of the Texas Constitution because the statutory limit of \$1.50 per \$100.00 of taxable assessed valuation on property taxes levied by school districts for maintenance and operation purposes had become both a floor and a ceiling, denying school districts meaningful discretion in setting their tax rates; (2) the constitutional mandate of adequacy set forth in Article VII, Section 1, of the Texas Constitution exceeded the maximum amount of funding available under the funding formulas administered by the State; and (3) the Finance System was financially inefficient, inadequate, and unsuitable in that it failed to provide sufficient access to revenue to provide for a general diffusion of knowledge as required by Article VII, Section 1, of the Texas Constitution.

The intervening school district groups contended that funding for school operations and facilities was inefficient in violation of Article VII, Section 1 of the Texas Constitution, because children in property-poor districts did not have substantially equal access to education revenue. All of the plaintiff and intervenor school districts asserted that the Finance System could not achieve "[a] general diffusion of knowledge" as required by Article VII, Section 1 of the Texas Constitution, because the Finance System was underfunded. The State, represented by the Texas Attorney General, made a number of arguments opposing the positions of the school districts, as well as asserting that school districts did not have standing to challenge the State in these matters.

In West Orange-Cove II, the Supreme Court's holding was twofold: (1) that the local M&O tax had become a state property tax in violation of Article VIII, Section 1-e of the Texas Constitution and (2) the deficiencies in the Finance System did not amount to a violation of Article VII, Section 1 of the Texas Constitution. In reaching its first holding, the Supreme Court relied on evidence presented in the District Court to conclude that school districts did not have meaningful discretion in levying the M&O tax. In reaching its second holding, the Supreme Court, using a test of arbitrariness determined that: the public education system was "adequate," since it is capable of accomplishing a general diffusion of knowledge; the Finance System was not "inefficient," because school districts have substantially equal access to similar revenues per pupil at similar levels of tax effort, and efficiency does not preclude supplementation of revenues with local funds by school districts; and the Finance System does not violate the constitutional requirement of "suitability," since the Finance System was suitable for adequately and efficiently providing a public education.

In reversing the District Court's holding that the Finance System was unconstitutional under Article VII, Section 1 of the Texas Constitution, the Supreme Court stated:

Although the districts have offered evidence of deficiencies in the public school finance system, we conclude that those deficiencies do not amount to a violation of Article VII, Section 1. We remain convinced, however, as we were sixteen years ago, that defects in the structure of the public school finance system expose the system to constitutional challenge. Pouring more money into the system may forestall those challenges, but only for a time. They will repeat until the system is overhauled.

In response to the intervenor districts' contention that the Finance System was constitutionally inefficient, the West Orange-Cove II decision states that the Texas Constitution does not prevent the Finance System from being structured in a manner that results in gaps between the amount of funding per student that is available to the richest districts as compared to the poorest district, but reiterated its statements in *Edgewood Independent School District v. Meno*, 917 S.W.2d 717 (Tex. 1995) ("Edgewood IV") that such funding variances may not be unreasonable. The Supreme Court further stated that "[t]he standards of Article VII, Section 1 - adequacy, efficiency, and suitability - do not dictate a particular structure that a system of free public schools must have." The Supreme Court also noted that "[e]fficiency requires only substantially equal access to revenue for facilities necessary for an adequate system," and the Supreme Court agreed with arguments put forth by the State that the plaintiffs had failed to present sufficient evidence to prove that there was an inability to provide for a "general diffusion of knowledge" without additional facilities.

### **Current Litigation Related to the Texas Public School Finance System**

On October 10, 2011, seven school districts, along with several other interested parties, filed suit in the 200<sup>th</sup> District Court of Travis County (the "200<sup>th</sup> District Court") against the Texas Commissioner of Education, the Texas Comptroller of Public Accounts and the Texas State Board of Education, in a case designated as Cause No. D-1-GN-11-003130. The plaintiffs have alleged that: (i) the Finance System is inefficient in violation of Article VII, Section 1 of the Texas Constitution; (ii) that the Finance System fails to make suitable provision for the support and maintenance of the Finance System in violation of Article VII, Section 1 of the Texas Constitution; (iii) that the Finance System imposes a tax that is unequal and not uniform in violation of Article VIII, Section 1(a) of the Texas Constitution; (iv) that the Finance System has created a state ad valorem property tax in violation of Article VIII, Section 1-e of the Texas Constitution; and (v) that the Finance System fails to provide equal protection to students in low-wealth districts in violation of Article I, Section 3 of the Texas Constitution. The plaintiffs have requested declaratory judgment on their claims and asked the 200<sup>th</sup> District Court to enjoin the State and its officials from distributing funds under the current Finance System until an equitable system is created. The defendants in this suit have yet to respond to the initial petition and request for declaratory judgment, and the statutory time limit for making such a response has not yet tolled.

The District can make no representations or predictions concerning the effect this litigation may have on the District's financial condition, revenues or operations. See "STATE AND LOCAL FUNDING OF SCHOOL DISTRICTS IN TEXAS – Possible Effects of Litigation and Changes in Law on District Bonds."

### **Funding Changes in Response to West Orange-Cove II**

In response to the decision in West Orange-Cove II, the Texas Legislature (the "Legislature") enacted House Bill 1 ("HB 1"), which made substantive changes in the way the Finance System is funded, as well as other legislation which, among other things, established a special fund in the State treasury to be used to collect new tax revenues that are dedicated under certain conditions for appropriation by the Legislature to reduce M&O tax rates, broadened the State business franchise tax, modified the procedures for assessing the State motor vehicle sales and use tax and increased the State tax on tobacco products (HB 1 and other described legislation are collectively referred to herein as the "Reform Legislation"). The Reform Legislation generally became effective at the beginning of the 2006–07 fiscal year of each district.

### **Possible Effects of Litigation and Changes in Law on District Bonds**

The Reform Legislation and the changes made by the State Legislature to the Reform Legislation since its enactment did not alter the provisions of Chapter 45, Texas Education Code, as amended, that authorize districts to secure their bonds by pledging the receipts of an unlimited ad valorem debt service tax as security for payment of such bonds (including the Bonds). Reference is made, in particular, to the information under the heading "THE BONDS - Source and Security Payment" in the Official Statement.

In the future, the Legislature could enact additional changes to the Finance System which could benefit or be a detriment to a school district depending upon a variety of factors, including the financial strategies that the district has implemented in light of past State funding systems. Among other possibilities, a district's boundaries could be redrawn, taxing powers restricted, State funding reallocated, or local ad valorem taxes replaced with State funding subject to biennial appropriation. In *Edgewood IV*, the Supreme Court stated that any future determination of unconstitutionality "would not, however, affect the district's authority to levy the taxes necessary to retire previously issued bonds, but would instead require the Legislature to cure the system's unconstitutionality in a way that is consistent with the Contract Clauses of the U.S. and Texas Constitutions" (collectively, the "Contract Clauses"). Consistent with the Contract Clauses, in the exercise of its police powers, the State may make such modifications in the terms and conditions of contractual covenants related to the payment of the Bonds as are reasonable and necessary for the attainment of important public purposes.

Although, as a matter of law, the Bonds, upon issuance and delivery, will be entitled to the protections afforded previously existing contractual obligations under the Contract Clauses, the District can make no representations or predictions concerning the effect of future legislation or litigation, or how such legislation or future court orders may affect the District's financial condition, revenues or operations. While the disposition of any possible future litigation or the enactment of future legislation to address school funding in Texas could substantially adversely affect the financial condition, revenues or operations of the District, as noted herein, the District does not anticipate that the security for payment of the Bonds, specifically, the District's obligation to levy an unlimited debt service tax and the Permanent School Fund guarantee of the Bonds would be adversely affected by any such litigation or legislation. See "CURRENT PUBLIC SCHOOL FINANCE SYSTEM."

## CURRENT PUBLIC SCHOOL FINANCE SYSTEM

### Overview

The following description of the Public School Finance System (the "Finance System") is a summary of the Reform Legislation and the changes made by the State Legislature to the Reform Legislation since its enactment, including modifications made during the regular through third called sessions of the 79th Texas Legislature (collectively, the "2006 Legislative Session"), the regular session of the 81st Texas Legislature (the "2009 Legislative Session") and the regular and first called sessions of the 82nd Texas Legislature (collectively, the "2011 Legislative Session"). For a more complete description of school finance and fiscal management in the State, reference is made to Vernon's Texas Codes Annotated, Education Code, Chapters 41 through 46, as amended.

Funding for school districts in the State is provided primarily from State and local sources. State funding for all school districts is provided through a set of funding formulas comprising the "Foundation School Program," as well as two facilities financing programs. Generally, the Finance System is designed to promote wealth equalization among school districts by balancing State and local sources of funds available to school districts. In particular, because districts with relatively high levels of property wealth per student can raise more local funding, such districts receive less State aid, and in some cases, are required to disburse local funds to equalize their overall funding relative to other school districts. Conversely, because districts with relatively low levels of property wealth per student have limited access to local funding, the Finance System is designed to provide more State funding to such districts. Thus, as a school district's property wealth per student increases, State funding to the school district is reduced. As a school district's property wealth per student declines, the Finance System is designed to increase its State funding. A similar equalization system exists for facilities funding wherein districts with the same tax rate for debt service raise the same amount of combined State and local funding. Facilities funding for debt incurred in prior years is expected to continue in future years; however, State funding for new school facilities was not appropriated by the 82nd Texas Legislature for the 2012–13 fiscal biennium.

Local funding is derived from collections of ad valorem taxes levied on property located within each district's boundaries. School districts are authorized to levy two types of property taxes: a limited maintenance and operations ("M&O") tax to pay current expenses and an unlimited interest and sinking fund ("I&S") tax to pay debt service on bonds. Under current law, M&O tax rates are subject to a statutory maximum rate of \$1.17 per \$100 of taxable value for most school districts. Current law also requires school districts to demonstrate their ability to pay debt service on outstanding indebtedness through the levy of an ad valorem tax at a rate of not to exceed \$0.50 per \$100 of taxable property at the time bonds are issued. Once bonds are issued, however, districts may levy a tax to pay debt service on such bonds unlimited as to rate or amount (see "AD VALOREM TAX PROCEEDURES – Tax Rate Limitations" herein). As noted above, because property values vary widely among school districts, the amount of local funding generated by the same tax rate is also subject to wide variation among school districts.

The Reform Legislation, which generally became effective at the beginning of the 2006–07 fiscal year of each school district in the State, made substantive changes to the Finance System, which are summarized below. While each school district's funding entitlement was calculated based on the same formulas that were used prior to the 2006–07 fiscal year, the Reform Legislation effected changes to the manner in which school districts are funded that were intended to reduce local M&O tax rates by one-third over two years through the introduction of the "State Compression Percentage," with M&O tax levies declining by approximately 11% in fiscal year 2006–07 and approximately another 22% in fiscal year 2007–08. (Prior to the Reform Legislation, the maximum M&O tax rate for most school districts was \$1.50 per \$100 of taxable assessed valuation.) Subject to local referenda, a district may increase its local M&O tax levy up to \$0.17 above the district's compressed tax rate. Based on the current State Compression Percentage, the maximum M&O tax rate is \$1.17 per \$100 of taxable value for most school districts (see "AD VALOREM TAX PROCEEDURES – Tax Rate Limitations" herein).

### Local Funding for School Districts

The primary source of local funding for school districts is collections from ad valorem taxes levied against the taxable property located in each school district. As noted above, prior to the Reform Legislation, the maximum M&O tax rate for most school districts was generally limited to \$1.50 per \$100 of taxable value, and the majority of school districts were levying an M&O tax rate of \$1.50 per \$100 of taxable value at the time the Reform Legislation was enacted. The Reform Legislation required each school district to "compress" its tax rate by an amount equal to the "State Compression Percentage." For fiscal years 2007–08 through 2012–13, the State Compression Percentage has been set at 66.67%, effectively setting the maximum compressed M&O tax rate for most school districts at \$1.00 per \$100 of taxable value. The State Compression Percentage is set by legislative appropriation for each State fiscal biennium or, in the absence of legislative appropriation, by the Commissioner. School districts are permitted, however, to generate additional local funds by raising their M&O tax rate by \$0.04 above the compressed tax rate without voter approval (for most districts, up to \$1.04 per \$100 of taxable value). In addition, if the voters approve the tax rate increase, districts may, in general, increase their M&O tax rate by an additional two or more cents and receive State equalization funds for such taxing effort up to a maximum M&O tax rate of \$1.17 per \$100 of taxable value (see "AD VALOREM TAX PROCEDURES – Public Hearing and Rollback Tax Rate" herein). Elections held in certain school districts under older laws, however, may subject M&O tax rates in such districts to other limitations (see "AD VALOREM TAX PROCEEDURES – Tax Rate Limitations" herein).

### State Funding for School Districts

State funding for school districts is provided through the Foundation School Program, which provides each school district with a minimum level of funding (a "Basic Allotment") for each student in average daily attendance ("ADA"). The Basic Allotment is calculated for each

school district using various weights and adjustments. This basic level of funding is referred to as "Tier One" of the Foundation School Program. The basic level of funding is then "enriched" with additional funds known as "Tier Two" of the Foundation School Program. Tier Two provides a guaranteed level of funding for each cent of local tax effort that exceeds the compressed tax rate (for most districts, M&O tax rates above \$1.00 per \$100 of taxable value). The Finance System also provides an Existing Debt Allotment ("EDA") to subsidize debt service on eligible outstanding school district bonds and an Instructional Facilities Allotment ("IFA") to subsidize debt service on newly issued bonds. IFA primarily addresses the debt service needs of property-poor school districts. A New Instructional Facilities Allotment ("NIFA") also is available to help pay operational expenses associated with the opening of a new instructional facility. Future-year IFA and NIFA awards, however, were not funded by the Legislature for the 2012–13 fiscal biennium, although funding awards for IFA made in prior years will continue to be funded (but not the second year for NIFA for the 2012–13 fiscal biennium for districts that first became eligible for NIFA in the 2010–11 fiscal year).

Tier One and Tier Two allotments represent the State's share of the cost of M&O expenses of school districts, with local M&O taxes representing the district's local share. EDA and IFA allotments supplement a school district's local I&S taxes levied for debt service on eligible bonds issued to construct, acquire and improve facilities. Tier One and Tier Two allotments and existing EDA and IFA allotments are generally required to be funded each year by the Legislature. Since future-year IFA awards were not funded by the Legislature for the 2012–13 fiscal biennium, and debt service assistance on school district bonds that are not yet eligible for EDA is not available, debt service on new bonds issued by districts to construct, acquire and improve facilities must be funded solely from local I&S taxes. State funding allotments may be adjusted in certain circumstances to account for shortages in State appropriations or to allocate available funds in accordance with wealth equalization goals.

Tier One allotments are intended to provide all districts a basic level of education necessary to meet applicable legal standards. Tier Two allotments are intended to guarantee each school district that is not subject to the wealth transfer provisions described below an opportunity to supplement that basic program at a level of its own choice; however, Tier Two allotments may not be used for the payment of debt service or capital outlay.

The cost of the basic program is based on an allotment per student known as the "Basic Allotment". The Basic Allotment is adjusted for all districts by a cost adjustment factor intended to address competitive labor markets for teachers known as the "cost of education index." In addition, district-size adjustments are made for small- and mid-size districts. The cost of education index and district-size adjustments applied to the Basic Allotment, create what is referred to as the "Adjusted Allotment". The Adjusted Allotment is used to compute a "regular program allotment," as well as various other allotments associated with educating students with other specified educational needs. For fiscal year 2007–08, the Basic Allotment was \$3,135, and for fiscal year 2008–09, the Basic Allotment was increased to \$3,218. For a discussion of the Basic Allotment in fiscal years 2009–10 and beyond, see "2009 Legislation" below.

Tier Two currently provides two levels of enrichment with different guaranteed yields depending on the district's local tax effort. For the 2012–13 State fiscal biennium, the first six cents of tax effort that exceeds the compressed tax rate (for most districts, M&O tax rates ranging from \$1.01 to \$1.06 per \$100 of taxable value) will, for most districts, generate a guaranteed yield of \$59.97 per cent per weighted student in average daily attendance ("WADA"). The second level of Tier Two is generated by tax effort that exceeds the compressed tax rate plus six cents (for most districts eligible for this level of funding, M&O tax rates ranging from \$1.07 to \$1.17 per \$100 of taxable value) and has a guaranteed yield per cent per WADA of \$31.95. Property-wealthy school districts are subject to recapture at the equivalent wealth per student of \$319,500 (see "Wealth Transfer Provisions" below). For school districts that adopted an M&O tax rate of \$1.17 per \$100 in taxable value for the 2010–11 fiscal year, the \$31.95 guaranteed yield is increased to \$33.95, but only for the 2011–12 fiscal year.

The IFA guarantees each awarded school district a specified amount per student (the "IFA Guaranteed Yield") in State and local funds for each cent of tax effort to pay the principal of and interest on eligible bonds issued to construct, acquire, renovate or improve instructional facilities. The guaranteed yield per cent of local tax effort per student in ADA has been \$35 since this program first began. To receive an IFA award, a school district must apply to the Commissioner in accordance with rules adopted by the Commissioner before issuing the bonds to be paid with IFA state assistance. The total amount of debt service assistance over a biennium for which a district may be awarded is limited to the lesser of (1) the actual debt service payments made by the district in the biennium in which the bonds are issued; or (2) the greater of (a) \$100,000 or (b) \$250 multiplied by the number of students in ADA. The IFA is also available for lease-purchase agreements and refunding bonds meeting certain prescribed conditions. Once a district receives an IFA award for bonds, it is entitled to continue receiving State assistance for such bonds without reapplying to the Commissioner. The guaranteed level of State and local funds per student per cent of local tax effort applicable to the bonds may not be reduced below the level provided for the year in which the bonds were issued. For the 2012–13 State biennium, however, no funds are appropriated for new IFA awards, although all current obligations are funded through the biennium.

State financial assistance is provided for certain existing eligible debt issued by school districts (referred to herein as EDA). The EDA guaranteed yield (the "EDA Yield") is the same as the IFA Guaranteed Yield (\$35 per cent of local tax effort per student in ADA), subject to adjustment as described below. For bonds that became eligible for EDA funding after August 31, 2001, and prior to August 31, 2005, EDA assistance was less than \$35 in revenue per student for each cent of debt service tax, as a result of certain administrative delegations granted to the Commissioner under State law. Effective September 1, 2003, the portion of the local debt service rate that has qualified for EDA assistance is limited to the first 29 cents of debt service tax or a greater amount for any year provided by appropriation by the Legislature. In general, a district's bonds are eligible for EDA assistance if (i) the district made payments on the bonds during the final fiscal year of the preceding State fiscal biennium or (ii) the district levied taxes to pay the principal of and interest on the bonds for that fiscal year. Each biennium, access to EDA funding is determined by the debt service taxes collected in the final year of the preceding

biennium. A district may not receive EDA funding for the principal and interest on a series of otherwise eligible bonds for which the district receives IFA funding.

Prior to the 2012–13 biennium, a district could also qualify for a NIFA allotment, which provided assistance to districts for operational expenses associated with opening new instructional facilities. As previously mentioned, this program was not funded for the 2012–13 State fiscal biennium.

### **2006 Legislation**

Since the enactment of the Reform Legislation in 2006, most school districts in the State have operated with a "target" funding level per student ("Target Revenue") that is based upon the "hold harmless" principles embodied in the Reform Legislation. This system of Target Revenue was superimposed on the Foundation School Program and made existing funding formulas substantially less important for most school districts. As noted above, the Reform Legislation was intended to lower M&O tax rates in order to give school districts "meaningful discretion" in setting their M&O tax rates, while holding school districts harmless by providing them with the same level of overall funding they received prior to the enactment of the Reform Legislation. Under the Target Revenue system, each school district is generally entitled to receive the same amount of revenue per student as it did in either the 2005–2006 or 2006–07 fiscal year (under existing laws prior to the enactment of the Reform Legislation), as long as the district adopted an M&O tax rate that was at least equal to its compressed rate. The reduction in local M&O taxes resulting from the mandatory compression of M&O tax rates under the Reform Legislation, by itself, would have significantly reduced the amount of local revenue available to fund the Finance System. To make up for this shortfall, the Reform Legislation authorized Additional State Aid for Tax Reduction ("ASATR") for each school district in an amount equal to the difference between the amount that each district would receive under the Foundation School Program and the amount of each district's Target Revenue funding level.

### **2009 Legislation**

During the 2009 Legislative Session, legislation was enacted that increased the Basic Allotment for the 2009–10 fiscal year from \$3,218 to \$4,765. In addition, each district's Target Revenue was increased by \$120 per WADA. Target Revenue amounts were also adjusted to provide for mandatory employee pay raises and to account for changes in transportation and NIFA costs since the original Target Revenues were set. Overall, the Legislature allocated approximately \$1.9 billion in new State aid for school districts.

### **2011 Legislation**

During the 2011 Legislative Session, the Legislature enacted a budget that cut \$4 billion from the Foundation School Program for the 2012–13 State fiscal biennium, as compared to the funding level school districts were entitled to under the current formulas, including Target Revenue, and also cut approximately \$1.3 billion in various grants (i.e., pre-kindergarten grant program, student success initiative, etc.) that were previously available. Such cuts were made in light of a projected State deficit of up to \$27 billion for the 2012–13 State fiscal biennium. In order to reduce formula funding, a Regular Program Adjustment Factor ("RPAF") was applied to the formula that determines a district's regular program allotment. RPAF is multiplied by a school district's count of students in ADA (not counting the time a student spends in special education and career & technology education) and its Adjusted Allotment, which is the \$4,765 Basic Allotment adjusted for the cost of education index and the small- and mid-sized district adjustments. The RPAF is set at 0.9239 for the 2011–12 fiscal year and 0.98 for the 2012–13 fiscal year. In order to balance these reductions across the two years for formula funded districts, such districts have the option to request that an RPAF value of 0.95195 be applied for both the 2011–12 and 2012–13 fiscal years. In order to be granted the request by the Commissioner, the district must demonstrate that using the 0.9239 RPAF will cause the district a financial hardship in 2011–12. By applying the RPAF only to the Adjusted Allotment, other Tier One allotments, such as special education, career and technology, gifted and talented, bilingual and compensatory education, were not affected. The State Board of Education however, was directed to decrease funding for these programs in proportion to the reductions to the Basic Allotment. The Legislature also established an RPAF value of 0.98 for the 2013–15 State fiscal biennium, subject to increases by subsequent legislative appropriation not to exceed an RPAF value of 1.0. The RPAF factor and its related provisions are scheduled to expire on September 1, 2015.

The RPAF is the primary mechanism for formula reductions in the 2011–12 fiscal year. In the 2012–13 fiscal year, the RPAF of 0.98 is combined with a percentage reduction in each school district's Target Revenue per WADA to 92.35% of its formula amount. For the 2013–14 and subsequent fiscal years, the percentage reduction will be set by legislative appropriation. With regard to this adjustment, the ASATR relief that funds the Target Revenue system is phased out between the 2013–14 and 2017–18 fiscal years.

### **Wealth Transfer Provisions**

Some districts have sufficient property wealth per student in WADA ("wealth per student") to generate their statutory level of funding through collections of local property taxes alone. Districts whose wealth per student generates local property tax collections in excess of their statutory level of funding are referred to as "Chapter 41" districts because they are subject to the wealth equalization provisions contained in Chapter 41 of the Texas Education Code, as amended. Chapter 41 districts may receive State funds for certain competitive grants and a few programs that remain outside the Foundation School Program, as well as receiving ASATR until their overall funding meets or exceeds their Target Revenue level of funding. Otherwise, Chapter 41 districts are not eligible to receive State funding. Furthermore, Chapter 41 districts must exercise certain options in order to reduce their wealth level to equalized wealth levels of funding, as determined by formulas set forth in the Reform Legislation. For most Chapter 41 districts, this equalization process entails paying the portion of the district's local taxes collected in excess of the equalized wealth levels of funding to the State (for redistribution to other

school districts) or directly to other school districts with a wealth per student that does not generate local funds sufficient to meet the statutory level of funding; a process known as "recapture".

The equalized wealth levels that subject Chapter 41 districts to wealth equalization measures for fiscal year 2011–12 are set at (i) \$476,500 per student in WADA with respect to that portion of a district's M&O tax effort that does not exceed its compressed tax rate (for most districts, the first \$1.00 per \$100 of taxable value) and (ii) \$319,500 per WADA with respect to that portion of a district's M&O tax effort that is beyond its compressed rate plus \$.06 (for most districts, M&O taxes levied above \$1.06 per \$100 in taxable value). M&O taxes levied above \$1.00 but below \$1.07 per \$100 of taxable value are not subject to the wealth equalization provisions of Chapter 41. Chapter 41 districts with a wealth per student above the lower equalized wealth level but below the higher equalized wealth level must equalize their wealth only with respect to the portion of their M&O tax rate, if any, in excess of \$1.06 per \$100 of taxable value. Chapter 41 districts may be entitled to receive ASATR from the State in excess of their recapture liability, and such districts may use their ASATR funds to offset their recapture liability.

Under Chapter 41, a district has five options to reduce its wealth per student so that it does not exceed the equalized wealth levels: (1) a district may consolidate by agreement with one or more districts to form a consolidated district; all property and debt of the consolidating districts vest in the consolidated district; (2) a district may detach property from its territory for annexation by a property-poor district; (3) a district may purchase attendance credits from the State; (4) a district may contract to educate nonresident students from a property-poor district by sending money directly to one or more property-poor districts; or (5) a district may consolidate by agreement with one or more districts to form a consolidated taxing district solely to levy and distribute either M&O taxes or both M&O taxes and I&S taxes. A Chapter 41 district may also exercise any combination of these remedies. Options (3), (4) and (5) require prior approval by the transferring district's voters; however, Chapter 41 districts may apply ASATR funds to offset recapture and to achieve the statutory wealth equalization requirements, as described above, without approval from voters.

A district may not adopt a tax rate until its effective wealth per student is at or below the equalized wealth level. If a district fails to exercise a permitted option, the Commissioner must reduce the district's property wealth per student to the equalized wealth level by detaching certain types of property from the district and annexing the property to a property-poor district or, if necessary, consolidate the district with a property-poor district. Provisions governing detachment and annexation of taxable property by the Commissioner do not provide for assumption of any of the transferring district's existing debt. The Commissioner has not been required to detach property in the absence of a district failing to select another wealth-equalization option.

## **THE SCHOOL FINANCE SYSTEM AS APPLIED TO THE SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

The District's wealth per student for the 2011-12 school year is less than the equalized wealth value. Accordingly, the District has not been required to exercise one of the permitted wealth equalization options. As a district with wealth per student less than the equalized wealth value, the District may benefit in the future by agreeing to accept taxable property or funding assistance from or agreeing to consolidate with a property-rich district to enable such district to reduce its wealth per student to the permitted level.

A district's wealth per student must be tested for each future school year and, if it exceeds the maximum permitted level, must be reduced by exercise of one of the permitted wealth equalization options. Accordingly, if the District's wealth per student should exceed the maximum permitted level in future school years, it will be required each year to exercise one or more of the wealth reduction options. If the District were to consolidate (or consolidate its tax base for all purposes) with a property-poor district, the outstanding debt of each district could become payable from the consolidated district's combined property tax base, and the District's ratio of taxable property to debt could become diluted. If the District were to detach property voluntarily, a portion of its outstanding debt (including the Bonds) could be assumed by the district to which the property is annexed, in which case timely payment of the Bonds could become dependent in part on the financial performance of the annexing district.

As described above under "CURRENT PUBLIC SCHOOL FINANCE SYSTEM - 2011 Legislation" during the 82nd legislative sessions in 2011, the Texas Legislature adopted SB 1, which failed to fully fund the Finance System for the 2012-13 State biennium. As a result of the funding action in the 2011 Legislature, and as compared to State funding for fiscal year 2011, the District expects to have its State funding reduced by approximately \$400,000 during the 2011-12 fiscal year and \$500,000 during the 2012-13 fiscal year (such reductions are net of additional local ad valorem tax revenues generated in each year). The estimated reduction in State funding for fiscal years 2011-12 and 2012-13 will be offset by reductions in expenditures in various categories including, but not limited to, the reduction in twelve positions over the past two years along with specific line item cuts in expenses.

## **AD VALOREM TAX PROCEDURES**

### **Tax Code and County-Wide Appraisal District**

The Texas Tax Code, as amended, (the "Tax Code"), provides for county-wide appraisal and equalization of taxable property values and establishes in each county of the State an appraisal district and an appraisal review board responsible for appraising property for all taxable units within the county. The Fayette County Appraisal District (the "Appraisal District") is responsible for appraising property within the District, generally, as of January 1 of each year. The appraisal values set by the Appraisal District are subject to review and change by the

Appraisal Review Board (the "Appraisal Review Board"), the members of which are appointed by the Appraisal District. Such appraisal rolls, as approved by the Appraisal Review Board, are used by the District in establishing its tax roll and tax rate.

### **Property Subject to Taxation by the District**

Except for certain exemptions provided by Texas law, all real and certain tangible personal property with a tax situs in the District is subject to taxation by the District. Principal categories of exempt property (including certain exemptions which are subject to local option by the Board of Trustees) include property owned by the State of Texas or its political subdivisions if the property is used for public purposes; property exempt from ad valorem taxation by federal law; certain improvements to real property and certain tangible personal property located in designated reinvestment zones on which the District has agreed to abate ad valorem taxes; so-called "freeport property" including property detained in the District for up to 175 days for purpose of assembly or other processing; certain household goods, family supplies and personal effects; farm products owned by the producers; certain real property and tangible personal property owned by a non-profit community business organization or a charitable organization. Other principal categories of exempt property include tangible personal property not held or used for production of income; solar and windpowered energy devices; most individually owned automobiles; \$10,000 exemption to residential homesteads of disabled persons or persons ages 65 or over; an exemption from \$5,000 to a maximum of \$12,000 for real or personal property of disabled veterans or the surviving spouse or children of a deceased veteran who died while on active duty in the armed forces; \$15,000 in market value for all residential homesteads, (see "Residential Homestead Exemption" below); and certain classes of intangible property. Effective January 1, 2010, State law mandates a complete exemption for the residential homestead of disabled veterans determined to be 100% disabled by the U.S. Department of Veterans Affairs.

A city or a county may create a tax increment financing district ("TIF") within the city or county, as applicable, with defined boundaries and establish a base value of taxable property in the TIF at the time of its creation. Overlapping taxing units, including school districts, may agree with the city or county to contribute all or part of future ad valorem taxes levied and collected against the "incremental value" (taxable value in excess of the base value) of taxable real property in the TIF to pay or finance the costs of certain public improvements in the TIF, and such taxes levied and collected for and on behalf of the TIF are not available for general use by such contributing taxing units. Effective September 1, 2001, school districts may not enter into tax abatement agreements under the general statute that permits cities and counties to initiate tax abatement agreements. Under current law, the Comptroller of Public Accounts is to determine taxable value of property within each school district in the State (which taxable value figure is used in calculating a district's wealth per student) and in making such determination the taxable value is to exclude (i) the total dollar amount of any captured appraised value of property located in a reinvestment zone on August 31, 1999, that generates taxes paid into a tax increment fund and is eligible for tax increment financing under a reinvestment zone financing plan approved before September 1, 1999, and (ii) the total dollar value of taxable property covered by a tax abatement agreement entered into prior to June 1, 1993. Notwithstanding the foregoing, in 2001 the Legislature enacted legislation known as the Texas Economic Development Act, which provides incentives for certain school districts to grant tax abatements on certain eligible property to encourage economic development in their tax base and provides additional State funding for each year of such tax abatement in the amount of the tax credit provided to the taxpayer by the district.

Article VIII, Section 1-j of the Texas Constitution provides for an exemption from ad valorem taxation for "freeport property," which is defined as goods detained in the State for 175 days or less for the purpose of assembly, storage, manufacturing, processing or fabrication. Taxing units that took action prior to April 1, 1990, may continue to tax freeport property and decisions to continue to tax freeport property may be reversed in the future. However, decisions to exempt freeport property are not subject to reversal.

Article VIII, section 1-n of the Texas Constitution provides for the exemption from taxation of "goods-in-transit." "Goods-in-transit" is defined by a provision of the Tax Code, which is effective for tax years 2008 and thereafter, as personal property acquired or imported into Texas and transported to another location in the State or outside of the State within 175 days of the date the property was acquired or imported into Texas. The exemption excludes oil, natural gas, petroleum products, aircraft and special inventory, including motor vehicle, vessel and out-board motor, heavy equipment and manufactured housing inventory. The Tax Code provision permits local governmental entities, on a local option basis, to take official action by January 1 of the year preceding a tax year, after holding a public hearing, to tax goods-in-transit during the following tax year. A taxpayer may receive only one of the freeport exemptions or the goods-in-transit exemptions for items of personal property.

### **Valuation of Property for Taxation**

Generally, property in the District must be appraised by the Appraisal District at market value as of January 1 of each year. In determining the market value of property, different methods of appraisal may be used, including the cost method of appraisal, the income method of appraisal and market data comparison method of appraisal. The Appraisal District's chief appraiser determines the method to be used. Once an appraisal roll is prepared and finally approved by the Appraisal Review Board, it is used by the District in establishing its tax rolls and tax rate. Assessments under the Tax Code are based on one hundred percent (100%) of market value, except as described below, and no assessment ratio can be applied.

State law further limits the appraised value of a residence homestead for a tax year to an amount not to exceed the lesser of (1) the market value of the property or (2) 110% of the appraised value of the resident homestead for the preceding tax year plus the market value of all new improvements to the property.

The Tax Code permits land designated for agricultural use, open space or timberland to be appraised at its value based on the land's capacity to produce agricultural or timber products rather than at its fair market value. Landowners wishing to avail themselves of the agricultural use designation must apply for the designation, and the appraiser is required by the Tax Code to act on each claimant's right to the designation individually. If a claimant receives the designation and later loses it by changing the use of the property or selling it to an unqualified owner, the District can collect taxes for previous years based on the new value, including three years for agricultural use and five years for agricultural open-space land and timberland prior to the loss of the designation.

The Tax Code requires the Appraisal District to implement a plan for periodic reappraisal of property to update appraisal values. The plan must provide for appraisal of all real property in the Appraisal District at least once every three years. The District, at its expense, has the right to obtain from the Appraisal District a current estimate of appraised values within the District or an estimate of any new property or improvements within the District. While such current estimate of appraisal values may serve to indicate the rate and extent of growth of taxable values within the District, it cannot be used for establishing a tax rate within the District until such time as the Appraisal District chooses to formally include such values on its appraisal rolls.

### **Residential Homestead Exemption**

The Texas Constitution permits the exemption of certain percentages of the market value of residential homesteads from ad valorem taxation. The Constitution authorizes the governing body of each political subdivision in the State to exempt up to twenty percent (20%) of the market value of all residential homesteads from ad valorem taxation, and permits an additional optional homestead exemption for taxpayers 65 years of age or older and disabled persons.

### **District and Taxpayer Remedies**

Under certain circumstances, taxpayers and taxing units, including the District, may appeal an order of the Appraisal Review Board by filing a petition for review in district court within 45 days after notice is received that a final order has been entered. In such event, the property value in question may be determined by the court, or by a jury, if requested by any party, or through binding arbitration, if requested by the taxpayer. Additionally, taxing units may bring suit against the Appraisal District to compel compliance with the Tax Code.

### **Public Hearing and Rollback Tax Rate**

In setting its annual tax rate, the governing body of a school district generally cannot adopt a tax rate exceeding the district's "rollback tax rate" without approval by a majority of the voters voting at an election approving the higher rate. The tax rate consists of two components: (1) a rate for funding of maintenance and operation expenditures and (2) a rate for debt service. The rollback tax rate for a school district is the lesser of (A) the sum of (1) the product of the district's "State Compression Percentage" for that year multiplied by \$1.50, (2) the rate of \$0.04, (3) any rate increase above the rollback tax rate in prior years that were approved by voters, and (4) the district's current debt rate, or (B) the sum of (1) the district's effective maintenance and operations tax rate, (2) the product of the district's State Compression Percentage for that year multiplied by \$0.06; and (3) the district's current debt rate (see "CURRENT PUBLIC SCHOOL FINANCE SYSTEM - Local Funding for School Districts" for a description of the "State Compression Percentage"). If for the preceding tax year a district adopted a maintenance and operation tax ("M&O tax") rate that was less than its effective M&O tax rate for that preceding tax year, the district's rollback tax for the current year is calculated as if the district had adopted an M&O tax rate for the preceding tax year equal to its effective M&O tax rate for that preceding tax year.

The "effective maintenance and operations tax rate" for a school district is the tax rate that, applied to the current tax values, would provide local maintenance and operating funds, when added to State funds to be distributed to the district pursuant to Chapter 42 of the Texas Education Code, as amended, for the school year beginning in the current tax year, in the same amount as would have been available to the district in the preceding year if the funding elements of wealth equalization and State funding for the current year had been in effect for the preceding year.

Section 26.05 of the Property Tax Code, as amended, provides that the governing body of a taxing unit is required to adopt the annual tax rate for the unit before the later of September 30 or the 60th day after the date the certified appraisal roll is received by the taxing unit, and a failure to adopt a tax rate by such required date will result in the tax rate for the taxing unit for the tax year to be the lower of the effective tax rate calculated for that tax year or the tax rate adopted by the taxing unit for the preceding tax year. Before adopting its annual tax rate, a public meeting must be held for the purpose of adopting a budget for the succeeding year. A notice of public meeting to discuss budget and proposed tax rate must be published in the time, format and manner prescribed in Section 44.004 of the Texas Education Code, as amended. Section 44.004(e) of the Texas Education Code provides that a person who owns taxable property in a school district is entitled to an injunction restraining the collection of taxes by the district if the district has not complied with such notice requirements or the language and format requirements of such notice as set forth in Section 44.004(b), (c) and (d) and if such failure to comply was not in good faith. Section 44.004(e) further provides the action to enjoin the collection of taxes must be filed before the date the district delivers substantially all of its tax bills. A district may adopt its budget after adopting a tax rate for the tax year in which the fiscal year covered by the budget begins if the district elects to adopt its tax rate before receiving the certified appraisal roll. A district that adopts a tax rate before adopting its budget must hold a public hearing on the proposed tax rate followed by another public hearing on the proposed budget rather than holding a single hearing on the two items.

## **Tax Freeze**

Pursuant to a constitutional amendment approved by the voters on May 12, 2007, legislation was enacted to reduce the school property tax limitation imposed by the freeze on taxes paid on residence homesteads of persons 65 years of age or over or of disabled persons to correspond to reductions in local school district tax rates from the 2005 tax year to the 2006 tax year and from the 2006 tax year to the 2007 tax year (see "CURRENT PUBLIC SCHOOL FINANCE SYSTEM - General" herein). The school property tax limitation provided by the constitutional amendment and enabling legislation apply to the 2007 and subsequent tax years.

## **Levy and Collection of Taxes**

The District is responsible for the collection of its taxes, unless it elects to transfer such function to another governmental entity. By September 30 or the 60<sup>th</sup> day after the District receives the appraisal roll, whichever is later, the rate of taxation must be set by the Board of Trustees of the District based upon the valuation of property within the District as of the preceding January 1. Taxes are due October 1, or when billed, whichever comes later, and become delinquent after January 31 of the following year. A delinquent tax incurs a penalty from six percent (6%) to twelve percent (12%) of the amount of the tax, depending on the time of payment, and accrued interest at the rate of one percent (1%) per month. If the tax is not paid by the following July 1, an additional penalty of up to twenty percent (20%) may under certain circumstances be imposed by the District. The Tax Code also makes provision for the split payment of taxes, discounts for early payment and the postponement of the delinquency date of taxes under certain circumstances.

## **District's Rights in the Event of Tax Delinquencies**

Taxes levied by the District are a personal obligation of the owner of the property. The District has no lien for unpaid taxes on personal property but does have a lien for unpaid taxes upon real property, which lien is discharged upon payment. On January 1 of each year, such tax lien attaches to property to secure the payment of all taxes, penalties, and interest ultimately imposed for the year on the property. The District's tax lien is on a parity with the tax liens of other such taxing units. A tax lien on real property taxes takes priority over the claims of most creditors and other holders of liens on the property encumbered by the tax lien, whether or not the debt or lien existed before the attachment of the tax lien. Personal property, under certain circumstances, is subject to seizure and sale for the payment of delinquent taxes, penalty, and interest.

Except with respect to taxpayers who are 65 years of age or older, at any time after taxes on property become delinquent, the District may file suit to foreclose the lien securing payment of the tax, to enforce personal liability for the tax, or both. In filing a suit to foreclose a tax lien on real property, the District must join other taxing units that have claims for delinquent taxes against all or part of the same property.

Collection of delinquent taxes may be adversely affected by the amount of taxes owed to other taxing units, by the effects of market conditions on the foreclosure sale price, by taxpayer redemption rights, or by bankruptcy proceedings which restrict the collection of taxpayer debts.

Federal bankruptcy law provides that an automatic stay of actions by creditors and other entities, including governmental units, goes into effect with the filing of any petition in bankruptcy. The automatic stay prevents governmental units from foreclosing on property and prevents liens for post-petition taxes from attaching to property and obtaining secured creditor status unless, in either case, an order lifting the stay is obtained from the bankruptcy court. In many cases post-petition taxes are paid as an administrative expense of the estate in bankruptcy or by order of the bankruptcy court.

## **Penalties and Interest**

Charges for penalty and interest on the unpaid balance of delinquent taxes are made as follows:

<u>Month</u>	<u>Cumulative Penalty</u>	<u>Cumulative Interest</u>	<u>Total</u>
February	6%	1%	7%
March	7	2	9
April	8	3	11
May	9	4	13
June	10	5	15
July	12	6	18

After July, the cumulative penalty remains at 12%, and interest increases at the rate of 1% each month. In addition, if an account is delinquent in July, a 20% attorney's collection fee may be added to the total tax, penalty and interest charge.

## **District Application of Tax Code**

The District has not granted an additional exemption to the market value of the residence homestead of persons 65 years of age or older, over the state-mandated exemption. The District has not granted an additional exemption to the market value of residence homesteads; minimum exemption of \$5,000. The exemption for a disabled veteran is equal to 100% of the market value of the residence homestead.

Ad valorem taxes are not levied by the District against the exempt value of residence homesteads for the payment of debt. The District does not tax nonbusiness personal property. The District does permit split payments and discounts are not allowed. The district does not tax Freeport property. The District has not entered into tax abatement agreements. The District does tax goods in transit.

### **TAX RATE LIMITATIONS**

A school district is authorized to levy maintenance and operation ("M&O") taxes subject to approval of a proposition submitted to district voters. The maximum M&O tax rate that may be levied by a district cannot exceed the voted maximum rate or the maximum rate described in the next succeeding paragraph. The maximum voted M&O tax rate for the District is \$1.50 per \$100 of assessed valuation as approved by the voters at an election held on February 19, 1966 pursuant to Article 2784e-1, Texas Revised Civil Statutes Annotated, as amended ("Article 2784e-1"). Article 2784e-1 limits the District's annual M&O tax rate based upon a comparison between the District's outstanding bonded indebtedness and the District's taxable assessed value per \$100 of assessed valuation. Article 2784e-1 provides for a reduction of \$0.10 for each one percent (1%) or major fraction thereof increase in bonded indebtedness beyond seven percent (7%) of assessed valuation of property in the District. This limitation is capped when the District's bonded indebtedness is ten percent (10%) (or greater) of the District's assessed valuation which would result in an annual M&O tax rate not to exceed \$1.20. Lastly, the Texas Attorney General in reviewing the District's transcript of proceedings will allow the District to reduce the amount of its outstanding bonded indebtedness by the amount of funds (on a percentage basis) that the District receives in State assistance for the repayment of this bonded indebtedness (For example, if the District anticipates that it will pay 75% of its bonded indebtedness from State assistance, for the purposes of Article 2784e-1, the Texas Attorney General will assume that only 25% of the District's bonded indebtedness is outstanding and payable from local ad valorem taxes). The bonded indebtedness of the District after the issuance of the Bonds will be approximately 1.83% of the District's current taxable assessed valuation of property. See "TAX INFORMATION - Table 1 Valuation, Exemptions and Tax Supported Debt" herein.

The maximum tax rate per \$100 of assessed valuation that may be adopted by the District may not exceed the lesser of (A) \$1.50, or such lower rate as described in the preceding paragraph, and (B) the sum of (1) the rate of \$0.17, and (2) the product of the "State Compression Percentage" multiplied by \$1.50. The State Compression Percentage has been set, and will remain, at 66.67% for fiscal years 2007–08 through 2012–13. The State Compression Percentage is set by legislative appropriation for each State fiscal biennium or, in the absence of legislative appropriation, by the Commissioner. For a more detailed description of the State Compression Percentage, see "CURRENT PUBLIC SCHOOL FINANCE SYSTEM - Local Funding for School Districts". Furthermore, a school district cannot annually increase its tax rate in excess of the district's "rollback tax rate" without submitting such tax rate to a referendum election and a majority of the voters voting at such election approving the adopted rate. See "TAX INFORMATION - Public Hearing and Rollback Tax Rate."

### **EMPLOYEES' BENEFIT PLANS**

The District's employees participate in a retirement plan (the "Plan") with the State of Texas. The Plan is administered by the Teacher Retirement System of Texas ("TRS"). State contributions are made to cover costs of the TRS retirement plan up to certain statutory limits. The District is obligated for a portion of TRS costs relating to employee salaries that exceed the statutory limit. For the year ended August 31, 2010, the State contributed \$273,736 to TRS on behalf of the District, District employees paid \$283,541 and other contributions into the plan made from private grants and from the District for salaries above the statutory minimum were \$74,919.

In addition to the TRS retirement plan, the District provides health care coverage for its employees. For a discussion of the TRS retirement plan and the District's medical benefit plan, see the audited financial statements of the District that are attached hereto as Appendix B.

Formal collective bargaining agreements relating directly to wages and other conditions of employment are prohibited by Texas law, as are strikes by teachers. There are various local, state and national organized employee groups who engage in efforts to better the terms and conditions of employment of school employees. Some districts have adopted a policy to consult with employer groups with respect to certain terms and conditions of employment. Some examples of these groups are the Texas State Teachers Association, the Texas Classroom Teachers Association, the Association of Texas Professional Educators and the National Education Association.

### **THE DISTRICT**

The District, an independent school district and political subdivision of the State of Texas is located within Fayette County, Texas. Fayette County, along with other overlapping governmental entities, has authority to levy ad valorem taxes. See Appendix A, Table 6, "ESTIMATED OVERLAPPING DEBT." Generally, see Appendix A – Information Regarding the District" for more information regarding the District.

#### **Administration**

The Board of Trustees is the governing body of the District and consists of seven members, who serve three-year terms without salary. The District is under the administrative supervision of the Superintendent of Schools, who is employed by the Board.

## District School Operations

On October 1, 2011, the District owned and operated an elementary school and a secondary school.

	<b>Fiscal Year Ended August 31</b>				
	<b>2012<sup>(a)</sup></b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Enrollment	723	727	745	739	742
Average Daily Attendance	697	693	699	690	685
Cost Per Student	\$8,741	\$8,822	\$8,987	\$8,800	\$9,497

<sup>(a)</sup> Projected.

## Governmental Fund Types

*General Fund* – is the government’s primary operating fund. It accounts for all financial resources of the District, except those required to be accounted for in another fund. Major revenue sources include local property taxes; state funding under the Foundation School Program and interest earnings. Expenditures include all costs associated with the daily operations of the District except for specific programs funded by the federal and state government, food service, debt service, and capital projects.

*Food Service Special Revenue Fund* – is established to account for federally financed and expenditures legally restricted for the food service program. The food service special revenue fund is the only required budgeted fund. Major revenue sources include fees charged for meals and federal (National School Lunch Program (NSLP)) revenues. Expenditures include all costs associated with the direct daily operations of food service program.

The District’s food service special revenue fund is considered a special revenue fund since it meets the following criteria: (1) User fees are charged to supplement the NSLP, (2) the General Fund subsidizes the food service program for all expenditures in excess of NSLP, and (3) the District does not consider the food service program completely self-supporting. Food service special revenue fund balances are used exclusively for child nutrition program purposes.

*Capital Projects Fund* – accounts for the resources accumulated and made for Board authorized acquisition, construction, or renovation, as well as, furnishing and equipping of major capital facilities. The major revenue source includes investment earnings and other resources from proceeds from sale of general obligation bonded debt.

*Internal Service Funds* – account for the District’s self-funded dental insurance plan provided for the benefit of eligible employees and its self-funded worker’s compensation program. The revenues of these funds are received from both the general and special revenue funds, and District employees and the expenses are comprised of claims paid on behalf of the District and its employees. The general fund is contingently liable for liabilities of these funds. Sub-fund accounting is employed to maintain the integrity of the various self-insurance activities of the District.

*Proprietary Funds* – distinguish operating revenues and expense from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund’s principal ongoing operations.

*Private-Purpose Trust Funds* – used to account for donations for endowments received from individuals and/or organizations for specified donor purposes for which the principal and earned interest or revenue may be used.

*Agency Fund* – accounts for resources held in a custodial capacity by the District, and consists of funds that are the property of students or others.

## INVESTMENTS

The District invests its funds in investments authorized by Texas law in accordance with investment policies approved by the Board of Trustees. Both State law and the District’s investment policies are subject to change.

### Legal Investments

Available District funds are invested as authorized by Texas law and in accordance with investment policies approved by the Board of Trustees. Both State law and the District’s investment policies are subject to change. Under Texas law, the District is authorized to invest in (1) obligations of the United States or its agencies and instrumentalities, including letters of credit; (2) direct obligations of the State of Texas or its agencies and instrumentalities; (3) collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States; (4) other obligations, the principal and interest of which is guaranteed or insured by or backed by the full faith and credit of, the State of Texas or the United States or their respective agencies and instrumentalities; (5) obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than “A” or its equivalent;

(6) bonds issued, assumed or guaranteed by the State of Israel; (7) certificates of deposit meeting the requirements of the Public Funds Investment Act (Chapter 2256, Texas Government Code) that are issued by or through an institution that either has its main office or a branch in Texas, and are guaranteed or insured by the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund, or are secured as to principal by obligations described in clauses (1) through (6) or in any other manner and amount provided by law for District deposits; (8) fully collateralized repurchase agreements that have a defined termination date, are fully secured by obligations described in clause (1), and are placed through a primary government securities dealer or a financial institution doing business in the State of Texas; (9) securities lending programs if (i) the securities loaned under the program are 100% collateralized, a loan made under the program allows for termination at any time and a loan made under the program is either secured by (a) obligations that are described in clauses (1) through (6) above, (b) irrevocable letters of credit issued by a state or national bank that is continuously rated by a nationally recognized investment rating firm at not less than “A” or its equivalent or (c) cash invested in obligations described in clauses (1) through (6) above, clauses (11) through (13) below, or an authorized investment pool; (ii) securities held as collateral under a loan are pledged to the District, held in the District’s name and deposited at the time the investment is made with the District or a third party designated by the District; (iii) a loan made under the program is placed through either a primary government securities dealer or a financial institution doing business in the State of Texas; and (iv) the agreement to lend securities has a term of one year or less; (10) certain bankers’ acceptances with the remaining term of 270 days or less, if the shortterm obligations of the accepting bank or its parent are rated at least “A-1” or “P-1” or the equivalent by at least one nationally recognized credit rating agency; (11) commercial paper with a stated maturity of 270 days or less that is rated at least “A-1” or “P-1” or the equivalent by either (a) two nationally recognized credit rating agencies or (b) one nationally recognized credit rating agency if the paper is fully secured by an irrevocable letter of credit issued by a U.S. or state bank; (12) no-load money market mutual funds registered with and regulated by the Securities and Exchange Commission that have a dollar weighted average stated maturity of 90 days or less and include in their investment objectives the maintenance of a stable net asset value of \$1 for each share; and (13) no-load mutual funds registered with the Securities and Exchange Commission that have an average weighted maturity of less than two years, invest exclusively in obligations described in the this paragraph, and are continuously rated as to investment quality by at least one nationally recognized investment rating firm of not less than “AAA” or its equivalent. In addition, bond proceeds may be invested in guaranteed investment contracts that have a defined termination date and are secured by obligations, including letters of credit, of the United States or its agencies and instrumentalities in an amount at least equal to the amount of bond proceeds invested under such contract, other than the prohibited obligations described in the next succeeding paragraph.

The District may invest in such obligations directly or through government investment pools that invest solely in such obligations provided that the pools are rated no lower than “AAA” or “AAAm” or an equivalent by at least one nationally recognized rating service. The District may also contract with an investment management firm registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) or with the State Securities Board to provide for the investment and management of its public funds or other funds under its control for a term up to two years, but the District retains ultimate responsibility as fiduciary of its assets. In order to renew or extend such a contract, the District must do so by order, ordinance, or resolution. The District is specifically prohibited from investing in: (1) obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal; (2) obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security and bears no interest; (3) collateralized mortgage obligations that have a stated final maturity of greater than 10 years; and (4) collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

### **Investment Policies**

Under Texas law, the District is required to invest its funds under written investment policies that primarily emphasize safety of principal and liquidity; that address investment diversification, yield, maturity, and the quality and capability of investment management; and that include a list of authorized investments for District funds, maximum allowable stated maturity of any individual investment owned by the District and the maximum average dollar-weighted maturity allowed for pooled fund groups. All District funds must be invested consistent with a formally adopted “Investment Strategy Statement” that specifically addresses each fund’s investment. Each Investment Strategy Statement will describe its objectives concerning: (1) suitability of investment type, (2) preservation and safety of principal, (3) liquidity, (4) marketability of each investment, (5) diversification of the portfolio, and (6) yield.

Under Texas law, District investments must be made “with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person’s own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived”. At least quarterly the investment officers of the District shall submit an investment report detailing: (1) the investment position of the District, (2) that all investment officers jointly prepared and signed the report, (3) the beginning market value, any additions and changes to market value and the ending value of each pooled fund group, (4) the book value and market value of each separately listed asset at the beginning and end of the reporting period, (5) the maturity date of each separately invested asset, (6) the account or fund or pooled fund group for which each individual investment was acquired, and (7) the compliance of the investment portfolio as it relates to: (a) adopted Investment Strategy Statements and (b) State law. No person may invest District funds without express written authority from the Board of Trustees.

### **Additional Provisions**

Under Texas law, the District is additionally required to: (1) annually review its adopted policies and strategies; (2) adopt a rule, order, ordinance or resolution stating that it has reviewed its investment policy and investment strategies and records any changes made to either its investment policy or investment strategy in the respective rule, order, ordinance or resolution; (3) require any investment officers with personal business relationships or relatives with firms seeking to sell securities to the entity to disclose the relationship and file a statement

with the Texas Ethics Commission and the Board of Trustees; (4) require the qualified representative of firms offering to engage in an investment transaction with the District to: (a) receive and review the District's investment policy, (b) acknowledge that reasonable controls and procedures have been implemented to preclude investment transactions conducted between the District and the business organization that are not authorized by the District's investment policy (except to the extent that this authorization is dependent on an analysis of the makeup of the District's entire portfolio or requires an interpretation of subjective investment standards), and (c) deliver a written statement in a form acceptable to the District and the business organization attesting to these requirements; (5) perform an annual audit of the management controls on investments and adherence to the District's investment policy; (6) provide specific investment training for the Treasurer, Chief Financial Officer and investment officers; (7) restrict reverse repurchase agreements to not more than 90 days and restrict the investment of reverse repurchase agreement funds to no greater than the term of the reverse purchase agreement; (8) restrict the investment in non-money market mutual funds in the aggregate to no more than 15% of the District's monthly average fund balance, excluding bond proceeds and reserves and other funds held for debt service; (9) require local government investment pools to conform to the new disclosure, rating, net asset value, yield calculation, and advisory board requirements; and (10) at least annually review, revise, and adopt a list of qualified brokers that are authorized to engage in investment transactions with the District.

### **Current Investments**

As of August 31, 2011, the District had approximately \$307,548 invested in Lone Star Investment Pool and \$21,375 invested in a money market account with the local depository. The market value of such investments is approximately 100% of their book value. No funds of the District are invested in derivative securities; i.e., securities whose rate of return is determined by reference to some other instrument, index or commodity.

## **TAX MATTERS**

### **Tax Exemption**

In the opinion of Andrews Kurth LLP, Houston, Texas, Bond Counsel, interest on the Bonds is (1) excludable under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), from gross income of the owners thereof for federal income tax purposes and (2) is not includable in the alternative minimum taxable income of individuals or corporations, except as described below.

The foregoing opinions of Bond Counsel are based on the Code and the regulations, rulings and court decisions thereunder in existence on the date of issue of the Bonds. Such authorities are subject to change and any such change could prospectively or retroactively result in the inclusion of the interest on the Bonds in gross income of the owners thereof or change the treatment of such interest for purposes of computing alternative minimum taxable income.

In rendering its opinions, Bond Counsel has assumed continuing compliance by the District with certain covenants of the Order authorizing the issuance of the Bonds (the "Order") and has relied on representations by the District with respect to matters solely within the knowledge of the District, which Bond Counsel has not independently verified. The covenants and representations relate to, among other things, the use of Bond proceeds and any facilities financed therewith, the source of repayment of the Bonds, the investment of Bond proceeds and certain other amounts prior to expenditure, and requirements that excess arbitrage earned on the investment of Bond proceeds and certain other amounts be paid periodically to the United States and that the District file an information report with the Internal Revenue Service (the "Service"). If the District should fail to comply with the covenants in the Order, or if its representations relating to the Bonds that are contained in the Order should be determined to be inaccurate or incomplete, interest on the Bonds could become taxable from the date of delivery of the Bonds, regardless of the date on which the event causing such taxability occurs.

Interest on all tax-exempt obligations, such as the Bonds, owned by a corporation (other than an S corporation, a regulated investment company, a real estate investment trust (REIT), a real estate mortgage investment conduit (REMIC) or a financial asset securitization investment trust (FASIT)) will be included in such corporation's adjusted current earnings for purposes of calculating such corporation's alternative minimum taxable income. A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by the Code is computed.

Except as stated above, Bond Counsel will express no opinion as to any federal, state or local tax consequences resulting from the ownership of, receipt or accrual of interest on or acquisition or disposition of the Bonds.

Bond Counsel's opinion is not a guarantee of a result, but represents its legal judgment based upon its review of existing statutes, regulations, published rulings and court decisions and the representations and covenants of the District described above. No ruling has been sought from the Service with respect to the matters addressed in the opinion of Bond Counsel, and Bond Counsel's opinion is not binding on the Service. The Service has an ongoing program of auditing the tax-exempt status of the interest on municipal obligations. If an audit of the Bonds is commenced, under current procedures the Service is likely to treat the District as the "taxpayer," and the owners of the Bonds may have no right to participate in the audit process. In responding to or defending an audit of the tax-exempt status of the interest on the Bonds, the District may have different or conflicting interests from the owners of the Bonds. Public awareness of any future audit of the Bonds could adversely affect the value and liquidity of the Bonds during the pendency of the audit, regardless of its ultimate outcome.

Under the Code, taxpayers are required to provide information on their returns regarding the amount of tax-exempt interest, such as interest on the Bonds, received or accrued during the year.

Prospective purchasers of the Bonds should be aware that the ownership of tax-exempt obligations, such as the Bonds, may result in collateral federal income tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain foreign corporations doing business in the United States, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who are deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations, taxpayers owning an interest in a FASIT that holds tax-exempt obligations, and individuals otherwise eligible for the earned income tax credit. Such prospective purchasers should consult their tax advisors as to the consequences of investing in the Bonds.

### **Impact of Proposed Jobs Creation Act**

On September 12, 2011, President Obama released the language of his proposed Jobs Creation Act of 2011 (the “Act”). One of the provisions of the Act would have the effect of imposing an additional amount of tax on certain “high income” taxpayers based on, among other things, the amount of interest on tax-exempt obligations, such as the Bonds, received by such taxpayers. As originally proposed, the Act will be effective for taxable years beginning on or after January 1, 2013, and will apply to interest on the Bonds and other tax-exempt obligations received by such taxpayers on or after that date. The introduction or enactment of the Act or any similar legislative proposal may also affect the market price for, or marketability of, the Bonds. Prospective purchasers of the Bonds are advised to consult their tax advisors with respect to any impact of the Act or other legislative proposals, as to which Bond Counsel expresses no opinion.

## **TAX TREATMENT OF ORIGINAL ISSUE DISCOUNT AND PREMIUM BONDS**

### **Discount Bonds**

Some of the Bonds may be offered at initial offering prices which are less than the stated redemption prices at maturity of such Bonds. If a substantial amount of any maturity of the Bonds is sold to members of the public (which for this purpose excludes bond houses, brokers and similar persons or entities acting in the capacity of wholesalers or underwriters) at such initial offering price, an initial owner who purchases the Bonds of that maturity (the “Discount Bonds”) will be considered to have “original issue discount” for federal income tax purposes equal to the difference between (a) the stated redemption price payable at the maturity of such Discount Bond and (b) the initial offering price to the public of such Discount Bond. Under existing law, such original issue discount will be treated for federal income tax purposes as additional interest on a Bond and such initial owner will be entitled to exclude from gross income for federal income tax purposes that portion of such original issue discount deemed to be earned (as discussed below) during the period while such Discount Bond continues to be owned by such initial owner. Except as otherwise provided herein, the discussion regarding interest on the Bonds under the caption “TAX MATTERS – Tax Exemption” generally applies to original issue discount deemed to be earned on a Discount Bond while held by an owner who has purchased such Bond at the initial offering price in the initial public offering of the Bonds and that discussion should be considered in connection with this portion of the Official Statement.

In the event of a redemption, sale, or other taxable disposition of a Discount Bond prior to its stated maturity, however, any amount realized by such initial owner in excess of the basis of such Discount Bond in the hands of such owner (increased to reflect the portion of the original issue discount deemed to have been earned while such Discount Bond continues to be held by such initial owner) will be includable in gross income for federal income tax purposes.

Because original issue discount on a Discount Bond will be treated for federal income tax purposes as interest on a Bond, such original issue discount must be taken into account for certain federal income tax purposes as it is deemed to be earned even though there will not be a corresponding cash payment. Corporations that purchase Discount Bonds must take into account original issue discount as it is deemed to be earned for purposes of determining alternative minimum tax. Other owners of a Discount Bond may be required to take into account such original issue discount as it is deemed to be earned for purposes of determining certain collateral federal tax consequences of owning a Bond. See “TAX MATTERS – Tax Exemption” for a discussion regarding the alternative minimum taxable income consequences for corporations and for a reference to collateral federal tax consequences for certain other owners.

The characterization of original issue discount as interest is for federal income tax purposes only and does not otherwise affect the rights or obligations of the owner of a Discount Bond or of the District. The portion of the principal of a Discount Bond representing original issue discount is payable upon the maturity or earlier redemption of such Bond to the registered owner of the Discount Bond at that time. Under special tax accounting rules prescribed by existing law, a portion of the original issue discount on each Discount Bond is deemed to be earned each day. The portion of the original issue discount deemed to be earned each day is determined under an actuarial method of accrual, using the yield to maturity as the constant interest rate and semi-annual compounding.

The federal income tax consequences of the purchase, ownership, redemption, sale or other disposition of Discount Bonds by an owner that did not purchase such Bonds in the initial public offering and at the initial offering price may be determined according to rules which differ from those described above. All prospective purchasers of Discount Bonds should consult their tax advisors with respect to the determination for federal, state and local income tax purposes of interest and original issue discount accrued upon redemption, sale or other disposition of such Discount Bonds and with respect to the federal, state, local and foreign tax consequences of the purchase, ownership, redemption, sale or other disposition of such Discount Bonds.

## **Premium Bonds**

Some of the Bonds may be offered at initial offering prices which exceed the stated redemption prices payable at the maturity of such Bonds. If a substantial amount of any maturity of the Bonds is sold to members of the public (which for this purpose excludes bond houses, brokers and similar persons or entities acting in the capacity of wholesalers or underwriters) at such initial offering price, each of the Bonds of such maturity ("Premium Bonds") will be considered for federal income tax purposes to have "bond premium" equal to the amount of such excess. The basis for federal income tax purposes of a Premium Bond in the hands of an initial purchaser who purchases such Bond in the initial offering must be reduced each year and upon the sale or other taxable disposition of the Bond by the amount of amortizable bond premium. This reduction in basis will increase the amount of any gain (or decrease the amount of any loss) recognized for federal income tax purposes upon the sale or other taxable disposition of a Premium Bond by the initial purchaser. Generally, no corresponding deduction is allowed for federal income tax purposes, for the reduction in basis resulting from amortizable bond premium. The amount of bond premium on a Premium Bond which is amortizable each year (or shorter period in the event of a sale or disposition of a Premium Bond) is determined under special tax accounting rules which use a constant yield throughout the term of the Premium Bond based on the initial purchaser's original basis in such Bond.

The federal income tax consequences of the purchase, ownership, redemption, sale or other disposition by an owner of Bonds that are not purchased in the initial offering or which are purchased at an amount representing a price other than the initial offering prices for the Bonds of the same maturity may be determined according to rules which differ from those described above. Moreover, all prospective purchasers of Bonds should consult their tax advisors with respect to the federal, state, local and foreign tax consequences of the purchase, ownership, redemption, sale or other disposition of Premium Bonds.

## **QUALIFIED TAX-EXEMPT OBLIGATIONS**

Section 265(a) of the Code provides, in general, that interest expenses incurred to acquire or carry tax-exempt obligations are not deductible from the gross income of the holder. For certain holders that are "financial institutions" within the meaning of such section, complete disallowance of such expense would apply to taxable years beginning after December 31, 1986, with respect to tax-exempt obligations acquired after August 7, 1986. Section 265(b) of the Code provides an exception to this rule for interest expense incurred by financial institutions to carry tax-exempt obligations (other than certain private activity bonds) which are designated by an issuer as "qualified tax-exempt obligations." An issuer may only designate an issue as an issue of "qualified tax-exempt obligations" where less than \$10 million of tax-exempt obligations are issued by the issuer during the calendar year in which the issue so designated is issued.

The District will designate the Bonds as "qualified tax-exempt obligations." Further, the District will represent that it has or will take such action necessary for the Bonds to constitute "qualified tax-exempt obligations."

Notwithstanding the designation of the Bonds as "qualified tax-exempt obligations," financial institutions acquiring the Bonds will be subject to a twenty percent (20%) disallowance of interest expenses allocable to the Bonds.

## **CONTINUING DISCLOSURE OF INFORMATION**

In the Order, the District has made the following agreement for the benefit of the holders and beneficial owners of the Bonds. The District is required to observe the agreement for so long as it remains obligated to advance funds to pay the Bonds. Under the agreement, the District will be obligated to provide certain updated financial information and operating data annually, and timely notice of specified material events, to the Municipal Securities Rulemaking Board (the "MSRB"). Information will be available free of charge via the Electronic Municipal Market Access ("EMMA") system at [www.emma.msrb.org](http://www.emma.msrb.org). See "The Permanent School Fund Guarantee Program" for a description of the TEA's continuing disclosure under taking to provide certain updated financial information and operations data annually with respect to the PSF and the State, as the case may be, and to the provide timely notice of specified material events related to the guarantee to the MSRB.

## **Annual Reports**

The District will provide updated financial information and operating data to the MSRB annually via EMMA. The information to be updated includes all quantitative financial information and operating data of the general type included in this Official Statement in APPENDIX A, Tables 1 through 5 and Tables 7 through 10, and APPENDIX B. The District will update and provide this information within six months after the end of each fiscal year.

The District may provide updated information in full text or may incorporate by reference other publicly available documents, as permitted by SEC Rule 15c2-12 (the "Rule"). The updated information will include audited financial statements if the District commissions an audit and the audit is completed by the required time. If audited financial statements are not available by the required time, the District will provide such financial statements on an unaudited basis within the required time and audited financial statements when they become available. Any such financial statements will be prepared in accordance with the accounting principles described in APPENDIX B or such other accounting principles as the District may be required to employ from time to time pursuant to State law or regulation.

The District's current fiscal year-end is the last day of August. Accordingly, the District must provide updated information by the last day of February in each year, unless the District changes its fiscal year. If the District changes its fiscal year, it will notify the MSRB of the change.

### **Material Event Notices**

The District shall notify the MSRB in an electronic format, as prescribed by the MSRB, in a timely manner not in excess of ten business days after the occurrence of the event, of any of the following events with respect to the Bonds: (1) principal and interest payment delinquencies; (2) non-payment related defaults, if material; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax status of the Bonds; (7) modifications to rights of holders of the Bonds, if material; (8) bond calls, if material, and tender offers; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the Bonds, if material; (11) rating changes; (12) bankruptcy, insolvency, receivership or similar event of the District; (13) the consummation of a merger, consolidation, or acquisition involving the District or the System or the sale of all or substantially all of the assets of the District, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (14) appointment of a successor or additional trustee or the change of name of trustee, if material. The District shall notify the MSRB in an electronic format prescribed by the MSRB, in a timely manner, of any failure by the District to provide financial information or operating data in accordance with the Rule.

### **Limitations and Amendments**

The District has agreed to update information and to provide notices of material events only as described above. The District has not agreed to provide other information that may be relevant or material to a complete presentation of its financial results of operations, condition, or prospects or agreed to update any information that has been provided except as described above. The District makes no representation or warranty concerning such information or concerning its usefulness to a decision to invest in or sell Bonds at any future date. The District disclaims any contractual or tort liability for damages resulting in whole or in part from any breach of its continuing disclosure agreement or from any statement made pursuant to its agreement, although holders of Bonds may seek a writ of mandamus to compel the District to comply with its agreement. Nothing in this paragraph is intended or shall act to disclaim, waive or limit the District's duties under federal or state securities laws.

The District may amend its continuing disclosure agreement to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of the District, if, but only if, (1) the agreement, as so amended, would have permitted underwriters to purchase or sell Bonds in the initial primary offering in compliance with the Rule, taking into account any amendments or interpretations of the Rule to the date of such amendment, as well as such changed circumstances, and (2) either (a) the holders of a majority in aggregate principal amount of the outstanding Bonds consent or (b) any qualified person unaffiliated with the District (such as nationally recognized bond counsel) determines that the amendment will not materially impair the interests of the holders and beneficial owners of the Bonds. If the District amends its agreement, it has agreed to include with the financial information and operating data next provided, in accordance with its agreement described above under "Annual Reports," an explanation, in narrative form, of the reasons for the amendment and of the impact of any change in the type of information and operating data so provided.

### **Compliance with Prior Undertakings**

During the past five years, the District has complied in all material respects with its previous continuing disclosure requirements in accordance with the Rule.

## **OTHER INFORMATION**

### **Rating**

Moody's Investors Service ("Moody's") has assigned its municipal rating of "\_\_\_\_" to the Bonds by virtue of the guarantee of the Texas Permanent School Fund on the Bonds. Moody's has also assigned an underlying rating of "\_\_\_\_" to the Bonds. An explanation of the rating may be obtained from Moody's. The rating reflects only the views of Moody's and the District makes no representation as to the appropriateness of the rating. There is no assurance that such rating will continue for any given period of time or that it will not be revised downward or withdrawn entirely by Moody's if in the judgment of Moody's circumstances so warrant. Any such downward revision or withdrawal by such rating may have an adverse effect on the market price of the Bonds. (See "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM herein.")

## **No Litigation Certificate**

The District will furnish to the Underwriters a certificate, dated as of the date of delivery of the Bonds, executed by an authorized officer of the Board of Trustees, to the effect that, except as disclosed in this Official Statement, no litigation of any nature has been filed or is then pending or threatened, either in state or federal courts, contesting or attacking the Bonds; restraining or enjoining the issuance, execution or delivery of the Bonds; affecting the provisions made for the payment of or security for the Bonds; in any manner questioning the authority or proceedings for the issuance, execution, or delivery of the Bonds; or affecting the validity of the Bonds.

## **Registration and Qualification of Bonds for Sale**

No registration statement relating to the Bonds has been filed with the Securities and Exchange Commission under the federal Securities Act of 1933, as amended, in reliance upon the exemption provided thereunder by Section 3(a)(2); and the Bonds have not been registered or qualified under the Securities Act of Texas in reliance upon various exemptions contained therein; nor have the Bonds been registered or qualified under the securities acts of any other jurisdiction. The District assumes no responsibility for registration or qualification of the Bonds under the securities laws of any other jurisdiction in which the Bonds may be offered, sold or otherwise transferred. This disclaimer of responsibility for registration and qualification for sale or other disposition of the Bonds shall not be construed as an interpretation of any kind with regard to the availability of any exemption from securities registration or qualification provisions in such other jurisdictions.

## **The Bonds as Legal Investments in Texas**

Under the Texas Public Security Procedures Act (Texas Government Code, Chapter 1201, as amended), the Bonds (1) are negotiable instruments, (2) are investment securities to which Chapter 8 of the Texas Business and Commerce Code applies, and (3) are legal and authorized investments for (A) an insurance company, (B) a fiduciary or trustee, or (C) a sinking fund of a municipality or other political subdivision or public agency of the State of Texas. The Bonds are eligible to secure deposits of any public funds of the State, its agencies and political subdivisions, and are legal security for those deposits to the extent of their market value. With respect to investment in the Bonds by municipalities or other political subdivisions or public agencies of the State of Texas, the Public Funds Investment Act, Chapter 2256, Texas Government Code, as amended, requires the Bonds to be assigned a rating of "A" or its equivalent as to investment quality by a national rating agency. (See "Rating" above). In addition, various provisions of the Texas Finance Code provide that, subject to a prudent investor standard, the Bonds are legal investments for State banks, savings banks, trust companies with at least \$1 million of capital and savings and loan associations.

The District has made no investigation of other laws, rules, regulations or investment criteria which might apply to such institutions or entities or which might limit the suitability of the Bonds for any of the foregoing purposes or limit the authority of such institutions or entities to purchase or invest in the Bonds for such purposes. The District has made no review of laws in other states to determine whether the Bonds are legal investments for various institutions in those states.

## **Legal Matters**

The delivery of the Bonds is subject to the approving opinion of the Attorney General of Texas to the effect that the Bonds are valid and legally binding obligations of the District and the approving legal opinion of Andrews Kurth LLP, Bond Counsel to the District ("Bond Counsel"), in substantially the form attached as APPENDIX C. The legal fee to be paid Bond Counsel for services rendered in connection with the issuance of the Bonds is contingent upon the sale and delivery of the Bonds.

The District will furnish a complete transcript of proceedings had incident to the authorization and issuance of the Bonds, including the legal opinion of the Attorney General of the State of Texas and the approving legal opinion of Bond Counsel. Bond Counsel was engaged by and only represents the District. Bond Counsel was not requested to participate, and did not take part, in the preparation of this Official Statement, and such firm has not assumed any responsibility with respect thereto or undertaken independently to verify any of the information contained therein, except that, in its capacity as Bond Counsel, such firm has reviewed the statements and information contained in the Official Statement under the captions and sub-captions "THE BONDS," (except for the information under the sub-captions "Yield on CABs," "Book-Entry-Only System," "Bondholders' Remedies," and "Sources and Uses of Funds," as to which no opinion is expressed), and "CONTINUING DISCLOSURE OF INFORMATION" (except for the information under the sub-caption "Compliance With Prior Undertakings," as to which no opinion is expressed), and Bond Counsel is of the opinion that the statements and information contained therein fairly and accurately reflect the provisions of the Order; further, Bond Counsel has reviewed the statements and information contained in the Official Statement under the captions and sub-captions "STATE AND LOCAL FUNDING OF SCHOOL DISTRICTS IN TEXAS," "CURRENT PUBLIC SCHOOL FINANCE SYSTEM" (except for the information under "Possible Effects of Wealth Transfer Provisions on the District's Financial Condition," as to which no opinion is expressed), "AD VALOREM TAX PROCEDURES – Tax Rate Limitations" "TAX MATTERS," "TAX TREATMENT OF ORIGINAL ISSUE DISCOUNT AND PREMIUM BONDS," "QUALIFIED TAX EXEMPT OBLIGATIONS" "OTHER INFORMATION – Registration and Qualification of Bonds for Sale," "- The Bonds as Legal Investments in Texas," and "- Legal Matters," and Bond Counsel is of the opinion that the statements and information contained therein are correct as to matters of law. Certain legal matters will be passed upon for the Underwriters by their counsel, Petruska & Associates, A Professional Limited Liability Company, Dallas, Texas.

The various legal opinions to be delivered concurrently with the delivery of the Bonds express the professional judgment of the attorneys rendering the opinions as to the legal issues explicitly addressed therein. In rendering a legal opinion, the attorney does not become an insurer or guarantor of the expression of professional judgment, of the transaction opined upon, or of the future performance of the parties to the transaction. The rendering of an opinion does not guarantee the outcome of any legal dispute that may arise out of the transaction.

### **Verification of Accuracy of Mathematical Computations**

The arithmetical accuracy of certain computations included in the schedules provided by Coastal Securities, Inc. on behalf of the District relating to (a) computation of forecasted receipts of principal and interest on the restricted acquired obligations and the forecasted payments of principal and interest to redeem the Refunded Bonds, and (b) computation of the yields on the Bonds and the restricted obligations was examined by Grant Thornton LLP, Minneapolis, Minnesota, certified public accountants. Such computations were completed using certain assumptions and information supplied by Coastal Securities, Inc. Grant Thornton LLP has restricted its procedures to examining the arithmetical accuracy of certain computations and has not made any study or evaluation of the assumptions and information upon which the computations are based and, accordingly, has not expressed an opinion on the data used, the reasonableness of the assumptions or the achievability of the forecasted outcome.

### **Financial Advisor**

Coastal Securities, Inc. ("Coastal") is employed as Financial Advisor to the District in connection with the issuance of the Bonds. The Financial Advisor's fee for services rendered with respect to the sale of the Bonds is contingent upon the issuance and delivery of the Bonds. Coastal, in its capacity as Financial Advisor, has not verified and does not assume any responsibility for the information, covenants and representations contained in any of the legal documents with respect to the federal income tax status of the Bonds, or the possible impact of any present, pending or future actions taken by any legislative or judicial bodies.

Coastal has reviewed the information in this Official Statement in accordance with its responsibilities to the District and, as applicable, to investors under federal securities laws as applied to the facts and circumstances of this transaction, but Coastal does not guarantee the accuracy or completeness of such information.

### **Underwriting**

The Bonds are being purchased by the Underwriters pursuant to a bond purchase contract with the District, at a price of \$ \_\_\_\_\_, which reflects the par amount of the Bonds, less an underwriting discount (including underwriting expenses) of \$ \_\_\_\_\_, plus a net premium of \$ \_\_\_\_\_, plus accrued interest on the CIBs to the date of initial delivery.

The Underwriters' obligation to purchase the Bonds is subject to certain conditions precedent, and the Underwriters will be obligated to purchase all of the Bonds if any of the Bonds are purchased. The District has no control over the price at which the Bonds are subsequently sold and the initial yields at which the Bonds will be priced and reoffered will be established by and will be the responsibility of the Underwriters. The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

## **MISCELLANEOUS**

### **Forward Looking Statements**

The statements contained in this Official Statement, and in any other information provided by the District, that are not purely historical, are forward-looking statements, including statements regarding the District's expectations, hopes, intentions, or strategies regarding the future. Readers should not place undue reliance on such forward-looking statements. All forward-looking statements included in this Official Statement are based on information available to the District on the date hereof, and the District assumes no obligation to update any such forward-looking statements. It is important to note that the District's actual results could differ materially from those in such forward-looking statements.

The forward-looking statements herein are necessarily based on various assumptions and estimates and are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or developments in social, economic, business, industry, market, legal and regulatory circumstances and conditions and actions taken or omitted to be taken by third parties, including customers, suppliers, business partners and competitors, and legislative, judicial and other governmental authorities and officials. Assumptions related to the foregoing involve judgments with respect to, among things, future economic, competitive, and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of the District. Any of such assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Official Statement would prove to be accurate.

**Concluding Statement**

No person has been authorized to give any information or to make any representations other than those contained in this Official Statement, and if given or made, such other information or representations must not be relied upon as having been authorized by the District. This Official Statement does not constitute an offer to sell or solicitation of an offer to buy in any state in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such offer of solicitation.

The information set forth herein has been obtained from the District’s records, audited financial statements and other sources which the District considers to be reliable. There is no guarantee that any of the assumptions or estimates contained herein will ever be realized. All of the summaries of the statutes, documents and the Order contained in this Official Statement are made subject to all of the provisions of such statutes, documents, and the Order. These summaries do not purport to be complete statements of such provisions and reference is made to such summarized documents for further information. Reference is made to official documents in all respects.

The Order authorizing the issuance of the Bonds will also approve the form and content of this Official Statement and any addenda, supplement or amendment thereto and authorize its further use in the re-offering of the Bonds by the Underwriters.

This Official Statement has been approved by the Board of Trustees of the District for distribution in accordance with the provisions of the Rule.

SCHULENBURG INDEPENDENT SCHOOL DISTRICT

\_\_\_\_\_  
President, Board of Trustees

ATTEST:

\_\_\_\_\_  
Secretary, Board of Trustees

**SCHEDULE 1 - ESTIMATED TABLE OF ACCRETED VALUES OF CAPITAL APPRECIATION BONDS**

The following schedule is calculated based on the yields as of the date of sale, and is included for informational purposes only. The accreted values may not reflect market values in the secondary market from time to time, if any.

**APPENDIX A**  
**INFORMATION REGARDING THE DISTRICT**

**TABLE 1 - VALUATION, EXEMPTIONS AND TAX-SUPPORTED DEBT**

**District Direct Debt**

2011 Certified Net Taxable Valuation (100% of Estimated Market Value)	\$ 345,623,006
Outstanding Debt (August 31, 2011)	\$ 6,335,000
Plus: The Bonds	5,574,948 <sup>(a)</sup>
Less: Refunded Bonds	<u>5,575,000 <sup>(a)</sup></u>
Total Direct Debt	6,334,948
As a % of Assessed Valuation	1.83%

<sup>(a)</sup> Preliminary, subject to change.

**TABLE 2 - TAXABLE ASSESSED VALUATIONS BY CATEGORY <sup>(a)</sup>**

	<u>Tax Year</u> <u>2011</u>	<u>Tax Year</u> <u>2010</u>	<u>Tax Year</u> <u>2009</u>	<u>Tax Year</u> <u>2008</u>	<u>Tax Year</u> <u>2007</u>
Real Property	\$ 354,841,237	\$ 347,856,301	\$ 338,971,214	\$ 333,154,689	\$ 309,213,592
Personal Property	87,424,595	56,552,745	71,269,390	64,567,165	61,699,250
Mineral Values	<u>17,320,390</u>	<u>29,057,130</u>	<u>1,179,820</u>	<u>1,299,640</u>	<u>604,930</u>
Gross Value	\$ 459,586,222	\$ 433,466,176	\$ 411,420,424	\$ 399,021,494	\$ 371,517,772
Less Exemption(s) <sup>(b)</sup>	<u>113,963,216</u>	<u>112,675,334</u>	<u>107,375,198</u>	<u>103,952,520</u>	<u>95,955,247</u>
Net Taxable Value	\$ 345,623,006	\$ 320,790,842	\$ 304,045,226	\$ 295,068,974	\$ 275,562,525

<sup>(a)</sup> Values may differ from those shown elsewhere in the document due to subsequent additions, deletions, and adjustments to the tax rolls.

<sup>(b)</sup> Includes exemptions, productivity loss, freeze adjustments and cap adjustments.

**TABLE 3 - TAX RATE, LEVY AND COLLECTION HISTORY; TAX RATE DISTRIBUTION**

Fiscal Year End	Tax Year	Taxable Assessed Valuation <sup>(a)</sup>	Tax Rate	Tax Levy	Percent Collected	
					Current	Total <sup>(b)</sup>
2007	2006	\$ 273,385,909	\$ 1.4896	\$ 4,072,357	98.08%	100.02%
2008	2007	299,411,472	1.2053	3,608,806	98.52%	100.65%
2009	2008	312,518,932	1.2053	3,766,791	97.74%	99.06%
2010	2009	327,977,672	1.1988	3,931,796	97.55%	100.03%
2011	2010	320,790,842	1.1920	3,823,827	95.00%	96.00%
2012	2011	345,623,006	1.1802	4,079,043	(In process of Collection)	

<sup>(a)</sup> Net of exemptions. Assessed valuations do not include adjustments in supplemental rolls made after the end of each fiscal year.

<sup>(b)</sup> Excludes penalties and interest.

**Tax Rate Distribution (Tax Year)**

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Maintenance	\$ 1.04000	\$ 1.04000	\$ 1.04000	\$ 1.04000	\$ 1.04000
Debt Service	<u>0.14020</u>	<u>0.15200</u>	<u>0.15880</u>	<u>0.16530</u>	<u>0.16530</u>
Total	\$ 1.18020	\$ 1.19200	\$ 1.19880	\$ 1.20530	\$ 1.20530

**TABLE 4 - TEN LARGEST TAXPAYERS**

<u>Name</u>	<u>2011 Net Taxable Assessed Valuation</u>	<u>% of Total 2011 Assessed Valuation</u>
DAIRY FARMERS OF AMERICA	\$ 29,883,970	8.65%
PNC EQUIPMENT FINANCE LLC	21,644,540	6.26%
VALERUS COMPRESSION SERVICES	6,103,110	1.77%
B W I SCHULENBURG INC	6,054,680	1.75%
UNION PACIFIC RAILROAD CO	5,590,310	1.62%
WESTSIDE COMMUNITY DEVELOPMENT CORP	4,416,380	1.28%
W H K FAMILY INTEREST PARTNERSHIP LTD	3,720,100	1.08%
DIAMOND B HOLDINGS LTD	3,409,200	0.99%
LCRA TRANSMISSION SVCS CORP	3,062,060	0.89%
GRACYWOODS HOLDING INC	2,559,470	0.74%
	\$ 86,443,820	25.01%

**TABLE 5 - TAX ADEQUACY**

**Unlimited Tax Debt <sup>(a)</sup>**

Estimated Average Annual Debt Service Requirements (2012-2028):	\$ 476,393
\$0.1452 per \$100 AV against the 2011 Taxable AV, at 95% collection, produces <sup>(b)</sup>	\$ 476,869
Estimated Maximum Annual Debt Service Requirements (2028):	\$ 499,800
\$0.1524 per \$100 AV against the 2011 Taxable AV, at 95% collection, produces <sup>(b)</sup>	\$ 500,300

<sup>(a)</sup> Includes the Bonds and excludes the refunded Bonds.

**Limited Tax Debt**

Estimated Average Annual Debt Service Requirements (2012-2018):	\$ 42,950
\$0.0131 per \$100 AV against the 2011 Taxable AV, at 95% collection, produces	\$ 42,993
Estimated Maximum Annual Debt Service Requirements (2012-2017):	\$ 42,953
\$0.0131 per \$100 AV against the 2011 Taxable AV, at 95% collection, produces	\$ 42,996

**TABLE 6 - ESTIMATED OVERLAPPING DEBT**

The following summary of estimated outstanding ad valorem tax bonds of taxing entities in the District was compiled from a variety of sources listed below. No representation is made with respect to the accuracy or completeness of information obtained from sources other than the District. Furthermore, certain entities listed below may have issued substantial amounts of bonds since the dates shown in this table and may have capital improvements programs requiring the issuance of substantial amounts of additional bonds. Sources include: Texas Municipal Reports compiled and published by the Municipal Advisory Council of Texas, and the Fayette County Appraisal Districts.

<u>Taxing Jurisdiction</u>	<u>Total Debt <sup>(a)</sup></u>	<u>As of</u>	<u>Estimated % Overlapping</u>	<u>Overlapping Debt</u>
Fayette Co	\$ 1,801,000	7/31/2011	14.72%	\$ 265,107
Estimated Overlapping Debt	1,801,000			\$ 265,107
 The District	 \$ 6,334,948 <sup>(b)</sup>		100.00%	 6,334,948 <sup>(b)</sup>
Total Direct & Estimated Overlapping Debt				\$ 6,600,056
 As a % of 2011 Taxable Assessed Valuation				1.91%

<sup>(a)</sup> Gross debt.

<sup>(b)</sup> Includes the Bonds and excludes the refunded Bonds. Preliminary, subject to change.

**TABLE 7 - PRO FORMA TAX SUPPORTED DEBT SERVICE REQUIREMENTS**

**Unlimited Tax Debt**

<b>FYE 31-Aug</b>	<b>Outstanding Debt Service</b>	<b>Refunded Debt Service <sup>(b)</sup></b>	<b>The Bonds <sup>(a)</sup></b>		<b>Total</b>	<b>Total Debt Service</b>
			<b>Principal</b>	<b>Interest <sup>(c)</sup></b>		
2012	\$ 482,409	\$ 240,525	\$ 95,000	\$ 125,233	\$ 220,233	\$ 462,116
2013	487,404	240,525	45,000	157,600	202,600	449,479
2014	501,479	484,775	64,948	382,202	447,150	463,854
2015	490,479	473,775	280,000	154,350	434,350	451,054
2016	505,072	488,369	305,000	148,500	453,500	470,204
2017	494,554	477,850	300,000	142,450	442,450	459,154
2018	532,683	515,988	345,000	134,275	479,275	495,970
2019	502,825	502,825	340,000	124,000	464,000	464,000
2020	513,900	513,900	365,000	113,425	478,425	478,425
2021	523,763	523,763	385,000	102,175	487,175	487,175
2022	507,919	507,919	380,000	90,700	470,700	470,700
2023	516,350	516,350	400,000	79,000	479,000	479,000
2024	522,975	522,975	420,000	66,700	486,700	486,700
2025	527,850	527,850	435,000	53,875	488,875	488,875
2026	531,813	531,813	455,000	40,525	495,525	495,525
2027	534,875	534,875	470,000	26,650	496,650	496,650
2028	536,813	536,813	490,000	9,800	499,800	499,800
	<u>\$ 8,713,158.95</u>	<u>\$ 8,140,887.50</u>	<u>\$5,574,948.40</u>	<u>\$1,951,459.38</u>	<u>\$ 7,526,407.78</u>	<u>\$ 8,098,679.23</u>

Estimated Average Annual Debt Service Requirements (2012-2028): \$ 476,393  
 Estimated Maximum Annual Debt Service Requirements (2028): \$ 499,800

<sup>(a)</sup> Preliminary, subject to change.

<sup>(b)</sup> Includes the required sinking fund deposits for the QZAB Bonds Series 2003B.

<sup>(c)</sup> Interest calculated at market rates for illustration purposes only.

**Limited Tax Debt**

<b>FYE 31-Aug</b>	<b>Outstanding Debt Service <sup>(a)</sup></b>
2012	\$ 42,953
2013	42,953
2014	42,953
2015	42,953
2016	42,953
2017	42,953
2018	42,934
	<u>\$ 300,652.24</u>

Estimated Average Annual Debt Service Requirements (2012-2018): \$ 42,950  
 Estimated Maximum Annual Debt Service Requirements (2012-2017): \$ 42,953

<sup>(a)</sup> Includes the required sinking fund deposits for the QZAB Notes Series 2003.

**TABLE 8 - AUTHORIZED BUT UNISSUED UNLIMITED TAX BONDS**

<u>Date Authorized</u>	<u>Purpose</u>	<u>Amount Authorized</u>	<u>Heretofore Issued</u>	<u>The Bonds</u>	<u>Authorized But Unissued</u>
None					

**TABLE 9 - INTEREST AND SINKING FUND BUDGET PROJECTION**

Estimated Tax Supported Debt Service Requirements, FYE August 31, 2012				\$	445,413
Debt Service Fund, August 31, 2011				\$	408,249
Interest and Sinking Fund Tax Levy @ 95%					<u>460,335</u>
					<u>868,584</u>
Estimated Balance, August 31, 2012				\$	423,172

**TABLE 10 - GENERAL FUND REVENUES AND EXPENDITURE HISTORY <sup>(a)</sup>**

<b>FOR FISCAL YEAR END</b>	<b><u>2010</u></b>	<b><u>2009</u></b>	<b><u>2008</u></b>	<b><u>2007</u></b>	<b><u>2006</u></b>
<b>REVENUES</b>					
Local and Intermediate Sources	\$ 3,553,012	\$ 3,422,041	\$ 3,691,175	\$ 4,247,843	\$ 4,997,915
State Program Revenues	2,687,287	2,780,653	2,971,036	1,847,023	518,167
<b>Total Revenues</b>	<b>\$ 6,240,299</b>	<b>\$ 6,202,694</b>	<b>\$ 6,662,211</b>	<b>\$ 6,094,866</b>	<b>\$ 5,516,082</b>
<b>EXPENDITURES</b>					
Instruction	\$ 3,354,673	\$ 3,398,904	\$ 3,680,671	\$ 3,199,904	\$ 2,990,113
Instructional Resources & Media Serv.	109,839	110,206	109,313	101,846	97,332
Curriculum & Instructional Staff Devel.	8,838	16,637	6,271	8,039	17,675
Instructional Leadership	-	33,191	16,398	16,699	13,165
School Leadership	413,961	435,919	381,118	349,392	313,069
Guidance, Counsel & Evaluation Serv.	104,557	244,080	234,108	249,991	250,819
Social Work Services	-	-	-	-	-
Health Services	55,988	62,787	62,603	62,392	67,390
Student (Pupil) Transportation	249,486	165,679	257,906	182,360	230,693
Food Services	-	-	-	-	3,737
Cocurricular/Extracurricular Activities	305,172	297,668	334,916	362,982	301,082
General Administration	413,464	442,983	438,949	377,162	369,232
Debt Service					
- Principal on long-term debt	54,900	54,900	54,900	78,653	82,838
- Interest on long-term debt	5,504	5,504	5,504	6,324	8,754
- Issuance Cost & Fees	-	-	-	-	-
Plant Maintenance and Operations	794,403	649,871	765,855	717,671	634,250
Security and Monitoring Services	35,537	1,140	-	-	-
Data Processing Services	204,507	152,732	157,518	162,516	123,558
Payments to Fiscal Agent/ SSA	155,537	-	-	-	-
Payments to Juvenile Justice Alternative	16,115	-	-	-	13,910
<b>Total Expenditures</b>	<b>\$ 6,282,481</b>	<b>\$ 6,072,201</b>	<b>\$ 6,506,030</b>	<b>\$ 5,875,931</b>	<b>\$ 5,517,617</b>
Excess (Deficiency) Rev. Over Exp.	\$ (42,182)	\$ 130,493	\$ 156,181	\$ 218,935	\$ (1,535)
Operating Transfers In	15,000	13,885	-	5,000	39,000
Operating Transfers Out	(60,000)	(21,061)	(37,911)	(20,500)	(42,774)
Sale of Real or Personal Property	-	2,301	-	-	-
Other Resources (Uses)	-	-	(36,180)	(49,918)	-
Excess (Deficiency) of Rev. and Other	(45,000)	(4,875)	(74,091)	(65,418)	(3,774)
Resources Over Exp. and Other Uses	\$ (87,182)	\$ 125,618	\$ 82,090	\$ 153,517	\$ (5,309)
Fund Balance - (Beginning)	\$ 530,304	\$ 404,687	\$ 322,596	\$ 169,079	\$ 174,389
Increase (Decrease) in Fund Balance					
<b>Fund Balance - (Ending)</b>	<b>\$ 443,122</b>	<b>\$ 530,305</b>	<b>\$ 404,686</b>	<b>\$ 322,596</b>	<b>\$ 169,080</b>

<sup>(a)</sup> Source: District's audited financial reports.

**TABLE 11 - SCHEDULE OF REFUNDED BONDS**

Series to be Refunded	Maturity Date	Par Amount	Call Date	Call Price
U/L Tax School Building and Refunding Bonds, Series 2003				
	2/15/2014	250,000	2/15/2013	100%
	2/15/2015	250,000	2/15/2013	100%
	2/15/2016	275,000	2/15/2013	100%
	2/15/2017	275,000	2/15/2013	100%
	2/15/2018	325,000	2/15/2013	100%
	2/15/2019	325,000	2/15/2013	100%
	2/15/2020	350,000	2/15/2013	100%
	2/15/2021	375,000	2/15/2013	100%
	2/15/2022	375,000	2/15/2013	100%
	2/15/2023	400,000	2/15/2013	100%
	2/15/2028	525,000	2/15/2013	100%
TERM	2/15/2025	875,000	2/15/2013	100%
TERM	2/15/2027	975,000	2/15/2013	100%
		\$ 5,575,000		

**APPENDIX B**

**EXCERPTS FROM THE DISTRICT'S  
AUDITED FINANCIAL REPORT  
For Year Ended  
August 31, 2010**

**SCHULENBURG  
INDEPENDENT SCHOOL DISTRICT**

*ANNUAL FINANCIAL REPORT*

*FOR THE YEAR ENDED AUGUST 31, 2010*

Schulenburg Independent School District  
Annual Financial Report  
For The Year Ended August 31, 2010

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Schulenburg Independent School District  
Annual Financial Report  
For The Year Ended August 31, 2010

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*Introductory Section*

CERTIFICATE OF BOARD

Schulenburg Independent School District  
Name of School District

Fayette  
County

075-903  
Co.-Dist. Number

We, the undersigned, certify that the attached annual financial reports of the above named school district were reviewed and (check one)  approved  disapproved for the year ended August 31, 2010, at a meeting of the board of trustees of such school district on the 26 day of January, 2011.

Don B. Fisher  
Signature of Board Secretary Vice-President

Norris Starnadel  
Signature of Board President

If the board of trustees disapproved of the auditors' report, the reason(s) for disapproving it is (are):  
(attach list as necessary)

*Financial Section*



## Independent Auditors' Report on Financial Statements

Board of Trustees  
Schulenburg Independent School District:

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Schulenburg Independent School District as of and for the year ended August 31, 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Schulenburg Independent School District's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Schulenburg Independent School District as of August 31, 2010, and the respective changes in financial position, and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 26, 2011, on our consideration of Schulenburg Independent School District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Providing Governmental & Nonprofit Audits Sealed with Excellence

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**Independent Auditors' Report on Financial Statements**  
**Page 2 of 2**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information identified as Required Supplementary Information in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Schulenburg Independent School District's financial statements as a whole. The introductory section and combining and individual nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U. S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the financial statements. The combining and individual nonmajor fund financial statements and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Respectfully submitted,

 BELT HARRIS PECHACEK, LLLP

Belt Harris Pechacek, LLLP  
*Certified Public Accountants*  
Bellville, Texas  
January 26, 2011

*Management's Discussion and Analysis*

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

For the Year Ended August 31, 2010

This discussion and analysis of the Schulenburg Independent School District's (the "District") financial performance provides an overview of the District's financial activities for the fiscal year ended August 31, 2010. It should be read in conjunction with the District's financial statements, which begin on page 16 this report.

### FINANCIAL HIGHLIGHTS

- The District's total combined net assets at August 31, 2010 were \$3,334,643.
- For the fiscal year ended August 31, 2010, the District's total expenses were \$21,337 less than the \$8,801,427 generated from ad valorem tax collections, State Foundation Program entitlements and other grants and miscellaneous revenues.
- The General Fund reported a fund balance of \$443,122 at August 31, 2010.
- The Debt Service Fund reported a fund balance of \$408,249 at August 31, 2010.
- The District's long-term debt had a net decrease of \$239,900.
- There were no current year financial audit findings.

### OVERVIEW OF THE FINANCIAL STATEMENTS

The annual report consists of three parts – *Management's Discussion and Analysis* (this section), the *Basic Financial Statements*, and *Required Supplemental Information*. The basic financial statements include two kinds of statements that present different views of the District.

- The first two statements are *government-wide financial statements* that provide both *long-term* and *short-term* information about the District's overall financial status.
- The remaining statements are *fund financial statements* that focus on *individual parts* of the government, reporting the District's operations in more detail than the government-wide statements.
- The *governmental funds* statements tell how *general government* services were financed in the *short term* as well as what remains for future spending.
- *Fiduciary fund* statements provide information about the financial relationships in which the District acts solely as a trustee or *agent* for the benefit of others, to whom the fiduciary resources belong. This fund includes student activity funds.
- *Proprietary fund* statements provide information about services provided to parties inside the District. The proprietary funds include the internal service fund (District's worker's compensation and unemployment fund activity).

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The notes to the financial statements are followed by a section entitled *Required Supplementary Information* that further explains and supports the information in the financial statements.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended August 31, 2010

### GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide statements report information about the District as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all of the government's assets and liabilities. All of the current period's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The government-wide statements report the District's net assets and how they have changed. Net assets is the difference between the District's assets and liabilities and is one way to measure the District's financial health or *position*.

- Over time, increases or decreases in the District's net assets are an indicator of whether its financial health is improving or deteriorating, respectively.
- To assess the overall health of the District, one needs to consider additional non-financial factors such as changes in the District's tax base, staffing patterns, enrollment and attendance.

The government-wide financial statements of the District include the *Governmental activities*. Most of the District's basic services such as instruction, extracurricular activities, curriculum and staff development, health services, general administration and plant operation and maintenance are included in *Governmental activities*. Locally assessed property taxes, together with State Foundation Program entitlements, which are based upon student enrollment and attendance, finance most of the government activities.

### FUND FINANCIAL STATEMENTS

The fund financial statements provide more detailed information about the District's most significant *funds* – not the District as a whole. Funds are simply accounting devices that are used to keep track of specific sources of funding and spending for particular purposes.

- Some funds are required by State law and other funds are mandated by bond agreements or bond covenants.
- The Board of Trustees establishes other funds to control and manage money set aside for particular purposes or to show that the District is properly using certain taxes and grants.
- Other funds are used to account for assets held by the District in a custodial capacity – these assets do not belong to the District but the District is responsible to properly account for them.

The District has the following kinds of fund:

- *Governmental Funds* – Most of the District's basic services are included in governmental funds, which focus on (1) how *cash and other financial assets* that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental fund statements provide a detailed *short-term* view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statement, or on the subsequent page, that explain the relationship (or differences) between them.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended August 31, 2010

- *Fiduciary funds* – the District serves as the trustee, or *fiduciary*, for certain funds such as student activity funds. The District is responsible for ensuring that the assets reported in these funds are used for their intended purposes. All of the District's fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. We exclude these activities from the District's government-wide financial statements because the District cannot use these assets to finance its governmental operations.
- *Proprietary funds* – These funds include the internal service fund. The District's worker's compensation and unemployment fund activity is reported in the internal service fund and is shown in a separate statement of proprietary net assets and as statement of changes in proprietary net assets.

### FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE

The District's combined net assets were \$3,334,643 at August 31, 2010. *Table 1* focuses on the net assets while *Table 2* shows the revenues and expenses that changed the net asset balance during the fiscal year ended August 31, 2010.

**Table 1**  
**Net Assets**

Description	Governmental Activities		Total Percentage Change 2010-2009
	2010	2009	
Current Assets	\$ 1,550,468	\$ 1,488,791	4.14%
Capital Assets (Net)	<u>9,159,347</u>	<u>9,433,089</u>	<u>-2.90%</u>
Total Assets	<u>10,709,815</u>	<u>10,921,880</u>	<u>-1.94%</u>
Current Liabilities	486,283	479,785	1.35%
Long-Term Liabilities	<u>6,888,889</u>	<u>7,128,789</u>	<u>-3.37%</u>
Total Liabilities	<u>7,375,172</u>	<u>7,608,574</u>	<u>-3.07%</u>
Net Assets:			
Invested in Capital Assets	2,257,792	2,291,524	-1.47%
Restricted	408,249	336,145	21.45%
Unrestricted	<u>668,602</u>	<u>685,637</u>	<u>-2.48%</u>
Total Net Assets	<u>\$ 3,334,643</u>	<u>\$ 3,313,306</u>	<u>0.64%</u>

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended August 31, 2010

**Table 2**  
**Changes in Net Assets**

Description	Governmental Activities		Total
	2010	2009	Percentage Change 2010-2009
<b>Program Revenues</b>			
Charges for Service	\$ 131,967	\$ 150,167	-12.12%
Operating Grants and Contributions	1,382,619	1,097,756	25.95%
<b>General Revenues</b>			
Property Taxes	4,008,835	3,844,981	4.26%
State Foundation Program	2,893,022	2,490,483	16.16%
Investment Earnings	43,350	55,639	-22.09%
Other Revenues	341,634	71,902	375.14%
Total Revenues	<u>8,801,427</u>	<u>7,710,928</u>	<u>14.14%</u>
<b>Program Expenditures:</b>			
Instruction	\$ 4,629,621	\$ 4,143,271	11.74%
Instructional Resources and Media Services	143,857	144,224	-0.25%
Curriculum and Staff Development	24,453	16,637	46.98%
Instructional Leadership	132,737	44,287	199.72%
School Leadership	419,255	441,213	-4.98%
Guidance and Counseling	382,404	246,694	55.01%
Health Services	56,082	62,881	-10.81%
Student Transportation	241,825	200,315	20.72%
Food Services	341,406	327,135	4.36%
Extracurricular Activities	319,748	312,644	2.27%
General Administration	476,492	466,014	2.25%
Plant Operating and Maintenance	836,099	686,402	21.81%
Security and Monitoring Services	35,537	1,140	96.79%
Data Processing Services	278,892	174,899	59.46%
Interest on Debt	279,154	287,194	-2.80%
Bond Issuance and Debt Fees	3,500	3,500	0.00%
Payments Related to Shared Service Arrangements	162,913	28,500	471.62%
Payments to Juvenile Justice Alternative Ed. Programs	16,115	-	100.00%
Total Expenses	<u>8,780,090</u>	<u>7,586,950</u>	<u>15.73%</u>
Increase (Decrease) in Net Assets	<u>\$ 21,337</u>	<u>\$ 123,978</u>	<u>-82.79%</u>

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended August 31, 2010

### Governmental Activities

Significant factors affecting the increase of \$21,337 in net assets included:

- Revenues for the District increased by approximately \$1,090,499 or 14.14%, while expenses increased by approximately \$1,193,140 or 15.73%.

### Cost of District's Functions

The District records its expenses in various cost centers or "functions" in accordance with the requirements of the Texas Education Agency. *Table 3* presents the cost of each of the functions with the largest expense totals with that function's net costs (total cost less fees and grants that are directly attributable to that function). The net cost of each function reflects what was funded primarily from state foundation program and tax revenues.

**Table 3**  
**Total and Net Cost of Selected District Functions**

Description	Total Cost of Services		Net Cost of Services		
	2010	2009	2010	2009	% Change
Instruction	\$ 4,629,621	\$ 4,143,271	\$ 3,712,197	\$ 3,299,215	12.52%
Plant Main. and Operation	836,099	686,402	820,619	686,402	19.55%
General Administration	476,492	466,014	466,100	462,090	0.87%
Cocurricular/Extracurricular	319,748	312,644	281,867	270,892	4.05%
School Leadership	419,255	441,213	397,660	441,213	-9.87%

### FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS

At the close of the fiscal year ending August 31, 2010, the District's combined governmental funds (as presented in the balance sheet, Exhibit C-1 on page 18 of this report) reported a combined fund balance of \$925,943. This compares to a combined fund balance of \$873,965 at August 31, 2009.

### GENERAL FUND BUDGETARY HIGHLIGHTS

During the period ended August 31, 2010, the District amended its budget as required by State law and to reflect current levels of revenue and anticipated expenses. There were material changes between the original budget and the final amended budget in data processing services, and there was not an original budget set up for payments to fiscal agent/member.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended August 31, 2010

### CAPITAL ASSETS AND DEBT ADMINISTRATION

#### Capital Assets

Capital assets are generally defined as those items that have useful lives of two years or more and have an initial cost or value (if donated) of an amount determined by the Board. During the fiscal year ended August 31, 2010, the District used a capitalization threshold of \$5,000, which means that all capital type assets, including library books, with a cost or initial value of less than \$5,000, were not included in the capital assets inventory.

At August 31, 2010, the District had a total of \$12,367,012 invested in capital assets such as land, buildings, vehicles and equipment (see Table 4). This total includes \$55,756 invested during the fiscal year ended August 31, 2010.

Table 4 shows the classifications of capital assets together with the District's accumulated cost and depreciation of those assets.

**Table 4**  
**Capital Assets and Depreciation**

Asset Description	Governmental Activities		Total Percentage Change
	2010	2009	2010-2009
Land	\$ 359,065	\$ 359,065	0.00%
Buildings and Improvements	11,213,975	11,213,975	0.00%
Vehicles	672,466	616,710	9.04%
Equipment	121,506	121,506	0.00%
Total Historical Cost	12,367,012	12,311,256	0.45%
Accumulated Depreciation	3,207,665	2,878,167	11.45%
Net Capital Assets	\$ 9,159,347	\$ 9,433,089	-2.90%

Notes to Table 4 –

More detailed information about the District's capital assets can be found in the notes to the financial statements on page 32.

#### Long-Term Debt

At August 31, 2010, the District had one bond issue and two notes outstanding of unpaid principal, in the amount of \$6,888,886.

Table 5 summarizes the District's outstanding debt at August 31, 2010. More detailed information regarding the District's debt obligations is presented in the notes to the financial statements on page 33.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended August 31, 2010

**Table 5**  
**Analysis of Debt**

Description of Debt Outstanding	Governmental Activities		Total Percentage Change
	2010	2009	2010-2009
Loans Payable	\$ 683,886	\$ 738,789	-7.43%
Bonds Payable	6,205,000	6,390,000	-2.90%
Total Debt Outstanding	<u>\$ 6,888,886</u>	<u>\$ 7,128,789</u>	<u>-3.37%</u>

### ECONOMIC FACTORS AND THE NEXT YEAR'S BUDGETS

#### Economic Factors

The following factors were considered in establishing the District's budget for 2010-2011:

- Student enrollment for 2010-2011 is estimated to remain stable compared to the 2009-2010 school year. The District will strive to maintain a 690 refined average daily attendance.
- Property values for ad valorem tax purposes remained stable as compared to 2009-2010.
- The District's total tax rate for 2010-2011 was \$1.1920 per \$100 of valuation. The rate approved was for \$1.04 for M&O and \$0.1520 for I&S. This was a slight decrease from 2009-2010 when the rates were \$1.04 for M&O and \$0.1588 for I&S.
- The District will receive the State ARRA funding of approximately \$236,000, which is year two of the funding and the final year. The funds will be used to enhance the instructional areas for the District by providing updated technology programs, and also to offer advanced classes at the secondary level, preparing students for college.
- The District will implement the CScope curriculum for the 2010-2011 to help enhance the educational needs of students. Eduphoria, Grand Central Station, and the Distance Learning Programs will continue to be available to teachers, parents and students.
- The District will continue to serve as the Fiscal Agent for the SSA Special Educational Cooperative with Flatonia and Waelder ISD's. The Special Education Coop helps to provide the best resources for students, faculty and parents.
- The District is continuing to look at the decreases to funding levels and will implement cautious spending guidelines and will look at employee to student ratios.

# **SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

## ***MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)***

**For the Year Ended August 31, 2010**

### **Next Year's Budget**

- The District's general fund revenues are budgeted to increase \$145,441 or 3.0% in comparison to \$6,240,299 of actual revenues in 2009-2010.
- The District's general fund expenditures are budgeted to increase \$103,260 or 2.0% in comparison to \$6,282,481 of actual expenses in 2009-2010.
- The budget adopted for the Debt Service Fund did not materially change from 2009-2010 to 2010-2011 and the Food Service Fund increased slightly due to the increase in products.

District officials anticipate that the fund balance for the general fund will be affected by the level of state funding.

### **CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our citizens, taxpayers, students and creditors with a general overview of the District's finances and to demonstrate the District's commitment to accountability for the money it receives. If you have questions about this report or need additional financial information, contact Water Padgett, Superintendent at (979) 743-3448.

*Basic Financial Statements*

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

## STATEMENT OF NET ASSETS

AUGUST 31, 2010

Data Control Codes	1	Governmental Activities
<b>ASSETS:</b>		
1110	Cash and Cash Equivalents	\$ 1,226,923
1220	Property Taxes Receivable (Delinquent)	188,676
1230	Allowance for Uncollectible Taxes	(41,593)
1240	Due from Other Governments	176,461
Capital Assets:		
1510	Land	359,066
1520	Buildings and Improvements, Net	8,551,650
1530	Furniture and Equipment, Net	248,631
1000	Total Assets	<u>10,709,815</u>
<b>LIABILITIES:</b>		
2110	Accounts Payable	174,208
2140	Interest Payable	12,666
2165	Accrued Liabilities	153,669
2180	Due to Other Governments	139,450
2300	Unearned Revenue	6,290
Noncurrent Liabilities:		
2501	Due Within One Year	249,900
2502	Due in More Than One Year	6,638,989
2000	Total Liabilities	<u>7,375,172</u>
<b>NET ASSETS</b>		
3200	Invested in Capital Assets, Net of Related Debt	2,257,792
Restricted For:		
3850	Debt Service	408,249
3900	Unrestricted	668,602
3000	Total Net Assets	<u>\$ 3,334,643</u>

The accompanying notes are an integral part of this statement.

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED AUGUST 31, 2010

Data Control Codes	Functions/Programs	1	3	4	Net (Expense) Revenue and Changes in Net Assets
		Expenses	Charges for Services	Program Revenues Operating Grants and Contributions	Governmental Activities
	Governmental Activities:				
11	Instruction	\$ 4,629,621	\$ --	\$ 917,424	\$ (3,712,197)
12	Instructional Resources and Media Services	143,857	--	5,723	(138,134)
13	Curriculum and Staff Development	24,453	--	15,615	(8,838)
21	Instructional Leadership	132,737	--	--	(132,737)
23	School Leadership	419,255	--	21,595	(397,660)
31	Guidance, Counseling, & Evaluation Services	382,404	--	63,422	(318,982)
33	Health Services	56,082	--	3,165	(52,917)
34	Student Transportation	241,825	--	5,804	(236,021)
35	Food Service	341,406	102,271	235,525	(3,610)
36	Cocurricular/Extracurricular Activities	319,748	29,696	8,185	(281,867)
41	General Administration	476,492	--	10,392	(466,100)
51	Plant Maintenance and Operations	836,099	--	15,480	(820,619)
52	Security and Monitoring Services	35,537	--	--	(35,537)
53	Data Processing Services	278,892	--	80,255	(198,637)
72	Interest on Long-term Debt	279,154	--	--	(279,154)
73	Bond Issuance Costs and Fees	3,500	--	--	(3,500)
93	Payments Related to Shared Services Arrangements	162,913	--	--	(162,913)
95	Payments to Juvenile Justice Alternative Ed. Programs	16,115	--	--	(16,115)
TG	Total Governmental Activities	<u>8,780,090</u>	<u>131,967</u>	<u>1,382,619</u>	<u>(7,265,504)</u>
TP	Total Primary Government	<u>\$ 8,780,090</u>	<u>\$ 131,967</u>	<u>\$ 1,382,619</u>	<u>(7,265,504)</u>
	General Revenues:				
MT	Property Taxes, Levied for General Purposes				3,478,855
DT	Property Taxes, Levied for Debt Service				529,980
IE	Investment Earnings				43,350
GC	Grants and Contributions Not Restricted to Specific Programs				2,893,022
MI	Miscellaneous				341,634
TR	Total General Revenues				<u>7,286,841</u>
CN	Change in Net Assets				21,337
NB	Net Assets - Beginning				3,313,306
NE	Net Assets - Ending				<u>\$ 3,334,643</u>

The accompanying notes are an integral part of this statement.

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

BALANCE SHEET - GOVERNMENTAL FUNDS

AUGUST 31, 2010

Data Control Codes	10 General Fund	50 Debt Service Fund	Other Governmental Funds	98 Total Governmental Funds	
<b>ASSETS:</b>					
1110	Cash and Cash Equivalents	\$ 861,478	\$ 283,988	\$ 77,633	\$ 1,223,099
1220	Property Taxes Receivable, (Delinquent)	164,884	23,793	--	188,676
1230	Allowance for Uncollectible Taxes	(37,365)	(4,228)		(41,593)
1240	Due from Other Governments	--	--	176,461	176,461
1260	Due from Other Funds	9,814	124,261	7,561	141,636
1000	Total Assets	<u>\$ 998,811</u>	<u>\$ 427,814</u>	<u>\$ 261,655</u>	<u>\$ 1,688,280</u>
<b>LIABILITIES:</b>					
Current Liabilities:					
2110	Accounts Payable	\$ --	\$ --	\$ 174,208	\$ 174,208
2160	Accrued Wages Payable	153,669	--	--	153,669
2170	Due to Other Funds	131,822	--	9,814	141,636
2180	Due to Other Governments	139,450	--	--	139,450
2300	Deferred Revenue	130,748	19,565	3,061	153,374
2000	Total Liabilities	<u>555,689</u>	<u>19,565</u>	<u>187,083</u>	<u>762,337</u>
<b>FUND BALANCES:</b>					
Reserved Fund Balances:					
3420	Debt Service	--	408,249	--	408,249
3450	Reserve for Food Service	--	--	10,477	10,477
3490	Other Reserves of Fund Balance	--	--	64,095	64,095
3600	Unreserved	443,122	--	--	443,122
3000	Total Fund Balances	<u>443,122</u>	<u>408,249</u>	<u>74,572</u>	<u>925,943</u>
4000	Total Liabilities and Fund Balances	<u>\$ 998,811</u>	<u>\$ 427,814</u>	<u>\$ 261,655</u>	<u>\$ 1,688,280</u>

The accompanying notes are an integral part of this statement.

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET  
 TO THE STATEMENT OF NET ASSETS  
 AUGUST 31, 2010

Total fund balances - governmental funds balance sheet	\$ 925,943
<p>Amounts reported for governmental activities in the Statement of Net Assets ("SNA") are different because:</p>	
Capital assets used in governmental activities are not reported in the funds.	9,159,346
Property taxes receivable unavailable to pay for current period expenditures are deferred in the funds.	147,085
The assets and liabilities of internal service funds are included in governmental activities in the SNA.	3,824
Payables for bond principal which are not due in the current period are not reported in the funds.	(6,205,000)
Payables for bond interest which are not due in the current period are not reported in the funds.	(11,978)
Payables for notes which are not due in the current period are not reported in the funds.	(683,889)
Other long-term liabilities which are not due and payable in the current period are not reported in the funds.	<u>(688)</u>
Net assets of governmental activities - Statement of Net Assets	<u>\$ 3,334,643</u>

The accompanying notes are an integral part of this statement.

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCES - GOVERNMENTAL FUNDS  
FOR THE YEAR ENDED AUGUST 31, 2010

Data Control Codes	10 General Fund	50 Debt Service Fund	Other Governmental Funds	98 Total Governmental Funds
<b>REVENUES:</b>				
5700 <i>Local and Intermediate Sources</i>	\$ 3,553,012	\$ 534,364	\$ 434,139	\$ 4,521,515
5800 <i>State Program Revenues</i>	2,687,287	--	123,405	2,810,692
5900 <i>Federal Program Revenues</i>	--	--	1,464,949	1,464,949
5020 <b>Total Revenues</b>	<u>6,240,299</u>	<u>534,364</u>	<u>2,022,493</u>	<u>8,797,156</u>
<b>EXPENDITURES:</b>				
Current:				
0011 <i>Instruction</i>	3,354,673	--	1,101,726	4,456,399
0012 <i>Instructional Resources and Media Services</i>	109,839	--	--	109,839
0013 <i>Curriculum and Staff Development</i>	8,838	--	15,615	24,453
0021 <i>Instructional Leadership</i>	--	--	128,509	128,509
0023 <i>School Leadership</i>	413,961	--	--	413,961
0031 <i>Guidance, Counseling, &amp; Evaluation Services</i>	104,557	--	275,633	380,190
0033 <i>Health Services</i>	55,988	--	--	55,988
0034 <i>Student Transportation</i>	249,486	--	751	250,237
0035 <i>Food Service</i>	--	--	335,148	335,148
0036 <i>Cocurricular/Extracurricular Activities</i>	305,172	--	--	305,172
0041 <i>General Administration</i>	413,464	--	11,816	425,280
0051 <i>Plant Maintenance and Operations</i>	794,403	--	5,165	799,568
0052 <i>Security and Monitoring Services</i>	35,537	--	--	35,537
0053 <i>Data Processing Services</i>	204,507	--	73,698	278,205
0071 <i>Principal on Long-term Debt</i>	54,900	185,000	--	239,900
0072 <i>Interest on Long-term Debt</i>	5,504	273,760	--	279,264
0073 <i>Bond Issuance Costs and Fees</i>	--	3,500	--	3,500
0093 <i>Payments to Shared Service Arrangements</i>	155,537	--	7,376	162,913
0095 <i>Payments to Juvenile Justice Alternative Education Programs</i>	16,115	--	--	16,115
6030 <b>Total Expenditures</b>	<u>6,282,481</u>	<u>462,260</u>	<u>1,955,437</u>	<u>8,700,178</u>
1100 <b>Excess (Deficiency) of Revenues Over (Under) Expenditures</b>	<u>(42,182)</u>	<u>72,104</u>	<u>67,056</u>	<u>96,978</u>
Other Financing Sources and (Uses):				
7915 <i>Transfers In</i>	15,000	--	--	15,000
8911 <i>Transfers Out</i>	(60,000)	--	--	(60,000)
7080 <b>Total Other Financing Sources and (Uses)</b>	<u>(45,000)</u>	<u>--</u>	<u>--</u>	<u>(45,000)</u>
1200 <b>Net Change in Fund Balances</b>	<u>(87,182)</u>	<u>72,104</u>	<u>67,056</u>	<u>51,978</u>
0100 <b>Fund Balances - Beginning</b>	<u>530,304</u>	<u>336,145</u>	<u>7,516</u>	<u>873,965</u>
3000 <b>Fund Balances - Ending</b>	<u>\$ 443,122</u>	<u>\$ 408,249</u>	<u>\$ 74,572</u>	<u>\$ 925,943</u>

The accompanying notes are an integral part of this statement.

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,  
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS  
TO THE STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED AUGUST 31, 2010

Net change in fund balances - total governmental funds	\$ 51,978
Amounts reported for governmental activities in the Statement of Activities ("SOA") are different because:	
Capital outlays are not reported as expenses in the SOA.	55,756
The depreciation of capital assets used in governmental activities is not reported in the funds.	(329,499)
Certain property tax revenues are deferred in the funds. This is the change in these amounts this year.	4,271
Repayment of bond principal is an expenditure in the funds but is not an expense in the SOA.	185,000
Repayment of loan principal is an expenditure in the funds but is not an expense in the SOA.	54,900
(Increase) decrease in accrued interest from beginning of period to end of period.	110
The net revenue (expense) of internal service funds is reported with governmental activities.	<u>(1,180)</u>
Change in net assets of governmental activities - Statement of Activities	<u>\$ 21,337</u>

The accompanying notes are an integral part of this statement.

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

STATEMENT OF NET ASSETS

PROPRIETARY FUNDS

AUGUST 31, 2010

Data Control Codes		Internal Service Funds
	<b>ASSETS:</b>	
	Current Assets:	
1110	<i>Cash and Cash Equivalents</i>	\$ 3,824
	Total Current Assets	<u>3,824</u>
1000	Total Assets	<u>\$ 3,824</u>
	<b>LIABILITIES:</b>	
2000	Total Liabilities	<u>--</u>
	<b>NET ASSETS:</b>	
3900	<i>Unrestricted Net Assets</i>	\$ 3,824
3000	Total Net Assets	<u>\$ 3,824</u>

The accompanying notes are an integral part of this statement.

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

STATEMENT OF REVENUES, EXPENSES, AND CHANGES

IN FUND NET ASSETS - PROPRIETARY FUNDS

FOR THE YEAR ENDED AUGUST 31, 2010

Data Control Codes		Internal Service Fund
	<b>OPERATING REVENUES:</b>	
5700	<i>Local and Intermediate Sources</i>	\$ 280
5020	Total Revenues	<u>280</u>
	<b>OPERATING EXPENSES:</b>	
6400	<i>Other Operating Costs</i>	46,460
6030	Total Expenses	<u>46,460</u>
	Income (Loss) before Contributions and Transfers	(46,180)
7915	<i>Transfers In</i>	60,000
8911	<i>Transfers Out</i>	<u>(15,000)</u>
1300	Change in Net Assets	(1,180)
0100	Total Net Assets - Beginning	5,004
3300	Total Net Assets - Ending	<u>\$ 3,824</u>

The accompanying notes are an integral part of this statement.

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

STATEMENT OF CASH FLOWS

PROPRIETARY FUNDS

FOR THE YEAR ENDED AUGUST 31, 2010

	Internal Service Funds		
	Employee Benefit Fund	Workers' Compensation Fund	Totals
<b>Cash Flows from Operating Activities:</b>			
<i>Cash Received from Interest Earnings</i>	\$ 15	\$ 265	\$ 280
<i>Cash Payments for claims</i>	--	(46,460)	(46,460)
Net Cash Provided (Used) by Operating Activities	<u>15</u>	<u>(46,195)</u>	<u>(46,180)</u>
<b>Cash Flows from Non-capital Financing Activities:</b>			
<i>Operating Transfers From (To) Other Funds</i>	--	45,000	45,000
Net Cash Provided (Used) by Non-capital Financing Activities	<u>--</u>	<u>45,000</u>	<u>45,000</u>
Net Increase (Decrease) in Cash and Cash Equivalents	15	(1,195)	(1,180)
Cash and Cash Equivalents at Beginning of Year	993	4,011	5,004
Cash and Cash Equivalents at End of Year	<u>\$ 1,008</u>	<u>\$ 2,816</u>	<u>\$ 3,824</u>
<b>Reconciliation of Operating Income to Net Cash     Provided by Operating Activities:</b>			
Operating Income (Loss)	15	(1,195)	(1,180)
Net Cash Provided (Used) by Operating Activities	<u>\$ 15</u>	<u>\$ (1,195)</u>	<u>\$ (1,180)</u>

The accompanying notes are an integral part of this statement.

**SCHULENBURG INDEPENDENT SCHOOL DISTRICT**

STATEMENT OF FIDUCIARY NET ASSETS

FIDUCIARY FUNDS

AUGUST 31, 2010

Data Control Codes		Agency Fund
ASSETS:		Student Activity
1110	Cash and Cash Equivalents	\$ 123,039
1000	Total Assets	<u>\$ 123,039</u>
	<b>LIABILITIES:</b>	
	Current Liabilities:	
2190	Due to Student Groups	\$ 123,039
2000	Total Liabilities	<u>123,039</u>
	<b>NET ASSETS</b>	
3000	Total Net Assets	<u><u>\$ --</u></u>

The accompanying notes are an integral part of this statement.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED AUGUST 31, 2010

### A. Summary of Significant Accounting Policies

The basic financial statements of Schulenburg Independent School District (the "District") have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") applicable to governmental units in conjunction with the Texas Education Agency's Financial Accountability System Resource Guide ("Resource Guide"). The Governmental Accounting Standards Board ("GASB") is the accepted standard setting body for establishing governmental accounting and financial reporting principles.

#### 1. Reporting Entity

The Board of School Trustees ("Board"), a seven-member group, has governance responsibilities over all activities related to public elementary and secondary education within the jurisdiction of the District. The Board is elected by the public and has the exclusive power and duty to govern and oversee the management of the public schools of the District. All powers and duties not specifically delegated by statute to the Texas Education Agency ("TEA") or to the State Board of Education are reserved for the Board, and the TEA may not substitute its judgment for the lawful exercise of those powers and duties by the Board. The District receives funding from local, state and federal government sources and must comply with the requirements of those funding entities. However, the District is not included in any other governmental "reporting entity" as defined by the GASB in its Statement No. 14, "The Financial Reporting Entity," as revised by GASB Statement No.39, and there are no component units included within the reporting entity.

#### 2. Basis of Presentation, Basis of Accounting

##### a. Basis of Presentation

Government-wide Financial Statements: The Statement of Net Assets and the Statement of Activities include the financial activities of the overall government, except for fiduciary activities. Eliminations have been made to minimize the double-counting of internal activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange transactions.

The Statement of Activities presents a comparison between direct expenses and program revenues for each function of the District's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. The District does not allocate indirect expenses in the statement of activities. Program revenues include (a) fees, fines, and charges paid by the recipients of goods or services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements: The fund financial statements provide information about the District's funds, with separate statements presented for each fund category. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column. All remaining governmental funds are aggregated and reported as nonmajor funds.

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

The District reports the following major governmental funds:

General Fund: This is the District's primary operating fund. It accounts for all financial resources of the District except those required to be accounted for in another fund.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED AUGUST 31, 2010

Debt Service Fund: This fund is used to account for tax revenues and for the payment of principal, interest and other related costs on long-term debts for which a tax has been dedicated. This is a budgeted fund and a separate bank account is maintained for this fund. Any unused sinking fund balances are transferred to the General Fund after all of the related debt obligations have been met.

In addition, the District reports the following fund types:

Special Revenue Funds: These funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes.

Internal Service Funds: These funds are used to account for revenues and expenses related to services provided to parties inside the District. These funds facilitate distribution of support costs to the users of support services on a cost-reimbursement basis. Because the principal users of the internal services are the District's governmental activities, this fund type is included in the "Governmental Activities" column of the government-wide financial statements.

Agency Funds: These funds are used to report student activity funds and other resources held in a purely custodial capacity (assets equal liabilities). Agency funds typically involve only the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other governments.

Fiduciary funds are reported in the fiduciary fund financial statements. However, because their assets are held in a trustee or agent capacity and are therefore not available to support District programs, these funds are not included in the government-wide statements.

b. Measurement Focus, Basis of Accounting

Government-wide, Proprietary, and Fiduciary Fund Financial Statements: These financial statements are reported using the economic resources measurement focus. The government-wide and proprietary fund financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the District gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, entitlements, and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental Fund Financial Statements: Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The District does not consider revenues collected after its year-end to be available in the current period. Revenues from local sources consist primarily of property taxes. Property tax revenues and revenues received from the State are recognized under the susceptible-to-accrual concept. Miscellaneous revenues are recorded as revenue when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

When the District incurs an expenditure or expense for which both restricted and unrestricted resources may be used, it is the District's policy to use restricted resources first, then unrestricted resources.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED AUGUST 31, 2010

Under GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," all proprietary funds will continue to follow Financial Accounting Standards Board ("FASB") standards issued on or before November 30, 1989. However, from that date forward, proprietary funds will have the option of either 1) choosing not to apply future FASB standards (including amendments of earlier pronouncements), or 2) continuing to follow new FASB pronouncements unless they conflict with GASB guidance. The District has chosen not to apply future FASB standards.

### 3. Financial Statement Amounts

#### a. Cash and Cash Equivalents

For purposes of the statement of cash flows, highly liquid investments are considered to be cash equivalents if they have a maturity of three months or less when purchased.

#### b. Property Taxes

Property taxes are levied by October 1 on the assessed value listed as of the prior January 1 for all real and business personal property in conformity with Subtitle E, Texas Property Tax Code. Taxes are due on receipt of the tax bill and are delinquent if not paid before February 1 of the year following the year in which imposed. On January 1 of each year, a tax lien attaches to property to secure the payment of all taxes, penalties, and interest ultimately imposed. Property tax revenues are considered available when they become due or past due and receivable within the current period.

Allowances for uncollectible tax receivables within the General and Debt Service Funds are based upon historical experience in collecting property taxes. Uncollectible personal property taxes are periodically reviewed and written off, but the District is prohibited from writing off real property taxes without specific statutory authority from the Texas Legislature.

#### c. Inventories and Prepaid Items

The District records purchases of supplies as expenditures, utilizing the purchase method of accounting for inventory in accordance with the Resource Guide.

#### d. Capital Assets

Purchased or constructed capital assets are reported at cost or estimated historical cost. Donated fixed assets are recorded at their estimated fair value at the date of the donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized. A capitalization threshold of \$5,000 is used.

Capital assets are being depreciated using the straight-line method over the following estimated useful lives:

<u>Asset Class</u>	<u>Estimated Useful Lives</u>
Buildings	50
Building Improvements	20
Vehicles	5-10
District Equipment	7-10

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED AUGUST 31, 2010

e. Receivable and Payable Balances

The District believes that sufficient detail of receivable and payable balances is provided in the financial statements to avoid the obscuring of significant components by aggregation. Therefore, no disclosure is provided which disaggregates those balances.

There are no significant receivables which are not scheduled for collection within one year of year end.

f. Interfund Activity

Interfund activity results from loans, services provided, reimbursements or transfers between funds. Loans are reported as interfund receivables and payables as appropriate and are subject to elimination upon consolidation. Services provided, deemed to be at market or near market rates, are treated as revenues and expenditures or expenses. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers In and Transfers Out are netted and presented as a single "Transfers" line on the government-wide statement of activities. Similarly, interfund receivables and payables are netted and presented as a single "Internal Balances" line of the government-wide statement of net assets.

g. Use of Estimates

The preparation of financial statements in conformity with GAAP requires the use of management's estimates.

h. Data Control Codes

Data Control Codes appear in the rows and above the columns of certain financial statements. The TEA requires the display of these codes in the financial statements filed with TEA in order to insure accuracy in building a statewide database for policy development and funding plans.

B. Compliance and Accountability

1. Finance-Related Legal and Contractual Provisions

In accordance with GASB Statement No. 38, "Certain Financial Statement Note Disclosures," violations of finance-related legal and contractual provisions, if any, are reported below, along with actions taken to address such violations:

<u>Violation</u>	<u>Action Taken</u>
None reported	Not applicable

2. Deficit Fund Balance or Fund Net Assets of Individual Funds

Following are funds having deficit fund balances or fund net assets at year end, if any, along with remarks which address such deficits:

<u>Fund Name</u>	<u>Deficit Amount</u>	<u>Remarks</u>
None reported	Not applicable	Not applicable

C. Deposits and Investments

The District's funds are required to be deposited and invested under the terms of a depository contract. The depository bank deposits for safekeeping and trust with the District's agent bank approved pledged securities in an amount sufficient to protect District funds on a day-to-day basis during the period of the contract. The pledge of approved securities is waived only to the extent of the depository bank's dollar amount of Federal Deposit Insurance Corporation ("FDIC") insurance.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED AUGUST 31, 2010

### 1. Cash Deposits:

At August 31, 2010, the carrying amount of the District's deposits (cash, certificates of deposit, and interest-bearing savings accounts included in temporary investments) was \$1,042,860 and the bank balance was \$1,165,492. The District's cash deposits at August 31, 2010 and during the year ended August 31, 2010, were entirely covered by FDIC insurance or by pledged collateral held by the District's agent bank in the District's name.

### 2. Investments:

The District is required by Government Code Chapter 2256, The Public Funds Investment Act, to adopt, implement, and publicize an investment policy. That policy must address the following areas: (1) safety of principal and liquidity, (2) portfolio diversification, (3) allowable investments, (4) acceptable risk levels, (5) expected rates of return, (6) maximum allowable stated maturity of portfolio investments, (7) maximum average dollar-weighted maturity allowed based on the stated maturity date for the portfolio, (8) investment staff quality and capabilities, and (9) bid solicitation preferences for certificates of deposit.

The Public Funds Investment Act ("Act") requires an annual audit of investment practices. Audit procedures in this area conducted as a part of the audit of the basic financial statements disclosed that in the areas of investment practices, management reports and establishment of appropriate policies, the District adhered to the requirements of the Act. Additionally, investment practices of the District were in accordance with local policies.

The Act determines the types of investments which are allowable for the District. These include, with certain restrictions, 1) obligations of the U.S. Treasury, U.S. agencies, and the State of Texas, 2) certificates of deposit, 3) certain municipal securities, 4) securities lending program, 5) repurchase agreements, 6) bankers acceptances, 7) mutual funds, 8) investment pools, 9) guaranteed investment contracts, and 10) commercial paper.

The District's investment at August 31, 2010 are shown below.

<u>Investment or Investment Type</u>	<u>Maturity</u>	<u>Fair Value</u>
Lone Star Investment Pool	N/A	\$ 307,104
Total Investments		<u>\$ 307,104</u>

### 3. Analysis of Specific Deposit and Investment Risks

GASB Statement No. 40 requires a determination as to whether the District was exposed to the following specific investment risks at year end and if so, the reporting of certain related disclosures:

#### a. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. For the fiscal year 2010, the District invested in the Lone Star Investment Pool. Lone Star Investment Pool is duly chartered by the State of Texas Interlocal Cooperation Act and is administered by First Public, LLC and the Lone Star Liquidity Plus Fund was rated AAAM by Standard and Poor's Investor Service.

#### b. Custodial Credit Risk

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in the District's name.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED AUGUST 31, 2010

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either the counterparty or the counterparty's trust department or agent but not in the District's name.

At year end, the District was not exposed to custodial credit risk.

c. Concentration of Credit Risk

This risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. At year end, the District was not exposed to concentration of credit risk.

d. Interest Rate Risk

This is the risk that changes in interest rates will adversely affect the fair value of an investment. At year end, the District was not exposed to interest rate risk.

e. Foreign Currency Risk

This is the risk that exchange rates will adversely affect the fair value of an investment. At year end, the District was not exposed to foreign currency risk.

### Investment Accounting Policy

The District's general policy is to report money market investments and short-term participating interest-earning investment contracts at amortized cost and to report nonparticipating interest-earning investment contracts using a cost-based measure. However, if the fair value of an investment is significantly affected by the impairment of the credit standing of the issuer or by other factors, it is reported at fair value. All other investments are reported at fair value unless a legal contract exists which guarantees a higher value. The term "short-term" refers to investments which have a remaining term of one year or less at time of purchase. The term "nonparticipating" means that the investment's value does not vary with market interest rate changes. Nonnegotiable certificates of deposit are examples of nonparticipating interest-earning investment contracts.

### Public Funds Investment Pools

Public funds investment pools in Texas ("Pools") are established under the authority of the Interlocal Cooperation Act, Chapter 79 of the Texas Government Code, and are subject to the provisions of the Public Funds Investment Act (the "Act"), Chapter 2256 of the Texas Government Code. In addition to other provisions of the Act designed to promote liquidity and safety of principal, the Act requires Pools to: 1) have an advisory board composed of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool; 2) maintain a continuous rating of no lower than AAA or AAA-m or an equivalent rating by at least one nationally recognized rating service; and 3) maintain the market value of its underlying investment portfolio within one half of one percent of the value of its shares.

The District's investments in Pools are reported at an amount determined by the fair value per share of the pool's underlying portfolio, unless the pool is 2a7-like, in which case they are reported at share value. A 2a7-like pool is one which is not registered with the Securities and Exchange Commission ("SEC") as an investment company, but nevertheless has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED AUGUST 31, 2010

### D. Capital Assets

Capital asset activity for the year ended August 31, 2010, was as follows:

	Beginning Balances	Increases	Decreases	Ending Balances
<u>Governmental activities:</u>				
<i>Capital assets not being depreciated:</i>				
Land	\$ 359,065	\$ --	\$ --	\$ 359,065
Total capital assets not being depreciated	<u>359,065</u>	<u>--</u>	<u>--</u>	<u>359,065</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	11,213,975	--	--	11,213,975
Equipment	121,506	--	--	121,506
Vehicles	672,466	--	--	672,466
Specify another category here if needed	(55,756)	55,756	--	--
Total capital assets being depreciated	<u>11,952,191</u>	<u>55,756</u>	<u>--</u>	<u>12,007,947</u>
Less accumulated depreciation for:				
Buildings and improvements	(2,390,089)	(272,236)	--	(2,662,325)
Equipment	(102,960)	(7,002)	--	(109,962)
Vehicles	(385,119)	(50,260)	--	(435,379)
Total accumulated depreciation	<u>(2,878,167)</u>	<u>(329,498)</u>	<u>--</u>	<u>(3,207,665)</u>
Total capital assets being depreciated, net	<u>9,074,024</u>	<u>(273,742)</u>	<u>--</u>	<u>8,800,282</u>
Governmental activities capital assets, net	<u>\$ 9,433,089</u>	<u>\$ (273,742)</u>	<u>\$ --</u>	<u>\$ 9,159,347</u>

Depreciation was charged to functions as follows:

Instruction	\$ 173,223
Instructional Resources and Media Services	34,018
Instructional Leadership	4,228
School Leadership	5,294
Guidance, Counseling, & Evaluation Services	2,214
Health Services	94
Student Transportation	47,344
Food Services	6,258
Extracurricular Activities	14,576
General Administration	5,032
Plant Maintenance and Operations	36,531
Data Processing Services	687
	<u>\$ 329,498</u>

### E. Interfund Balances and Activities

#### 1. Due To and From Other Funds

Balances due to and due from other funds at August 31, 2010, consisted of the following:

Due To Fund	Due From Fund	Amount	Purpose
General Fund	Special Revenue Funds	\$ 9,814	Short-term loans
Special Revenue Funds	General Fund	7,561	Short-term loans
Debt Service	General Fund	124,261	Short-term loans
	Total	<u>\$ 141,636</u>	

All amounts due are scheduled to be repaid within one year.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED AUGUST 31, 2010

### 2. Transfers To and From Other Funds

Transfers to and from other funds at August 31, 2010, consisted of the following:

Transfers From	Transfers To	Amount	Reason
General fund	Workers' Compensation Fund	\$ 60,000	Supplement other funds sources Over Transfer
Workers' Compensation Fund	General fund	15,000	
	Total	<u>\$ 75,000</u>	

### F. Workers' Compensation

During the year ended August 31, 2010, the Schulenburg Independent School District participated in a self funded worker compensation program. Contributions were paid to a third party administrator, acting on behalf of the self funded pool. The contract between the Schulenburg Independent School District and the third party administrator is renewable September 1, 2010, and terms of coverage and contribution costs are included in the contractual provisions.

In accordance with state statutes, the District was protected against unanticipated catastrophic individual or aggregate loss by reinsurance coverage carried through Midwest Employers. Reinsurance coverage was in effect for individual claims exceeding \$500,000 and for aggregate claims with a statutory limit of \$5,000,000. Claims Administrative Services Inc. reported that the District had total unpaid claims of \$39,764 and there was \$139,761 in claims incurred but not reported (IBNR) at August 31, 2010.

### G. Long-Term Obligations

#### 1. Long-Term Obligation Activity

Long-term obligations include debt and other long-term liabilities. Changes in long-term obligations for the year ended August 31, 2010, are as follows:

	Original Issue	Beginning Balance	Net Changes	Ending Balance	Amounts Due Within One Year
<u>Governmental activities:</u>					
Building Bonds, Series 2003	\$ 6,565,000	\$ 6,390,000	\$ (185,000)	\$ 6,205,000	\$ 195,000
Maint. Tax Notes, Series 2003	743,190	514,009	(38,197)	475,812	38,197
Maint. Tax Notes, Series 2003B	325,000	224,777	(16,704)	208,073	16,704
Total governmental activities	<u>\$ 7,633,190</u>	<u>\$ 7,128,786</u>	<u>\$ (239,900)</u>	<u>\$ 6,888,886</u>	<u>\$ 249,901</u>

Current requirements for principal and interest expenditures for the bond issues are accounted for in the Debt Service Fund. This bond was issued as school building bonds and the interest rate on the bond is 3.75% to 4.60%

Interest expense was \$273,760 for the year ended August 31, 2010. The maintenance tax notes are accounted for in the General Fund, the interest rate is 2.3% to 6.40% and interest expense was 5,503.92 for the year ended August 31, 2010.



# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED AUGUST 31, 2010

### K. Retiree Health Care Plan

#### 1. Plan Description

The District contributes to the Texas Public School Retired Employees Group Insurance Program (TRS-Care), a cost-sharing multiple-employer defined benefit postemployment health care plan administered by the Teacher Retirement System of Texas (TRS). TRS-Care Retired Plan provides health care coverage for certain persons (and their dependents) who retired under the Teacher Retirement System of Texas. The statutory authority for the program is Texas Insurance Code, Chapter 1575. Section 1575.052 grants the TRS Board of Trustees the authority to establish and amend basic and optional group insurance coverage for participants. The TRS issues a publicly available financial report that includes financial statements and required supplementary information for TRS-Care. That report may be obtained by visiting the TRS web site at [www.trs.state.tx.us](http://www.trs.state.tx.us), by writing to the Communications Department of the Teacher Retirement System of Texas at 1000 Red River Street, Austin, Texas 78701, or by calling 1-800-223-8778.

#### 2. Funding Policy

Contribution requirements are not actuarially determined but are legally established each biennium by the Texas Legislature. Texas Insurance Code, Sections 1575.202, 203, and 204 establish state, active employee, and public school contributions, respectively. The State of Texas and active public school employee contribution rates were 1.0% and 0.65% of public school payroll, respectively, with school districts contributing a percentage of payroll set at 0.55% for fiscal years 2010, 2009 and 2008. Per Texas Insurance Code, Chapter 1575, the public school contribution may not be less than 0.25% or greater than 0.75% of the salary of each active employee of the public school. For the years ended August 31, 2010, 2009, and 2008, the State's contributions to TRS-Care were \$4,935, \$2,028, and \$2,532, respectively, the active member contributions were \$28,788, \$26,700, and \$27,011, respectively, and the District's contributions were \$24,359, \$22,592, and \$22,855, respectively, which equaled the required contributions each year.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003, which was effective January 1, 2006, established prescription drug coverage for Medicare beneficiaries known as Medicare Part D. One of the provisions of Medicare Part D allows for the Texas Public School Retired Employee Group Insurance Program (TRS-Care) to receive retiree drug subsidy payments from the federal government to offset certain prescription drug expenditures for eligible TRS-Care participants. For the fiscal years ended August 31, 2010, 2009, and 2008, the subsidy payments received by TRS-Care on behalf of the District were \$11,131, \$9,769, and \$9,701, respectively.

### L. Employee Health Care Coverage

During the year ended August 31, 2010, employees of the District were covered by a health insurance plan (the Plan). The District paid premiums of \$275 per month per employee to the Plan. Employees, at their option, authorized payroll withholdings to pay premiums for dependents. All premiums were paid to a licensed insurer. The Plan was authorized by Section 21.922, Texas Education Code and was documented by contractual agreement.

The contract between the District and the licensed insurer is renewable September 1, 2010, and terms of coverage and premium costs are included in the contractual provisions.

# SCHULENBURG INDEPENDENT SCHOOL DISTRICT

NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED AUGUST 31, 2010

## M. Commitments and Contingencies.

### 1. Contingencies

The District participates in grant programs which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the District has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectibility of any related receivable may be impaired. In the opinion of the District, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying basic financial statements for such contingencies.

### 2. Litigation

No reportable litigation was pending against the District at August 31, 2010.

## N. Shared Services Arrangements

### Shared Services Arrangement - Fiscal Agent

The District is the fiscal agent for a Shared Services Arrangement ("SSA") which provides resource education services to the member districts listed below. All services are provided by the fiscal agent. The member districts and federal and state grants provide the funds to the fiscal agent. According to guidance provided in TEA's Resource Guide, the District has accounted for the fiscal agent's activities of the SSA in special revenue funds as required by the TEA's Resource Guide and are accounted for using Model 3 in the SSA section of the Resource Guide. Expenditures of of the SSA are summarized as follows: Schulenburg ISD \$574,002.51; Flatonia ISD \$287,693.71; Waelder ISD \$168,883.97.

**APPENDIX C**

**FORM OF BOND COUNSEL'S OPINION**

\_\_\_\_\_, 2011

WE HAVE ACTED as Bond Counsel for the Schulenburg Independent School District (the “District”) in connection with an issue of bonds (the “Bonds”) described as follows:

SCHULENBURG INDEPENDENT SCHOOL DISTRICT UNLIMITED TAX REFUNDING BONDS, SERIES 2011, dated November 1, 2011, in the aggregate principal amount of \$\_\_\_\_\_.

The Bonds mature, bear interest, are subject to redemption prior to maturity and may be transferred and exchanged as set out in the Bonds and in the order (the “Order”) adopted by the Board of Trustees of the District authorizing their issuance.

WE HAVE ACTED as Bond Counsel for the sole purpose of rendering an opinion with respect to the legality and validity of the Bonds under the Constitution and laws of the State of Texas and with respect to the exclusion of interest on the Bonds from gross income under federal income tax law. In such capacity we have examined the Constitution and laws of the State of Texas; federal income tax law; and a transcript of certain certified proceedings pertaining to the issuance of the Bonds and the bonds that are being refunded (the “Refunded Bonds”) with the proceeds of the Bonds, as described in the Order. The transcript contains certified copies of certain proceedings of the District and the Wells Fargo Bank, N.A. (the “Escrow Agent”); the report (the “Report”) of Grant Thornton LLP (the “Verification Agent”), which verifies the sufficiency of the deposits made with the Escrow Agent for the defeasance of the Refunded Bonds and the mathematical accuracy of certain computations of the yield on the Bonds and the obligations acquired with the proceeds of the Bonds; certain certifications and representations and other material facts within the knowledge and control of the District, upon which we rely; and certain other customary documents and instruments authorizing and relating to the issuance of the Bonds and the firm banking and financial arrangements for the discharge and final payment of the Refunded Bonds. We have also examined executed Bond No. R-1 of this issue.

WE HAVE NOT BEEN REQUESTED to examine, and have not investigated or verified, any original proceedings, records, data or other material, but have relied upon the transcript of certified proceedings. We have not assumed any responsibility with respect to the financial condition or capabilities of the District or the disclosure thereof in connection with the sale of the Bonds. Our role in connection with the District’s Official Statement prepared for use in connection with the sale of the Bonds has been limited as described therein.

BASED ON SUCH EXAMINATION, it is our opinion as follows:

- (1) The transcript of certified proceedings evidences complete legal authority for the issuance of the Bonds in full compliance with the Constitution and laws of the State of Texas presently in effect; the Bonds constitute valid and legally binding obligations of the District enforceable in accordance with the terms and conditions thereof, except to the extent that the rights and remedies of the owners of the Bonds may be limited by laws heretofore or hereafter enacted relating to bankruptcy, insolvency, reorganization, moratorium or other similar laws affecting the rights of creditors of political subdivisions and the exercise of judicial discretion in appropriate cases; and the Bonds have been authorized and delivered in accordance with law;
- (2) The Bonds are payable, both as to principal and interest, from the receipts of an annual ad valorem tax levied, without legal limit as to rate or amount, upon all taxable property located within the District, which taxes have been pledged irrevocably to pay the principal of and interest on the Bonds; and
- (3) The escrow agreement between the District and the Escrow Agent (the "Escrow Agreement") has been duly executed and delivered and constitutes a binding and enforceable agreement in accordance with its terms; the establishment of the Escrow Fund pursuant to the Escrow Agreement and the deposit made therein constitute the making of firm banking and financial arrangements for the discharge and final payment of the Refunded Bonds; in reliance upon the accuracy of the calculations contained in the Report, the Refunded Bonds, having been discharged and paid, are no longer outstanding and the lien on and pledge of ad valorem taxes and other revenues as set forth in the order authorizing their issuance will be appropriately and legally defeased; the holders of the Refunded Bonds may obtain payment of the principal of, redemption premium, if any, and interest in the Refunded Bonds only out of the funds provided therefor now held in escrow for that purpose by the Escrow Agent pursuant to the terms of the Escrow Agreement; and therefore the Refunded Bonds are deemed to be fully paid and no longer outstanding, except for the purpose of being paid from the funds provided therefor in such Escrow Agreement.

BASED ON OUR EXAMINATION AS DESCRIBED ABOVE, it is further our opinion that, subject to the restrictions hereinafter described, interest on the Bonds is excludable from gross income of the owners thereof for federal income tax purposes under existing law and is not subject to the alternative minimum tax on individuals or, except as hereinafter described, corporations. The opinion set forth in the first sentence of this paragraph is subject to the condition that the District comply with all requirements of the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon be, or continue to be, excluded from gross income for federal income tax purposes. The District has covenanted in the Order to comply with each such requirement. Failure to comply with certain of such requirements may cause the inclusion of interest on the Bonds in gross income for federal income tax purposes to be retroactive to the date of issuance of the Bonds. The Code and the existing regulations, rulings and court decisions thereunder, upon which the foregoing opinions of Bond Counsel are based, are subject to change, which could prospectively or retroactively result in the inclusion of the interest on the Bonds in gross income of the owners thereof for federal income tax purposes.

INTEREST ON all tax-exempt obligations, including the Bonds, owned by a corporation (other than an S corporation, a regulated investment company, a real estate investment trust (REIT), a real estate mortgage investment conduit (REMIC) or a financial asset securitization investment trust (FASIT)) will be included in such corporation's adjusted current earnings for purposes of calculating such corporation's alternative minimum taxable income. A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by the Code is computed.

EXCEPT AS DESCRIBED HEREIN, we express no opinions as to any other matters except with respect to the excludability of the interest on the Bonds from gross income from the owners thereof for federal income tax purposes.

IN PROVIDING THE FOREGOING OPINIONS, we have relied upon representations of the District with respect to matters solely within the knowledge of the District, which we have not independently verified, and have assumed the accuracy and completeness thereof.

IN ADDITION, EXCEPT AS DESCRIBED ABOVE, we express no opinion as to any federal, state or local tax consequences under present law, or future legislation, resulting from the ownership of, receipt or accrual of interest on, or the acquisition or disposition of, the Bonds. Prospective purchasers of the Bonds should be aware that the ownership of tax-exempt obligations, such as the Bonds, may result in collateral federal income tax consequences to, among others, financial institutions, property and casualty insurance companies, certain foreign corporations doing business in the United States, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who are deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations, taxpayers owning an interest in a FASIT that holds tax-exempt obligations and individuals otherwise qualified for the earned income credit. For the foregoing reasons, prospective purchasers should consult their tax advisors as to the consequences of investing in the Bonds.

OUR OPINIONS ARE BASED ON EXISTING LAW, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service; rather, such opinions represent our legal judgment based upon our review of existing law that we deem relevant to such opinions and in reliance upon the representations and covenants referenced above.

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**COASTAL SECURITIES, INC.**

*Financial Advisor to the District*