

PRELIMINARY OFFICIAL STATEMENT DATED AUGUST 30, 2010

Rating: Moody's Investors Service: "____"
Standard & Poor's Ratings Group "____"

See ("THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM", AND
"OTHER INFORMATION – RATINGS") HEREIN

NEW ISSUE - Book-Entry-Only

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" herein, and is not includable in the alternative minimum taxable income of individuals or corporations. See "TAX MATTERS" for a discussion of the opinion of Bond Counsel.

The District will designate the Bonds as qualified tax exempt obligations. See "QUALIFIED TAX-EXEMPT OBLIGATIONS."

\$8,999,898.95*
SHELDON INDEPENDENT SCHOOL DISTRICT
(Harris County, Texas)
UNLIMITED TAX SCHOOL BUILDING BONDS
SERIES 2010A

Dated Date: October 1, 2010

Due: February 15, as shown on the inside cover page hereof

The Sheldon Independent School District Unlimited Tax School Building Bonds, Series 2010A (the "Bonds") are issued in part as current interest bonds ("CIBs") and in part as premium capital appreciation bonds ("CABs"). The Bonds are issued pursuant to the Constitution and general laws of the State of Texas (the "State") including particularly Chapter 45, Texas Education Code, and an election held within the District on October 7, 2000, and are direct obligations of the Sheldon Independent School District (the "District"), payable from a continuing direct annual ad valorem tax levied, without legal limit as to rate or amount, on all taxable property located within the District, as provided by an order adopted by the Board of Trustees of the District authorizing the Bonds (the "Order"). (See "THE BONDS – Authority for Issuance").

The CIBs are dated October 1, 2010 (the "Dated Date"); but interest will accrue from the date of delivery to the Underwriters (as defined herein), and will be payable on August 15 and February 15 of each year until maturity or prior redemption, commencing February 15, 2011. Interest on the CABs will accrete from the date they are initially delivered to the Underwriters, compounded semiannually on February 15 and August 15, commencing February 15, 2011, and will be payable only upon maturity. The CIBs will be issued in principal denominations of \$5,000 or any integral multiple thereof within a maturity. The CABs will be issued in denominations of \$5,000 of the total amount of principal, plus the initial premium, if any, and accrued interest payable upon maturity (the "Maturity Amount"), or any integral multiple thereof within a maturity. Principal of the CIBs and the Maturity Amount of the CABs will be payable by the Paying Agent/Registrar, initially The Bank of New York Mellon Trust Company, N.A., Dallas, Texas (the "Paying Agent/Registrar"), upon presentation and surrender of the Bonds for payment. Interest accruing on the CIBs and the accreted/compounded interest on the CABs will be calculated on the basis of a 360-day year of twelve 30-day months. (See "THE BONDS—Description").

The definitive Bonds will be initially registered and delivered to Cede & Co., the nominee of the Depository Trust Company ("DTC") pursuant to the Book-Entry-Only System described herein. Beneficial ownership of the Bonds may be acquired in denominations of \$5,000 of principal or Maturity Amount, as applicable, or integral multiples thereof. **No physical delivery of the Bonds will be made to the beneficial owners thereof.** Principal, premium, if any, interest on the CIBs and the Maturity Amount of the CABs will be payable by the Paying Agent/Registrar to Cede & Co., which will make distribution of the amount 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").

The District has applied for and received conditional approval for the payment of the principal and interest of the Bonds to be guaranteed by the corpus of the Permanent School Fund of the State of Texas. (See "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM").

Proceeds from the sale of the Bonds will be used for (1) the construction, acquisition and equipping of school buildings (2) the acquisition of necessary sites for school buildings in the District and (3) the payment of the costs of issuing the Bonds. (See "THE BONDS—Sources and Uses of Funds").

The CIBs maturing on and after February 15, 2020, are subject to optional redemption in whole or in part on February 15, 2019, or any date thereafter, at a price equal to the principal amount thereof, plus accrued interest to the date of redemption. The CABs are not subject to redemption prior to maturity. (See "THE BONDS—Optional Redemption").

SEE MATURITY SCHEDULE ON THE INSIDE COVER PAGE

The Bonds are offered for delivery when, as and if issued and received by the underwriters listed below (the "Underwriters") and will be subject to the approving opinion of the Attorney General of Texas and the approval of certain legal matters by Andrews Kurth LLP, Houston, Texas, Bond Counsel (see "APPENDIX C – FORM OF BOND COUNSEL'S OPINION"). Certain legal matters will be passed upon for the Underwriters by their Counsel, Vinson & Elkins, LLP, Houston, Texas.

It is expected that the Bonds will be available for delivery through the facilities of The Depository Trust Company on or about October 6, 2010.

* Preliminary, subject to change.

Morgan Keegan and Co., Inc.

Piper Jaffray & Co.

First Public, LLC

The Preliminary Official Statement and the information contained herein are subject to completion or amendment. These securities may not be sold, nor any offers to buy be accepted prior to the time the Official Statement is delivered in final form. Under no circumstances shall this Preliminary Official Statement constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation, or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction.

MATURITY SCHEDULE

**SHELDON INDEPENDENT SCHOOL DISTRICT
(Harris County, Texas)**

\$8,999,898.95* UNLIMITED TAX SCHOOL BUILDING BONDS, SERIES 2010A

\$8,765,000* Current Interest Bonds

<u>Maturity</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Initial Reoffering Yield</u> ^(b)	<u>CUSIP NO.</u> ^(c)	<u>Maturity</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Initial Reoffering Yield</u> ^(b)	<u>CUSIP NO.</u> ^(c)
2/15/2012	\$ 190,000	%	%		2/15/2027 ^(a)	\$ 305,000	%	%	
****					2/15/2028 ^(a)	320,000			
2/15/2015	195,000				2/15/2029 ^(a)	330,000			
2/15/2016	200,000				2/15/2030 ^(a)	345,000			
2/15/2017	210,000				2/15/2031 ^(a)	360,000			
2/15/2018	215,000				2/15/2032 ^(a)	375,000			
2/15/2019	225,000				2/15/2033 ^(a)	395,000			
2/15/2020 ^(a)	230,000				2/15/2034 ^(a)	410,000			
2/15/2021 ^(a)	235,000				2/15/2035 ^(a)	430,000			
2/15/2022 ^(a)	245,000				2/15/2036 ^(a)	450,000			
2/15/2023 ^(a)	255,000				2/15/2037 ^(a)	470,000			
2/15/2024 ^(a)	270,000				2/15/2038 ^(a)	490,000			
2/15/2025 ^(a)	280,000				2/15/2039 ^(a)	510,000			
2/15/2026 ^(a)	290,000				2/15/2040 ^(a)	535,000			

(Interest to accrue from the Date of Delivery)

\$234,898.95* Capital Appreciation Bonds^(d)

<u>Maturity</u>	<u>Principal</u>	<u>Yield to Maturity</u> ^(b)	<u>Maturity Amount</u>	<u>Initial Offering Price per \$5,000 in Maturity Amount</u>	<u>CUSIP NO.</u> ^(c)
2/15/2013 ^(d)	\$ 127,920.00	%	\$	\$	
2/15/2014 ^(d)	106,978.95				

(Interest to accrete from the Date of Delivery)

* Preliminary, subject to change.

^(a) The District reserves the right, at its option, to redeem CIBs having stated maturities on and after February 15, 2020, in whole or in part, in principal amounts of \$5,000 or any integral multiple thereof, on February 15, 2019, or any date thereafter, at the par value thereof plus accrued interest to the date of redemption. (See "THE BONDS – Optional Redemption")

^(b) 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.

^(c) CUSIP numbers have been assigned to this issue by CUSIP Global Services managed by Standard & Poor's Financial Services LLC on behalf of the American Bankers Association and are included solely for the convenience of the purchasers of the Bonds. None of the District, the Financial Advisor, or the Underwriters shall be responsible for the selection or correctness of the CUSIP numbers set forth herein.

^(d) The CABs are not subject to redemption prior to maturity.

DISTRICT OFFICIALS, STAFF AND CONSULTANTS

<u>Name</u>	<u>Title</u>	<u>Years of Service</u>	<u>Term Expires November</u>	<u>Occupation</u>
Fred Rivas	President	4	2010	Rotating Equipment & Repair (RER)
Ken Coleman	Vice President	4	2010	Xerox Corporation - Representative
Eileen Palmer	Secretary	3	2012	Grossman & Waldman LLP
Ed Lipscomb	Member	9	2010	Tyco Valves and Controls
Debbie Kolacny	Member	14	2010	Office of Wayne Smith, TX State Rep
Latricia Archie	Member	1	2012	Homemaker
Keith Norwood	Member	1	2012	St. Luke Missionary Baptist Church

Administrators

<u>Name</u>	<u>Title</u>	<u>Years in Position</u>
Dr. Vickey Giles	Superintendent	2
Larry Pfeifer	Assistant Superintendent of Administrative Services	8
Dr. Joan Bowman	Assistant Superintendent of Instructional Services	2
Abraham George	Chief Financial Officer	8

Consultants and Advisors

Certified Public Accountant	Null Lairson, CPA Houston, Texas
Bond Counsel	Andrews Kurth LLP Houston, Texas
Financial Advisor	Coastal Securities, Inc. Houston, Texas

USE OF INFORMATION IN OFFICIAL STATEMENT

This Official Statement, which includes the cover page, schedule and the Appendices attached 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.

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.

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.

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 THE BONDS HAVE BEEN REGISTERED, QUALIFIED, OR EXEMPTED SHOULD NOT BE REGARDED AS A RECOMMENDATION THEREOF.

IN CONNECTION WITH THE OFFERING OF THE BONDS, THE UNDERWRITERS 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 Underwriters 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** Sheldon Independent School District (the “District”) operates as an independent school district under the laws of the State of Texas. It is located in Harris County, Texas. (See “THE DISTRICT”).
- The CIBs** The current interest bonds (the “CIBs”) are being issued in the principal amounts and mature on the dates set forth on page ii hereof. The CIBs are dated October 1, 2010, but interest will accrue from the date of delivery to the Underwriters at the rates per annum set forth on the inside cover hereof, which interest is payable each August 15 and February 15, commencing February 15, 2011, until maturity or prior redemption. (See “THE BONDS—Description”).
- The CABs** The premium capital appreciation bonds (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 accrues from the date of delivery to the Underwriters and will be compounded February 15 and August 15 of each year, commencing February 15, 2011, and will be payable only at maturity (see “THE BONDS – Description”).
- Authority for Issuance** ... The District’s Unlimited Tax School Building Bonds, Series 2010A (the “Bonds”) are being issued pursuant to an order passed by the Board of Trustees of the District (the “Order”), the Constitution and general laws of the State of Texas, including particularly Chapter 45, Texas Education Code, as amended, and an election held in the District on October 7, 2000. (See “THE BONDS - Authority for Issuance”).
- Security for Bonds** Principal of and interest on the Bonds will be payable from the receipts of a continuing direct 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 “TAX RATE LIMITATIONS”).
- Permanent School Fund Guarantee** The District has applied to the Texas Education Agency and has received conditional approval for the payment of the principal and interest on the Bonds to be guaranteed by the corpus of the Permanent School Fund of the State of Texas. (See “THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM”).
- Optional Redemption** The District reserves the right, at its option, to redeem the CIBs having stated maturities on and after February 15, 2020, in whole or in part, in principal amounts of \$5,000 or any integral multiple thereof, on February 15, 2019, or any date thereafter, at the par value 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 for (1) the construction, acquisition and equipping of school buildings (2) the acquisition of necessary sites for school buildings in the District, and (3) the payment of the 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” herein, and is not includable in the alternative minimum taxable income of individuals or corporations. See “TAX MATTERS” for a discussion of the opinion of Bond Counsel.
- Qualified Tax-Exempt Obligations** The District will designate the Bonds as qualified tax-exempt obligations. See “QUALIFIED TAX-EXEMPT OBLIGATIONS”
- Rating** Moody’s Investors Service (“Moody’s”) and Standard & Poor’s Ratings Group (“S&P”) have assigned their municipal bond ratings of “ ” and “ ”, respectively to the Bonds by virtue of the guarantee of the Permanent School Fund of the State of Texas on 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. Beneficial ownership of the Bonds may be acquired in denominations of \$5,000 of principal or Maturity Amount, as applicable, or integral multiples thereof. No physical delivery of the Bonds will be made to the beneficial owners thereof. Principal of, premium, if any, and interest on the CIBs and Maturity Amount of the CABs 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

Fiscal Year Ended 31-Aug	Estimated District Population ^(a)	Taxable Assessed Valuation ^(b)	Per Capita Taxable Assessed Valuation	Ad Valorem Tax-Supported Debt ^(c)	Per Capita Tax-Supported Tax Debt	Ratio Tax Debt to Assessed Valuation	Tax Year
2002	17,681	\$ 1,604,024,852	\$ 90,720.26	\$ 50,543,989	\$ 2,858.66	3.15%	2001
2003	17,101	1,918,066,708	112,161.08	55,093,989	3,221.68	2.87%	2002
2004	19,847	1,749,209,818	88,134.72	70,333,989	3,543.81	4.02%	2003
2005	21,070	1,464,060,338	69,485.54	72,211,914	3,427.24	4.93%	2004
2006	23,414	1,927,391,387	82,317.90	88,546,338	3,781.77	4.59%	2005
2007	24,302	2,167,878,396	89,205.76	142,072,818	5,846.14	6.55%	2006
2008	24,997	3,262,365,274	130,510.27	156,522,817	6,261.66	4.80%	2007
2009	26,509	3,695,490,933	139,405.14	152,962,817	5,770.22	4.14%	2008
2010	26,509	4,214,129,540	158,969.77	166,102,533 ^(d)	6,265.89 ^(d)	3.94% ^(d)	2009

^(a) Population estimates obtained from Texas Municipal Reports.

^(b) Net of exemptions. Assessed valuations do not include adjustments in supplemental rolls made after the end of each fiscal year.

^(c) Includes the Cumulative Sinking Fund Deposits for the District's QZAB Bonds Series 2000B, 2001B and 2005.

^(d) Includes the Bonds. Preliminary, subject to change.

General Fund Consolidated Statement Summary

	2009	2008	2007	2006	2005
Beginning Balance	\$ 23,001,222	\$16,168,865	\$ 11,700,211	\$ 7,376,194	\$ 9,024,036
Total Revenue	56,248,674	54,246,840	48,320,524	37,584,125	31,636,703
Total Expenditures	57,144,915	47,474,771	43,860,478	41,803,884	33,534,992
Net Other Resources (Uses)	(83,137)	60,289	8,608	8,543,776	250,447
Ending Balance	\$ 22,021,844	\$23,001,223	\$ 16,168,865	\$ 11,700,211	\$ 7,376,194

For additional information regarding the District, please contact:

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 Superintendent
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**SHELDON INDEPENDENT SCHOOL DISTRICT
(Harris County, Texas)**

\$8,999,898.95*

**UNLIMITED TAX SCHOOL BUILDING BONDS
SERIES 2010A**

INTRODUCTION

This Official Statement, including the Schedule and Appendices hereto, provides certain information regarding the issuance of the Sheldon Independent School District (the "District") Unlimited Tax School Building Bonds, Series 2010A (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 of 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 to its date, and the information contained herein is subject to change. Copies of the Final Official Statement pertaining to the Bonds will be deposited with the Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. 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 Bonds shall be dated October 1, 2010, and will be issued in part as current interest bonds ("CIBs") and in part as premium capital appreciation bonds ("CABs"). Interest accruing on the CIBs and the accreted/compounded interest on the CABs will be calculated on the basis of a 360-day year of twelve 30-day months. The paying agent and transfer agent (the "Paying Agent/Registrar") for the Bonds is initially The Bank of New York Mellon Trust Company, N.A., Dallas, Texas.

Initially, the Bonds will be registered and delivered only to Cede & Co., the nominee of The Depository Trust Company ("DTC") pursuant to the Book-Entry-Only System described below. No physical delivery of the Bonds will be made to the beneficial owners. Principal and Maturity Amount (hereinafter defined) of the Bonds at maturity or upon prior redemption (with respect to the CIBs), and interest on the CIBs will be payable by the Paying Agent/Registrar to Cede & Co., which will distribute the amounts paid to the participating members of DTC for subsequent payment to the beneficial owners of the Bonds. See "BOOK-ENTRY-ONLY SYSTEM" for a more complete description of such system.

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 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.

CIBs. The CIBs are to mature on the dates and in the principal amounts shown on page ii hereof. The CIBs will each be issued as fully registered obligations in principal denominations of \$5,000 or any integral multiple thereof within a maturity. The CIBs are dated October 1, 2010, but interest will accrue from the date of delivery to the underwriters listed on the cover page of this Official Statement (the "Underwriters"), at the interest rates shown on page ii hereof and such interest shall be payable to the registered owners thereof on February 15, 2011, and semiannually thereafter on February 15 and August 15 in each year, until maturity or prior redemption.

* Preliminary, subject to change.

Interest on the CIBs will be payable to the registered owner whose name appears on the bond registration books of the Paying Agent/Registrar at the close of business on the Record Date (hereinafter defined) and such accrued interest will be paid by (i) check sent United States mail, first class, postage prepaid, to the address of the registered owner appearing on such registration books of the Paying Agent/Registrar or (ii) such other method, acceptable to the Paying Agent/Registrar, requested by, and at the risk and expense of, the registered owner. See "Transfer, Exchange and Registration" and "Record Date for Interest Payment." The principal of the CIBs at maturity or on a prior redemption date will be payable only upon presentation of such Bonds at the designated office of the Paying Agent/Registrar.

CABs. The CABs will mature on the dates and in the Maturity Amounts set forth on page ii hereof. The CABs will be issued as fully registered obligations in Maturity Amounts of \$5,000 or any integral multiple thereof within a maturity. The "Maturity Amount" for the CABs represents the total amount of principal, plus the initial premium, if any, paid therefore, and the accreted/compounded interest thereon at maturity. The CABs will be initially priced by discounting the Maturity Amount to the issue price paid therefor by the initial purchaser (being the original principal amount shown on page ii and any premium paid therefor) and using the applicable approximate yield shown on page ii of this Official Statement as the discount rate and providing for such Maturity Amount to be discounted semiannually on February 15 and August 15 in each year, commencing February 15, 2011. The Maturity Amount of the CABs will be payable only at maturity. A table of Accreted Values of the CABs per \$5,000 Maturity Amount based on (i) the initial offering prices and (ii) the approximate initial yields set forth on page ii of this Official Statement is presented in Schedule I attached hereto, and such table of Accreted Values is provided for informational purposes only and may not reflect the prices or yields for the CABs in the secondary market. The Maturity Amount of the CABs will be payable only upon presentation of such Bonds at the designated office of the Paying Agent/Registrar.

Yield on CABs

The approximate 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 price includes the principal amount of such CABs plus premium, if any, 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 interest rates thereon. The yield on the CABs to a particular purchaser may differ depending upon the price paid by that 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 Constitution and laws of the State of Texas, including particularly Chapter 45, Texas Education Code, as amended, the Order and an election held in the District on October 7, 2000 (the "Election"). The Bonds constitute the eleventh installment of the total \$97,000,000 of unlimited tax school building bonds approved at the Election. After the issuance of the Bonds, the District will have \$1,760,000 of authorized but unissued bonds from the Election and \$35,100,000 of authorized but unissued bonds from an election held on November 7, 2006.

Security and Source of Payment

The Bonds constitute direct obligations of the District, payable as to principal and interest from a continuing direct annual ad valorem tax levied, without legal limit as to rate or amount, against all taxable property within the District. Additionally, the payment of principal of and interest on the Bonds is expected to be guaranteed by the Permanent School Fund Guarantee Program of Texas. See "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM" herein.

Optional Redemption

The District reserves the right, at its option, to redeem CIBs having stated maturities on and after February 15, 2020, in whole or in part in principal amounts of \$5,000 or any integral multiple thereof, on February 15, 2019, 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.

Notice of Redemption

Not less than 30 days prior to a redemption date for the CIBs, the Paying Agent/Registrar shall cause a notice of redemption to be sent by United States mail, first class, postage prepaid, to the registered owners of the CIBs to be redeemed, in whole or in part at the address of the registered owner appearing on the registration books of the Paying Agent/Registrar.

ANY NOTICE SO MAILED SHALL BE CONCLUSIVELY PRESUMED TO HAVE BEEN DULY GIVEN, WHETHER OR NOT THE REGISTERED OWNER RECEIVES SUCH NOTICE. NOTICE HAVING BEEN SO GIVEN, THE CIBS CALLED FOR

REDEMPTION SHALL BECOME DUE AND PAYABLE ON THE SPECIFIED REDEMPTION DATE, NOTWITHSTANDING THAT ANY CIB OR PORTION THEREOF HAS NOT BEEN SURRENDERED FOR PAYMENT, INTEREST ON SUCH CIB OR PORTION THEREOF SHALL CEASE TO ACCRUE.

The Paying Agent/Registrar and the District, so long as a Book-Entry-Only System is used for the Bonds, will send any notice of redemption, notice of proposed amendment to the Order or other notices with respect to the Bonds only to DTC. In such an event, DTC may implement, through its Book-Entry-Only System, a redemption of such CIBs held for the account of DTC participants in accordance with its rules or other agreements with DTC participants and then DTC participants and indirect participants may implement a redemption of such CIBs from the beneficial owners.

Any such selection of CIBs to be redeemed will not be governed by the Order and will not be conducted by the District or the Paying Agent/Registrar. Neither the District nor the Paying Agent/Registrar will have any responsibility to DTC participants, indirect participants or the persons for whom DTC participants act as nominees, with respect to the payments on the CIBs or the providing of notice to DTC participants, indirect participants, or beneficial owners of the selection of portions of the CIBs selected for redemption (see “THE BONDS – Book-Entry Only System”).

Any failure by DTC to advise any DTC participant, or of any DTC participant or indirect participant to notify the beneficial owner, shall not affect the validity of the redemption of the CIBs called for redemption or any other action premised on any such notice. Redemption of portions of the CIBs by the District will reduce the outstanding principal amount of such CIBs held by DTC.

Defeasance

The Order provides for the defeasance of 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, Maturity Amount 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 Standard & Poor’s highest rating: “AAA.” 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 and 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 CIBs 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 of 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 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 of 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.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the District believes to be reliable, but none of the District, the Financial Advisor or the Underwriters take responsibility for the accuracy thereof.

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 for the Bonds is The Bank of New York Mellon Trust Company, N.A., Dallas, 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, 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 or 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 other 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 the 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 defined 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 preceding month. In the event of a non-payment close 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 or provide for the appointment of a trustee to represent the interests of the bondholders upon any failure of the District to perform in accordance with the terms of the Order, or upon any other condition. If the District defaults in any payment due on the Bonds, and if the State of Texas fails to honor the Permanent School Fund Guarantee as hereinafter discussed, or if the District defaults in the observance or performance of any of the covenants, conditions, or obligations set forth in the Order, any registered owner is entitled to seek a writ of mandamus or mandatory injunction from a court of proper jurisdiction to compel the District to levy, assess and collect an annual ad valorem tax sufficient to pay principal or Maturity Amount of and interest on the Bonds as they become due or to perform other material covenants, conditions or obligations contained in the Order, as well as, for the Bonds, enforce rights of payment under the Permanent School Fund Guarantee. In general, Texas courts have held that a writ of mandamus may be issued to require a public official to perform legally imposed ministerial duties necessary for the performance of a valid contract; and, Texas law provides that, following their approval by the Attorney General and issuance, the Bonds are valid and binding obligations for all purposes according to their terms. However, 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. Such rights are in addition to any other rights the registered owners of the Bonds may be provided by the laws of the State of Texas 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. A registered owner of Bonds could file suit against the District if a default occurred in the payment of principal or Maturity Amount of or interest on any such Bonds; however, a suit for monetary damages could be vulnerable to the defense of sovereign immunity and any judgment could not be satisfied by execution against any property of the District.

The District is also eligible to seek relief from its creditors under Chapter 9 of the U.S. Bankruptcy Code ("Chapter 9"). Although Chapter 9 provides for the recognition of a security interest represented by a specifically pledged source of revenues, the pledge of taxes in support of a general obligation of a bankrupt entity is not specifically recognized as a security interest under Chapter 9. Chapter 9 also includes an automatic stay provision that would prohibit, without Bankruptcy Court approval, the prosecution of any other legal action by creditors or bondholders of an entity, which has sought protection under Chapter 9. Therefore, should the District avail itself of Chapter 9 protection from creditors, the ability to enforce would be subject to the approval of the Bankruptcy Court (which could require that the action be heard in Bankruptcy Court instead of other federal or state court); and, the Bankruptcy Code provides for broad discretionary powers of a Bankruptcy Court in administering any proceeding brought before it. The opinion of Bond Counsel will note that all opinions relative to the enforceability of the Order and the Bonds are qualified with respect to the customary rights of debtors relative to their creditors.

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. Also see “THE BONDS - Book-Entry-Only System” herein for a description of the duties of DTC with regard to ownership of Bonds.

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	
Net Premium	
Total	\$
 <u>Uses of Funds</u>	
Deposit to Construction Fund	\$
Costs of Issuance	
Underwriters’ Discount	
Deposit to Debt Service Fund (Additional Proceeds)	
Total	\$

THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM

This disclosure 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.

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 Texas Permanent School Fund (the “PSF” or the “Fund”). 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 2009, distributions to the ASF amounted to \$163.07 per student and the total amount distributed to the ASF was \$716.54 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, 2009 and for a description of the financial results of the PSF for the year ended August 31, 2009, the most recent year for which audited financial information regarding the Fund is available. The 2009 Annual Report is incorporated herein and made a part hereof for all purposes, but the 2009 Annual Report speaks only as of its date and the TEA has not obligated itself to update the 2009 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 and with the MSRB at 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, AMEX) 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. A list of the Fund's equity and fixed income holdings as of August 31, 2009 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 Education ("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 (see "Other Events and Disclosures").

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 anticipates that it will make similar \$100 million releases to the PSF in the 2010 and 2011 fiscal years. In November, 2008, 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, and in January 2009, the SBOE reconfirmed the 2.5% Distribution Rate, which was expected to produce transfers of approximately \$1.15 billion during the 2010-11 biennium, but also adopted a contingency plan in case the Distribution Rate should temporarily exceed the Ten Year Total Return during the 2010-2011 biennium. In November 2009, in accordance with GA-0707, and due to one of the constitutional measurements that limit transfers from the PSF, the SBOE determined that the authorized transfer amount for fiscal year 2010 would be limited to \$60.7 million. Depending on the value of the PSF and market conditions, the 2011 transfer could be sufficient to reach the full \$1.15 billion for the biennium, provided that the increase is in accordance with the Total Return Constitutional Amendment and a calculation to be made in 2011 of historic Fund returns. In July 2010, in accordance with provisions of State law, the SBOE voted to give notice to the Legislative Budget Board and the Governor that the Distribution Rate will be between 1.5% and 3.5% for the 2012 – 2013 biennium. The SBOE is expected to set the Distribution Rate for the upcoming biennium prior to the start of the next legislative session in January 2011. 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. 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. With respect to the charter school investment category, the SBOE Chair has indicated that she will seek an opinion of the Attorney General with respect to several questions presented by that allocation, including whether investments in Texas charter school facilities are consistent with the constitutionally-established prudent person standard applicable to the Fund. Any charter school investments would be made in part for the purpose of increasing funding for charter school facilities in the State.

The Fund's investment advisor is 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, 2009, based on unaudited records, the Fund was invested as follows: 67.40% in equity investments; 21.87% in fixed income investments; 10.70% in alternative assets; and 0.03% in cash.

In accordance with the Texas Constitution, the SBOE views the PSF as a perpetual institution. Consistent with its perpetual nature, the PSF 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.

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 the fiduciary standards, and to provide transactional advice in connection with the investment of Fund assets in non-traditional investments.

Prior to June 1995, the PSF was invested exclusively by the internal staff of the TEA's Investments Office, under the direction of the Executive Administrator of the Fund. The portion of the Fund that is managed by external managers declined from 39% at August 31, 2002 to 26.46% at August 31, 2008, in large part due to legislative appropriations riders that reduced the appropriation for the administrative costs of managing the Fund during that period, including, in particular, the payment of fees of external managers. As the TEA has implemented its asset allocation policies since 2005 in a manner outlined in GA-0293, the portion of the Fund that is administered by external managers has begun to increase, in large part due to changes in the fair market value of the various asset classes, and at August 31, 2009 29.87% of the Fund was managed by external managers.

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 (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 guarantee 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. Effective September 1, 2009, 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.

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 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. 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, 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, 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). For the years ending on and after August 31, 1998, the State Auditor has separately audited the financial statements of the PSF. The TEA has filed the audited annual report of the PSF for the year ended August 31, 2009 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 issuers 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(1)	Market Value(1)
2005	\$18,497,507,739	\$25,994,480,027
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(2)	25,443,104,623(2)

(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, 2009, land, external real estate investments and mineral assets managed by the SLB had book values of approximately \$471.4 million, \$979.9 million, and \$13.4 million, respectively, and market values of approximately \$817.3 million, \$622.8 million, and \$2.628 billion, respectively.

(2) At July 31, 2010, the PSF had a book value of \$23,532,592,541 and a market value of \$27,575,380,568 (in each case, based on unaudited data).

Permanent School Fund Guaranteed Bonds	
At 8/31	Principal Amount(1)
2005	\$35,230,425,201
2006	37,793,429,328
2007	44,856,621,419
2008	49,860,572,025
2009(2)	50,032,724,439

(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) At July 31, 2010, there were \$49,577,720,694 of bonds guaranteed under the Guarantee Program and the capacity of the Guarantee Program was \$70,597,777,623 based on the three times cost value multiplier approved by the SBOE on May 21, 2010 (based on unaudited data). Such capacity figures include the Reserve Capacity.

Discussion and Analysis Pertaining to Fiscal Year Ended August 31, 2009

The following discussion is derived from the Annual Report for the year ended August 31, 2009, 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, 2009, 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 2009, the total Fund balance was \$22.6 billion and includes a restatement of beginning Fund balance by \$197 million, resulting from the implementation of GASB Statement 52, Land and Other Real Estate Held as Investments by Endowments. Including the result of the restatement, Fund balance decreased \$2.6 billion from the prior year. 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 -8.47%, -0.63%, 4.35% and 3.67% 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 -17.63%, -0.24%, and 4.00% 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, 2009, the PSF(SBOE) portion of the Fund had diversified into emerging market international equities and absolute return funds. Searches for real estate and private equity advisors are underway and other asset classes such as 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. During fiscal year 2009, the SLB made capital commitments to four externally managed real assets investment funds in a total amount of \$200 million. At August 31, 2009, the SLB had approved total capital commitments of \$1.9 billion to thirty-three funds, of which \$920 million remains unfunded.

The PSF(SBOE)'s investment in equity securities experienced a return of -16.68% during the fiscal year ended August 31, 2009. The PSF(SBOE)'s investment in fixed income securities produced a return of 10.20% during the fiscal year and absolute return investments yielded a return of -4.86%. Combined, all PSF(SBOE) asset classes produced an investment return of -8.47% for the fiscal year ended August 31, 2009, outperforming the target index by approximately 17 basis points. All PSF(SLB) real assets (including cash) returned -17.63% for the fiscal year ending August 31, 2009.

For fiscal year 2009, total revenues, inclusive of unrealized gains and losses and net of security lending rebates and fees, continued to decline, totaling negative \$1.98 billion by the end of the year. This decline is primarily attributable to the fact that domestic and international securities markets were lower in all sectors in fiscal year 2009 and the fair market valuations of the Fund's assets experienced declines commensurate with market conditions. In fiscal year 2009, 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. Total operating expenditures, net of security lending rebates and fees, decreased 29.3% for the fiscal year ending August 31, 2009. 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 2008 and 2009, this distribution to the ASF totaled \$716.54 million and \$716.5 million, respectively.

At the end of the 2009 fiscal year, PSF assets guaranteed \$50.03 billion in bonds issued by 781 local school districts. Since its inception in 1983, the Fund has guaranteed 4,050 school district bond issues totaling \$85.9 billion in principal amount. During the 2009 fiscal year, the number of outstanding issues guaranteed under the Guarantee Program decreased by 65, or -2.5%. The dollar amount of guaranteed school bond issues outstanding increased by \$172.1 million or 0.3%. The guarantee capacity of the Fund increased by \$445.7 million, or 0.8%, during fiscal year 2009.

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.

For the 2008-2009 biennium, the SBOE requested an additional appropriation of approximately \$18 million to be used for the implementation of the 2008 Asset Allocation Policy. Such amount was requested in addition to a general operating appropriation for 2008-2009 of \$14 million. The 2007 Legislature appropriated \$9 million of the requested 2008-2009 additional appropriation for external management services, and a \$14 million operating appropriation. For the 2010-2011 biennium, the SBOE made an exceptional item request of approximately \$12.5 million to fund costs of implementing the 2008 Asset Allocation Policy, but the exceptional item was not funded. The Legislature provided a total appropriation of \$23.2 million for the general administration of the Fund for the 2010-2011 biennium. While funds were not appropriated in the 2009 Legislature to implement the 2008 Asset Allocation Policy, Fund management is of the view that there are sufficient resources available to continue the phased implementation of new alternative asset allocations during the 2010-2011 biennium. In accordance with HB 3699, the SLB approved a resolution on August 7, 2007 to begin depositing revenues previously deposited with the PSF into the Real Estate Account, commencing September 1, 2007. Also on August 7, 2007, July 23, 2008 and August 6, 2009, the SLB adopted resolutions to make four quarterly payments of \$25,000,000 during fiscal years 2008, 2009 and 2010, respectively, from the Real Estate Account to the SBOE for investment, which action was taken to honor a SLB commitment to the Fund that was made prior to the enactment of HB 3699.

As of August 31, 2009, 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 H of the TEA Investment Procedure Manual, which relates to the Guarantee Program. 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. Under the 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.

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. The TEA will provide notice of any of the following events with respect to the Guarantee Program, if such event is material within the meaning of the federal securities laws: (1) principal and interest payment delinquencies; (2) non-payment related defaults; (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 or events affecting the tax-exempt status of the Guarantee Program; (7) modifications to rights of holders of Bonds guaranteed by the Guarantee Program; (8) Bond calls; (9) defeasances; (10) release, substitution, or sale of property securing repayment of Bonds guaranteed by the Guarantee Program; and (11) rating changes. (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, or early redemption.) 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.

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 the Official Statement relating to the Bonds.

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 tax rate (the “M&O Tax”) 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.

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 did not alter the provisions of Chapter 45, Texas Education Code, as amended, that authorizes districts to secure their bonds by pledging the receipts of an unlimited ad valorem debt service tax as security for payment of such bonds. Reference is made, in particular, to the information under the heading "THE BONDS – Security and Source of Payment" in this 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 would be adversely affected by any such litigation or legislation. See "CURRENT PUBLIC SCHOOL FINANCE SYSTEM."

CURRENT PUBLIC SCHOOL FINANCE SYSTEM

General

The following description of 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 session of the 81st Texas Legislature (the "2009 Regular 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.

The Reform Legislation, which generally became effective at the beginning of the 2006-07 fiscal year of each district, made substantive changes to the manner in which the Finance System is funded, but did not modify the basic structure of the Finance System. The changes to the manner in which the Finance System is funded were intended to reduce local M&O Tax rates by one third over two years, with M&O Tax levies declining by approximately 11% in fiscal year 2006-07 and approximately another 22% in fiscal year 2007-08, subject to local referenda that may increase local M&O Tax levies, thus offsetting a part of the compression in local M&O Tax levies (see "AD VALOREM TAX PROCEDURES – Tax Rate Limitations"). Additional State funding needed to offset local tax rate reductions must be generated by the modified State franchise, motor vehicle and tobacco taxes or any other revenue source appropriated by the Legislature. The Legislative Budget Board projected that the Reform Legislation would be underfunded from the Reform Legislation revenue sources by a cumulative amount of \$25 billion over fiscal years 2006-07 through 2010-11, however State surpluses have been appropriated to offset the revenue shortfall in fiscal year 2006-07 and for the 2008-09 and 2010-11 State biennia.

Under the Finance System, as modified during the 2009 Regular Legislative Session, a school district that imposes an M&O Tax at least equal to the product of the “state compression percentage” (as defined below) multiplied by the district’s 2005-06 M&O Tax rate is entitled to at least the amount of State funding necessary to provide the district with the sum of (A) the amount of State and local revenue per weighted average daily attendance (“WADA”) to which the school district would be entitled for the 2009-10 school year as calculated under the law as it existed on January 1, 2009, (B) an additional \$120 per WADA, (C) an amount to which the district is entitled based on supplemental payments owed to any tax increment fund for a reinvestment zone and (D) any amount due to the district to the extent the district contracts for students residing in the district to be educated in another district (i.e., tuition allotment). If a district adopts an M&O Tax rate in any fiscal year below a rate equal to the state compression percentage for the district in that year multiplied by the M&O Tax rate adopted by the district for the 2005-06 fiscal year, the district’s guaranteed amount is reduced in a proportionate amount. If a district would receive more State and local revenue from the Tier One and Tier Two allotments (each as hereinafter defined) and wealth equalization than the guaranteed amount described above, the amount of State funding will be reduced by the amount of such surplus over the guaranteed amount described above.

In general terms, funds are allocated to districts in a manner that requires districts to “compress” their tax rates in order to receive increased State funding at a level that equalizes local tax wealth at the 88th percentile yield for the 2006-07 fiscal year. The state compression percentage is a basic component of the funding formulas. The state compression percentage was 66.67% for fiscal years 2007-08 and 2008-09. For fiscal year 2009-10 and thereafter, the Commissioner is required to determine the state compression percentage for each fiscal year based on the percentage by which a district is able to reduce its M&O Tax rate for that year, as compared to such district’s adopted M&O Tax rate for the 2005-06 fiscal year, as a result of State funds appropriated for distribution for the current fiscal year from the property tax relief fund established under the Reform Legislation, or from any other funding source made available by the Legislature for school district property tax relief. For fiscal year 2009-10, the Commissioner determined the State compression percentage to be 66.67%.

State Funding for Local School Districts

To limit disparities in school district funding abilities, the Finance System (1) compels districts with taxable property wealth per weighted student higher than the “equalized wealth level” (described under “Wealth Transfer Provisions”) to reduce their wealth to the equalized wealth level or to divert a portion of their tax revenues to other districts as described below and (2) provides various State funding allotments, including a basic funding allotment and other allotments for “enrichment” of the basic program, for debt service tax assistance and for new facilities construction.

The Finance System provides for (1) State guaranteed basic funding allotments per student (“Tier One”) and (2) State guaranteed revenues per student for each cent of local tax effort that exceeds the compressed tax rate to provide operational funding for an “enriched” educational program (“Tier Two”). In addition, to the extent funded by the Legislature, the Finance System includes, among other funding allotments, an allotment to subsidize existing debt service up to certain limits (“EDA”), the Instructional Facilities Allotment (“IFA”), and an allotment to pay operational expenses associated with the opening of a new instructional facility. Tier One, Tier Two, EDA and IFA are generally referred to as the Foundation School Program. Tier One and Tier Two allotments represent the State funding share of the cost of maintenance and operations of school districts and supplement local ad valorem M&O Taxes levied for that purpose. Tier One and Tier Two allotments and prior year IFA allotments are generally required to be funded each year by the Legislature. EDA and future year IFA allotments supplement local ad valorem taxes levied for debt service on bonds issued by districts to construct, acquire and improve facilities and are generally subject to appropriation by the Legislature. State funding allotments may be altered and adjusted to penalize school districts with high administrative costs and, 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 program of education rated academically acceptable and meeting other applicable legal standards. If needed, the State will subsidize local tax receipts at a tax rate of the state compression percentage multiplied by the lesser of (a) \$1.50 or (b) the district’s 2005 M&O Tax to ensure that the cost to a district of the basic program is met. 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 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 “Tier One Basic Allotment.” The Tier One Basic Allotment is adjusted for all districts by a cost-of-living factor known as the “cost of education index.” In addition, a district-size adjustment further adjusts the Tier One Basic Allotment for districts that (i) have not more than 1,600 students in average daily attendance (with alternative formulas established for such districts that contain at least 300 square miles and those districts that contain less than 300 square miles) or (ii) offer a kindergarten through grade 12 program and have less than 5,000 students in average daily attendance. For fiscal year 2007-08, the Tier One Basic Allotment was \$3,135 based upon a guaranteed yield of \$36.45 for each cent of tax effort, and for fiscal year 2008-09, the Tier One Basic Allotment was \$3,218 based upon a guaranteed yield of \$37.42 for each cent of tax effort. For the 2009-10 through 2012-13 school years, the basic allotment is set at the greater of \$4,765 or 1.65% of the statewide average property value per student in WADA and, thereafter, at the lesser of \$4,765 or that amount multiplied by the quotient of the district’s compressed tax rate divided by the State maximum compressed tax rate of \$1.00. This increase was due to changes in law effected by the Legislature during the 2009 Regular Legislative Session, which combined certain funding allotments that previously were separate components of Tier Two funding into the Tier One Basic Allotment. An additional change made during the 2009 Regular Legislative Session limits, beginning with

2010-11 school year, the annual increases in a district's M&O Tax revenue per WADA for purposes of State funding to not more than \$350, excluding Tier Two funds. For the 2009-10 school year, the revenue increases are limited to the funds that a district would have received under the school finance formulas as they existed on January 1, 2009, plus an additional \$350 per WADA, excluding Tier Two funds.

Tier Two currently provides two levels of enrichment with different guaranteed yields depending on the district's local tax effort. For fiscal year 2009-10, the first six cents of tax effort that exceeds the compressed tax rate will generate a guaranteed yield equivalent to (a) that of the Austin Independent School District or (b) the amount of tax revenue per WADA received on that tax effort in the previous year, whichever is greater. The second level of Tier Two is generated by tax effort that exceeds the compressed tax rate plus six cents and has a guaranteed yield per penny of local tax effort of \$31.95. Before 2009-10, Tier Two consisted of a district's M&O Tax levy above \$0.86. For fiscal year 2008-09, State funding to equalize local M&O Tax levies above \$0.86, up to a district's compressed rate, was funded at a guaranteed yield of \$37.42 per student in WADA for each cent of tax effort; any amount above a district's compressed rate up to \$0.04 was funded at a guaranteed yield of \$50.98 per WADA for each cent of tax effort; and any tax effort associated with a tax approved by voters at a rollback election was funded at a guaranteed yield of \$31.95 per WADA for each cent of tax effort above a district's compressed rate plus \$0.04. See "CURRENT PUBLIC SCHOOL FINANCE SYSTEM - General" for a discussion of the state compression percentage.

The IFA guarantees each school district a specified amount per student (the "IFA Guaranteed Yield") in State and local funds for each cent of tax effort to pay principal of and interest on eligible bonds issued to construct, acquire, renovate or improve instructional facilities. To receive an IFA, a school district must apply to the Commissioner in accordance with rules adopted by the Commissioner before issuing the bonds to be paid with 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 average daily attendance. The IFA is also available for lease-purchase agreements and refunding bonds meeting certain prescribed conditions. If the total amount appropriated by the State for IFA in a year is less than the amount of money school districts applying for IFA are entitled to for that year, districts applying will be ranked by the Commissioner by wealth per student, and State assistance will be awarded to applying districts in ascending order of adjusted wealth per student beginning with the district with the lowest adjusted wealth per student. In determining wealth per student for purposes of IFA, adjustments are made to reduce wealth for certain fast growing districts. Once a district receives an IFA award for bonds, it is entitled to continue receiving State assistance without reapplying to the Commissioner and the guaranteed level of State and local funds per student per cent of tax effort applicable to the bonds may not be reduced below the level provided for the year in which the bonds were issued. In 2007, the Legislature appropriated funds for outstanding school district bonds that qualified in prior budget cycles for IFA allotments and added funding for qualified debt to be issued for instructional facilities in the State's 2008-09 fiscal biennium; however, the Texas Education Agency has indicated that it intends to reserve all such new appropriation for the second year of the biennium.

State financial assistance is provided for certain existing debt issued by school districts (referred to herein as EDA) to produce a guaranteed yield (the "EDA Yield"), which for the 2009-11 State Biennium is \$35.00 (subject to adjustment as described below) in State and local revenue per student for each cent of debt service tax levy; however, for bonds that became eligible for EDA funding after August 31, 2001, and prior to August 31, 2005, EDA assistance for such eligible bonds may be less than \$35.00 in revenue per student for each cent of debt service tax, as a result of certain administrative delegations to the Commissioner under State law. Effective September 1, 2003, the portion of the local debt service rate that has qualified for equalization funding by the State has been 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 school year of the preceding State fiscal biennium or (ii) levied taxes to pay the principal of and interest on the bonds for that school year. Access to EDA funding will be 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.

A district may also qualify for an allotment for operational expenses associated with opening new instructional facilities. This funding source may not exceed \$25,000,000 in one school year on a State-wide basis. For the first school year in which students attend a new instructional facility, a district is entitled to an allotment of \$250 for each student in average daily attendance at the facility. For the second school year in which students attend that facility, a district is entitled to an allotment of \$250 for each additional student in average daily attendance at the facility. The new facility operational expense allotment will be deducted from wealth per student for purposes of calculating a district's Tier Two State funding.

Local Revenue Sources - Property Tax Authority

The primary source of local funding for school districts is ad valorem taxes levied against the local tax base. The former provision of the Education Code, Section 45.003, as amended, that in general limited the M&O Tax rate to \$1.50 per \$100 of taxable assessed value, was replaced by the Reform Legislation with a formula using the state compression percentage so that the maximum tax rate that may be adopted by a district in any fiscal year is limited based on the amount of State funds to be received by the District in that year. For the 2006-07 and 2007-08 fiscal years, districts were permitted to generate additional local funds by raising their M&O Tax rate by \$0.04 above the compressed tax rates (without taking into account changes in taxable valuation) without voter approval, and such amounts generated equalized funding dollars from the State under the Tier Two program. In fiscal year 2008-09 and thereafter, districts may, in general, increase their tax rate by an additional two or more cents and receive State equalization funds for such taxing effort so long as the voters approve such tax rate increase. Many school districts, however, voted their M&O Tax under prior law and may be subject to other limitations on the M&O Tax rate. School districts are also authorized to levy a bond debt service tax that may be unlimited in rate. See

“AD VALOREM TAX PROCEDURES – Tax Rate Limitations” herein. The governing body of a school district cannot adopt an annual tax rate which exceeds the district’s “rollback tax rate” without submitting such proposed tax rate to the voters at a referendum election. See “AD VALOREM TAX PROCEDURES” – Public Hearing and Rollback Tax Rate” herein.

Wealth Transfer Provisions

Under the Finance System, districts are required, with certain limited exceptions, to effectively adjust taxable property wealth per weighted student (“wealth per student”) for each school year to no greater than the “equalized wealth level”, determined in accordance with a formula set forth in the Reform Legislation. A district may effectively reduce its wealth per student either by reducing the amount of taxable property within the district relative to the number of weighted students, by transferring revenue out of the district or by exercising any combination of these remedies.

The wealth level that required wealth reduction measures for fiscal year 2006-07 was \$319,500 per student in average daily attendance. For 2007-08 that wealth level was increased to \$364,500 per student in average daily attendance with respect to that portion of a district’s M&O tax effort that did not exceed its compressed tax rate, and remained at \$319,500 with respect to that portion of a district’s local tax effort that was beyond its compressed rate plus \$.04. For 2008-09 that wealth level was further increased to \$374,200 per student in average daily attendance with respect to that portion of a district’s M&O Tax effort that did not exceed its compressed tax rate, and remained at \$319,500 with respect to that portion of a district’s local tax effort that was beyond its compressed rate plus \$0.06. For 2009-10 that wealth level has been increased to \$476,500 per student in average daily attendance with respect to that portion of a district’s M&O Tax effort that does not exceed its compressed tax rate, and remains at \$319,500 with respect to that portion of a district’s local tax effort that is beyond its compressed rate plus \$.06.

Property wealthy districts may also be able to levy up to an additional six cents per \$100 of assessed valuation of M&O Taxes above their compressed rate to provide revenue that is not subject to recapture.

A district has four options to reduce its wealth per student so that it does not exceed the equalized wealth level: (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) Subject to approval by the voters of all affected districts, 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 debt service taxes. (3) A district may detach property from its territory for annexation by a property-poor district. (4) A district may educate students from other districts who transfer to the district without charging tuition to such students.

A district has three options to transfer tax revenues from its excess property wealth. First, a district with excess wealth per student may purchase “attendance credits” by paying the tax revenues to the State for redistribution under the Foundation School Program. Second, it can contract to disburse the tax revenues to educate students in another district, if the payment does not result in effective wealth per student in the other district to be greater than the equalized wealth level. Both options to transfer property wealth are subject to approving elections by the transferring district’s qualified voters. Third, a wealthy district may reduce its wealth by paying tuition to a non-wealthy district for the education of students that reside in the wealthy district.

A district may not adopt a tax rate until its effective wealth per student is the equalized wealth level or less. If a final court decision holds any of the preceding permitted remedial options unlawful, districts may exercise any remaining option under a revised schedule approved by the Commissioner.

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.

Possible Effects of Wealth Transfer Provisions on the District's Financial Condition

The District's wealth per student for the 2010-2011 school year is \$535,000 which is more than the equalized wealth value. Accordingly, the District has been required to exercise one of the permitted wealth equalization options, and has purchased attendance credits from the State and contracted with a property-poor District to make payments to educate students in that district.

Like other school districts in Texas, future budgets of the District could be significantly impacted by future funding decisions made by the Texas Legislature.

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 Harris 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. However, State law also 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 constitutional amendment was approved by the voters on November 6, 2007, that authorizes the Legislature to enact legislation to reduce the frozen amount of taxes for taxpayers 65 years of age or older and the disabled, so that the frozen tax amount will be proportionate to the reduction in local ad valorem taxes under the Reform Legislation. Legislation to implement the constitutional amendment has been passed by the 80th Legislature and signed by the Governor. Owners of agricultural and open space land, under certain circumstances, may request valuation of such land on the basis of productive capacity rather than market value.

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. For the 2007-08 fiscal year and thereafter, 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 - General" for a description of the "state compression percentage"). If for the preceding tax year a district adopted an 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, as amended, 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. Beginning September 1, 2009, 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.

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 60th 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 granted an additional \$10,860 exemption to the market value of the residence homestead of persons 65 years of age or older. The District has granted an additional local exemption of 20% for the market value of residence homesteads.

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 non-business personal property. The District does not permit split payments and discounts are allowed. The District does not tax freport property. The District has not adopted a tax abatement policy and has no current tax abatements. The District does tax goods-in-transit.

Tax Rate Limitations

A school district is authorized to levy 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 District voted its maintenance tax under the provisions of Article 2784g, Vernon's Texas Civil Statutes. Pursuant to such election, the District's maintenance tax rate is limited to \$1.75 per \$100 of assessed value, less the rate per \$100 of assessed value levied for debt service on the District's bonds. 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 "AD VALOREM TAX PROCEDURES – Public Hearing and Rollback Tax Rate." 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 2784g-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 3.94% of the District's current taxable assessed valuation of property. See "APPENDIX A – 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 is 88.67% for fiscal year 2006-07 and 66.67% for fiscal year 2007-08. For fiscal year 2008-09 and thereafter, the Commissioner is required to determine the state compression percentage for each fiscal year which is based on the amount of State funds appropriated for distribution to the District for the current fiscal year (for a more detailed description of the state compression percentage, see "CURRENT PUBLIC SCHOOL FINANCE SYSTEM - General"). 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 "AD VALOREM TAX PROCEDURES – Public Hearing and Rollback Tax Rate."

A school district is also authorized to issue Bonds and levy taxes for payment of Bonds subject to voter approval of a proposition submitted to the voters under Section 45.003(b)(1), Texas Education Code, as amended, which provides a tax unlimited as to rate or amount for the support of school district bonded indebtedness (see "THE BONDS - Security and Source of Payment").

Chapter 45 of the Texas Education Code, as amended, requires a district to demonstrate to the Texas Attorney General that it has the prospective ability to pay debt service on a proposed issue of Bonds, together with debt service on other outstanding "new debt" of the district, from a tax levied at a rate of \$0.50 per \$100 of assessed valuation before Bonds may be issued. In demonstrating the ability to pay debt service at a rate of \$0.50, a district may take into account State allotments to the district which effectively reduces the district's local share of debt service. Once the prospective ability to pay such tax has been shown and the Bonds are issued, a district may levy an unlimited tax to pay debt service. Taxes levied to pay debt service on Bonds approved by district voters at an election held on or before April 1, 1991 and issued before September 1, 1992 (or debt issued to refund such Bonds) are not subject to the foregoing threshold tax rate test. In addition, taxes levied to pay refunding Bonds issued pursuant to Chapter 1207, Texas Government Code, are not subject to the \$0.50 tax rate test; however, taxes levied to pay debt service on such Bonds are included in the calculation of the \$0.50 tax rate test as applied to subsequent issues of "new debt." The Bonds are not "new debt" and are therefore not subject to the \$0.50 threshold tax rate test. Under current law, a district may demonstrate its ability to comply with the \$0.50 threshold tax rate test by applying the \$0.50 tax rate to an amount equal to 90% of projected future taxable value of property in the district, as certified by a registered professional appraiser, anticipated for the earlier of the tax year five years after the current tax year or the tax year in which the final payment for the Bonds is due. However, if a district uses projected future taxable values to meet the \$0.50 threshold tax rate test and subsequently imposes a tax at a rate greater than \$0.50 per \$100 of valuation to pay for Bonds subject to the test, then for subsequent bond issues, the Attorney General must find that the district has the projected ability to pay principal and interest on the proposed Bonds and all previously issued Bonds subject to the \$0.50 threshold tax rate test from a tax rate of \$0.45 per \$100 of valuation. The District has not used projected property values to satisfy this threshold test.

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, 2009, the State contributed \$1,730,000 to TRS on behalf of the District, District employees paid \$2,249,000 and other contributions into the plan made from private grants and from the District for salaries above the statutory minimum were \$586,000.

In addition to the TRS retirement plan, the District provides health care coverage for its employees. During the year ended August 31, 2009, the district contributed \$225.00 per month per employee into the Plan. Employees authorize payroll withholdings to pay monthly premiums. All contributions are paid to a third party administrator, acting on behalf of the self-funded pool. The Plan is authorized under Chapter 172, Local Government Code. The contract between the District and the third party administrator is renewable September 1st, and terms of coverage and contribution costs are included in the contractual provisions. In accordance with State statute, the District was protected against unanticipated catastrophic individual or aggregate loss by stop-loss coverage carried through Symetra Reinsurance Company, a commercial insurer licensed or eligible to do business in Texas in accordance with the Texas Insurance Code. Stop-loss coverage was in effect for individual claims exceeding \$150,000 and for aggregate loss exceeding \$1,000,000.

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, comprises approximately 54 square miles within Harris County, Texas. The Greenwood UD, Harris Co. FCD, Harris Co. MUD #148, Harris County, Harris Co. Dept. of Education, Harris Co. Hospital District, City of Houston, Parkway UD, Port of Houston Authority, Royalwood MUD, and San Jacinto JCD within the District each have authority to levy ad valorem taxes. See APPENDIX A – Table 6 – "Estimated Overlapping Debt."

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 of Trustees.

District School Operations

On July 1, 2010, the District owned and operated a high school, 2 middle schools, 2 early childhood schools and four elementary schools.

Fiscal Year Ended August 31

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Student Enrollment	6,892	6,667	6,245	5,809	5,528
Average Daily Attendance	6,547	6,267	5,870	5,470	5,196
Cost Per Student ^(a)	\$8,865	\$8,801	\$7,929	\$7,775	\$7,245

Government Fund Types

General Fund – Used to account for all financial transactions except those required to be accounted for in another fund. Major revenue sources include local property taxes, state funding under the Available School Fund and interest earnings. Expenditures include all costs associated with the daily operations of the schools except for certain programs funded by the federal and state governments, food services, school construction and debt service.

Capital Projects Fund – Used to account for the proceeds and investment earnings of long-term debt financing. Revenue from the sale of Bonds is used for acquiring school sites, constructing and equipping new school facilities and renovating existing facilities.

Special Revenue Funds – Used to account for resources restricted to, or designated for, specific purposes by a grantor including federally-funded and state-funded grants. These grants are awarded to the District for the purpose of accomplishing specific educational tasks as defined in the grant awards. The District's school lunch and breakfast program operations are accounted for in the Special Revenue Funds since the students are charged for meals, and the General Fund subsidizes the school lunch and breakfast program for all expenditures in excess of food service revenues and federal program reimbursements.

Debt Service Fund – Used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interest and related costs. The primary revenue source is local property taxes levied specifically for debt service.

Amounts reported as program revenues include (1) charges to customers or applicants for goods, services or privileges provided, and (2) operating grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

Agency Funds – Custodial in nature, Agency Funds do not involve measurement of results of operations. The District's Agency Funds include Student Activity Funds. Student Activity Funds are monies collected principally through fund-raising efforts of the individual school-sponsored groups. By authority of the Board, the school principal is responsible for collecting, controlling, disbursing and accounting for all Student Activity Funds.

Private Purpose Trust Fund – Used to account for scholarship donations which stipulate that the principal not be expended and that the income be used for scholarship disbursements only.

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 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 includes 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 June 30, 2010, the District had approximately \$27,584,006 invested in TexPool; \$29,075,297 invested in LoneStar Investment Pool; \$7,169,766 invested in Bank of New York; \$5,601,664 invested in Woodforest National Bank; and, \$25,436 invested in Sterling Bank Certificates of Deposits. 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

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.

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 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.

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 financial asset securitization investment trust 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.

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" 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 Bond and that discussion should be considered in connection with this portion of this 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" 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 \$30 million of tax-exempt obligations are issued by the issuer during the calendar years 2009 and 2010.

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.

Section 265(b) of the Code provides an exception to the disallowance provision described above for an amount of tax-exempt obligations issued after December 31, 2008 and before January 1, 2011, in a total amount not exceeding two percent (2%) of the adjusted basis of all of the assets of the financial institution.

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.

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 also will provide timely notices of certain events to the MSRB. Specifically, the District will provide notice of any of the following events with respect to the Bonds, if such event is material to a decision to purchase or sell Bonds: (1) principal and interest payment delinquencies; (2) non-payment related defaults; (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 or events affecting the tax-exempt status of the Bonds; (7) modifications to rights of holders of the Bonds; (8) Bond calls; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the Bonds; and (11) rating changes. Neither the Bonds nor the Order makes any provision for liquidity enhancement or require the funding of debt service reserves. In addition, the District will provide timely notice of any failure by the District to provide annual financial information, data or financial statements in accordance with its agreement described above under "Annual Reports." The District will provide each notice described in this paragraph only to the MSRB.

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

The District has complied in all material respects with its continuing disclosure agreements in accordance with the Rule.

OTHER INFORMATION

Rating

Moody's Investors Service ("Moody's") and Standard & Poor's Ratings Group have assigned their municipal ratings of " " and " ", respectively to the Bonds by virtue of the guarantee of the Texas Permanent School Fund on the Bonds. An explanation of the ratings may be obtained from Moody's and S&P. The ratings reflect only the views of Moody's and S&P and the District makes no representation as to the appropriateness of the ratings. There is no assurance that such ratings will continue for any given period of time or that it will not be revised downward or withdrawn entirely by Moody's and S&P if in the judgment of the company circumstances so warrant. Any such downward revision or withdrawal by such ratings 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 District, 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 sold, assigned, pledged hypothecated 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, as amended, Texas Government Code, requires the Bonds to be assigned a rating of not less than "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 payable from the proceeds of a continuing ad valorem tax levied, without legal limit as to rate or amount, upon all taxable property in the District, and the approving legal opinions of Andrews Kurth LLP, Bond Counsel to the District ("Bond Counsel"), in substantially the form attached as APPENDIX C. In connection with the issuance of the Bonds, Bond Counsel has represented only the District. 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. Bond Counsel only represents the issuer in connection with the issuance of the Bonds.

Bond Counsel has reviewed the statements and information contained in this 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 this 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 – Legal Matters” “OTHER INFORMATION – Registration and Qualification of Bonds for Sale” and “OTHER INFORMATION – The Bonds as Legal Investments in Texas” and Bond Counsel is of the opinion that the statements and information contained therein are correct as to matters of law. Bond Counsel has not independently verified any of the factual information contained in this Official Statement nor have they conducted an investigation of the affairs of the District for the purpose of passing upon the accuracy or completeness of this Official Statement. No person is entitled to rely upon such firm’s limited participation as an assumption of responsibility for, or an expression of opinion of any kind with regard to, the accuracy or completeness of any of the information contained herein. Certain legal matters will be passed upon for the Underwriters by their counsel, Vinson & Elkins, LLP, Houston, Texas whose fee for services rendered is contingent upon the sale and delivery of the Bonds.

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. Nor does the rendering of an opinion guarantee the outcome of any legal dispute that may arise out of the transaction.

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 sale 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 agreement 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 \$_____.

The Underwriters’ obligation to purchase the Bonds is subject to certain conditions precedent, and they 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 Bonds may be offered and sold to certain dealers and others at prices lower than such public offering prices, and such public prices may be changed from time to time, by 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 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

other 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 will be approved by the Board of Trustees of the District for distribution in accordance with the provisions of SEC’s Rule 15c2-12, as amended.

SHELDON INDEPENDENT SCHOOL DISTRICT

/s/

President, Board of Trustees

ATTEST:

/s/

Secretary, Board of Trustees

SCHEDULE I - TABLE OF ACCRETED VALUES OF CAPITAL APPRECIATION BONDS

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

Date	Capital Appreciation Bonds 2/15/2013	Capital Appreciation Bonds 2/15/2014
	%	%
10/6/2010		
2/15/2011		
8/15/2011		
2/15/2012		
8/15/2012		
2/15/2013		
8/15/2013		
2/15/2014		

APPENDIX A
INFORMATION REGARDING THE DISTRICT

TABLE 1 - VALUATION, EXEMPTIONS AND TAX-SUPPORTED DEBT**District Direct Debt**

2009 Certified Taxable Valuation (100% of Estimated Market Value)	\$ 4,214,129,540
Outstanding Debt (August 31, 2010)	\$ 157,102,634
Plus The Bonds	8,999,899 ^(a)
Total Direct Debt	<u>\$ 166,102,533</u>
As a % of Assessed Valuation	3.94%

^(a) Preliminary, subject to change.**TABLE 2 - TAXABLE ASSESSED VALUATIONS BY CATEGORY ^(a)**

	<u>Tax Year 2009</u>	<u>Tax Year 2008</u>	<u>Tax Year 2007</u>	<u>Tax Year 2006</u>	<u>Tax Year 2005</u>
Real Property	\$1,492,112,174	\$1,902,293,305	\$ 1,695,782,797	\$1,340,211,185	\$1,065,014,936
Personal Property	<u>3,179,239,341</u>	<u>2,164,991,275</u>	<u>1,872,376,030</u>	<u>985,310,034</u>	<u>887,927,730</u>
Gross Value	<u>\$ 4,671,351,515</u>	<u>\$4,067,284,580</u>	<u>\$ 3,568,158,827</u>	<u>\$2,325,521,219</u>	<u>\$1,952,942,666</u>
Less Exemptions	<u>457,221,975</u>	<u>424,956,891</u>	<u>411,628,011</u>	<u>307,934,688</u>	<u>183,052,868</u>
Net Taxable Value	<u>\$4,214,129,540</u>	<u>\$3,642,327,689</u>	<u>\$ 3,156,530,816</u>	<u>\$2,017,586,531</u>	<u>\$1,769,889,798</u>

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

Source: Harris County Appraisal District.

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

Fiscal Year End	Tax Year	Taxable Assessed Valuation ^(a)	Tax Rate	Tax Levy	Percent Collected	
					Current	Total ^(b)
2002	2001	\$1,604,024,852	\$ 1.6330	\$ 25,374,277	97.37%	101.01%
2003	2002	1,918,066,708	1.6330	29,002,643	97.02%	98.83%
2004	2003	1,749,209,818	1.7030	29,702,321	97.24%	99.68%
2005	2004	1,464,060,338	1.7460	30,815,629	96.56%	99.84%
2006	2005	1,927,391,387	1.7500	33,664,958	97.34%	100.38%
2007	2006	2,167,878,396	1.6340	35,423,133	97.74%	100.37%
2008	2007	3,262,365,274	1.4300	45,138,391	97.86%	99.56%
2009	2008	3,695,490,933	1.4300	52,845,520	97.75%	97.75%
2010	2009	4,214,129,540	1.4300	61,704,697	95.28% ^(c)	96.50% ^(c)

^(a) Net of exemptions. Assessed valuations do not include adjustments in supplemental rolls made after the end of each fiscal year.^(b) Excludes penalties and interest.^(c) Partial collections through June 30, 2010.**Tax Rate Distribution (Tax Year)**

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Maintenance	\$ 1.0400	\$ 1.0400	\$ 1.0400	\$ 1.0400	\$ 1.3700
Debt Service	<u>0.3900</u>	<u>0.3900</u>	<u>0.3900</u>	<u>0.3900</u>	<u>0.2640</u>
Total	<u>\$ 1.4300</u>	<u>\$ 1.4300</u>	<u>\$ 1.4300</u>	<u>\$ 1.4300</u>	<u>\$ 1.6340</u>

TABLE 4 - TEN LARGEST TAXPAYERS

<u>Name</u>	<u>2009 Net Taxable Assessed Valuation</u>	<u>% of Total 2009 Assessed Valuation</u>
Equistar Chemicals	\$ 329,602,343	7.82%
Amoco Chemical Co	295,485,350	7.01%
GIM Channelview	202,036,500	4.79%
V&M Star	100,738,688	2.39%
Champions Pipe & Supply Inc	87,452,208	2.08%
Wilson Supply	79,184,527	1.88%
Sooner Pipe	67,424,496	1.60%
Petro Hunt	58,432,392	1.39%
Tenaris Hickman	57,500,220	1.36%
Premier Pipe LLC	54,149,862	1.28%
	<u>\$ 1,332,006,586</u>	<u>31.61%</u>

^(a) The District has a substantial concentration of taxable assessed valuation in oil and gas and chemical manufacturing activities. Among other things, adverse developments in economic conditions or changes in the regulatory environment could adversely impact the businesses that own such properties and the tax values of the District. If any major taxpayer of the District were to default in the payment of taxes, the ability of the District to make timely payment of debt service on the Bonds could be affected.

TABLE 5 - TAX ADEQUACY ^(a)

Estimated Average Annual Debt Service Requirements (2010-2040):	\$ 7,957,734
\$0.1988 per \$100 AV against the 2009 Taxable AV, at 95% collection, produces	7,957,813
Estimated Maximum Annual Debt Service Requirements (2011):	\$12,361,579
\$0.3088 per \$100 AV against the 2009 Taxable AV, at 95% collection, produces	12,361,703

^(a) Includes the Bonds and Cumulative Sinking Fund Deposits for the QZAB Bonds Series 2000B, 2001B and 2005.
Preliminary, subject to change.

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 improvement 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 Harris County Appraisal District.

Taxing Jurisdiction	Total Debt ^(a)	Estimated % Overlapping	As Of	Overlapping Debt
Greenwood UD	\$ 6,271,720	100.00%	12/31/08	\$ 6,271,720
Harris Co.	2,139,831,094	1.47%	2/29/2009	31,455,517
Harris Co. Dept. of Education	8,160,000	1.47%	5/31/10	119,952
Harris Co. FCD	92,904,373	1.47%	2/18/09	1,365,694
Harris Co. MUD #148	8,040,698	96.29%	8/31/09	7,742,388
Harris Co. MUD #285	42,427,426	72.75%	4/14/09	30,865,952
Harris Co. Toll Rd. Bds.	-	1.47%	2/28/09	-
Houston, City of	2,690,603,271	0.01%	6/30/09	269,060
Northeast Harris Co MUD #1	1,500,000	100.00%	5/31/10	1,500,000
Parkway UD	18,712,723	100.00%	3/17/09	18,712,723
Port of Houston Authority	522,954,397	1.47%	12/31/08	7,687,430
San Jacinto JCD	268,105,000	10.71%	5/31/10	28,714,046
Estimated Overlapping Debt				\$ 134,704,482
The District	\$ 157,102,634 ^(b)	100.00%		157,102,634 ^(b)
Total Direct & Estimated Overlapping Debt				\$ 291,807,117
As a % of 2009 Taxable Assessed Valuation				6.92%

^(a) Gross debt.

^(b) Includes the Bonds and Cumulative Sinking Fund Deposits for the QZAB Bonds Series 2000B, 2001B and 2005.

Preliminary, subject to change.

TABLE 7 - PRO FORMA TAX SUPPORTED DEBT SERVICE REQUIREMENTS

FYE 31-Aug	Outstanding Debt Service	The Bonds ^(a)			Total Debt Service
		Principal	Interest ^(b)	Total	
2010	\$ 11,333,311	\$ -	\$ -	\$ -	\$ 11,333,311
2011	12,056,640	-	304,939	304,939	12,361,579
2012	11,047,866	190,000	353,131	543,131	11,590,997
2013	10,997,228	127,920	418,074	545,994	11,543,222
2014	11,015,074	106,979	439,015	545,994	11,561,068
2015	11,042,458	195,000	348,800	543,800	11,586,258
2016	10,943,872	200,000	343,356	543,356	11,487,228
2017	10,940,963	210,000	336,694	546,694	11,487,657
2018	10,984,675	215,000	329,788	544,788	11,529,463
2019	10,987,383	225,000	322,638	547,638	11,535,021
2020	11,034,963	230,000	315,244	545,244	11,580,207
2021	10,897,265	235,000	307,688	542,688	11,439,952
2022	10,912,512	245,000	298,663	543,663	11,456,174
2023	10,964,962	255,000	288,038	543,038	11,507,999
2024	10,937,218	270,000	276,881	546,881	11,484,099
2025	10,951,818	280,000	265,194	545,194	11,497,012
2026	10,954,352	290,000	253,081	543,081	11,497,433
2027	10,757,618	305,000	240,438	545,438	11,303,056
2028	6,509,506	320,000	227,156	547,156	7,056,663
2029	5,978,753	330,000	213,344	543,344	6,522,097
2030	5,533,744	345,000	199,000	544,000	6,077,744
2031	5,545,681	360,000	184,019	544,019	6,089,700
2032	5,532,619	375,000	168,400	543,400	6,076,019
2033	5,537,088	395,000	152,038	547,038	6,084,125
2034	5,545,038	410,000	134,931	544,931	6,089,969
2035	5,551,666	430,000	116,813	546,813	6,098,478
2036	4,949,234	450,000	97,563	547,563	5,496,797
2037	3,879,047	470,000	77,438	547,438	4,426,484
2038	1,125,438	490,000	56,438	546,438	1,671,875
2039	-	510,000	34,563	544,563	544,563
2040	-	535,000	11,703	546,703	546,703
	\$ 254,447,990	\$ 8,999,899	\$ 7,115,062	\$ 16,114,961	\$ 270,562,951

Estimated Average Annual Debt Service Requirements (2010-2040):

\$ 7,957,734

Estimated Maximum Annual Debt Service Requirements (2011):

\$ 12,361,579

^(a) Preliminary, subject to change.

^(b) Interest calculated for illustration purposes only.

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>
October 7, 2000	School Building	\$ 97,000,000	\$ 86,240,000	\$ 9,000,000	\$ 1,760,000
November 7, 2006	School Building, Buses & Technology	98,700,000	63,600,000	-	35,100,000
			Total	\$ 9,000,000	\$ 36,860,000

TABLE 9 - INTEREST AND SINKING FUND BUDGET PROJECTION

Tax Supported Debt Service Requirements, FYE August 31, 2010 ^(a)		\$ 11,333,311
Debt Service Fund, August 31, 2009	\$ 9,627,451	
Estimated Interest and Sinking Fund Tax Levy @ 95%	15,613,350	25,240,801
Estimated Balance, August 31, 2010		\$ 13,907,490

^(a) Includes the Bonds and Cumulative Sinking Fund Deposits for the QZAB Bonds Series 2000B, 2001B and 2005.

Preliminary, subject to change.

TABLE 10 - GENERAL FUND REVENUES AND EXPENDITURE HISTORY ^(a)

For Fiscal Year Ended August 31

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
REVENUES					
Local and Intermediate Sources	\$ 39,475,561	\$ 35,785,931	\$ 37,526,630	\$ 31,382,869	\$ 27,070,278
State Program Revenues	16,603,668	18,294,584	10,621,199	6,084,040	3,834,717
Federal Program Revenues	169,445	166,325	172,695	117,216	731,708
Total Revenues	<u>\$ 56,248,674</u>	<u>\$ 54,246,840</u>	<u>\$ 48,320,524</u>	<u>\$ 37,584,125</u>	<u>\$ 31,636,703</u>
EXPENDITURES					
Instruction	\$ 27,842,965	\$ 25,888,928	\$ 21,850,290	\$ 19,934,373	\$ 18,120,825
Instructional Resources and Media	843,304	738,859	491,454	411,119	367,869
Curriculum & Staff Dev.	300,196	330,610	248,009	182,091	154,228
Instructional Leadership	1,500,870	1,157,816	885,057	659,104	631,589
School Leadership	2,975,804	2,690,553	2,372,403	2,009,444	1,715,843
Guidance, Counsel & Evaluation. Serv.	1,642,573	1,464,786	1,165,764	1,124,475	1,127,986
Social Work Services	64,275	37,995	29,791	30,595	27,036
Health Services	532,092	417,902	336,713	258,509	294,877
Student (Pupil) Transportation	2,711,883	2,687,256	2,205,994	2,030,390	1,960,290
Extracurricular Activities	1,545,020	1,070,773	1,017,122	856,782	804,928
General Administration	1,878,916	2,178,797	1,865,389	1,775,542	1,782,758
Plant Maintenance and Operations	7,111,272	6,278,668	5,864,195	6,061,965	5,080,141
Security and Monitoring Services	531,668	531,850	506,420	462,620	406,581
Data Processing Services	133,454	117,330	109,299	91,069	103,574
Community Service	1,603	1,356	3,969	2,014	2,200
Principal on Long-Term Debt	729,016	420,000	570,931	295,430	307,765
Interest on long-term debt	-	310,581	517,768	12,335	-
Bond issuance costs and fees	-	-	-	77,177	-
Capital Outlay	1,386,102	368,798	3,807,520	5,524,109	522,020
Contracted instructional services	4,959,105	763,013	-	-	-
Pmts related to Shared Serv. Arrang.	-	-	-	-	117,053
Pmts to Juvenile Justice Alt. Ed. Prog.	14,595	18,900	12,390	4,741	7,429
Other Intergovernmental Charges	440,202	-	-	-	-
Total Expenditures	<u>\$ 57,144,915</u>	<u>\$ 47,474,771</u>	<u>\$ 43,860,478</u>	<u>\$ 41,803,884</u>	<u>\$ 33,534,992</u>
Excess (Deficiency) Rev. Over Exp.	\$ (896,241)	\$ 6,772,069	\$ 4,460,046	\$ (4,219,759)	\$ (1,898,289)
Operating Transfers Out	-	-	-	-	-
Other Resources	-	-	-	-	250,447
Maintenance Tax Notes	-	-	-	8,200,000	-
Sale of real or personal property	22,164	27,892	8,608	13,926	-
Transfers Out	(83,694)	-	-	-	-
Proceeds from capital lease	-	-	-	271,788	-
Premium or discount on issuance of bonds	-	-	-	77,177	-
Other (Uses)	(105,301)	32,397	-	(19,115)	-
Excess (Deficiency) of Rev. and Other Resources Over Exp. and Other Uses	\$ (1,063,072)	\$ 6,832,358	\$ 4,468,654	\$ 4,324,017	\$ (1,647,842)
Fund Balance - Sept. 1 (Beginning)	\$ 23,001,222	\$ 16,168,865	\$ 11,700,211	\$ 7,376,194	\$ 9,024,036
Increase (Decrease) in Fund Balance	-	-	-	-	-
Fund Balance - August 31 (Ending)	<u>\$ 21,938,150</u>	<u>\$ 23,001,223</u>	<u>\$ 16,168,865</u>	<u>\$ 11,700,211</u>	<u>\$ 7,376,194</u>

^(a) Source: District's audited financial reports. See "APPENDIX B - Audited Financial Statements."

APPENDIX B

**EXCERPTS FROM THE DISTRICT'S
AUDITED FINANCIAL REPORT**

**For Year Ended
August 31, 2009**

**SHELDON
INDEPENDENT SCHOOL DISTRICT**

**ANNUAL FINANCIAL AND
COMPLIANCE REPORT**

For The Year Ended August 31, 2009



2000 Loop 197 N., Suite 200
Texas City, Texas 77590
(409) 948-4406

SHELDON INDEPENDENT SCHOOL DISTRICT
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CERTIFICATE OF THE BOARD

Sheldon Independent School District
Name of School District

Harris
County

101-924
Co. - Dist. No.

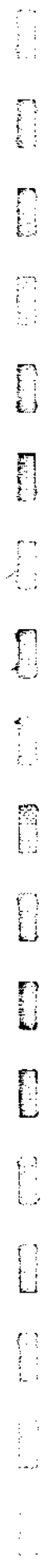
We, the undersigned, certify that the attached annual financial reports of the above named school district were reviewed and approved for the year ended August 31, 2009, at a meeting of the board of trustees of such school district on January 19, 2010.

Board President

Board Secretary



Financial Section





Independent Auditors' Report

To the Board of Trustees
Sheldon Independent School District
Houston, Texas

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of Sheldon Independent School District (the "District") as of and for the year ended August 31, 2009, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the 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 consideration of internal controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic 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, business-type activities, each major fund and the aggregate remaining fund information of the District as of August 31, 2009, and the respective changes in financial position, and the 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 19, 2010 on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the 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.

To the Board of Trustees
Sheldon Independent School District
Houston, Texas
Page 2

The Management's Discussion and Analysis and budgetary comparison information on pages 5 to 13 and pages 52 to 54, respectively, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's 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 not a required part of the basic financial statements. In addition, the combining nonmajor fund statements and other schedules listed in the table of contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements of the District. Such information, except for that portion marked "unaudited" on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

Null Larson, AC

Houston, Texas
January 19, 2010

Management's Discussion and Analysis

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SHELDON INDEPENDENT SCHOOL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the Sheldon Independent School District (the "District"), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended August 31, 2009.

Financial Highlights

- The assets of the District exceeded its liabilities at the close of the most recent fiscal year by \$45,997,958 (*net assets*). Of this amount, \$24,981,813 (*unrestricted net assets*) may be used to meet the District's ongoing obligations to students and creditors.
- As of the close of the current fiscal year, the District's governmental funds reported combined ending fund balances of \$45,056,947, a decrease of \$26,073,982 in comparison with the prior year. The decrease in governmental fund balances was primarily due to the decrease in the capital projects fund balance of \$29,567,159. The general fund balance decreased by \$1,063,072.
- At the end of the current fiscal year, unreserved, undesignated fund balance for the general fund was \$11,045,254 or 19 percent of total general fund expenditures.
- The District's total bonded debt decreased by \$3,891,868 (2 percent) during the current fiscal year.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains required supplementary information and other supplementary information in addition to the basic financial statements.

Government-wide financial statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of the District's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The *Statement of Activities* presents information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused sick leave).

The government-wide financial statements of the District are principally supported by taxes and intergovernmental revenues (*governmental activities*). The governmental activities of the District include Instruction, Instructional Resources and Media Services, Curriculum and Instructional Staff Development, Instructional Leadership, School Leadership, Guidance, Counseling, and Evaluation Services, Social Work Services, Health Services, Student Transportation, Food Services, Co-curricular/Extracurricular Activities, General Administration, Plant Maintenance and Operations, Security and Monitoring Services, Data Processing Services, Community Services, Interest on Long-term Debt, Bond Issuance Costs and Fees, Facilities Acquisition and Construction, Payments to Juvenile Justice Alternative Education Programs, and Appraisal District Fees.

SHELDON INDEPENDENT SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

The business-type activities include the District's tuition/fee based self sustaining Early Learning Center Daycare, an employee child care program. Business-type activities are intended to recover all or a significant portion of their costs through user fees and charges.

The government-wide financial statements can be found on pages 17 through 19 of this report.

Fund financial statements

A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The District, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the District can be divided into two categories: governmental funds and fiduciary funds.

Governmental funds

Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a District's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the District's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The District maintains thirty-four individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund, debt service fund, and the capital projects fund, all of which are considered to be major funds. Data from the other thirty-one governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of combining statements elsewhere in the financial statements. The District adopts an annual appropriated budget for its general fund, debt service fund, and National School Breakfast and Lunch Program special revenue fund.

The basic governmental fund financial statements can be found on pages 20 through 26 of this report.

SHELDON INDEPENDENT SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Proprietary fund

The propriety fund provides the same type of information as the government-wide financial statements, only in more detail. There are two types of proprietary funds. Enterprise funds, are used to report the same function presented as business-type activities in the government-wide financial statements. As mentioned above in the government-wide definition, the District has one business-type activities or enterprise fund, which is the tuition-based self sustaining employee child care program, Early Learning Center Daycare. The second type of proprietary fund is the Internal Service fund. Internal Service funds as an accounting device used to accumulate and allocate costs internally among the various functions. The District does not have any internal service funds to report. The basic proprietary fund financial statements can be found on pages 27 through 29 of this report.

Fiduciary fund

The fiduciary fund is used to account for resources held for the benefit of students. The fiduciary fund is *not* reflected in the government-wide financial statement because the resources of those funds are *not* available to support the District's own programs. The fund is custodial in nature (assets equal liabilities) and does not involve measurement of results of operation.

The basic fiduciary fund financial statements can be found on pages 30 through 31 of this report.

Notes to financial statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 32 through 50 of this report.

Required supplementary information

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information that further explains and supports the information in the financial statements. The required supplementary information relates to comparison of the original adopted budget, the final amended budget, and the actual amounts for the fiscal year. This is required supplementary information for the general fund and any major special revenue funds. The District did not have any major special revenue funds; therefore, only the general fund is presented as required supplementary information. The required supplementary information can be found on pages 48 through 50 of this report.

Other information

The combining and individual fund statements and schedules and other supplementary information are presented immediately following the required supplementary information and can be found on pages 52 through 69 of this report.

SHELDON INDEPENDENT SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a District's financial position. In the case of the District, assets exceeded liabilities by \$45,997,958 at the close of the most recent fiscal year.

The District's investment in capital assets (e.g., capitalized bond and debt issuance costs, land, buildings and improvements, furniture and equipment, construction in progress), less any outstanding related debt used to acquire those assets, amounted to \$5,605,001. The District uses these capital assets to provide services to students; consequently, these assets are *not* available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

	Governmental Activities		Business-Type Activities		Total	
	2009	2008	2009	2008	2009	2008
Current and other assets	\$ 64,064,106	\$ 87,898,805	\$ 10,545	\$	\$ 64,074,651	\$ 87,898,805
Capital and non current assets	156,012,061	130,272,339			156,012,061	130,272,339
Total Assets	220,076,167	218,171,144	10,545		220,086,712	218,171,144
Current liabilities	12,817,261	12,407,318	10,470		12,827,731	12,407,318
Long term liabilities	161,260,948	165,152,816			161,260,948	165,152,816
Total Liabilities	174,078,209	177,560,134	10,470		174,088,679	177,560,134
Net Assets						
Invested in capital assets net of related debt	5,605,001	5,541,937			5,605,001	5,541,937
Restricted	15,411,144	10,144,245			15,411,144	10,144,245
Unrestricted	24,981,813	24,924,828	75		24,981,888	24,924,828
Total Net Assets	\$ 45,997,958	\$ 40,611,010	\$ 75	\$	\$ 45,998,033	\$ 40,611,010

Net assets \$15,411,144 are restricted for state and federal programs, debt service, campus activities and local grants. The remaining balance of *unrestricted net assets* \$24,981,813 may be used to meet the District's ongoing obligations to students and creditors. At the end of the current fiscal year, the District is able to report positive balances in all three categories of net assets. The District's net assets increased by \$5,386,948 during the current fiscal year primarily due to increases in state revenues.

**SHELDON INDEPENDENT SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Sheldon Independent School District's Changes in Net Assets

	Governmental Activities		Business-Type Activities		Total	
	2009	2008	2009	2008	2009	2008
Program Revenues						
Charges for services	\$ 738,824	\$ 683,450	\$ 2,445	\$	\$ 741,269	\$ 683,450
Operating grants	9,855,426	8,505,474			9,855,426	8,505,474
General Revenues						
Property taxes	55,111,764	47,906,799			55,111,764	47,906,799
State aid	14,427,258	16,353,044			14,427,258	16,353,044
Grants and contributions not restricted	172,963	111,962			172,963	111,962
Interest earnings	1,009,464	3,281,511			1,009,464	3,281,511
Other	372,223	205,119			372,223	205,119
Total Revenues	81,687,922	77,047,359	2,445		81,690,367	77,047,359
Expenses						
Instruction	33,957,964	31,184,000			33,957,964	31,184,000
Instructional resources and media services	964,175	852,176			964,175	852,176
Curriculum and staff development	443,259	353,063			443,259	353,063
Instructional leadership	1,875,673	1,316,204			1,875,673	1,316,204
School leadership	3,308,200	3,002,174			3,308,200	3,002,174
Guidance, counseling, and evaluation services	1,764,186	1,582,102			1,764,186	1,582,102
Social work services	64,275	37,995			64,275	37,995
Health services	588,312	446,231			588,312	446,231
Student transportation	3,153,044	3,085,855			3,153,044	3,085,855
Food service	3,480,559	3,146,446			3,480,559	3,146,446
Extracurricular activities	1,762,196	1,349,424			1,762,196	1,349,424
General administration	1,939,351	2,190,231			1,939,351	2,190,231
Plant, maintenance and operations	7,348,047	6,481,063			7,348,047	6,481,063
Security and monitoring services	531,668	531,850			531,668	531,850
Data processing services	139,498	122,995			139,498	122,995
Community services	16,900	9,799	86,064		102,964	9,799
Interest on long-term debt	7,062,185	6,761,191			7,062,185	6,761,191
Debt issuance costs and fees	9,457	9,124			9,457	9,124
Facilities acquisition and construction	2,394,429	3,448,760			2,394,429	3,448,760
Contracted instructional services between schools	4,959,105	763,013			4,959,105	763,013
Payments to Juvenile Justice Alternative Education Programs	14,595	18,900			14,595	18,900
Other intergovernmental charges	440,202					
Total Expenses	76,217,280	66,692,596	86,064		75,863,142	66,692,596
Excess (deficiency) before special items and transfers	5,470,642	10,354,763	(83,619)		5,827,225	10,354,763
Transfers	(83,694)		83,694		83,694	
Increase (Decrease) in Net Assets	5,386,948	10,354,763	75		5,910,919	5,387,023
Beginning net assets	40,611,010	30,256,247			45,998,033	40,611,010
Ending Net Assets	\$ 45,997,958	\$ 40,611,010	\$ 75	\$	\$ 51,908,952	\$ 45,998,033

SHELDON INDEPENDENT SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Governmental activities

Governmental activities increased the District's net assets by \$5,386,948. Key elements of this increase are as follows:

Revenues are generated primarily from two sources. State Aid Formula Grant, operating grants and contributions (program and general revenues totaling (\$24,282,684) represent 30 percent of total revenues and property taxes (\$55,111,764) represent 67 percent of total revenues. The remaining 3 percent is generated from charges for services, investment earnings, and miscellaneous revenues. Higher tax revenues were the result of the District's tax base increasing by almost 15 percent from the previous year.

The primary functional expense of the District is instruction (\$33,957,964), which represents 45 percent of total expenses. Plant maintenance and operations (\$7,348,047) represents 10 percent of total expenses. Interest on long-term debt (\$7,062,185) also represents 9 percent of total expenses of the District. The remaining individual functional categories of expenses are each less than 6 percent of total expenses. For the most part, increases in expenses clearly paralleled student growth in the District.

Financial Analysis of the Government's Funds

As noted earlier, the District uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds

The focus of the District's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the District's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a District's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the District's governmental funds reported combined ending fund balances of \$46,056,947, a decrease of \$26,073,982 in comparison with the prior year. The decrease in ending governmental fund balances is primarily due to a decrease in the capital projects fund balance.

The general fund is the chief operating fund of the District. At the end of the current fiscal year, unreserved, undesignated fund balance of the general fund was \$11,045,254, while total fund balance reached \$21,938,150. As a measure of the general fund's liquidity, it may be useful to compare both unreserved, undesignated fund balance and total fund balance to total fund expenditures. Unreserved, undesignated fund balance represents 19 percent of total general fund expenditures, while total fund balance represents 38 percent of that same amount.

The fund balance of the District's general fund decreased by \$1,063,072 during the current fiscal year primarily due to additional expenditures incurred for opening two new campuses and an Early Learning Center (Daycare) for the District.

The debt service fund has a total fund balance of \$14,093,195, all of which is reserved for the payment of debt service. The net increase in the debt service fund balance during the current year of 4,465,746 was attributable to increases in local tax revenues resulting from higher than estimated property values.

SHELDON INDEPENDENT SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

The capital projects fund has a total fund balance of \$9,320,300, all of which is reserved for authorized construction and technology projects/enhancements. The net decrease in fund balance during the current year of \$29,567,159 was primarily due to ongoing construction projects.

General Fund Budgetary Highlights

Differences between the original budget and the final amended budget of the general fund can be briefly summarized as follows:

	Estimated Revenues
Original	\$ 55,894,570
Final	58,787,390
Total estimated revenues increase	\$ 2,892,820

	Appropriations
Original	\$ 54,249,841
Final	60,168,035
Total appropriations increase	\$ 5,918,194

The review of the final amended budget versus actual for the general fund reflected that revenues were less than budgetary estimates and although expenditures were less than budgetary estimates, the need to draw upon existing fund balances was created. Fund balances were designated in the prior years to meet Chapter 41 payments and additional start-up costs associated with the District's two new campuses.

Capital Assets and Long-term Liabilities

Capital assets

The District's investment in capital assets for its governmental type activities as of August 31, 2009, amounts to \$156,012,061 (net of accumulated depreciation). This investment in capital assets includes land, buildings and improvements, and furniture and equipment. The total increase in the District's investment in capital assets for the current fiscal year was 20 percent.

Major capital asset events during the current fiscal year included the following:

- Renovations completed at Intermediate campus to accommodate the need for the Second Early Childhood Academy.
- Addition and renovation to four existing campus buildings with current year expenditures of \$5.5 million.
- Construction completed at Null Middle School.
- The remainder of increases in capital assets was improvements and additions to existing facilities and furniture and equipment.

SHELDON INDEPENDENT SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Sheldon Independent School District's Capital Assets

	Balance August 31, 2008	Additions	Retirements and Transfers	Balance August 31, 2009
Land	\$ 5,775,196	\$	\$	\$ 5,775,196
Buildings and improvements	142,641,039	41,974,265		184,615,304
Furniture and equipment	7,855,780	706,014	(160,283)	8,401,511
Construction in progress	13,363,185		(13,363,185)	
	<u>169,635,200</u>	<u>42,680,279</u>	<u>(13,523,468)</u>	<u>198,792,011</u>
Less accumulated depreciation for:				
Buildings and improvements	(35,537,217)	(2,920,822)		(38,458,039)
Furniture and Equipment	(3,825,644)	(656,550)	160,283	(4,321,911)
	<u>(39,362,861)</u>	<u>(3,577,372)</u>	<u>160,283</u>	<u>(42,779,950)</u>
Governmental Capital Assets	<u>\$ 130,272,339</u>	<u>\$ 39,102,907</u>	<u>\$ (13,363,185)</u>	<u>\$ 156,012,061</u>

Additional information on the District's capital assets can be found in note 6, on pages 44 through 45 of the notes to the financial statements.

Long-term liabilities

At the end of the current fiscal year, the District had \$161,260,948 in bonded debt outstanding, a decrease of \$3,891,868 over the previous year. The District's bonds are sold with a "AAA" rating and are guaranteed through the Texas Permanent School Fund Guarantee Program or by a municipal bond insurance policy. The underlying rating of the bonds from Standard and Poor's is "A" and from Moody's Investors Service is "A1" for general obligation debt.

Changes to long-term debt, for the year ended August 31, 2009, are as follows:

Sheldon Independent School District's Long-term Liabilities

	Balance August 31, 2008	Additions	Retirements	Balance August 31, 2009
General obligation bonds	\$ 164,067,818	\$	\$ 3,995,000	\$ 160,072,818
Plus amounts for issuance premiums	880,196		37,340	842,856
Gain or loss on refunding bonds	(133,959)		(91,735)	(42,224)
Accreted interest on premium compound interest bonds	338,761	48,737		387,498
	<u>\$ 165,152,816</u>	<u>\$ 48,737</u>	<u>\$ 3,940,605</u>	<u>\$ 161,260,948</u>

Additional information on the District's long-term liabilities can be found in note 7, on pages 45 through 47 of the notes to the financial statements.

SHELDON INDEPENDENT SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Economic Factors and Next Year's Budgets and Tax Rates

- Peak enrollment totaled 6,292 students, which is a 9 percent increase from the prior year.
- District staff totals 855 employees, which primarily consists of 424 teachers and 150 teachers' aides and secretaries.
- The District maintains 7 campuses for instruction.
- Adjusted taxable property values of the district have increased 15 percent over the past year.
- The property tax rate will remain \$1.43 per \$100 of assessed value for 2009-10.

All of these factors were considered in preparing the District's budget for the 2010 fiscal year.

The general fund reserved fund balance (\$602,686) is for future legal obligations such as investments in inventory and outstanding encumbrances. The general fund designated fund balance (\$10,290,210) is for expected wealth equalization, state revenue settlement and start up cost for two new campuses.

Requests for Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the District's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, Sheldon Independent School District, 11411 C.E. King Parkway, Houston, TX 77044-7192.

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Basic Financial Statements

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SHELDON INDEPENDENT SCHOOL DISTRICT
STATEMENT OF NET ASSETS
August 31, 2009

Exhibit A-1

<u>Data Control Codes</u>		<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Assets				
1110	Cash and Cash Equivalents	\$ 57,134,434	\$ 2,445	\$ 57,136,879
1220	Property Taxes - net of allowance for doubtful accounts	4,531,110		4,531,110
1240	Due from Other Governments	704,974		704,974
1250	Accrued Interest	70		70
1260	Internal Balances	(8,100)	8,100	
1267	Due from Fiduciary Funds	5,572		5,572
1290	Other Receivables (net)	187,401		187,401
1310	Inventories	362,555		362,555
1420	Capital Bond & Other Debt Issuance Cost	1,146,090		1,146,090
Capital Assets, not subject to depreciation:				
1510	Land	5,775,196		5,775,196
Capital Assets, net of accumulated depreciation:				
1520	Buildings and improvements, net	146,157,265		146,157,265
1530	Furniture and equipment, net	4,079,600		4,079,600
1000	Total Assets	<u>220,076,167</u>	<u>10,545</u>	<u>220,086,712</u>
Liabilities				
2110	Accounts Payable	6,367,676	10,470	6,378,146
2140	Interest Payable	273,462		273,462
2160	Accrued Wages Payable	1,862,325		1,862,325
2180	Due to Other Governments	3,800,728		3,800,728
2200	Accrued Expenditures	69		69
2300	Unearned Revenue	513,001		513,001
Noncurrent Liabilities:				
2501	Due within one year	4,515,000		4,515,000
2502	Due in more than one year	156,745,948		156,745,948
2000	Total Liabilities	<u>174,078,209</u>	<u>10,470</u>	<u>174,088,679</u>
Net Assets				
3200	Invested in capital assets, net of related debt	5,605,001		5,605,001
Restricted for:				
3840	Food service	663,700		663,700
3850	Debt service	14,747,444		14,747,444
3900	Unrestricted	24,981,813	75	24,981,888
	Total net assets	<u>\$ 45,997,958</u>	<u>\$ 75</u>	<u>\$ 45,998,033</u>

See Notes to Financial Statements

SHELDON INDEPENDENT SCHOOL DISTRICT
STATEMENT OF ACTIVITIES
For the Year Ended August 31, 2009

Data Control Codes	Functions/Programs	Expenses	Program Revenue	
			Charges for Services	Operating Grants and Contributions
	Governmental activities:			
11	Instruction	\$ 33,957,964	\$	\$ 5,780,630
12	Instructional resources and media services	964,175		28,630
13	Curriculum and staff development	443,259		151,175
21	Instructional leadership	1,875,673		370,098
23	School leadership	3,308,200		166,230
	Guidance, counseling, and evaluation services	1,764,186		155,568
32	Social work services	64,275		
33	Health services	588,312		54,812
34	Student transportation	3,153,044		115,600
35	Food service	3,480,559	589,352	2,698,208
36	Extracurricular activities	1,762,196	133,675	31,710
41	General administration	1,939,351		75,480
51	Plant, maintenance and operations	7,348,047	15,797	176,038
52	Security and monitoring services	531,668		
53	Data processing services	139,498		7,320
61	Community services	16,900		15,297
72	Interest on long-term debt	7,062,185		
73	Debt issuance costs and fees	9,457		
81	Facilities acquisition and construction	2,394,429		28,630
	Contracted instructional services between schools	4,959,105		
	Payments to Juvenile Justice			
95	Alternative Education Programs	14,595		
99	Other intergovernmental charges	440,202		
TG	Total governmental activities	<u>76,217,280</u>	<u>738,824</u>	<u>9,855,426</u>
	Business-type activities			
01	Early Learning Center - Daycare	86,064	2,445	
TB	Total business-type activities	<u>86,064</u>	<u>2,445</u>	
TP	Total primary government	<u>\$ 76,303,344</u>	<u>\$ 741,269</u>	<u>\$ 9,855,426</u>

Data Control Codes

General revenues:

- Taxes:
- MT Property taxes, levied for general purposes
- DT Property taxes, levied for debt service
- SF State-aid formula grants
- GC Grants and contributions not restricted
- IE Investment earnings
- MI Miscellaneous
- FR Transfers
- TR Total general revenues, special items, and transfers
- CN Change in net assets
- NB Net assets - beginning
- NE Net assets - ending

See Notes to Financial Statements

<u>Net (Expense) Revenue and Changes in Net Assets</u>		
<u>Primary Government</u>		
<u>Governmental</u>	<u>Business-type</u>	<u>Total</u>
<u>Activities</u>	<u>Activities</u>	
\$ (28,177,334)		\$ (28,177,334)
(935,545)		(935,545)
(292,084)		(292,084)
(1,505,575)		(1,505,575)
(3,141,970)		(3,141,970)
(1,608,618)		(1,608,618)
(64,275)		(64,275)
(533,500)		(533,500)
(3,037,444)		(3,037,444)
(192,999)		(192,999)
(1,596,811)		(1,596,811)
(1,863,871)		(1,863,871)
(7,156,212)		(7,156,212)
(531,668)		(531,668)
(132,178)		(132,178)
(1,603)		(1,603)
(7,062,185)		(7,062,185)
(9,457)		(9,457)
(2,365,799)		(2,365,799)
(4,959,105)		(4,959,105)
(14,595)		(14,595)
(440,202)		(440,202)
<u>(65,623,030)</u>		<u>(65,623,030)</u>
	<u>(83,619)</u>	<u>(83,619)</u>
	<u>(83,619)</u>	<u>(83,619)</u>
<u>\$ (65,623,030)</u>	<u>\$ (83,619)</u>	<u>\$ (65,706,649)</u>
40,145,059		40,145,059
14,966,705		14,966,705
14,427,258		14,427,258
172,963		172,963
1,009,464		1,009,464
372,223		372,223
(83,694)	83,694	
<u>71,009,978</u>	<u>83,694</u>	<u>71,093,672</u>
5,386,948	75	5,387,023
<u>40,611,010</u>		<u>40,611,010</u>
<u>\$ 45,997,958</u>	<u>\$ 75</u>	<u>\$ 45,998,033</u>

SHELDON INDEPENDENT SCHOOL DISTRICT

BALANCE SHEET

GOVERNMENTAL FUNDS

August 31, 2009

<u>Data Control Codes</u>		<u>General Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>
Assets				
1110	Cash and temporary investments	\$ 28,382,931	\$ 14,004,667	\$ 13,472,191
Receivables:				
1220	Property taxes - delinquent	4,202,149	1,144,536	
1230	Allowance for uncollectible taxes (credit)	(640,989)	(174,586)	
1240	Receivables from other governments	122,145		
1250	Accrued interest	70		
1260	Due from other funds	610,944	46,289	3,264
1290	Other receivables	187,401		
1300	Inventories, at cost	260,890		
	Total Assets	<u>\$ 33,125,541</u>	<u>\$ 15,020,906</u>	<u>\$ 13,475,455</u>
 Liabilities and Fund Balance				
Liabilities:				
2110	Accounts payable	\$ 2,050,752	\$	\$ 4,155,155
2160	Accrued wages payable	1,817,735		
2170	Due to other funds	118,088		
2180	Payable to other governments	3,800,728		
2200	Accrued expenses			
2300	Deferred revenues	3,400,088	927,711	
2000	Total Liabilities	<u>11,187,391</u>	<u>927,711</u>	<u>4,155,155</u>
 Fund Balance:				
Reserved for:				
3410	Investments in inventories	260,890		
3420	Retirement of funded indebtedness		14,093,195	
3440	Encumbrances	341,796		2,020,963
3450	Food service operations			
3470	Capital acquisition program			7,192,801
Unreserved, Designated for:				
3590	Other purposes	10,290,210		106,536
Unreserved, Undesignated Reported in:				
3600	General fund	11,045,254		
3610	Special revenue funds			
3000	Total fund balances	<u>21,938,150</u>	<u>14,093,195</u>	<u>9,320,300</u>
4000	Total Liabilities and Fund Balances	<u>\$ 33,125,541</u>	<u>\$ 15,020,906</u>	<u>\$ 13,475,455</u>

See Notes to Financial Statements.

Exhibit A-3

<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
\$ 1,274,645	\$ 57,134,434
	5,346,685
	(815,575)
582,829	704,974
	70
60,435	720,932
	187,401
101,665	362,555
<u>\$ 2,019,574</u>	<u>\$ 63,641,476</u>

\$ 161,769	\$ 6,367,676
44,590	1,862,325
605,372	723,460
	3,800,728
69	69
502,472	4,830,271
<u>1,314,272</u>	<u>17,584,529</u>

101,665	362,555
	14,093,195
	2,362,759
562,035	562,035
	7,192,801
	10,396,746
	11,045,254
41,602	41,602
<u>705,302</u>	<u>46,056,947</u>
<u>\$ 2,019,574</u>	<u>\$ 63,641,476</u>

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SHELDON INDEPENDENT SCHOOL DISTRICT
RECONCILIATION OF BALANCE SHEET FOR GOVERNMENTAL FUNDS TO
STATEMENT OF NET ASSETS
August 31, 2009

Exhibit A-4

<u>Data Control Codes</u>		
	Total fund balance, governmental funds	\$ 46,056,947
	Amounts reported for governmental <i>activities</i> in the statement of net assets are different because:	
	Capital assets used in governmental activities are not financial resources and therefore are not reported as assets in governmental funds.	
1	Capital assets at historical cost, net of accumulated depreciation, where applicable	156,012,061
2	Property taxes receivable have been levied and are due this year, but are not available soon enough to pay for the current period's expenditures, these property taxes and related penalty and interest amounts (net of allowance for uncollectible accounts).	4,317,270
3	Bond issuance costs are not financial resources and, therefore, are not reported as assets in governmental funds. These costs are to be amortized over the life of the bonds.	1,146,090
	Long-term liabilities, including bonds payable, are not due and payable in the current period, and therefore are not reported as liabilities in the funds. Long-term liabilities at year end consist of:	
4	General obligation bonds	(160,072,818)
5	Premiums on issuance	(842,856)
6	Deferred loss on refunding	42,224
7	Accreted interest on premium compound interest bonds	(387,498)
8	Accrued interest payable	(273,462)
9	Total net assets - governmental activities	<u>\$ 45,997,958</u>

See Notes to Financial Statements.

SHELDON INDEPENDENT SCHOOL DISTRICT
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - GOVERNMENTAL FUNDS
For the Year Ended August 31, 2009

Data Control Codes		General Fund	Debt Service Fund	Capital Projects Fund
Revenues				
5700	Local, intermediate, and out-of-state	\$ 39,475,561	\$ 14,887,460	\$ 408,269
5800	State program revenues	16,603,668		
5900	Federal program revenues	169,445		
5020	Total revenues	<u>56,248,674</u>	<u>14,887,460</u>	<u>408,269</u>
Expenditures				
Current:				
0011	Instruction	27,842,965		
0012	Instruction resources and media services	843,304		
0013	Curriculum and instructional staff development	300,196		
0021	Instructional leadership	1,500,870		
0023	School leadership	2,975,804		
0031	Guidance, counseling and evaluation services	1,642,573		
0032	Social work services	64,275		
0033	Health services	532,092		
0034	Student transportation	2,711,883		
0035	Food services			
0036	Extracurricular activities	1,545,020		
0041	General administration	1,878,916		
0051	Plant maintenance and operations	7,111,272		
0052	Security and monitoring services	531,668		
0053	Data processing services	133,454		
0061	Community services	1,603		
Debt service:				
0071	Principal and interest on long-term debt	729,016	10,412,257	
0073	Bond issuance costs and fees		9,457	
Capital outlay:				
0081	Capital outlay	1,386,102		30,177,909
Intergovernmental:				
0091	Contracted instructional services	4,959,105		
0095	Payments to Juvenile Justice Alt. Ed. Prgm.	14,595		
0099	Other intergovernmental charges	440,202		
6030	Total Expenditures	<u>57,144,915</u>	<u>10,421,714</u>	<u>30,177,909</u>
1100	Excess (deficiency) of revenues over expenditures	<u>(896,241)</u>	<u>4,465,746</u>	<u>(29,769,640)</u>
Other Financing Sources (Uses)				
7912	Sale of real or personal property	22,164		
7989	Other non-operating revenues			202,481
8911	Transfers out	(83,694)		
8949	Other uses	(105,301)		
7080	Total other financing sources and uses	<u>(166,831)</u>		<u>202,481</u>
1200	Net change in fund balances	(1,063,072)	4,465,746	(29,567,159)
0100	Fund Balance - September 1 (Beginning)	<u>23,001,222</u>	<u>9,627,449</u>	<u>38,887,459</u>
3000	Fund Balance - August 31 (Ending)	<u>\$ 21,938,150</u>	<u>\$ 14,093,195</u>	<u>\$ 9,320,300</u>

See Notes to Financial Statements.

Exhibit A-5

Other Governmental Funds	Total Governmental Funds
\$ 594,220	\$ 55,365,510
1,071,962	17,675,630
6,610,572	6,780,017
<u>8,276,754</u>	<u>79,821,157</u>
4,384,454	32,227,419
	843,304
143,063	443,259
314,368	1,815,238
	2,975,804
61,178	1,703,751
	64,275
26,002	558,094
	2,711,883
3,186,841	3,186,841
	1,545,020
	1,878,916
26,418	7,137,690
	531,668
	133,454
15,297	16,900
	11,141,273
	9,457
28,630	31,592,641
	4,959,105
	14,595
	440,202
<u>8,186,251</u>	<u>105,930,789</u>
<u>90,503</u>	<u>(26,109,632)</u>
	22,164
	202,481
	(83,694)
	(105,301)
	<u>35,650</u>
90,503	(26,073,982)
<u>614,799</u>	<u>72,130,929</u>
<u>\$ 705,302</u>	<u>\$ 46,056,947</u>

SHELDON INDEPENDENT SCHOOL DISTRICT

Exhibit A-6

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE
STATEMENT OF ACTIVITIES**

For the Year Ended August 31, 2009

<u>Data Control Codes</u>		
	Net change in fund balances - total governmental funds (from A-5)	\$ (26,073,982)
	Amounts reported for governmental activities in the statement of activities (A-2) are different because:	
	Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation.	25,739,722
1		
2	Property tax revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	1,642,120
3	Repayment of bond principal is an expenditure in the governmental fund, but the repayment reduces long-term liabilities in the statement of net assets.	3,995,000
	Some expenses reported in the statement of activities do not require the use of current financial resources and these are not reported as expenditures in governmental funds:	
4	Decrease in interest payable not recognized in fund statements	237,325
5	Accreted interest on capital appreciation bonds and amortization of bond issuance costs and deferred loss on refunding	<u>(153,237)</u>
	Change in net assets of governmental activities	<u>\$ 5,386,948</u>

See Notes to Financial Statements.

SHELDON INDEPENDENT SCHOOL DISTRICT

Exhibit A-7

STATEMENT OF NET ASSETS

PROPRIETARY FUND

August 31, 2009

<u>Data Control Codes</u>		<u>Enterprise Funds</u>
		<u>Early Learning Center - Daycare</u>
	Assets	
	Current Assets:	
1110-75	Cash and cash equivalents	\$ 2,445
1260	Due from other funds	8,100
1000	Total Assets	<u>\$ 10,545</u>
	Liabilities	
	Current Liabilities:	
2110	Accounts payable	\$ 10,470
2000	Total Liabilities	<u>10,470</u>
	Net Assets	
3300	Unrestricted net assets	75
3000	Total Net Assets	<u>\$ 75</u>

See Notes to Financial Statements

SHELDON INDEPENDENT SCHOOL DISTRICT
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUND
For the Year Ended August 31, 2009

Exhibit A-8

<u>Data Control Codes</u>		<u>Enterprise Funds</u>
		<u>Early Learning Center - Daycare</u>
	Operating Revenues	
5739	Tuition	\$ 2,445
5020	Total Operating Revenues	<u>2,445</u>
	Operating Expenses	
6100	Payroll costs	33,410
6200	Purchased and contracted services	1,550
6300	Supplies and materials	47,217
6400	Claims expense and other operating expenses	3,887
6030	Total Operating Expenses	<u>86,064</u>
1200	Operating Income (Loss)	<u>(83,619)</u>
	Income (Loss) before Transfers	(83,619)
	Transfers	
7915	Transfers in	<u>83,694</u>
1200	Change in Net Assets	75
0100	Net Assets - September 1 (Beginning)	<u> </u>
3300	Net Assets - August 31 (Ending)	<u>\$ 75</u>

See Notes to Financial Statements

SHELDON INDEPENDENT SCHOOL DISTRICT
COMBINING STATEMENT OF CASH FLOWS
PROPRIETARY FUND
Year Ended August 31, 2009

Exhibit A-9

	<u>Enterprise Funds</u>
	<u>Early Learning Center - Daycare</u>
Cash Flows from Operating Activities:	
Cash received from customers	\$ 2,445
Cash payments to suppliers for goods and services	(42,184)
Cash payments to employees	(33,410)
Net Cash Provided by (Used for) Operating Activities	<u>(73,149)</u>
Cash Flows from Non-Capital Financing Activities:	
Advances from other funds	75,594
Net Cash Provided by (Used for) Non-Capital Financing Activities	<u>75,594</u>
Net Increase in Cash and Cash Equivalents	2,445
Cash and Cash Equivalents at Beginning of Year	
Cash and Cash Equivalents at End of Year	<u>\$ 2,445</u>
Reconciliation to Balance Sheet	
Cash and Cash Equivalents Per Cash Flow	<u>\$ 2,445</u>
Cash and Cash Equivalents per Balance Sheet	<u>\$ 2,445</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities	
Operating Income (Loss)	\$ (83,619)
Change in Assets and Liabilities:	
Increase (decrease) in Accounts Payable	10,470
Net Cash Provided by (Used for) Operating Activities	<u>\$ (73,149)</u>

See Notes to Financial Statements

SHELDON INDEPENDENT SCHOOL DISTRICT

Exhibit A-10

STATEMENT OF FIDUCIARY NET ASSETS

August 31, 2009

<u>Data Control Codes</u>		<u>810 Scholarship Fund</u>	<u>865 Student Activity Fund</u>
	Assets		
1110	Cash and cash equivalents	\$ 203,800	\$ 149,844
	Receivables:		
1250	Interest receivable		84
	Total Assets	<u>\$ 203,800</u>	<u>\$ 149,928</u>
	Liabilities		
2170	Due to other funds	5,334	238
2190	Due to student groups	34,736	149,690
2000	Total Liabilities	<u>40,070</u>	<u>149,928</u>
	Net Assets		
3590	Reserved for scholarships	<u>\$ 163,730</u>	<u>\$</u>

See Notes to Financial Statements.

SHELDON INDEPENDENT SCHOOL DISTRICT
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
For the Year Ended August 31, 2009

Exhibit A-11

	810 Scholarship Fund
Additions	
Gifts and contributions	\$ 49,776
Earnings on investments	1,646
Total Additions	<u>51,422</u>
Deductions	
Scholarships awarded	<u>57,816</u>
Total deductions	<u>57,816</u>
Change in net assets	(6,394)
Net assets beginning of year	<u>170,124</u>
Net assets end of year	<u>\$ 163,730</u>

See Notes to Financial Statements.

Note 1 - Summary of Significant Accounting Policies

Reporting Entity

The Sheldon Independent School District (District) is governed by a seven-member Board of Trustees (Board), which has governance responsibilities over all activities related to public elementary and secondary education within the District. Because members of the Board are elected by the public; have authority to make decisions; appoint management and significantly influence operations; and have primary accountability for fiscal matters; the District is not included in any other governmental reporting entity. The accompanying financial statements present the District. There are no component units, entities for which the District is considered to be financially accountable, included within the reporting entity.

Considerations regarding the potential for inclusion of other entities, organizations or functions in the District's financial reporting entity are based on criteria prescribed by generally accepted accounting principles. These same criteria are evaluated in considering whether the District is a part of any other governmental or other type of reporting entity. The overriding elements associated with prescribed criteria considered in determining that the District's financial reporting entity status is that of a primary government are; that it has a separately elected governing body; it is legally separate; and, it is fiscally independent of other state and local governments. Additionally, prescribed criteria under generally accepted accounting principles include: considerations pertaining to organizations for which the primary government is financially accountable; and, considerations pertaining to other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the District. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities* normally are supported by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to students or users who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

Separate financial statements are provided for governmental funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

Note 1 - Summary of Significant Accounting Policies (continued)

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The fiduciary fund financial statements reflect the District's agency fund, reporting only assets and liabilities, and do not have a measurement focus.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Grant revenues and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the District.

The District reports the following major governmental funds:

- The *general fund* is the District's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.
- The *debt service fund* accounts for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.
- The *capital projects fund* is used to account for proceeds from sales of bonds and other revenues to be used for authorized construction and technology projects/enhancements.

Additionally, the District reports the following fund types:

- The *special revenue funds* are used to account for resources restricted to, or designated for, specific purposes by a grantor including federally-funded and state-funded grants. These grants are awarded to the District for the purpose of accomplishing specific educational tasks as defined in the grant awards.
- The *enterprise fund* is used to account for revenues and expenses related to the District's tuition/fee based employee child care program.
- The *agency fund* is used to account for assets held by the District as an agent for student organizations. The fund is custodial in nature (assets equal liabilities) and does not involve measurement of results of operation.

Note 1 - Summary of Significant Accounting Policies (continued)

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as *program revenues* include 1) charges to students or users for goods, services, or privileges provided and 2) operating grants and contributions. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes and investment income.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

Deposits and Investments

The District's cash and cash equivalents are considered to be cash on hand, demand deposits, certificates of deposit, investment pools, and short-term investments with original maturities of three months or less from the date of acquisition.

Investments for the District are reported at fair value based on quoted market prices at August 31, 2009. The investment pools operate in accordance with appropriate state laws and regulations. The reported value of the pools is the same as the fair value of the pool shares.

Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds."

Property tax receivables include unpaid property taxes at year-end along with penalties and interest assessed on these unpaid taxes and are shown net of an allowance for uncollectibles. Allowances for uncollectible tax receivable within the general and debt service funds are based on historical experience in collecting property taxes. Revenues from property taxes are recognized when levied to the extent they are available. The District considers property taxes as available when collected. However, not all outstanding property taxes are expected to be collected within one year of the date of the financial statements. Property values are determined by the Harris County Appraisal District as of January 1 of each year. Prior to September 1 of each year, the District must adopt its annual budget and as soon thereafter as practicable, shall adopt a tax rate thus creating the tax levy. Property taxes for the current calendar year are levied on approximately October 1 of each year and are payable by January 31 of the following year. Property tax receivables are recorded as of the date levied. Unpaid taxes become delinquent on February 1 and a tax lien on real property is created as of July 1 of each year.

Note 1 - Summary of Significant Accounting Policies (continued)

Inventories and Prepaid Items

Inventories consisting of supplies and materials are valued at weighted average cost and they include maintenance, transportation, office and instructional supplies, and food service commodities. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased. Food service commodity inventory is recorded at fair market value on the date received. Commodities are recognized as revenues in the period received when all the eligibility requirements are met. Commodity inventory items are recorded as expenditures when distributed to user locations. A portion of fund balance is reserved to reflect minimum inventory quantities considered necessary for the District's continuing operations.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

Capital Assets

Capital assets, which include land, construction in progress, buildings and improvements, furniture and equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental column in the government-wide financial statements. The District's infrastructure includes parking lots and roads associated with various buildings. The cost of the infrastructure was initially capitalized with the building cost and is being depreciated over the same useful life as the building. Capital assets are defined by the District as assets with an initial, individual cost that equals or exceeds \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Buildings and improvements, and furniture and equipment of the District are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and Improvements	15-60
Furniture and Equipment	7-25

Compensated Absences

The District's employees earn sick leave and vacation benefits which may be accumulated each year. The District's policy permits employees, upon retirement, who have worked in the District for a minimum of three consecutive years prior to their retirement to be compensated for their accumulated unused sick leave at their daily rate of pay, not to exceed the daily cost of a degreed substitute teacher. The District estimates that the liability for accumulated unpaid sick leave for all employees eligible to be \$152,830 as of August 31, 2009.

Note 1 - Summary of Significant Accounting Policies (continued)

Long-term Obligations

The District's long-term obligations consist of bond indebtedness, notes payable, and compensated absences. In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities and proprietary fund type statement of net assets. Bond premiums and discounts are deferred and amortized over the life of the bonds using the bonds outstanding method, which approximates the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

The current requirements for general obligation bonds principal and interest expenditures are accounted for in the debt service fund. The current requirements for notes payable principal and interest expenditures are accounted for in the general fund. The current requirements for are accounted for in the general fund.

Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

Reserved Fund Balance

In the fund financial statements, governmental funds report fund balance reserves to indicate that a portion of the fund balance is legally restricted for a specific future use or to indicate that a portion of the fund balance is not available for expenditures. The following is a list of fund balance reserves recognized by the District and a description of each:

Investment in Inventory

An account used to indicate that inventory, which will be charged to future periods, does not represent expendable resources.

Retirement of Funded Indebtedness

An account used to indicate the Debt Service assets are restricted for the retirement of bonded debt.

Outstanding Encumbrances

An account used to indicate outstanding encumbrances at year end, which the District intends to honor in the subsequent year.

Note 1 - Summary of Significant Accounting Policies (continued)

Food Service Operations

An account used to indicate that a portion of the Special Revenue Fund assets is reserved for future food service operations.

Designated Fund Balance

The District designated a portion of fund balances to indicate the administration's tentative plans for future use of financial resources.

Construction

An account used to indicate the administration's tentative plans for capital projects.

Data Control Codes

The Data Control Codes refer to the account code structure prescribed by the Texas Education Agency (TEA) in the Financial Accountability System Resource Guide. TEA requires school districts to display these codes in the financial statements filed with the Agency in order to insure accuracy in building a statewide database for policy development and funding plans.

Use of Estimates

The presentation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Comparative Data/Reclassifications

Comparative data for the prior year has not been presented in the District's financial statements.

Note 2 - Deposits and Investments

Cash Deposits

Deposits and investment transactions of the District are regulated by State statutes through provisions of Chapter 23, Subchapter E, Sections 23.71 through 23.8 (the School Depository Act) of the Texas Education Code and other Code sections referenced therein and through provisions of the Texas Revised Civil Statutes, Title 47, Articles 2529c and 2548a, regarding security for District funds in depository institutions.

In accordance with applicable statutes, the District has a depository contract with an area bank (depository) providing for interest rates to be earned on deposited funds and for banking charges the District incurs as a result of banking services received. All depository contracts have a term of two years commencing with the start of every odd-numbered fiscal year. Depository contracts are awarded on the basis of competitive bids received from area banks and can be awarded to more than one bank if the bids received are relatively equal.

Note 2 - Deposits and Investments (continued)

Section 23.80 of the Texas Education Code provides that the depository shall not be compelled to accept time deposits from the proceeds of District debt issues; however, the depository is entitled to receive these funds under certain conditions.

The District may place funds with the depository in interest and non-interest bearing accounts. Statutes and the depository contract require that all funds in the depository institution be fully secured by federal depository insurance or a combination of federal depository insurance and acceptable collateral securities and/or an acceptable surety bond. The collateral securities must be delivered to the District or placed with an independent trustee institution with safekeeping receipts delivered to the District and copies of the safekeeping receipts delivered to the Texas Education Agency. In accordance with State statutes pertaining to lawful collateralization of District deposits, safekeeping receipts are issued in the name of the depository with proper indication that the collateral securities are pledged by the depository to secure funds of the District. Acceptable collateral securities include direct obligations of the United States of America (U.S.), bonds of any agency of the U.S. (except Farmers Home Administration Insured Notes), Bonds of the State of Texas, or of any county, school district, city, or town of the State of Texas that have been rated A or better by Moody's Investors Service, Inc., as authorized by Chapter 2257 Collateral for Public Funds of the Government Code.

The District must approve all collateral securities prior to their being pledged. The depository can change collateral securities pledged to secure District funds only upon obtaining the written approval of the District.

The District is authorized by Section 20.42 of the Texas Education Code to place the proceeds from debt issues in properly secured or collateralized interest bearing time deposits with any Texas state or national bank having federal deposit insurance (FDIC) coverage for depositors or directly in bonds or other obligations of the U.S., provided that these time deposits cannot be cashed, sold or redeemed for an amount less than that originally invested by the District. Additionally, Section 23.80 of the Texas Education Code authorizes the District to invest in direct debt securities of the U.S. or other types of bonds, securities, warrants, etc., which the District is authorized by law to invest in. Cash includes petty cash on hand in various functional areas for use in routine operations and demand and time deposit accounts held by the depository bank.

All demand, money market and time deposits in the depository bank were entirely covered by federal depository insurance and by acceptable collateral securities held in the District's name by an agent of the District at year end in accordance with provisions of the depository contract. Demand and time deposits at various banks, held on behalf of different student groups, were entirely covered by federal depository insurance at year end. Deposits were properly secured at all times.

Investments

The Board of Trustees of the District has adopted a written investment policy regarding the investment of its funds as defined in the Public Funds Investment Act of 1995 (Chapter 2256, Texas Government Code). The Public Funds Investment Act (the "Act") requires an annual audit of investment practices. Audit procedures in this area, conducted as part of the Audit, disclosed that in the area of investment practices, management reports and establishment of appropriate policies, the District was in substantial compliance with the requirements of the Act. Additionally, the investments and investment practices of the District are in compliance with the Trustees' investment policies.

Note 2 - Deposits and Investments (continued)

The District's Investment Policy emphasizes safety of principal and liquidity, addresses investment diversification, yield and maturity and addresses the quality and capability of investment personnel. The Investment Policy includes a list of authorized investment instruments, a maximum allowable stated maturity of any individual investment and the maximum average dollar weighted maturity allowed. In addition, it includes an "Investment Strategy Statement" that specifically describes the priorities of suitability of investment type, preservation and safety of principal, liquidity, marketability, diversification and yield.

The District is authorized to invest in the following investment instruments provided that they meet the guidelines of the Investment Policy:

1. Obligations of the United States or its agencies and instrumentalities;
2. Direct obligations of the State of Texas, or its agencies and instrumentalities;
3. Other obligations, the principal and interest on which are unconditionally guaranteed or insured by the State of Texas or the United States, or its agencies and instrumentalities;
4. Certificates of deposit. Must be fully collateralized and guaranteed or insured by the FDIC;
5. Repurchase agreement. Must be fully collateralized, pledged to and held in the District's name, and deposited at the time the investment is made with the District or with a third party selected and approved by the District, with a defined termination date, and placed through a primary government securities dealer;
6. Commercial paper. Must have a stated maturity of 270 days or fewer and a rating of not less than A-1/P-1 by two nationally recognized credit rating agencies; or a fully secured irrevocable letter of credit from a US bank and one A-1/P-1 credit rating;
7. Money Market funds. Must be approved by the Board and invest its funds only in investments approved by the Investment Policy; and
8. Public Funds Investment Pools. Must be approved by the Board and invest its funds only in investments approved by the Investment Policy.

A summary of the District's cash and investments at August 31, 2009, are shown below:

	Cash and Deposits	Money Market Accounts	External Investment Pools	Investment Securities	Total
Governmental Funds					
General Fund	\$ 1,006,160	\$ 2,820,293	\$ 24,556,478	\$	\$ 28,382,931
Debt Service Fund	7,145	4,294,169	3,513,233	6,190,120	14,004,667
Capital Projects Fund	5,230	1,522,866	11,944,095		13,472,191
Non-major Governmental Funds	518,380	694,495	61,770		1,274,645
Total Governmental Funds	<u>1,536,915</u>	<u>9,331,823</u>	<u>40,075,576</u>	<u>6,190,120</u>	<u>57,134,434</u>
Proprietary Funds	<u>2,445</u>				<u>2,445</u>
Fiduciary Funds	<u>175,802</u>		<u>177,842</u>		<u>353,644</u>
Total Cash and Investments	<u>\$ 1,715,162</u>	<u>\$ 9,331,823</u>	<u>\$ 40,253,418</u>	<u>\$ 6,190,120</u>	<u>\$ 57,490,523</u>

The District's investments are insured, registered or the District's agent holds the securities in the District's name; therefore, the District is not exposed to custodial credit risk. Custodial credit risk for investments is the risk that, in the event of failure by the counterparty (e.g. broker dealer) to a transaction, a government will not be able to recover the value of its investments or collateral securities that are in the possession of another party. The District's policy requires that a third party bank trust department hold all securities owned by the District.

Note 2 - Deposits and Investments (continued)

Investments

The District holds all US government securities to maturity date. The District did not purchase any derivative investment products during the current year nor participate in any reverse purchase agreements or securities lending agreements during the fiscal year.

The following table includes the portfolio balance, credit rating and percentage of the portfolio balance by investment type of the District as of August 31, 2009:

Investment Type	Fair Market Value	S & P Credit Quality Ratings	Percentage of Investments
Local Government Investment Pools			
Lone Star	\$ 17,385,715	AAAm	31.14%
TexStar	22,867,703	AAAf	40.96%
	<u>40,253,418</u>		
Certificates of Deposit	55,000	Not Rated	0.10%
Investment Securities			
Federal National Mortgage Assn	5,503,756	AAA	9.86%
Federal Home Loan Mortgage Corp	686,364	AAA	
Money Market Mutual Fund	9,331,823	Not Rated	16.71%
	<u>15,521,943</u>		
Total Investments	<u>\$ 55,830,361</u>		

Local Government Investment Pools

The District participates in two Local Government Investment Pools: Texas Short Term Asset Reserve Program (TexSTAR) and Lone Star Investment Pool (Lone Star). The TexSTAR and Lone Star investment pools' investments are not evidenced by securities that exist in physical or book entry form and, accordingly, do not have custodial risk.

TexSTAR and Lone Star policies require that local government deposits be used to purchase investments authorized by the Public Funds Investment Act of 1995, as amended. The value of the District's portion in TexSTAR and Lone Star are the same as the value of the shares. The external investment pool funds operate in a manner consistent with the SEC's rule 2a7 of the Investment Company Act of 1940. The external investment pool funds use amortized cost rather than market value to report net assets to compute share price. Accordingly, the fair value of the positions of the pooled funds are the same as the value of the external investments pool funds shares. The funds are structured similar to a money market mutual fund which allows shareholders the ability to deposit or withdraw funds on a daily basis. Interest rates are also adjusted on a daily basis. Such funds seek to maintain a constant net asset value of \$1.00, although this cannot be fully guaranteed. At August 31, 2009, TexSTAR and Lone Star had a weighted average maturity of 49 days and 52 days, respectively. Although the external investment pool funds had a weighted average maturity of more than one day, the District considers the holdings in these funds to have a one day weighted average maturity. This is due to the fact that the share position can usually be redeemed each day at the discretion of the shareholder, unless there has been a significant change in value.

Note 2 - Deposits and Investments (continued)

Oversight Responsibility

Oversight responsibility includes the ability to significantly influence operations, designation of management and accountability for fiscal matters. For the investment pools utilized by the District, oversight responsibility for each is as follows:

- **TexSTAR** - The State Comptroller of Public Accounts exercises responsibility over TexSTAR. Day to day administration of the Fund is performed by Federated Investors, Inc.
- **Lone Star** - The Local Government Investment Cooperative's governing body is a eleven-member Board of Directors all of whom are Participants of the Pool. Day to day administration of the Fund is administered by First Public, LLC and managed by Standish Mellon and American Beacon Advisors.

Ratings - TexSTAR is rated "AAAm" by Standards & Poors. Lone Star is rated "AAAf/S1" by Standard & Poors.

The Investments of the District are reported at fair value in accordance with Governmental Accounting Standards Board Statement (GASB) No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools". The amount of increases or decreases in the fair value of investments for the year is included in Investment Income.

At year-end, the District's cash and investments balances and the weighted average maturity of these investments were as follows:

	Fair Market Value	Weighted Average Maturity (Days)
Cash and deposits	\$ 1,661,075	1
Certificates of deposit	55,717	34
Investments:		
Local Government Investment Pools:		
Lone Star	17,385,715	52
TexStar	22,867,703	49
Investment Securities:		
Federal National Mortgage Assn	5,503,756	77
Federal Home Loan Mortgage Corp	686,364	106
Money Market Mutual Fund	9,331,823	1
Total Investments	<u>55,775,361</u>	<u>45</u>
Total Cash and Investments	<u>\$ 57,492,153</u>	

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates may adversely affect the value of the investments. The District monitors interest rate risk utilizing weighted average maturity analysis. In accordance with its investment policy, the District reduces its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio as a whole to no more than 360 days, with the exception of bond proceeds that are matched to a specific cash flow; diversification; and by holding securities to maturity. In addition, the District shall not directly invest in an individual security maturing more than twenty-four months from the date of purchase.

Note 2 - Deposits and Investments (continued)

Credit Risk:

State law and the District's investment policy limits investments in all categories to top ratings issued by nationally recognized credit rating organizations. As of August 31, 2009 the District's investment in TexSTAR was rated AAA_m by Standard and Poor's. The District's investment in Lone Star Investment Pool was rated AAA_f/S1 by Standard and Poor's.

Note 3 - Receivables

Property taxes are considered available when collected within the current period. Property taxes are levied by October 1 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 the property to secure the payment of all taxes, penalties and interest ultimately imposed. Appraised values are established by the Central Appraisal District (CAD) of Harris County, Texas. Taxes are levied by the District's Board of Trustees based on the appraised values received from the CAD. Billing and collection of tax levies are performed by the District.

Property tax rates, established in accordance with state law, are levied on real and personal property within the District's boundaries for use in financing general government and debt service expenditures. Tax rates levied to finance general government and debt service expenditures for 2008-2009 were \$1.04 and \$0.39, respectively, based on an adjusted assessed property valuation of approximately \$3.38 billion resulting in an adjusted tax levy of approximately \$45.0 million. Allowances for uncollectible taxes are based on 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.

Net receivables, at August 31, 2009, consisted of the following:

	<u>General Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Nonmajor and Fiduciary Funds</u>	<u>Total</u>
Property Taxes	\$ 4,202,149	\$ 1,144,536	\$	\$	\$ 5,346,685
Due from other governments	122,145			582,829	704,974
Interest	70				70
Other	187,401				187,401
Gross Receivables	4,511,765	1,144,536		582,829	6,239,130
Less allowance for doubtful accounts	(640,989)	(174,586)			(815,575)
Net Total Receivables	<u>\$ 3,870,776</u>	<u>\$ 969,950</u>	<u>\$</u>	<u>\$ 582,829</u>	<u>\$ 5,423,555</u>

SHELDON INDEPENDENT SCHOOL DISTRICT
NOTES TO FINANCIAL STATEMENTS (continued)

Exhibit A-12

Note 3 - Receivables (continued)

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period or in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of deferred revenues reported in the governmental funds were as follows:

	<u>Unavailable</u>	<u>Unearned</u>
Delinquent property taxes receivable (General Fund)	\$ 3,389,559	\$
Delinquent property taxes receivable (Debt Service Fund)	927,711	
Advanced collection of fees		10,530
Grant funds received prior to meeting all eligibility requirements		502,471
	<u>\$ 4,317,270</u>	<u>\$ 513,001</u>

Note 4 - Due from other Governments

Amounts reported as due from other governments consist primarily of receivables due from state agencies for federal grant expenditure reimbursement.

Note 5 - Interfund Activities

Interfund balances consist of short-term lending/borrowing arrangements that result primarily from payroll, and other regularly occurring charges that are paid by the general fund and then charged back to the appropriate fund. Additionally, some lending/borrowing may occur between two or more non-major governmental funds.

The composition of interfund balances as of August 31, 2009, is as follows:

	<u>Interfund Receivable</u>	<u>Interfund Payable</u>
General Fund	\$ 610,944	\$ 118,088
Debt Service Fund	46,289	
Capital Projects Fund	3,264	
Proprietary Funds	8,100	
Fiduciary Funds		5,572
Nonmajor Funds	60,435	605,372
	<u>\$ 729,032</u>	<u>\$ 729,032</u>

Interfund transfers are defined as "flows of assets without equivalent flow of assets in return and without a requirement for repayment." The following is a summary of the District's transfers for the year ended August 31, 2009:

<u>Transfer Out</u>	<u>Transfer In</u>	<u>Amount</u>
General Fund	Proprietary Fund	\$ 83,694

SHELDON INDEPENDENT SCHOOL DISTRICT
NOTES TO FINANCIAL STATEMENTS (continued)

Exhibit A-12

Note 6 - Capital Assets

Changes in Capital Assets

A summary of changes in general fixed assets, for the year ended August 31, 2009 follows:

	Balance		(Retirements and Transfers	Balance
	August 31, 2008	Additions		August 31, 2009
Capital assets, not being depreciated:				
Land	\$ 5,775,196	\$	\$	\$ 5,775,196
Construction in progress	13,363,185		(13,363,185)	
Total Capital assets, not being depreciated	19,138,381		(13,363,185)	5,775,196
Capital assets, being depreciated:				
Buildings and improvements	142,641,039	41,974,265		184,615,304
Furniture and equipment	7,855,780	706,014	(160,283)	8,401,511
Total Capital assets, being depreciated	150,496,819	42,680,279	(160,283)	193,016,815
Less accumulated depreciation for:				
Buildings and improvements	(35,537,217)	(2,920,822)		(38,458,039)
Furniture and Equipment	(3,825,644)	(656,550)	160,283	(4,321,911)
Total Accumulated depreciation	(39,362,861)	(3,577,372)	160,283	(42,779,950)
Governmental Capital Assets	\$ 130,272,339	\$ 39,102,907	\$ (13,363,185)	\$ 156,012,061

Depreciation expense has been charged to the following functions in the government-wide statements:

Function	Depreciation Expense
Instruction	\$ 1,642,246
Instructional resources and media services	120,871
Instructional leadership	60,435
School leadership	332,396
Guidance, counseling and evaluation services	60,435
Health services	30,218
Student transportation	441,161
Food Services	294,430
Extracurricular activities	286,958
General administration	60,435
Plant maintenance and operations	241,743
Data processing services	6,044
	\$ 3,577,372

SHELDON INDEPENDENT SCHOOL DISTRICT
NOTES TO FINANCIAL STATEMENTS (continued)

Exhibit A-12

Note 6 - Capital Assets (continued)

The District has active construction projects as of August 31, 2009. At year end the District's commitments with contractors are as follows:

Project	Approved Construction Budget	Remaining Commitment
Renovation - KMS	\$ 3,957,200	\$ 220,083
Renovation - KHS	1,688,184	88,690
Renovation - ME	1,287,900	71,627
Renovation - RE	591,200	32,882
Null Middle School	29,496,560	1,672,771
Sheldon/Sheldon ECA	2,914,533	187,822
Paving at KHS & KMS complex	758,000	47,091
Utility work for Null Middle School	745,619	401,467
Repair work/ Gates	79,263	12,286
Track & Artificial Turf at stadium	1,547,570	366,796
Food Service Equipment	635,050	900
	<u>\$ 43,701,079</u>	<u>\$ 3,102,415</u>

Note 7 - Long-Term Debt and Debt Service Requirements

General long-term debt consists of bonds payable and related accretion values on premium compound interest bonds. Bonds are payable solely from future revenues of the debt service fund, which consists principally of property taxes collected by the District, state existing debt and instructional facilities allotments and investment income.

A summary of general long-term debt transactions of the District for the year ended August 31, 2009, follows:

	Balance August 31, 2008	Additions	Retirements	Balance August 31, 2009	Due Within One Year
General obligation bonds	\$ 164,067,818	\$	\$ 3,995,000	\$ 160,072,818	\$ 4,515,000
Less deferred amounts:					
For issuance premiums/discounts	880,196		37,340	842,856	
Gain or loss on refunding bonds	(133,959)		(91,735)	(42,224)	
Accreted interest on premium compound interest bonds	338,761	48,737		387,498	
	<u>\$ 165,152,816</u>	<u>\$ 48,737</u>	<u>\$ 3,940,605</u>	<u>\$ 161,260,948</u>	<u>\$ 4,515,000</u>

SHELDON INDEPENDENT SCHOOL DISTRICT
NOTES TO FINANCIAL STATEMENTS (continued)

Exhibit A-12

Note 7 - Long-Term Debt and Debt Service requirements (continued)

Bonded long-term debt, at August 31, 2009, is comprised of the following individual issues:

Issue	Interest Rate (%)	Maturity Date	Debt Outstanding
Unlimited Tax School Building Bonds, Series 1999	4.25% to 4.80%	2019	\$ 6,075,000
Unlimited Tax School Building and Refunding Bonds, Series 2000A	4.50% to 6.0%	2010	350,000
Unlimited Tax School Building Bonds, Series 2000B	2.30% to 2.55%	2012	2,150,000
Unlimited Tax School Building Bonds, Series 2001A	4.35% to 5.25%	2026	8,275,000
Unlimited Tax School Building Bonds, Series 2001B	0%	2015	8,000,000
Unlimited Tax School Building Bonds, Series 2002	3.40% to 4.00%	2027	13,325,000
Unlimited Tax School Building and Refunding Bonds, Series 2003A	2.00% to 5.25%	2028	14,800,000
Unlimited Tax School Building and Refunding Bonds, Series 2004	4.50% to 5.125%	2029	6,030,000
Unlimited Tax School Building Bonds, Series 2005	0%	2020	3,000,000
Unlimited Tax School Building Bonds, Series 2005	3.70% to 6.00%	2035	9,150,000
Maintenance Tax Notes, Series 2006	3.875% to 4.125%	2021	7,110,000
Unlimited Tax School Building Bonds, Series 2006	4.00% to 5.00%	2036	15,750,000
Unlimited Tax School Building and Refunding Bonds, Series 2007	4.25% to 7.00%	2037	48,657,818
Unlimited Tax School Building Bonds, Series 2008	4.25% to 7.00%	2038	17,400,000
			<u>\$ 160,072,818</u>

The District is in compliance with all significant bond compliance requirements.

Annual requirements to amortize all bonded long-term debt outstanding, as of August 31, 2009 follow:

Year Ending August 31,	Principal	Interest	Totals
2010	\$ 4,515,000	\$ 6,743,603	\$ 11,258,603
2011	4,765,000	6,538,577	11,303,577
2012	6,110,000	6,354,911	12,464,911
2013	4,260,000	6,132,051	10,392,051
2014	4,113,156	6,295,437	10,408,593
2015 - 2019	34,419,661	27,099,535	61,519,196
2020 - 2024	34,915,000	19,988,605	54,903,605
2025 - 2029	30,905,000	11,949,156	42,854,156
2030 - 2034	21,620,000	6,074,174	27,694,174
2035 - 2039	14,450,000	1,055,386	15,505,386
	<u>\$ 160,072,817</u>	<u>\$ 98,231,435</u>	<u>\$ 258,304,252</u>

Note 7 - Long-Term Debt and Debt Service requirements (continued)

Accreted Interest on Premium Compound Interest Bonds

A portion of the bonds sold in the Series 2007 bond issue was capital appreciation bonds commonly referred to as "premium compound interest bonds". The District annually records the appreciation of bond principal for the accreted value of the bonds through maturity of the issue. The interest of these bond series will be paid upon maturity. The following table summarizes the significant features of the individual bonds, by issue:

<u>Series</u>	<u>Accreted Value</u>	<u>Principal</u>	<u>Accreted Interest</u>	<u>Maturity Value</u>	<u>Maturity Dates</u>
2007	\$ 1,120,316	\$ 732,818	\$ 387,498	\$ 1,100,509	2014-2015

Prior Year Refunding of General Obligation Bonds

The District refunded certain general obligation bonds in 2007. Proceeds of the new bonds were placed in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and liability for the defeased bonds are not included in the District's financial statements. At August 31, 2009, the outstanding balance of defeased bonds totaled \$4,975,000.

Note 8 - Revenues from Local, Intermediate, and Out-of-State sources

Revenues from local, intermediate and out-of-state sources in the governmental fund types are as follows:

	<u>General Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Property Taxes	\$ 38,935,089	\$ 14,534,555	\$	\$	\$ 53,469,644
Investment Income	318,422	352,905	333,269	4,868	1,009,464
Co-curricular student activities	133,675				133,675
Food Sales				589,266	589,266
Other	88,375		75,000	86	163,461
	<u>\$ 39,475,561</u>	<u>\$ 14,887,460</u>	<u>\$ 408,269</u>	<u>\$ 594,220</u>	<u>\$ 55,365,510</u>

Note 9 - Retirement Plan

Plan Description

Sheldon Independent School District contributes to the Teacher Retirement System of Texas (TRS), a cost-sharing multiple-employer defined benefit pension plan. TRS administers retirement and disability annuities, and death and survivor benefits to employees and beneficiaries of the employees of the public school systems of Texas. It operates primarily under the provisions of the Texas Constitution, Article XVI, Sec. 67, and Texas Government Code, Title 8, Subtitle C. TRS also administers proportional retirement benefits and service credit transfer under Texas Government Code, Title 8, Chapters 803 and 805, respectively. The Texas state legislature has the authority to establish and amend benefits provisions of the pension plan and may, under certain circumstances, grant special authority to the TRS Board of Trustees. TRS issues a publicly available financial report that includes financial statements and required supplementary information for the defined benefit pension plan. That report may be obtained by writing to the TRS Communications Department, 1000 Red River Street, Austin, Texas 78701, by calling the TRS Communications Department at 1-800-223-8778, or by downloading the report from the TRS Internet website, www.trs.state.tx.us, under the TRS Publications heading.

Funding Policy

State law provides for fiscal 2007 a state contribution rate of 6.0% and for fiscal years 2008 and 2009 a state contribution rate of 6.58% and for 2007, 2008 and 2009 a member contribution rate of 6.4%. In certain instances, the reporting district is required to make all or a portion of the state's 6.58% contribution for 2008 and 2009, and 6.0% for fiscal year 2007. Contribution requirements are not actuarially determined but are legally established each biennium pursuant to the following state funding policy: (1) The state constitution requires the legislature to establish a member contribution rate of not less than 6.0% of the member's annual compensation and a state contribution rate of not less than 6.0% and not more than 10.0% of the aggregate annual compensation of all members of the system during that fiscal year; (2) A state statute prohibits benefit improvements or contribution reductions if, as a result of the particular action, the time required to amortize TRS's unfunded actuarial liabilities would be increased to a period that exceeds 31 years, or, if the amortization period already exceeds 31 years, the period would be increased by such action.

Contributions

Staff members of the District are required to pay 6.40% of their eligible gross earnings to TRS pension plan. The State of Texas contributes 6.58% (6.0% for fiscal year 2007) of all employees' eligible gross earnings, except for those District staff members subject to statutory minimum requirements and those staff members being paid from and participating in federally funded programs. State statutes establish these rates. The statutory minimum requirements are based on the State of Texas teacher schedule adjusted based on local tax rates. For staff members funded by federal programs, the federal programs are required to contribute 6.58% (6.0% for fiscal year 2007).

Note 9 - Retirement Plan (continued)

Contributions made by the State, District and staff members for the years ended August 31, 2007, 2008, and 2009, are as follows:

Fiscal Year	Contributions Required and Made (in \$millions)				Annual Covered Payroll
	State	District	Employees	Totals	
2007	\$ 1.179	\$ 0.380	\$ 1.820	\$ 3.379	\$ 28.403
2008	1.617	0.703	2.102	4.422	32.643
2009	1.950	0.760	2.310	5.020	35.606

For the current fiscal year and each of the past two years, the District's actual contributions were equal to 100 percent of the required contributions. The contributions made by the state on behalf of the District have been recorded in the governmental funds financial statements of the District as both state revenues and expenditures. These contributions are the legal responsibility of the State.

Note 10 - Retiree Health Plan

Plan Description

The Sheldon Independent School 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 Retire Plan provides health care coverage for certain person (and their dependents) who retired under TRS. The statutory authority for the program is Texas Insurance Code, Chapter 1575. Section 1575 grants the TRS Board of Trustees the authority to establish and amend basic and optional insurance coverage for participants. TRS issues a publicly available financial report that includes financial statements and required supplementary information for TRS-Care. That report may be obtained by writing to the TRS Communications Department, 1000 Red River Street, Austin, Texas 78701, by calling the TRS Communications Department at 1-800-223-8778, or by downloading the report from the TRS Internet website, www.trs.state.tx.us, under the TRS Publications heading.

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 percentage of payroll set at 0.55% for the fiscal year 2009, 2008, and 2007. Per Texas Insurance Code 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 staff members funded by federal programs, the federal programs are required to contribute 1.0%.

Note 10 - Retiree Health Plan (continued)

Contributions made by the State, District and staff members for the years ended August 31, 2009, 2008, and 2007, are as follows:

Fiscal Year	Contributions Required and Made (in \$millions)				Annual Covered Payroll
	State	District	Employees	Totals	
2007	\$ 0.254	\$ 0.186	\$ 0.156	\$ 0.596	\$ 28.403
2008	0.307	0.199	0.212	0.718	32.643
2009	0.296	0.211	0.231	0.738	35.606

For the current fiscal year and each of the past two years, the District's actual contributions were equal to 100 percent of the required contributions. The contributions made by the state on behalf of the District have been recorded in the governmental funds financial statements of the District as both state revenues and expenditures. These contributions are the legal responsibility of the State.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 established prescription drug coverage for Medicare beneficiaries known as Medicare Part D. Under Medicare Part D, TRS-Care retiree drug subsidy payments from the federal government to offset certain prescription drug expenditures for eligible TRS-Care participants. For the years ended August 31, 2009, 2008 and 2007, the subsidy payments received by TRS-Care on behalf of the District were \$79,151, \$71,877 and \$60,266, respectively. These payments are recorded as equal revenues and expenditures in the governmental funds financial statement of the District.

Note 11 - Litigation

From time to time, the District is a defendant in legal proceedings relating to its operations as a school district. In the best judgment of the District's management, the outcome of any present legal proceedings will not have any adverse material effect on the accompanying financial statements.

Note 12 - Contingent Liabilities

Amounts received or receivable from grant agencies are subject to audit and adjustment by grantor agencies. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of expenditures that may be disallowed by the grantor cannot be determined at this time, although the District expects such amounts, if any, to be immaterial.

Required Supplementary Information

SHELDON INDEPENDENT SCHOOL DISTRICT
BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
For the Year Ended August 31, 2009

Data Control Codes	Budgeted Amounts		Actual Amounts, Budgetary Basis	
	Original	Final		
Revenues				
5700	Local revenues	\$ 34,910,050	\$ 39,252,870	\$ 39,475,561
5800	State program revenues	20,854,520	19,404,520	16,603,668
5900	Federal program revenues	130,000	130,000	169,445
	Total revenues	55,894,570	58,787,390	56,248,674
Expenditures				
Current:				
0011	Instruction	26,976,811	28,848,566	27,842,965
0012	Instruction resources and media services	642,884	958,263	843,304
0013	Curriculum and instructional staff development	274,374	338,936	300,196
0021	Instructional leadership	1,312,654	1,635,304	1,500,870
0023	School leadership	2,908,460	2,977,939	2,975,804
0031	Guidance, counseling and evaluation services	1,702,765	1,719,048	1,642,573
0032	Social work services	82,200	82,200	64,275
0033	Health services	517,691	546,626	532,092
0034	Student transportation	2,983,579	3,138,383	2,711,883
0036	Extracurricular activities	1,084,699	1,787,238	1,545,020
0041	General administration	2,245,930	2,406,705	1,878,916
0051	Plant maintenance and operations	6,711,356	6,965,271	7,111,272
0052	Security and monitoring services	612,520	643,720	531,668
0053	Data processing services	137,152	157,152	133,454
0061	Community services	4,250	4,250	1,603
Debt Service:				
0071	Principal and interest on long-term debt	729,016	729,016	729,016
Capital outlay:				
0081	Capital outlay	802,500	1,861,454	1,386,102
Intergovernmental:				
0091	Contracted instructional services	4,500,000	5,271,964	4,959,105
0095	Payments to Juvenile Justice Alt. Ed. Prgm.	21,000	96,000	14,595
0099	Other intergovernmental charges			440,202
	Total Expenditures	54,249,841	60,168,035	57,144,915
1100	Excess (deficiency) of revenues over expenditures	1,644,729	(1,380,645)	(896,241)
Other Financing Sources (Uses)				
7912	Sale of real or personal property			22,164
8911	Transfers Out			(83,694)
8949	Other uses		(105,301)	(105,301)
	Total other financing sources and uses		(105,301)	(166,831)
1200	Net change in fund balances	1,644,729	(1,485,946)	(1,063,072)
0100	Fund balances - beginning	23,001,222	23,001,222	23,001,222
3000	Fund balances - ending	\$ 24,645,951	\$ 21,515,276	\$ 21,938,150

Exhibit B-1

**Variance with
Final Budget -
Positive
(Negative)**

\$ 222,691
(2,800,852)
39,445

(2,538,716)

1,005,601
114,959
38,740
134,434
2,135
76,475
17,925
14,534
426,500
242,218
527,789
(146,001)
112,052
23,698
2,647

475,352

312,859
81,405
(440,202)

3,023,120

484,404

22,164
(83,694)

(61,530)

422,874

\$ 422,874

Budgets and Budgetary Accounting

The District adopts annual appropriations type budgets for the General Fund, Food Service Special Revenue Fund, and the Debt Service Fund using the same method of accounting as for financial reporting, as required by law. The remaining Special Revenue Funds (primarily federal grant programs) utilize a managerial type budget approved at the fund level by the Board of Trustees upon acceptance of the grants. These grants are subject to Federal, State and locally imposed project length budgets and monitoring through submission of reimbursement reports.

Expenditures may not legally exceed budgeted appropriations at the function or activity level. Expenditure requests which would require an increase in total budgeted appropriations must be approved by the Trustees through formal budget amendment. State law prohibits trustees from making budget appropriations in excess of funds available and estimated revenues. State law also prohibits amendment of the budget after fiscal year end. Supplemental appropriations were made to the General Fund during the fiscal year ended August 31, 2009.

The administrative level at which responsibility for control of budgeted appropriations begins is at the organizational level within each function of operations. The finance department reviews closely the expenditure requests submitted by the various organizational heads (principal and department heads) throughout the year to ensure proper spending compliance. No public funds of the District shall be expended in any manner other than as provided for in the budget adopted by the Board of Trustees.

The official school budget was prepared for adoption for budgeted governmental fund types by August 26, 2008. The budget was formally adopted by the Board of Trustees at a duly advertised public meeting prior to the expenditure of funds. The final amended budget is filed with the Texas Education Agency (TEA) through inclusion in the annual financial and compliance report.

Encumbrance accounting is utilized in all government fund types. Encumbrances for goods or purchased services are documented by purchase orders or contracts. Under Texas law, appropriations lapse at year-end and encumbrances outstanding at that time are appropriately provided for in the subsequent year's budget.

Expenditures In Excess Of Appropriations

All expenditures in the General Fund were within budgeted appropriations, except for plant maintenance and operations in the amount of \$146,001 and other intergovernmental charges in the amount of \$440,202.

APPENDIX C

FORM OF BOND COUNSEL'S OPINION

October 6, 2010

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

SHELDON INDEPENDENT SCHOOL DISTRICT UNLIMITED TAX SCHOOL BUILDING BONDS, SERIES 2010A, dated October 1, 2010, 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, as described in the Order. The transcript contains certified copies of certain proceedings of the District; 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. We have also examined executed Bond Nos. ICI-1 and ICA-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; and

- (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.

ALSO BASED ON OUR EXAMINATION AS DESCRIBED ABOVE, it is our further 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 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.

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, 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 qualified for the earned income tax credit. For the foregoing reasons, prospective purchasers should consult their tax advisors as to the consequences of investing in the Bonds.

October 6, 2010

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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.

COASTAL SECURITIES, INC.

Financial Advisor to the District