OFFICE OF THE GOVERNOR

November 16, 2007

RICK PERRY
GOVERNOR

Mr. Henry M. Paulson, Jr.
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue
Washington, D.C. 20220

Dear Mr. Secretary:

I am writing to urge a change in an Internal Revenue Service (IRS) regulation that limits the ability of the Texas Permanent School Fund (PSF) to guarantee school district bonds. The current regulation will force Texas taxpayers to unnecessarily pay millions of dollars in financing costs for the construction of school facilities.

The Texas Bond Guarantee Program (the Program) backs school district bonds. The Program saves Texas school districts roughly $110 million per year by allowing districts to receive a "AAA" rating on their facility bonds, thereby lowering their interest rates and insurance costs. By saving districts money, the Program substantially reduces the amount of school facilities taxes that must be levied on local property owners. To date, no district has defaulted, and the guarantee has never been used.

Texas law currently allows the Program's guarantee capacity limit to be up to five times the cost value of the PSF. However, the related IRS regulation restricts the guarantee capacity to two and a half times the lower of cost or market value of the PSF.

On November 7, 2007, voters in numerous Texas school districts approved bonds which exceed the Program's guarantee capacity limit by approximately $1 billion. As a result, unless the IRS regulation is changed, $1 billion in district bonds will not be guaranteed by the PSF. Without the PSF guarantee, bond financing and insurance costs will substantially increase, hurting Texas taxpayers. Further, the amount of taxpayer money needlessly spent will continue to mount with each new district bond election.

I have enclosed the change that needs to be made to the relevant IRS regulation. It is my understanding that you are currently considering revisions to regulations involving this subject. I would deeply appreciate your quick attention to this matter.

Sincerely,

Rick Perry

Rick Perry
Governor

RP:kbp

Enclosure

Proposed Revision to Section 1.148-11(d)(1)(vi) of the Arbitrage Regulations Concerning Guarantees by State Public School Trust Funds, Including the Texas Permanent School Fund

(d) Transition rule excepting certain state guarantee funds from the definition of replacement proceeds — (1) Certain perpetual trust funds. A guarantee by a fund created and controlled by a State and established pursuant to its constitution does not cause the amounts in the fund to be pledged funds treated as replacement proceeds if —

(i) Substantially all of the corpus of the fund consists of nonfinancial assets, revenues derived from these assets, gifts, and bequests;

(ii) The corpus of the guarantee fund may be invaded only to support specifically designated essential governmental functions (designated functions) carried on by political subdivisions with general taxing powers;

(iii) Substantially all of the available income of the fund is required to be applied annually to support designated functions;

(iv) The issue guaranteed consists of general obligations that are not private activity bonds substantially all of the proceeds of which are to be used for designated functions;

(v) The fund satisfied each of the requirements of paragraphs (d)(1)(i) through (d)(1)(iii) of this section on August 16, 1986; and

~~(vi) The guarantee is not attributable to a deposit to the fund made after May 14, 1989, unless—~~

~~(A) The deposit is attributable to the sale or other disposition of fund assets; or~~

~~(B) Prior to the deposit, the outstanding amount of the bonds guaranteed by the fund did not exceed 250 percent of the lower of the cost or fair market value of the fund.~~

(vi) Either of the following limitations are satisfied —

(A) The guarantee is not attributable to a deposit to the fund made after May 14, 1989, unless — the deposit is attributable to the sale or other disposition of fund assets; or prior to the deposit, the amount of the bonds guaranteed by the fund did not exceed 250 percent of the lower of the cost or fair market value of the fund; or

(B) On the last business day of the month immediately preceding written preliminary approval of the guarantee of a particular issue of bonds issued after May 14, 1989, the amount of the bonds currently guaranteed by the fund and preliminarily approved for guarantee by the fund did not exceed 500 percent of the cost value of the fund.