



CONSTRUCTION AND CAPITAL EXPENSES AT INSTITUTIONS OF HIGHER EDUCATION

CONSTITUTIONALLY DEDICATED FUNDING

Since the days of the Texas Republic, Texas has provided constitutionally dedicated funding for development of the higher education infrastructure, but it has never been sufficient, in and of itself, to provide for the needs of a growing Texas.

The 1876 constitution created the Permanent University Fund with 1 million acres of land. The original design, similar to the permanent school fund and county school funds for public elementary and secondary schools, was to create an endowment from the sale of land. Since the discovery of oil and gas on PUF lands, however, instead of selling the land itself, the state has sold the minerals from the land and invested the proceeds, resulting in an endowment today valued at \$17 billion.

The PUF originally benefitted only the University of Texas, including its medical branch at Galveston, and Texas A&M University (TAMU). Interest from the investment of PUF revenues, described as the “Available University Fund,” was appropriated to those schools for capital improvements. As Texas’ higher education needs continued to grow, the state by law created additional universities and medical schools, but the PUF was constitutionally limited to the eligible schools, and the revenues were insufficient to accommodate the total need.

Post World War II, the need for sufficient revenue to accommodate higher education growth was magnified by the veterans returning with GI Bill benefits. As a result, in 1947 the legislature proposed and the voters adopted Sections 17 and 18 of Article VII of the Texas Constitution. Section 18 authorized the UT and TAMU systems to pledge PUF income to debt service on bonds for new construction at system institutions. Section 17 established a 5-cent state property tax to provide funds, allocated by formula, for new construction at 15 universities outside these two systems and authorized the universities to pledge the tax revenue to bond debt service.

Again, as needs grew and the baby boomers were born in increasing numbers, the constitutional authority proved insufficient. Both provisions were amended in 1956. The authority for PUF bonds was expanded to 20 percent of the value of the PUF and each existing academic and health institution within the systems was listed as a beneficiary. The property tax was increased to 10 cents and two additional institutions were added to the list of its beneficiaries. As of that time, all state senior colleges and all system health institutions were included in one or the other of the dedicated construction funds, and those institutions were prohibited from receiving general revenue for new construction except in the case of a natural disaster.

Texas continued to grow. By the mid-1980s, 12 additional four-year universities and two upper-level colleges had been created, but did not benefit from either fund. In addition, a major property tax reform movement resulted in significant restructuring of Texas property taxes, including a 1980 statute that reduced the assessment ratio on the state property tax to .0001 percent, effectively eliminating the tax. The combination of additional institutions with no dedicated funding and pressure for property tax reform resulted in amendments to Sections 17 and 18 in 1984.

The 1984 amendment abolished the state property tax and prohibited state property taxes in the future. To replace the state property tax, the amendment to Section 17 established a constitutional, first-call appropriation of \$100 million a year for higher education construction for non-PUF schools, allocated by formula. Under authority expressly granted by the constitution, that amount has since been legislatively increased to \$262.5 million a year. This is commonly referred to as



the Higher Education Assistance Fund (HEAF). HEAF institutions are authorized to pledge 50 percent of their share to the payment of bonds, but rarely do because the provision authorizes a reallocation every 10 years, effectively limiting bonds to terms not exceeding 10 years. Those short-term bonds are generally considered unattractive in comparison to long-term debt, such as the 30-year bonds issued under the PUF.

For the PUF systems, the 1984 amendment increased the amount of bonds that could be issued by the respective systems to 30 percent of the book value of the PUF and expanded eligible institutions to include all UT and TAMU system institutions that existed at that time, including institutions that had previously benefited from the state property tax. Institutions added to the respective systems after 1984 remained in the HEAF, while new institutions created within those systems by a 2/3 membership vote of the legislature could be added to the PUF. All institutions existing in 1984 benefit from one of the two funds, and additional institutions, when created, are entitled to benefit from one of the two funds.

The purposes for which HEAF dollars, including debt service, may be expended, and the purposes for which PUF bond proceeds may be expended, are the same: “acquiring land either with or without permanent improvements, constructing and equipping buildings or other permanent improvements, major repair or rehabilitation of buildings or other permanent improvements, acquisition of capital equipment, library books and library materials.” Neither HEAF dollars, including bond proceeds, nor PUF bond proceeds may be expended for operational expenses.

TUITION REVENUE BONDS

Even with constitutionally dedicated funding, the growth in Texas higher education required additional support for capital expenses. To support that need, beginning in 1969, the legislature has authorized institutions to issue revenue bonds for acquisition and construction of facilities and to pledge tuition, fees, and other revenue to the payment of those bonds. These came to be known as “tuition revenue bonds” (TRBs).

Revenue bonds generally are bonds for which a specific and continuing stream of revenue is pledged to the debt service. The Texas constitution prohibits state debt unless there are identified revenues that run current with the debt and from which the debt can be paid. Authorizing debt without such a revenue stream, such as a general obligation bond, requires a constitutional amendment or similar voter-approved debt proposition.

When an institution issues a TRB, the institution legally pledges its revenue from tuition, as well as all or any part of its other revenues, to the payment of the bond. As a result, the name is appropriately descriptive; if the legislature fails to appropriate reimbursement for debt service, the institution remains obligated to pay the debt service from tuition and other revenues of the institution.

TRB legislation typically specifies both the specific project to be funded by the bonds and the amount of bonds authorized for that project. This is unlike other capital projects, such as projects funded by PUF or HEAF, for which the governing board of the institution determines the project's size, scope and source of funding. As a result of the legislature choosing the project and specifying the amount of authorized revenue bonds, it has been the practice for the legislature to reimburse institutions for the debt service on the bonds. For that reason, even though the institution has legally pledged tuition to the debt service, the legislature is understood to have made an unenforceable commitment to cover the cost of that project.

As a practical matter, institutions that participate in a system-wide revenue financing system (RFS), first authorized by law in 1993, do not issue a specific form of debt called a TRB. With RFS debt, the institution pledges all of system revenue to the payment of the bond, a pledge that results in a very favorable credit rating and reduced borrowing costs.



In 1971, the legislature provided TRB authority in specific amounts for Texas Tech and for the UT System to fund facilities for new institutions placed under their respective boards the previous session. The following session, in 1973, the legislature authorized TRBs in specific amounts for the University of Houston, the University of Houston at Clear Lake City, and Texas A&M's Texas Maritime Academy and Moody College of Maritime Sciences.

TRBs were not authorized again until 1991 and 1993, when the legislature authorized TRBs for multiple institutions across higher education, many of which were identified with a South Texas Border initiative, beginning with Laredo State University. In 1997, the legislature authorized TRBs for 41 institutions and in 2001 for 49 institutions. The last general TRB authorization was in 2006 (projects across all systems and independent institutions), although in 2009 the legislature authorized TRBs for two institutions for Hurricane Ike recovery.

NEEDS CONTINUE TO GROW

Even with the 1984 expansion of constitutionally dedicated funding for higher education capital expenses, higher education growth has continued to outpace the capital needs that can be addressed with the dedicated funding. For example, the book value of Permanent University Fund investments has grown from \$6 billion in 1999 to \$14 billion in 2014, but the bond capacity of the fund at any one time is highly variable, depending on investment performance and the amount of outstanding bonded indebtedness. The constitutional limits on PUF bond debt have not been increased since 1984—and may only be increased by constitutional amendment—even as the legislature has created new PUF-eligible institutions in both the UT and TAMU systems.

Similarly, the HEAF appropriation has proved insufficient to meet needs. From its original \$100 million a year, the amount of the annual appropriation was increased by statute to \$175 million in 1995 and to \$262.5 million in 2007. The appropriation to HEAF schools over the last 10 years has averaged about \$660 per student. Although the different structure between HEAF and PUF makes comparison difficult, the most comparable figure for PUF schools is about \$596 per student in the PUF schools.

The overall growth rate at public and independent colleges and universities from fall 2007, after the time TRBs were last generally authorized and the HEAF appropriation increased, through fall 2010 was 20.4 percent. For public universities, fall 2012 enrollment totaled 577,000 students, or 92,000 more students than in fall 2005. Although the rate of enrollment growth has somewhat slowed recently, the Texas Higher Education Coordinating Board projects a fall 2020 headcount enrollment of 630,000, a 9 percent increase from 2012. Of the total enrollment for fall 2012, about 43 percent were enrolled at PUF schools and 57 percent were enrolled at HEAF schools.

Use of technology through online and hybrid online/classroom education mitigates, but does not eliminate, the need for new construction, particularly in the STEM (science, technology, engineering and math) fields that are dependent on lab time. In addition, technology does even less to mitigate the need for repair and rehabilitation of existing facilities; a facility built and funded with a TRB in 1971 is more than 40 years old and has the inefficient and expensive building systems of that era and completely lacks modern technological infrastructure.