

**OFFICIAL STATEMENT**

**Dated July 12, 2012**

**Ratings:**

**S&P: "AAA"**

**PSF Guarantee: "Approval Received"**

(See "OTHER INFORMATION - Ratings" and "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM" herein)

**NEW ISSUE - Book-Entry-Only**

*In the opinion of Bond Counsel, interest on the Bonds will be excludable from gross income for federal income tax purposes under statutes, regulations, published rulings and court decisions existing on the date thereof, subject to the matters described under "TAX MATTERS" herein, including the alternative minimum tax on corporations.*

THE BONDS HAVE NOT BEEN DESIGNATED AS  
"QUALIFIED TAX-EXEMPT OBLIGATIONS" FOR FINANCIAL INSTITUTIONS

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
(Lubbock County, Texas)**

**\$17,990,000**

**UNLIMITED TAX SCHOOL BUILDING BONDS, SERIES 2012**

**Dated Date: July 1, 2012**

**Interest Accrual Date: Delivery Date**

**Due: February 15, As shown on Page 2**

**PAYMENT TERMS...**Interest on the \$17,990,000 Shallowater Independent School District Unlimited Tax School Building Bonds, Series 2012 (the "Bonds") will accrue from August 9, 2012 (the "Delivery Date") and will be payable on February 15 and August 15 of each year commencing on February 15, 2013, until maturity or prior redemption and will be calculated on the basis of a 360-day year consisting of twelve 30-day months. The Bonds will be issued as fully registered obligations in the denominations of \$5,000 of principal amount or any integral multiple thereof for any one stated maturity. The definitive Bonds 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. Beneficial ownership of the Bonds may be acquired in authorized denominations thereof. **No physical delivery of the Bonds will be made to the beneficial owners thereof.** The principal and interest on the Bonds will be payable by the Paying Agent/Registrar to Cede & Co., which will make distribution of the amounts so paid to the participating members of DTC for subsequent payment to the beneficial owners of the Bonds. See "THE BONDS - Book-Entry-Only System" herein. The initial Paying Agent/Registrar is The Bank of New York Mellon Trust Company, N.A., Dallas, Texas (see "THE BONDS - Paying Agent/Registrar").

**AUTHORITY FOR ISSUANCE...**The Bonds are issued pursuant to the Constitution and general laws of the State of Texas (the "State"), including Sections 45.001 and 45.003(b)(1) of the Texas Education Code, as amended, an election held on May 12, 2012 and passed by a majority of the participating voters, and an order (the "Bond Order") to be adopted by the Board of Trustees (the "Board") of the Shallowater Independent School District (the "District"), on the date of sale of the Bonds. The Bonds are direct and voted obligations of the District, payable from an ad valorem tax levied, without legal limitation as to rate or amount, on all taxable property located within the District, as provided in the Order authorizing the Bonds (see "THE BONDS - Authority for Issuance"). **The District has applied for and has received conditional approval for the payment of the Bonds to be guaranteed by the Permanent School Fund of Texas (see "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM" herein).**

**PURPOSE . . .**Proceeds from the sale of the Bonds will be used (1) to construct, equip, acquire and renovate school buildings in the District and to purchase necessary sites for school buildings and (2) to pay the costs associated with the issuance and sale of the Bonds.

**LEGALITY...**The Bonds are offered for delivery when, as and if issued and received by the Underwriters and subject to the approving opinion of the Attorney General of Texas and the opinion of Underwood, Wilson, Berry, Stein & Johnson, P.C., Amarillo, 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, Andrews Kurth LLP, Austin, Texas.

**DELIVERY...**It is expected that the Bonds will be available for delivery through DTC on August 9, 2012.

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CUSIP PREFIX: 819309 – MATURITY SCHEDULE AND 9-DIGIT CUSIP - See Schedule on Page 2

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**HUTCHINSON SHOCKEY ERLEY & CO.**

**ESTRADA HINOJOSA & COMPANY, INC.**

**MATURITY SCHEDULE**

**CUSIP Prefix: 819309<sup>(1)</sup>**

Maturity (2/15)	Principal Amount	Interest Rate	Initial Yield	CUSIP <sup>(1)</sup> Suffix	Maturity (2/15)	Principal Amount	Interest Rate	Initial Yield	CUSIP <sup>(1)</sup> Suffix
2014	\$ 260,000	2.000%	0.550%	JQ9	2024	\$ 595,000	5.000%	2.420% <sup>(2)</sup>	KA2
2015	305,000	1.875%	0.750%	JR7	2025	635,000	5.000%	2.570% <sup>(2)</sup>	KB0
2016	320,000	4.000%	0.900%	JS5	2026	375,000	3.000%	3.020%	KC8
2017	380,000	4.000%	1.100%	JT3	2027	395,000	3.000%	3.080%	KD6
2018	415,000	5.000%	1.350%	JU0	2028	420,000	5.000%	2.790% <sup>(2)</sup>	KE4
2019	425,000	5.000%	1.600%	JV8	2029	445,000	3.125%	3.230%	KF1
2020	460,000	5.000%	1.830%	JW6	2030	475,000	5.000%	2.930% <sup>(2)</sup>	KG9
2021	510,000	5.000%	2.000%	JX4	2031	490,000	3.250%	3.370%	KH7
2022	550,000	5.000%	2.130%	JY2	2032	665,000	3.375%	3.440%	KJ3
2023	565,000	5.000%	2.270% <sup>(2)</sup>	JZ9					

**\$2,145,000 3.500% Term Bonds due February 15, 2035 Priced to Yield 3.600% - CUSIP<sup>(1)</sup> Suffix: KM6**  
**\$7,160,000 5.000% Term Bonds due February 15, 2039 Priced to Yield 3.350%<sup>(2)</sup> - CUSIP<sup>(1)</sup> Suffix: KR5**

**(Interest to accrue from the Delivery Date)**

- (1) CUSIP is a registered trademark of the American Bankers Association. CUSIP data is provided by CUSIP Global Services, managed by Standard & Poor’s Financial Services LLC on behalf of the American Bankers Association. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP services. Neither the District, the Financial Advisor, nor the Underwriters take any responsibility for the accuracy of CUSIP numbers.
- (2) Yield shown is yield to first call date, February 15, 2022.

**OPTIONAL REDEMPTION...**The District reserves the right, at its option, to redeem Bonds having stated maturities on and after February 15, 2023, in whole or in part in principal amounts of \$5,000 or any integral multiple thereof, on February 15, 2022, or any date thereafter, at the par value thereof plus accrued interest to the date of redemption (see “THE BONDS - Optional Redemption”).

**MANDATORY SINKING FUND REDEMPTION.** . . The Term Bonds maturing on February 15 in the years 2035 and 2039 are subject to mandatory redemption prior to maturity on the dates and in the amounts described herein under “THE BONDS – Mandatory Sinking Fund Redemption”.

*No dealer, broker, salesman or other person has been authorized by the District or the Underwriters 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 or the Underwriters. This Official Statement does not constitute an offer to sell the Bonds in any jurisdiction to any person to whom it is unlawful to make such offer in such jurisdiction.*

*Certain information set forth herein has been obtained from the District and other sources which are believed to be reliable but is not guaranteed as to accuracy or completeness, and is not to be construed as a representation by the Financial Advisor or the Underwriters. Any information and expressions of opinion herein contained 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 since the date hereof. See "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM - PSF Continuing Disclosure Undertaking" and "CONTINUING DISCLOSURE INFORMATION" for a description of the undertakings of the Texas Education Agency (the "TEA") and the District, respectively, 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 JURISDICTION IN WHICH THE BONDS HAVE BEEN REGISTERED, QUALIFIED OR EXEMPTED SHOULD NOT BE REGARDED AS A RECOMMENDATION THEREOF.*

*THIS OFFICIAL STATEMENT CONTAINS "FORWARD-LOOKING" STATEMENTS WITHIN THE MEANING OF SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. SUCH STATEMENTS MAY INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES AND OTHER FACTORS WHICH MAY CAUSE THE ACTUAL RESULTS, PERFORMANCE AND ACHIEVEMENTS TO BE DIFFERENT FROM THE FUTURE RESULTS, PERFORMANCE AND ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. INVESTORS ARE CAUTIONED THAT THE ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE SET FORTH IN THE FORWARD-LOOKING STATEMENTS.*

*NEITHER THE DISTRICT, ITS FINANCIAL ADVISOR, NOR THE UNDERWRITERS MAKE ANY REPRESENTATION OR WARRANTY WITH RESPECT TO THE INFORMATION CONTAINED IN THIS OFFICIAL STATEMENT REGARDING THE DEPOSITORY TRUST COMPANY ("DTC") OR ITS BOOK-ENTRY-ONLY SYSTEM OR THE AFFAIRS OF THE TEXAS EDUCATION AGENCY ("TEA") DESCRIBED UNDER "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM," AS SUCH INFORMATION HAS BEEN PROVIDED BY DTC AND TEA, RESPECTIVELY.*

*IN CONNECTION WITH THE OFFERING OF THE BONDS, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES 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 Underwriters have reviewed the information in this Official Statement pursuant to their responsibilities to investors under the federal securities laws, but the Underwriters do not guarantee the accuracy or completeness of such information.*

*The cover page contains certain information for general reference only and is not intended as a summary of this offering. Investors should read the entire Official Statement, including all appendices attached hereto, to obtain information essential to making an informed investment decision.*

**TABLE OF CONTENTS**

**OFFICIAL STATEMENT SUMMARY ..... 5**

**DISTRICT OFFICIALS, STAFF AND CONSULTANTS..... 7**

ELECTED OFFICIALS ..... 7

SELECTED ADMINISTRATIVE STAFF..... 7

CONSULTANTS AND ADVISORS..... 7

**INTRODUCTION ..... 8**

**THE BONDS ..... 8**

**THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM ..... 14**

**STATE AND LOCAL FUNDING OF SCHOOL DISTRICTS IN TEXAS ..... 25**

**CURRENT PUBLIC SCHOOL FINANCE SYSTEM..... 27**

**TAX INFORMATION ..... 31**

TABLE 1 - VALUATION, EXEMPTIONS AND TAX SUPPORTED DEBT ..... 36

TABLE 2 - TAXABLE ASSESSED VALUATIONS BY CATEGORY..... 37

TABLE 3 - VALUATION AND TAX SUPPORTED DEBT HISTORY ..... 38

TABLE 4 - TAX RATE, LEVY AND COLLECTION HISTORY..... 38

TABLE 5 - TEN LARGEST TAXPAYERS ..... 38

TABLE 6 - ESTIMATED OVERLAPPING DEBT ..... 39

**DEBT INFORMATION..... 40**

TABLE 7 - PRO-FORMA TAX SUPPORTED DEBT SERVICE REQUIREMENTS ..... 40

TABLE 8 - INTEREST AND SINKING FUND BUDGET PROJECTION ..... 41

TABLE 9 - AUTHORIZED BUT UNISSUED UNLIMITED TAX BONDS..... 41

TABLE 10 - OTHER OBLIGATIONS ..... 41

**FINANCIAL INFORMATION ..... 42**

TABLE 11 - SCHEDULE OF CHANGES IN NET ASSETS ..... 42

TABLE 11A – SCHEDULE OF GENERAL FUND REVENUES AND EXPENDITURE HISTORY ..... 43

TABLE 12 - CURRENT INVESTMENTS..... 46

**TAX MATTERS ..... 46**

**CONTINUING DISCLOSURE INFORMATION ..... 48**

**OTHER INFORMATION ..... 49**

RATINGS..... 49

LITIGATION ..... 49

REGISTRATION AND QUALIFICATION OF BONDS FOR SALE ..... 49

LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS ..... 49

LEGAL MATTERS ..... 50

FINANCIAL ADVISOR ..... 50

UNDERWRITING ..... 50

FORWARD-LOOKING STATEMENTS DISCLAIMER ..... 51

MISCELLANEOUS ..... 51

**APPENDICES**

GENERAL INFORMATION REGARDING THE DISTRICT ..... A

EXCERPTS FROM THE ANNUAL FINANCIAL REPORT ..... B

FORM OF BOND COUNSEL'S OPINION ..... C

The cover page hereof, this page, the appendices included herein and any addenda, supplement or amendment hereto, are part of the Official Statement.

## 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**..... The Shallowater Independent School District (the “District”) is a political subdivision located in Lubbock County, Texas. The District is approximately 92 square miles in area (see “APPENDIX A – General Information Regarding the District”).
- THE BONDS**..... The \$17,990,000 Unlimited Tax School Building Bonds, Series 2012 (the “Bonds”) are issued as serial bonds maturing on February 15 in the years 2014 through 2032; and in part as term bonds maturing on February 15 in the years 2035 and 2039 (see “THE BONDS - Description of the Bonds”).
- PAYMENT OF INTEREST** ..... Interest on the Bonds accrues from the date of their delivery to the Underwriters and will be due semiannually on February 15 and August 15 of each year commencing on February 15, 2013 until maturity or prior redemption (see “THE BONDS - Description of the Bonds”, “THE BONDS - Optional Redemption” and “THE BONDS – Mandatory Sinking Fund Redemption”).
- AUTHORITY FOR ISSUANCE**..... The Bonds are being issued pursuant to the Constitution and general laws of the State of Texas, including Sections 45.001 and 45.003(b)(1) of the Texas Education Code, as amended, an election held in the District on May 12, 2012, and an order (the “Bond Order”) which was passed by the Board of Trustees of the District on the date of sale of the Bonds (see “THE BONDS - Authority for Issuance”).
- SECURITY FOR THE BONDS** ..... The Bonds constitute direct obligations of the District, payable from a continuing direct annual ad valorem tax levied by the District, without legal limit as to rate or amount, on all taxable property within the District, as provided in the Order. Additionally, the payment of the Bonds is expected to be guaranteed by the corpus of the Permanent School Fund of Texas (see “THE BONDS - Security and Source of Payment” and “THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM”).
- PERMANENT SCHOOL FUND GUARANTEE**..... The District has applied for and has received conditional approval from the Texas Education Agency for the payment of the Bonds to be guaranteed by the Permanent School Fund Guarantee Program of the State of Texas (see “THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM”).
- OPTIONAL REDEMPTION** ..... The District reserves the right, at its option, to redeem Bonds having stated maturities on and after February 15, 2023, in whole or in part in principal amounts of \$5,000 or any integral multiple thereof, on February 15, 2022, or any date thereafter, at the par value thereof plus accrued interest to the date of redemption (see “THE BONDS - Optional Redemption”). Additionally, the Term Bonds maturing on February 15 in the years 2035 and 2039 are subject to mandatory sinking fund redemption prior to maturity at a price of par plus accrued interest to the redemption date (see “THE BONDS – Mandatory Sinking Fund Redemption”).
- NOT QUALIFIED TAX-EXEMPT OBLIGATIONS**..... The Bonds have not been designated as “Qualified Tax-Exempt Obligations” for financial institutions.
- TAX EXEMPTION**..... In the opinion of Bond Counsel, interest on the Bonds will be excludable from gross income for federal income tax purposes under statutes, regulations, published rulings and court decisions existing on the date thereof, subject to the matters described under “TAX MATTERS” herein, including the alternative minimum tax on corporations.
- USE OF PROCEEDS** ..... Proceeds from the sale of the Bonds will be used (1) to construct, equip, acquire and renovate school buildings in the District and to purchase necessary sites for school buildings and (2) to pay the costs associated with the issuance and sale of the Bonds.
- 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 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 Bonds will be payable by the Paying Agent/Registrar to Cede & Co., which will make distribution of the amounts so paid to the participating members of DTC for subsequent payment to the beneficial owners of the Bonds (see “THE BONDS - Book-Entry-Only System”).

**RATINGS** ..... The Bonds have been rated “AAA” by Standard & Poor’s Ratings Services, a Standard & Poor’s Financial Services LLC business (“S&P”) by virtue of the guarantee of the Permanent School Fund of the State of Texas, as S&P generally rates all bond issues guaranteed by the Permanent School Fund of the State of Texas “AAA”. **Such rating is based solely upon the Permanent School Fund Guarantee and the Bonds did not receive an underlying rating** (see “OTHER INFORMATION - Ratings”).

**PAYMENT RECORD** ..... The District has never defaulted in payment of its tax supported debt.

**SELECTED FINANCIAL INFORMATION**

Fiscal Year Ended 8/31	Estimated District Population <sup>(1)</sup>	Taxable Assessed Valuation <sup>(2)</sup>	Per Capita Taxable Assessed Valuation	Tax Supported Debt at End of Fiscal Year <sup>(3)</sup>	Per Capita Tax Supported Debt	Ratio Tax Supported Debt to Taxable Assessed Valuation	% of Total Tax Collections
2008	8,400	\$ 186,640,223	\$ 22,219	\$ 15,020,864	\$ 1,788	8.05%	100.07%
2009	8,519	205,221,129	24,090	14,697,553	1,725	7.16%	98.27%
2010	8,620	214,400,303	24,872	14,127,435	1,639	6.59%	98.56%
2011	8,731	239,630,144	27,446	13,704,442	1,570	5.72%	100.22%
2012	8,842	253,721,583	28,695	30,645,000 <sup>(4)</sup>	3,466 <sup>(4)</sup>	12.08% <sup>(4)</sup>	101.48% <sup>(5)</sup>

(1) Source: The District.

(2) As reported by the Lubbock Central Appraisal District on the District’s annual State Property Tax Reports and such values are subject to change during the ensuing year.

(3) Excludes interest accreted on outstanding capital appreciation bonds.

(4) Projected, includes the Bonds.

(5) Partial collections as of May 31, 2012.

For additional information regarding the District, please contact:

Phil Warren Superintendent Shallowater Independent School District 1100 Avenue K Shallowater, Texas 79363 (806) 832-4531 x.2004	or	Jeff Robert Senior Vice President First Southwest Company 325 N. St. Paul Street, Ste. 800 Dallas, Texas 75201 (214) 953-8744
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**DISTRICT OFFICIALS, STAFF AND CONSULTANTS**

**ELECTED OFFICIALS**

<u>Board of Trustees</u>	<u>Length of Service</u>	<u>Term Expires</u>	<u>Occupation</u>
David Blackburn President	4 Years	2014	Banking
Camie Davis Secretary	4 Years	2014	Homemaker
Garett Nelson Vice President	4 Years	2013	Fire Marshall
Mitch Elmore Board Member	2 Years	2013	Xcel Supervisor
Anthony Foerster Board Member	2 Months	2015	Banking
Sandy Peters Board Member	4 1/2 Years	2015	Vice President of Development
David Young Board Member	2 Months	2015	Forensic DNA Analyst

**SELECTED ADMINISTRATIVE STAFF**

<u>Name</u>	<u>Position</u>	<u>Length of Service with the District</u>	<u>Total School District Service</u>
Phil Warren	Superintendent	12 Years	38 Years
Rhonda Cox	Business Manager	11 Years	32 Years

**CONSULTANTS AND ADVISORS**

Auditors ..... Bolinger, Segars, Gilbert & Moss, L.L.P.  
Lubbock, Texas

Bond Counsel ..... Underwood, Wilson, Berry, Stein & Johnson, P.C.  
Amarillo, Texas

Financial Advisor ..... First Southwest Company  
Dallas, Texas

**OFFICIAL STATEMENT  
RELATING TO**

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT**

**\$17,990,000**

**UNLIMITED TAX SCHOOL BUILDING BONDS, SERIES 2012**

**INTRODUCTION**

This Official Statement, which includes the Appendices hereto, provides certain information regarding the issuance of the Shallowater Independent School District (the "District") \$17,990,000 Unlimited Tax School Building Bonds, Series 2012 (the "Bonds"). Capitalized terms used in this Official Statement have the same meanings assigned to such terms in the Order (defined herein), except as otherwise indicated herein.

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 District's Financial Advisor, First Southwest Company, Dallas, Texas.

**DESCRIPTION OF THE DISTRICT . . .** The District is a political subdivision located in Lubbock County, Texas. The District is governed by a seven-member Board of Trustees (the "Board"), the members of which serve staggered three-year terms with elections held in May of each year. Policy-making and supervisory functions are the responsibility of, and are vested in, the Board. The Board delegates administrative responsibilities to the Superintendent of Schools who is the chief administrative officer of the District. Support services are supplied by consultants and advisors. The District covers approximately 92 square miles in Lubbock County, encompassing the City of Shallowater. For more information regarding the District, see "Appendix A - General Information Regarding the District."

**THE BONDS**

**DESCRIPTION OF THE BONDS...** The Bonds will be dated July 1, 2012 and mature on the dates and in the amounts shown on page 2 of this Official Statement. Interest on the Bonds will accrue from the date of their delivery to the Underwriters and will be calculated on the basis of a 360-day year of twelve 30-day months. Such interest will be payable on February 15 and August 15 of each year commencing on February 15, 2013, until maturity or prior redemption. The definitive Bonds will be issued only in fully registered form in any integral multiple of \$5,000 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 owners thereof.** Principal of, premium, if any, and interest on the Bonds will be payable by the Paying Agent/Registrar to Cede & Co., which will make distribution of the amounts so paid to the participating members of DTC for subsequent payment to the beneficial owners of the Bonds. See "THE BONDS - Book-Entry-Only System" herein.

**AUTHORITY FOR ISSUANCE...**The Bonds are issued and the tax levied for their payment pursuant to authority conferred by the Constitution and the laws of the State of Texas, including Sections 45.001 and 45.003(b)(1) of the Texas Education Code, as amended; an election held within the District on May 12, 2012, and passed by a majority of the participating voters; and an order (the "Bond Order") for the Bonds which was passed by the Board on the date of sale of the Bonds.

**SECURITY AND SOURCE OF PAYMENT...**All taxable property within the District is subject to a continuing direct annual ad valorem tax levied by the District, without legal limit as to rate or amount, sufficient to provide for the payment of principal of and interest on the Bonds. See "TAX INFORMATION - Tax Rate Limitations" and "STATE AND LOCAL FUNDING OF SCHOOL DISTRICTS IN TEXAS" and "CURRENT PUBLIC SCHOOL FINANCE SYSTEM." Additionally, the payment of the Bonds is expected to be guaranteed by the corpus of the Permanent School Fund of Texas.

**PERMANENT SCHOOL FUND GUARANTEE...**In connection with the sale of the Bonds, the District has submitted an application to the Texas Education Agency and has received conditional approval from the Commissioner of Education for the payment of the Bonds to be guaranteed under the Permanent School Fund Guarantee Program (Chapter 45, Subchapter C of the Texas Education Code). Subject to satisfying certain conditions discussed under the heading "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM" herein, the payment of the Bonds will be guaranteed by the corpus of the Permanent School Fund of the State of Texas. In the event of default, registered owners will receive all payments due on the Bonds from the corpus of the Permanent School Fund.

**PURPOSE . . .** Proceeds from the sale of the Bonds will be used (1) to construct, equip, acquire and renovate school buildings in the District and to purchase necessary sites for school buildings and (2) to pay the costs associated with the issuance of the Bonds.



**OPTIONAL REDEMPTION . . .** The District reserves the right, at its option, to redeem Bonds having stated maturities on and after February 15, 2023, in whole or in part in principal amounts of \$5,000 or any integral multiple thereof, on February 15, 2022, or any date thereafter, at the par value thereof plus accrued interest to the date of redemption. If less than all of the Bonds are to be redeemed, the District may select the maturities of Bonds to be redeemed. If less than all the Bonds of any maturity are to be redeemed, the Paying Agent/Registrar (or DTC while the Bonds are in Book-Entry-Only form) shall determine by lot the Bonds, or portions thereof, within such maturity to be redeemed. If a Bond (or any portion of the principal sum thereof) shall have been called for redemption and notice of such redemption shall have been given, such Bond (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.

**MANDATORY SINKING FUND REDEMPTION . . .** The Bonds maturing on February 15 in the years 2035 and 2039 (the “Term Bonds”) are subject to mandatory redemption prior to maturity at a price of par plus accrued interest to the redemption date as follows:

Bonds Maturing February 15, 2035		Bonds Maturing February 15, 2039	
Year	Amount	Year	Amount
2033	\$ 690,000	2036	\$ 1,665,000
2034	715,000	2037	1,750,000
2035 <sup>(1)</sup>	740,000	2038	1,825,000
		2039 <sup>(1)</sup>	1,920,000

(1) Stated Maturity.

The Paying Agent/Registrar shall select by lot the numbers of the Term Bonds within the applicable Stated Maturity to be redeemed on the next following February 15 from moneys set aside for that purpose in the Interest and Sinking Fund. Any Term Bonds not selected for prior redemption shall be paid on the date of their Stated Maturity.

The principal amount of the Term Bonds for a Stated Maturity required to be redeemed on a mandatory redemption date may be reduced, at the option of the District, by the principal amount of Term Bonds of like Stated Maturity which, at least 45 days prior to the mandatory redemption date, (1) shall have been acquired by the District and delivered to the Paying Agent/Registrar for cancellation, (2) shall have been purchased and canceled by the Paying Agent/Registrar at the request of the District at a price not exceeding the principal amount of such Term Bonds plus accrued interest to the date of purchase, or (3) shall have been redeemed pursuant to the optional redemption provisions set forth above and not theretofore credited against a mandatory redemption requirement.

**NOTICE OF REDEMPTION . . .** Not less than 30 days prior to a redemption date for the Bonds, the District shall cause a notice of redemption to be sent by United States mail, first class, postage prepaid, to the registered owners of the Bonds 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 at the close of business on the business day next preceding the date of mailing such notice. 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 AND ANY OTHER CONDITION TO REDEMPTION SATISFIED, THE BONDS CALLED FOR REDEMPTION SHALL BECOME DUE AND PAYABLE ON THE SPECIFIED REDEMPTION DATE, AND NOTWITHSTANDING THAT ANY BOND OR PORTION THEREOF HAS NOT BEEN SURRENDERED FOR PAYMENT, INTEREST ON SUCH BOND OR PORTION THEREOF SHALL CEASE TO ACCRUE.

With respect to any optional redemption of the Bonds, unless certain prerequisites to such redemption required by the Order have been met and money sufficient to pay the principal of and premium, if any, and interest on the Bonds to be redeemed will have been received by the Paying Agent/Registrar prior to the giving of such notice of redemption, such notice may state that said redemption is conditional upon the satisfaction of such prerequisites and receipt of such money by the Paying Agent/Registrar on or prior to the date fixed for such redemption or upon any prerequisite set forth in such notice of redemption. If a conditional notice of redemption is given and such prerequisites to the redemption are not fulfilled, such notice will be of no force and effect, the District will not redeem such Bonds, and the Paying Agent/Registrar will give notice in the manner in which the notice of redemption was given, to the effect that such Bonds have not been redeemed.

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 only to DTC. 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 Bonds called for redemption or any other action premised on any such notice. Redemption of portions of the Bonds by the District will reduce the outstanding principal amount of such Bonds held by DTC. In such event, DTC may implement, through its Book-Entry-Only System, a redemption of such Bonds 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 Bonds from the beneficial owners. Any such selection of Bonds 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 Bonds or the providing of notice to DTC participants, indirect participants, or beneficial owners of the selection of portions of the Bonds for redemption (see "THE BONDS - Book-Entry-Only System").

**DEFEASANCE . . .** The Order provides for the defeasance of the Bonds when the payment of the principal of and premium, if any, on such Bonds, plus interest thereon to the due date thereof (whether such due date be by reason of maturity, redemption, or otherwise), is provided by irrevocably depositing with the Paying Agent/Registrar, or other authorized escrow agent, in trust (1) money sufficient to make such payment or (2) Government Securities to mature as to principal and interest in such amounts and at such times to insure the availability, without reinvestment, of sufficient money to make such payment, and all necessary and proper fees, compensation and expenses of the paying agent for the Bonds. The Order provides that "Government Securities" means (a) direct, noncallable obligations of the United States of America, including obligations that are unconditionally guaranteed by the United States of America, (b) noncallable obligations of an agency or instrumentality of the United States of America, including obligations that are unconditionally guaranteed or insured by the agency or instrumentality and that, on the date of their acquisition or purchase by the District, are rated as to investment quality by a nationally recognized investment rating firm not less than "AAA" or its equivalent, (c) noncallable obligations of a state or an agency or a county, municipality, or other political subdivision of a state that have been refunded and that, on the date of their acquisition or purchase by the District, are rated as to investment quality by a nationally recognized investment rating firm not less than "AAA" or its equivalent, and (d) any other then authorized securities or obligations under applicable law that may be used to defease obligations such as the Bonds. The District has the right, subject to satisfying the requirements of (1) and (2) above, to substitute other Government Securities for the Government Securities originally deposited, to reinvest the uninvested moneys on deposit for such defeasance and to withdraw for the benefit of the District moneys in excess of the amount required for such defeasance.

There is no assurance that the current law will not be changed in a manner which would permit investments other than those described above to be made with amounts deposited to defease the Bonds. Because the Order does not contractually limit such investments, registered owners may be deemed to have consented to defeasance with such other investments, notwithstanding the fact that such investments may not be of the same investment quality as those currently permitted under State law. There is no assurance that the ratings for U.S. Treasury securities used as Government Securities or that for any other Government Security will be maintained at any particular rating category.

Upon such deposit as described above, such Bonds shall no longer be regarded to be outstanding or unpaid and will cease to be outstanding obligations secured by the Order or treated as debt of the District for purposes of taxation or applying any limitation on the District's ability to issue debt or for any other purpose. After firm banking and financial arrangements for the discharge and final payment or redemption of the Bonds have been made as described above, all rights of the District to initiate proceedings to call the Bonds for redemption or take any other action amending the terms of the Bonds are extinguished; provided, however, that the right to call the Bonds for redemption is not extinguished if the District: (i) in the proceedings providing for the firm banking and financial arrangements, expressly reserves the right to call the Bonds for redemption; (ii) gives notice of the reservation of that right to the owners of the Bonds immediately following the making of the firm banking and financial arrangements; and (iii) directs that notice of the reservation be included in any redemption notices that it authorizes.

Upon defeasance, such defeased Bonds shall no longer be regarded to be outstanding or unpaid and the Bonds will no longer be guaranteed by the Texas Permanent School Fund.

**AMENDMENTS . . .** The District may amend the Order without the consent of or notice to any registered owners in any manner not detrimental to the interests of the registered owners, including the curing of any ambiguity, inconsistency or formal defect or omission therein. In addition, the District may, with the written consent of the holders of a majority in aggregate principal amount, as the case may be, of the Bonds then outstanding, amend, add to, or rescind any of the provisions of the Order; except that, without the consent of the registered owners of all of the Bonds then outstanding, no such amendment, addition, or rescission may (1) extend the time or times of payment of the principal of and interest on the Bonds, reduce the principal amount thereof, the redemption price, or the rate of interest thereon, or in any other way modify the terms of payment of the principal of or interest on the Bonds, (2) give any preference to any Bond over any other Bond, or (3) reduce the aggregate principal amount of Bonds required to be held by Holders for consent to any such amendment, addition or rescission.

**BOOK-ENTRY-ONLY SYSTEM...***This section describes how ownership of the Bonds is to be transferred and how the principal of, premium, if any, and interest on the Bonds are to be paid to and accredited by DTC 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 and the Underwriters believe the source of such information to be reliable, but take no responsibility for the accuracy or completeness thereof.*

*The District and the Underwriters cannot and do not give any assurance that (1) DTC will distribute payments 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 Bonds registered 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 Bond certificate will be issued for each maturity of the Bonds, each in the aggregate principal amount of such maturity, 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 the 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 corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has a Standard & Poor's rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com).

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 confirmations 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 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 registrar and request that copies of notices be provided directly to them.

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

All payments on the Bonds 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 Bonds 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, the Paying Agent/Registrar, or the District, subject to any statutory or regulatory requirements as may be in effect from time to time. All payments on the Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) are the responsibility of the District or the Paying Agent/Registrar, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement 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.

The District may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered to DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the District and the Underwriters believe to be reliable, but neither the District nor the Underwriters take any responsibility for the accuracy thereof.

**EFFECT OF TERMINATION OF BOOK-ENTRY-ONLY SYSTEM...**In the event that the Book-Entry-Only System is discontinued, printed certificates will be issued to the holders and the Bonds will be subject to transfer, exchange and registration provisions as set forth in the Order and summarized under "THE BONDS - Transfer, Exchange and Registration" below.

**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 Direct or Indirect Participant acquires an interest in the Bonds, but (i) all rights of ownership must be exercised through DTC and the Book-Entry-Only System, and (ii) except as described above, notices that are to be given to registered owners under the Order will be given only to DTC.

**PAYING AGENT/REGISTRAR...**The initial Paying Agent/Registrar is 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 until the Bonds are duly paid and any successor Paying Agent/Registrar shall be a bank or trust company or other entity duly qualified and legally authorized to serve as and perform the duties and services of Paying Agent/Registrar for the Bonds. Upon any change in the Paying Agent/Registrar for the Bonds, the District agrees to promptly cause a written notice thereof to be sent to each registered owner of the Bonds by United States mail, first class, postage prepaid, which notice shall also give the address of the new Paying Agent/Registrar.

In the event the Book-Entry-Only System should be discontinued, interest on the Bonds will be paid to the registered owners appearing on the registration books of the Paying Agent/Registrar at the close of business on the Record Date (hereinafter defined), and such interest will be paid (i) by check sent United States mail, first class postage prepaid to the address of the registered owner recorded in the registration books of the Paying Agent/Registrar or (ii) by such other method, acceptable to the Paying Agent/Registrar requested by, and at the risk and expense of, the registered owner. Principal of the Bonds will be paid to the registered owner at the stated maturity or earlier redemption upon presentation to the designated payment/transfer office of the Paying Agent/Registrar; provided, however, that so long as Cede & Co. (or other DTC nominee) is the registered owner of the Bonds, all payments will be made as described under "THE BONDS - Book-Entry-Only System" herein. If the date for the payment of the principal of or interest on the Bonds is a Saturday, Sunday, a legal holiday or a day when banking institutions in the city where the designated payment/transfer office of the Paying Agent/Registrar is located are authorized to close, then the date for such payment will be the next succeeding day which is not such a day, and payment on such date will have the same force and effect as if made on the date payment was due.

**TRANSFER, EXCHANGE AND REGISTRATION...**In the event the Book-Entry-Only System should be discontinued, printed Bond certificates will be delivered to registered owners and thereafter the Bonds may be transferred and exchanged on the registration books of the Paying Agent/Registrar only upon presentation and surrender of such printed certificates to the Paying Agent/Registrar and such transfer or exchange shall be without expense 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 respective Bonds or by other instrument of transfer and assignment acceptable to the Paying Agent/Registrar. New Bonds will be delivered by the Paying Agent/Registrar, in lieu of the Bonds being transferred or exchanged, at the designated office of the Paying Agent/Registrar, or sent by United States mail, first class, postage prepaid, to the new registered owner or his designee. To the extent possible, new Bonds issued in an exchange or transfer of Bonds will be delivered to the registered owner or assignee of the registered owner in not more than three business days after the receipt of the Bonds to be canceled, and the written instrument of transfer or request for exchange duly executed by the registered owner or his duly authorized agent, in form satisfactory to the Paying Agent/Registrar. New Bonds registered and delivered in an exchange or transfer shall be in any integral multiple of \$5,000 for any one maturity and for a like aggregate

principal amount as the Bonds surrendered for exchange or transfer. Neither the District nor the Paying Agent/Registrar shall be required to transfer or exchange any Bond called for redemption, in whole or in part, within 45 days of the date fixed for redemption; provided, however, such limitation on transfer shall not be applicable to an exchange by the registered owner of the uncalled balance of a Bond.

**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 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 registered owner 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...**If the District defaults in the payment of principal, interest or redemption price on the Bonds when due, or if it fails to make payments into any fund or funds created in the Order, or defaults in the observation or performance of any other covenants, conditions or obligations set forth in the Order, and the State fails to honor the Permanent School Fund Guarantee as hereinafter discussed, the registered owners may seek a writ of mandamus to compel District officials to carry out their legally imposed duties with respect to the Bonds if there is no other available remedy at law to compel performance of the covenants contained in the Bonds or in the Order and the District’s obligations are not uncertain or disputed. The issuance of a writ of mandamus is controlled by equitable principles and rests with the discretion of the court, but may not be arbitrarily refused. There is no acceleration of maturity of the Bonds in the Event of Default and, consequently, the remedy of mandamus may have to be relied upon from year to year. The Order does not provide for the appointment of a trustee to represent the interest of the Bondholders upon any failure of the District to perform in accordance with the terms of the Order, or upon any other condition and accordingly all legal actions to enforce such remedies would have to be undertaken at the initiative of, and be financed by, the registered owners. The Texas Supreme Court has ruled in *Tooke v. City of Mexia*, 197 S.W.3d 325 (Tex. 2006), that a waiver of sovereign immunity in a contractual dispute must be provided for by statute in “clear and unambiguous” language. Because it is unclear whether the Texas legislature has effectively waived the District’s sovereign immunity from a suit for money damages, Bondholders may not be able to bring such a suit against the District for breach of the Bonds or Order covenants. Even if a judgment against the District could be obtained, it could not be enforced by direct levy and execution against the District’s property. Further, the registered owners cannot themselves foreclose on property within the District or sell property within the District to enforce the tax lien on taxable property to pay the principal of and interest on the Bonds. Furthermore, the District is 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 ad valorem 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. 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. The opinion of Bond Counsel will note that all opinions relative to the enforceability of the Bonds are qualified with respect to the customary rights of debtors relative to their creditors and by general principles of equity which permit the exercise of judicial discretion.

**SOURCES AND USES OF PROCEEDS . . .** The proceeds from the sale of the Bonds will be applied approximately as follows:

<u>Sources of Funds</u>	
Par Amount of the Bonds	\$ 17,990,000.00
Net Reoffering Premium	2,070,010.50
Total Sources of Funds	<u>\$ 20,060,010.50</u>
<u>Uses of Funds</u>	
Deposit to Construction Fund	\$ 19,515,000.00
Deposit of Capitalized Interest to the Debt Service Fund	279,954.06
Deposit of Rounding Amount to the Debt Service Fund	3,285.54
Underwriter's Discount and Costs of Issuance	261,770.90
Total Uses of Funds	<u>\$ 20,060,010.50</u>

## THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM

*The information below concerning the Texas Permanent School Fund and the Guarantee Program for School District Bonds has been provided by the Texas Education Agency and is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by the District or the Underwriters.*

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 2011, distributions to the ASF amounted to \$246.09 per student and the total amount distributed to the ASF was \$1.093 billion.

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, 2011 and for a description of the financial results of the PSF for the year ended August 31, 2011, the most recent year for which audited financial information regarding the Fund is available. The 2011 Annual Report is incorporated herein and made a part hereof for all purposes, but the 2011 Annual Report speaks only as of its date and the TEA has not obligated itself to update the 2011 Annual Report or any other Annual Report. The TEA posts each Annual Report, which includes statistical data regarding the Fund as of the close of each fiscal year, the most recent disclosure for the Guarantee Program, the Statement of Investment Objectives, Policies and Guidelines of the Texas Permanent School Fund, which is codified at 19 Texas Administrative Code, Chapter 33 (the "Investment Policy"), monthly updates with respect to the capacity of the Guarantee Program (collectively, the "Web Site

Materials”) on the TEA web site at [www.tea.state.tx.us/psf](http://www.tea.state.tx.us/psf) and with the MSRB at [www.emma.msrb.org](http://www.emma.msrb.org). Such monthly updates regarding the Guarantee Program are also incorporated herein and made a part hereof for all purposes. In addition to the Web Site Materials, the Fund is required to make quarterly filings with the Securities and Exchange Commission (“SEC”) under Section 13(f) of the Securities Exchange Act of 1934. Such filings, which consist of a list of the Fund’s holdings of securities specified in Section 13(f), including exchange-traded (*e.g.*, NYSE) or NASDAQ-quoted stocks, equity options and warrants, shares of closed-end investment companies and certain convertible debt securities, is available from the SEC at [www.sec.gov/edgar.shtml](http://www.sec.gov/edgar.shtml). A list of the Fund’s equity and fixed income holdings as of August 31, 2011 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. In GA-0707 the Attorney General opined, among other advice, that (i) the Ten Year Total Return should be calculated on an annual basis, (ii) a contingency plan adopted by the SBOE, to permit monthly transfers equal in aggregate to the annual Distribution Rate to be halted and subsequently made up if such transfers temporarily exceed the Ten Year Total Return, is not prohibited by State law, provided that such contingency plan applies only within a fiscal year time basis, not on a biennium basis, and (iii) that the amount distributed from the Fund in a fiscal year may not exceed 6% of the average of the market value of the Fund or the Ten Year Total Return. In accordance with GA-0707, in the event that the Ten Year Total Return is exceeded during a fiscal year, transfers to the ASF will be halted. However, if the Ten Year Total Return subsequently increases during that biennium, transfers may be resumed, if the SBOE has provided for that contingency, and made in full during the remaining period of the biennium, subject to the limit of 6% in any one fiscal year. Any shortfall in the transfer that results from such events from one biennium may not be paid over to the ASF in a subsequent biennium as the SBOE would make a separate payout determination for that subsequent biennium.

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. In the 2011 fiscal year, the SLB also released \$100 million to the investment assets of the PSF. 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. That distribution rate produced total transfers of \$1.1535 billion to the ASF from the PSF during the 2010-11 biennium. The SBOE has set the Distribution Rate for the 2012-13 biennium at 4.2%, which rate was determined after the SLB authorized the release of a total of \$500 million to the PSF in quarterly installments during the 2012-13 biennium. See “2011 Constitutional Amendment” below for a description of amendments made to the Texas Constitution on November 8, 2011 that permits the SLB to make transfers directly to the ASF up to the amount of \$300 million in each fiscal year.

Since the enactment of a prior amendment to the Texas Constitution in 1964, the investment of the Fund has been managed with the dual objectives of producing current income for transfer to the ASF and growing the Fund for the benefit of future generations. As a result of this prior constitutional framework, prior to the adoption of the 2004 Asset Allocation Policy (as defined below) the investment of the Fund historically included a significant amount of fixed income investments and dividend-yielding equity investments, to produce income for transfer to the ASF.

With respect to the management of the Fund's investment portfolio, the single most significant change made to date as a result of the Total Return Constitutional Amendment has been new asset allocation policies adopted by the SBOE in February 2004 (the "2004 Asset Allocation Policy"), in July 2006 (as subsequently reaffirmed in July 2008 such asset allocation is referred to herein as the "2008 Asset Allocation Policy") and in July 2010 (the "2010 Asset Allocation Policy"), which have significantly altered the asset allocations of the Fund. The Fund's investment policy provides for minimum and maximum ranges among the components of each of the three general asset classifications: equities, fixed income and alternative asset investments. The 2004 Asset Allocation Policy decreased the fixed income target from 45% to 25% of Fund investment assets and increased the allocation for equities from 55% to 75% of investment assets. In July 2006, the SBOE modified its asset allocation to reduce the equity allocation, including both domestic and foreign equity portfolios, to a target of 53% of Fund assets, further reduced the fixed income allocation target to 19% and added an alternative asset allocation, which included real estate, real return, absolute return and private equity components, totaling 28% of the Fund's asset target. Alternative asset classes diversify the SBOE-managed assets and are not as correlated to traditional asset classes, which is intended to increase investment returns over the long run while reducing risk and return volatility of the portfolio. In July 2010, the SBOE modified the 2008 Asset Allocation Policy by decreasing the equity allocation to 50%, and the fixed income allocation to 15%, while increasing the alternative asset allocation (which may include equity and fixed income investments as part of a variety of alternative investment strategies) to 35%. The new asset categories added by the 2010 Asset Allocation Policy are a new 7% allocation for risk parity investments, added in accordance with the recommendation of a new investment advisor, and a .5% allocation for charter school investments, both of which are categorized within the Fund's alternative asset category. Based on an opinion of the Texas Attorney General, which was received by the Chair of the SBOE in August 2011, and which stated that the PSF may not be invested for an objective that does not meet the prudent person investment standard, the charter school investment allocation was discontinued without being implemented in September 2011, with the .5% allocation being reallocated into other alternative investment allocations. The PSF Staff and the Fund's investment advisor are tasked with advising the SBOE with respect to the implementation of the 2010 Asset Allocation Policy, including the timing and manner of the selection of any external managers and other consultants. For a variety of reasons, each change in asset allocation for the Fund, including the 2010 Asset Allocation Policy, has been, and is being, implemented in phases. At August 31, 2011, the Fund was invested as follows: 54.60% in public market equity investments; 22.18% in fixed income investments; 10.34% in absolute return assets; 0.72% in private equity assets; 1.42% in real estate assets; 7.73% in risk parity assets; 2.88% in real return assets; and 0.13% in cash.

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

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

#### **MANAGEMENT AND ADMINISTRATION OF THE FUND**

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

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



funds the indirect management costs deducted from the assets of a mutual fund or other investment company in which PSF funds have been invested.

Texas law assigns control of the Fund's land and mineral rights to the three-member SLB, which consists of the elected Commissioner of the General Land Office ("GLO"), an appointee of the Governor, and an appointee of the Attorney General. Administrative duties related to the land and mineral rights reside with the GLO, which is under the guidance of the Commissioner of the GLO. In 2007, the Legislature established the real estate special fund account of the PSF (the "Real Estate Account") consisting of the land, mineral or royalty interest, real estate investment, or other interest, including revenue received from those sources, that is set apart to the PSF under the Texas Constitution and laws, together with the mineral estate in riverbeds, channels, and the tidelands, including islands. The investment of the Real Estate Account is subject to the sole and exclusive management and control of the SLB and the Land Commissioner, who is also the head of the GLO. The 2007 legislation that established the Real Estate Account, House Bill 3699 ("HB 3699") presented constitutional questions regarding the respective roles of the SBOE and the SLB relating to the disposition of proceeds of real estate transactions to the ASF, among other questions. On April 9, 2008, the Attorney General issued a legal opinion, Op. Tex. Att'y Gen. No. GA-0617 (2008), at the request of the Chair of the SBOE advising, among other matters, that any proceeds from the sale of real estate that are not reinvested by the SLB in other real estate assets must be invested under the direction of the SBOE, and that the provisions of H.B. 3699 that permit the SLB to directly transfer real estate investment proceeds to the ASF (in lieu of transfer to the investment portfolio of the PSF under the management of the SBOE), would likely be determined by a court to be in violation of the State constitution. Amounts in the investment portfolio of the PSF are taken into account by the SBOE for purposes of determining the Distribution Rate. An amendment to the Texas Constitution was approved by State voters on November 8, 2011, which permits the SLB to make transfers directly to the ASF, see "2011 Constitutional Amendment" below.

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

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

## **THE GUARANTEE**

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

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

If a district fails to pay principal or interest on a bond as it is stated to mature, other amounts not due and payable are not accelerated and do not become due and payable by virtue of the district's default. The Guarantee Program does not apply to the

payment of principal and interest upon redemption of bonds, except upon mandatory sinking fund redemption, and does not apply to the obligation, if any, of a school district to pay a redemption premium on bonds.

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

For a discussion of legislative developments that have authorized the use of the Fund to guarantee revenue bonds issued by certain open-enrollment charter schools, see “Other 2011 Legislative Actions – Charter School Guarantee Program” below.

#### **CAPACITY LIMITS FOR THE GUARANTEE PROGRAM**

The capacity of the Fund to guarantee bonds under the Guarantee Program is limited in two ways: by State law (the “State Capacity Limit”) and by regulations and a notice issued by the Internal Revenue Service (the “IRS” and the “IRS Limit,” respectively). Prior to May 20, 2003, the State Capacity Limit was equal to two times the lower of cost or fair market value of the Fund’s assets, exclusive of real estate. During the 78th Regular Session of the Legislature in 2003, legislation was enacted that increased the State Capacity Limit by 25%, to two and one half times the lower of cost or fair market value of the Fund’s assets as estimated by the SBOE and certified by the State Auditor, and eliminated the real estate exclusion from the calculation.

Prior to the issuance of the IRS Notice (defined below), the capacity of the program under the IRS Limit was limited to two and one-half times the lower of cost or fair market value of the Fund’s assets adjusted by a factor that excluded additions to the Fund made since May 14, 1989. During the 2007 Texas Legislature, Senate Bill 389 (“SB 389”) was enacted providing for additional increases in the capacity of the Guarantee Program, and specifically providing that the SBOE may by rule increase the capacity of the Guarantee Program from two and one-half times the cost value of the PSF to an amount not to exceed five times the cost value of the PSF, provided that the increased limit does not violate federal law and regulations and does not prevent bonds guaranteed by the Guarantee Program from receiving the highest available credit rating, as determined by the SBOE. SB 389 further provides that the SBOE shall at least annually consider whether to change the capacity of the Guarantee Program. Since 2005, the Guarantee Program has twice reached capacity under the IRS Limit, and in each instance the Guarantee Program was closed to new bond guarantee applications until relief was obtained from the IRS. The most recent closure of the Guarantee Program commenced in March 2009 and the Guarantee Program reopened in February 2010 on the basis of receipt of the IRS Notice.

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

The IRS Notice establishes a static capacity for the Guarantee Program based upon the cost value of Fund assets on December 16, 2009 multiplied by five. On December 16, 2009, the cost value of the Guarantee Program was \$23,463,730,608 (estimated and unaudited), thereby producing an IRS Limit of approximately \$117.3 billion. The State Capacity Limit is determined on the basis of the cost value of the Fund from time to time multiplied by the capacity multiplier determined annually by the SBOE, but not to exceed a multiplier of five. The capacity of the Guarantee Program will be limited to the lower of the State Capacity Limit and the IRS Limit. On May 21, 2010, the SBOE modified the regulations that govern the Guarantee Program (the “Guarantee Program Rules”), and increased the State Law Capacity to an amount equal to three times the cost value of the PSF. Such modified regulations, including the revised capacity rule, became effective on July 1, 2010. The Guarantee Program Rules provide that the Commissioner may reduce the multiplier to maintain the AAA credit rating of the Guarantee Program, but provide that any changes to the multiplier made by the Commissioner are to be ratified or rejected by the SBOE at the next meeting following the change. See “Valuation of the PSF and Guaranteed Bonds,” below.

Since July 1991, when the SBOE amended the Guarantee Program Rules to broaden the range of bonds that are eligible for guarantee under the Guarantee Program to encompass most Texas school district bonds, the principal amount of bonds guaranteed under the Guarantee Program has increased sharply. In addition, in recent years a number of factors have caused an increase in the amount of bonds issued by school districts in the State. See the table “Permanent School Fund Guaranteed Bonds” below. The SBOE has approved and modified the Guarantee Program Rules in recent years, most recently in May 2010. Generally, the Guarantee Program Rules limit guarantees to certain types of notes and bonds, including, with respect to refunding bonds, a requirement that the bonds produce debt service savings, and that bonds issued for capital facilities must have been voted as unlimited tax debt of the issuing district. The Guarantee Program regulations include certain accreditation criteria for districts applying for a guarantee of their bonds, and limit guarantees to districts that have less than the amount of annual debt service per average daily attendance that represents the 90th percentile of annual debt service per average daily attendance for all districts, but such limitation will not apply to school districts that have enrollment growth of at least 25% over the previous five school years. Effective September 1, 2009, the Act provides that the SBOE may annually establish a percentage of the cost value of the Fund to be reserved from use in guaranteeing bonds. The capacity of the Guarantee Program in excess of any reserved portion is referred to herein as the “Capacity Reserve.” The Guarantee Program Rules provide for a minimum Capacity

Reserve of no less than 5%, and provide that the amount of the Capacity Reserve may be increased by a majority vote of the SBOE. The Commissioner is authorized to change the Capacity Reserve, which decision must be ratified or rejected by the SBOE at its next meeting following any change made by the Commissioner. The Guarantee Program Rules are codified in the Texas Administrative Code at 19 TAC sections 33.65 et seq., and are available on the TEA web site at [www.tea.state.tx.us/rules/tac/chapter033/index.html](http://www.tea.state.tx.us/rules/tac/chapter033/index.html). The current Capacity Reserve is noted in the monthly updates with respect to the capacity of the Guarantee Program on the TEA web site at [www.tea.state.tx.us/psf](http://www.tea.state.tx.us/psf), which are also filed with the MSRB.

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

The Act requires that the Commissioner prepare, and the SBOE approve, an annual report on the status of the Guarantee Program (the Annual Report). The State Auditor audits the financial statements of the PSF, which are separate from other State financial statements. The TEA has filed the audited annual report of the PSF for the year ended August 31, 2011 with the MSRB. The 2011 Annual Report has also been filed with the Municipal Advisory Council of Texas and posted to the PSF web site. Such report speaks only as of the date thereof.

**RATINGS OF BONDS GUARANTEED UNDER THE GUARANTEE PROGRAM**

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

**VALUATION OF THE PSF AND GUARANTEED BONDS**

<b>Permanent School Fund Valuations</b>		
Fiscal Year Ended	Book Value <sup>(1)</sup>	Market Value <sup>(1)</sup>
8/31		
2007	\$ 21,234,323,093	\$29,251,882,931
2008	22,926,299,922	29,336,248,611
2009	23,117,052,793	25,443,104,623
2010	23,653,185,489	27,066,200,259
2011	24,701,156,685 <sup>(2)</sup>	29,643,439,794 <sup>(2)</sup>

<sup>(1)</sup> 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, 2011, land, external real estate investments, mineral assets and cash managed by the SLB had book values of approximately \$352.24 million, \$1.41 billion, \$13.39 million and \$1.30 billion, respectively, and market values of approximately \$691.50 million, \$1.19 billion, \$2.37 billion and \$1.30 billion, respectively.

<sup>(2)</sup> At December 31, 2011, the PSF had a book value of \$24,799,654,060 and a market value of \$29,438,411,036 (in each case, based on unaudited data).

**Permanent School Fund Guaranteed Bonds**

At 8/31	Principal Amount <sup>(1)</sup>
2007	\$ 44,856,621,419
2008	49,860,572,025
2009	50,032,724,439
2010	49,301,683,338
2011	52,653,930,546 <sup>(2)</sup>

<sup>(1)</sup> 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.

<sup>(2)</sup> As of August 31, 2011, the TEA expected that the principal and interest to be paid by school districts over the remaining life of the bonds guaranteed by the Guarantee Program is \$90,023,091,264, of which \$37,369,160,718 represents interest to be paid. At December 31, 2011, there were \$53,299,989,658 of bonds guaranteed under the Guarantee Program and the capacity of the Guarantee Program was \$74,398,962,180 based on the three times cost value multiplier approved by the SBOE on May 21, 2010. Such capacity figures include the Reserve Capacity.

**DISCUSSION AND ANALYSIS PERTAINING TO FISCAL YEAR ENDED AUGUST 31, 2011**

The following discussion is derived from the Annual Report for the year ended August 31, 2011, 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, 2011, 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 2010 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 2011, the total Fund balance was \$26.9 billion. Fund balance increased \$2.55 billion from the prior year primarily attributable to the increase in the fair value of the PSF(SBOE) alternative investments and the recovering markets. During the year, the SBOE continued implementing its revised long term strategic asset allocation to diversify and strengthen the PSF(SBOE) investment assets of the Fund. The revised allocation is projected to increase returns over the long run while reducing risk and return volatility of the portfolio. The one year, three year, five year and ten year annualized total returns for the PSF(SBOE) assets were 13.64%, 3.80%, 3.70% and 5.60% 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 9.52%, -4.30%, and 1.10% 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, 2011, the PSF(SBOE) portion of the Fund had diversified into emerging market international equities, absolute return funds, real estate, private equity, risk parity and real return Treasury Inflation-Protected Securities. Other asset classes such as real return commodities and small/midcap international securities will be strategically added commensurate with the economic environment and the goals and objectives of the SBOE. As of August 31, 2011, the SBOE had approved and the PSF(SBOE) made capital commitments to externally managed real estate funds in the amount of \$705 million and capital commitments to two private equity limited partnerships in the total amount of \$1.3 billion. Unfunded commitments at August 31, 2011, were \$380.7 million in real estate and \$1.13 billion in private equity.

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 all of the minerals that are associated with PSF lands. The investment focus of PSF(SLB) discretionary real assets investments has shifted from internally managed direct real estate investments to externally managed real assets investment funds. Approximately \$417 million of capital commitments to externally managed real assets investment funds were funded during fiscal year 2011. As of August 31, 2011, approximately \$1.62 billion of total capital commitments had been funded by PSF(SLB) and the fair value of the investments was \$1.19 billion.

The PSF(SBOE)'s investment in equity securities experienced a return of 16.71% during the fiscal year ended August 31, 2011. The PSF(SBOE)'s investment in fixed income securities produced a return of 4.58% during the fiscal year and absolute return

investments yielded a return of 4.48%. The PSF(SBOE) real estate and private equity investments returned 15.53% and 20.32%, respectively. Risk parity and real return assets were funded so late in the fiscal cycle that a full year's performance was not reportable at August 31, 2011. Combined, all PSF(SBOE) asset classes produced an investment return of 13.64% for the fiscal year ended August 31, 2011, outperforming the target index by approximately 49 basis points. All PSF(SLB) real assets (including cash) returned 9.52% for the fiscal year ending August 31, 2011.

For fiscal year 2011, total revenues, inclusive of unrealized gains and losses and net of security lending rebates and fees, totaled \$3.73 billion, an increase of \$1.8 billion from fiscal year 2010 earnings of \$1.93 billion. This increase reflects the performance of the securities markets in which the Fund was invested in fiscal year 2011. In fiscal year 2011, revenues earned by the Fund included lease payments, bonuses and royalty income received from oil, gas and mineral leases; lease payments from commercial real estate; surface lease and easement revenues; revenues from the resale of natural and liquid gas supplies; dividends, interest, and securities lending revenues; the net change in the fair value of the investment portfolio; and, other miscellaneous fees and income.

Expenditures are paid from the Fund before distributions are made under the total return formula. Such expenditures include the costs incurred by the SLB to manage the land endowment, as well as operational costs of the Fund, including external management fees paid from appropriated funds. Total operating expenditures, net of security lending rebates and fees, increased 21.0% for the fiscal year ending August 31, 2011. This increase is primarily attributable to the increase in the operational costs to manage the PSF(SLB) investments.

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 2010 and 2011, this distribution to the ASF totaled \$60.7 million and \$1.093 billion, respectively.

At the end of the 2011 fiscal year, PSF assets guaranteed \$52.7 billion in bonds issued by 791 local school districts. Since its inception in 1983, the Fund has guaranteed 4,587 school district bond issues totaling \$96.2 billion in principal amount. During the 2011 fiscal year, the number of outstanding issues guaranteed under the Guarantee Program increased by 84, or 3.4%. The dollar amount of guaranteed school bond issues outstanding increased by \$3.35 billion or 6.8%. The guarantee capacity of the Fund increased by \$3.41 billion, or 4.8%, during fiscal year 2011 due to the investment performance of the Fund.

## **2011 CONSTITUTIONAL AMENDMENT**

During the Regular Session of the 82nd Legislature, which concluded May 30, 2011, a joint resolution ("HJR 109") was enacted proposing amendments to various sections of the Texas Constitution that pertain to the PSF. In accordance with HJR 109, a referendum was held in the State on November 8, 2011. At that referendum, voters of State approved non-substantive changes to the Texas Constitution to clarify references to the Fund, and, in addition, approved an amendment that effects an increase to the base amount used in calculating the Distribution Rate from the Fund to the ASF. The amendments approved at the referendum include an increase to the base used to calculate the Distribution Rate by adding to the calculation base certain discretionary real assets and cash in the Fund that is managed by entities other than the SBOE (at present, by the SLB). The value of those assets were already included in the value of the Fund for purposes of the Guarantee Program, but prior to the amendment had not been included in the calculation base for purposes of making transfers from the Fund to the ASF. While the amendment provides for an increase in the base for the calculation of approximately \$2 billion, no new resources were provided for deposit to the Fund. As described under "The Total Return Constitutional Amendment" the SBOE is prevented from approving a Distribution Rate or making a pay out from the Fund if the amount distributed would exceed 6% of the average of the market value of the Fund, excluding real property in the Fund, but including discretionary real asset investments on the last day of each of the sixteen State fiscal quarters preceding the Regular Session of the Legislature that begins before that State fiscal biennium or if such pay out would exceed the Ten Year Total Return. The new calculation base is required to be used to determine all payments to the ASF from the Fund beginning with the 2012-13 biennium. As described under "The Total Return Constitutional Amendment" the SBOE approved a distribution rate of 4.2% in January 2011 based on a commitment of the SLB to transfer \$500 million to the PSF during the biennium.

The constitutional amendments approved on November 8, 2011 also provides authority to the GLO or other entity other than the SBOE that has responsibility for the management of land or other properties of the Fund to determine in its sole discretion whether to transfer each year from Fund assets to the ASF revenue derived from such land or properties, an amount not to exceed \$300 million. Any amount transferred to the ASF by an entity other than the SBOE is excluded from the 6% Distribution Rate limitation applicable to SBOE transfers.

The impact of the increase in the base against which the Distribution Rate is applied will be an increase in the distributions from the PSF to the ASF, provided that there are no reductions in the percentage established biennially by the SBOE to be the Distribution Rate. For the 2012-13 biennium, the Distribution Rate has been set by the SBOE at 4.2%. Given the increase in the calculation base effected by the November 8, 2011 constitutional amendment, the effect on transfers made by the SBOE in 2012-12 will be an increase in the total return distribution by an estimated \$73.7 million in each year of the biennium. Going forward, it may be necessary for the SBOE to reduce the Distribution Rate in order to preserve the corpus of the Fund in accordance with its management objective of preserving intergenerational equity. Assuming a static Distribution Rate in the 2014-15 biennium and beyond, as the value of the real assets investments increase annually, distributions to the ASF would increase in the out

years. The increased amounts distributed from the Fund will be a loss to either the investment corpus of the PSF managed by SBOE or, should the SLB increase its transfers to the SBOE to cover this share of the distribution, to the assets managed by the SLB. In addition, the changes made by the amendment will reduce the compounding interest in the Fund that would be derived from these assets remaining in the corpus of the Fund. Other factors that may affect the corpus of the Fund that are associated with this change include the decisions that are made by the SLB or others that are or may in the future be authorized to make transfers of funds from the PSF to the ASF. While the SBOE has oversight of the Guarantee Program, it will not have the decision making power with respect to all transfers to the ASF, as it has had in the past, which could adversely affect the ability of the SBOE to optimally manage its portion of the PSF assets.

#### **OTHER 2011 LEGISLATIVE ACTIONS – CHARTER SCHOOL GUARANTEE PROGRAM**

During the First Called Session of the 82nd Texas Legislature, which ended June 29, 2011, Senate Bill 1 (“SB 1”) was enacted. Among other provisions, SB 1 authorizes the use of the PSF to guarantee revenue bonds issued by certain open-enrollment charter schools that are designated as “charter districts” by the Commissioner. The program authorized by SB 1 is referred to herein as the “Charter School Guarantee Program.” It is anticipated that the Charter School Guarantee Program will not become effective until certain contingent requirements are satisfied, including the establishment of regulations by the Commissioner for the administration of the program. It is also expected that the new program will not be implemented until the SBOE has received a response from the IRS with respect to certain federal tax law matters concerning the Charter School Guarantee Program that have been submitted to the IRS for review. As a result, the date of implementation and the ultimate structure of the Charter School Guarantee Program are presently unknown, although the program could be implemented in calendar year 2012.

In general, the Charter School Guarantee Program has been authorized through the enactment of amendments to the Act. As amended, the Act provides that a qualified charter district may make application to the Commissioner under the Act for a guarantee of its bonds, including refunding bonds, by the PSF. The capacity of the Charter School Guarantee Program is limited to the total amount that equals the result of the percentage that is equal to the ratio of the number of students enrolled in open-enrollment charter schools in the State compared to the total number of students enrolled in all public schools in the State multiplied by the combined capacities of the Guarantee Program and Charter School Guarantee Program. As of March 1, 2011 (the most recent date for which data is available), the percentage of students enrolled in open-enrollment charter schools to the total State scholastic census was approximately 2.72%. For the capacity of the Guarantee Program, see “Capacity Limits for the Guarantee Program.”

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

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

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

#### **OTHER EVENTS AND DISCLOSURES**

The State Investment Ethics Code governs the ethics and disclosure requirements for financial advisors and other service providers who advise certain State governmental entities, including the PSF. In accordance with the provisions of the State Investment Ethics Code, the SBOE periodically modifies its code of ethics, which occurred most recently in May 2010. The SBOE code of ethics includes prohibitions on sharing confidential information, avoiding conflict of interests and requiring disclosure filings with respect to contributions made or received in connection with the operation or management of the Fund. The code of ethics applies to members of the SBOE as well as to persons who are responsible by contract or by virtue of being a TEA PSF staff member for managing, investing, executing brokerage transactions, providing consultant services, or acting as a custodian of the PSF, and persons who provide investment and management advice to a member of the SBOE, with or without

compensation under certain circumstances. The code of ethics is codified in the Texas Administrative Code at 19 TAC sections 33.5 et seq., and is available on the TEA web site at [www.tea.state.tx.us/rules/tac/chapter033/index.html](http://www.tea.state.tx.us/rules/tac/chapter033/index.html).

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

As of August 31, 2011, 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.

The SBOE is a named defendant in litigation described in the Official Statement pertaining to the Bonds that has been filed in State District Court that has challenged the constitutionality of the Texas public school finance system, and which, among other relief requested, seeks an injunction to prohibit the State and its officials from distributing any funds under the current finance system until a constitutional system is created. The TEA does not anticipate that the security for payment of the Bonds, including the PSF guarantee of school district bonds, would be adversely affected by such litigation.

#### **PSF CONTINUING DISCLOSURE UNDERTAKING**

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

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

#### **ANNUAL REPORTS**

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

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

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

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

#### **MATERIAL EVENT NOTICES**

The TEA will also provide timely notices of certain events to the MSRB. Such notices will be provided not more than ten business days after the occurrence of the event. The TEA will provide notice of any of the following events with respect to the Guarantee Program: (1) principal and interest payment delinquencies; (2) non-payment related defaults, if such event is material within the meaning of the federal securities laws; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions, the issuance by the IRS of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB), or other material notices or determinations with respect to the tax-exempt status of the Guarantee Program, or other material events affecting the tax status of the Guarantee Program; (7) modifications to rights of holders of Bonds guaranteed by the Guarantee Program, if such event is material within the meaning of the federal securities laws; (8) Bond calls, if such event is material within the meaning of the federal securities laws, and tender offers; (9) defeasances; (10) release, substitution, or sale of property securing repayment of Bonds guaranteed by the Guarantee Program, if such event is material within the meaning of the federal securities laws; (11) rating changes; (12) bankruptcy, insolvency, receivership, or similar event of the Guarantee Program (which is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent, or similar officer for the Guarantee Program in a proceeding under the United States Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Guarantee Program, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement, or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the Guarantee Program); (13) the consummation of a merger, consolidation, or acquisition involving the Guarantee Program or the sale of all or substantially all of its assets, other than in the ordinary course of business, the entry into of a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (14) the appointment of a successor or additional trustee with respect to the Guarantee Program or the change of name of a trustee, if such event is material within the meaning of the federal securities laws. (Neither the Act nor any other law, regulation or instrument pertaining to the Guarantee Program make any provision with respect to the Guarantee Program for bond calls, debt service reserves, credit enhancement, liquidity enhancement, early redemption or the appointment of a trustee with respect to the Guarantee Program.) In addition, the TEA will provide timely notice of any failure by the TEA to provide information, data, or financial statements in accordance with its agreement described above under "Annual Reports."

#### **AVAILABILITY OF INFORMATION**

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

#### **LIMITATIONS AND AMENDMENTS**

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

The continuing disclosure agreement of the TEA is made only with respect to the PSF and the Guarantee Program. The District may make a continuing disclosure undertaking in accordance with Rule 15c2-12 with respect to its obligations arising under Rule 15c2-12 pertaining to financial and operating data concerning the District and notices of material events relating to the Bonds. A description of the District's undertaking, if any, is included elsewhere in 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 ("M&O") tax rate had become in effect a state property tax, in violation of Article VIII, Section 1-e of the Texas Constitution, because it precluded them and other school districts from having meaningful discretion to tax at a lower rate. Forty school districts intervened alleging that the Texas public school finance system (the "Finance System") was inefficient, inadequate, and unsuitable, in violation of Article VII, Section 1 of the Texas Constitution, because the State of Texas (the "State") did not provide adequate funding. As described below, this case has twice reached the Texas Supreme Court (the "Supreme Court"), which rendered decisions in the case on May 29, 2003 ("West Orange-Cove I") and November 22, 2005 ("West Orange-Cove II"). After the remand by the Supreme Court back to the District Court in West Orange-Cove I, 285 other school districts were added as plaintiffs or intervenors. The plaintiffs joined the intervenors in their Article VII, Section 1 claims that the Finance System was inadequate and unsuitable, but not in their claims that the Finance System was inefficient.

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

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

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

and efficiency does not preclude supplementation of revenues with local funds by school districts; and the Finance System does not violate the constitutional requirement of "suitability," since the Finance System was suitable for adequately and efficiently providing a public education.

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

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

In response to the intervenor districts' contention that the Finance System was constitutionally inefficient, the West Orange-Cove II decision states that the Texas Constitution does not prevent the Finance System from being structured in a manner that results in gaps between the amount of funding per student that is available to the richest districts as compared to the poorest district, but reiterated its statements in *Edgewood Independent School District v. Meno*, 917 S.W.2d 717 (Tex. 1995) ("Edgewood IV") that such funding variances may not be unreasonable. The Supreme Court further stated that "the 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 "efficiency 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.

## **CURRENT LITIGATION RELATED TO THE TEXAS PUBLIC SCHOOL FINANCE SYSTEM**

Several lawsuits have been filed in District Courts of Travis County, Texas, which allege that the Finance System, as modified by legislation enacted by the Legislature since the decision in West Orange Cove II, and in particular, as modified by Senate Bill 1 in 2011 (see "CURRENT PUBLIC SCHOOL FINANCE SYSTEM - 2011 Legislation"), has resulted in a funding system that violates principles established in West Orange Cove I and West Orange Cove II, and prior decisions of the Supreme Court relating to the constitutionality of the Finance System and several provisions of the Texas Constitution. In general, each suit presents the legal perspectives and arguments of the different coalitions of school districts represented, but as a general matter, each group has challenged the adequacy of funding provided by the Legislature for the Finance System, and the plaintiffs in each suit are seeking to have an injunction issued to the State and its officials to prevent the distribution of any funds under the current Finance System until a constitutional system is created and seek a declaration that changes in funding for the Finance System since the enactment of HB 1 have effectively converted the local M&O Tax into a state property tax in violation of the Texas Constitution. The defendants in the suits include State officials and the State Board of Education (the "State Defendants"). The first suit was filed on October 10, 2011, styled "The Texas Taxpayer & Student Fairness Coalition, et al. v. Robert Scott, Commissioner of Education et al." A second suit was filed on December 9, 2011, styled "Calhoun County Independent School District, et al. v. Robert Scott, Commissioner of Education, et al." A third suit was filed on December 13, 2011, styled "Edgewood Independent School District, et al. v. Robert Scott, Commissioner of Education, et al." and a fourth suit was filed on December 23, 2011, styled "Fort Bend Independent School District, et al. v. Robert Scott, Commissioner of Education, et al." (the "Fort Bend Suit"). The State Defendants have filed an answer with respect to the each of the first four suits filed, denying the plaintiff's allegations, and all of such suits have been assigned to the 250th District Court of Travis County for the handling of all pre-trial, trial and post-judgment proceedings. On February 24, 2012 a plea of intervention to the Fort Bend Suit was filed by seven parents and a group named "Texans for Real Efficiency and Equity in Education." The intervenors assert that the school finance system is qualitatively inefficient, and that the Finance System is unconstitutional, in part based on arguments made by other plaintiffs. A fifth suit was filed on June 26, 2012 by individuals and the Texas Charter School Association, styled "Flores, et al. v. Robert Scott, Commissioner of Education, et al. (the "Charter School Suit". The petition for the Charter School Suit agrees with the arguments of the school districts in the first four suits filed that the Finance System is unconstitutional and seeks to have an injunction issued against the State Defendants in the same manner as the first four suits. The Charter School Suit also adds additional grounds that relate to the circumstances of charter schools as a basis for holding the Finance System unconstitutional, including that charter schools receive no funding for facilities and that the statutory cap on charter schools is unconstitutionally arbitrary. The first four suits have been consolidated by the 250<sup>th</sup> District Court of Travis County, and trial

has been scheduled for October 22, 2012. It is possible that the Charter School Suit will be consolidated into that matter. It is also possible that additional plaintiffs will join the suits and that other, independent lawsuits may be filed challenging various aspects of the Finance System, and that any such additional legal challenges may be consolidated with the suits referenced above.

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

#### **POSSIBLE EFFECTS OF LITIGATION AND CHANGES IN LAW ON DISTRICT BONDS**

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

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

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

### **CURRENT PUBLIC SCHOOL FINANCE SYSTEM**

#### **OVERVIEW**

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

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

Local funding is derived from collections of ad valorem taxes levied on property located within each district's boundaries. School districts are authorized to levy two types of property taxes: a limited maintenance and operations ("M&O") tax to pay current expenses and an unlimited interest and sinking fund ("I&S") tax to pay debt service on bonds. Under current law, M&O

tax rates are subject to a statutory maximum rate of \$1.17 per \$100 of taxable value for most school districts. Current law also requires school districts to demonstrate their ability to pay debt service on outstanding indebtedness through the levy of an ad valorem tax at a rate of not to exceed \$0.50 per \$100 of taxable property at the time bonds are issued. Once bonds are issued, however, districts may levy a tax to pay debt service on such bonds unlimited as to rate or amount (see "TAX INFORMATION – Tax Rate Limitations" herein). As noted above, because property values vary widely among school districts, the amount of local funding generated by the same tax rate is also subject to wide variation among school districts.

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

#### **LOCAL FUNDING FOR SCHOOL DISTRICTS**

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

#### **STATE FUNDING FOR SCHOOL DISTRICTS**

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

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

Tier One allotments are intended to provide all districts a basic level of education necessary to meet applicable legal standards. Tier Two allotments are intended to guarantee each school district that is not subject to the wealth transfer provisions described

below an opportunity to supplement that basic program at a level of its own choice; however, Tier Two allotments may not be used for the payment of debt service or capital outlay.

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

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

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

State financial assistance is provided for certain existing eligible debt issued by school districts (referred to herein as EDA). The EDA guaranteed yield (the "EDA Yield") is the same as the IFA Guaranteed Yield (\$35 per cent of local tax effort per student in ADA), subject to adjustment as described below. For bonds that became eligible for EDA funding after August 31, 2001, and prior to August 31, 2005, EDA assistance was less than \$35 in revenue per student for each cent of debt service tax, as a result of certain administrative delegations granted to the Commissioner under State law. Effective September 1, 2003, the portion of the local debt service rate that has qualified for EDA assistance is limited to the first 29 cents of debt service tax or a greater amount for any year provided by appropriation by the Legislature. In general, a district's bonds are eligible for EDA assistance if (i) the district made payments on the bonds during the final fiscal year of the preceding State fiscal biennium or (ii) the district levied taxes to pay the principal of and interest on the bonds for that fiscal year. Each biennium, access to EDA funding is determined by the debt service taxes collected in the final year of the preceding biennium. A district may not receive EDA funding for the principal and interest on a series of otherwise eligible bonds for which the district receives IFA funding.

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

## **2006 LEGISLATION**

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

significantly reduced the amount of local revenue available to fund the Finance System. To make up for this shortfall, the Reform Legislation authorized Additional State Aid for Tax Reduction ("ASATR") for each school district in an amount equal to the difference between the amount that each district would receive under the Foundation School Program and the amount of each district's Target Revenue funding level.

#### **2009 LEGISLATION**

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

#### **2011 LEGISLATION**

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

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

#### **WEALTH TRANSFER PROVISIONS**

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

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

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

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

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

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

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

#### **TAX INFORMATION**

**AD VALOREM TAX LAW . . .** The appraisal of property within the District is the responsibility of the Lubbock Central Appraisal District (the "Appraisal District"). Excluding agricultural and open-space land, which may be taxed on the basis of productive capacity, the Appraisal District is required under Title I of the Texas Tax Code (the "Property Tax Code") to appraise all property within the Appraisal District on the basis of 100% of its market value and is prohibited from applying any assessment ratios. 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 the market data comparison method of appraisal, and the method considered most appropriate by the chief appraiser is to be used. Effective January 1, 2010, State law requires the appraised value of a residence homestead to be based solely on the property's value as a residence homestead, regardless of whether residential use is considered to be the highest and best use of the property. State law further limits the appraised value of a residence homestead for a tax year to an amount that would not exceed the lesser of (1) the market value of the property for the most recent tax year that the market value was determined by the appraisal office or (2) the sum of (a) 10% of the property's appraised value in the preceding tax year, plus (b) the property's appraised value in the preceding tax year, plus (c) the market value of all new improvements to the property. The value placed upon property within the Appraisal District is subject to review by an Appraisal Review Board, consisting of members appointed by the Board of Directors of the Appraisal District. The Appraisal District is required to review the value of property within the Appraisal District at least every three years. The District may require annual review at its own expense, and is entitled to challenge the determination of appraised value of property within the District by petition filed with the Appraisal Review Board.

Reference is made to the Property Tax Code, for identification of property subject to taxation; property exempt or which may be exempted from taxation, if claimed; the appraisal of property for ad valorem taxation purposes; and the procedures and limitations applicable to the levy and collection of ad valorem taxes.

Article VIII of the State Constitution ("Article VIII") and State law provide for certain exemptions from property taxes, the valuation of agricultural and open-space lands at productivity value, and the exemption of certain personal property from ad valorem taxation.

Certain residence homestead exemptions from ad valorem taxes for public school purposes are mandated by Section 1-b, Article VIII, and State law and apply to the market value of residence homesteads in the following sequence:

\$15,000; and an additional

\$10,000 for those 65 years of age or older, or the disabled. A person over 65 and disabled may receive only one \$10,000 exemption, and only one such exemption may be received per family, per residence homestead; in addition, effective January 1, 2012, surviving spouses of a deceased veteran who had received a disability rating of 100% are entitled to receive a residential homestead exemption equal to the exemption received by the deceased spouse until such surviving spouse remarries.

State law also mandates a freeze on taxes paid on residence homesteads of persons who are 65 years of age or older and persons who are disabled which receive the \$10,000 exemption. Such residence homesteads shall be appraised and taxes calculated as on any other property, but taxes shall never exceed the amount imposed in the first year in which the property received the \$10,000 exemption. The freeze on ad valorem taxes for general elementary and secondary public school purposes on the homesteads of persons who are 65 years of age or older and persons who are disabled is also transferable to a different residence homestead. Also, a surviving spouse of a taxpayer who qualifies for the freeze on ad valorem taxes is entitled to the same exemption so long as the property was the residence homestead of the surviving spouse when the deceased spouse died and remains the residence homestead of the surviving spouse and the surviving spouse was at least 55 years of age at the time of the death of the individual's spouse. If improvements (other than repairs or improvements required to comply with governmental requirements) are made to the property, the value of the improvements is taxed at the then current tax rate, and the total amount of taxes imposed is increased to reflect the new improvements with the new amount of taxes then serving as the ceiling on taxes for the following years. A "disabled" person is one who is "under a disability for purposes of payment of disability insurance benefits under the Federal Old Age, Survivors and Disability Insurance". Pursuant to a constitutional amendment approved by the voters on May 12, 2007, legislation was enacted to reduce the school property tax limitation imposed by the freeze on taxes paid on residence homesteads of persons who are 65 years of age or over or persons who are disabled to correspond to reductions in local school district tax rates from the 2005 tax year to the 2006 tax year and from the 2006 tax year to the 2007 tax year (see "CURRENT PUBLIC SCHOOL FINANCE SYSTEM – General"). The school property tax limitation provided by the constitutional amendment and enabling legislation apply to the 2007 and subsequent tax years.

In addition, under Section 1-b, Article VIII, and State law, the governing body of a political subdivision, at its option, may grant either or both of the following

- (i) An exemption of not less than \$3,000 of the market value of the residence homestead of persons 65 years of age or older and the disabled from all ad valorem taxes thereafter levied by the political subdivision;
- (ii) An exemption of up to 20% of the market value of residence homesteads; minimum exemption \$5,000.

After the exemption described in (i) above is authorized, such exemption may be repealed or decreased or increased in amount (a) by the governing body of the political subdivision or (b) by a favorable vote of a majority of the qualified voters at an election called by the governing body of the political subdivision, which election must be called upon receipt of a petition signed by at least 20% of the number of qualified voters who voted in the preceding election of the political subdivision. In the case of a decrease, the amount of the exemption may not be reduced to less than \$3,000 of the market value.

The surviving spouse of an individual who qualifies for the exemption listed in (i) above for the residence homestead of a person 65 or older (but not the disabled) is entitled to an exemption for the same property in an amount equal to that of the exemption for which the deceased spouse qualified if (i) the deceased spouse died in a year in which the deceased spouse qualified for the exemption, (ii) the surviving spouse was at least 55 years of age at the time of the death of the individual's spouse and (iii) the property was the residence homestead of the surviving spouse when the deceased spouse died and remains the residence homestead of the surviving spouse.

In the case of residence homestead exemptions granted under Section 1-b, Article VIII, ad valorem taxes may continue to be levied against the value of homesteads exempted where ad valorem taxes have previously been pledged for the payment of debt if cessation of the levy would impair the obligation of the contract by which the debt was created.

State law and Section 2, Article VIII, mandate an additional property tax exemption for disabled veterans or the surviving spouse or children of a deceased veteran who died while on active duty in the armed forces; the exemption applies to either real or personal property with the amount of assessed valuation exempted ranging from \$5,000 to a maximum of \$12,000; and, beginning in tax year 2009, a disabled veteran who receives 100% disability compensation from the United States Department of Veterans Affairs or its successor due to a service-connected disability and a rating of 100% disabled or of individual unemployment is entitled to an exemption from taxation of the total appraised value of the veteran's residence homestead.

Article VIII provides that eligible owners of both agricultural land (Section 1-d) and open-space land (Section 1-d-1), including open-space land devoted to farm or ranch purposes or open-space land devoted to timber production, may elect to have such



property appraised for property taxation on the basis of its productive capacity. The same land may not be qualified under both Section 1-d and 1-d-1.

Nonbusiness personal property, such as automobiles or light trucks, are exempt from ad valorem taxation unless the governing body of a political subdivision elects to tax this property. Boats owned as nonbusiness property are exempt from ad valorem taxation.

Article VIII, Section 1-j of the Texas Constitution provides for "freeport property" to be exempted from ad valorem taxation. Freeport property is defined as goods detained in Texas for 175 days or less for the purpose of assembly, storage, manufacturing, processing or fabrication. Notwithstanding such exemption, counties, school districts, junior college districts and cities may tax such tangible personal property provided official action to tax the same was taken before April 1, 1990. Decisions to continue to tax may be reversed in the future; 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 are defined as tangible personal property that: (i) is acquired in or imported into the State to be forwarded to another location in the State or outside the State; (ii) is detained at a location in the State in which the owner of the property does not have a direct or indirect ownership interest for assembling, storing, manufacturing, processing or fabricating purposes by the person who acquired or imported the property; (iii) is transported to another location in the State or outside the State not later than 175 days after the date the person acquired the property in or imported the property into the State. 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. Section 11.253 of the Tax Code 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 only receive either the freeport exemption or the "goods-in-transit" exemption for items of personal property.

A city or county may create a tax increment financing district ("TIF") within the city or county 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. In addition, credit will not be given by the Commissioner of Education in determining a district's property value wealth per student for (1) the appraised value, in excess of the "frozen" value, of property that is located in a TIF created after May 31, 1999 (except in certain limited circumstances where the municipality creating the tax increment financing zone gave notice prior to May 31, 1999 to all other taxing units that levy ad valorem taxes in the TIF of its intention to create the TIF and the TIF was created and had its final project and financing plan approved by the municipality prior to August 31, 1999), or (2) for the loss of value of abated property under any abatement agreement entered into after May 31, 1993. Prior to September 1, 2001, school districts were allowed to enter into tax abatement agreements to encourage economic development. Under such agreements, a property owner agrees to construct certain improvements on its property. The school district in turn agrees not to levy a tax on all or part of the increased value attributable to the improvements until the expiration of the agreement. The abatement agreement could last for a period of up to 10 years. 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. Notwithstanding the foregoing, in 2001 the Legislature enacted legislation known as the Texas Economic Development Act, which provides incentives for school districts to grant limitations on appraised property values and provide ad valorem tax credits to certain corporations and limited liability companies to encourage economic development within the district. Generally, during the last eight years of the ten-year term of a tax limitation agreement, the school district may only levy and collect ad valorem taxes for maintenance and operation purposes on the agreed-to limited appraised property value. The taxpayer is entitled to a tax credit from the school district for the amount of taxes imposed during the first two years of the tax limitation agreement on the appraised value of the property above the agreed-to limited value. Additional State funding is provided to a school district for each year of such tax limitation in the amount of the tax credit provided to the taxpayer. During the first two years of a tax limitation agreement, the school district may not adopt a tax rate that exceeds the district's rollback tax rate (see "TAX INFORMATION - Public Hearing and Rollback Tax Rate").

**TAX RATE LIMITATIONS . . .** A school district is authorized to levy M&O taxes subject to approval of a proposition submitted to district voters under Section 45.003(d) of the Texas Education Code, as amended. The maximum M&O tax rate that may be levied by a district cannot exceed the voted maximum rate or the maximum rate described in the next succeeding paragraph. The maximum voted M&O tax rate for the District is \$1.50 per \$100 of assessed valuation as approved by the voters at an election held on September 8, 1973, under Chapter 45, Texas Education Code.

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 and (B) the sum of (1) the rate of \$0.17, and (2) the product of the "State Compression Percentage" multiplied by \$1.50. The State Compression Percentage has been set, and will remain, at 66.67% for fiscal years 2007-08 through 2012-13. The State Compression Percentage is set by legislative appropriation for each State fiscal biennium or, in the absence of legislative appropriation, by the Commissioner. For a more detailed description of the State Compression Percentage, see "CURRENT PUBLIC SCHOOL FINANCE SYSTEM - Local Funding for School Districts." Furthermore, a school district cannot annually increase its tax rate in excess of the district's "rollback tax rate" without submitting such tax rate to a referendum election and a

majority of the voters voting at such election approving the adopted rate. See "TAX INFORMATION - Public Hearing and Rollback Tax Rate."

A school district is also authorized to issue bonds and levy taxes for payment of bonds subject to voter approval of one or more propositions 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 issued for school building purposes pursuant to Chapter 45, Texas Education Code as new debt and are subject to the 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.

**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"). Effective June 19, 2009, 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 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.

By each September 1 or as soon thereafter as practicable, the Board of Trustees adopts a tax rate per \$100 taxable value for the current 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. Section 44.004(e) of the Texas Education Code provides that a person who owns taxable property in a school district is entitled to an injunction restraining the collection of taxes by the district if the district has not complied with such notice requirements or the language and format requirements of such notice as set forth in Section 44.004(b), (c) and (d) and if such failure to comply was not in good faith. Section 44.004(e) further provides the action to enjoin the collection of taxes must be filed before the date the district delivers substantially all of its tax bills. Furthermore, Section 26.05 of the Property Tax Code 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. 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.

**PROPERTY ASSESSMENT AND TAX PAYMENT . . .** Property within the District is generally assessed as of January 1 of each year. Business inventory may, at the option of the taxpayer, be assessed as of September 1. Oil and gas reserves are assessed on the basis of a valuation process which uses an average of the daily price of oil and gas for the prior year. Taxes become due October 1 of the same year, and become delinquent on February 1 of the following year. Taxpayers 65 years old or older are permitted by State law to pay taxes on homesteads in four installments with the first installment due on February 1 of each year and the final installment due on August 1.

**PENALTIES AND INTEREST...**Charges for penalty and interest on the unpaid balance of delinquent taxes are made as follows:

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

(a) After July, penalty remains at 12%, and interest accrues at a rate of one percent (1%) for each month or portion of a month the tax remains unpaid. A delinquent tax continues to accrue interest as long as the tax remains unpaid, regardless of whether a judgment for the delinquent tax has been rendered. The purpose of imposing such interest penalty is to compensate the taxing unit for revenue lost because of the delinquency. In addition, if a business personal property account is delinquent on April 1, an attorney’s collection fee of up to 20% may be added to the total tax, penalty & interest charge. If a real property account is delinquent on July 1, an attorney’s collection fee of up to 20% may be added to the total tax, penalty & interest charge.

Taxes levied by the District are a personal obligation of the owner of the property. On January 1 of each year, a tax lien attaches to property to secure the payment of all taxes, penalties and interest ultimately imposed for the year on the property. The lien exists in favor of the State and each taxing unit, including the District, having the power to tax the property. The District’s tax lien is on a parity with tax liens of all other such taxing units. A tax lien on real property has priority over the claim 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. The ability of the District to collect delinquent taxes by foreclosure may be adversely affected by the amount of taxes owed to other taxing units, adverse market conditions, taxpayer redemption rights, or bankruptcy proceedings which restrain the collection of a taxpayer’s debt. **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.**

**DISTRICT APPLICATION OF TAX CODE . . .** The District has not granted an exemption to the market value of the residence homestead of persons 65 years of age or older or the disabled.

The District has not granted any part of the local-option additional exemption of up to 20% of 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 nonbusiness personal property; and Lubbock Central Appraisal District collects taxes for the District.

The District does not permit split payments of taxes and discounts for the early payment of taxes are not allowed, though State law permits these options on a local-option basis.

The District does not grant the freeport property tax exemption.

The District does not tax goods-in-transit.

The District has not adopted a tax abatement policy and does not participate in any TIFs.

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

2011/12 Market Valuation Established by the Appraisal District (excluding totally exempt property)		\$ 294,722,615
Less Exemptions/Reductions at 100% Market Value:		
State Mandated-Residential Homestead Exemptions	\$ 17,857,985	
State Mandated-Over 65 Homestead Exemptions	2,787,230	
State Mandated-Disabled Homestead Exemptions	359,005	
Disabled Veterans Exemptions	518,316	
Productivity Loss	10,659,432	
Homestead Cap Adjustment	1,001,158	
House Bill 366 Exemptions	42,606	
Prorated Exempt Property	4,273	
Lease Vehicle Exemptions	405,184	
Freeze Value Loss	7,365,843	41,001,032
2011/12 Taxable Assessed Valuation		\$ 253,721,583
Debt Payable from Ad Valorem Taxes estimated as of 8/9/12		
Outstanding Unlimited Tax Bonds <sup>(1)</sup>	\$ 13,220,000	
The Bonds	17,990,000	
Total Debt Payable from Ad Valorem Taxes estimated as of 8/9/12 <sup>(1)</sup>		\$ 31,210,000
Ratio Tax Supported Debt to 2011/12 Taxable Assessed Valuation <sup>(1)</sup>		12.30%
Current Estimated District Population - 8,842 Per Capita 2011/12 Taxable Assessed Valuation - \$28,695 Per Capita General Obligation Debt - \$3,530		

(1) Excludes interest accreted on outstanding capital appreciation bonds.

**TABLE 2 - TAXABLE ASSESSED VALUATIONS BY CATEGORY**

Category	Taxable Appraised Value for Fiscal Year Ended August 31,					
	2012		2011		2010	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Real, Residential, Single-Family	\$146,092,082	49.57%	\$140,837,942	50.75%	\$137,062,455	53.60%
Real, Residential, Multi-Family	1,802,666	0.61%	1,798,879	0.65%	1,744,379	0.68%
Real, Vacant Lots/Tracts	3,611,351	1.23%	3,670,246	1.32%	4,132,297	1.62%
Acreage (Land Only)	27,703,527	9.40%	27,671,511	9.97%	27,490,503	10.75%
Farm & Ranch Improvements	10,402,511	3.53%	10,303,132	3.71%	10,067,402	3.94%
Commercial, Real	12,976,376	4.40%	12,220,306	4.40%	11,595,572	4.53%
Oil, Mineral & Gas	67,781,450	23.00%	54,921,510	19.79%	37,376,680	14.62%
Utilities	10,520,482	3.57%	9,431,562	3.40%	9,003,502	3.52%
Commercial, Personal	9,831,251	3.34%	12,806,831	4.62%	13,059,395	5.11%
Industrial, Personal	1,638,869	0.56%	1,689,810	0.61%	1,724,140	0.67%
Tangible Personal, Mobile Homes & Other	980,486	0.33%	1,025,191	0.37%	1,133,398	0.44%
Residential Inventory	1,369,900	0.46%	1,115,800	0.40%	1,342,572	0.52%
Special Inventory	11,664	0.00%	6,024	0.00%	3,755	0.00%
Total Appraised Value Before Exemptions	\$294,722,615	100.00%	\$277,498,744	100.00%	\$255,736,050	100.00%
Less: Total Exemptions/Reductions	(41,001,032)		(37,868,600)		(41,335,747)	
Taxable Assessed Value	<u>\$253,721,583</u>		<u>\$239,630,144</u>		<u>\$214,400,303</u>	

Category	Taxable Appraised Value for Fiscal Year Ended August 31,			
	2009		2008	
	Amount	% of Total	Amount	% of Total
Real, Residential, Single-Family	\$124,731,206	50.66%	\$121,151,848	53.70%
Real, Residential, Multi-Family	1,768,064	0.72%	1,731,806	0.77%
Real, Vacant Lots/Tracts	5,637,157	2.29%	3,333,843	1.48%
Acreage (Land Only)	27,495,835	11.17%	28,114,838	12.46%
Farm & Ranch Improvements	9,318,088	3.78%	9,389,483	4.16%
Commercial, Real	10,116,822	4.11%	6,813,707	3.02%
Oil, Mineral & Gas	43,696,970	17.75%	30,835,850	13.67%
Utilities	8,784,842	3.57%	8,474,751	3.76%
Commercial, Personal	11,396,247	4.63%	12,745,322	5.65%
Industrial, Personal	1,798,860	0.73%	1,708,390	0.76%
Mobile Homes	1,273,661	0.52%	1,300,639	0.58%
Residential Inventory	158,194	0.06%	12,950	0.01%
Special Inventory	20,000	0.01%	16,091	0.01%
Total Appraised Value Before Exemptions	\$246,195,946	100.00%	\$225,629,518	100.00%
Less: Total Exemptions/Reductions	(40,974,817)		(38,989,295)	
Taxable Assessed Value	<u>\$205,221,129</u>		<u>\$186,640,223</u>	

NOTE: Valuations shown are certified taxable assessed values reported by the Lubbock Central Appraisal District to the State Comptroller of Public Accounts. Certified values are subject to change throughout the year as contested values are resolved and the Appraisal District updates records.

**TABLE 3 - VALUATION AND TAX SUPPORTED DEBT HISTORY**

Fiscal Year Ended 8/31	Estimated Population <sup>(1)</sup>	Taxable Assessed Valuation <sup>(2)</sup>	Taxable Assessed Valuation Per Capita	Tax Debt Outstanding at End of Fiscal Year <sup>(3)</sup>	Ratio of Tax Debt to Taxable Assessed Valuation	Tax Debt Per Capita
2008	8,400	\$ 186,640,223	\$ 22,219	\$ 15,020,864	8.05%	\$ 1,788
2009	8,519	205,221,129	24,090	14,697,553	7.16%	1,725
2010	8,620	214,400,303	24,872	14,127,435	6.59%	1,639
2011	8,731	239,630,144	27,446	13,704,442	5.72%	1,570
2012	8,842	253,721,583	28,695	30,645,000 <sup>(4)</sup>	12.08% <sup>(4)</sup>	3,466 <sup>(4)</sup>

(1) Source: District Officials.

(2) As reported by the Lubbock Central Appraisal District on the District's annual State Property Tax Reports. Such values are subject to change during the ensuing year.

(3) Excludes interest accreted on outstanding capital appreciation bonds.

(4) Projected, includes the Bonds.

**TABLE 4 - TAX RATE, LEVY AND COLLECTION HISTORY**

Fiscal Year Ended 8/31	Tax Rate	Local Maintenance	Interest and Sinking Fund	Tax Levy	% Current Collections	% Total Collections
2008	\$ 1.41000	\$ 1.17000	\$ 0.24000	\$ 2,595,731	97.67%	100.07%
2009	1.40490	1.17000	0.23490	2,885,807	96.77%	98.27%
2010	1.41000	1.17000	0.24000	3,027,852	96.64%	98.56%
2011	1.41000	1.17000	0.24000	3,379,408	97.51%	100.22%
2012	1.41000	1.17000	0.24000	3,441,230	100.00% <sup>(1)</sup>	101.48% <sup>(1)</sup>

(1) Collections as of May 31, 2012.

**TABLE 5 - TEN LARGEST TAXPAYERS**

Name of Taxpayer	Nature of Property	2011/12 Taxable Assessed Valuation	% of Total Taxable Assessed Valuation
Merit Energy Company	Oil & Gas	\$ 24,559,720	9.68%
Texland Petroleum LP	Oil & Gas	11,199,141	4.41%
BNSF Railway Co.	Railroad	5,628,970	2.22%
Cove Petroleum Corp.	Oil & Gas	4,333,510	1.71%
Brown H L Operating LLC	Oil & Gas	4,073,350	1.61%
Plains Cotton Co-op Association	Cotton Gin	3,737,717	1.47%
Western Commercial LTD.	Real Estate	1,987,852	0.78%
Tamarack Petroleum Co. Unit WI	Oil & Gas	1,580,840	0.62%
South Plains Electric Co-op Inc.	Electric Utility	1,511,540	0.60%
Hohertz, Charles R.	Residential	1,457,549	0.57%
		<u>\$ 60,070,189</u>	<u>23.68%</u>

**TABLE 6 - ESTIMATED OVERLAPPING DEBT**

Expenditures of the various taxing entities within the territory of the District are paid out of ad valorem taxes levied by such entities on properties within the District. Such entities are independent of the District and may incur borrowings to finance their expenditures. This statement of direct and estimated overlapping ad valorem tax debt ("Tax Debt") was developed from information contained in "Texas Municipal Reports" published by the Municipal Advisory Council of Texas. Except for the amounts relating to the District, the District has not independently verified the accuracy or completeness of such information, and no person should rely upon such information as being accurate or complete. Furthermore, certain of the entities listed may have issued additional Tax Debt since the date hereof, and such entities may have programs requiring the issuance of substantial amounts of additional Tax Debt, the amount of which cannot be determined. The following table reflects the estimated share of overlapping Tax Debt of the District.

<u>Taxing Jurisdiction</u>	<u>2011/12 Taxable Assessed Value</u>	<u>2011/12 Tax Rate</u>	<u>Total Tax Supported Debt As Of 8/9/2012</u>	<u>Estimated % Applicable</u>	<u>Overlapping Tax Supported Debt As Of 8/9/2012</u>
Shallowater ISD	\$ 253,721,583	\$ 1.4100	\$ 31,210,000 <sup>(1)</sup>	100.00%	\$ 31,210,000 <sup>(1)</sup>
City of Shallowater	104,599,442	0.6000	0	100.00%	0
Lubbock County	13,779,575,406	0.3295	69,715,000	1.77%	<u>1,233,956</u>
Total Direct and Overlapping Tax Supported Debt					\$ 32,443,956
Ratio of Direct and Overlapping Tax Supported Debt to Taxable Assessed Valuation					12.79%
Per Capita Direct and Overlapping Tax Supported Debt					\$ 3,669

(1) Projected, includes the Bonds.

**DEBT INFORMATION**

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

Fiscal Year	Ending 8/31	Outstanding Debt <sup>(1)</sup>			The Bonds			Total Debt Service Requirements	% of Principal Retired
		Principal	Interest	Total	Principal	Interest	Total		
2012		\$ 484,442	\$ 739,401	\$ 1,223,844				\$ 1,223,844	1.53%
2013		290,000	576,263	866,263	260,000	813,200	813,200	1,679,462	2.44%
2014		305,000	566,813	871,813		797,269	1,057,269	1,929,081	4.23%
2015		315,000	556,913	871,913	305,000	791,809	1,096,809	1,968,722	6.18%
2016		330,000	546,444	876,444	320,000	782,550	1,102,550	1,978,994	8.23%
2017		340,000	534,900	874,900	380,000	768,550	1,148,550	2,023,450	10.50%
2018		355,000	522,375	877,375	415,000	750,575	1,165,575	2,042,950	12.93%
2019		370,000	509,913	879,913	425,000	729,575	1,154,575	2,034,488	15.44%
2020		390,000	496,388	886,388	460,000	707,450	1,167,450	2,053,838	18.12%
2021		400,000	480,706	880,706	510,000	683,200	1,193,200	2,073,906	21.00%
2022		425,000	463,756	888,756	550,000	656,700	1,206,700	2,095,456	24.07%
2023		445,000	445,881	890,881	565,000	628,825	1,193,825	2,084,706	27.26%
2024		430,000	427,038	857,038	595,000	599,825	1,194,825	2,051,863	30.49%
2025		450,000	407,188	857,188	635,000	569,075	1,204,075	2,061,263	33.92%
2026		770,000	379,313	1,149,313	375,000	547,575	922,575	2,071,888	37.53%
2027		810,000	342,938	1,152,938	395,000	536,025	931,025	2,083,963	41.33%
2028		845,000	304,831	1,149,831	420,000	519,600	939,600	2,089,431	45.32%
2029		890,000	264,563	1,154,563	445,000	502,147	947,147	2,101,709	49.53%
2030		935,000	221,888	1,156,888	475,000	483,319	958,319	2,115,206	53.98%
2031		980,000	176,672	1,156,672	490,000	463,481	953,481	2,110,153	58.62%
2032		730,000	135,525	865,525	665,000	444,297	1,109,297	1,974,822	63.02%
2033		765,000	99,084	864,084	690,000	421,000	1,111,000	1,975,084	67.61%
2034		805,000	60,816	865,816	715,000	396,413	1,111,413	1,977,228	72.41%
2035		845,000	20,597	865,597	740,000	370,950	1,110,950	1,976,547	77.41%
2036					1,665,000	316,375	1,981,375	1,981,375	82.66%
2037					1,750,000	231,000	1,981,000	1,981,000	88.18%
2038					1,825,000	141,625	1,966,625	1,966,625	93.94%
2039					1,920,000	48,000	1,968,000	1,968,000	100.00%
		<u>\$ 13,704,442</u>	<u>\$ 9,280,201</u>	<u>\$ 22,984,644</u>	<u>\$ 17,990,000</u>	<u>\$ 14,700,409</u>	<u>\$ 32,690,409</u>	<u>\$ 55,675,053</u>	

(1) "Outstanding Debt" does not include lease/purchase obligations.



**TABLE 8 - INTEREST AND SINKING FUND BUDGET PROJECTION <sup>(1)</sup>**

Tax Supported Debt Service Requirements, Fiscal Year Ending 8/31/12		\$ 1,223,844
Interest and Sinking Fund Balance (as of 8/31/11)	\$ 337,569	
Budgeted Interest and Sinking Fund Tax Revenues (at 99% collection)	566,617	
Existing Debt Allotment <sup>(1)</sup>	380,527	
Instructional Facilities Allotment Funds <sup>(1)</sup>	<u>259,531</u>	<u>\$ 1,544,244</u>
Estimated Balance, Fiscal Year Ending 8/31/12		<u><u>\$ 320,400</u></u>

(1) The amount of State aid for debt service may substantially differ from year to year, depending on a number of factors, including amounts, if any, appropriated for that purpose by the Texas Legislature. See "STATE AND LOCAL FUNDING OF SCHOOL DISTRICTS IN TEXAS."

**TABLE 9 - AUTHORIZED BUT UNISSUED UNLIMITED TAX BONDS**

After the issuance of the Bonds, the District will not have any outstanding authorized but unissued unlimited tax bonds.

**ANTICIPATED ISSUANCE OF ADDITIONAL UNLIMITED TAX DEBT . . .** The District does not anticipate the issuance of additional unlimited tax bonds within the next 12 months.

**TABLE 10 - OTHER OBLIGATIONS**

There are three capital leases for copiers. A copier lease for one copier originated in November 2007 for \$9,600. A copier lease for four additional copiers originated in September 2008 for \$22,334. Finally, another copier lease for five copiers originated in January 2011 for \$30,169. During the year the District made payments on these leases in the amount of \$37,630, including interest of \$3,106.

There were three capital leases for computers throughout the year. A computer lease was originated in September 2008 for \$93,111, another originated in March 2010 for \$178,786, and an additional lease originated in June 2011 for \$36,398. During the year the District made payments on these leases totaling \$108,726, including interest of \$10,920. The lease originating in March 2010 will be paid through the ARRA - IDEA, Part B shared service arrangement.

There are three capital leases for buses. The District entered into a lease for a bus in September 2008 for \$76,923. A lease for an additional bus originated in September 2009 for \$79,281. An additional bus lease originated in September 2010 for \$61,670. During the year the District made payments on these leases totaling \$76,450, including interest of \$3,373. The lease originating in September 2009 will be paid through the IDEA, Part B shared service arrangement.

The District also entered into a capital lease for a Dodge truck in February 2010 for \$30,169. During the year the District made payments on this lease totaling \$11,027, including \$1,912 in interest.

Future minimum payments for these leases are as follows:

FYE	Amount
<u>8-31</u>	
2012	\$ 144,953
2013	<u>35,816</u>
Total Payments	\$ 180,769
Less: Interest	<u>(12,762)</u>
Total Principal	<u><u>\$ 168,007</u></u>

**PENSION FUND...** Pension funds for employees of Texas school districts, and any employee in public education in Texas, are administered by the Teacher Retirement System of Texas (the "System"). The individual employees contribute a fixed amount of their salary to the System, currently 6.4%, and the State of Texas contributes funds to the System based on statutory required minimum salary for certified personnel, except any District personnel paid by Federally funded programs. For more detailed information concerning the retirement plan (see Appendix B, "Excerpts from the District's Annual Financial Report" - Note 10).

In addition to participation in the System, the District provides health care coverage for its employees. For a discussion of the District's medical benefit plan (see Appendix B, "Excerpts from the District's Annual Financial Report" - Note 12).

## FINANCIAL INFORMATION

**TABLE 11 - SCHEDULE OF CHANGES IN NET ASSETS**

	Fiscal Year Ended August 31				
	2011	2010	2009	2008	2007
<b>REVENUES:</b>					
<b>Program Revenues:</b>					
Charges for Services	\$ 1,068,957	\$ 483,985	\$ 1,470,175	\$ 112,192	\$ 1,067,644
Operating Grants and Contributions	3,713,420	5,140,568	2,754,654	4,459,057	3,101,475
<b>General Revenues:</b>					
Maintenance & Operations Taxes	2,840,324	2,534,980	2,400,648	2,179,335	2,141,954
Debt Service Taxes	582,420	545,514	481,276	446,011	468,103
State Aid - Not Restricted	8,370,191	8,374,480	8,332,316	8,142,445	6,945,381
Other Grants and Contributions	345,419	0	0	0	0
Investment Earnings	40,399	60,178	67,789	280,563	424,698
Miscellaneous	151,107	207,957	90,042	84,207	249,512
Total Revenues	<u>\$ 17,112,237</u>	<u>\$ 17,347,662</u>	<u>\$ 15,596,900</u>	<u>\$ 15,703,810</u>	<u>\$ 14,398,767</u>
<b>EXPENSES:</b>					
Instruction and Instructional-Related Services	\$ 8,804,047	\$ 9,587,642	\$ 8,617,298	\$ 7,821,599	\$ 7,116,086
Instructional and School Leadership	245,712	255,029	235,469	185,076	147,126
Curriculum and Instructional Staff Development	50,425	88,518	48,095	48,627	53,488
Instructional Leadership	274,059	282,901	292,458	310,825	312,324
School Leadership	791,214	768,421	694,389	630,945	620,094
Guidance, Counseling and Evaluation Services	949,377	936,183	845,661	791,769	712,494
Health Services	119,108	122,549	115,835	159,338	145,215
Student Transportation	491,935	451,886	402,039	452,531	505,852
Food Services	752,178	693,263	676,328	598,808	526,876
Co-Curricular/Extracurricular Activities	731,709	724,078	739,510	622,829	566,318
General Administration	448,368	594,786	528,480	516,122	490,892
Plant Maintenance and Data Processing	1,529,623	1,490,185	1,537,316	1,434,048	1,398,212
Security and Monitoring Services	77,457	69,976	67,062	74,525	59,972
Data Processing Services	254,648	237,428	191,834	149,893	238,620
Community Services	0	5,757	672	0	7,496
Debt Service	680,004	736,811	742,140	806,254	777,203
Bond Issuance Costs and Fees	(28,940)	(11,311)	33,332	(51,754)	(4,045)
Payments to Fiscal Agent/Member Districts	449,071	441,475	383,424	426,359	510,997
Payments to Juvenile Alternative Education Program	50,091	50,086	43,374	23,444	11,268
Other Intergovernmental Charges	35,606	35,871	24,694	0	0
Total Expenses	<u>\$ 16,705,692</u>	<u>\$ 17,561,534</u>	<u>\$ 16,219,410</u>	<u>\$ 15,001,238</u>	<u>\$ 14,196,488</u>
Increase in Net Assets	\$ 406,545	\$ (213,872)	\$ (622,510)	\$ 702,572	\$ 202,279
Net Assets Beginning	7,034,785	7,248,657	7,871,167	7,168,595	6,966,316
Net Assets at August 31	<u>\$ 7,441,330</u>	<u>\$ 7,034,785</u>	<u>\$ 7,248,657</u>	<u>\$ 7,871,167</u>	<u>\$ 7,168,595</u>

**TABLE 11A – SCHEDULE OF GENERAL FUND REVENUES AND EXPENDITURE HISTORY**

	Fiscal Years Ended August 31,				
	2011	2010	2009	2008	2007
<b>Revenues:</b>					
Local and Intermediate Sources	\$ 3,198,568	\$ 2,775,607	\$ 2,674,967	\$ 2,516,151	\$ 2,616,164
State Sources	8,867,927	8,846,532	8,679,134	8,606,799	7,270,446
Federal Sources	18,220	23,749	11,233	10,169	18,250
Total Revenues	<u>\$ 12,084,715</u>	<u>\$ 11,645,888</u>	<u>\$ 11,365,334</u>	<u>\$ 11,133,119</u>	<u>\$ 9,904,860</u>
<b>Expenditures:</b>					
Instruction	\$ 6,111,029	\$ 6,421,819	\$ 6,486,205	\$ 5,819,311	\$ 5,158,952
Instructional Resources and Media Services	222,669	233,360	215,630	168,549	131,906
Curriculum and Instructional Staff Development	26,070	148	16,354	27,085	23,232
Instructional Leadership	72,838	82,314	84,175	87,769	93,993
School Leadership	717,012	702,618	635,885	573,331	555,946
Guidance, Counseling and Evaluation Services	325,187	333,094	312,918	274,680	210,305
Health Services	103,419	105,672	100,359	121,863	109,325
Student (Pupil) Transportation	359,083	344,250	348,525	361,104	405,493
Food Services	5,894	5,179	11,598	3,351	5,128
Extracurricular Activities	663,088	681,495	677,194	565,956	507,733
General Administration	435,177	496,135	477,002	485,951	475,599
Plant Maintenance and Operations	1,488,179	1,459,173	1,433,497	1,438,569	1,284,715
Security and Monitoring Services	77,457	69,976	75,962	72,883	57,906
Data Processing Services	191,418	177,887	166,672	128,941	204,972
Debt Service-Principal	160,364	156,695	139,683	170,629	173,942
Debt Service-Interest	7,922	11,456	9,896	8,968	14,586
Facilities Acquisition and Construction	246,390	210,052	198,728	140,271	195,867
Payments to Fiscal Agent	175,982	219,179	218,688	168,045	146,949
Payments to Juvenile Alternative Education Program	50,091	50,086	68,068	23,444	11,268
Other Intergovernmental Charges	35,606	35,871	0	0	0
Total Expenditures	<u>\$ 11,474,875</u>	<u>\$ 11,796,459</u>	<u>\$ 11,677,039</u>	<u>\$ 10,640,700</u>	<u>\$ 9,767,817</u>
Other Resources and (Uses) & Special Items	<u>\$ 36,602</u>	<u>\$ 125,793</u>	<u>\$ 212,745</u>	<u>\$ 109,343</u>	<u>\$ 134,858</u>
Excess (Deficiency) of					
Revenues Over Expenditures	\$ 646,442	\$ (24,778)	\$ (98,960)	\$ 601,762	\$ 271,901
Beginning Fund Balance on					
September 1	<u>\$ 2,323,716</u>	<u>\$ 2,348,494</u>	<u>\$ 2,447,454</u>	<u>\$ 1,845,692</u>	<u>\$ 1,573,791</u>
Ending Fund Balance on					
August 31	<u>\$ 2,970,158</u>	<u>\$ 2,323,716</u>	<u>\$ 2,348,494</u>	<u>\$ 2,447,454</u>	<u>\$ 1,845,692</u>

**FINANCIAL POLICIES**

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the primary government. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities which rely to a significant extent on fees and charges for support.

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. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. 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 proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

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.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue 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 government 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.

Property taxes, franchise taxes, licenses, 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 government.

Budgetary Procedures . . . Prior to August 20 the District prepares a budget for the next succeeding fiscal year beginning September 1. The operating budget includes proposed expenditures and the means of financing them.

A meeting of the Board is then called for the purpose of adopting the proposed budget. At least ten days' public notice of the meeting must be given.

Prior to September 1, the budget is legally enacted through passage of a resolution by the Board. Once a budget is approved, it can only be amended at the function and fund level by approval of a majority of the members of the Board. Amendments are presented to the Board at its regular meetings. Each amendment must have Board approval. As required by law, such amendments are made before the fact, are reflected in the official minutes of the Board, and are not made after fiscal year end.

Each budget is controlled by the budget coordinator at the revenue and expenditure function/object level. Budgeted amounts are as amended by the Board. All budget appropriations lapse at year end.

Encumbrances for goods or purchases services are documented by purchase orders or contracts. Under Texas law, appropriations lapse at August 31, and encumbrances outstanding at that time are to be either canceled or appropriately provided for in the subsequent year's budget.

GASB 34 Statement . . . In June 1999, the Governmental Accounting Standards Board ("GASB") issued Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments" ("GASB 34"). The objective of GASB 34 is to enhance the clarity and usefulness of the general-purpose external financial reports of state and local governments to its citizenry, legislature and oversight bodies, and investors and creditors. The District implemented GASB 34 beginning with its fiscal year ending August 31, 2002. While adoption of GASB 34 has altered the presentation of the District's financial information, District management does not believe that adoption of GASB 34 has had any material adverse impact on the District's financial position, results of operation, or cash flows.

## **INVESTMENTS**

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

**INVESTMENT AUTHORITY AND INVESTMENT POLICIES...** 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 obligation, 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, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States; (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 and share certificates meeting the requirements of the Texas Public Funds Investment Act (Chapter 2256, Texas Government Code, as amended) that are (i) issued by an institution that has its main office or a branch office in the State of 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 or (ii) that are invested by the District through a depository institution that has its main office or a branch office in the State of Texas and otherwise meet the requirements of the Public Funds Investment Act; (8) fully collateralized repurchase agreements that have a defined termination date, are fully secured by a combination of cash and obligations described in clause (1) which are pledged to the District, 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 and are placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in the State (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 governmental body or a third party designated by the governmental body; (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) 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; (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 comply with the information requirements of the Securities Exchange Act of 1934 or the Investment Company Act of 1940 and have a dollar weighted average stated maturity of 90 days or fewer 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, and conform to the requirements set forth in Sections 2256.016(b) and (c) of the Texas Government Code, as amended, relating to the eligibility of investment pools to receive and invest funds of investing entities. 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 continuously 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.

Under Texas law, the District is required to invest its funds under written investment policies that primarily emphasize safety of principal and liquidity; that address investment diversification, yield, maturity, and the quality and capability of investment management; and that include a list of authorized investments for District funds, the maximum allowable stated maturity of any individual investment, the maximum average dollar-weighted maturity allowed for pooled fund groups, methods to monitor the market price of investments acquired with public funds, a requirement for settlement of all transactions, except investment pool funds and mutual funds, on a delivery versus payment basis, and procedures to monitor rating changes in investments acquired with public funds and the liquidation of such investments consistent with the Public Funds Investment Act. 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, the District's 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 probable income to be derived." At least quarterly the District's investment officers must submit an investment report to the Board of Trustees detailing: (1) the investment position of the District, (2) that all investment officers jointly prepared and signed the report, (3) the beginning market value, the ending market value and fully accrued interest during the reporting period of each pooled fund group, (4) the book value and market value of each separately listed asset at the 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 strategies and (b) Texas law. No person may invest District funds without express written authority from the Board of Trustees.

**ADDITIONAL PROVISIONS...**Under State 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 District 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, prohibit the investment in mutual funds of any portion of bond proceeds, reserves and funds held for debt service, and prohibit the investment of funds in either a money market or non-money market mutual fund in an amount that exceeds 10% of the total assets of such fund; (9) require local government investment pools to conform to advisory board requirements and the additional requirements set forth in Sections 2256.016(b) and (c) of the Texas Government Code, as amended; 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.

**TABLE 12 - CURRENT INVESTMENTS**

As of May 31, 2012, the District's investable funds were invested in the following categories:

Description of Investment	Market Value	Percent
Certificates of Deposit	\$ 1,000,000	34.78%
First State Bank	1,875,000	65.22%
	<u>\$ 2,875,000</u>	<u>100.00%</u>

**TAX MATTERS**

**OPINION . . .**The delivery of the Bonds is subject to the opinion of Bond Counsel to the effect that interest on the Bonds for federal income tax purposes (1) will be excludable from gross income, as defined in section 61 of the Internal Revenue Code of 1986, as amended to the date of such opinion (the "Code"), pursuant to section 103 of the Code and existing regulations, published rulings, and court decisions, and (2) will not be included in computing the alternative minimum taxable income of individuals and corporations except as described below in the discussion regarding the adjusted current earning adjustment for corporations. A form of Bond Counsel's opinion is reproduced as Appendix C. The statutes, regulations, rulings, and court decisions on which such opinion is based are subject to change.

In rendering the foregoing opinions, Bond Counsel will rely upon representations and certifications of the District made in a certificate dated the date of delivery of the Bonds pertaining to the use, expenditure, and investment of the proceeds of the Bonds and will assume continuing compliance by the District with the provisions of the Order subsequent to the issuance of the Bonds. The Order contains covenants by the District with respect to, among other matters, the use of the proceeds of the Bonds and the facilities financed therewith by persons other than state or local governmental units, the manner in which the proceeds of the Bonds are to be invested, the periodic calculation and payment to the United States Treasury of arbitrage "profits" from the investment of proceeds, and the reporting of certain information to the United States Treasury. Failure to comply with any of these covenants would cause interest on the Bonds to be includable in the gross income of the owners thereof for Federal income taxes from date of the issuance of the Bonds.

The Code also imposes a 20% alternative minimum tax on the "alternative minimum taxable income" of a corporation if the amount of such alternative minimum tax is greater than the corporation's regular income tax. Generally, the alternative minimum taxable income of a corporation (other than an S corporation, regulated investment company, REIT, REMIC or FASIT) includes 75% of the amount by which its "adjusted current earnings" exceed its other "alternative minimum taxable income." Because interest on tax-exempt obligations, such as the Bonds, is included in a corporation's "adjusted current earnings," ownership of the Bonds could subject a corporation to alternative minimum tax consequences.

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 Internal Revenue Service (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 tax-exempt 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 would 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. 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.

Except as described above, Bond Counsel expresses no other opinion with respect to any other federal, state or local tax consequences under present law, or proposed legislation, resulting from the 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 tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain foreign corporations doing business in the United States, S corporations with subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, owners of an interest in a financial asset securitization investment trust, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Prospective purchasers should consult their own tax advisors as to the applicability of these consequences to their particular circumstances.

**TAX ACCOUNTING TREATMENT OF DISCOUNT AND PREMIUM ON CERTAIN BONDS...**The initial public offering price of certain Bonds (the “Discount Bonds”) may be less than the amount payable on such Bonds at maturity. An amount equal to the difference between the initial public offering price of a Discount Bond (assuming that a substantial amount of the Discount Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes original issue discount to the initial purchaser of such Discount Bond. A portion of such original issue discount allocable to the holding period of such Discount Bond by the initial purchaser will, upon the disposition of such Discount Bond (including by reason of its payment at maturity), be treated as interest excludable from gross income, rather than as taxable gain, for federal income tax purposes, on the same terms and conditions as those for other interest on the Bonds described above under “Tax Exemption.” Such interest is considered to be accrued actuarially in accordance with the constant interest method over the life of a Discount Bond, taking into account the semiannual compounding of accrued interest, at the yield to maturity on such Discount Bond and generally will be allocated to an original purchaser in a different amount from the amount of the payment denominated as interest actually received by the original purchaser during the tax year.

However, such interest may be required to be taken into account in determining the amount of the branch profits tax applicable to certain foreign corporations doing business in the United States, even though there will not be a corresponding cash payment. In addition, the accrual of such interest may result in certain other collateral federal income tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, S corporations with “subchapter C” earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Moreover, in the event of the redemption, sale or other taxable disposition of a Discount Bond by the initial owner prior to maturity, the amount realized by such owner in excess of the basis of such Discount Bond in the hands of such owner (adjusted upward by the portion of the original issue discount allocable to the period for which such Discount Bond was held) is includable in gross income.

Owners of Discount Bonds should consult with their own tax advisors with respect to the determination of accrued original issue discount on Discount Bonds for federal income tax purposes and with respect to the state and local tax consequences of owning and disposing of Discount Bonds. It is possible that, under applicable provisions governing determination of state and local income taxes, accrued interest on Discount Bonds may be deemed to be received in the year of accrual even though there will not be a corresponding cash payment.

The initial public offering price of certain Bonds (the “Premium Bonds”) may be greater than the amount payable on such Bonds at maturity. An amount equal to the difference between the initial public offering price of a Premium Bond (assuming that a substantial amount of the Premium Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes premium to the initial purchaser of such Premium Bonds. The basis for federal income tax purposes of a Premium Bond in the hands of such initial purchaser must be reduced each year by the amortizable bond premium, although no federal income tax deduction is allowed as a result of such reduction in basis for amortizable bond premium. Such reduction in basis will increase the amount of any gain (or decrease the amount of any loss) to be recognized for federal income tax purposes upon a sale or other taxable disposition of a Premium Bond. The amount of premium which is amortizable each year by an initial purchaser is determined by using such purchaser’s yield to maturity.

Purchasers of the Premium Bonds should consult with their own tax advisors with respect to the determination of amortizable bond premium on Premium Bonds for federal income tax purposes and with respect to the state and local tax consequences of owning and disposing of Premium Bonds.

## CONTINUING DISCLOSURE 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 certain specified events, to the Municipal Securities Rulemaking Board (the "MSRB"). See "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM" for a description of the TEA's continuing disclosure undertaking to provide certain updated financial information and operating data annually with respect to the Permanent School Fund and the State of Texas, as the case may be, and to provide timely notice of certain specified events related to the guarantee to the MSRB.

**ANNUAL REPORTS** . . . The District will provide certain updated financial information and operating data to the MSRB annually. The information to be updated includes all quantitative financial information and operating data with respect to the District of the general type included in this Official Statement under Tables numbered 1 through 5 and 7 through 12 and in Appendix B. The District will update and provide this information within six months after the end of each fiscal year ending in and after 2012. The District will provide the updated information to the MSRB in electronic format, which will be available to the public free of charge via the Electronic Municipal Market Access ("EMMA") system at [www.emma.msrb.org](http://www.emma.msrb.org).

The financial information and operating data to be provided may be set forth in full in one or more documents or may be included by specific reference to any document available to the public on the MSRB's Internet Web site or filed with the United States Securities and Exchange Commission (the "SEC"), as permitted by SEC Rule 15c2-12 (the "Rule"). The updated information will include audited financial statements, if the District commissions an audit and it is completed by the required time. If audited financial statements are not available by the required time, the District will provide unaudited financial information of the type described in the preceding paragraph by the required time and audited financial statements when and if such audited financial statements 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 August 31. Accordingly, it must provide updated information by the last day of February in each year following the end of its fiscal year, unless the District changes its fiscal year. If the District changes its fiscal year, it will notify the MSRB of the change.

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

For these purposes, any event described in (12) in the immediately preceding paragraph is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent, or similar officer for the District in a proceeding under the United States Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the District, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement, or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the District.

**AVAILABILITY OF INFORMATION FROM MSRB** . . . The District has agreed to provide the foregoing information only as described above. Investors will be able to access continuing disclosure information filed with the MSRB free of charge at [www.emma.msrb.org](http://www.emma.msrb.org).

**LIMITATIONS AND AMENDMENTS** . . . The District has agreed to update information and to provide notices of certain specified 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 is



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 the 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 and beneficial owners of the Bonds may seek a writ of mandamus to compel the District to comply with its agreement.

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 (1) the agreement, as amended would have permitted an underwriter to purchase or sell the Bonds in the offering made hereby in compliance with the Rule, taking into account any amendments or interpretations of the Rule since such offering as well as such changed circumstances, and (2) either (a) the registered owners of a majority in aggregate principal amount (or any greater amount required by any other provisions of the Order that authorizes such amendment) of the outstanding Bonds consent to such amendment or (b) a person that is unaffiliated with the District (such as nationally recognized bond counsel) determined that such amendment will not materially impair the interest of the registered owners and beneficial owners of the Bonds. The District may also amend or repeal the provisions of this continuing disclosure agreement if the SEC amends or repeals the applicable provisions of the Rule 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 in the primary offering of the Bonds. If the District amends its agreement, it must include with the next financial information and operating data 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 type of information and data provided.

**COMPLIANCE WITH PRIOR UNDERTAKINGS...** During the last five years, the District has complied in all material respects with all continuing disclosure agreements made by it in accordance with the Rule.

## OTHER INFORMATION

### RATINGS

The Bonds have been rated "AAA" by Standard & Poor's Ratings Services, a Standard & Poor's Financial Services LLC business ("S&P") by virtue of the guarantee of the Permanent School Fund of the State of Texas, as S&P generally rates all bond issues guaranteed by the Permanent School Fund of the State of Texas "AAA". **Such rating is based solely upon the Permanent School Fund Guarantee and the Bonds did not receive an underlying rating.** An explanation of the significance of such rating may be obtained from the company furnishing the rating. The rating reflect only the respective view of such organization and the District makes no representation as to the appropriateness of the rating. There is no assurance that such rating will continue for any given period of time or that it will not be revised downward or withdrawn entirely by such rating company, if in the judgment of such company, circumstances so warrant. Any such downward revision or withdrawal of such rating may have an adverse effect on the market price of the Bonds.

### LITIGATION

The District is not a party to any litigation or other proceeding pending or to its knowledge, threatened, in any court, agency or other administrative body (either state or federal) which, if decided adversely to the District, would have a material adverse effect on the financial condition of the District.

### REGISTRATION AND QUALIFICATION OF BONDS FOR SALE

The sale of the Bonds has not been registered 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 qualified under the Securities Act of Texas in reliance upon various exemptions contained therein; nor have the Bonds been qualified under the securities acts of any jurisdiction. The District assumes no responsibility for qualification of the Bonds under the securities laws of any jurisdiction in which the Bonds may be sold, assigned, pledged, hypothecated or otherwise transferred. This disclaimer of responsibility for 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 provisions.

### LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS

Section 1201.041 of the Public Security Procedures Act (Chapter 1201, Texas Government Code) provides that the Bonds are negotiable instruments, investment securities governed by Chapter 8, Texas Business and Commerce Code, and are legal and authorized investments for insurance companies, fiduciaries, and trustees, and for the sinking funds of municipalities or other political subdivisions or public agencies of the State of Texas. With respect to investment in the Bonds by municipalities or other political subdivisions or public agencies of the State of Texas, the Public Funds Investment Act, Chapter 2256, Texas Government Code, requires that the Bonds be assigned a rating of not less than "A" or its equivalent as to investment quality by a national rating agency. See "OTHER INFORMATION - Ratings" herein. 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 capital of one million dollars or more, and savings and loan associations. The Bonds are eligible to secure deposits of any public funds of the State, its agencies, and its political subdivisions, and are legal security for those deposits to

the extent of their market value. No review by the District has been made of the laws in other states to determine whether the Bonds are legal investments for various institutions in those states.

#### **LEGAL MATTERS**

The District will furnish to the Underwriters a complete transcript of proceedings had incident to the authorization and issuance of the Bonds, including the unqualified approving legal opinion of the Attorney General of Texas as to the Bonds to the effect that the Bonds are valid and legally binding obligations of the District, and based upon examination of such transcript of proceedings, the approving legal opinion of Bond Counsel with respect to the Bonds issued in compliance with the provisions of the Order, form of which opinion are attached to this Official Statement as Appendix C. Though it represents the Financial Advisor and the Underwriters from time to time in matters unrelated to the issuance of the Bonds, Bond Counsel has been engaged by and only represents the District in connection with the issuance of the Bonds. The customary closing papers, including a certificate to the effect that no litigation of any nature has been filed or is then pending to restrain the issuance and delivery of the Bonds which would affect the provision made for their payment or security or in any manner questioning the validity of said Bonds will also be furnished to the Underwriters. Bond Counsel was not requested to participate, and did not take part, in the preparation of the Official Statement, and such firm has not assumed any responsibility with respect thereto or undertaken independently to verify any of the information contained herein, except that, in its capacity as Bond Counsel, such firm has reviewed the information under the captions and subcaptions "THE BONDS" (excluding the information under the subcaptions "Permanent School Fund Guarantee," "Book-Entry-Only-System", "Sources and Uses of Proceeds" and "Bondholders' Remedies"), "STATE AND LOCAL FUNDING OF SCHOOL DISTRICTS IN TEXAS", "CURRENT PUBLIC SCHOOL FINANCE SYSTEM" (except under the subcaption "The School Finance System as Applied to the District"), "TAX INFORMATION – Tax Rate Limitations" (first paragraph only), "TAX MATTERS", "CONTINUING DISCLOSURE INFORMATION" (excluding the information under the subcaption "Compliance with Prior Undertakings" and "Availability of Information from MSRB"), "OTHER INFORMATION - Legal Investments and Eligibility to Secure Public Funds In Texas", "OTHER INFORMATION – Registration and Qualification of Bonds for Sale" and "OTHER INFORMATION - Legal Matters" (excluding the last sentence of the first paragraph thereof) in the Official Statement and such firms are of the opinion that the information relating to the Bonds and the legal issues contained under such captions and subcaptions is an accurate and fair description of the laws and legal issues addressed therein and, with respect to the Bonds, such information conforms to the provisions of the Order. The legal fee to be paid to Bond Counsel for services rendered in connection with the issuance of the Bonds is contingent upon the sale and delivery of the Bonds. Certain legal matters will be passed upon for the Underwriters by their counsel, Andrews Kurth LLP, Austin, Texas.

The legal opinion to be delivered concurrently with the delivery of the Bonds express the professional judgment of the attorneys rendering the opinion as to the legal issues explicitly addressed therein. In rendering a legal opinion, the attorney does not become an insurer or guarantor of that 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**

First Southwest Company is employed as Financial Advisor to the District in connection with the issuance of the Bonds. The Financial Advisor's fee for services rendered with respect to the sale of the Bonds is contingent upon the issuance and delivery of the Bonds. First Southwest Company, 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. In the normal course of business, the Financial Advisor may also from time to time sell investment securities to the District for the investment of bond proceeds or other funds of the District upon the request of the District.

The Financial Advisor to the District has provided the following sentence for inclusion in this Official Statement. The Financial Advisor has reviewed the information in this Official Statement in accordance with, and as part of, its responsibilities to the District and, as applicable, to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Financial Advisor does not guarantee the accuracy or completeness of such information.

#### **UNDERWRITING**

The Underwriters have agreed, subject to certain conditions, to purchase the Bonds from the District at a price equal to the initial offering prices to the public, as shown on the inside cover page of this Official Statement, less an underwriting discount of \$121,770.90. The Underwriters will be obligated to purchase all of the Bonds if any Bonds are purchased. The Bonds to be offered to the public may be offered and sold to certain dealers (including the Underwriters and other dealers depositing Bonds into investment trusts) at prices lower than the public offering prices of such Bonds, and such public offering prices may be changed, from time to time, by the Underwriters.

The Underwriters have reviewed the information in this Official Statement pursuant to their responsibilities to investors under the federal securities laws, but the Underwriters do not guarantee the accuracy or completeness of such information.

**FORWARD-LOOKING STATEMENTS DISCLAIMER**

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. The District's actual results could differ materially from those discussed in such forward-looking statements.

The forward-looking statements included 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 will prove to be accurate.

**MISCELLANEOUS**

The financial data and other information contained herein have been obtained from the District's records, audited financial statements and other sources which are believed to be reliable. There is no guarantee that any of the assumptions or estimates contained herein will be realized. All of the summaries of the statutes, documents and order contained in this Official Statement are made subject to all of the provisions of such statutes, documents and orders. These summaries do not purport to be complete statements of such provisions and reference is made to such documents for further information. Reference is made to original documents in all respects.

The Order approved the form and content of this Official Statement, and any addenda, supplement or amendment thereto, and authorized its use in the reoffering of the Bonds by the Underwriters.

DAVID BLACKBURN  
President, Board of Trustees  
Shallowater Independent School District

ATTEST:

CAMIE DAVIS  
Secretary, Board of Trustees  
Shallowater Independent School District

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**APPENDIX A**

GENERAL INFORMATION REGARDING THE DISTRICT

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**THE DISTRICT**

The Shallowater Independent School District (the “District”) is an agricultural area located in Lubbock County. The District has an estimated population of 8,842 and includes the City of Shallowater (the “City”). Lubbock County is located in northwest Texas and has an economy based on agriculture, manufacturing, higher education and medical services.

**DISTRICT ENROLLMENT**

FYE 8/31	Total Enrollment
2008	1,384
2009	1,434
2010	1,457
2011	1,506
2012	1,590

Source: The District.

**EMPLOYEE INFORMATION**

<u>Shallowater Independent School District</u>	
Number of teachers holding masters degrees	18
Number of teachers holding bachelors degrees	100
Employee Information	
Number of Employees	228
Number of Teachers	118
Pupil/Teacher ratios:	
Elementary School	16.6:1
Intermediate School	14.8:1
Middle School	13.0:1
High School	9.9:1

Source: The District.

**CAMPUS INFORMATION**

<u>Campus</u>	<u>Number of Schools</u>	<u>Capacity</u>	<u>Number of Portables</u>
Elementary Schools	1	300	0
Intermediate Schools	1	300	0
Middle Schools	1	525	0
High Schools plus AEP Center	2	300	8
Totals	<u>5</u>	<u>1,425</u>	<u>8</u>

Source: The District.

**HISTORICAL EMPLOYMENT DATA (ANNUAL AVERAGE DATA)**

	Annual Averages				
	2011	2010	2009	2008	2007
<b>Lubbock County</b>					
Civilian Labor Force	144,509	143,869	141,908	138,119	135,925
Total Employment	135,332	134,995	134,304	132,896	130,989
Unemployment	9,177	8,874	7,604	5,223	4,936
Percent Unemployment	6.4%	6.2%	5.4%	3.8%	3.6%
<b>State of Texas</b>					
Civilian Labor Force	12,273,385	12,136,384	11,930,847	11,635,095	11,421,105
Total Employment	11,271,945	11,141,903	11,020,226	11,059,298	10,921,706
Unemployment	1,001,440	994,481	910,621	575,797	499,399
Percent Unemployment	8.2%	8.2%	7.6%	4.9%	4.4%

Source: Texas Employment Commission.



**APPENDIX B**

EXCERPTS FROM THE  
SHALLOWATER INDEPENDENT SCHOOL DISTRICT

ANNUAL FINANCIAL REPORT

For the Year Ended August 31, 2011

The information contained in this Appendix consists of excerpts from the Shallowater Independent School District Annual Financial Report for the Year Ended August 31, 2011, and is not intended to be a complete statement of the District's financial condition. Reference is made to the complete Report for further information.

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**BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.**

**CERTIFIED PUBLIC ACCOUNTANTS**

**PHONE: (806) 747-3806**

**FAX: (806) 747-3815**

**8215 NASHVILLE AVENUE**

**LUBBOCK, TEXAS 79423-1954**

Independent Auditors' Report

**UNQUALIFIED OPINION ON THE BASIC FINANCIAL STATEMENTS**

Board of School Trustees  
Shallowater Independent School District  
Shallowater, Texas

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Shallowater Independent School District (the District), as of and for the year ended August 31, 2011, 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 administrators. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Shallowater Independent School District, as of August 31, 2011, and the respective changes in financial position and where applicable, the cash flows, 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 November 8, 2011, 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.

The Management's Discussion and Analysis and budgetary comparison information on pages 3-9 and 35, 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 Shallowater Independent School 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. The other supplementary information, including the Texas Education Agency required schedules, listed in the table of contents are likewise presented for purposes of additional analysis and not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

*Bolinger, Segars, Gilbert & Moss LLP*

Certified Public Accountants

November 8, 2011

## **SHALLOWATER INDEPENDENT SCHOOL DISTRICT MANAGEMENT'S DISCUSSION AND ANALYSIS**

### **INTRODUCTION**

Our discussion and analysis of the Shallowater Independent School District's (the District) financial performance provides an overview of the District's financial performance for the year ended August 31, 2011. It should be read in conjunction with the District's Basic Financial Statements and Independent Auditors' Report.

The Management's Discussion and Analysis (MD&A) is an element of the new financial reporting model adopted by the Governmental Accounting Standards Board (GASB) in their Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, issued June, 1999. The Texas Education Agency mandated all school districts in Texas adopt the new financial reporting model effective September 1, 2001.

### **FINANCIAL HIGHLIGHTS**

- The net assets of the District increased by \$406,545. The District's statement of activities showed total revenues were \$17,112,237, and expenses totaled \$16,705,692.
- The District ended the year, August 31, 2011, with total net assets of \$7,441,330, including unrestricted net assets of \$3,382,732. The balance of cash and investments at August 31, 2011, was \$3,463,133.
- The District made principal payments on bonds of \$422,993 and accreted interest on those bonds totaling \$39,869. Bonds Payable and Interest Payable on those bonds at August 31, 2011 total \$13,816,098. This compares to a balance of \$14,127,435 in 2010.
- During the year, the District approved new capital leases for computers and a bus for a total of \$101,068. The District made principal payments on capital leases and notes payable totaling \$239,457. Total Capital Leases Payable at August 31, 2011 was \$168,008. This compares to a balance of \$281,462 in 2010. The Note Payable was paid off at August 31, 2011. This compares to a balance of \$24,935 in 2010.
- Total government-wide expenses were \$16,705,692 for the year ended August 31, 2011. This compares with expenses of \$17,561,534 for the year ended August 31, 2010.
- The District's total revenues on the Statement of Activities decreased from \$17,347,662 in 2009-10 to \$17,112,237 in 2010-11.

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

This annual report consists of a series of financial statements and notes to those statements. The statements are organized so the reader can understand the District as a whole and then proceed to provide an increasingly detailed look at specific financial activities.

The government-wide financial statements include the Statement of Net Assets and the Statement of Activities. These provide information about the activities of the District as a whole and present a longer-term view of the District's property and debt obligations and other financial matters. They reflect the flow of total economic resources in a manner similar to the financial reports of a business enterprise.

Fund financial statements report the District's operations in more detail than the government-wide statements by providing information about the District's most significant funds. For governmental activities, these statements tell how services were financed in the short-term as well as what resources remain for future spending. They reflect the flow of current financial resources and supply the basis for tax levies and the appropriations budget. For proprietary activities, fund financial statements tell how the services of the District were sold to departments within the District. The fiduciary statements provide financial information about activities for which the District acts solely as a trustee.

The notes to the financial statements provide narrative explanations and additional data needed for full disclosure in the government-wide statements and the fund financial statements.

The combining statements for non-major funds contain information about the District's individual non-major funds. The sections labeled TEA Required Schedules and Federal Awards Section contain data used by monitoring or regulatory agencies for assurance that the District is using funds supplied in compliance with the terms of grants.

## **Reporting the District as a Whole**

### ***Government-Wide Financial Statements***

The analysis of the District's overall financial condition and operations is presented in the Statement of Net Assets and the Statement of Activities. Its primary purpose is to show whether the District is better off or worse off as a result of the year's activities. The Statement of Net Assets includes all the District's assets and liabilities at the end of the year while the Statement of Activities includes all the revenues and expenses generated by the District's operations during the year. These statements apply the accrual basis of accounting which is the basis used by private sector companies.

All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. The District's revenues are divided into those provided by outside parties who share the costs of some programs, such as tuition received from students from outside the district and grants provided by the U.S. Department of Education to assist children with disabilities or from disadvantaged backgrounds (program revenues), and revenues provided by the taxpayers or by TEA in equalization funding processes (general revenues). All the District's assets are reported whether they serve the current year or future years. Liabilities are considered regardless of whether they must be paid in the current or future years.

These two statements report the District's net assets and changes in them. The District's net assets (the difference between assets and liabilities) provide one measure of the District's financial health, or financial position. Over time, increases or decreases in the District's net assets are one indicator of whether its financial health is improving or deteriorating. To fully assess the overall health of the District, however, you should consider nonfinancial factors as well, such as changes in the District's average daily attendance or its property tax base and the condition of the District's facilities.

In the Statement of Net Assets and the Statement of Activities, the District is reporting its governmental activities. The District currently has no business-type activities or component units as defined in the GASB Statement No. 34.

- Governmental activities – All of the District's basic services are reported here, including the instruction, counseling, co-curricular activities, food services, transportation, maintenance, community services, and general administration. Property taxes, tuition, fees, and state and federal grants finance most of these activities.

## **Reporting the District's Most Significant Funds**

### ***Fund Financial Statements***

The fund financial statements provide detailed information about the most significant funds—not the District as a whole. Laws and contracts require the District to establish some funds, such as grants received from the U.S. Department of Education through TEA. The District's administration establishes many other funds to help it control and manage money for particular purposes. The District's three fund types – governmental, proprietary, and fiduciary – use different accounting approaches.

- Governmental funds – Most of the District's basic services are included in governmental funds. These use modified accrual accounting (a method that measures the receipt and disbursement of cash and all other financial assets that can be readily converted to cash) and report balances that are available for future spending. The governmental fund statements provide a detailed short-term view of the District's general operations and the basic services it provides. We describe the differences between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in reconciliation schedules following the fund financial statements.
- Proprietary funds – The District reports the activities for which it charges users (other units of the District) in proprietary funds using the same accounting methods employed in the Statement of Net Assets and the Statement of Activities. The internal service funds (the District's only category of proprietary funds) report activities that provide worker's compensation insurance coverage to the District's other programs and activities.
- Fiduciary funds – The District is the trustee, or fiduciary, for money raised by student activities. The District is responsible for ensuring that the assets reported in these funds are used only for their intended purposes and by those to whom the assets belong. We exclude these activities from the government-wide financial statements because the District cannot use these assets to finance its operations.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

Our analysis focuses on the net assets (Table I) and changes in net assets (Table II) of the District's governmental and business-type activities.

**Table I**  
**Shallowater Independent School District**  
**Net Assets**  
**August 31, 2011 and 2010**

	August 31,	
	2011	2010
Cash and Temporary Investments	\$ 3,463,133	\$ 3,085,673
Receivables and Deferred Expenditures	939,127	854,729
Unamortized Bond Issue Costs and Premium	259,799	290,720
Capital Assets, Net of Accumulated Depreciation	17,445,597	18,195,664
Total Assets	<u>\$ 22,107,656</u>	<u>\$ 22,426,786</u>
Current Liabilities and Deferred Revenues	\$ 463,305	\$ 606,307
Long-Term Liabilities	13,984,105	14,505,619
Unamortized Bond Premium	218,916	280,075
Total Liabilities	<u>\$ 14,666,326</u>	<u>\$ 15,392,001</u>
Net Assets		
Invested in Capital Assets Net of Related Debt	\$ 3,502,375	\$ 3,700,690
Restricted for Debt Service	375,585	228,512
Restricted for Federal Programs	280,638	501,207
Unrestricted Net Assets	3,282,732	2,604,376
Total Net Assets	<u>\$ 7,441,330</u>	<u>\$ 7,034,785</u>

## Changes in Net Assets

The District's net assets increased during the year ended August 31, 2011, by \$406,545 (see Table II). Unrestricted net assets – the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements – increased \$686,212 from \$2,637,504 in 2010 to \$3,323,716 in 2011.

**Table II**  
**Shallowater Independent School District**  
**Changes in Net Assets**  
**For the Years Ended August 31, 2011 and 2010**

	August 31,	
	2011	2010
Revenues:		
Program Revenues:		
Charges For Services	\$ 1,068,957	\$ 483,985
Operating Grants and Contributions	3,713,420	5,140,568
General Revenues:		
Maintenance and Operations Taxes	2,840,324	2,534,980
Debt Service Taxes	582,420	545,514
State Aid - Formula Grants	8,370,191	8,374,480
Other Grants and Contributions	345,419	
Investment Earnings	40,399	60,178
Miscellaneous	151,107	207,957
Total Revenue	<u>\$ 17,112,237</u>	<u>\$ 17,347,662</u>
Expenses:		
Instruction	\$ 8,804,047	\$ 9,587,642
Instructional Resources and Media Services	245,712	255,029
Curriculum and Instructional Staff Development	50,425	88,518
Instructional Leadership	274,059	282,901
School Leadership	791,214	768,421
Guidance, Counseling, and Evaluation Services	949,377	936,183
Health Services	119,108	122,549
Student Transportation	491,935	451,886
Food Services	752,178	693,263
Co-curricular / Extracurricular Activities	731,709	724,078
General Administration	448,368	594,786
Plant Maintenance and Data Processing	1,529,623	1,490,185
Security and Monitoring Services	77,457	69,976
Data Processing Services	254,648	237,428
Community Services		5,757
Debt Service	680,004	736,811
Bond Issuance Costs and Fees	(28,940)	(11,311)
Payments to Fiscal Agent/Member Districts	449,071	441,475
Payments to Juvenile Alternative Education Program	50,091	50,086
Other Intergovernmental Charges	35,606	35,871
	<u>\$ 16,705,692</u>	<u>\$ 17,561,534</u>
Increase (Decrease) in Net Assets	\$ 406,545	\$ (213,872)
Net Assets - Beginning of Year	<u>7,034,785</u>	<u>7,248,657</u>
Net Assets - End of Year	<u>\$ 7,441,330</u>	<u>\$ 7,034,785</u>



The District's total revenues decreased from \$17,347,662 in fiscal year 2010 to \$17,112,237 in fiscal year 2011, a decrease of \$235,425. This decrease is largely due to the decrease in federal funding with a large amount of funding provided through the American Recovery and Reinvestment Act in the previous year. The total expenses of the District decreased by \$855,842, from \$17,561,534 to \$16,705,692. This decrease is attributable to a large decrease expenditures in Instruction.

Other factors impacting the District's financial position include the following:

- The District appraised valuation of taxable property increased from \$214,741,294 to \$239,674,294, an increase of 11.6%. This increase is attributable largely to property reappraisals. The total school property taxes assessed for school year 2011 were \$3,379,408. This is an increase of \$351,556 from the \$3,027,852 assessed in 2010.
- Total tax collections for 2011 were \$3,386,961 (100.2% of the current year levy). The tax collections for 2010 were \$2,984,294 (98.6% of that year's levy).

### **Fund Balances**

The District's total Governmental Funds fund balance was \$3,588,365. This fund balance is reported in the various Governmental funds as follows:

General Fund \$2,970,158. Of this balance, \$1,190,000 is assigned for future construction and equipment purchases and other expenditures. This balance is available for current spending; however, it has been the practice of the District to try and maintain a fund balance that is at least several months operating expenses. The balance in the General Fund in 2010 was \$2,323,716.

Debt Service Fund \$337,569. This balance is reserved for extinguishing of long-term debt. The fund balance reserved for Debt Service in 2010 was \$187,527.

Special Revenue Fund \$280,638. The District serves as fiscal agent for the H.O.N.D.A. Special Education Cooperative. This entire balance is restricted for use in the Special Education Cooperative. The fund balance reserved in 2010 was \$501,207.

### **Budgetary Highlights**

Over the course of the year, the Board of Trustees revised the District's budget several times. These budget amendments were necessary to reflect the revised estimates of revenues and expenses. The largest amendments were increases in facilities acquisition and construction expenditures with an offset to other financing sources-capital leases for the copiers, computers, and busses acquired.

### **CAPITAL ASSET AND DEBT ADMINISTRATION**

#### Capital Assets

At the end of 2011, the District had \$17,445,597 of capital assets, net of accumulated depreciation. Financial statement Footnote No. 6 discloses the capital asset activity of the District for the year ended August 31, 2011.

#### Debt

At August 31, 2011, the District's long-term debt included \$13,816,098 in Bonds Payable and \$168,008 in Capital Leases Payable. The funding for the payment of these leases and bonds come from operating revenues. Interest and Sinking property taxes will assist in making bond payments. Financial statement Footnote No. 8 discloses the debt activity of the District for the year ended August 31, 2011.

## **FACTORS BEARING ON THE DISTRICT'S FUTURE**

The process of setting the District's annual fiscal year budget and tax rate continues to present numerous challenges for the District's elected and appointed officials. The economy, which affects the rising cost of goods, fuel, and services along with our increasing enrollment naturally necessitate a higher level of revenue needed in order to sustain the type of educational environment we have developed for the students of our district. Beginning with the 2011-12 budget year public schools are faced with major shortfalls in state funding due to the massive budget crises at the state level. The financial shortfall in the state's budget that we have been predicting ever since the passage of HB 1 from the 79<sup>th</sup> Legislature, 3rd Called Session which was centered around tax payer relief has become our reality. With the cooperation of our staff the district was able to make an addition to the general operating fund balance at the end of the 2010-2011 fiscal year which is a huge financial benefit due to the fact that we know that there will be a lack of state funding until the state financial crisis is resolved. Knowing that our Maintenance and Operating tax rate is at the maximum level allowed (\$1.17/\$100), due to the Rollback Referendum which was approved by voters on November 6, 2007, and trying to prepare ourselves for anticipated state funding cuts estimated at \$5.4 billion to public schools, school leaders were forced to find any way possible to reduce staff payroll expenses, travel expense and supplies allowances as we began our budget planning for the 2011-12 fiscal year. The district initially offered all staff an "Early Resignation Incentive Payment" of \$2000 if a resignation was submitted by April 4, 2011. There were eight employees that took advantage of this incentive. The district was able to eliminate several of these positions or create a savings to the district through reemployment of less experienced individuals. The Principals eventually were able to redesign their campus staffing and our district made the difficult decision terminate nine paraprofessional positions. These positions are very valuable to the daily management of classroom activities. We were able to give these nine individuals a "Payment in Lieu of Notice" equal to 4 months of their 2010-2011 monthly salary. The 2011-2012 budget also reduced travel expenses across the district by one-half and eliminated or reduced many other areas. Our largest reduction in state funding will occur in 2011-2012, but we will have additional loses to our state funding in 2012-2013. Our school finance system desperately needs changes. We must have a system that will equitably and adequately invest in our children's future. In recognition and support of the school finance changes necessary to sustain public education many school districts in the state, along with ours, have elected to become a party to a law suit filed against the state to petition for necessary school finance equity and adequacy reform.

Construction projects funded through past school bonds have provided our students some of the finest facilities in our region and have accommodated most of the growth occurring in our population. HB3646 also established a permanent "roll-forward" for the Existing Debt Allotment (EDA) program, but there has been no increase in EDA funding allocations. However, the 82<sup>nd</sup> Legislature, in 2011, eliminated the Instructional Facilities Allotment (IFA) program for future facility expansion. The elimination of the IFA program for future bond indebtedness will greatly impact the districts assistance from state sources for future building programs. The District's I&S Tax Rate was again set at \$0.24 per \$100 valuation for 2012 in order to collect adequate funds for payments of current school bonds. The total tax rate for 2012 was set at \$1.41 per \$100 valuation (\$1.17 M&O and \$0.24 I&S). Appraised property values for 2012 were \$284,044,148 an increase of 7.534% over the 2011 values of \$264,142,380. Local tax revenues are expected to increase about \$300,000 due to increased property value assessments and significant amounts of new property being added to the tax roll.

The District continues to realize steady growth in student enrollment across the district. Student enrollment growth will result in additional student ADA which will generate additional State Revenue. Preliminary attendance figures indicate an increase of approximately 84 students for 2012 above 2011. This equates to a 5.6% student growth rate. In the past, we have traditional seen a 2.0% to 3.5% annual student growth rate.

This student enrollment growth continues to emphasis the need for expanded and additional facilities. Even though the \$18.5 million bond package presented to voters in May 2010 failed to pass, the district was able to fund a few projects during 2010-2011 with general operating funds. The new Ag Show barn was completed at the Ag Farm and some renovation was done to the old Ag barn so that it could be utilized as a welding shop instructional area. We were able to add lights to our softball field and bleachers at the tennis courts. Various scoreboards were updated through the utilization of funds received from scoreboard advertising. The fueling pump system for our district fleet was upgraded and there were also capital expenditures to repair some unexpected leaks in the natural gas lines at

the High School and also major repairs to sewer lines in the older part of the Middle School. Our facilities continue to be in great shape, but we are seeing an ever increasing need for additional facilities. We continue to utilize four double classroom portable buildings at the High School and probably will need to seek out additional portable classroom buildings during 2011-2012 in order to accommodate the district student growth. The district continues to work with our architect for the development of a Master Plan to be used in planning for facility expansion and projected cost of facility needs. The Board and School Administrators continue to be optimistic toward the future of this district and will continue to utilize all resources available for the advancement and progress of the Shallowater Independent School District.

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

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's business office, at Shallowater Independent School District, 1100 Avenue K, Shallowater, Texas 79363.

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## **BASIC FINANCIAL STATEMENTS**

SHALLOWATER INDEPENDENT SCHOOL DISTRICT

Exhibit A-1

STATEMENT OF NET ASSETS  
GOVERNMENT WIDE  
AUGUST 31, 2011

1

<u>Data Control Codes</u>		<u>Primary Government</u>
		<u>Governmental Activities</u>
	ASSETS AND OTHER DEBITS:	
1110	Cash and Temporary Investments	\$ 3,463,133
1220	Property Taxes - Delinquent	249,694
1230	Allowance for Uncollectible Taxes	(17,845)
1240	Due from Other Governments	528,503
1290	Other Receivables	26,839
1410	Deferred Expenditures	151,936
1420	Unamortized Bond Issue Costs	259,799
	Capital Assets:	
1510	Land	344,002
1520	Buildings, Net	16,378,036
1530	Vehicles and Equipment, Net	562,058
1550	Leased Equipment, Net	<u>161,501</u>
1000	Total Assets	<u>\$ 22,107,656</u>
	LIABILITIES:	
2110	Accounts Payable	\$ 62,363
2160	Accrued Wages Payable	390,725
2200	Accrued Expenditures/Expenses	10,217
2501	Due Within One Year	618,721
2502	Due in More Than One Year	13,365,384
2516	Unamortized Bond Premium	218,916
2000	Total Liabilities	<u>\$ 14,666,326</u>
	NET ASSETS:	
3200	Invested in Capital Assets, Net of Related Debt	\$ 3,502,375
3820	Restricted for Federal Programs	280,638
3850	Restricted for Debt Service	375,585
3900	Unrestricted Net Assets	<u>3,282,732</u>
3000	Total Net Assets	<u><u>\$ 7,441,330</u></u>

The accompanying notes are an integral part of the financial statements.

SHALLOWATER INDEPENDENT SCHOOL DISTRICT

Exhibit B-1

STATEMENT OF ACTIVITIES  
GOVERNMENT WIDE  
FOR THE YEAR ENDED AUGUST 31, 2011

Data Control Codes	1 Expenses	Program Revenues		Net (Expense) Revenue and Changes in Net Assets	
		3 Charges for Services	4 Operating Grants and Contributions	6 Total Governmental Activities	
11	Instruction	\$ 8,804,047	\$ 459,819	\$ 1,827,995	\$ (6,516,233)
12	Instructional Resources and Media Services	245,712	12,409	11,912	(221,391)
13	Curriculum and Staff Development	50,425		24,355	(26,070)
21	Instructional Leadership	274,059	78,086	53,011	(142,962)
23	School Leadership	791,214		35,962	(755,252)
31	Guidance, Counseling, and Evaluation Services	949,377		514,233	(435,144)
33	Health Services	119,108		6,522	(112,586)
34	Student Transportation	491,935	52,057	16,350	(423,528)
35	Food Services	752,178	328,149	346,953	(77,076)
36	Extracurricular Activities	731,709	4,751	15,068	(711,890)
41	General Administration	448,368		16,397	(431,971)
51	Plant Maintenance and Operations	1,529,623	3,542	36,747	(1,489,334)
52	Security and Monitoring Services	77,457		4,647	(72,810)
53	Data Processing Services	254,648		45,220	(209,428)
72	Debt Service - Interest	680,004		696,198	16,194
73	Bond Issuance Costs and Fees	(28,940)			28,940
93	Payments to Fiscal Agent	449,071	130,144	59,713	(259,214)
95	Juvenile Alternative Education Program	50,091		2,137	(47,954)
99	Other Intergovernmental Charges	35,606			(35,606)
TP	Total Primary Government	\$ 16,705,692	\$ 1,068,957	\$ 3,713,420	\$ (11,923,315)

Data  
Control  
Codes

General Revenues:

MT	Property Taxes, Levied for General Purposes	\$ 2,840,324
DT	Property Taxes, Levied for Debt Service	582,420
SF	State Aid - Formula Grants	8,370,191
GC	Grants and Contributions for Capital Outlay	325,706
GC	Grants and Contributions not Restricted	19,713
IE	Investment Earnings	40,399
MI	Miscellaneous Local and Intermediate Revenue	151,107
TR	Total General Revenues, Special Items, and Transfers	\$ 12,329,860
CN	Change in Net Assets	\$ 406,545
NB	Net Assets - Beginning	7,034,785
NE	Net Assets - Ending	\$ 7,441,330

The accompanying notes are an integral part of the financial statements.

SHALLOWATER INDEPENDENT SCHOOL DISTRICT

Exhibit C-1

BALANCE SHEET  
GOVERNMENTAL FUNDS  
AUGUST 31, 2011

Data Control Codes	Major Funds			98 Total Governmental Funds	
	10 General Fund	Title XIV ARRA State Stabilization	Other Governmental Funds		
	<b>ASSETS AND OTHER DEBITS:</b>				
1110	Cash and Temporary Investments	\$ 2,835,549	\$	\$ 617,584	\$ 3,453,133
1220	Property Taxes - Delinquent	205,126		44,568	249,694
1230	Allowance for Uncollectible Taxes	(11,292)		(6,553)	(17,845)
1240	Due from Other Governments	244,296	111,848	172,359	528,503
1260	Due from Other Funds	220,131			220,131
1290	Other Receivables	26,839			26,839
1410	Deferred Expenditures	118,036		33,900	151,936
1000	Total Assets	<u>\$ 3,638,685</u>	<u>\$ 111,848</u>	<u>\$ 861,858</u>	<u>\$ 4,612,391</u>
	<b>LIABILITIES:</b>				
2110	Accounts Payable	\$ 21,996	\$	\$ 4,723	\$ 26,719
2160	Accrued Wages Payable	302,636		88,089	390,725
2170	Due to Other Funds	144,385	111,848	108,283	364,516
2200	Accrued Expenditures/Expenses	5,676		4,541	10,217
2300	Deferred Revenue	193,834		38,015	231,849
2000	Total Liabilities	<u>\$ 668,527</u>	<u>\$ 111,848</u>	<u>\$ 243,651</u>	<u>\$ 1,024,026</u>
	<b>FUND BALANCES:</b>				
	Restricted:				
3480	Debt Service	\$	\$	\$ 337,569	\$ 337,569
3490	Other			280,638	280,638
	Assigned:				
3550	Construction	850,000			850,000
3570	Capital Expenditures for Equipment	250,000			250,000
3590	Other Assigned Fund Balance	90,000			90,000
3600	Unassigned	1,780,158			1,780,158
3000	Total Fund Balances	<u>\$ 2,970,158</u>	<u>\$ 0</u>	<u>\$ 618,207</u>	<u>\$ 3,588,365</u>
4000	Total Liabilities and Fund Balances	<u>\$ 3,638,685</u>	<u>\$ 111,848</u>	<u>\$ 861,858</u>	<u>\$ 4,612,391</u>

The accompanying notes are an integral part of the financial statements.



SHALLOWATER INDEPENDENT SCHOOL DISTRICT

Exhibit C-2

RECONCILIATION OF THE GOVERNMENTAL FUNDS  
BALANCE SHEET TO THE STATEMENT  
OF NET ASSETS  
AUGUST 31, 2011

Data  
Control  
Codes

	Total Fund Balances - Governmental Funds (Exhibit C-1)	\$ 3,588,365
1	The District uses internal service funds to charge the costs of certain activities, such as workers compensation, to appropriate functions in other funds. The assets and liabilities of the internal service fund are included in governmental activities in the statement of net assets. The net effect of this consolidation is to increase net assets.	118,741
2	Capital assets used in governmental activities are not financial resources and therefore are not reported in governmental funds. At the beginning of the year, the cost of these assets was \$32,288,831, and the accumulated depreciation was (\$14,093,167). In addition, long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported as liabilities in these funds. The long-term debt at the beginning of the year was (\$14,494,974) including issuance cost of \$290,720 and premium of (\$280,075). The effect of including the beginning balances for capital assets net of depreciation and long-term debt in the governmental activities is to increase net assets.	3,700,690
3	Lease and Bond proceeds are reported as other financing sources in the fund financial statements, but they increase long-term debt in the government-wide financial statements. The District entered into leases for vehicles and equipment in the amount of (\$101,068).	(101,068)
4	Current year capital outlays and long-term debt principal payments are expenditures in the fund financial statement, but they should be shown as increases in capital assets and reductions in long-term debt in the government-wide financial statements. The net effect of including the current year capital outlays of \$698,700 and debt principal payments of \$662,449 is to increase net assets.	1,361,149
5	Current year accretion on capital appreciation bonds.	(39,869)
6	The current year depreciation expense increases accumulated depreciation. The net effect of the current year's depreciation is to decrease net assets.	(1,448,768)
7	Various other reclassifications and eliminations are necessary to convert from the modified accrual basis of accounting to accrual basis of accounting. These include recognizing deferred revenue of \$231,850 as revenue, eliminating interfund transactions, and recognizing the amortization of bond issuance costs and bond premium of \$30,240. The net effect of these reclassifications and recognitions is to increase net assets.	<u>262,090</u>
19	Total Net Assets of Governmental Activities (Exhibit A-1).	<u>\$ 7,441,330</u>

The accompanying notes are an integral part of the financial statements.

SHALLOWATER INDEPENDENT SCHOOL DISTRICT

Exhibit C-3

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES  
GOVERNMENTAL FUNDS  
FOR THE YEAR ENDED AUGUST 31, 2011

Data Control Codes	Major Funds			98 Total Governmental Funds	
	10 General Fund	266 Title XIV ARRA SFSF	Other Governmental Funds		
Revenues:					
5700	Local and Intermediate Sources	\$ 3,198,568	\$	\$ 1,693,210	\$ 4,891,778
5800	State Program Revenues	8,867,927		787,069	9,654,996
5900	Federal Program Revenues	<u>18,220</u>	<u>409,505</u>	<u>2,157,581</u>	<u>2,585,306</u>
5020	Total Revenues	<u>\$ 12,084,715</u>	<u>\$ 409,505</u>	<u>\$ 4,637,860</u>	<u>\$ 17,132,080</u>
Expenditures:					
0011	Instruction	\$ 6,111,029	\$ 409,505	\$ 1,457,856	\$ 7,978,390
0012	Instructional Resources and Media Services	222,669			222,669
0013	Curriculum and Staff Development	26,070		24,355	50,425
0021	Instructional Leadership	72,838		175,519	248,357
0023	School Leadership	717,012			717,012
0031	Guidance, Counseling, and Evaluation Services	325,187		535,156	860,343
0033	Health Services	103,419		15,689	119,108
0034	Student Transportation	359,083		86,717	445,800
0035	Food Services	5,894		675,743	681,637
0036	Extracurricular Activities	663,088			663,088
0041	General Administration	435,177		15,354	450,531
0051	Plant Maintenance and Operations	1,488,179		12,724	1,500,903
0052	Security and Monitoring Services	77,457			77,457
0053	Data Processing Services	191,418		39,349	230,767
0071	Debt Service - Principal	160,364		513,649	674,013
0072	Debt Service - Interest	7,922		620,649	628,571
0073	Debt Service - Bond Issuance Cost and Fees			1,300	1,300
0081	Facilities Acquisition and Construction	246,390		325,706	572,096
0093	Payments to Fiscal Agent	175,982		273,089	449,071
0095	Payments to Juvenile Justice AEP	50,091			50,091
0099	Other Intergovernmental Charges	<u>35,606</u>			<u>35,606</u>
6030	Total Expenditures	<u>\$ 11,474,875</u>	<u>\$ 409,505</u>	<u>\$ 4,772,855</u>	<u>\$ 16,657,235</u>
1100	Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>\$ 609,840</u>	<u>\$ 0</u>	<u>\$ (134,995)</u>	<u>\$ 474,845</u>
Other Financing Sources (Uses):					
7913	Capital Lease	\$ 101,068	\$	\$	\$ 101,068
7915	Transfers In	20,979		64,467	85,446
8911	Transfers Out(Use)	<u>(85,445)</u>			<u>(85,445)</u>
7080	Total Other Financing Sources	<u>\$ 36,602</u>	<u>\$ 0</u>	<u>\$ 64,467</u>	<u>\$ 101,069</u>
1200	Net Change in Fund Balance	\$ 646,442	\$ 0	\$ (70,528)	\$ 575,914
0100	September 1 - Fund Balance	<u>2,323,716</u>		<u>688,735</u>	<u>3,012,451</u>
3000	August 31 - Fund Balance	<u>\$ 2,970,158</u>	<u>\$ 0</u>	<u>\$ 618,207</u>	<u>\$ 3,588,365</u>

The accompanying notes are an integral part of the financial statements.

SHALLOWATER INDEPENDENT SCHOOL DISTRICT

Exhibit C-4

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, 2011

Net Change in Fund Balances - Total Governmental Funds (Exhibit C-3)	\$ 575,914
Amounts reported for governmental activities in the statement of activities (Exhibit B-1) 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 depreciation exceeded capital outlay in the current period.	(750,068)
Property Tax revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. This is the net amount by which deferred property tax revenue changed between the current year and the prior year.	(19,840)
Capital leases are recorded as other financing resources in the fund financial statements, but they should be shown as an increase to the capital lease payable in the government-wide financial statements. The net effect of including the current year capital lease acquisitions is to decrease net assets.	(101,068)
Repayment of the bonds and other long-term debt principal of \$662,449 is an expenditure in the governmental funds, but repayment reduces long-term liabilities in the statement of net assets. This amount of repayments, plus bond issue cost and premium amortizations of \$30,240, is an increase to net assets.	692,689
Current year accretion on capital appreciation bonds.	(39,869)
Internal service funds are used by management to charge the costs of certain activities, such as workers compensation, to individual funds. The net revenue (expense) of the internal service fund is reported with governmental activities (Exhibit D-2).	<u>48,787</u>
Change in Net Assets of Governmental Activities (Exhibit B-1).	\$ <u><u>406,545</u></u>

The accompanying notes are an integral part of the financial statements.

SHALLOWATER INDEPENDENT SCHOOL DISTRICT

Exhibit D-1

STATEMENT OF NET ASSETS  
PROPRIETARY FUND  
AUGUST 31, 2011

	<u>Governmental Activities</u>
	755
	<u>Internal Service Fund</u>
ASSETS:	
Cash and Temporary Investments	\$ 10,000
Due from Other Funds	<u>144,385</u>
Total Assets	\$ <u>154,385</u>
LIABILITIES:	
Accounts Payable	\$ <u>35,644</u>
	<u>\$ 35,644</u>
NET ASSETS:	
Unrestricted Net Assets	\$ <u><u>118,741</u></u>

The accompanying notes are an integral part of the financial statements.

SHALLOWATER INDEPENDENT SCHOOL DISTRICT

Exhibit D-2

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN  
NET ASSETS  
PROPRIETARY FUND  
YEAR ENDED AUGUST 31, 2011

	Governmental Activities
	<u>755</u>
	Internal Service Fund
	<u>          </u>
OPERATING REVENUES	
Charges to Other Funds	\$ 91,138
Interest Income - Checking Account	60
Total Revenues	<u>\$ 91,198</u>
OPERATING EXPENSES	
Fixed Costs and Insurance Expense	\$ 42,411
Total Expenses	<u>\$ 42,411</u>
Change in Net Assets	\$ 48,787
Net Assets - September 1 (Beginning)	<u>69,954</u>
Net Assets - August 31 (Ending)	<u>\$ 118,741</u>

The accompanying notes are an integral part of the financial statements.

SHALLOWATER INDEPENDENT SCHOOL DISTRICT

Exhibit D-3

STATEMENT OF CASH FLOWS  
PROPRIETARY FUND  
YEAR ENDED AUGUST 31, 2011

	<u>Governmental Activities</u>
	755
	<u>Internal Service Fund</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	
Cash Flows from Operating Activities	
Cash Receipts from Charges to Other Funds	\$ 75,174
Cash Receipts from Interest Income - Checking Account	60
Cash Payments to Suppliers for Services	<u>(75,234)</u>
Net Cash Used in Operating Activities	<u>\$ 0</u>
Net Decrease in Cash and Cash Equivalents	\$ 0
Cash and Cash Equivalents at Beginning of the Year	<u>10,000</u>
Cash and Cash Equivalents at End of Year	<u><u>\$ 10,000</u></u>
RECONCILIATION OF OPERATING INCOME TO NET CASH USED IN OPERATING ACTIVITIES	
Operating Income (Loss)	\$ 48,787
Changes in Assets and Liabilities	
Increase in Due from Other Funds	(15,964)
Decrease in Accounts Payable	<u>(32,823)</u>
Net Cash Used in Operating Activities	<u><u>\$ 0</u></u>

The accompanying notes are an integral part of the financial statements.

SHALLOWATER INDEPENDENT SCHOOL DISTRICT

Exhibit E-1

STATEMENT OF FIDUCIARY NET ASSETS  
FIDUCIARY FUND  
AUGUST 31, 2011

	<u>Agency Funds</u>
ASSETS:	
Cash and Temporary Investments	\$ <u>124,348</u>
Total Assets	\$ <u>124,348</u>
LIABILITIES:	
Due to Student Groups	\$ <u>124,348</u>
Total Liabilities	\$ <u>124,348</u>
NET ASSETS:	
Unrestricted Net Assets	\$ <u><u>0</u></u>

The accompanying notes are an integral part of the financial statements.

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Shallowater Independent School District's (the District) basic financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America promulgated by the Governmental Accounting Standards Board and other authoritative sources identified in *Statement and Auditing Standards No. 69* of the American Institute of Certified Public Accountants; as applied to governmental units in conjunction with the Texas Education Agency's Financial Accountability System Resource Guide (FAR). The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant accounting policies of the District are described below.

**A. REPORTING ENTITY**

The Board of School Trustees (the Board), a seven member group, has fiscal accountability over all activities related to public elementary and secondary education within the jurisdiction of the District. The Board is elected by the public. The Board has the exclusive power and duty to govern and oversee the management of the District. All powers and duties not specifically delegated by statute to the Texas Education Agency (the Agency) or to the State Board of Education are reserved for the Board, and the Agency may not substitute its judgment for the lawful exercise of those powers and duties by the Board. The District is not included in any other governmental "reporting entity" as defined in governmental accounting and financial reporting standards. There are no component units included within the reporting entity.

The District receives funding from local, state, and federal government sources and must comply with the requirements of these funding entities.

**B. BASIS OF ACCOUNTING AND PRESENTATION**

**GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The Statement of Net Assets and the Statement of Activities display information about the government-wide entity as a whole. These statements 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, which normally are supported by taxes, state foundation funds, grants, and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support (i.e., internal service funds are considered governmental activities and not business-type activities). The District currently has no business-type activities.

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities or statement of net assets. Bond issue costs and premiums are deferred and amortized over the life of the bonds. Interest payable on capital appreciation bonds are recognized as an increase in long-term debt and an increase in interest expense as accreted.



**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

These government-wide financial statements were prepared using the economic resources measurement focus and the accrual basis of accounting. 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 Statement of Activities demonstrates how other people or entities that participate in programs the District operates have shared in the payment of the direct costs. The “charges for services” column includes payments made by parties that purchase, use, or directly benefit from goods or services provided by a given function or segment of the District. Examples include tuition paid by students not residing in the District, school lunch charges, etc. The “operating grants and contributions” column includes amounts paid by organizations outside the District to help meet the operational or capital requirements of a given function. Examples include grants under the Elementary and Secondary Education Act. If a revenue is not a program revenue, it is a general revenue used to support all of the District’s functions. Taxes are always general revenues.

The District reports all direct expenses by function in the Statement of Activities. Direct expenses are those that are clearly identifiable with a function. Indirect expenses of other functions are not allocated to those functions but are reported separately in the Statement of Activities. Depreciation expense is specifically identified by function and is included in the direct expense to each function allocated. Interest on general long-term debt is considered an indirect expense and is reported separately on the Statement of Activities.

Interfund activities between governmental funds and between governmental funds and proprietary funds appear as due to/due from on the Governmental Fund Balance Sheet and Proprietary Fund Statement of Net Assets and as other resources and other uses on the governmental fund Statement of Revenues, Expenditures and Changes in Fund Balance and on the Proprietary Fund Statement of Revenues, Expenses, and Changes in Fund Net Assets. All interfund transactions between governmental funds and between governmental funds and internal service funds are eliminated on the government-wide statements. Interfund activities between governmental funds and fiduciary funds remain as due to/due from on the government-wide Statement of Activities.

**FUND FINANCIAL STATEMENTS**

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds. Since the resources in the fiduciary funds cannot be used for District operations, they are not included in the government-wide statements. Major governmental funds are reported as separate columns in the fund financial statements.

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 government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

## SHALLOWATER INDEPENDENT SCHOOL DISTRICT NOTES TO FINANCIAL STATEMENTS

Revenues from local sources consist primarily of property taxes. No amounts have been recorded for property tax revenues collected after August 31, 2011. State revenues are recognized under the susceptible-to-accrual concept. Miscellaneous revenues are recorded as revenue when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned since they are both measurable and available.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures and claims and judgments are recorded only when payment is due.

In the fund financial statements, governmental fund types recognize bond issue costs in the current period. The face amount of the debt issued is reported as other financing sources. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

The proprietary fund and the fiduciary fund financial statements were reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. The District applies all GASB pronouncements, as well as the Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless these pronouncements conflict or contradict GASB pronouncements.

Propriety funds distinguish operating revenues and expenses from non-operating items. Operating revenues result from providing goods and services in connection with a propriety fund's principal ongoing operations, they usually come from exchange or exchange-like transactions. All other revenues are non-operating.

### GOVERNMENTAL FUND TYPES

The District reports the following major governmental funds:

**General Fund** – This fund is established to account for resources used for general operations. All general tax revenues and other receipts that are not allocated by law or contractual agreement to some other fund are accounted for in this fund. This is a budgeted fund and undesignated fund balances are considered resources available for current operations.

**Special Revenue Funds** – The following special revenue fund is reported as major governmental funds: Title XIV ARRA State Fiscal Stabilization Fund.

Additionally, the government reports the following governmental fund types:

**Special Revenue Funds** – These funds are used to account for resources restricted to, or designated for, specific purposes by a grantor. Federal financial assistance generally is accounted for in a special revenue fund. Except for the food service fund, any unused balances are returned to the grantor at the close of specified project periods. The food service fund is the only required budgeted special revenue fund and historically operates at a deficit that is funded by an operating transfer from the general fund.

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

The District's food service is considered a special revenue fund since the general fund only subsidizes the food service program for all expenditures in excess of NSLP and user fees. For all other funds in this fund type, project accounting is employed to maintain integrity for the various sources of funds.

**Debt Service Fund** – This fund is used to account for payment of principal and interest on long-term general obligation debt and other long-term debts for which tax has been dedicated. This is a budgeted fund and any unused sinking fund balances will be transferred to the general fund after all of the related debt obligations have been met.

**PROPRIETARY FUND TYPES**

**Internal Service Funds** – Internal service funds are used to account for revenues and expenses related to services provided to parties inside the District, specifically for the operation of the District's partially self-funded insurance plan for workers' compensation on a cost-reimbursement basis.

**FIDUCIARY FUND TYPES**

**Agency Funds** – These custodial funds are used to account for activities of student groups and other organizational activities requiring clearing accounts. Financial resources for the agency funds are recorded as assets and liabilities; therefore, these funds do not include revenues and expenditures and have no fund equity. Student activity organizations exist with the explicit approval of, and are subject to revocation by, the District's Board of Trustees. If any unused resources are declared surplus by the student groups, they are transferred to the general fund with a recommendation to the Board for an appropriate utilization through a budgeted program.

**C. BASIS OF ACCOUNTING APPLICABLE TO ALL FINANCIAL STATEMENTS**

Capital assets, which include buildings and improvements, furniture and equipment, vehicles, and work in progress are reported in the government-wide financial statements. Capital assets are defined by the District as assets with an individual cost of more than \$5,000. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the assets' useful lives are not capitalized.

Revenues from state and federal grants are considered to be earned to the extent of expenditures made under the provisions of the grant. Funds received but unexpended are reflected as deferred revenues, and funds expended but not yet received are shown as receivables. If balances have not been expended by the end of the project period, grantors generally require the District to refund all or part of the unused amount. Supplies and materials are debited as expenditures when purchased.

It is the District's policy to permit some employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the District does not have a policy to pay any amounts when employees separate from service with the District.

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

Since Internal Service Funds support the operations of governmental funds, they are consolidated with the governmental funds in the government-wide financial statements. The expenditures of governmental funds that create the revenues of internal service funds are eliminated to avoid "grossing up" the revenues and expenses of the District as a whole.

When the District incurs an expense for which it may use either restricted or unrestricted assets, it uses the restricted assets first whenever they will have to be returned if they are not used.

In accordance with the FAR, the District has adopted and installed an accounting system which exceeds the minimum requirements prescribed by the State Board of Education and approved by the State Auditor. Specifically, the District's accounting system uses codes and the code structure presented in the Accounting Code Section of the FAR. Mandatory codes are utilized in the form provided in that section.

**D. BUDGETARY DATA**

The official budget was prepared on the modified accrual basis of accounting, which is consistent with accounting principles generally accepted in the United States of America, for the general fund, debt service fund, and the food service special revenue fund. The remaining special revenue funds adopt project-length budgets which do not correspond to the District's fiscal year. The following procedures are followed in establishing the budgetary data reflected in the basic financial statements:

- a. Prior to August 20th of the preceding fiscal year, the District prepares a budget for the next succeeding fiscal year beginning September 1st. The operating budget includes proposed expenditures and the means of financing them.
- b. A meeting of the Board is then called for the purpose of adopting the proposed budget. At least 10 days public notice of the meeting must be given.
- c. Prior to September 1st, the budget is legally enacted through passage of a resolution by the Board.

The budget is prepared and controlled at the function level within each fund and is amended at this level as needed. Amendments are presented to the Board at its regular meetings. Each amendment must have Board approval. Such amendments are made before the fact, and they are reflected in the official minutes of the Board. During the year, several amendments were necessary.

**E. ENCUMBRANCE ACCOUNTING**

Encumbrances for goods or purchased services are documented by purchase orders or contracts. Under Texas law, appropriations lapse at August 31st, and encumbrances outstanding at that time are to be either cancelled or appropriately provided for in the subsequent year's budget. There were no outstanding encumbrances at August 31, 2011.

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

**F. FUND EQUITY**

During the current year, the District has adopted GASB Statement 54, which redefined how fund balances of the governmental funds are presented in the financial statements. Fund balances are classified as follows:

Restricted – Amounts that can be spent only for specific purposes because of restrictions by external sources (creditors, laws of other governments, etc) or by constitutional provision or enabling legislation.

Committed – Amounts that can be used only for specific purposes determined by formal action by the Board of Trustees, the highest level of decision making authority.

Assigned – Amounts that can be used for a specific purpose as expressed by the authorized administrator, the Superintendent.

Unassigned – Amounts not included in other spendable classifications.

When an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available, the District considers restricted funds to have been spent first. When an expenditure for which committed, assigned, or unassigned fund balances are available, the District considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds, as needed, unless the Board has provided otherwise in its commitment or assignment actions.

During the year, the Board of Trustees adopted a minimum fund balance policy for the general fund. The policy requires the unassigned fund balance at fiscal year end to be at least 10% of the current fiscal expenditures less capital outlay and transfers out budgeted for the fund.

**G. NET ASSETS ON THE STATEMENT OF NET ASSETS**

Net assets on the statement of net assets include the following:

Investment in Capital Assets, Net of Related Debt – this component of net assets represents the difference between capital assets less both the accumulated depreciation and the outstanding balance of debt, excluding any unspent bond proceeds, that is directly attributable to the acquisition, construction, or improvement of those assets.

Restricted for Federal Program – this component of net assets represents the balance of the Local Special Education SSA Cooperative, known as HONDA.

Restricted for Debt Service – this component of net assets represents the difference between assets and liabilities of the Debt Service Fund that consists of assets with constraints placed on their use by creditors.

Unrestricted – the difference between assets and liabilities that is not reported in Net Assets Invested in Capital Assets, Net of Related Debt, Net Assets Restricted for Capital Projects, and Net Assets Restricted for Debt Service.

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

**H. CASH AND CASH EQUIVALENTS – PROPRIETARY FUNDS**

For purposes of the statement of cash flows for proprietary fund types, the District considers highly liquid investments to be cash equivalents if they have a maturity of three months or less when purchased.

**I. MANAGEMENT’S USE OF ESTIMATES**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

**2. DEPOSITS AND INVESTMENTS**

Legal and Contractual Provisions Governing Deposits and Investments

The **Public Funds Investment Act** (Government Code Chapter 2256) (The Act) contains specific provisions in the areas of investment practices, management reports and establishment of appropriate policies. Among other things, it requires the District to adopt, implement, and publicize an investment policy. That policy must address the following areas: (1) safety of principal and liquidity, (2) portfolio diversification, (3) allowable investments, (4) acceptable risk levels, (5) expected rates of return, (6) maximum allowable stated maturity of portfolio investments, (7) maximum average dollar-weighted maturity allowed based on the stated maturity date for the portfolio, (8) investment staff quality and capabilities, and (9) bid solicitation preferences for certificates of deposit. Statutes authorize the District to invest in (1) obligations of the U.S. Treasury, certain U.S. agencies, and the State of Texas; (2) certificates of deposit, (3) certain municipal securities, (4) money market savings accounts, (5) repurchase agreements, (6) bankers acceptances, (7) Mutual Funds, (8) Investment pools, (9) guaranteed investment contracts, and (10) common trust funds. The Act also requires the District to have independent auditors perform test procedures related to investment practices as provided by the Act. The District is in substantial compliance with the requirements of the Act and with local policies.

Policies Governing Deposits and Investments

In compliance with the **Public Funds Investment Act**, the District has adopted a deposit and investment policy. That policy does not address the following risks:

- a. Custodial Credit Risk – Deposits and Investments: In the case of deposits, this is the risk that in the event of a bank failure, the government's deposits and investments in certificates of deposits may not be returned to it. The District's policy does not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits and investments, other than the following: The State of Texas requires that a financial institution secure deposits and investments made by state or local governments by pledging securities in excess of the highest cash balance of the government. The District is not exposed to custodial credit risk for its deposits and investments in certificates of deposit are all covered by depository insurance and pledged securities held by a third party in the District's name.

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

- b. Concentration of Credit Risk – The investment policy of the District contains no limitations on the amount that can be invested in any one issuer. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of the total entity investments represent a concentration risk. At August 31, 2011, all of the District's investments are in certificates of deposit with its depository bank, and are completely covered by pledged securities as described in the preceding paragraph.
- c. Credit Risk – The risk that an issuer of other counterparty to an investment will not fulfill its obligations. The ratings of securities by nationally recognized rating agencies are designed to give an indication of credit risk. At August 31, 2011, the District was not significantly exposed to credit risk.
- d. Interest Rate Risk – Not applicable
- e. Foreign Currency Risk – Not applicable

The carrying amount of the District's cash and temporary investments at August 31, 2011, approximates fair value and consisted of the following shown below:

	General Fund	Other Funds	Internal Service Fund	Total
Cash in Bank	\$ 1,835,549	\$ 617,584	\$ 10,000	\$ 2,463,133
Certificates of Deposit	1,000,000			1,000,000
	\$ 2,835,549	\$ 617,584	\$ 10,000	\$ 3,463,133
Fiduciary Fund Cash in Bank				124,348
Total Cash and Temporary Investments				\$ 3,587,481

**3. PROPERTY TAXES**

Property taxes are levied by October 1st on the assessed value listed as of the prior January 1st for all real and business personal property located in the District 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 1st of the year following the year in which imposed. On January 1st of each year, a tax lien attaches to property to secure the payment of all taxes, penalties, and interest ultimately imposed.

Delinquent taxes are prorated between maintenance and debt service based on rates adopted for the year of the levy. All property taxes remaining uncollected after ten years are provided for in the allowance for uncollectible 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.

**4. RECEIVABLE FROM OTHER GOVERNMENTS**

The amount due from other governments consisted of \$244,296 due from the state for Foundation underpayment per the Near-Final Summary of Finance and \$284,207 due various special revenue fund programs.

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

**5. INTERFUND RECEIVABLES AND PAYABLES**

Interfund balances at August 31, 2011, consisted of the following individual fund receivables and payables:

	<u>Due from Other Funds</u>	<u>Due to Other Funds</u>
General Fund		
Special Revenue Funds	\$	\$ 220,131
Internal Service Funds	144,385	
	<u>\$ 144,385</u>	<u>\$ 220,131</u>
 Internal Service Funds		
General Fund	\$	\$ 144,385
 Special Revenue Funds		
General Fund	\$ 220,131	\$
	<u>\$ 364,516</u>	<u>\$ 364,516</u>

**6. CAPITAL ASSETS**

Capital asset activity for the year ended August 31, 2011, was as follows:

	<u>9/1/2010</u>	<u>Additions</u>	<u>Retirements</u>	<u>Transfers</u>	<u>8/31/2011</u>
Capital Assets:					
Land	\$ 344,002	\$	\$	\$	\$ 344,002
Building	28,711,485	846,271			29,557,756
Equipment/Vehicles	2,400,913	16,618		188,138	2,605,669
Leased Equipment	567,175	101,068		(188,138)	480,105
Construction Work in Progress	265,256	(265,256)			0
	<u>\$ 32,288,831</u>	<u>\$ 698,701</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 32,987,532</u>
Accumulated Depreciation:					
Buildings	\$ 12,049,612	\$ 1,130,108	\$	\$	\$ 13,179,720
Equipment/Vehicles	1,884,310	159,302		85,313	2,128,925
Leased Equipment	159,245	159,358		(85,313)	233,290
	<u>\$ 14,093,167</u>	<u>\$ 1,448,768</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 15,541,935</u>
Total Net Value of Capital Assets	<u>\$ 18,195,664</u>	<u>\$ (750,067)</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 17,445,597</u>

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

Buildings and Improvements	15 - 30 years
Furniture and Equipment	5 - 20 years
Vehicles	5 - 10 years



**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

Depreciation Expense was spread by function as follows:

Instruction	\$ 825,661
Instruction Resources and Media Services	23,043
Instructional Leadership	25,702
School Leadership	74,202
Guidance, Counseling, and Evaluation Services	89,034
Student Transportation	46,135
Food Services	70,541
Extracurricular Activities	68,621
General Administration	46,624
Plant Maintenance and Operations	155,324
Data Processing Services	23,881
	<u>\$ 1,448,768</u>

**7. DEFERRED REVENUES**

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. Deferred revenues consisted of the following at August 31, 2011:

	General Fund	Debt Service Fund	Total
Property Taxes - Delinquent	\$ 205,126	\$ 44,568	\$ 249,694
Less: Allowance for Uncollectible Taxes	11,292	6,553	17,845
Total Deferred Tax Revenues	<u>\$ 193,834</u>	<u>\$ 38,015</u>	<u>\$ 231,849</u>

**8. LONG-TERM DEBT**

General Obligation Bonds

A summary of changes in bonds payable for the year ended August 31, 2011, is as follows:

Description	Interest Rates	Amounts Originally Issued	Amount Outstanding 9/1/2010	Increases Current Year	Retired Current Year	Amount Outstanding 8/31/2011
2005 Building Bonds	4.75% - 4.875%	\$ 7,310,000	\$ 7,310,000	\$	\$	\$ 7,310,000
2007 Building Bonds	4.00%	1,199,997	510,000		160,000	350,000
2007 Refunding Bonds	4.00%	3,884,999	3,852,435		2,993	3,849,442
2010 Refunding Bonds	2.00% - 4.00%	2,460,000	2,455,000		260,000	2,195,000
Total Unlimited Tax Bonds		<u>\$ 14,854,996</u>	<u>\$ 14,127,435</u>	<u>\$ 0</u>	<u>\$ 422,993</u>	<u>\$ 13,704,442</u>
Accumulated Accretion on Capital Appreciation Bonds	NA		71,787	39,869		111,656
			<u>\$ 14,199,222</u>	<u>\$ 39,869</u>	<u>\$ 422,993</u>	<u>\$ 13,816,098</u>

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

Interest expenditures for bonded debt for the year ended August 31, 2011, totaled \$619,532. Scheduled debt service requirements are as follows:

Fiscal Year Ending August 31,	Principal	Interest	Total
2012	\$ 484,442	\$ 739,401	\$ 1,223,843
2013	290,000	576,263	866,263
2014	305,000	566,812	871,812
2015	315,000	556,913	871,913
2016	330,000	546,444	876,444
2017-2021	1,855,000	2,544,281	4,399,281
2022-2026	2,520,000	2,123,174	4,643,174
2027-2031	4,460,000	1,310,891	5,770,891
2032-2035	3,145,000	316,022	3,461,022
	<u>\$ 13,704,442</u>	<u>\$ 9,280,201</u>	<u>\$ 22,984,643</u>
Accumulated Accretion on Capital Appreciation Bonds	<u>111,656</u>		
	<u>\$ 13,816,098</u>		

As of August 31, 2011 the balance of the Unamortized Bond Issuance Cost is \$259,799 and the balance of the Unamortized Bond Premium is (\$218,916).

Other Long-Term Debt

A note was obtained in August of 2007 for the purchase of an athletic bus in the amount of \$97,000 with a stated interest rate of 5.15% to be paid in annual payments over 4 years. Interest paid during the year on this note totaled \$2,539.

A summary of the activity for the District's note payable is as follows:

Date of Issue	Interest Rate	Amount Outstanding 9/1/2010	Current Year Payments	Amount Outstanding 8/31/2011
8/31/2007	5.15%	\$ <u>24,935</u>	\$ <u>24,935</u>	\$ <u>0</u>

Obligations under Capital Lease

There are three capital leases for copiers. A copier lease for one copier originated in November 2007 for \$9,600. A copier lease for four additional copiers originated in September 2008 for \$22,334. Finally, another copier lease for five copiers originated in January 2011 for \$30,169. During the year the District made payments on these leases in the amount of \$37,630, including interest of \$3,106.

There were three capital leases for computers throughout the year. A computer lease was originated in September 2008 for \$93,111, another originated in March 2010 for \$178,786, and an additional lease originated in June 2011 for \$36,398. During the year the District made payments on these leases totaling \$108,726, including interest of \$10,920. The lease originating in March 2010 will be paid through the ARRA - IDEA, Part B shared service arrangement.

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

There are three capital leases for buses. The District entered into a lease for a bus in September 2008 for \$76,923. A lease for an additional bus originated in September 2009 for \$79,281. An additional bus lease originated in September 2010 for \$61,670. During the year the District made payments on these leases totaling \$76,450, including interest of \$3,373. The lease originating in September 2009 will be paid through the IDEA, Part B shared service arrangement.

The District also entered into a capital lease for a Dodge truck in February 2010 for \$30,169. During the year the District made payments on this lease totaling \$11,027, including \$1,912 in interest.

A summary of the activity for the District's capital lease obligations is as follows:

Date of Issue	Description	Interest Rate	Amounts Outstanding 9/1/2010	Issued Current Year	Retired Current Year	Amounts Outstanding 8/31/2011
11/1/2007	Copier Lease	8.725%	\$ 2,492	\$	\$ 2,492	\$ 0
9/1/2008	Bluebird Bus Lease	4.400%	25,718		25,718	0
9/4/2008	Copier Lease	5.250%	7,355		7,355	0
9/5/2008	Computer Lease	6.600%	35,536		28,520	7,016
9/9/2009	Bluebird Bus Lease (HONDA)	5.093%	26,123		26,123	0
2/1/2010	Dodge Truck	9.987%	19,142		9,116	10,026
1/1/2010	Copier Lease	3.920%	50,321		24,677	25,644
3/1/2010	Computer Lease	7.602%	114,775		55,287	59,488
6/1/2011	Computer Lease	6.559%		39,398	14,000	25,398
9/2/2010	Bluebird Bus Lease	4.000%		61,670	21,235	40,435
	<b>Total Leases</b>		<b>\$ 281,462</b>	<b>\$ 101,068</b>	<b>\$ 214,523</b>	<b>\$ 168,007</b>

Future minimum payments for these leases are as follows:

<u>Fiscal Year Ending August 31,</u>	
2012	\$ 144,953
2013	<u>35,816</u>
Total Payments	\$ <u>180,769</u>
Less: Interest	<u>12,762</u>
Total Principal	\$ <u><u>168,007</u></u>

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

**9. REVENUES FROM LOCAL AND INTERMEDIATE SOURCES**

During the current year, fund financial statement revenues from local and intermediate sources consisted of the following:

	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Debt Service Fund</u>	<u>Total</u>
Property Taxes, Penalties, Interest, and Other Tax-Related Income	\$ 2,857,197	\$	\$ 585,388	\$ 3,442,585
Food Sales		264,323		264,323
Interest Income	36,433		3,966	40,399
Co-curricular Student Activities	62,826			62,826
Rent	6,904			6,904
Insurance Recovery	10,219			10,219
Special Ed Coop Member Charges		650,718		650,718
Pre-K Tuition	66,288			66,288
Advertising Revenue	12,409			12,409
Other	146,292	188,728	87	335,107
	<u>\$ 3,198,568</u>	<u>\$ 1,103,769</u>	<u>\$ 589,441</u>	<u>\$ 4,891,778</u>

**10. DEFINED BENEFIT PENSION PLAN**

Plan Description – All employees of the District employed for one-half or more of the standard workload and who are not exempt from membership under Texas Government Code participate in 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 employees of the public school system of Texas. It operates primarily under the provisions of the Texas Constitution and Texas Government Code. TRS also administers proportional retirement benefits and service credit transfers under Texas Government Code. 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 TRS at 1-800-223-8778, or by downloading the report from the TRS Internet website, [www.trs.state.tx.us](http://www.trs.state.tx.us), under the TRS Publication heading.

Funding Policy – State law provides for fiscal years 2009, 2010, and 2011, a state contribution rate of 6.64% and a member contribution rate of 6.4%. In certain instances, the District is required to make all or a portion of the State's 6.64% contribution. Contribution requirements are not actuarially determined but are legally established each biennium pursuant to state funding policy. State contributions TRS made on behalf of the District's employees for the years ended August 31, 2009, 2010, and 2011, were \$512,281, \$550,000, and \$551,494, respectively. The amounts contributed by the State are reflected in the financial statements in the general fund by respective function, in accordance with Governmental Accounting Standards Board Statement No. 24. The District paid additional state contributions for the years ended August 31, 2009, 2010, and 2011, in the amounts of \$111,043, \$111,826, and \$120,328, respectively, on the portion of the employees' salaries that exceeded the statutory minimum and those salaries funded from federal grants, equal to the required contributions for each year. Additionally, payments made on behalf of the District by the State for

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

Medicare, Part D fringe benefits and salaries amounted to \$19,313, \$22,484, and \$24,284 for the years ended August 31, 2009, 2010, and 2011, respectively.

The payroll for employees covered by the system for the years ended August 31, 2009, 2010, and 2011, were \$8,267,817, \$8,868,491, and \$8,788,887, respectively. The District's total payroll was \$8,929,008, \$9,576,711, and \$9,450,750, respectively.

**11. SELF-INSURANCE – WORKMEN'S COMPENSATION**

The District participates in a public entity risk pool for its Workmen's Compensation Insurance needs. Over 100 school districts participate in the pool administered by Claims Administrative Services, Inc. The agreement between the District and the pool is renewable annually on September 1. The District's maximum loss under the agreement for 2011 was set at \$75,797, excluding fixed costs of \$48,742. The pool is protected against unanticipated catastrophic loss by stop-loss coverage provided through Midwest Employers Casualty Corporation. The stop-loss policy covers individual claims in excess of \$500,000 per incident. The District accounts for its costs associated with the pool through an internal service fund.

The claims administrator for the pool has estimated the District's share of unpaid claims as of August 31, 2011, to be \$51,179, including estimated claims incurred but not reported of \$28,653. The District has recorded claims payable of \$35,645 at August 31, 2011, for the claims incurred within the last five years related to this liability.

**12. HEALTH INSURANCE**

During the year ended August 31, 2011, employees of the District were covered by a health insurance plan through TRS – Active Care Program administered by the Teacher Retirement System. The District contributed \$225 of the employee-only premium per month and employees, at their option, authorized payroll withholdings to pay contributions for dependents. Under this plan, the District is not liable for costs incurred beyond the premiums paid.

**13. LITIGATION**

There is no litigation pending against the District which would have a material effect on the financial statements.

**14. COMMITMENTS AND CONTINGENCIES**

Federal and State Funding

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

**SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
NOTES TO FINANCIAL STATEMENTS**

**15. SUBSEQUENT EVENTS**

The District's management has evaluated subsequent events through November 8, 2011, the date which the financial statements were available for issue.

**16. SHARED SERVICE ARRANGEMENTS**

The District is the fiscal agent for five Shared Services Arrangements (SSAs) which provide services for various member school districts under federal grants. All services are provided by the fiscal agent. The District accounts for the SSAs in special revenue funds prescribed by TEA in its FASRG.

The District utilizes the account codes and procedures outlined in the FASRG for SSAs using Models #1, #2, and #3. These SSA funds are listed below:

Model #1 SSAs

Vocational Education Basic Grant (Fd 331) 9 Member Districts

Model #2 SSAs

IDEA, Part B – Formula (Fd 313) 5 Member Districts  
 IDEA, Part B – Preschool (Fd 314) 5 Member Districts  
 IDEA, Part B – Formula – ARRA (Fd 364) 5 Member Districts  
 IDEA, Part B – Preschool – ARRA (Fd 365) 5 Member Districts

Model #3 SSA

HONDA Special Education Coop (Fd 437) 5 Member Districts

Expenditures of the SSA by member district are noted below:

District	CDN	313 IDEA, B Formula	314 IDEA, B Preschool	364 IDEA, B Formula ARRA	365 IDEA, B Preschool ARRA	331 Vocational Ed. Basic Grant	437 HONDA Special Ed. Coop
Shallowater ISD	152-909	\$ 242,643	\$ 3,095	\$ 100,957	\$	\$ 13,857	\$ 262,285
Abernathy ISD	095-901	187,838	5,011	14,409			133,421
Bovina ISD	185-901					5,812	
Cotton Center ISD	095-902					1,881	
Farwell ISD	185-902					5,213	
Friona ISD	185-903					9,497	
Hale Center ISD	095-903	138,031	1,531	14,862		8,736	148,937
Lazbuddie ISD	185-907					112	
New Deal ISD	152-902	154,391	2,416	3,944		10,426	281,526
Olton ISD	140-905	145,218	5,418	23,741	2,454		98,016
Springlake-Earth ISD	140-907					5,769	
		<u>\$ 868,121</u>	<u>\$ 17,471</u>	<u>\$ 157,913</u>	<u>\$ 2,454</u>	<u>\$ 61,303</u>	<u>\$ 924,185</u>

**APPENDIX C**

**FORM OF BOND COUNSEL'S OPINION**

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# UNDERWOOD

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August 9, 2012

17,990,000 SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
UNLIMITED TAX SCHOOL BUILDING BBONDS  
SERIES 2012

WE HAVE represented Shallowater Independent School District (the "District") as its bond counsel, in connection with an issue of bonds (the "Bonds") described as follows:

SHALLOWATER INDEPENDENT SCHOOL DISTRICT  
UNLIMITED TAX SCHOOL BUILDING BONDS,  
SERIES 2012, dated July 1, 2012

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

WE HAVE represented the District 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 rendering an opinion with respect to the exclusion of interest on the Bonds from gross income for federal income tax purposes. We have not investigated or verified original proceedings, records, data or other material, but have relied solely upon the transcript of proceedings described in the following paragraph. 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. We have also examined applicable provisions of the Internal Revenue Code of 1986 as amended (the "Code"), court decisions, Treasury Regulations, and published rulings of the Internal Revenue Service as we have deemed relevant.

IN OUR CAPACITY as bond counsel, we have participated in the preparation of and have examined a transcript of certified proceedings pertaining to the Bonds, on which we have relied in giving our opinion. The transcript contains certified copies of certain proceedings of the District, customary certificates of officers, agents, and representatives of the District and other public officials and other certified showings relating to the authorization and issuance of the Bonds. We have also examined executed Bond No. T-1.

BASED ON SUCH EXAMINATION, IT IS OUR OPINION THAT:

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UNDERWOOD, WILSON, BERRY, STEIN & JOHNSON, P.C.

AMARILLO

HEREFORD

LUBBOCK

(A) 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 effective and that therefore, the Bonds constitute valid and legally binding obligations of the District; and

(B) 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, on all taxable property located within the District; and

(C) Interest on the Bonds is excludable from gross income, as defined in section 61 of the Internal Revenue Code of 1986, as amended to the date of this opinion (the "Code"), pursuant so section 103 of the Code and existing regulations, published rulings and court decisions; and

(D) The Bonds will not be treated as "specified private activity bonds" the interest on which would be included as an alternative minimum tax preference item under section 57(a)(5) of the Internal Revenue Code of 1986 (the "Code") except that interest on the Bonds will be included in the "adjusted current earnings" of a corporation (other than any S corporation, regulated investment company, REIT, REMIC or FASIT) for purposes of computing its alternative minimum tax liability.

THE RIGHTS OF THE OWNERS of the Bonds are subject to the applicable provisions of the federal bankruptcy laws and any other similar laws affecting the rights of creditors of political subdivisions generally, and may be limited by general principles of equity which permit the exercise of judicial discretion.

In providing such opinions, we have relied on legal opinions of the Attorney General of the State of Texas regarding the legality and validity of the Bonds under the Constitution and laws of the State of Texas and representations of the District and the Underwriter with respect to matters solely within the knowledge of the District and the Underwriter, respectively, which we have not independently verified. In addition, we have assumed for purposes of this opinion continuing compliance with the covenants in the Order pertaining to those sections of the Code that affect the exclusion from gross income of interest on the Bonds for federal income tax purposes. In the event that such representations are determined to be inaccurate or incomplete or the District fails to comply with the foregoing covenants of the Order, interest on the Bonds could become includable in gross income from the date of their original delivery, regardless of the date on which the event causing such inclusion occurs.

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

Owners of the Bonds should be aware that the ownership of tax-exempt obligations may result in collateral federal income tax consequences to financial institutions, life insurance and property and casualty insurance companies, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be 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 qualifying for the earned income credit. In addition, certain foreign corporations doing business in the United States may be subject to the “branch profits tax” on their effectively-connected earnings and profits (including tax-exempt interest such as interest on the Bonds).

Our opinions are based on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service (the “Service”); rather, such opinions represent our legal judgment based upon our review of existing law and in reliance upon the representations and covenants referenced above that we deem relevant to such opinions. The Service has an ongoing audit program to determine compliance with rules that relate to whether interest on state or local obligations is includable in gross income for federal income tax purposes. No assurance can be given whether or not the Service will commence an audit of the Bonds. If an audit is commenced, in accordance with its current published procedures the Service is likely to treat the District as the taxpayer. We observe that the District has covenanted in the Order not to take any action, or omit to take any action within its control, that if taken or omitted, respectively, may result in the treatment of interest on the Bonds as includable in gross income for federal income tax purposes.

Sincerely,





Financial Advisory Services  
Provided By

