FINAL REPORT

Summary of the Financial Impact of the Proposed DCP Midstream Gas Plant on the Edna ISD Under a Requested Chapter 313 Property Value Limitation

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Introduction

DCP Midstream, LP (DCP) has requested that the Edna ISD (EISD) grant a property value limitation under Chapter 313 of the Texas Tax Code for the construction and operation of a gas plant. An application has been submitted by DCP to EISD and the EISD Board of Trustees approved that application on August 29, 2011. DCP proposes to invest $100 million initially in this project with two additional $100 million investments to occur in subsequent years as set forth in the application. This project is consistent with the state's goal for economic development, the expanded intent of House Bill 1200 as passed by the Texas Legislature in 2001, and Chapter 313 of the Texas Tax Code.

Background

In accordance with the application, this project will be fully taxable for both maintenance and operations (M&O) and debt service (I&S) purposes in the first two years (school years 2013-14 and 2014-15) which represent the project's qualifying time period. EISD intends to offer a value limitation for this project of $10 million effective school year 2015-16 through 2022-23. As a result, the project will impact the local tax roll of the school district at that same amount for M&O taxes only. Taxes for debt service, voter approved projects financed by the sale of bonds, will continue at the full taxable value. I&S taxes for any future projects approved by the voters of the district will also be assessed against the full taxable value. Depreciation will reduce the taxable value of the project over time.

While taxes are collected by the district on the current year county appraisal district (CAD) value, the state funding formulas use the comptroller's property tax division (CPTD) value for the purpose of calculating the district's required local shares within the funding tiers of that formula. The CPTD is a reflection of last year's CAD value; therefore, it lags behind the CAD value in all years. As a result, state and local revenues are generated by two different values in any given year.

With the passage of House Bill 1 in the 2006 special legislative session, the school finance system in Texas moved from one that was formula driven with a maximum M&O tax rate of $1.50 to one that was, and continues to be, target revenue driven at a maximum tax rate of generally $1.04, voter approval for a higher tax rate up to $1.17 notwithstanding. This means that most districts now receive additional state aid for tax reduction (ASATR) to offset the loss in state and local funds at the new maximum $1.04 M&O tax cap vs. what was previously generated at the $1.50 maximum M&O tax cap.

With the passage of Senate Bill 1 in the 2011 special legislative session, funding reductions to the school finance system in Texas amounted to $4 billion for the biennium or $2 billion each year of the biennium. To accomplish these reductions, schools' regular program allotments are reduced by 7.61 percent in school year 2011-12 while those same calculated allotments are reduced by 2 percent in school year 2012-13 in addition to the ASATR funding also being reduced by 7.65%. The stated goal is for ASATR revenue to be completely eliminated by school year 2017-18. Anticipated legal challenges and future legislative sessions will determine the course of school finance beginning in school year 2013-14 and beyond.

Assumptions
As required of chapter 313 projects, 15 years of data must be assimilated in order to produce revenue projections for that same number of years. The revenue projections for the EISD that accompany this project, therefore, adhere the following general assumptions:

1. The current school funding system and formulas as set forth in Senate Bill 1 were used to project state aid; although, no guarantee exists that this system or these formulas will remain in effect after the 2012-13 school year.
2. This system and its formulas are driven by student data, property values, and tax collections. As a result, certain assumptions were made concerning each of these details.
3. The student counts were held constant across the 15 years.
4. The certified CAD taxable value for school year 2011-12 was used as the base value to which the estimated project values for each year were added. These projected CAD values were then used for the CPTD values in each of the following years based on the lag between these two values as heretofore explained.
5. Tax collections each year were based on the district's 2011-12 adopted M&O rate of $1.04 and the adopted I&S rate of $0.3382 and an assumed collection rate of 100 percent each year.

These assumptions allow for the isolation of the effects of the property value limitation on the district's finances. The detail of these assumptions are summarized and depicted in Table I.

School Finance Impact on the District
In accordance with the proposed agreement and under the assumptions heretofore outlined, two models were prepared for comparison purposes in an effort to determine the projected financial impact, if any, to EISD resulting from this agreement.

The first model projects state and local revenue to the district under the agreement. In it, the taxable value of the project each year is added to the district's baseline taxable value including those years in which the value limitation is applicable.

The second model projects state and local revenue to the district without the provisions of the agreement. In this model, no value limitation is applied to the district's base taxable value; instead, the full taxable value of the project when added to the district's base year taxable value is used in place of the value limitation.

A summary of the differences is depicted in separate spreadsheet entitled "Exhibit B." Relatively small losses to the district are noted in years 3-7. Relatively small gains are also noted in years 8-10. The larger gain noted in year 11 is due primarily to the value lag between the CPTD and CAD values and the target revenue effect, both heretofore mentioned. As also mentioned, no attempt was made to forecast further reductions in ASATR funding beyond school year 2012-13. It should be noted, however, that this source of funding will come under future legislative review as early as the 2013 legislative session. **NOTE:** Because ASATR funding has the effect of offsetting school district revenue losses arising from limitations on the value of a qualified investment, any reduction of ASATR funding after the 2012-13 school year may result in significant increases in the amount of estimated revenue protection payable by the applicant to the district pursuant to the tax limitation agreement.

Impact on the Taxpayer (DCP)

As heretofore mentioned, the property resulting from this project is fully taxable in the first two years under this agreement. In year three, the tax value limitation applies, but only to the M&O taxes collected at the assumed M&O tax rate of $1.04 per $100 of taxable value.

Under the assumptions used herein, the potential tax savings resulting from the value limitation total $12,009,582. In addition, DCP is eligible for a tax credit on taxes paid on value in excess of the value limitation in each of the first two years. The cumulative tax credits are projected to be approximately $1,000,000; although, the Texas Education Agency (TEA) issues the reminder that these estimates will be recalculated based on current data prior to any issuance of the tax credits. The school district is to be reimbursed by the state for tax credit payments.

A separate spreadsheet entitled “chapter 313 template” illustrates the projected tax credits.

Facilities Funding Impact

The DCP project remains fully taxable for I&S taxes. This stipulation applies not only to the district’s current debt, but also to any future debt the district’s voters may choose to incur.

EISD is currently eligible for existing debt allotment (EDA) facilities assistance from the state. Increasing CPTD values resulting from taxable value added by the project may reduce, if not totally eliminate, future EDA payments. However, the increase in taxable value resulting from the project and the fact that the full value of this project remains fully taxable should offset, if not more than offset, any loss of state facilities assistance.

Summary

While some uncertainty abounds with regard to the future of the state’s public school finance system, the following points appear to currently apply to the DCP project and the EISD:

1. It meets the intent of the economic development initiative for the State of Texas.
2. It substantially enhances the district’s I&S tax base without creating substantial financial loss for the district with regard to M&O earnings over the term of the project.
3. It produces substantial tax incentives and savings for DCP.