



LEGISLATIVE BUDGET BOARD

Texas State Government Effectiveness and Efficiency Report Selected Issues and Recommendations

SUBMITTED TO THE 84TH TEXAS LEGISLATURE

PREPARED BY LEGISLATIVE BUDGET BOARD STAFF

JANUARY 2015

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January 20, 2015

Honorable Governor of Texas
Honorable Members of the Eighty-fourth Texas Legislature

Ladies and Gentlemen:

This edition of the Legislative Budget Board staff's *Texas State Government Effectiveness and Efficiency Report: Selected Issues and Recommendations* contains 49 analyses of the effectiveness and efficiency of Texas state government agencies and programs. The report has been prepared in compliance with the provisions of Chapter 322 of the Texas Government Code.

The evaluation and audit process, established under the provision of Chapter 322, are valuable tools to help the Texas Legislature identify and implement changes to improve state agency effectiveness and efficiency and ensure transparency of government programs. The results of these evaluations, coupled with ongoing reviews of each agency's progress towards the achievement of performance targets contained in the General Appropriations Act, help ensure state goals and objectives are met.

The analyses and 106 recommendations contained in this report pertain to a broad range of policy areas such as the funding and operation of the Economic Stabilization Fund; addressing the insolvency of the Teacher Retirement System Retiree Insurance Fund; increasing the number of graduate medical training positions for medical residents; improving transparency of how Medicaid rates for managed care organizations are set; and improving coordination and oversight of border security activities. Each review provides an overview of the salient findings and concerns related to the issue or program reviewed by Legislative Budget Board staff, as well as any associated recommendations and fiscal implications. The fiscal impact of these recommendations would vary depending on the option the Legislature chose to implement to address the concern identified in the report.

The staff of the Legislative Budget Board appreciates the cooperation and assistance of state agencies and other entities provided during the preparation of this report.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ursula Parks".

Ursula Parks
Director

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IMPROVE DATA COLLECTION AND REFORM STATE TRUANCY LAWS TO ENHANCE THE QUALITY OF TRUANCY INTERVENTIONS

Truancy generally refers to unexcused absence from school. Truancy is correlated with several negative outcomes for students, schools, and society. It is a major risk factor for dropping out, delinquency, and substance use. Literature on truancy programs indicates that combining school and community resources to address the specific cause of truancy for each student is a best practice.

School districts in Texas have a high degree of discretion to enforce truancy laws. Statute mandates that school districts must refer a student to court after accruing 10 unexcused absences in a six-month period, but the district may refer students to court upon accruing three unexcused absences in a four-week period. Districts are also given discretion regarding which court to refer a truancy offender to in jurisdictions where multiple courts hear such cases. Additionally, statute requires districts to develop truancy reduction plans but does not prescribe minimum standards for how truancy prevention should be carried out. This results in districts implementing truancy interventions that may be ineffective.

More than 160,000 complaints of failure to attend school and parent contributing to nonattendance were filed with local Texas courts in fiscal year 2014. The offense of failure to attend school is committed by a student; however, attendance violation cases for students age 12 or older are handled through adult criminal courts rather than juvenile justice courts, which only handle about 1,000 of these cases per year. Criminal courts do not provide all of the same protections for children as civil juvenile courts. Failure to attend school and parent contributing to nonattendance are both Class C misdemeanors that carry maximum fines of up to \$500 each, in addition to court costs and other sanctions. Judges have discretion regarding how much to fine defendants, and can impose a variety of court orders on defendants who are on deferred disposition or have been convicted. A lack of data collection by courts and school districts hinders policy makers' ability to measure the effects of various responses to truancy. Studying the variation among courts and increasing the consistency of truancy interventions would improve the Legislature's ability to compare and evaluate the effectiveness of programs and policies across the state. Implementing reforms to certain court procedures would provide additional protections for children and

families while maintaining the court's ability to enforce state law.

FACTS AND FINDINGS

- ◆ School districts have discretion in choosing when and how to intervene for students at risk of truancy.
- ◆ Texas received Safe and Drug-Free Schools and Communities grant funding to track truancy information, but the program allowed latitude in deciding which specific data to track.
- ◆ Texas processes most attendance violations through the adult criminal court system as Class C misdemeanors, while most other states process attendance violations by students through their juvenile courts.
- ◆ Data on the use of fines, fees, and other court orders for failure to attend school cases is not collected statewide.

CONCERNS

- ◆ Some school districts conduct ineffective interventions with students at risk for truancy that focus more on notifying students of the consequences of truancy rather than making meaningful interventions to address root causes.
- ◆ Some school districts enter inaccurate and incomplete truancy data in the Public Education Information Management System, which limits the system's reliability and usefulness to policy makers and stakeholders.
- ◆ The lack of centralized data collection on the use of fines, fees, and other court orders for failure to attend school cases limits the ability of policy makers and stakeholders to understand the variation of court practices and evaluate their impact on reducing truancy.
- ◆ Justice and municipal courts cannot charge a juvenile case manager fee prior to employing a juvenile case manager. Start-up costs can be a barrier to establishing a court juvenile case management program. Funds from a new court cost established in fiscal year 2013

have not been appropriated for truancy prevention and intervention activities and could be used to start juvenile case management programs.

- ◆ While courts are required to dismiss flawed complaints, statute does not specify at what point in the process this must occur. As a result, some courts accept flawed complaints and hold hearings, which families are required to attend, only to dismiss the complaints. These hearings result in unnecessary absences from school and work for families and use of the judges' and court staffs' time at hearings.
- ◆ Children are not entitled to appointed counsel for failure to attend school cases, and judges are not required to explain the long-term potential consequences of having a Class C misdemeanor criminal record. Therefore, children in these cases may not understand the full consequences of their pleas.
- ◆ Research on truancy and juvenile delinquency indicates overly punitive sanctions are ineffective and can alienate children from school. Not all children are given the option to avoid fines and a criminal conviction for their first offense by complying with court orders and attending school.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require the Texas Education Agency to adopt rules to define minimum standards for truancy prevention measures required by the Texas Education Code and establish best practices for these measures.
- ◆ **Recommendation 2:** Include a rider in the introduced 2016–17 General Appropriations Bill to require the Texas Education Agency to report on efforts to improve the completeness, accuracy, and usefulness of truancy data reported by school districts.
- ◆ **Recommendation 3:** Include a contingency rider to increase General Revenue Fund appropriations to the Office of Court Administration by \$150,000 in the introduced 2016–17 General Appropriations Bill and require the Office of Court Administration to study court processes and data on failure to attend school and parent contributing to nonattendance cases. The appropriation and study would be contingent on failure to attend school remaining a misdemeanor.

In consultation with the Texas Judicial Council Committee on Juvenile Justice, the Office of Court Administration also would be required to make recommendations to the Legislature to improve the effectiveness and efficiency of how courts manage these cases.

- ◆ **Recommendation 4:** Increase General Revenue Fund appropriations to Trusteed Programs Within the Office of the Governor by an estimated \$4.6 million and include a rider in the introduced 2016–17 General Appropriations Bill to distribute grants to local entities for truancy prevention and intervention services. The Eighty-third Legislature established a court cost to fund grants for juvenile case manager services and prevention activities. Revenue would have been deposited to a new General Revenue–Dedicated Truancy Prevention and Diversion Fund; however, this fund was not exempt from funds consolidation. Revenue is therefore deposited to the General Revenue Fund and no funds were appropriated for these grants.
- ◆ **Recommendation 5:** Amend statute to clarify that courts are required to dismiss failure to attend school complaints before they are scheduled for a hearing and without requiring the presence of the defendant if the complaints are missing statutorily required elements, filed against defendants outside the age range for the offense, or filed after the required deadline.
- ◆ **Recommendation 6:** Amend statute to require judges who preside over juvenile fine-only misdemeanor cases to explain the potential consequences of having a criminal record for applications to college, the military, and employment using standard language that would be developed by the Supreme Court of Texas.
- ◆ **Recommendation 7:** Amend statute to require courts to offer a deferred disposition option for students charged with failure to attend school for the first time, if they have not already gone through a diversion program approved by the court.

DISCUSSION

Although the legal definition of truancy varies by state, truancy generally refers to an unexcused absence from school. The following sections use the terms school districts, districts and schools to refer to independent school districts and

charter schools. In Texas, statute authorizes schools to file a complaint with a court against an individual from age 12 to 18 who is required to attend school but has at least three unexcused absences in a four-week period. If the student accrues 10 unexcused absences in six months, the school is required to file a complaint against the student, the student’s parents, or both. Texas statutes include two school attendance offenses for which schools can file with the courts. The two types of offenses can cause confusion when discussing attendance violations, because the term “truancy” has both a general meaning and a specific legal meaning. The more commonly cited offense is failure to attend school (FTAS). However, the school may sometimes instead refer a student (ages 10 to 17) to juvenile court for conduct indicating a need for supervision (CINS) if the truancy occurred when the student was younger than age 17. Schools also can file complaints against parents or guardians for parent contributing to nonattendance (PCTN).

Truancy is correlated with several negative outcomes. When students are truant, they can fall behind academically, which contributes to course failure and dropping out. Students who do not graduate high school are more likely to be unemployed and earn less on average than those who graduate. Truant students are more likely to participate in delinquent behavior and try drugs than students who are not truant. These outcomes affect the individuals who are truant and cost taxpayers. School districts do not earn funding for those

students with unexcused absences. Students who do not graduate are more likely to use social services and enter the criminal justice system.

CAUSES OF TRUANCY AND BEST PRACTICES

While each student who is truant may have different reasons for not attending school, research on truancy has identified some common school, family and community, and student factors that may lead to student truancy. **Figure 1** shows these factors.

Given the prevalence of truancy nationwide, many intervention methods have been tried throughout the country. Several truancy reduction programs have been found to be effective or promising by national clearinghouses of social services research. Literature on prevention and intervention programs identifies combining school and community resources to address the specific cause of truancy for each student as a best practice. Interventions should minimize punitive measures while still holding students and parents accountable. Interventions should also include a continuum of meaningful incentives and sanctions with progressive responses that escalate with the severity of problems.

TRUANCY IN TEXAS SCHOOLS

State law governing truancy provides significant discretion to districts on when and how schools can file a complaint.

**FIGURE 1
PRIMARY FACTORS IDENTIFIED AS CONTRIBUTING TO TRUANCY, AS OF FISCAL YEAR 2014**

SCHOOL FACTORS		
Inconsistent and ineffective school attendance policies	Poor record keeping	Not notifying parents/guardians of absences
Unsafe school environment	Poor school climate	Poor relations with teachers
Inadequate identification of special education needs	Poor interventions that fail to address root causes	Poor communication with parents by schools
FAMILY AND COMMUNITY FACTORS		
Negative peer influences, such as other truant youth	Financial, social, medical, or other issues that pressure students to stay home to help family	Child abuse and neglect
Family disorganization	Teen pregnancy or parenthood	Lack of family support for educational and other goals
Violence in or near the home or school	Differing culturally based attitudes toward education	
STUDENT FACTORS		
Lack of personal and educational ambition	Poor academic performance	Low school attachment
Alcohol and drug use and abuse	Unmet mental health needs	Lack of self-esteem
Retention/overage for grade	Poor relationships with other students	Gang involvement

SOURCES: Office of Juvenile Justice and Delinquency Prevention; U.S. Department of Justice.

Before filing, school districts are required to have a truancy reduction plan in place designed to reduce incidences of truancy, and districts must state in the complaint that truancy prevention measures were attempted for the student but were unsuccessful. However, no specifications or minimum standards exist for what constitutes a truancy reduction plan. Districts have the discretion to file on the student, the parent, or both. Additionally, districts in some jurisdictions have multiple courts to which they can refer students, and this practice has led to allegations that districts can choose to file in one court instead of another to achieve a specific outcome.

For these reasons, the application of truancy laws can vary depending on the school district. A district could have rigorous interventions with potentially truant students, file only after 10 unexcused absences, and could file on the student in a court in which the judge typically chooses not to issue fines. Another district could have a relatively ineffective truancy prevention program, file after three unexcused absences in four weeks, and file on both the student and parent to a court that regularly charges \$500 in fees for each charge and court costs. Students and parents could have differing outcomes for the same offense depending solely on the district in which the student attends school and in which court the district files.

In addition to avoiding the negative aspects of truancy for students and their communities and better promoting education, school districts' success in preventing truancy and absenteeism could increase state average daily attendance (ADA) funding to the district. According to estimates from the Texas Education Agency (TEA), districts received an average of approximately \$7,500 per student in unweighted ADA funding in fiscal year 2014, which equates to approximately \$41.67 per day that a student is in attendance. Increased funding would vary by district and is subject to

weighting based on specific student demographics, so this number cannot be used to determine costs in a particular district.

Some exemptions from these attendance requirements exist. Students who attend a private or parochial school that includes in its course a study of good citizenship are exempted from the requirements of school attendance. For this purpose home schools are considered a private school.

TRACKING AND REPORTING SCHOOL ATTENDANCE

Texas school districts track and report attendance in three ways: monitoring truancy, recording course credit, and reporting ADA for state funding. Attendance tracking for truancy is carried out by class period, with unexcused absences for days or parts of days counting toward a truancy referral. A school district may refer a student to court after three unexcused absences in a four-week period and, by law, must refer a student to court after 10 unexcused absences in a six-month period. Attendance keeping for course credit is also conducted by class period, and statute requires that a student must be present at least 90 percent of the days when a class is offered to receive full credit for the course. If a student is present between 75 and 90 percent of class days, the student is eligible for credit recovery by completing a plan approved by the principal that provides for the student to meet the instructional requirement of the class. ADA attendance is taken once each day to determine the attendance-based state funding a district will receive. School districts receive funding for students who are present; there is no process for excusing an absence for ADA funding purposes. **Figure 2** shows a comparison of these three tracking methods.

FIGURE 2
SCHOOL ATTENDANCE TRACKING METHODS, AS OF FISCAL YEAR 2014

MEASURE	TRUANCY	CREDIT	AVERAGE DAILY ATTENDANCE
Purpose	Tracking for court filings	Determining if student is eligible to graduate	Determining state average daily attendance funding
Frequency Recorded	Each class period	Each class period	Once per day
Excusal	Can be excused if determined appropriate	Cannot be excused but credit can be recovered	Cannot be excused
Threshold	Three unexcused absences in four weeks (district may file); 10 unexcused absences in six months (district must file)	90% or more: student is eligible for credit; 75% to 90%: student is eligible for credit recovery	Each occurrence

SOURCE: Legislative Budget Board.

SCHOOL DISTRICT REVIEWS OF ATTENDANCE AND TRUANCY

The Legislative Budget Board (LBB) School Performance Review Team conducted targeted reviews at nine school districts to gain an understanding of student attendance and truancy at the district level. School districts were identified and selected through analysis of the attendance and truancy Public Education Information Management System (PEIMS) data. LBB staff identified the top 30 districts with the highest number of reported truancy referrals, as well as the districts that reported zero or no truancy referrals. In addition, based on LBB staff research regarding the court-related programs in Harris and Dallas counties, all of the districts in these two counties were considered. Based on this analysis, nine districts were selected for LBB review, including Burleson Independent School District (ISD), Corpus Christi ISD, Del Valle ISD, Ector County ISD, Everman ISD, Garland ISD, Pasadena ISD, Raymondville ISD, and Roma ISD. LBB staff also surveyed all public school districts, including charter schools to augment what was learned through targeted onsite reviews. Of those surveyed, 330 districts responded, representing a 26.7 percent response rate.

The objectives of targeted reviews were to learn: how districts were tracking, recording, and reporting attendance; districts’ policies, procedures, practices, and management of attendance and truancy; and how districts and courts worked together to address attendance and truancy. To gather information, LBB staff conducted onsite activities at each district, including interviewing key district staff; conducting focus groups of staff, administrators and teachers; reviewing district data and related attendance and truancy information; and observing truancy court proceedings and/or meeting with court staff.

Figure 3 shows attendance and truancy data for the nine districts selected for targeted review. Only two districts’ attendance rates exceeded the state attendance rate of 95.9 percent in school year 2011–12. In four districts, PEIMS truancy data was either zero or not reported for school year 2012–13. However, during the onsite fieldwork, the review team learned that these districts had truancy referrals that were not reported to PEIMS.

ATTENDANCE REPORTING

Attendance tracking, recording, and reporting begins with the classroom teacher. Each district that LBB staff visited uses an electronic system to record attendance that was either

**FIGURE 3
ATTENDANCE AND TRUANCY DATA
SCHOOL YEARS 2011–12 AND 2012–13**

DISTRICT	ATTENDANCE RATE (1)	TRUANT ACTIONS (2)	TRUANT STUDENTS (2)
Burleson	96.2	583	395
Corpus Christi	94.9	1,083	1,018
Del Valle	95.5	0	0
Ector County	94.3	1,080	711
Everman	95.5	0	0
Garland	96.5	4,924	1,909
Pasadena	95.6	2,768	1,800
Raymondville	93.6	0	0
Roma	95.5	0	0

NOTES:

- (1) Attendance rate is for school year 2011–12, all other data is for school year 2012–13.
- (2) Although PEIMS data indicated some districts had zero or no truancy actions or students, LBB fieldwork revealed these districts had truancy referrals that were not reported to PEIMS.

SOURCE: Texas Education Agency.

developed by the district or was purchased from a vendor. Teachers have access to the system to record student attendance. Attendance reporting may vary by campus and district, depending on the administrator, but typically all districts reviewed reported attendance at 10:00 A.M. Most of the attendance systems have an automatic calling system that will call the student’s home to inform parents that the student is absent.

At the high school and middle school levels, attendance is taken at every class period for course credit. This attendance is used to determine if students are meeting the attendance requirement of 90 percent needed to receive credit for academic work. Districts have established various credit recovery initiatives for students to receive credit when they fail to meet the 90 percent requirement. These initiatives may include attending classes on Saturdays, before and after school, and during summer. Teachers and staff in the districts reviewed expressed concern that the credit recovery initiatives did not always require attendance equal to the amount of missed class time.

Each district has campus-level attendance staff responsible for generating attendance reports and reviewing the data for accuracy. This staff is responsible for resolving issues related to excused and unexcused absences. If there is an error in attendance reporting, the teacher has an opportunity to correct it by submitting the necessary documentation to

support the change. A reported absence automatically defaults to unexcused status in the system. However, when the student brings in a medical or parent's note for an absence, the attendance staff will change the student's attendance to an excused absence and maintain the documentation to support the change. Schools are required to accept a medical note but are given discretion to excuse an absence based on a parent's note. Discretion is also allowed to establish how many parent-excused absences are allowed before requiring a medical note. Across the nine districts reviewed, teachers and staff expressed concern regarding the number of parent notes that districts allowed for an excused absence. District policies and practices in this area varied, but overall the teachers and staff expressed the belief that the practice of accepting parent notes should be stricter. Most of the teachers and staff interviewed said that there should be a firm limit on the number of parent notes that would be allowed for an excused absence. Additionally, very few of the districts placed a limit on the number of days that could lapse after an absence before the note would be considered unacceptable.

After campus-level attendance staff complete review of the attendance reports, the data is submitted to the district-level attendance or PEIMS coordinator (this title varies by district) to complete the data review and prepare the data for PEIMS submission. The data review occurs periodically to ensure accuracy before submitting to TEA. The staff is responsible for resolving any discrepancies in the data.

ATTENDANCE AND TRUANCY MANAGEMENT

The process to identify and file truancy complaints varied. Each of the districts reviewed sent an attendance letter home when students met the initial number of absences that allows a district to file a truancy complaint with the court. At this point, districts employed some level of intervention, including home visits, phone calls, meeting with the parent and student, and referral for external support services. Some districts required that a minimum number of interventions occur to improve a student's attendance before the district proceeded with filing a truancy complaint with the court.

The districts that had dedicated staff to manage and handle truancy had more detailed processes and practices to ensure student attendance was monitored and court referrals were filed as necessary. For example, one district divided the schools into vertical learning communities. Each learning community consisted of a high school and middle and elementary schools that were in its attendance zones. The

office of student support services at the district assigned an attendance officer to each learning community. These attendance officers are housed at each of the district's five regular high school campuses, and each attendance officer is assigned to one of the justices of the peace in the area precincts. These officers met with students and parents regularly and conducted home visits specifically for students with attendance issues.

Most of the districts made additional efforts to get students to attend school before filing truancy complaints. In some districts, the result was that truancy referrals were made after the filing window. District staff reported various reasons for this delay. If district staff saw improved attendance while working with students and families, the district did not file truancy complaints with the court. If students appeared to understand the system and attended enough days that the 10 unexcused absences did not fall within a six-month period, the district did not file complaints.

Schools are required by statute to adopt truancy prevention measures that address student conduct and minimize referrals to court for charges related to truancy, and to file a statement with the court certifying that these measures were attempted and failed when filing a truancy complaint. However, having no defined minimum standards for what qualifies as truancy prevention measures has led to inconsistency across districts.

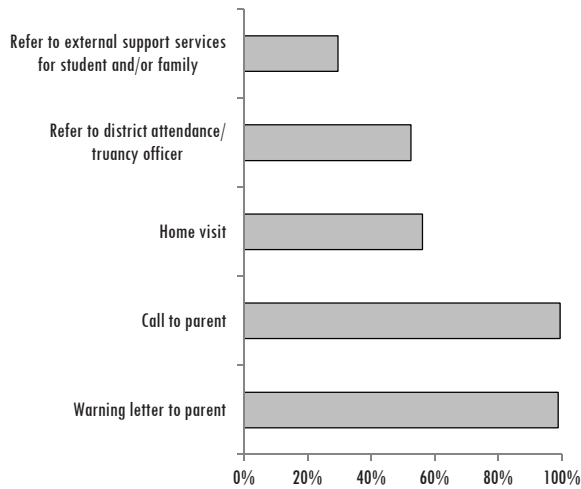
Some of the districts reviewed have adopted intervention plans with multiple strategies and points of contact, including holding conferences with students and parents, referring students to community resources, and sending an attendance clerk to conduct home visits. Districts also promote attendance by offering attendance rewards to students and campuses with the best attendance during a specified period. Other incentives included gift cards, free dress day at schools that require uniforms, and allocation of funds in the budget for student rewards. However, in other districts, the intervention consisted solely of a brief meeting between attendance staff and the student to outline the law regarding truancy and its consequences.

The survey of school districts reinforced these findings. The most common methods of interventions for districts that responded to the survey were sending a warning letter to the parent and calling the parent; about 99 percent of the districts reported using these interventions. About 50 percent of the districts reported conducting home visits and/or referring the student to a district/truancy officer. The least reported (30 percent) method of intervention was to refer the student

and/or family to external support services. **Figure 4** shows these results.

**FIGURE 4
ATTENDANCE AND TRUANCY SCHOOL DISTRICT SURVEY
RESULTS, SEPTEMBER 2014**

Survey Question: What truancy intervention activities does the district/campus staff use to encourage student attendance prior to filing a truancy complaint with the court? (Select all that apply)



SOURCE: Legislative Budget Board.

Lack of clarity in statute about what constitutes acceptable intervention measures has led to inconsistent application and use of interventions that may be ineffective at reducing truancy and treating its root causes.

Recommendation 1 would amend the Texas Education Code to require TEA to adopt rules to define minimum standards for truancy prevention measures currently required by the Texas Education Code and establish best practices for these measures. Most states require early interventions such as mandatory home visits and truancy conferences among students, parents, and school staff.

FILING TRUANCY COMPLAINTS

Once the district has exhausted its intervention efforts and is prepared to file a complaint, the district compiles the necessary supporting documentation to file with the court. Documentation includes attendance records, grades, documented interventions, disciplinary incidents, and any other information as needed.

Districts with dedicated truancy staff are able to attend court and follow the proceedings more closely. Districts without

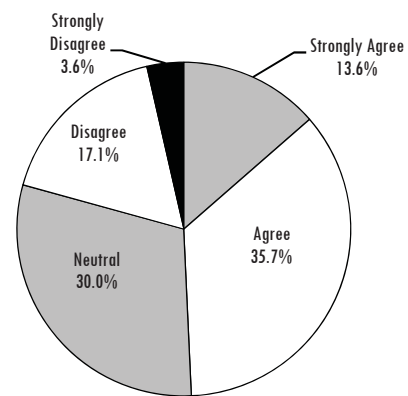
staff resources fully dedicated to truancy were not always available to send staff to court.

Relationships between the districts and courts varied. An example where the district worked closely with its court was the “Stay-in-School” program. This program is established as a diversion program to allow parents and students the opportunity to correct attendance issues. Parents and students are placed on a contract that requires attending training classes to assist with the identified needs of the student and family and the student to attend school and maintain passing grades. However, another district reported that no truancy cases have been heard in its court in at least six years. Specifically, the district said that, in school year 2012–13, it filed approximately 200 truancy complaints with the justice courts that have not been heard. According to the district, the justice courts in the county have consistently refused to hear any truancy cases. Students in this district know that there are no consequences for failure to attend school, so the attendance problem persists.

LBB’s survey of school districts asked whether state requirements about filing truancy complaints are effective at reducing truancy rates. **Figure 5** shows that 49 percent of districts agreed or strongly agreed with this statement.

**FIGURE 5
ATTENDANCE AND TRUANCY SCHOOL DISTRICT SURVEY
RESULTS, SEPTEMBER 2014**

Survey Question: State requirements about filing truancy complaints are effective at reducing truancy rates.



SOURCE: Legislative Budget Board.

SCHOOL DISTRICT ONSITE REVIEW OBSERVATIONS

While the way in which districts implement attendance and truancy laws differs, school districts use similar strategies to

address challenges in providing truancy interventions. District staff identified the following as strengths of their efforts to address attendance:

- attendance accounting and automated calling systems;
- dedicated attendance/truancy officers;
- communication with parents;
- attendance incentives; and
- Communities in Schools (in the districts that used this service).

The areas that district staff said were lacking included:

- staff resources;
- consistency among the districts' campuses;
- parental involvement;
- parental understanding of state laws; and
- court support.

When considering the external resources that districts could access, districts said there could be a greater effort at accessing the media to educate parents and the community regarding the importance of attending school and the consequences for not attending school. Districts noted that several external factors hinder progress in reducing truancy, including:

- mobile students and population;
- poor parenting skills;
- economically disadvantaged status;
- inaccurate contact information for students and parents;
- high homeless rates among the student population; and
- poor transportation infrastructure.

LBB staff also found that parents can withdraw students to avoid truancy referrals. Parents may take their children out of one district and enroll them in another district or choose to home school them. By doing this, the students and parents avoid the legal consequences of truancy, and the district has to dismiss the case once a student leaves the district.

INCONSISTENCIES IN RECORDING AND REPORTING TRUANCY DATA

Despite the effects of truancy on individuals and society, data on the scope of the problem is difficult to gather, both locally and nationally. Average daily attendance rates do not clearly show how many students are frequently absent without excuse or have failed to enroll in school. Schools may not always file complaints, or they may file multiple complaints against the same student for repeated offenses. As a result, filed case numbers likely underestimate the actual incidence of truancy.

Statute establishes two school attendance offenses for which schools can file with the courts. The more common offense is failure to attend school (FTAS), which is usually filed with a justice of the peace, municipal, or constitutional county court. However, the school may sometimes instead refer a student (ages 10 to 17) to juvenile court for a charge of conduct indicating a need for supervision (CINS) for truancy. Schools can also file complaints against parents or guardians for a charge of parent contributing to nonattendance (PCTN).

Data on school attendance offenses is reported by school districts via PEIMS to TEA. The database includes fields to capture detailed information, including both incidents of truancy and number of students, a breakdown of whether charges were accompanied by a fine, and whether the charge was filed after three absences or 10.

PEIMS was authorized by the Legislature in fiscal year 1984 to centralize and digitalize educational recordkeeping. The federal No Child Left Behind Act of 2001 established grants through the Safe and Drug-Free Schools and Communities (SDFSC) program. As a requirement to receive funds through this program, states were required to track truancy data but had discretion on how to implement the requirement.

Texas received SDFSC funding and implemented this grant reporting requirement by adding fields to PEIMS to allow districts to report truancy data to TEA, including: counts for the number of truancy complaints for three absences in four weeks (optional) or for 10 absences in six months (mandatory); number of PCTN filings; number of complaints reported for failure to enroll; and number of cases in which fines were and were not assessed by the court. PEIMS truancy data is compiled and submitted at the district level. Although these grants are no longer funded and states are no longer required to submit truancy data, TEA continues

to collect truancy data through PEIMS and submit it voluntarily to the U.S. Department of Education.

The usefulness of PEIMS truancy data is limited because it is inaccurate and incomplete. As discussed previously, some districts selected for review reported no truancy data. PEIMS data entry screens prompt the user for missing information with “fatal errors” that notify the PEIMS coordinator that crucial information has not been entered, and the PEIMS submission cannot be completed until these blank fields have been filled. However, with the exception discussed below, there is no prompt for missing truancy data. As a result, some school districts do not enter truancy data. In other cases, districts reported that they were not aware that truancy data should be entered in PEIMS. PEIMS data also does not distinguish what offense was filed against students.

To enter information in the fields relating to number of filings that resulted in a fine or no fine, the district must have access to information on the outcome of court cases. Some districts have dedicated staff present in court for all truancy-related hearings, and the staff report outcome information to the PEIMS coordinator so that it may be entered in PEIMS. However, many districts, particularly those smaller in population, do not have personnel to attend court and gather this information and thus have more difficulty in obtaining it. Districts reported that if data is entered for truancy referrals but court outcomes are left blank, PEIMS generates a fatal error that blocks data from being submitted until this is resolved. As a result, districts that do not have access to court outcome information either do not enter truancy referral information or incorrectly enter “0” in the field for court outcomes. This results in inaccurate and incomplete truancy information being reported in the PEIMS database.

One data field in the PEIMS data truancy section is labeled “failure to enroll,” which corresponds to the number of students who were not enrolled in school at the beginning of the school year. However, failure to enroll is not a charge, and if these cases are referred to a court they are referred as FTAS, PCTN, or both charges, leading to confusion regarding how to count these cases. In addition, schools are not required to track incidents of failure to enroll and many do not, leading to missing and inconsistent PEIMS reporting. In school year 2012–13, 33 of the 1,025 independent school districts in Texas (3.2 percent) entered data for failure to enroll. Eight districts (0.8 percent) entered data for each year from school year 2008–09 to school year 2012–13.

There is no state-level process to verify that PEIMS truancy data is complete and accurate. TEA cross-checks attendance and financial information in PEIMS to identify inaccuracies and inconsistencies in reported data used to calculate state funding. There is no similar process for PEIMS truancy data, and school-reported truancy data cannot be compared to aggregate court data because jurisdictional boundaries of school districts and court districts do not all align. The result of this lack of oversight and verification of data is that PEIMS truancy data is missing, inaccurate, and unreliable for policy makers to make informed decisions.

TEA has the statutory authority and ability to address these concerns. Recommendation 2 would include a rider in TEA’s bill pattern in the introduced 2016–17 General Appropriations Bill to require TEA to report to the LBB and the Office of the Governor by January 1, 2017, on efforts to improve the completeness, accuracy, and usefulness of truancy data reported by school districts. To improve the quality of truancy data, TEA should modify PEIMS to collect data that is of the greatest value and utility to school districts and to inform state policy analysis. This should include, at a minimum, modifying PEIMS Code 425, Student–Disciplinary Action record, to:

- consolidate Disciplinary Action Codes 16 (fine assessed) and 17 (no fine assessed) into a single code that does not reference fines;
- retain codes for number of filings for three unexcused absences in four weeks, 10 unexcused absences in six months, and parent contributing to nonattendance;
- remove PEIMS Disciplinary Action Reason Code 45 (failure to enroll in school); and
- prompt the user with a fatal error when truancy data has been left blank.

TEA should include in its report a summary of efforts undertaken, an assessment of the prevalence of truancy, and any recommendations for further improving state data collection efforts or truancy policy.

In addition to truancy data reported by school districts, courts report data on the number of truancy complaints filed. **Figure 6** shows the total number of complaints filed in Texas for FTAS and PCTN as reported to the Office of Court Administration (OCA) by local courts. **Figure 7** shows the number of CINS offenses referred to juvenile courts.

**FIGURE 6
NUMBER OF COMPLAINTS FILED FOR FAILURE TO ATTEND SCHOOL AND PARENT CONTRIBUTING TO NONATTENDANCE BY COURT, FISCAL YEARS 2010 TO 2014**

FAILURE TO ATTEND SCHOOL					
COURT	2010	2011	2012	2013	2014
Justice of the Peace	94,824	95,897	68,189	69,967	54,997
Municipal	18,252	23,449	10,020	10,804	8,501
Dallas County Truancy	38,465	35,031	28,506	25,495	19,971
Fort Bend County Truancy			5,190	4,722	4,594
TOTAL	151,541	154,377	111,905	110,988	88,063

PARENT CONTRIBUTING TO NONATTENDANCE					
COURT	2010	2011	2012	2013	2014
Justice of the Peace	65,958	67,606	57,475	65,852	60,297
Municipal	6,499	5,785	5,121	5,349	4,269
Dallas County Truancy	9,081	13,623	9,185	9,713	10,202
Fort Bend County Truancy			255	422	338
TOTAL	81,538	87,014	72,036	81,336	75,106

NOTE: Fort Bend County Truancy Court was established in fiscal year 2012. Justice reporting rates: 2010–99.7%, 2011–98.1%, 2012–100%, 2013–99.2%, 2014–99.2%. Municipal reporting rates: 2010–99.2%, 2011–99.3%, 2012–94.6%, 2013–93%, 2014–91.8%.
SOURCE: Legislative Budget Board.

**FIGURE 7
CONDUCT INDICATING A NEED FOR SUPERVISION
REFERRALS STATEWIDE, FISCAL YEARS 2012 AND 2013**

OFFENSE	2012	2013
Failure to Attend School	502	538
Truancy	453	507
Other CINS	7,532	6,618
Total CINS	8,487	7,663

NOTE: CINS: Conduct Indicating a Need for Supervision.
SOURCE: Legislative Budget Board.

Courts are not required to report other data to OCA about these cases. For example, courts are not required to report data specifically for FTAS and PCTN cases on:

- demographics of the defendant (e.g. age, race, family income, primary language spoken);
- number of unexcused absences at time of filing;
- previous charges filed against the defendant;
- plea;
- disposition of the case (e.g. dismissed and reason for dismissal, or fine or other sanction ordered);
- amount of fine;
- whether the fine was paid or not;

- whether the defendant was held in contempt of court;
- whether the defendant was referred to juvenile court;
- whether the court employs a juvenile case manager; or
- whether a juvenile case manager was assigned to the defendant.

The lack of data collection by school districts and courts hinders policy makers’ ability to measure the effects of responses to truancy. No agency tracks what prevention or intervention measures have been used by school districts statewide before filing charges against students and parents. No single agency collects complete, statewide data on the outcome of each FTAS and PCTN case. Legislation passed by the Eighty-third Legislature, Regular Session, 2013, to increase the confidentiality of juvenile cases may further reduce the availability of that data. Therefore, there is no way to compare the amount of fines assessed, collected, or waived across the state without contacting each court individually. There is also no central source of data on how frequently court orders other than fines are issued, such as community service, counseling, tutoring, drug testing, electronic monitoring, or other requirements. The lack of a central source for this data makes gathering statewide information to measure the range and variation of practices resource- and

time-intensive and limits the availability of this information to policy makers.

Recommendation 3 would include a contingency rider to increase General Revenue Fund appropriations to OCA by \$150,000 in the introduced 2016–17 General Appropriations Bill and require OCA to study court processes and data on cases that involve complaints of FTAS or PCTN, in consultation with the Texas Judicial Council Committee on Juvenile Justice (Judicial Council). This would be contingent on failure to attend school remaining a misdemeanor. OCA and the Judicial Council would be required to make recommendations to the Legislature to improve the effectiveness and efficiency of the courts for these cases. Areas of analysis should, at a minimum, include:

- average time between date of filing and date of first hearing;
- number of unexcused absences cited in complaint;
- information included in complaints regarding interventions attempted;
- the plea and disposition of each FTAS and PCTN case;
- court orders issued;
- amount and frequency of fines or special expense fees assessed;
- amount of fines and special expense fees collected;
- amount of fines and special expense fees waived;
- availability of deferred disposition for first-time offenders;
- rate of repeat offenses for FTAS and PCTN;
- whether the court has a juvenile case manager on staff; and
- demographic data on the age and family income of each defendant.

TRUANCY IN TEXAS COURTS

As of calendar year 2012, truancy violations were specified in statute as status offenses in 42 states, including Texas. A status offense is a behavior that is an offense that would not be a crime if committed by an adult. Examples of other common status offenses include running away, violating curfews, or ungovernability. As of 2012, status offenses in 36 states were handled exclusively in the same courts that handle

juvenile delinquency cases. Other states have multiple courts with jurisdiction regarding status offenses, as Texas does, or completely separate jurisdiction regarding status offenses and juvenile delinquency.

In Texas, there are two potential offenses a student can commit by violating attendance laws. The first is found in the Texas Family Code: Nonattendance is one of several behaviors that can be considered for a CINS charge. Students ages 10 to 17 can be referred to juvenile court for a CINS offense for truancy. Juvenile courts are considered civil, not criminal. The second offense, FTAS, is found in the Texas Education Code and applies to students age 12 and older but younger than age 18. FTAS is a Class C misdemeanor, which is usually adjudicated in a criminal court rather than a civil juvenile court. The offense of FTAS as a Class C misdemeanor was established by the Seventy-third Legislature, Regular Session, 1993. At the time, some juvenile courts were not hearing CINS truancy cases for six to 18 months after they were filed because of the volume of cases filed. To alleviate the backlog, the Legislature authorized juvenile courts to transfer jurisdiction regarding CINS truancy cases to justice of the peace courts (“justice courts”). Supporters for the change argued that justice courts could more quickly hear the cases and monitor youth for compliance with their orders.

According to judicial educators, it is less costly and faster to adjudicate cases in criminal court than in juvenile court. Many cases that could be filed as CINS are now filed as Class C misdemeanors in Texas. Criminal courts, which include municipal, justice, and certain county courts, have jurisdiction regarding many cases that previously were the jurisdiction of juvenile courts, and often still are in other states. In Texas, the majority of FTAS cases are heard in justice courts, and some are heard in municipal courts. In fiscal year 2003, the Legislature authorized county courts in counties with populations of more than two million to hire magistrates dedicated to hearing only FTAS and PCTN cases. This allowed the formation of the Dallas County truancy court. Fort Bend County was also allowed to form a dedicated truancy court by legislation in fiscal year 2011. **Figure 8** shows the criminal courts that could exercise jurisdiction over FTAS cases. Together, these criminal courts process more complaints against youth accused of offenses than do juvenile courts and juvenile probation services combined.

The juvenile and criminal court systems have different approaches to truancy cases. Some stakeholders have argued

**FIGURE 8
CRIMINAL COURTS WITH POTENTIAL JURISDICTION REGARDING FAILURE TO ATTEND SCHOOL CASES, CALENDAR YEAR 2014**

COURT	JURISDICTION	LOCATION	NUMBER
Justice of the Peace	Class C misdemeanors, minor civil matters, small claims, magistrate functions	Every county in Texas must have between one and eight precincts, and each precinct must have one or two courts, or "places," depending on population.	817 courts, 817 judges
Municipal	Class C misdemeanors, violations of city ordinances, civil cases involving dangerous dogs, magistrate functions	Incorporated cities and towns	927 cities, 1586 judges
Constitutional county court magistrates dedicated to truancy	Cases involving charges of failure to attend school and parent contributing to nonattendance	Dallas County and Fort Bend County, but authorized for any county with a population of more than 1.75 million, or counties with a population of more than 585,000 that are contiguous to a county with a population of at least four million	2 courts, 9 magistrates

SOURCE: Legislative Budget Board.

cases involving children should be returned to the civil juvenile system, but neither juvenile courts nor probation departments have the capacity to absorb the caseloads served by the criminal courts without a significant increase in resources. Recent legislation has focused on increasing parity between juvenile and criminal courts by adding requirements and options for criminal courts processing cases against children. **Figure 9** shows summaries of select provisions of certain recently passed bills that were intended to increase parity between the court systems. The introduced version of

Senate Bill 1234, Eighty-third Legislature, Regular Session, 2013, included language to repeal failure to attend school and parent contributing to non-attendance from the Education Code altogether, leaving only the CINS offense for truancy. However, this language was removed from subsequent versions of the bill. At least three substantial differences remain between the juvenile and criminal systems in the potential outcomes for children. **Figure 10** shows a comparison of select features of the juvenile and criminal

**FIGURE 9
SUMMARIES OF SELECT PROVISIONS OF CERTAIN PASSED BILLS REGARDING CHILDREN AND COURTS
FISCAL YEARS 2009 TO 2013**

BILL	SUMMARY OF SELECT PROVISIONS
Eighty-first Legislature, 2009	
House Bill 1793	<ul style="list-style-type: none"> requires judges hearing juvenile Class C misdemeanor cases to complete two hours of training on child welfare and the Individuals with Disabilities Education Act every five years
Eighty-second Legislature, 2011	
Senate Bill 1489	<ul style="list-style-type: none"> specifies that the offense of failure to attend school applies to an individual ages 12 to 18 states that a dispositional order for failure to attend school would be limited to being effective for 180 days after the date of the order, or beyond the end of the school year in which the order was entered, whichever period is longer requires a county, justice, or municipal court to dismiss the complaint against an individual for failure to attend school if the individual proves that he or she has complied with the court order or obtains a high school diploma or equivalency certificate authorizes a court to waive a fee or court costs if it is determined that the fee would cause financial hardship authorizes an individual's conviction for failure to attend school to be expunged if the court finds that the individual complied with the court orders or obtained a high school diploma or equivalency certificate before age 21 requires school districts to adopt unspecified truancy prevention measures and certify that the districts applied truancy prevention measures, and that the measures failed to address the student's conduct related to truancy, in order for the school district to file a complaint or referral on an individual requires school districts to specify in a complaint against a student for failure to attend school whether or not the student is eligible for or receives special education services

FIGURE 9 (CONTINUED)
SUMMARIES OF SELECT PROVISIONS OF CERTAIN PASSED BILLS REGARDING CHILDREN AND COURTS
FISCAL YEARS 2009 TO 2013

BILL	SUMMARY OF SELECT PROVISIONS
Eighty-second Legislature, 2011 (Continued)	
Senate Bill 209	<ul style="list-style-type: none"> • requires that juvenile case managers give priority to cases of failure to attend school and parent contributing to nonattendance • requires the juvenile case manager to timely report any information relevant to assisting the judge in making decisions in the best interest of the child • requires the judge to consult with the juvenile case manager supervising a case regarding the child's circumstances; these provisions do not apply to county court judges with magistrates to hear attendance violation cases
Senate Bill 61	<ul style="list-style-type: none"> • establishes minimum training and educational standards for juvenile case managers, including case planning and management; juvenile law; courtroom proceedings and presentation; law enforcement proceedings; local programs and services, including access procedures; code of ethics and disciplinary procedures; and detecting and preventing abuse, exploitation, and neglect of children
House Bill 1964	<ul style="list-style-type: none"> • authorizes a judge to dismiss all or part of a defendant's fines or costs for a Class C misdemeanor through community service if the defendant is younger than age 17 • restricts the total amount of community service hours sentenced to a juvenile to be 200 hours or fewer, and no more than 16 hours per week; the defendant would be authorized to pay the fine and costs assessed at any time to discharge the community service obligation
House Bill 350	<ul style="list-style-type: none"> • authorizes a judge to dismiss all or part of a defendant's fines or costs for a Class C misdemeanor through community service or tutoring if the defendant is younger than age 17 • restricts the amount of community service or tutoring hours required to no more than 16 hours per week
Eighty-third Legislature, 2013	
House Bill 528	<ul style="list-style-type: none"> • adds confidentiality for the records of children charged with a fine-only misdemeanor (other than a traffic offense) who had appealed, been found not guilty, been granted deferred disposition, or had a charge dismissed (1)
Senate Bill 393	<ul style="list-style-type: none"> • authorizes a criminal court to permit a child defendant to choose to discharge a fine or cost by either paying the fine or cost or by performing community service or receiving tutoring • authorizes a justice or municipal court to waive payment of a fine or cost accrued during childhood if discharging the fine or cost in an alternative method, including performing community service, would impose an undue hardship • provides that all records and files relating to a child who has received a dismissal after deferral of disposition are confidential • authorizes a criminal court to employ one or more juvenile case managers to provide prevention and early intervention services before cases are filed • requires that a criminal court dismiss a complaint made by a school district if the complaint is not filed correctly • requires that courts determine, on motion, if there is probable cause to believe that a child, including a child with a mental illness or developmental disability, lacks the capacity to understand the proceedings or assist in her or his own defense, or to appreciate the wrongfulness of her or his own behavior; and, if so, the court may dismiss the complaint • clarifies that a person cannot be prosecuted or convicted for an offense that occurred before age 10 • establishes a rebuttable presumption that a person 10 years of age but younger than 15 is generally incapable of committing many fine-only misdemeanors; • authorizes juvenile boards to expand the use of first offender and diversion programs used in the juvenile system to include non-traffic Class C misdemeanors
Senate Bill 394	<ul style="list-style-type: none"> • adds that records and files relating to a child who has received a dismissal after deferral of disposition for a fine-only misdemeanor (other than a traffic offense) are confidential and may not be disclosed to the public
Senate Bill 395	<ul style="list-style-type: none"> • authorizes a criminal court to permit a child defendant to choose to discharge a fine or cost by either paying the fine or cost or by performing community service or receiving tutoring • authorizes a justice or municipal court to waive payment of a fine or cost accrued during childhood on a defendant who defaults on payment if discharging the fine or cost in an alternative method, including performing community service, would impose an undue hardship

FIGURE 9 (CONTINUED)
SUMMARIES OF SELECT PROVISIONS OF CERTAIN PASSED BILLS REGARDING CHILDREN AND COURTS
FISCAL YEARS 2009 TO 2013

BILL	SUMMARY OF SELECT PROVISIONS
Eighty-third Legislature, 2013 (Continued)	
Senate Bill 1114	<ul style="list-style-type: none"> • requires a court to dismiss a complaint or a referral made by a school district that does not comply with statutory requirements • permits a child accused of a Class C misdemeanor, other than a traffic offense, to be referred to a first offender program • prohibits a case from being filed with a criminal court when the child has successfully completed the first offender program
Senate Bill 1234	<ul style="list-style-type: none"> • clarifies that a high school equivalency certificate used for dismissal or expungement must be from taking a high school equivalency exam administered under section 7.111 of the Education Code. • removes school districts from entities that may employ a case manager or contribute to the costs of a case manager. • prevents a school district from revoking the enrollment of a person voluntarily enrolled or attending school after age 18, but who has more than five unexcused absences in a semester, on a day when the person is physically present at school.
Senate Bill 1234 (continued)	<ul style="list-style-type: none"> • adds that after the third unexcused absences of a person voluntarily enrolled or attending school after age 18, a school district shall issue a warning letter to the person notifying the person that his or her enrollment may be revoked for the remainder of the school year if the person has more than five unexcused absences in a semester. As an alternative to revoking the person's enrollment, the school district may impose a behavior improvement plan. • adds that truancy prevention measures should be designed to address student conduct before the student commits a failure to attend school offense. • defines potential truancy prevention measures • requires certain counties to establish a committee to recommend uniform truancy policies for school districts in those counties • requires school districts to employ a truancy prevention facilitator or designate an existing employee to implement truancy prevention measures and meet at least annually to discuss effective truancy prevention measures with a case manager or other court staff designated to provide services to students in truancy cases • changes failure to attend school from a Class C misdemeanor to a fine-only misdemeanor and set limits on fines based on the number of offenses. • adds that school districts may file a complaint against both the student and the parent only if the district provides evidence both the student and the parent contributed to the student's failure to attend school. (2)
Senate Bill 1419	<ul style="list-style-type: none"> • establishes a new \$2 court cost on certain municipal and justice court cases to be deposited into a dedicated state account for truancy prevention and diversion (3) • permits the county or city to keep 50% of the cost for the purposes of operating or establishing a juvenile case manager program • authorizes a local government entity to request funds from the dedicated state account to provide truancy prevention and intervention services

NOTES:

- (1) The Office of Court Administration submitted a request to the Attorney General to determine whether this provision conflicted with the provisions regarding confidentiality in Senate Bills 393 and 394 because of differences in the timing during the case of when confidentiality applied. The Attorney General stated in opinion GA-1035 that the bills did not irreconcilably conflict, and that, as of January 1, 2014, confidentiality begins at the moment of charging; however, according to the Court of Criminal Appeals, while Attorney General opinions are persuasive, they are not binding on courts.
- (2) This bill was vetoed by the Governor.
- (3) The dedicated state account that Senate Bill 1419 established was not exempted from funds consolidation, and with the enactment of House Bill 6, Eighty-third Legislature, Regular Session, 2013, the Truancy Prevention and Diversion Fund was abolished and all revenues dedicated to that fund are instead deposited to General Revenue Funds.

SOURCE: Legislative Budget Board.

justice system that could affect the outcome for a student charged with an attendance violation.

Citing these differences and other issues, advocacy groups filed a complaint in June 2013 with the U.S. Department of Justice alleging that the Dallas County truancy court violates children's rights guaranteed by the U.S. Constitution, the

**FIGURE 10
COMPARISON OF FEATURES OF THE JUVENILE JUSTICE
AND CRIMINAL JUSTICE SYSTEMS FOR ATTENDANCE
VIOLATIONS, AS OF CALENDAR YEAR 2014**

JUVENILE COURT: CONDUCT INDICATING A NEED FOR SUPERVISION FOR TRUANCY	CRIMINAL COURT: FAILURE TO ATTEND SCHOOL
A prosecutor is required to review cases before the initial hearing.	There is no requirement for prosecutorial or judicial review before the initial hearing.
A child cannot be fined.	If convicted, a child could be fined up to \$500 per offense and possibly face additional fines and charges for noncompliance with court orders.
A child is appointed counsel for all proceedings if the child is indigent.	A child would not be entitled to appointed counsel, even if the child were indigent and the case went to trial.

SOURCE: Legislative Budget Board.

Equal Educational Opportunities Act of 1974, Title II of the Americans with Disabilities Act, and Title IV of the Civil Rights Act of 1964.

POTENTIAL PENALTIES FOR CRIMINAL CHARGES

Failing to attend school has negative academic and social consequences, but the criminal charges associated with it also have consequences for children and families. Pursuant to law, the maximum penalty for families could be more than \$1,000 in fines and court costs if a student is convicted of FTAS and the parent is convicted of PCTN for the first time, which could happen if a student missed three class periods in four weeks. To appear in court, students often have to miss additional school, and parents often have to miss work, sometimes several times, which could jeopardize some parents’ jobs. If parents do not attend the hearings, they could be charged with another Class C misdemeanor. Research by the U.S. Department of Justice’s Office of Juvenile Justice and Delinquency Prevention (OJJDP) showed that 87 percent of the students participating in Truancy Reduction Demonstration Programs qualified for free or reduced-price lunches. Families with lower incomes are likely to be more affected by court fines than families with higher incomes. Courts have the authority to enforce collaboration and cooperation among families, schools, and community services, and some stakeholders believe that the financial and legal sanctions imposed are necessary to motivate a change in behavior by students or parents. Others

believe that these sanctions are too punitive, do not address the underlying causes of truancy, and are imposed on many families with extenuating circumstances.

Some Texas communities have implemented specific diversion programs for FTAS cases to avoid criminal court. In fiscal year 2013, the Legislature amended the Texas Family Code to authorize juvenile boards to use juvenile first offender programs for non-traffic Class C misdemeanors, instead of only for CINS offenses or certain delinquent conduct. These programs allow for the informal disposition of cases without referral to courts, also known as “deferred prosecution.” However, statute only mentions referrals to the program explicitly from law enforcement officers charging children with an offense. Given that FTAS is filed by a school district, it is not clear how often first offender programs will, in practice, be used for students with FTAS complaints filed against them.

The Legislature also expanded the role of juvenile case managers in fiscal year 2013 to further divert cases from court when possible. Juvenile case managers were authorized to be involved in diversion measures without a formal court order and provide prevention and intervention services to juveniles before a case is filed. The position of juvenile case manager was authorized in fiscal year 2001, and training and educational standards were established in fiscal year 2011. Juvenile case managers are required to assist the court in administering the court’s juvenile docket, and the case managers are required to give priority to FTAS and PCTN cases. The juvenile case managers are required to timely report to the judge any information or recommendations relevant to assisting the judge in making decisions that are in the best interest of the child, and the judge is required to consult with the juvenile case manager supervising a case on the child’s history, home environment and status, and any sanctions available that would be best for the child. However, part-time judges and county court judges that have appointed full-time magistrates are not subject to this requirement.

Before fiscal year 2012, all justice and municipal courts were allowed to charge an optional \$5 court cost to hire and fund a juvenile case manager position. However, in fiscal year 2011, the Legislature amended statute to limit the optional court cost only to courts that already had a juvenile case manager. As a result, courts without a juvenile case manager cannot charge that fee until they hire a juvenile case manager. Lack of funding can be a barrier to courts starting a new juvenile case management program. Senate Bill 1419, Eighty-third Legislature, Regular Session, 2013, established a

new, mandatory \$2 court cost to fund juvenile case manager services and prevention activities. If a county or municipality had established or is in the process of establishing a juvenile case manager program, it could retain 50 percent of the court cost locally for the program; if not, all the revenue from this court cost is remitted to the state. The Legislature also established a new Truancy Prevention and Diversion Fund as a General Revenue–Dedicated account to which the revenue from the court cost would be deposited. Monies deposited into this account were to be appropriated only to the Office of the Governor’s criminal justice division to be distributed as grants to local entities for truancy prevention and intervention services. This revenue was intended to provide more resources to hire juvenile case managers and to provide alternatives to adjudicating youth, which could include funding other community prevention and diversion programming.

However, the Truancy Prevention and Diversion Fund was not exempted from funds consolidation, and with the passage of House Bill 6, Eighty-third Legislature, Regular Session, 2013, the Truancy Prevention and Diversion Fund was abolished, and all revenues dedicated to that fund are instead deposited to the General Revenue Fund. From January through August 2014, \$1.6 million was collected from the fee. No funds were appropriated to the Office of the Governor specifically for truancy prevention and intervention services for the 2014–15 biennium. Recommendation 4 would increase appropriations to Trusteed Programs Within the Office of the Governor in the introduced 2016–17 General Appropriations Bill by \$4.6 million in General Revenue Funds for grants to local entities for truancy prevention and intervention services, consistent with provisions in Senate Bill 1419, Eighty-third Legislature, Regular Session, 2013. Grants could be used for programs designed to reduce the incidence of truancy and its consequences, which include higher rates of academic failure, substance use, and juvenile delinquency. For example, prevention and intervention services could include court diversion programs, juvenile case manager positions, or social services to families to address the causes of students’ truancy. The associated rider would prioritize the use of these funds to establish juvenile case managers in jurisdictions that do not already have them, to efficiently leverage funds.

In fiscal year 2011, the Legislature required school districts to implement truancy prevention measures to minimize FTAS complaints, although the elements of what constitutes a truancy prevention measure were not defined. At the time a

school district files a complaint for FTAS, the district is required to certify in writing that it has unsuccessfully tried a prevention measure. The district also is required to specify in the complaint whether or not the student is eligible for or receiving special education services. In fiscal year 2013, the Legislature clarified that if these elements are not present in a complaint from a school district, the court is required to dismiss the complaint. Courts also are required to dismiss the complaint if it is not filed within the given time frame. However, courts differ in how they interpret this requirement. Some send flawed complaints back to school districts and allow them to correct the complaint. Others accept the complaint but dismiss it before setting it for a hearing. Some courts accept the complaint and schedule a hearing, which requires the student and parent to appear, and then dismiss the complaint during the initial hearing. Some courts have expressed uncertainty about their authority to dismiss these complaints in advance of a hearing. Requiring students and parents to appear, only for the case to be dismissed as required by law, is an inefficient use of a family’s time, and could jeopardize a parent’s job and increase time missed from school for students. It also requires judges’ and court staff’s time in a hearing, as well as resources used to summon families. Recommendation 5 would amend the Texas Code of Criminal Procedure to clarify that courts are required to dismiss failure to attend school complaints before they are scheduled for a hearing and without requiring the presence of the defendant if the complaints are missing statutorily required elements, are filed against defendants outside the age range for the offense, or are filed after the required deadline.

When children attend hearings in criminal court for Class C misdemeanors, they are not entitled to court-appointed counsel regardless of indigency, although they would be entitled to counsel if they were indigent and their cases were heard in juvenile court. All criminal courts in Texas have the authority to appoint counsel in the “interest of justice,” but in practice, municipal and justice courts do not typically provide counsel for fine-only offenses. Because children often do not have counsel, they may have difficulty understanding the long-term consequences of pleading guilty or no contest to a Class C offense. Judges are trained to explain the charge against the child, the definition of each plea option, and the immediate sanctions that are possible for conviction. Judges do sometimes recommend that families hire their own attorneys if they plan to plead not guilty and go to trial. Judges are not required to explain the long-term potential consequences of having a Class C misdemeanor criminal

record. Class C misdemeanor charges could affect employment and enlistment into the military in the following ways:

- some applications for college, the military, and employment can require disclosure of even misdemeanor convictions, and some questionnaires ask if the applicant has ever pled to any offense; traffic offenses are often excluded, but other Class C misdemeanors may not be. Failure to disclose convictions or charges accurately can be held against an applicant as a sign of bad character, even if inaccurate disclosure was inadvertent. Military branches expect disclosure and can access expunged records. Failure to disclose even expunged convictions could prevent someone from enlisting in the military;
- driver's permits or licenses can be suspended for up to one year upon conviction, and indefinitely if an individual age 16 or younger is held in contempt for failure to comply or pay fines; license suspension can hinder the individual from getting or keeping a job or joining the military;
- open cases, including ongoing diversion or deferred disposition cases, can prevent an individual from enlisting in the military; once open cases or tickets are resolved, enlistment eligibility still can be affected by the severity and number of offenses, and whether the applicant accurately disclosed the case; and
- some jobs could be inaccessible; certain employers will not consider any applicants with Class C misdemeanors (excluding traffic offenses) within the last five years, or employers may limit the number of allowable Class C misdemeanors acceptable, including traffic offenses.

Recommendation 6 would amend the Texas Code of Criminal Procedure to require judges and magistrates presiding over juvenile fine-only misdemeanor cases to explain the potential consequences of having a criminal record for applications to college, the military, and employment using standard language developed by the Supreme Court of Texas. The Supreme Court has developed standardized language for judges in other situations.

POTENTIAL SANCTIONS AND COURT ORDERS

If a defendant pleads *nolo contendere* (no contest) or guilty to FTAS, the judge may choose to apply any of the following sanctions and court orders.

Deferred disposition: After the defendant enters a plea, a judge can postpone the adjudication of guilt and place the defendant on probation for up to 180 days. During this probation, a judge can impose a special expense fee up to the amount of the fine (a maximum of \$500) that would be due if the defendant were guilty. During the deferral period, the judge may require the defendant to comply with conditions at the judge's discretion, including submitting to professional counseling or drug testing and treatment. If the defendant complies, the case is dismissed without a final conviction. If the defendant does not comply, the court must notify the defendant of the defendant's failure and hold a hearing for the defendant to "show cause" why the deferral should not be revoked. If the defendant does not show good cause for noncompliance, the judge can impose a fine (the special expense fee is credited toward the payment of this fine) and convict the defendant of the original offense.

Teen Court: Justice and municipal court judges can send a defendant who has pled no contest or guilty to Class C misdemeanors to a teen court program, if the defendant is age 17 or younger or enrolled in high school and the court approves the teen court program. According to the Teen Court Association of Texas, at least 78 Teen Courts are operating as of calendar year 2014. In a teen court program, volunteer teen "attorneys" present the case to a jury of volunteer peers and youth who were previously defendants. The teen jury can sentence the defendant to community service. The defendant must request to attend the teen court program, and the defendant must not have already gone through the teen court program within two years before the alleged offense. The defendant may be required to pay a fee to attend the teen court program. If the defendant complies with the requirements of the program, the charge will be dismissed.

Fines: A judge can impose fines of up to \$500 per offense, in addition to court costs, but the judge also has the discretion to impose a lower fine, or no fine at all. The fines assessed are technically only the burden of the defendant, which in these cases is most often a child, even if the defendant is not legally old enough to work. In some cases, parents are expected to pay the fine. A judge can also impose a fine, but allow it to be discharged entirely through community service or tutoring if the defendant is age 17 or younger. Some judges use the fine to incentivize choosing deferred disposition because they believe the extra period of supervision is important. In these instances, judges give offenders a choice between paying a fine and closing their cases immediately or going on deferred

disposition. Judges also sometimes use a fine as motivation to successfully complete deferred disposition—if the defendant complies with court orders, the judge will waive the fine. Other judges place a case “on hold” without officially using deferred disposition, to see if the defendant will attend school voluntarily; if the defendant attends, the judge dismisses the case or the school district withdraws the case. As discussed previously, accurate statewide data is not available on the frequency with which fines are actually used as a sanction, nor at what dollar amount.

Additional sanctions upon conviction: When a student is convicted of FTAS, a judge can place additional orders upon the student or the parents. These orders can include requirements such as:

- attending school without further unexcused absences;
- attending a high school equivalency exam preparatory class;
- taking a high school equivalency exam if the student is at least age 16;
- the student and parent completing a class for students at risk of dropping out of school;
- completing community service;
- attending tutoring; and
- attending a special program that the court determines is in the best interest of the individual, such as:
 - an alcohol and drug abuse program;
 - a rehabilitation program;
 - a counseling program, including self-improvement counseling;
 - a program that provides training in self-esteem and leadership;
 - a work and job skills training program;
 - a program that provides training in parenting, including parental responsibility;
 - a program that provides training in manners;
 - a program that provides training in violence avoidance;
 - a program that provides sensitivity training; and
 - a program that provides training in advocacy and mentoring;

For a judge to order a defendant to one of these programs, the program must be available in the community and have capacity to serve all those who are referred, which may not always be the case. Courts can require parents to pay up to \$100 for the cost of these programs. A judge can also order a defendant’s parent to complete any act or refrain from any act the court determines will increase the likelihood a defendant will comply with the orders of the court and that is reasonable and necessary for the defendant’s welfare. These acts include attending a parenting class or the student’s school class or function.

Courts may also order the Texas Department of Public Safety to suspend or deny issuance of a driver’s license or permit to the defendant for up to one year.

If a defendant successfully complies with all court orders or earns a diploma or high school equivalency degree before age 21, the original complaint can be dismissed and the conviction and records can be expunged.

Contempt: If a defendant at least 10 years old and younger than 17 fails to obey an order of a justice or municipal court within circumstances that would constitute contempt of court, the judge, after providing notice and an opportunity to be heard, may do either or both of the following:

- refer the defendant to juvenile court for delinquent conduct for alleged contempt of the justice or municipal court (only if the defendant was younger than age 17 when the defendant violated the court orders); or
- retain jurisdiction of the case, hold the defendant in contempt, and impose a fine of up to \$500 for contempt, or suspend or deny issuance of the defendant’s driver’s license or permit until the defendant complies with court orders.

A justice or municipal court may not order the confinement of a defendant age 16 or younger for failure to pay fines or court costs for fine-only misdemeanors or for contempt of another order. Certain orders given to parents for these cases are also enforceable by contempt.

For defendants age 17 and older who fail to obey an order of a justice or municipal court, contempt may be punished by a fine of not more than \$100, confinement in the county or city jail for not more than three days, or both a fine and confinement.

Additional charges possible: For FTAS, although the charge is against the student, a parent also is required to appear in

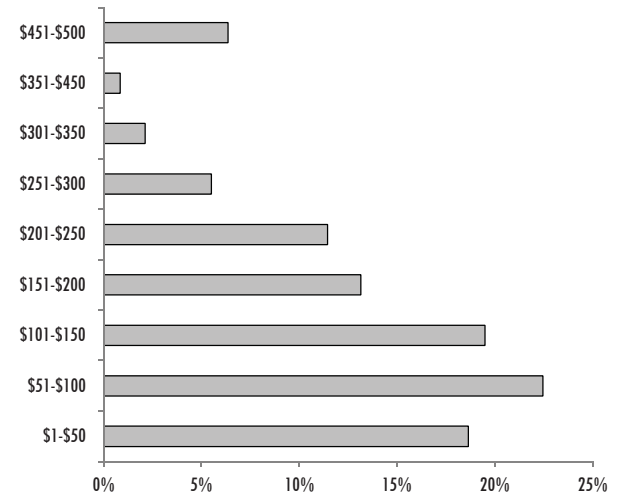
court. If the parent fails to appear as ordered, the parent could be charged with a separate Class C misdemeanor and could be arrested. A student and parent required to appear before the court are also required to provide the court with the student’s address until the discharge and satisfaction of judgment or the final disposition of the case. As long as the student and parent have been informed of this obligation in writing during their initial appearance, failure to provide address updates could be charged as an additional Class C misdemeanor.

Academic and policy literature on truancy, status offenses, and juvenile justice suggest that overly punitive sanctions are not considered best practices for changing behavior and can further alienate students from school. In the Texas juvenile justice system, juveniles are not fined for these offenses, although court costs are assessed. However, fines are commonplace in some criminal courts that handle FTAS cases. In the LBB survey of school districts, when districts were allowed to select multiple options, about 80 percent of the districts reported that the outcome of a referral for FTAS to court may be deferred disposition. Some of the deferred disposition options offered include community service, referral to social service programs, and support programs for parents. If a student complies with the terms of the disposition the judge waives the fine or special expense fees associated with the case. Approximately 52 percent of the districts said deferred disposition may be the outcome with the judge lowering the fine or special expense fees. However, 60 percent of the districts said the outcome may be fine only assessed. **Figure 11** shows the range of fines or special expense fees, if assessed, districts reported were typically assessed for first time FTAS cases. About 24 percent of districts reported that suspending the student’s driver’s license was a potential outcome.

Recent legislative changes added options for communities to use juvenile first offender programs, as defined by the Texas Family Code, Section 52.031, that divert cases from being formally adjudicated in court. These changes expand judges’ options for discharging fines to include community service and tutoring. Many people accused of traffic violations are entitled to deferred disposition via a driving safety course if they meet certain criteria. However, some courts choose not to give students accused of FTAS the option of deferred disposition, and instead the courts issue fines and convict them on their first offenses. Recommendation 7 would amend the Texas Code of Criminal Procedure to require courts to offer a deferred disposition option for students

FIGURE 11
ATTENDANCE AND TRUANCY SCHOOL DISTRICT SURVEY RESULTS, SEPTEMBER 2014

Survey Question: If fine or special expenses are assessed, select the range that the court typically assesses for a first time truancy case (not including court cost).



SOURCE: Legislative Budget Board.

charged with FTAS for the first time who have not already gone through a diversion program approved by the court. If students fail to comply with court orders, they could still be convicted, but they would have a chance to avoid conviction by reforming their behavior.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations together would have an estimated net cost of \$4.7 million in General Revenue Funds in the 2016–17 biennium, as shown in **Figure 12**.

FIGURE 12
FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2016 TO 2020

YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS
2016	(\$2,428,330)
2017	(\$2,278,330)
2018	(\$2,278,330)
2019	(\$2,278,330)
2020	(\$2,278,330)

SOURCE: Legislative Budget Board.

Recommendation 1 would amend statute to require TEA to adopt rules to define minimum standards for truancy prevention measures as required by the Texas Education

Code and establish best practices for these measures. It is assumed that TEA could implement these recommendations within existing resources. This recommendation may result in costs to local school districts depending on current practices and the minimum requirements defined by TEA, but this impact cannot be estimated.

Recommendation 2 would include a rider to require TEA to report on efforts to improve the completeness, accuracy, and usefulness of truancy data reported by school districts. It is assumed that TEA and local school districts could implement this recommendation within existing resources.

Recommendation 3 would include a contingency rider to appropriate \$150,000 in General Revenue Funds to the Office of Court Administration to study court processes and data on failure to attend school and parent contributing to nonattendance cases and make recommendations to the Legislature to improve the effectiveness and efficiency of the courts for these cases. This recommendation would be contingent on FTAS remaining a misdemeanor, and would cost \$150,000 in General Revenue Funds in the 2016–17 biennium.

Recommendation 4 would appropriate an estimated \$4.6 million in General Revenue Funds to the Truancy Programs Within the Office of the Governor to be distributed as grants to local entities for truancy prevention and intervention services. This amount is estimated based on collections from the court cost of \$2 that was added by the Eighty-third Legislature, Regular Session, 2013, for this purpose, and would result in a cost equal to the amount collected and appropriated to the agency.

Recommendation 5 would amend statute to clarify that courts are required to dismiss failure to attend school complaints that lack statutorily required elements, are filed against defendants outside the age range for the offense, or are filed after the required deadline. Courts would be required to dismiss complaints before scheduling a hearing and without requiring the presence of the defendant. This recommendation has no fiscal impact to the state. Potential local costs to review complaints before scheduling hearings are assumed to be offset by savings that would result from reduced costs for summoning defendants and reduced court staff time used during hearings. Therefore it is assumed this recommendation could be implemented within the existing resources of the local court system.

Recommendation 6 would amend statute to require judges who preside over juvenile fine-only misdemeanors to explain

the potential consequences of having a criminal record for applications to college, the military, and employment. Standard language to this effect would be developed by the Supreme Court of Texas. It is assumed local courts and the Supreme Court could implement these recommendations within existing resources.

Recommendation 7 would amend statute to require courts to offer a deferred disposition option for individuals charged with FTAS for the first time who have not already gone through a diversion program approved by the court. This recommendation could result in local costs and a loss of local revenue, but those impacts cannot be determined because data is not available on the frequency of use of deferred disposition nor on the cost of one case of deferred disposition.

The introduced 2016–17 General Appropriations Bill includes riders and an increase in appropriated amounts to implement Recommendations 2, 3, and 4.

INCREASE TRANSPARENCY OF DISCRETIONARY TRANSFERS FROM THE SCHOOL LAND BOARD'S REAL ESTATE SPECIAL FUND

The Texas General Land Office's real estate portfolio for public schools is managed by the School Land Board. The returns from that portfolio are held in the Real Estate Special Fund. The School Land Board can make discretionary transfers from the Real Estate Special Fund directly to the Available School Fund and the State Board of Education-controlled portion of the Permanent School Fund, which the board passes through the Available School Fund. From fiscal years 2003 to 2015, more than \$1.8 billion in returns from real estate and mineral rights has been transferred to the Available School Fund from the Permanent School Fund. In 2013, the School Land Board exercised its constitutional authority to transfer \$300 million directly to the Available School Fund. Transfers to the Available School Fund reduce the amount of unrestricted General Revenue Funds needed to meet the state's obligation for funding the Foundation School Program.

These transfers are entirely discretionary, and the School Land Board does not have formal policies or procedures to determine whether to make transfers or the amount of those transfers. Furthermore, the School Land Board does not have formal policies to notify the Texas Comptroller of Public Accounts of expected transfers to the Available School Fund, which may limit the Comptroller's ability to count discretionary transfers toward certification of the budget. Establishing formal policies to determine transfer amounts and to provide notification of transfers would increase transparency and information available to the Texas Legislature, while preserving the School Land Board's discretion to make transfers.

CONCERN

- ◆ The timing and amount of transfers from the Real Estate Special Fund to the Available School Fund and to the State Board of Education-controlled portion of the Permanent School Fund are unpredictable. These factors diminish: (1) the information available to the Texas Legislature to make appropriation decisions; and (2) the State Board of Education's ability to determine the appropriate contribution rate from the Permanent School Fund to the Available School Fund.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require the School Land Board to adopt a rule that establishes a procedure to determine the amount of transfers to the Available School Fund and to the State Board of Education-controlled portion of the Permanent School Fund.
- ◆ **Recommendation 2:** Amend statute to require the School Land Board to notify the Texas Comptroller of Public Accounts, State Board of Education, and the Legislative Budget Board of the amount and timing of transfers to the Available School Fund and to the State Board of Education-controlled portion of the Permanent School Fund for the next biennium, by September 1 of each even-numbered year.

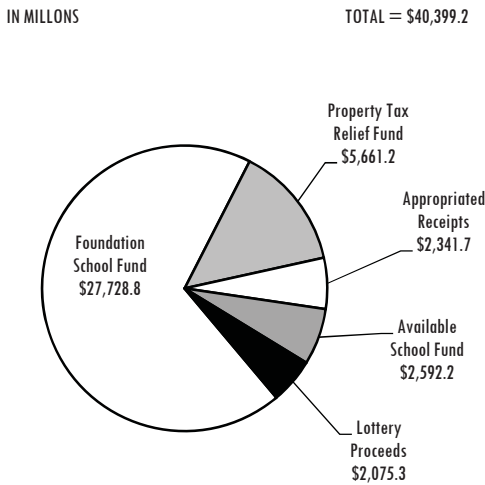
DISCUSSION

In Texas, state and local governments share responsibility for funding public education. The Foundation School Program (FSP) is the primary means of distributing state aid to public schools. FSP entitlement for Texas public schools is funded through a combination of state aid and local property tax revenue. In the 2014–15 biennium, these funding sources combined to total approximately \$83.3 billion. The state share is funded with an appropriation of \$40.4 billion in All Funds. FSP entitlement is calculated for each school district and charter school using formulas established in the Texas Education Code and the General Appropriations Act and supports public schools' operating costs and the repayment of locally authorized debt for public school facility construction.

The FSP appropriation of All Funds is sum-certain, but the methods of finance are estimated. Of the five methods of financing the FSP, four are dedicated funds that can be used only to fund public education. These are the Available School Fund (ASF), Lottery Proceeds, the Property Tax Relief Fund, and Appropriated Receipts (recapture revenues). The difference between the sum-certain appropriation of All Funds and the total available from these dedicated funds is supplemented by the Foundation School Fund, which is an account within the General Revenue Fund. If revenue from any of the dedicated funds exceeds expectations, the state can reduce its reliance on the unrestricted General Revenue

Funds. **Figure 1** shows the 2014–15 biennial FSP appropriation of All Funds by method of finance.

**FIGURE 1
APPROPRIATIONS TO THE FOUNDATION SCHOOL PROGRAM BY METHOD OF FINANCE
2014–15 BIENNIUM**



SOURCE: Legislative Budget Board.

AVAILABLE SCHOOL FUND

The ASF is constitutionally dedicated for the support of the public education system. It is funded, in part, from returns on investment of the Permanent School Fund (PSF), a constitutionally dedicated endowment fund with a portfolio of securities managed by the State Board of Education (SBOE) and a portfolio of land holdings managed by the Texas General Land Office (GLO). The ASF receives 25 percent of the state’s motor fuels tax revenue, and the GLO may transfer up to \$300 million from holdings that the GLO manages. The Texas Education Code requires that 50 percent of the amount transferred from the PSF to the ASF be transferred to the Instructional Materials Fund to fund instructional materials for school districts. The remaining portion of the ASF is used as a method of finance for the FSP. **Figure 2** shows the relationship between components of the ASF and PSF.

PERMANENT SCHOOL FUND

The PSF is a constitutionally established endowment that is managed to be a permanent and perpetual source of funding for public education. The PSF was established with a \$2.0

million appropriation by the Texas Legislature in 1854. It consists of a securities portfolio that is managed by SBOE and a portfolio of land holdings that is managed by GLO. As of August 31, 2013, the portfolio managed by SBOE had a value of approximately \$27.2 billion, and the portfolio managed by the GLO had a value of approximately \$6.0 billion.

PORTFOLIO OF LAND HOLDINGS

The GLO’s portfolio, which held 706,586 acres of surface lands as of August 31, 2013, is managed by the School Land Board (SLB). SLB was established by the Forty-sixth Legislature, Regular Session, 1939. SLB is composed of three members: an appointee of the Governor, an appointee of the Attorney General, and the Commissioner of GLO, who serves as Chairman. The portfolio managed by the SLB consists of three broad categories of assets: discretionary real assets investments, sovereign and other lands, and mineral interests.

Mineral interests are the largest asset in this portfolio. The next largest category is total discretionary real assets, followed by cash, and sovereign and other lands. Discretionary real assets include externally managed real estate, cash that is deposited in the Real Estate Special Fund Account (RESFA), infrastructure and energy/mineral investment funds, and internally managed real estate investments. The RESFA is a special fund in the state Treasury that holds the proceeds of mineral leases and royalties. A majority of the discretionary real assets investments are managed externally. **Figure 3** shows the value by asset class of the GLO-controlled portion of the PSF.

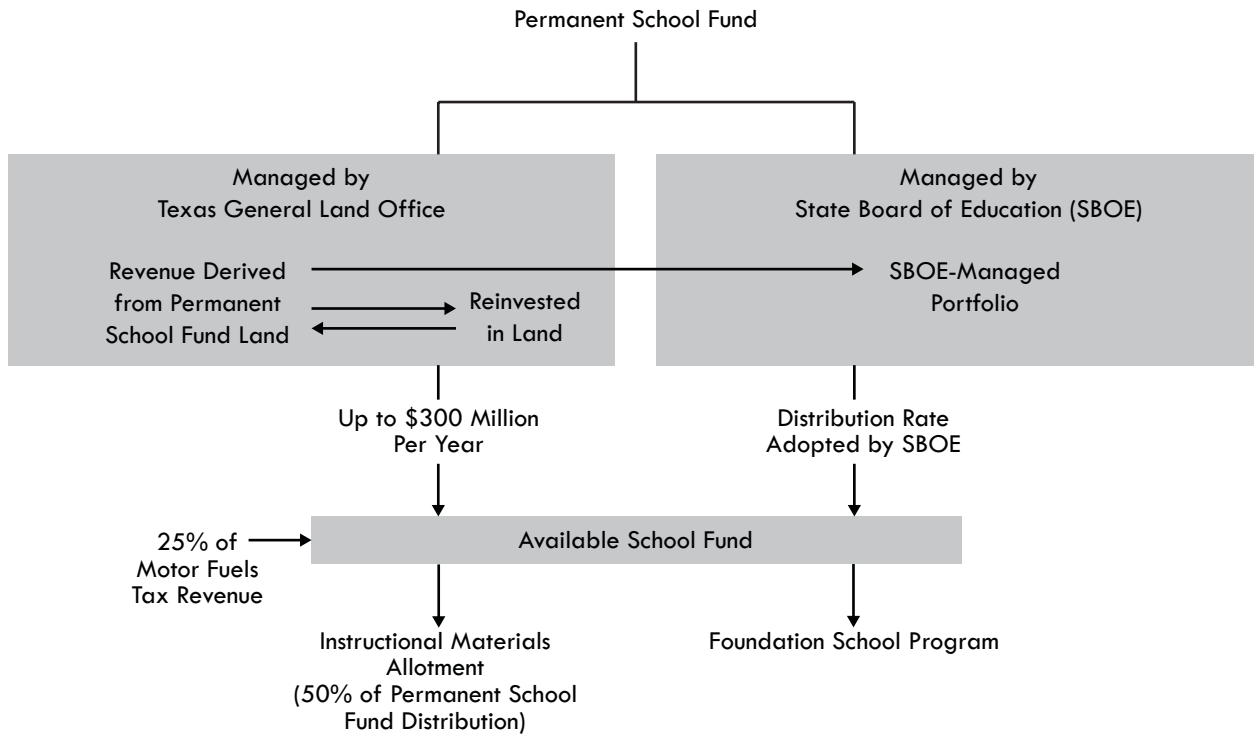
Gross revenue deposited to the RESFA totaled \$457.2 million in fiscal year 2013. In the same year, investment income from PSF land totaled \$295.5 million. Revenue generated by these investments may be:

- reinvested in additional real estate;
- transferred to the portion of the PSF overseen by SBOE; or
- transferred directly to the ASF in an amount not to exceed \$300.0 million per year.

TRANSFERS TO THE AVAILABLE SCHOOL FUND

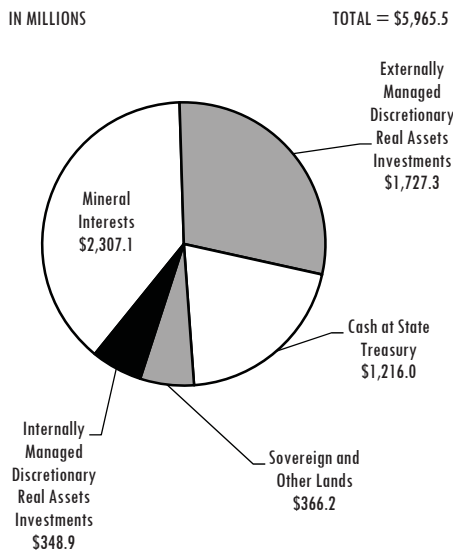
SBOE makes annual distributions from its portion of the PSF to the ASF. SBOE sets the distribution rate by a two-thirds majority vote before the start of the legislative session. SBOE considers expected total return of the fund, projected

FIGURE 2
FUNDING FLOW OF PERMANENT SCHOOL FUND AND AVAILABLE SCHOOL FUND, AS OF FISCAL YEAR 2014



SOURCE: Legislative Budget Board.

FIGURE 3
GENERAL LAND OFFICE-CONTROLLED PORTION OF THE PERMANENT SCHOOL FUND BY ASSET CLASS AS OF AUGUST 31, 2013

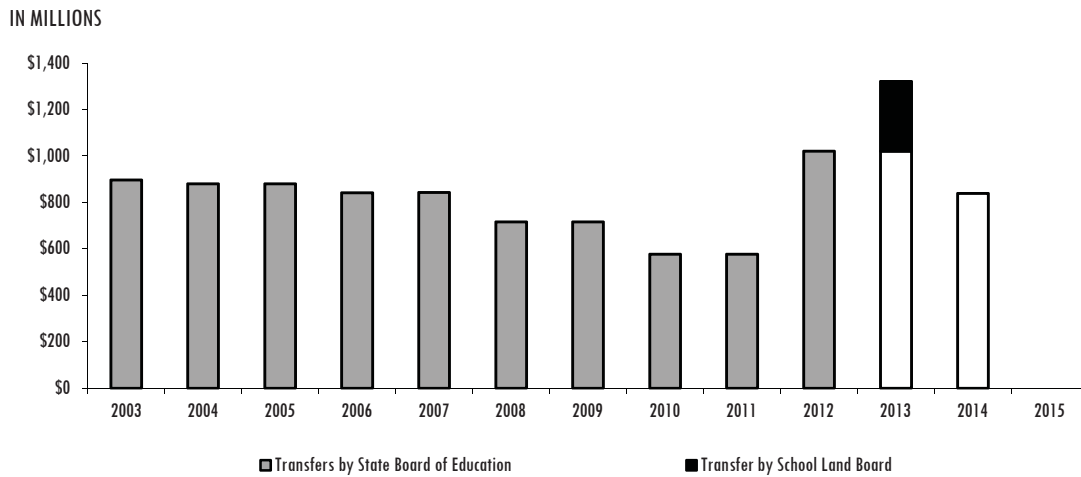


SOURCE: Texas Education Agency.

student population growth, administrative expenses, and contributions from SLB when setting the distribution rate. There are two statutory limitations on distributions from the SBOE-controlled portion of the PSF: The distribution rate may not exceed 6.0 percent of the average market value of the portfolio in the 16 previous fiscal quarters; and total distributions to the ASF in a 10-fiscal year period may not exceed the total return of the portfolio during those 10 fiscal years. If SBOE does not set a distribution before the start of the legislative session, then the Legislature establishes the rate. For the 2014–15 biennium, SBOE approved a distribution rate of 3.3 percent. This amount is approximately \$838.7 million per fiscal year. According to the Texas Education Agency (TEA), SBOE does not typically consider SLB transfers to the ASF when setting distribution rates, because SBOE only considers the assets it controls. **Figure 4** shows transfer amounts from the PSF to the ASF from fiscal years 2003 to 2015.

In November 2011, voters approved an amendment to the Texas Constitution that authorized SLB to make discretionary transfers to the ASF of up to \$300 million per year. SLB may vote to authorize a transfer to the ASF at any of their regularly

FIGURE 4
TRANSFERS FROM THE PERMANENT SCHOOL FUND TO THE AVAILABLE SCHOOL FUND, FISCAL YEARS 2003 TO 2015



SOURCES: Legislative Budget Board; Texas Education Agency.

scheduled bi-weekly meetings. For SLB’s approved transfer to be recognized by the Comptroller of Public Accounts (CPA) for certification of appropriations, SLB must provide the CPA with a copy of the Secretary’s Certificate of Adoption of Resolution by the School Land Board. The certificate details the amount and timing of the distributions before the date on which the General Appropriations Act is reported enrolled by the house of origin. In the 2012–13 biennial appropriation process, \$300 million of the appropriation for the FSP was contingent upon voter approval of the constitutional amendment. Despite gaining voter approval in November 2011, SLB did not vote to authorize a transfer to the ASF until January 8, 2013. Without SLB approval of the transfer, the appropriation supporting the state’s fiscal year 2013 FSP obligation would have been \$300 million less than needed to fund the obligation.

The 2013 transfer was the only direct SLB transfer to the ASF. According to GLO, the SLB does not have plans to make additional transfers to the ASF. GLO indicated that making transfers to the ASF in addition to transfers to the SBOE-controlled portion of the PSF is not a sustainable practice. According to GLO, no formal process is in place to determine whether SLB will make a transfer to the ASF, or to determine the value of a transfer. Furthermore, SLB’s transfers from the RESFA to the ASF would be on an ad hoc basis, reflective of the circumstances and the investment opportunities available

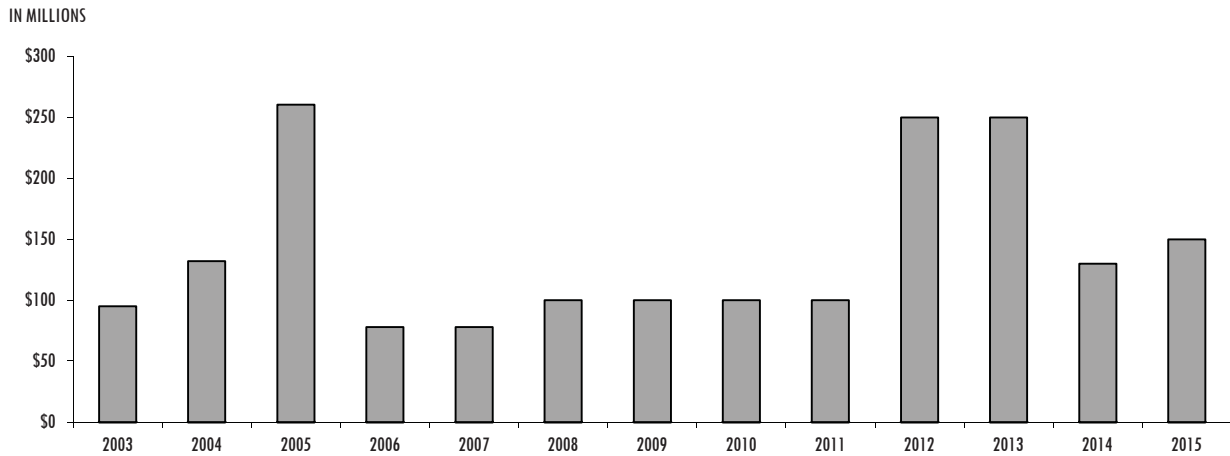
INTERNAL TRANSFERS

The Texas Natural Resources Code, Chapter 51, authorizes SLB to make transfers from the RESFA to the SBOE-controlled portion of the PSF. There is no statutory requirement to do so, but SLB regularly has made such transfers. SLB typically approves a resolution in the summer or fall of each even-numbered year that transfers 6 percent of the projected trailing 16-quarter average market value of the RESFA to SBOE during the next biennium for investment in the PSF. Historically, SBOE has not set the distribution rate for its contribution to the ASF until it received notification of the amount of the transfer from the RESFA. TEA indicated that SBOE sets a distribution rate such that all of the contribution from the RESFA is passed through to the ASF. For the 2012–13 biennium, SBOE set a contribution rate that was contingent upon SLB making an additional \$300 million transfer to the SBOE-controlled portion of the PSF. According to TEA, this is the only time that SBOE has set a rate with such a contingency. At the August 5, 2014, SLB meeting, the board approved a resolution that transferred \$375 million from the RESFA to the SBOE-controlled portion of the PSF for the 2016–17 biennium. **Figure 5** shows SLB distributions from the RESFA to the SBOE-controlled portion of the PSF from fiscal years 2003 to 2015.

INCREASE TRANSPARENCY OF DISCRETIONARY TRANSFERS

The authority of SLB to release funds from the RESFA to the ASF and the SBOE-controlled portion of the PSF is an important tool for funding the state’s obligations for public

FIGURE 5
SCHOOL LAND BOARD DISTRIBUTIONS FROM THE REAL ESTATE SPECIAL FUND ACCOUNT TO THE STATE BOARD OF
EDUCATION-CONTROLLED PORTION OF THE PERMANENT SCHOOL FUND, FISCAL YEARS 2003 TO 2015



Sources: Legislative Budget Board; General Land Office.

education. However, SLB has no formal process to determine whether to make transfers from RESFA or the amount of transfer. The process to determine transfer amounts to the SBOE-controlled portion of the PSF is informal and has evolved.

Recommendation 1 would amend the Texas Natural Resources Code to require SLB to adopt a rule establishing procedures to determine the amount of the transfers to the ASF and the SBOE-controlled portion of the PSF. The procedures should consider the expected total return of the fund, projected student population growth, administrative expenses, the state’s revenue expectations, and investment opportunities available to GLO.

The Texas Natural Resources Code requires SLB to submit a report regarding the PSF real assets investment portfolio to the Legislature by September 1 of each even-numbered year. The report is required to include the amount of funds SLB expects to distribute to the ASF or to the SBOE-controlled portion of the PSF. SLB complies with this requirement by providing expected transfer amounts for the fiscal year beginning September 1. This transfer amount was determined two years before and was the basis for funding decisions for the current biennium. Recommendation 2 would amend the Texas Natural Resources Code to require SLB to notify CPA, SBOE, and the Legislative Budget Board of the amount and timing of transfers for the next biennium from the RESFA to the ASF and the PSF by September 1 of each even-numbered year. This recommendation would ensure that SBOE is

informed of expected transfers to its portion of the PSF in a predictable manner and before adopting a distribution rate. This recommendation also would ensure that if SLB authorizes a transfer from the RESFA to the ASF, the resulting increase in General Revenue Funds would be available for appropriation by the Legislature and certification by CPA for the upcoming biennium. Together, Recommendations 1 and 2 would formalize policies and procedures, including those currently in use; increase information available to the Legislature; and increase transparency regarding the use of the RESFA, while preserving SLB’s discretion in making transfers.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would have no fiscal impact to the state. Instead, the recommendations would increase transparency related to SLB’s processes used to determine whether to make transfers and to determine the appropriate amount of those transfers. These recommendations also would enhance the Legislature’s ability to make appropriation decisions for public education funding in a timely manner.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

MODIFY THE TEXAS MEDICAL LIABILITY JOINT UNDERWRITING ASSOCIATION

The Texas Legislature established the Texas Medical Liability Joint Underwriting Association in 1975 to assist medical providers experiencing difficulty obtaining affordable medical liability insurance. The act establishing the association described a temporary authorization, and a requirement was later put in statute that the association be suspended by December 1985. Despite this, the Texas Medical Liability Joint Underwriting Association continues to underwrite policies for a small number of providers. The association may also be extending insurance to high-risk providers who cannot obtain insurance in the current medical liability market, which poses a risk to medical consumers. Modification of the association could mitigate this risk. The association has accumulated a large amount of assets during its operations. There is no statutory mechanism to refund or distribute surpluses during ongoing operations. Additionally, statute provides insufficient guidance on how to distribute reserves if the Texas Medical Liability Joint Underwriting Association were suspended. Distributing the association's surplus funds would result in a one-time allocation to the state and/or policyholders. If funds were distributed to the state, they could be used to increase the supply of and access to medical providers in Texas.

FACTS AND FINDINGS

- ◆ The Texas Medical Liability Joint Underwriting Association covers two hospitals, 15 corporations or associations, and 60 individual providers.
- ◆ Twenty-eight of the 60 (46.7 percent) individual medical providers currently covered by the Texas Medical Liability Joint Underwriting Association have had a disciplinary action taken against them by a professional licensing board.
- ◆ The Legislature originally intended for the Texas Medical Liability Joint Underwriting Association to operate for two years after enactment in 1975. Current statute indicates a plan of suspension should have taken effect by December 1985, yet the association continues to operate and write policies.
- ◆ In calendar year 2013, the Texas Medical Liability Joint Underwriting Association held \$292.0 million

in assets and experienced \$4.0 million in losses and expenses.

CONCERNS

- ◆ The extension of insurance through a medical liability underwriting association may unnecessarily increase risk to consumers by providing coverage to high-risk providers and medical facilities. Texas' current association was established in 1975. Since this time there have been changes in the medical malpractice marketplace and regulation, and the Legislature has not recently considered modifications to the association to account for these changes.
- ◆ Any surplus held by the Texas Medical Liability Joint Underwriting Association was originally to be distributed to insurance companies upon dissolution. The Texas Legislature later changed the distribution to policyholders. Because dissolution has not occurred, the association has built up a large surplus over time, and there is no current mechanism in place for the equitable distribution of assets during ongoing operations. Statute also provides insufficient guidance on how to distribute reserves if the association were suspended.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to reduce risk to medical consumers resulting from the Texas Medical Liability Joint Underwriting Association by modifying the association using one of the following options: (1) suspend operations of the Texas Medical Liability Joint Underwriting Association; (2) remove the Joint Underwriting Association from statute and privatize the entity; or (3) require the Texas Department of Insurance to develop more rigorous underwriting standards.
- ◆ **Recommendation 2:** Amend statute to establish a method for distribution of the Texas Medical Liability Joint Underwriting Association's surplus funds to: (1) the state for appropriation by the Texas Legislature; and/or (2) current and prior policy holders through an unclaimed property process.

DISCUSSION

In the United States, injured patients can sue their providers for medical malpractice under state tort law. Settlements and judgments against providers can occasionally be large. As a result, almost all healthcare providers obtain medical liability insurance to protect themselves against claims that could cause bankruptcy or significant financial harm. The existence of medical liability insurance also helps ensure that assets are available to compensate injured patients. The presence of insurance, however, mitigates the deterrence role of tort law as physicians typically pay premiums based on their location and specialty and not their individual risk or claims history. Prices instead tend to fluctuate with market cycles rather than individual experience.

Due to concern that providers in Texas were having difficulty obtaining affordable medical liability insurance, the Texas Legislature established the Texas Medical Liability Joint Underwriting Association (JUA) in 1975. JUA was intended to help providers obtain medical liability coverage at reasonable rates and to spread the risk of offering malpractice coverage throughout the liability market. Intended as a temporary solution, the authorization for JUA to write policies was set to expire on December 31, 1977.

This deadline for halting new policy underwriting and developing a plan for dissolution was extended by two years in 1977 as the number of JUA policyholders continued to rise. Profit sharing by the member insurers of the JUA was also eliminated. Instead, policyholders were assigned first responsibility for funding shortfalls and were assigned the surpluses of the association upon dissolution.

The number of policyholders peaked in 1978 at 4,503 and then declined to 901 in 1982. Despite this decline, in 1983, operations of JUA were legislatively extended for another two years. However, in extending operations of JUA, the Texas Legislature required the Texas Department of Insurance (TDI) to determine whether JUA was still necessary and required a plan of suspension be developed and implemented by December 31, 1985.

TDI subsequently determined JUA was necessary and did not develop a plan for suspension. Statute still includes language requiring TDI to develop a plan of dissolution by December 31, 1985. JUA's continued operation since this time has resulted in the accrual of substantial reserves.

MEDICAL LIABILITY MARKETS AND THE TEXAS MEDICAL LIABILITY JOINT UNDERWRITING ASSOCIATION

In the current medical liability market, demand for JUA is low. Extending coverage to a small number of providers through JUA in the current market may increase risk to medical consumers due to the risk profiles of the providers. During periods of higher demand, coverage through JUA may also delay restoration of market competition. As a result, in both periods of high and low demand for JUA coverage, JUA may be adversely competing with existing market alternatives. Evidence from other states suggests that this competition is unnecessary and the negative effects could be eliminated through the suspension of JUA operations. Alternatively, revising underwriting requirements or the organization of JUA could help to address the risk of JUA to medical consumers and market competition.

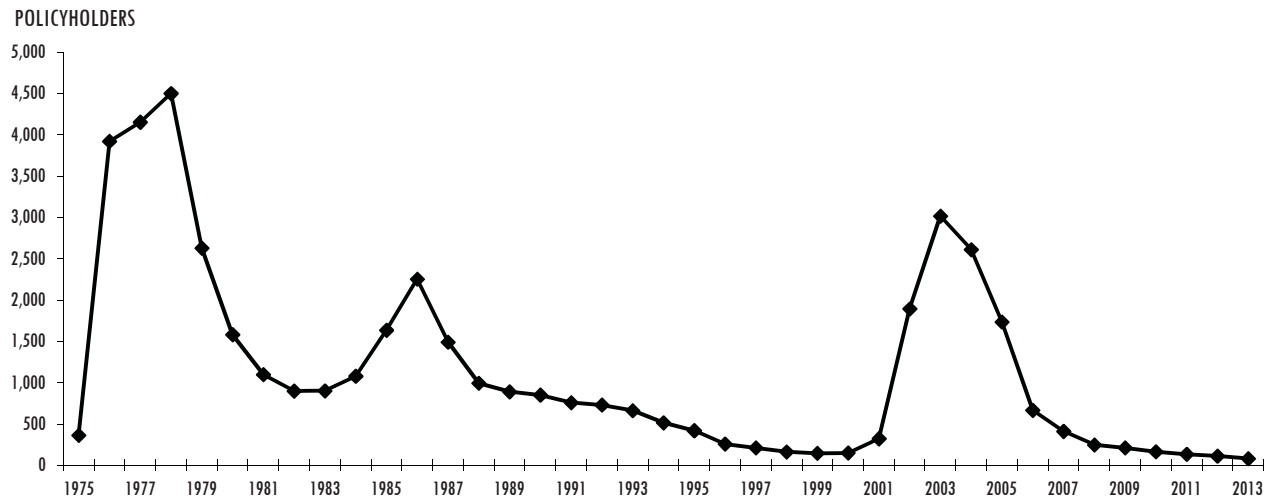
Cyclical changes in demand for JUA coverage correspond to broader trends in the medical liability insurance market. Since 1975, Texas has experienced three insurance market cycles with a corresponding increase in demand for JUA coverage from 1976 to 1978; 1985 and 1986; and 2002 and 2003. The changes in demand for JUA coverage are shown in **Figure 1**.

Periods where premiums are lower and insurers are competing aggressively for new business are commonly described as "soft" insurance markets. During soft insurance markets, demand for JUA coverage decreases. Conversely, market cycles where premiums rise sharply are known as "hard" insurance markets. As prices increase and fewer insurers offer coverage, demand for JUA coverage has historically increased.

In medical liability insurance markets, hard market cycles develop from some combination of increasing claims costs, declining investment returns, and poor insurer business decisions such as forecasting errors. Though rising claims costs are sometimes a component of market changes, dramatic increases in lawsuits or claims are not typical. During the development of the most recent hard market cycle in Texas during the early 2000s, research found that claims frequency and amounts remained stable.

During hard insurance markets, insurers increase premiums to establish greater reserves. Medical liability rates are regulated by TDI. Price increases during a hard insurance market, therefore, largely reflect attempts to stabilize the insurance market in general. After insurers restore reserves, their profitability typically increases. This increase in profitability attracts additional market entrants, pushing the

FIGURE 1
TEXAS MEDICAL LIABILITY JOINT UNDERWRITING ASSOCIATION POLICYHOLDERS, CALENDAR YEARS 1975 TO 2013



SOURCE: Texas Medical Liability Joint Underwriting Association.

insurance market back to a soft market. As a result, medical liability market cycles tend to be self-correcting.

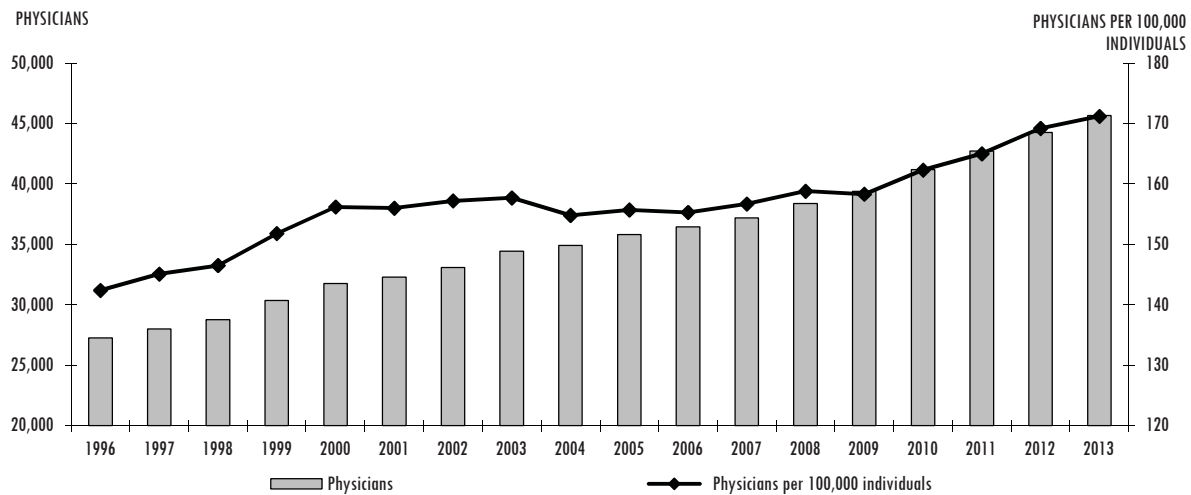
Due to the long-term nature of medical claims, insurers can receive claims for years after premiums are collected. Significant premium increases to cover prior years may be therefore necessary when insurers recognize new trends. These increases in premiums can temporarily cause larger than normal financial costs for providers to pay for premiums. This impact is more significant if providers lack the market leverage to pass the liability insurance premium increase onto payers and consumers.

However, medical providers can typically shift the majority of the cost for increased premiums onto consumers, and research has not consistently found a link between liability premiums and broad changes in the number of providers. Some studies show increased premium prices have no impact on physician supply while others show a small impact on the supply of physicians in a state or county, ranging between 1 percent and 4 percent depending on the statistical methodology used in the study. Research in Texas found there was no impact on the number of physicians from changes in medical liability premium prices during the most recent hard insurance market cycle in the early 2000s. If premium prices were impacting physician supply then a rate increase should result in a decline in the growth rate of physicians per capita. Data from the Texas Department of State Health Services shows the opposite. The supply of physicians rose even though premium prices increased

through calendar year 2003. As premium prices declined after this point, the number of physicians per 100,000 individuals declined. **Figure 2** shows the number of direct practice physicians in Texas between 1996 and 2013, as reported by the Texas Department of State Health Services, in terms of both the total number of physicians as well as the number of physicians per capita. From calendar years 2003 to 2004, the number of direct practice physicians decreased from 157.7 per 100,000 to 154.8 per 100,000 as premiums declined. The number of direct practice physicians did not exceed 157.7 per 100,000 until 2008.

Even in states without a joint underwriting association, evidence suggests minimal to no impact of high medical malpractice premiums in hard insurance markets on access to providers. The U.S. Government Accountability Office (GAO) evaluated access problems related to medical malpractice premiums and found limited evidence for any relationship. West Virginia, for example, was widely identified as a state with significant increases in medical liability premiums during the early 2000s. It never formed a joint underwriting association, although the statutory authority to establish one has been in place since 1986. GAO found many of the access problems commonly described and reported to the agency were not actually related to the medical malpractice insurance market. GAO was able to verify a few instances of access issues in rural areas, but these instances were also related to other long-standing factors that affected the availability of services and were sometimes resolved during GAO's investigation. A systematic state-wide

FIGURE 2
DIRECT PRACTICE PHYSICIANS IN TEXAS, CALENDAR YEARS 1996 TO 2013



SOURCE: Department of State Health Services.

analysis by the agency did not reveal any statewide access to care issues that could be attributed to malpractice pressures.

In states without joint underwriting associations, the surplus market typically absorbs unmet demand in the standard market. The standard market, which is regulated by state insurance agencies, is known as the admitted market. In Texas, if an individual or business has difficulty obtaining insurance in the admitted market, the entity can seek coverage from surplus carriers. Surplus carriers are not regulated as closely by TDI because they are based in other states or countries. By definition, surplus carriers are not subject to the same rate approval process and can offer more flexible terms for insurance. Surplus market carriers therefore often have a greater ability to allow prices to rise with demand. A study conducted in the late 1980s, for example, showed that individuals covered in the surplus market paid two to five times the standard market rate with high deductibles and scope of practice restrictions imposed.

Coverage through the surplus market, thus, provides a market aligned solution to supply constraints within a state. Joint underwriting association coverage, in contrast, may increase risk to medical consumers by providing a below-market priced coverage option for providers considered to have a high risk of incurring medical malpractice claims. The mission of joint underwriting associations may make them less inclined to reject high-risk providers or set premium rates based on the claims history of providers in comparison to commercial insurers. This difference may be especially

problematic in a soft insurance market, where failure to obtain insurance may be a more salient indicator of poor medical practices. Currently, 28 of the 60 individual providers holding policies with the JUA have had a disciplinary action taken against them by a professional licensing board. The Texas JUA includes a risk management program in which providers are compelled to participate to help mitigate avoidable risks. Individual provider information was not available to enable an evaluation of the effectiveness of the risk management program. Other states have also recognized the risk of covering doctors with adverse claims and disciplinary histories and have taken steps to reduce this risk. Pennsylvania, for example, automatically raises premium rates at their joint underwriting association by up to 190 percent based on the type of disciplinary action or claims history presented by the physician applying for coverage. Applying similar underwriting standards in Texas could help to mitigate risk to medical consumers.

Coverage by JUA during a hard insurance market may also delay a market correction. The Texas JUA is allowed to extend coverage to providers based on a provider's attestation that they received two quotes at a higher price from admitted market carriers and individuals can price-shop through brokers and JUA's publicly available prices. Statute requires JUA to avoid competition with the admitted market. During the last hard market insurance cycle, JUA's rates increased by only 3 percent, compared to an average increase of 110 percent for other Texas medical liability carriers. In 2003,

TDI disallowed a rate increase request by JUA. This price differential may have driven a large portion of the increase in policyholders JUA experienced between 1999 and 2004, which potentially delayed new investment in the admitted market and a restoration of a soft insurance market cycle.

In the current market, the demand for the Texas JUA is low. As a result, JUA relies on investment returns to fund underwriting losses. Estimates from Virginia suggest that a joint underwriting association needs at least 500 policyholders to generate premiums and risk sharing on a self-supporting basis. The Texas JUA covers two hospitals, 15 corporations and associations, and 60 individual providers. If only a small group of high-risk providers are covered by a joint underwriting association, then these members lose the benefit of spreading risk across a large number of providers. The recent financial performance of Texas JUA is consistent with this dynamic. In each of the last five years, JUA incurred more losses than it has collected in premiums. In 2013, JUA collected \$2.1 million in premiums and incurred \$6.3 million in both loss and loss adjustment expenses and \$2.2 million in underwriting expenses (on a cash basis). According to JUA, without investment returns to meet these shortfalls, premiums would have to increase.

Recommendation 1 would amend statute to reduce the current risk at the Joint Underwriting Association to medical consumers through one of the following options: (1) suspension of JUA, (2) privatization of JUA, or (3) the evaluation and development of policies to ensure appropriate underwriting standards by TDI. The first option, suspension of operations, would amend statute to require JUA to cease underwriting new policies and TDI to develop a plan of suspension to be completed by the end of fiscal year 2017. This two-year plan would allow current policyholders time to seek alternative coverage. The original legislation did not establish a permanent JUA, and current statute requires that a plan of dissolution should have been developed by 1985. Additionally, since the inception of JUA, market conditions have changed substantially and the current market does not support the need for a JUA.

Suspending operations of JUA during a period of low demand reduces the number of policyholders who would need to seek coverage from other insurers. The first option to suspend operations of JUA, however, does not depend solely on the low demand for JUA in the current market cycle. It is likely that the insurance market will go through another hard market cycle. When this cycle occurs, demand for coverage outside of the admitted market would likely increase.

However, the lack of evidence showing decreased access to providers during hard markets in states without joint underwriting associations suggests that even in the next hard market cycle Texas would not need the JUA. Any proposal to reestablish JUA would need to consider the potential for consumer harm from the operation of a JUA by covering physicians engaging in high-risk medical decisions.

As an alternative to suspension, the Legislature could remove JUA from statute. This would effectively privatize the association. Under current statute, the association is required to be a self-supporting and actuarially-sound entity. As such, the new organization could retain its mission as a non-profit. If the surplus of the association is distributed before privatization, the new organization would be incentivized by market forces as a private entity to avoid underwriting losses for high-risk providers. This option may not fully alleviate the concern of insuring high-risk providers, as the new entity may retain underwriting standards that allow it to cover some or all of the current providers, especially if the funds retained during conversion are large enough to underwrite the current providers. Some current policy holders could seek coverage through other means. A large self-insurance pool is already available to providers through the Texas Medical Liability Trust (TLMT). In 1978, the Texas Medical Association (TMA) formed TMLT as a self-insurance trust for medical providers who are members of the TMA. Since its inception, TLMT's role in the Texas medical liability market has grown. In 1983, TMLT covered 2,900 policyholders. By 2013, TLMT covered more than 17,000 physicians. In a future hard market cycle, providers could also seek coverage in the surplus market to the extent that they are unable to obtain coverage from commercial insurers or the TMLT.

As an alternative to suspension or privatization, the Legislature could amend statute to direct TDI to develop more rigorous underwriting standards to be applied to JUA. New underwriting standards, for example, could prohibit JUA from insuring certain high risk providers. If TDI finds that revisions to the underwriting standards cannot be developed to reduce risk during ongoing operations of JUA, then TDI could dissolve the JUA.

SURPLUS ASSETS AT THE TEXAS MEDICAL LIABILITY JOINT UNDERWRITING ASSOCIATION

As originally conceived, JUA was intended to be self-sufficient, meaning that revenues should cover claims incurred. However, under current statute, if claims exceed

JUA's current reserves and revenue, an assessment may be made against policyholders. The size of this assessment is capped at 100 percent of a policyholder's annual premium. If the assessment against policyholders is insufficient to meet the deficit, JUA can also collect assessments from liability insurers.

The state bears some risk for the cost of shortfalls that are beyond the capacity of policyholders because assessed insurers can claim tax credits against their premium tax liability in an amount equal to their assessment. After the insurers claim their tax credits, if JUA has a surplus, it must reimburse the state for the tax credits. With the exception of potential refunds to the state, surpluses are otherwise added to JUA's reserves.

There are no provisions in statute governing how to refund or distribute surpluses during ongoing operations of JUA. Though JUA has identified that it holds more assets than necessary, with \$292 million in assets for less than 100 policies, it has been unable to identify a mechanism for disbursing these surplus funds. There is no statutory mechanism to refund or distribute surpluses during ongoing operations in part because JUA was originally intended to operate for two years. The distribution of profits, as originally conceived, was to occur at dissolution of JUA.

Pursuant to current statute, if JUA were suspended, most reserves would be distributed to policyholders. However, according to JUA, current statute provides insufficient guidance on how to manage this process, and there is a potential litigation risk surrounding the distribution methodology. If refunds were made to all policyholder since 1975, for example, some funds would be distributed to entities with no current contractual relationship with JUA. Some business entities that held policies may have dissolved and some individuals who held policies may be deceased. Distributing the surplus funds to all prior policyholders may therefore be administratively complex and costly. It may also be subject to litigation due to the lack of clear statutory guidance on how to disburse the funds. Recommendation 2 would amend statute to direct the distribution of JUA's surplus funds to: (1) the state and/or (2) policyholders.

JUA was established by the Texas Legislature, and the state bears some financial risk for shortfalls. The Legislature has made changes to the distribution of surplus funds in the past, and there is no contractual obligation to disburse funds to prior policyholders with no current relationship with JUA. If surplus funds were distributed to the state through

Recommendation 2, funds would be available for appropriation by the Legislature and could be used to increase access to healthcare providers.

Using the surplus for medical residency programs, for example, would allow the state to directly address physician shortages. Approximately 70 percent of Texas counties are designed as a primary care Health Professional Shortage Areas either in whole or in part. Increasing funding for graduate medical education and preceptorship programs in family medicine would allow the state to specifically target specialties and locations where provider shortages exist in Texas. Funds could also be used for immunization and vaccination programs provided through the Department of State Health Services or medical provider loan repayment programs such as the physician education, dental education, or border county doctoral faculty education loan repayment programs.

Another option for the distribution of JUA's surplus that could be used to implement Recommendation 2 would be to distribute the funds to policyholders. Statute could be amended to use an unclaimed property process to facilitate the distribution of refunds to policyholders. Because JUA has offered policies for more than three decades this process would be administratively complex. It may be difficult to identify former policyholders who might be eligible to receive funds and the amount each should receive. Therefore, the statute should also limit how much an individual policyholder could collect to prevent any single policyholder from receiving a windfall in the event not all policy holders could be identified. After a set period of time, any unclaimed funds could revert to general revenue funds.

FISCAL IMPACT OF THE RECOMMENDATIONS

At the end of calendar year 2013, according to the audited financial statements of the association, JUA held \$292.0 million in assets. The value of the assets if sold, however, was estimated at a higher value of approximately \$322.2 million. The market value of these assets is subject to change. JUA also held \$21.5 million in reserves for losses and loss adjustment expenses. After accounting for these potential future liabilities, the net assets of JUA at the end of 2013 were approximately \$300.8 million. There would be a cost to modify JUA, but the net cost would vary depending upon the option chosen to implement Recommendation 1. It is assumed this cost would be incurred by the association and there would be no negative fiscal impact to the state.

Recommendation 1 would modify JUA in one of the following ways: (1) suspension of the association, (2) removing the association from statute and allowing it to operate independent of the state, or (3) requiring TDI to develop more appropriate underwriting standards for JUA. If JUA were suspended, it is assumed this would occur over a two year period to provide policyholders time to transition coverage. During this time, JUA's operational expenses may increase as a result of implementing steps to prepare the program for suspension. Investment returns may be used for suspension costs during preparation for suspension. Because the exact value of JUA's assets is subject to change over time, the fair value of the assets in December 2013 is used to estimate the impact of suspension. If JUA were removed from statute and allowed to operate as a private entity, some amount of funds for ongoing operations would be required. These costs would vary depending on the manner and timing of privatization and could be more or less than the \$21.5 million in reserves for losses and loss adjustment expenses reflected on JUA's balance sheet at the end of 2013. If this option were to be implemented, the Legislature could determine whether to provide all or a portion of JUA's existing assets to the private entity.

If Recommendation 1 were implemented by requiring TDI to develop underwriting standards for the association, TDI would incur administrative costs. It is assumed these costs would be paid for through a memorandum of understanding in which JUA transfers funds from its assets to the agency.

Recommendation 2 would distribute JUA's surplus funds in one of the following ways: (1) to the state and/or (2) to policyholders. The state could realize a one-time revenue gain depending upon which option would be used to implement Recommendation 2. Reserves associated with nursing facilities, which represented \$6.0 million of the assets (unadjusted for their fair market value) are state funds held outside of the state Treasury. In accordance with statute, these must be transferred upon dissolution for a use related to ensuring access to affordable liability insurance for nursing facilities. This would apply in the first and second option that could be used to implement Recommendation 1 described above. These funds could be used for programs that improve the risk profile of nursing facilities through quality improvement and risk management.

The estimated remainder of the funds would total \$294.8 million. Under the first option to implement Recommendation 2, the remainder of JUA surplus funds would be available to the Legislature for appropriation and

could be used for purposes such as increasing access to healthcare providers. Transferring the entire surplus to the state in fiscal year 2018 would result in a transfer of \$294.8 million in unencumbered funds to the General Revenue Fund and approximately \$6.0 million for uses related to nursing programs for a total of \$300.8 million in revenue.

The second option to implement Recommendation 2 would make these funds available to policy holders. There would be administrative costs to administer an unclaimed property process to distribute these funds which could be paid for using the surplus; but the amount cannot be estimated at this time. Therefore, the amount available for distribution would be less than the \$294.8 million remaining for distribution. Depending upon the specific distribution and eligibility criteria established in statute, the state could receive a reduced amount of revenue gain if not all former policyholders or the amount they should receive can be identified. The amount cannot be determined at this time; any funds received by the state would be deposited to the General Revenue Fund.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

MODIFY THE INSURANCE GUARANTY MODEL TO BETTER ALIGN MARKET INCENTIVES AND PREVENT THE LOSS OF FUTURE STATE REVENUE

The Texas Legislature established the Texas Property and Casualty Insurance Guaranty Association to provide reimbursement to individuals and businesses holding policies with insolvent insurers. After an insurer is declared insolvent, the association collects assets from the insurers to pay outstanding claims. If the assets are insufficient to pay for the claims covered by the association, the association collects assessments from solvent insurers. The state subsequently provides tax credits to the assessed insurers, which reduces the amount of revenue the state receives from these insurers. As a result of these tax credits, from 1993 to 2013 the state did not collect \$713.9 million in revenues when adjusted for inflation. Eliminating the state's financial liability and collecting risk-based premiums before insolvencies occur would increase the stability of insurance markets and prevent the state from foregoing future revenue as a result of tax credits associated with assessments.

FACTS AND FINDINGS

- ◆ The Texas Property and Casualty Insurance Guaranty Association has paid claims on behalf of 73 insolvent insurers since 1992.
- ◆ Most states do not provide tax credits for assessments issued after insolvencies. Instead, insurers are allowed to recover assessments through rate increases or premium surcharges.
- ◆ New Jersey, New York, and Pennsylvania operate guaranty funds that issue assessments before insolvencies occur.

CONCERNS

- ◆ The issuance of assessments after insolvencies occur prevents the state from recovering the costs of deficits at the Texas Property and Casualty Insurance Guaranty Association from insolvent insurers. It may also jeopardize solvent insurers when assessments are collected during periods of market instability.
- ◆ Insurers and policyholders do not fund the Texas Property and Casualty Insurance Guaranty Association based on the risk they pose to the association. Instead, the state provides tax credits to insurers when they are required to pay assessments to

offset the association's shortfalls. Studies have shown this results in insurers and consumers that are more likely to engage in high-risk behaviors that destabilize insurance markets.

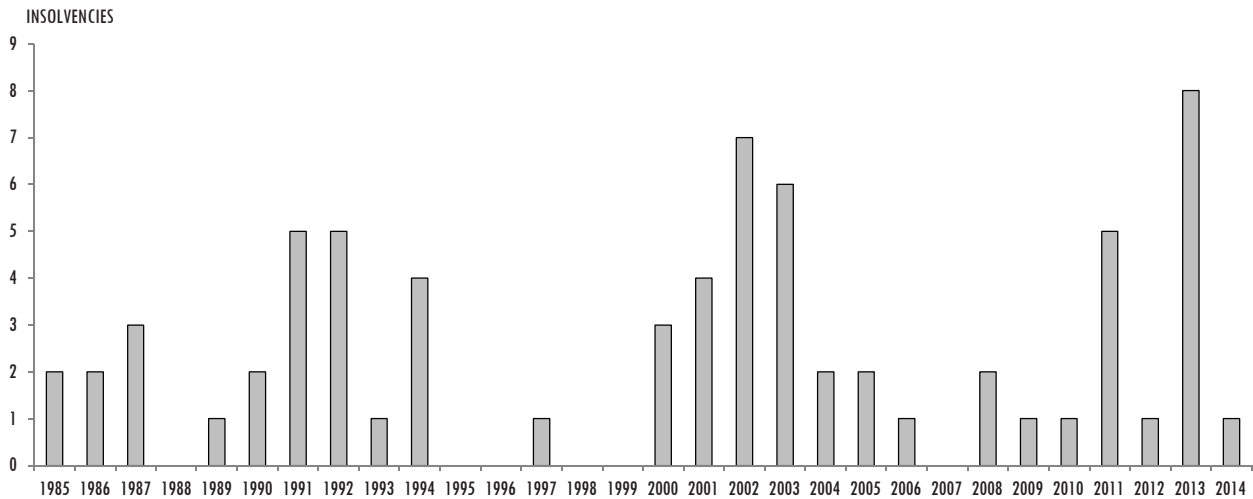
RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require the Texas Property and Casualty Insurance Guaranty Association to issue assessments before insolvencies occur to more broadly distribute the cost of guaranty coverage.
- ◆ **Recommendation 2:** Amend statute to eliminate tax credits to insurers for assessments issued by the Texas Property and Casualty Insurance Guaranty Association to remove the state's financial liability for insolvencies in the private insurance industry.
- ◆ **Recommendation 3:** Amend statute to require the Texas Department of Insurance and the Texas Property and Casualty Insurance Guaranty Association to develop risk-based assessments to improve market-based incentives.

DISCUSSION

The Texas Property and Casualty Insurance Guaranty Association (TPCIGA) was established by the Texas Legislature in 1977 to guarantee the policies of insolvent property and casualty insurers. TPCIGA covers property, workers' compensation, and casualty lines of insurance such as auto, homeowner's, general liability, and professional liability policies. When an insurer becomes insolvent in Texas, the Commissioner of Insurance requests an order of impairment from the Travis County District Court. After this order, the claims of Texas residents with a net worth of \$50 million or less are eligible for coverage by TPCIGA. Workers' compensation policies are exempted from this net worth exclusion. This coverage applies to the insurance policies of companies based in or outside of Texas but does not apply to residents of other states unless the policy covers property permanently based in Texas. Since 1992, TPCIGA has paid claims for 73 insolvent insurers. The number of insolvencies covered by TPCIGA is shown in **Figure 1** by the year that each insurer was declared insolvent.

**FIGURE 1
NUMBER OF INSOLVENCIES WITH CLAIMS PAID BY TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION, CALENDAR YEARS 1985 TO 2014**

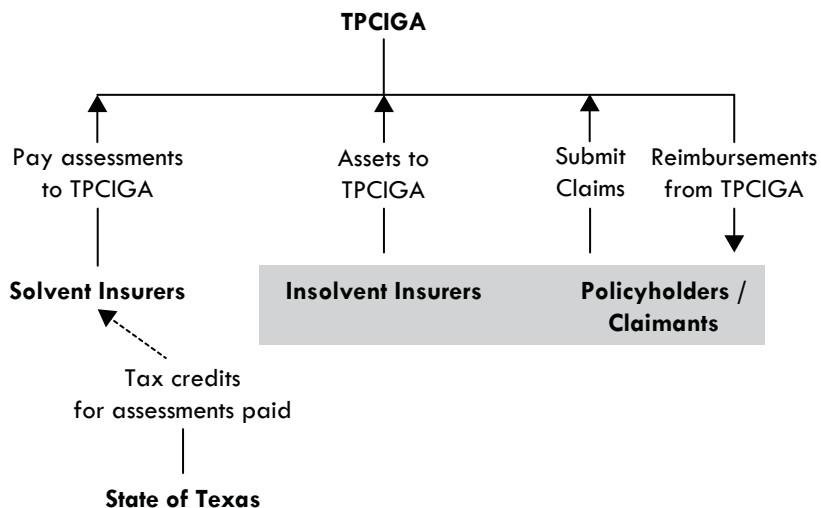


NOTE: Insolvencies shown by calendar year of impairment.
SOURCE: Texas Property and Casualty Insurance Guaranty Association.

To pay for covered claims, TPCIGA receives assets from the insolvent insurer. If the assets are not sufficient to pay claims, then TPCIGA can issue assessments against the remaining solvent insurers writing policies in Texas. When this occurs, the state forgoes revenue, as assessed insurers can subsequently claim tax credits for the full value of their assessments. This flow of funds is shown in **Figure 2**.

Because policyholders and insurers do not pay for the deficits insolvent insurers cause at TPCIGA, research shows those policyholders and insurers take greater amounts of risk. Some states, however, operate guaranty funds using alternative models that could help reduce the risks that result from guaranty coverage. These models provide a more market-based reinsurance system that limits the states' liability and improves the stability of insurance markets.

**FIGURE 2
TEXAS' GUARANTY FLOW OF FUNDS, AS OF FISCAL YEAR 2014**



NOTE: Assessments are issued by the Texas Property and Casualty Insurance Guaranty Association (TPCIGA) against remaining solvent insurers when TPCIGA liabilities exceed assets.
SOURCE: Legislative Budget Board.

INCREASED RISK IN THE AUTO INSURER INDUSTRY

The recent case of the Santa Fe Auto Insurance Company illustrates the relationship between insolvency and guarantee coverage. In 1999, the U.S. Auto Insurance Services company was incorporated in Texas to offer high-risk auto insurance policies. A Texas Department of Insurance (TDI) investigation into U.S. Auto found that, from 2001 to 2003, the company violated numerous insurance regulations. An official order of the Commissioner of Insurance described how applicants “never actually fill[ed] out an application,” and agents selling coverage frequently did not ask applicants any underwriting questions. U.S. Auto made no attempts to verify that its limited underwriting standards were satisfied by, for example, checking driving records. Instead, the company collected premiums and only verified records when policyholders filed claims. If a policyholder filed a claim, U.S. Auto checked its underwriting standards in an attempt to rescind the policy and avoid payment for claims. Within eight months, U.S. Auto rescinded approximately 900 policies using this procedure. TDI also found the company used unapproved forms and paid unlicensed individuals for referrals.

In 2007, the reinsurer of U.S. Auto sued the company and its owner for withholding payments to the reinsurer. That same year, the owner transitioned business away from U.S. Auto to Santa Fe Insurance. The website previously used by U.S. Auto continued, offering the ability to “get a quote in five seconds” and coverage in “five minutes” through Santa Fe Insurance.

In 2013, the reinsurer won a \$16.5 million judgment against the companies held by the owner of Santa Fe and U.S. Auto. Several months later, Santa Fe Insurance was ordered into liquidation. Santa Fe’s claims (an estimated \$8.1 million) were transferred to TPCIGA. With only \$2.3 million in early asset distributions from Santa Fe, this reduced TPCIGA’s projected cash flow by \$5.8 million. At the time Santa Fe Insurance was declared insolvent, it was one of the top 25 auto insurers in Texas in premiums. This occurred despite the troubled history of the owner’s other auto insurance-related companies and a complaint index at TDI of more than double the industry average.

According to a 1986 article published in the *Journal of Insurance Regulation*, since the inception of guaranty coverage in the early 20th century, high-risk auto insurance carriers have presented a problem for policyholders and drivers involved in accidents. The insolvency of high-risk auto insurers is one factor that contributed to the movement to

establish state guaranty funds. Thus, even before guaranty coverage, high-risk auto insurers were a factor in market disruptions and problematic for individuals who sought claims from insolvent insurers.

However, the establishment of guaranty coverage may increase the likelihood of insolvencies such as Santa Fe Insurance. In the situation of Santa Fe Insurance, policyholders were able to obtain coverage regardless of their underwriting risk at the low rates that Santa Fe advertised. Even if the rates they paid were not sufficient to pay for claims, policyholders did not bear the full risk of having to pay for claims with their own assets after insolvency. Instead, TPCIGA covered payment for claims after Santa Fe was declared insolvent. Insurers, therefore, may compete more aggressively on price regardless of the long-term effects on their financial stability.

RESEARCH ON RISKS RELATED TO GUARANTY COVERAGE

When the guaranty system was first developed few proponents or stakeholders focused on the potential risks of guaranty coverage. Since the inception of guaranty funds and coverage, however, numerous studies have evaluated the impact of this coverage. Research shows that, following the establishment of guaranty coverage, insurers started taking additional risks to increase profits.

A 1997 article in the *Journal of Financial Economics* showed that guaranty coverage prompted insurers to increase the risk of their investments. The researchers pulled a random sample of insurers and evaluated their financial holdings. After each state established guaranty coverage, insurers increased the amount of stocks they held on average by 6 percent. This increase was above the industry average change in stocks and corresponded to a decreased investment in bonds. In a 1999 article in the *Journal of Banking and Finance*, the researchers also found that insurers decreased the amount of reserves they held after guaranty coverage was established. A National Bureau of Economic Research (NBER) paper demonstrated that nearly insolvent insurers also attempted to delay insolvency by writing more policies. Using data from 1987 to 1995, the article posited that many insurers tried to rebuild resources by increasing premium volumes shortly before they were declared insolvent. This strategy ultimately amplified the cost and size of the insolvency. It was also more commonly employed by insurers who wrote long-tail lines of insurance, such as workers’ compensation. Long-tail lines of insurance can receive claims for a “long” period after the payment of premiums. In workers’ compensation, for

example, an insurer may receive premiums for a policy in relation to one year. A worker may file a claim 10 years later in relation to an injury that occurred during that covered year. This delay is why some types of insurance are considered “long-tail.” Thus, increasing premium volumes shortly before insolvency in a long-tail line of insurance increases costs to guaranty funds more than in other types of insurance.

In addition to this historical evidence, recent financial modeling has also demonstrated that insurers, shareholders, and policyholders have incentives from guaranty coverage that may increase the amount of risk taken by insurers. Guaranty funds operating in other states, however, provide some solutions for addressing these problems.

ALTERNATIVE MODELS IN OTHER STATES

Assessments for shortfalls at TPCIGA are levied against solvent insurers for costs that result from insolvent insurers. This practice increases the incentives for taking additional risk—thereby increasing the likelihood of insolvencies. New Jersey, New York, and Pennsylvania, however, reduce the extent of this problem by issuing assessments before insolvencies occur. As a result, insurers pay into the system before insolvency. All three states have operated their funds for significant periods, and the funds include features Texas could emulate.

New Jersey’s workers’ compensation guaranty fund is funded by assessments against insurers until the net assets of the fund reach at least 3 percent of the loss reserves of insurers (loss reserves represent the liability for future claims). If the fund balance falls below this amount, an assessment is automatically triggered to rebuild the fund. Insurers can subsequently increase their premiums to recover funds transferred for assessments. The state made some modifications recently, transferring fund operations in 2010 to a private, nonprofit entity to increase operational efficiency and distinguish the guaranty system’s funds from the state’s funds. Otherwise, the state has used a pre-insolvency assessment model continuously since the 1930s. Pennsylvania has operated a workers’ compensation guaranty fund in a similar manner for a significant period of time. The primary difference is that, in Pennsylvania, the fund balance is set in statute as a fixed dollar amount rather than a percentage of loss reserves.

New York operates a guaranty fund using the same principles. In New York, however, the fund covers all property and casualty insurance. Similar to Pennsylvania, the fund balance is set in statute as a fixed dollar amount. Like New Jersey and Pennsylvania, the New York fund has operated for a

significant period without any major operational issues or plans to alter the features of the assessment process.

All three of these funds are analogous to reserving at commercial insurers. Instead of waiting for an insolvency to occur and then collecting funds from the remaining insurers, the guaranty funds maintain a pre-determined balance. For the New Jersey fund, the balance is based on the amount of business in the state. This pre-insolvency funding strategy in other states has a number of benefits, including:

- spreading the cost of shortfalls at the guaranty fund across a larger number of insurers by collecting funds from insurers before they become insolvent; this practice may reduce the ability of insurers to take risks at the expense of the state and solvent insurers;
- reducing the likelihood of insolvencies that result during market turmoil; during a period of heightened financial instability in the insurance market, a number of insolvencies may occur at the same time. If the guaranty fund has to collect funds from the remaining solvent insurers at a time of market instability, the assessments could weaken their financial stability and possibly result in more insolvencies. If the guaranty fund has some discretion on the fund balance and timing of assessment, building a fund balance before an insolvency may reduce or eliminate the need to issue assessments during market turmoil;
- increasing the efficiency of distributing funds for claims during insolvencies; when claims are received by the guaranty fund, the fund would have cash on hand to pay claims, even before assets can be collected from insolvent insurers; and
- excluding tax credits; the pre-insolvency model decreases the forgone revenue from assessment tax credits for the state; instead of recovering costs through tax credits provided after assessments are issued to pay for claims, insurers can choose to modify premiums.

Recommendation 1 would amend the Texas Insurance Code to establish a pre-insolvency funding mechanism at TPCIGA. The size of the fund would be based on a one-year assessment reserve. Using a framework similar to New Jersey’s, the net asset balance of the fund would be capitalized to a minimum of 0.75 percent and a maximum of 2 percent of the direct property and casualty insurance premiums written in Texas. Currently, TPCIGA has the capacity to issue assessments up to 2 percent of net direct written premiums. Recommendation

I would set a target net balance of 1 percent. TPCIGA would have the discretion to go higher or lower than this amount based on market conditions and the judgment of the TPCIGA board. TPCIGA could, for example, maintain a net balance closer to 2 percent for workers' compensation, given the high costs of insolvencies in this line.

If TPCIGA's net assets (assets minus liabilities) drop below 0.75 percent of direct written premiums in Texas, however, an assessment would be required to restore the balance to at least 0.75 percent. Based on estimates from premiums written in Texas during a four-quarter period ending in March 2014, the net balance would be between \$238 million and \$635 million, with a target net balance of \$317 million. Initial capitalization could occur within four years to smooth the cost of funding across multiple years. To establish net assets of \$317 million at TPCIGA, assessments of approximately \$80 million per year would be issued. As shown in **Figure 3**, these initial assessments would represent amounts less than many of the assessments TPCIGA has issued in the last 10 years.

Capitalization to 1 percent of direct written premiums would result in a net balance that represents an amount less than what TPCIGA issued in assessments from 1993 to 1994. At a target funding amount of 1 percent, net assets would also be below the net balance in New Jersey, which held a net balance of 5.2 percent in 2011. The amount would be approximately equivalent to the largest single-year assessment issued by TPCIGA and provide a buffer to ensure that all insurers make adequate contributions into the guaranty fund.

To ensure the funds at TPCIGA are used only for guaranty coverage, Recommendation 1 would amend statute to

exclude any state use of the money. Specific language could also prevent future appropriations out of the fund. Courts have blocked appropriations out of funds similar to TPCIGA's where the state specifically renounced any future right to the funds. This occurred, for example, in Oregon when the Oregon Supreme Court blocked an appropriation out of the State Accident Insurance Fund Corporation based on statutory language restricting use of the funds. Adopting similar language in Texas would ensure that if TPCIGA is ever suspended, the funds would be obligated by statute as a refund to insurers. Otherwise, during ongoing operations, if TPCIGA accrues a surplus above the statutory cap of 2 percent of direct written premiums, the funds would be obligated by statute as refunds to insurers.

In conjunction with the first recommendation, Recommendation 2 would amend the Texas Insurance Code to eliminate insurers' ability to claim tax credits for any future assessments. Instead, insurers would be allowed to recover assessments by increasing premiums or by charging policyholders a surcharge. Among all states, even those that do not utilize pre-insolvency funding, most do not provide tax credits for assessments. Instead, most states allow insurers to recover assessments through surcharges or premium adjustments, which helps adjust market prices to reflect the cost of the reinsurance provided by the guaranty fund. Allowing insurers to claim tax credits for pre-assessments would eliminate one of the primary benefits of converting to a pre-assessment model. Absent tax credits, the premiums charged by insurers would more closely reflect in aggregate the cost of guaranty coverage, thereby reducing the industry-wide incentive to increase risk at TPCIGA's expense. No state that utilizes pre-assessment funding allows insurers to claim

**FIGURE 3
ASSESSMENTS AND REFUNDS ISSUED BY THE TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION, IN MILLIONS, CALENDAR YEARS 1993 TO 2010**

INSURANCE TYPE	1993	1994	1995	1996	1998	2001	2002	2003	2006	2010
Auto	\$32.1	\$39.2	(\$53.9)	(\$10.7)		\$13.2				(\$4.9)
Other	15.4	101.3	(73.3)		\$11.8	39.6			\$50.0	(42.7)
Workers' Compensation	45.1	44.0				30.5	\$59.2	\$30.2		
Administrative	22.7	4.6								
TOTAL	\$115.3	\$189.1	(\$127.2)	(\$10.7)	\$11.8	\$83.3	\$59.2	\$30.2	\$50.0	(\$47.6)
INFLATION ADJUSTED TOTAL	\$190.11	\$304.00	(\$198.9)	(\$16.5)	\$17.25	\$112.1	\$78.4	\$39.2	\$59.1	(\$52.0)

NOTES:
 (1) Refunds are shown as negative values.
 (2) Years not included in chart reflect years without an assessment or refund.
 SOURCE: Texas Property and Casualty Guaranty Association.

tax credits, and experts recommend recovery through premium surcharges or rates.

Figure 4 shows the amount of tax credits claimed each year by insurers assessed by TPCIGA. In the last twenty years, insurers have claimed an average of \$34 million in inflation adjusted tax credits per year. However, insurers claimed more than three times this amount in both 1993 and 1994 with total tax credits exceeding \$116 million in both years, when adjusted for inflation. In these two years, the premium tax due was reduced by approximately 25 percent as a result of the tax credits. Although the amounts claimed each year declined over time, the value of inflation adjusted tax credits claimed by insurers totaled almost \$714 million between 1993 and 2013.

RISK-BASED ASSESSMENTS

Even though there are differences in risk between insurers and lines of business, insurers that pose a high risk to TPCIGA pay the same assessment per dollar of premiums written as insurers that pose a small risk.

Santa Fe Insurance, for example, had characteristics indicating it posed a high risk to cause a shortfall at TPCIGA. Santa Fe was a small, regional auto insurer that wrote policies for high-risk individuals. These characteristics have been shown historically to produce shortfalls at guaranty funds. In 2013, five insolvencies of auto-only insurers resulted in a \$28.8 million net negative impact for TPCIGA.

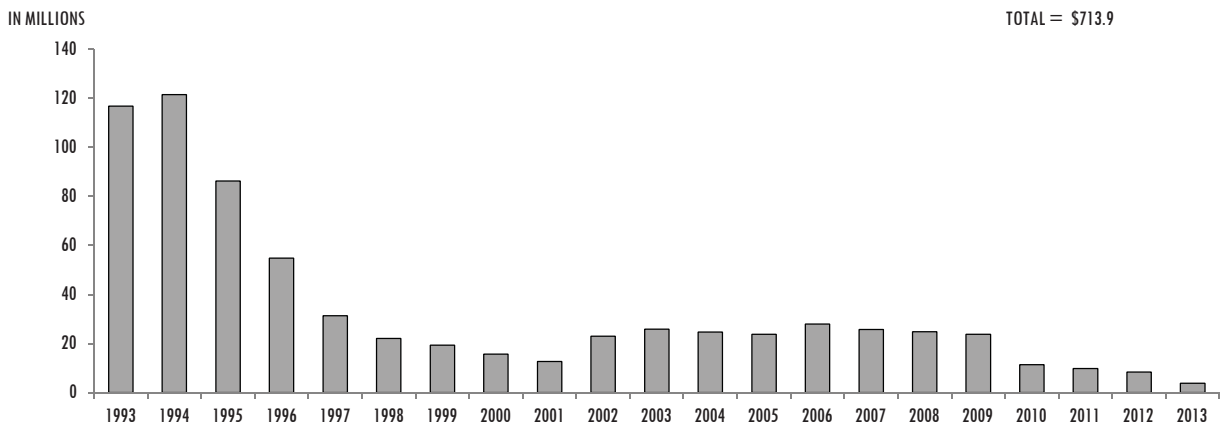
Long-tail lines such as workers’ compensation are also significantly more likely to produce deficits at guaranty

funds. Nationally, total payments from guaranty funds per dollar of premium written for long-tail insurance have been twice as high as other lines of insurance. Local experiences in Texas are consistent with this dynamic; the majority of payments at TPCIGA have been for workers’ compensation insolvencies.

If there are clear differences between the risks that insurers pose to TPCIGA but all insurers pay the same rate, then the guaranty is essentially a state form of reinsurance that has no market-based pricing. This lack of market-based pricing allows insurers to underprice premiums at the guaranty fund’s expense—even if assessments were collected before insolvencies occur. The Santa Fe Insurance company was able to grow into one of the state’s top insurers in terms of direct written premiums in part by underpricing premiums in relation to its policyholders. Before the Santa Fe insolvency occurred, the owner and policyholders benefited from low prices and profits collected through overly low reserves. This may have resulted in insurers with more appropriately priced premiums losing market share.

A risk-based assessment would help correct this disparity by collecting payments based on the risk of insurers to TPCIGA. For example, a \$10 assessment per policyholder at Santa Fe Insurance, compared to a \$2 per member assessment at a large national auto insurer, could have decreased Santa Fe’s incentive to underprice premiums. It could also have helped to apply market discipline to premiums, especially for buyers with limited assets subject to recovery for unpaid third-party claims.

FIGURE 4
INFLATION ADJUSTED TAX CREDITS CLAIMED FOR ASSESSMENTS ISSUED BY THE TEXAS PROPERTY AND CASUALTY
INSURANCE GUARANTY ASSOCIATION, CALENDAR YEARS 1993 TO 2013



SOURCE: Texas Comptroller of Public Accounts.

Recommendation 3 would amend the Texas Insurance Code to require that the pre-insolvency assessments be risk-based. Risk-based assessments have been developed in other forms of guaranty coverage such as insurance provided by the Federal Deposit Insurance Corporation to reduce the same types of problems present in guaranty coverage at TPCIGA. To ensure the differences in premium prices are meaningful, TDI and TPCIGA should develop risk ratings that maximize the differential in rates paid to TPCIGA to an extent that can be supported by actuarial analysis. Without rates that accurately reflect the different risks that insurers pose to TPCIGA, the burden of funding the guaranty will apply disproportionately to less-risky insurers and policyholders. To balance the share of funds held in proportion to the risk that results from each insurer, TPCIGA will need to occasionally issue refunds as the risk-adjusted obligations due to TPCIGA change each year. **Figure 5** shows how the assessment model proposed in Recommendations 1 through 3 would operate.

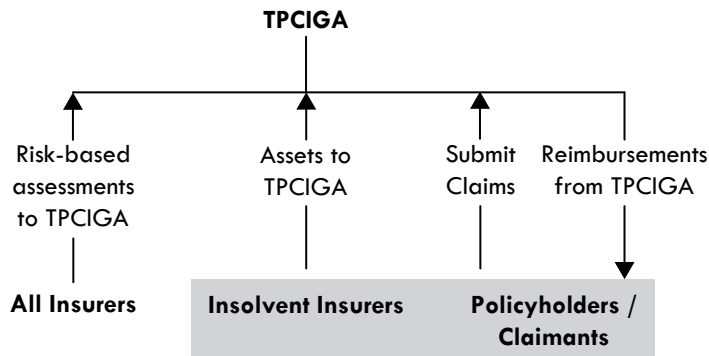
FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would have a positive fiscal impact to the state in the long term. In accordance with the proposed model in Recommendations 1 through 3, insurers would not recover the cost of TPCIGA’s assessments through tax credits. Insurers would, however, have the option of recovering assessments through rate increases or surcharges. The exact timing of a reduction in tax credits and resulting gain in General Revenue Funds would depend on when insolvencies occur and cannot be predicted. Additionally, based on TPCIGA’s financial statements, it is not assumed this

reduction in tax credits would occur within the current biennium. However, a new major insolvency could result in a positive fiscal impact to the state in a shorter period.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

**FIGURE 5
GUARANTY FLOW OF FUNDS, AS PROPOSED IN RECOMMENDATIONS 1 TO 3**



NOTE: Assessments would be transferred in advance of insolvencies to establish a fixed funding level at the Texas Property and Casualty Insurance Guaranty Association.
SOURCE: Legislative Budget Board.

STRENGTHEN ENFORCEMENT OF THE AMUSEMENT RIDE PROGRAM TO IMPROVE COMPLIANCE

The Amusement Ride Program at the Texas Department of Insurance regulates amusement ride operations in the state. Amusement rides include inflatable rides such as bounce houses, mobile carnival rides, and fixed-location rides such as roller coasters. The Department of Insurance is responsible for ensuring that amusement ride operators comply with statutory requirements for inspection, insurance, and registration and issues compliance stickers for each ride that meets all requirements. In fiscal year 2014, the agency issued 8,705 compliance stickers. However, the agency lacks a mechanism to consistently identify noncompliance. The agency may request proof of inspection and insurance from ride operators, but does not have any other oversight authority over amusement ride operators. Ensuring that the Department of Insurance has adequate resources and additional tools to identify noncompliant operators would strengthen the Amusement Ride Program and help ensure that amusement ride operators meet current statutory requirements.

FACTS AND FINDINGS

- ◆ The number of ride operators that register with the Texas Department of Insurance has increased nearly 500 percent from fiscal years 2005 to 2014. In large part, this is due to the addition of bounce houses to the list of amusement rides covered by the Amusement Ride Safety Inspection and Insurance Act in 2011.
- ◆ The Texas Department of Insurance refers violations of inspection, insurance, and registration requirements to the Office of the Attorney General and local enforcement officials. Since 2011, the Department of Insurance has referred more than 330 noncompliant amusement ride operators.
- ◆ Most noncompliant amusement ride operators referred by the Texas Department of Insurance have failed to meet both the inspection and insurance mandates. A majority of these referrals pertain to noncompliant operators of bounce houses.
- ◆ Of the approximately \$335,000 in revenue generated from registration fees by the Amusement Ride Program in fiscal year 2013, the Texas Department of Insurance was appropriated about one-third to

administer the program. Revenue that exceeds the appropriated amount remains in the Insurance Operating Account.

CONCERNS

- ◆ Resources dedicated to administer the Amusement Ride Program have not kept pace with growth in the number of rides overseen. As a result, a portion of the amount collected from fees paid by amusement ride operators is not being used to administer the program.
- ◆ The Texas Department of Insurance lacks a systematic method to identify amusement ride operators that conduct business in Texas and to assess their compliance with inspection, insurance, and registration requirements.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Increase appropriations to the Texas Department of Insurance by an estimated \$386,000 in General Revenue–Dedicated Funds and include a rider in the 2016–17 General Appropriations Bill directing the department to expend the amount of appropriated funds necessary to administer and enforce the Amusement Ride Program and to report biennially to the Legislature on: (1) efforts to bring all amusement ride operators into compliance; and (2) the result of those efforts.
- ◆ **Recommendation 2:** Amend statute to require the Texas Department of Insurance to set the filing fee for the Amusement Ride Program at the amount necessary to generate revenue to cover the cost of administering the program, not to exceed the current statutory limit of \$40 per year.
- ◆ **Recommendation 3:** Include a rider in the 2016–17 General Appropriations Bill directing the Texas Department of Insurance to: (1) request a monthly report from the Comptroller of Public Accounts regarding amusement ride owners or operators that apply for a sales tax permit and those that pay sales tax; and (2) use this information

to ensure that all operators have filed evidence of inspection and insurance.

DISCUSSION

The Texas Amusement Ride Safety Inspection and Insurance Act, requires that amusement ride operators comply with annual inspection and insurance requirements. Amusement rides include inflatable rides such as bounce houses, mobile carnival rides, and fixed-location rides such as roller coasters. The Amusement Ride Program is funded by collections from fees for each ride when operators annually register by filing proof of compliance with the Texas Department of Insurance (TDI).

Statute requires that amusement rides be inspected annually. Inspections must be conducted by the insurer or its contractor. TDI does not endorse or license inspectors but provides a directory of sources. The inspection must test for stress-related and wear-related damage of the critical parts of a ride that the ride manufacturer determines are subject to failure with time and could cause injury. All rides must be assembled, tested, operated, and inspected in accordance with standards established by the American Society of Testing and Materials, manufacturer standards, or the insurer’s standards, whichever are most stringent. Mobile amusement ride operators also must perform daily inspections of safety restraints and maintain a log of these checks.

A \$40 fee is assessed annually when operators file evidence with TDI that the ride has been inspected, meets the insurer’s underwriting standards, and is covered by a liability policy that meets minimum coverage requirements. Insurance policies should insure the owner or operator against liability for injury to persons as a result of the use of the amusement ride. **Figure 1** shows the minimum coverage requirements. Class A amusement rides include those with a fixed location that are designed for children younger than age 13, and Class B refers to all other rides.

**FIGURE 1
MINIMUM INSURANCE COVERAGE STANDARDS
AS OF FISCAL YEAR 2015**

CLASS A RIDES	CLASS B RIDES
\$100,000 bodily injury and \$50,000 property damage per occurrence with a \$300,000 annual aggregate; or	\$1,000,000 bodily injury and \$500,000 property damage per occurrence; or
\$150,000 per occurrence combined single limit with a \$300,000 annual aggregate	\$1,500,000 per occurrence combined single limit

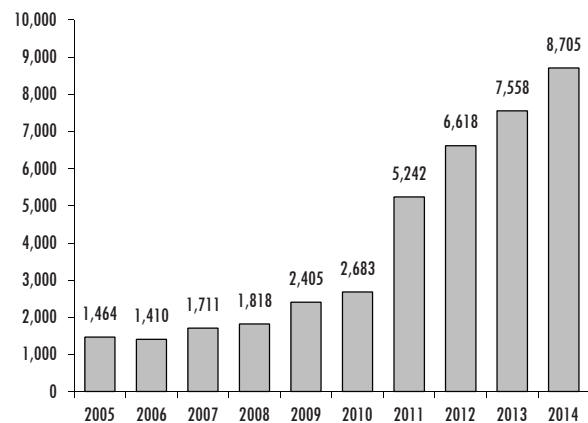
SOURCE: Legislative Budget Board.

Amusement rides are defined to include inflatable rides known as bounce houses that have a surface for bouncing and jumping. These rides are included in the Class B category but have separate insurance requirements calling for a combined single-limit policy of no less than \$1 million. Many bounce houses are owned by companies that rent them out to the public for community events.

TRENDS IN REGISTERED RIDE OPERATORS

The number of ride operators that register with TDI has increased nearly 500 percent from fiscal years 2005 to 2014. Bounce houses were added to the list of amusement rides covered by the Amusement Ride Safety Inspection and Insurance Act in 2011; this addition to the definition in statute has contributed to the increase in registered operators. TDI also attributes the rise to a general increase in the number of mobile amusement rides in the state. Registration entails filing proof of inspection and insurance and paying a \$40 filing fee. The agency issues compliance stickers for each ride when operators register. As shown in **Figure 2**, the number of compliance stickers issued increased from 2,683 in fiscal year 2010 to 5,242 in fiscal year 2011.

**FIGURE 2
AMUSEMENT RIDE COMPLIANCE STICKERS ISSUED
FISCAL YEARS 2005 TO 2014**

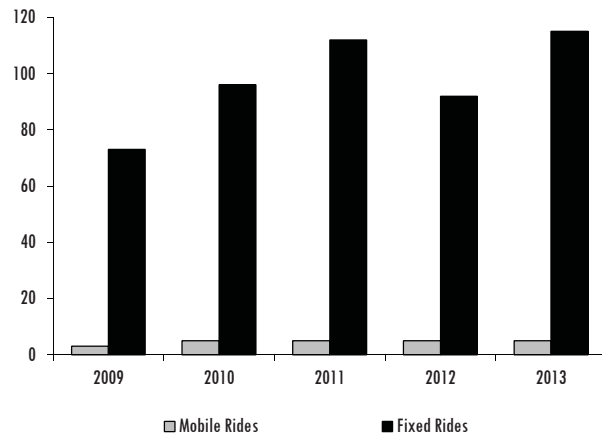


SOURCE: Texas Department of Insurance.

REPORTED INJURIES

The Amusement Ride Safety Inspection and Insurance Act also requires ride operators to maintain records of each injury caused by a ride that results in death or requires medical treatment and to file an injury report with TDI on a quarterly basis. **Figure 3** shows data from the quarterly injury reports published by TDI since 2009. The agency lacks the means

FIGURE 3
REPORTED AMUSEMENT RIDE INJURIES
CALENDAR YEARS 2009 TO 2013



NOTES:

- (1) Class A rides include only fixed location rides, while Class B rides include both fixed and mobile rides.
- (2) Injuries include one death on a fixed location ride in 2013.
- (3) The year 2009 includes only injuries occurring from July through December.

SOURCE: Texas Department of Insurance.

and authority to independently verify the accuracy of these self-reported injury figures. Fixed-location rides are operated at large amusement parks. Bounce houses are included in the mobile ride category.

LIMITATIONS OF THE AMUSEMENT RIDE PROGRAM

Texas' system of amusement ride oversight and regulation contains a number of gaps. TDI reports that it does not have the means to consistently determine the level of noncompliance across the state, particularly with respect to bounce houses. The fee revenue that TDI collects increased from \$167,180 in fiscal year 2010 to \$277,195 in fiscal year 2012, which reflects the addition of bounce houses to the rides covered by the program in 2011. Since that time, the agency has added a full-time equivalent (FTE) to the program staff. During busy times of the year when a disproportionate number of ride operators register, however, the agency temporarily assigns an additional FTE to help process compliance stickers.

According to TDI, agency staff typically learn of unregistered rides from competitors of noncompliant amusement ride operators, consumers, and the news media. Agency staff also perform Web searches to match advertised businesses with registration files. However, according to TDI, these efforts have not been sufficient to identify the full extent of noncompliance.

When TDI identifies noncompliance with statutory inspection, insurance, and registration requirements, it does not have the authority to enforce these requirements. Pursuant to statute, TDI can refer violations of inspection, insurance, and registration requirements to the Office of the Attorney General (OAG) and local enforcement officials, who have the authority to seek an injunction against a person operating an amusement ride in violation of the Amusement Ride Safety Inspection and Insurance Act. However, neither entity is required by statute to take any action. TDI requests proof of inspection and insurance from operators and refers operators that, after several notices, do not comply to the OAG and local enforcement officials. TDI sends a single referral of a noncompliant operator to the OAG and local enforcement officials at the same time. Since 2011, TDI has referred more than 330 noncompliant amusement ride operators. Legislative Budget Board staff reviewed a random sample representing more than 20 percent of these referrals and found that 95.8 percent were against bounce house operators. Approximately 77.5 percent of the sample referrals were sent to the OAG for operator failure to meet both the inspection and insurance mandates. According to the OAG, 272 of the referred operators have come into compliance or ceased operations during the OAG's investigation.

TDI can request proof of inspection and insurance from operators, but the agency does not have the authority to conduct ride inspections, investigate accidents, and review ride safety inspection and maintenance logs. Insurance companies or their contractors conduct inspections. However, in at least one major insurance carrier's liability policy, the company claims they are not obligated to make any inspections and when they do it is only to determine insurability, not to ensure compliance with regulations or required operating standards. According to TDI, the operator is responsible for ensuring compliance with all legal requirements before operation of the ride.

IMPROVE THE AMUSEMENT RIDE PROGRAM

Revenue from the \$40 amusement ride registration fee is deposited into the Texas Department of Insurance Operating Account (General Revenue–Dedicated Funds), and has steadily increased from approximately \$167,180 in fiscal year 2010 to approximately \$334,724 in fiscal year 2013. TDI has the authority to adjust the fee, but statute caps it at \$40. The increase in fee revenue is due to the growth in the number of amusement rides registered, and no downward adjustment has been made to the fee assessed per ride. TDI estimates that it expends about \$142,000 annually on the

program from funds appropriated to Strategy A.5.1 (Loss Control Programs). This expenditure primarily employs three insurance specialists who process ride registrations, issue notices to noncompliant operators, and issue referrals to the OAG and local enforcement officials. Revenue that exceeds this amount remains in the Insurance Operating Account.

Recommendation 1 would increase General Revenue–Dedicated Fund appropriations to the Texas Department of Insurance by an estimated \$386,000 and include a rider in the 2016–17 General Appropriations Bill directing TDI to expend the amount of appropriated funds necessary to administer and enforce the Amusement Ride Program. The additional appropriation would allow TDI to increase efforts, including hiring additional staff, to oversee the increased number of rides subject to the statute and to identify operators who are not in compliance with its requirements. The rider would also require TDI to report on efforts to bring all amusement ride operators into compliance and the result of those efforts in the agency’s biennial report to the Legislature. This report should include schedules detailing how the agency is expending the additional funds, as well as summary statistics of noncompliance among amusement ride operators in Texas based on the agency’s implementation of Recommendation 3. This data would better inform the Legislature about operators’ noncompliance. The rider would also authorize TDI to carry any unexpended balances into the second fiscal year of the biennium if the agency does not use the full appropriation to administer the program and enforce statutory requirements during the first fiscal year. Recommendation 2 would amend statute to limit the filing fee so it does not generate revenue in excess of the amount necessary to operate the program.

TDI also lacks a systematic method to identify amusement ride operators that conduct business in Texas and assess their compliance with inspection, insurance, and registration requirements. TDI identifies unregistered operators from third parties, including other operators, consumers, the news media, and the Internet. According to the OAG, a significant proportion (82.4 percent) of operators obey the law after intervention, either by coming into compliance or ceasing operations. Recommendation 3 would direct TDI to request a monthly report from the Comptroller of Public Accounts regarding amusement ride operators that apply for sales tax permits and for those that pay sales tax. The recommendation would direct TDI to use these reports to ensure that all operators have filed evidence of inspection and insurance.

When an amusement ride operator or owner applies for a sales tax permit, the operator or owner must provide a North American Industry Classification System (NAICS) number. This number allows for the tracking of new companies by type and the sale of any service or product associated with a NAICS code. Bringing more operators into compliance could also result in an increase of injury reports submitted quarterly to TDI, which would provide the state with a more accurate assessment of injuries related to amusement ride operations.

FISCAL IMPACT OF THE RECOMMENDATIONS

Since fiscal year 2011, revenue from the Amusement Ride Program has increased and reached \$334,724 in fiscal year 2013. TDI has spent about \$142,000 on the program annually, and the excess revenue remains in the Insurance Operating Account (General Revenue–Dedicated Funds). Recommendation 1 would appropriate all revenue collected from the program to be used to administer and enforce it. Based on fiscal year 2013 revenue and expenditures, appropriations to TDI would increase by approximately \$193,000, and there would be an equivalent loss to the Insurance Operating Account as shown in **Figure 4**. Actual revenue and appropriations would depend on the number of amusement rides that register and fee collections. Any increase in the number of amusement ride operators that register and pay the associated fee as a result of increased enforcement activity at TDI would result in a revenue increase; however, this amount cannot be determined at this time. Recommendation 2 would require TDI to reduce the filing fee if revenue generated were to exceed amounts needed to administer the program. This would prevent the accumulation of an account balance. This analysis assumes TDI could implement Recommendation 3 with the additional resources directed to the program by Recommendation 1. TDI has unfilled positions in its FTE cap, so no adjustments would be needed for additional staff hired to implement these changes and administer the program.

FIGURE 4
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 1
FISCAL YEARS 2016 TO 2020

YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE–DEDICATED FUNDS
2016	(\$193,000)
2017	(\$193,000)
2018	(\$193,000)
2019	(\$193,000)
2020	(\$193,000)

SOURCE: Legislative Budget Board.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

DEFINE AND ESTABLISH PENALTIES FOR WORKER MISCLASSIFICATION

Worker misclassification occurs when an employer intentionally classifies an employee as an independent contractor to evade state and federal taxes or because the employer does not understand the legal distinction between an employee and an independent contractor. The practice results in lost revenue to the state's unemployment insurance fund, undercuts the competitiveness of other employers, and results in the denial of unemployment insurance benefits to laid-off workers who would otherwise be eligible. Misclassified workers ultimately owe both the employee and employer portions of the payroll tax that funds Medicare and Social Security.

The unemployment insurance program is funded with state and federal payroll taxes and provides short-term, limited income replacement for people who are unemployed through no fault of their own. Federal statutes establish general provisions for unemployment insurance program coverage, benefits, and administration; though each state sets up its own program within the framework of the federal requirements. The Texas Workforce Commission administers Texas' unemployment insurance program. Amending statute to more clearly define an independent contractor and to give the Texas Workforce Commission the authority to assess penalties for intentional or repeated employee misclassification would help both protect good-faith business owners and workers and help ensure that required employer contributions are made to the unemployment insurance system.

FACTS AND FINDINGS

- ◆ The state's unemployment insurance system is financed by an employer payroll tax on the first \$9,000 of an employee's annual wages. Tax rates vary for employers based on the unemployment insurance benefits that have been paid to former employees.
- ◆ Approximately 491,000 employers make contributions to the state's unemployment insurance system on wages paid to 12 million workers.
- ◆ An annual average of 632,000 individuals in Texas received unemployment insurance benefits, for an average of 16.3 weeks, from fiscal year 2011 to 2013.
- ◆ Employer audits are the Texas Workforce Commission's main way of identifying misclassified workers and recovering unemployment insurance contributions.

From fiscal years 2010 to 2012, the Texas Workforce Commission audited 25,277 employers within 20 industries. These audits identified 34,846 misclassified workers and approximately \$2.4 million in additional payroll taxes due to the unemployment insurance fund.

- ◆ Current statutory provisions and penalties address the underreporting of employee wages in the private market, but not misclassification. There is a \$200 penalty per misclassified worker that applies to employers with government contracts.

CONCERNS

- ◆ Worker misclassification results in a loss of revenue to the unemployment insurance fund. It also undercuts the competitiveness of other employers and results in the denial of future unemployment insurance benefits to workers who might otherwise have been eligible for them.
- ◆ While employers in the private market are charged interest on past due unemployment insurance contributions, there is no penalty for misclassification.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to clarify the definitions of employee and independent contractor by including a rebuttable presumption of employee status.
- ◆ **Recommendation 2:** Amend statute to give the Texas Workforce Commission the authority to assess penalties for misclassification in the private market.

DISCUSSION

The 1935 Social Security Act established the federal-state unemployment insurance (UI) program. The program is funded with state and federal payroll taxes and provides short-term, limited income replacement for people who are unemployed not through any fault of their own, such as because of conditions in the economy. While federal statutes set general provisions for unemployment insurance program coverage, benefits, and administration, each state establishes its own program within the framework of the federal

requirements. The Texas Workforce Commission (TWC) administers the Texas UI program.

The Federal Unemployment Tax Act (FUTA) authorizes the federal payroll tax that funds the federal and state administrative costs associated with state UI programs. It also provides a loan fund for states whose unemployment compensation costs exceed state revenues and, when applicable, pays for extended unemployment benefits. The federal tax rate is 6.0 percent of wages up to \$7,000, or \$420, per employee per year. Employers who pay into a state UI system earn credits against their federal tax worth 5.4 percent on wages up to \$7,000, making their federal tax liability 0.6 percent, or \$42, per employee per year.

State UI tax revenues, referred to in statute as contributions, finance state UI benefits. Texas employers make UI contributions on the first \$9,000 in wages they pay each employee each year. According to TWC, approximately 491,000 employers make contributions to the state’s unemployment insurance system on wages paid to 12 million workers. As in all other states, employers in Texas are subject to two types of contribution rates: their initial (or standard) rate and their subsequent experience (or general) rate. When an entity first becomes an employer in Texas, the employer pays an initial contribution rate that is the greater of either 2.6 percent (\$234 per employee) or the average rate paid by employers in that major industry group. This revenue is deposited into Texas’ Unemployment Compensation Fund (UCF) in the U.S. Department of Treasury, where it is held until TWC requisitions it for paying benefits. The initial contribution rate applies from the time the entity first becomes an employer until it is eligible for a rate based on experience.

States have systems to set contribution rates that vary for employers based on the benefits that have been paid to former employees and charged to the employer’s account. This is an employer’s experience tax rate. A Texas employer’s experience rate is computed in two steps: (1) dividing the last three years’ worth of UI benefits paid to former employees by the last three years’ worth of taxable wages paid by the employer and (2) multiplying the result by the state fund replenishment ratio, which is calculated annually by TWC. An employer’s general tax rate also includes TWC’s replenishment tax rate, an unemployment obligation assessment rate, and a deficit tax rate. The latter two components are mechanisms the agency may use when the balance in the UCF falls below the statutory floor. In years when there is neither a deficit assessment nor an obligation

assessment rate, an employer’s tax rate is the sum of its experience rate, the replenishment rate, and a flat Employment and Training Assessment that funds TWC’s Skills Development Program.

UNEMPLOYMENT INSURANCE BENEFITS

Individuals are eligible for benefits if they are unemployed through no fault of their own, which generally means they neither quit voluntarily nor were justifiably fired. Unemployment benefits for each applicant are based on the applicant’s wages during the base period, which is the first four of the five completed calendar quarters preceding the applicant’s filed claim. In Texas, individuals are eligible for UI benefits for up to 26 weeks provided they meet certain conditions. To be and remain eligible for benefits the individual must, among other things:

- have earned wages in at least two of the calendar quarters in the base period;
- have been totally or partially unemployed for a waiting period of at least seven consecutive days;
- register with and report regularly to an employment office;
- be actively seeking and available for work;
- participate in re-employment services, if TWC’s profiling system indicates the applicant may exhaust eligibility for benefits;
- keep a detailed work search log so TWC can verify the applicant’s job-seeking activities; and
- request benefit payments every two weeks.

Figure 1 shows the recipients of state-financed UI benefits and the average length of their benefits for the last three fiscal years.

**FIGURE 1
RECIPIENTS OF UNEMPLOYMENT INSURANCE BENEFITS
FISCAL YEARS 2011 TO 2013**

FISCAL YEAR	REGULAR UNEMPLOYMENT INSURANCE BENEFITS RECIPIENTS	AVERAGE WEEKS OF BENEFITS
2011	676,015	16.7
2012	624,710	16.3
2013	594,754	15.9

SOURCE: Texas Workforce Commission.

WORKER MISCLASSIFICATION IN TEXAS

Employee misclassification occurs either because an employer knowingly misclassifies employees as independent contractors to evade state and federal taxes or because the employer does not understand the legal distinction between an employee and an independent contractor. This distinction is based on the degree to which workers are free from direction and control in how they do their jobs. Employers do not pay UI contributions on workers classified as independent contractors. An employer that misclassifies reduces its labor costs and gains a competitive advantage over other employers. The amount of UI benefits paid to former employees is a factor in setting an employer’s experience rate. Therefore, misclassifying workers also reduces future tax liabilities of employers to the extent that they lay off workers who would have otherwise been eligible for UI benefits.

Independent contractors have a greater tax liability and less protection against unemployment than employees. Misclassified workers ultimately are legally responsible for both the employee and employer portions of the payroll tax that funds Medicare and Social Security. Because independent contractors are not eligible for UI benefits when they are out of work, misclassified workers are denied UI benefits they otherwise would have been eligible for after being laid off.

The Texas Labor Code explicitly prohibits an employer with a government contract from misclassifying workers, but the statute does not address misclassification among private employers. TWC rules require employers to report on a quarterly basis the name, social security number, and total wages paid for employment of each employee. Employer

audits are TWC’s main way of identifying misclassified workers and recovering unemployment insurance contributions.

TWC verifies compliance with wage reporting through an information exchange with the Internal Revenue Service. The agency also exchanges audit results with the U.S. Department of Labor (DOL). DOL requires TWC to audit one percent of all employer accounts in the state each year. TWC may also audit an employer when:

- a former worker’s claim for UI benefits is denied because no wages have been reported for that worker; or
- TWC has received a report that the employer is misclassifying employees.

TWC auditors use a 20-point test of employment status to determine whether a worker has sufficient freedom from direction and control to be classified as an independent contractor. TWC’s test is derived from one used by the IRS. **Figure 2** shows the 20 test factors and how they differentiate an employee from an independent contractor. During the audit process, TWC does not distinguish between purposeful misclassification and misclassification that was the result of not understanding the rules. Employers may access TWC’s test of employment status through the Texas Administrative Code. The agency also makes the test available to employers in printed and electronic forms. Additionally, TWC addresses employer groups, professional organizations, and business conferences on the distinction between employees and independent contractors.

**FIGURE 2
TEXAS WORKFORCE COMMISSION EMPLOYMENT STATUS COMPARISON, AS OF FISCAL YEAR 2014**

FACTOR	EMPLOYEE	INDEPENDENT CONTRACTOR
Instructions	Employees receive instructions about when, where, and how the work is to be performed.	Independent contractors do the job with few, if any, instructions as to the details or methods of the work.
Training	Employees are often trained by a more experienced employee or are required to attend meetings or training courses.	Independent contractors use their own methods and do not receive training from the purchaser of those services.
Integration	Services of employees are usually merged into the firm’s overall operation.	Independent contractor services are usually separate from the client’s business and not integrated or merged into it.
Services rendered personally	Employees do not hire their own substitutes or delegate work to them.	An independent contractor may assign another to do the job in his or her place and need not perform services personally.
Hiring, supervising, and paying helpers	An employee may act as a foreman for the employer, but, if so, helpers are paid with the employer’s funds.	Independent contractors select, hire, pay, and supervise any helpers used and are responsible for the results of the helpers’ labor.

FIGURE 2 (CONTINUED)
TEXAS WORKFORCE COMMISSION EMPLOYMENT STATUS COMPARISON, AS OF FISCAL YEAR 2014

FACTOR	EMPLOYEE	INDEPENDENT CONTRACTOR
Continuing relationship	Employees often continue to work for the same employers month after month.	Independent contractors are usually hired to do one job of limited or indefinite duration and have no expectation of continuing work.
Set hours of work	An employee may work "on call" or during hours and days as set by the employer.	Independent contractors work the days and hours they choose.
Full-time required	An employee ordinarily devotes full-time service to the employer, or the employer may have a priority on the employee's time.	Independent contractors cannot be required to devote full-time service to one firm exclusively.
Location where services performed	Employment is indicated if the employer has the right to mandate where services are performed.	Independent contractors ordinarily work where they choose, which may be away from the client's premises.
Order or sequence set	Performs services in the order or sequence set by the employer, showing the employer's control.	Independent contractors are concerned only with the finished product and set their own order or sequence of work.
Oral or written reports	Employees may be required to submit regular oral or written reports about the work in progress.	Independent contractors are usually not required to submit regular oral or written reports about the work in progress.
Payment by the hour, week, or month	Typically paid by the employer in regular amounts at stated intervals.	Independent contractors are normally paid by the job, either a negotiated flat rate or after acceptance of a bid.
Payment of business and travel expense	An employee's business and travel expenses are either paid directly or reimbursed by the employer.	Independent contractors normally pay all their own business and travel expenses without reimbursement.
Furnishing tools and equipment	Employers furnish all necessary tools, materials, and equipment for employees' use.	Independent contractors ordinarily provide all of the tools and equipment necessary to complete the job.
Significant investment	Employees usually have little or no investment in the business; they are economically dependent on the employer.	Independent contractors usually have a substantial financial investment in their independent businesses.
Realize profit or loss	Employees do not ordinarily realize a profit or loss in the business; they are paid for services rendered.	Independent contractors can either realize a profit or suffer a loss depending on the management of expenses and revenues.
Working for more than one firm at a time	Employees ordinarily work for one employer at a time and may be prohibited from joining a competitor.	Independent contractors often work for more than one client or firm at the same time and are not subject to a non-competition rule.
Making service available to the public	Employees do not make their services available to the public except through the employer's company.	Independent contractors may advertise, carry business cards, open a private office, or hold separate business licenses.
Right to discharge without liability	Employees can be discharged at any time without liability on the employer's part.	If the work meets the contract terms, independent contractors cannot be fired without liability for breach of contract.
Right to quit without liability	Employees may quit work at any time without liability on the employee's part.	Independent contractors are legally responsible for job completion and, on quitting, become liable for breach of contract.

SOURCE: Texas Workforce Commission.

If TWC finds that an employer has incorrectly classified employees (workers who are not free from direction and control) as independent contractors, the agency may by statute assess interest on past due contributions of 1.5 percent of the contribution for each month or portion of a month that the contribution and interest payments are not paid in

full, not to exceed 37.5 percent. Back UI taxes are deposited in the UCF. Interest penalties are deposited into the Unemployment Compensation Special Administration Fund (General Revenue–Dedicated Funds), which funds TWC's investigations of unpaid wage claims and unemployment insurance claims filed by state employees.

Figure 3 shows the results of TWC audits for fiscal years 2010 to 2012. These audits identified \$229.1 million in wages paid to misclassified workers and almost \$2.4 million in additional UI contributions.

In December 2010, the DOL changed its audit requirements, which resulted in fewer total audits but more misclassified workers being identified. In fiscal year 2012, TWC's audits identified 12,733 more misclassified workers and approximately \$1.4 million more in additional taxes due than were identified in fiscal year 2010.

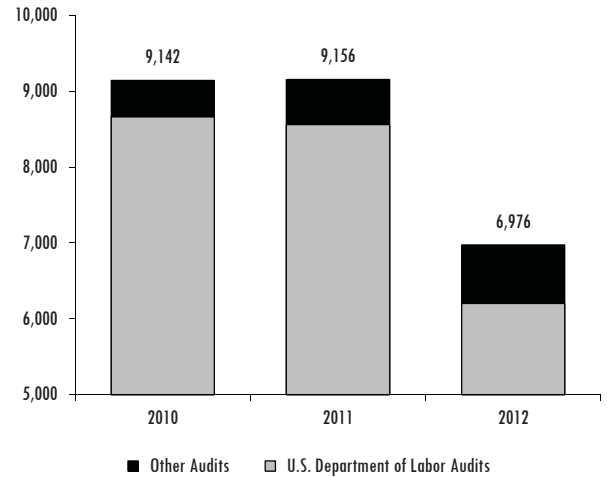
Of the audits shown in Figure 3, the majority were part of the DOL's required audit regimen. Figure 4 shows the total number of employer audits for fiscal years 2010 to 2012 and whether the audit was part of DOL's audit regimen or happened for other reasons, such as the result of an appealed UI claim denial or report that an employer misclassified workers. The number of DOL audits performed by TWC decreased by approximately 28.4 percent between fiscal years 2010 and 2012. During the same time, the number of audits for other reasons increased by approximately 61.5 percent.

Figure 5 shows the total number of misclassified workers identified by TWC audits for fiscal years 2010 to 2012 by the type of audit. The number of misclassified workers that audits found from fiscal years 2010 to 2012 increased by 12,733. Approximately 66.5 percent (8,472) of these workers were found via audits done for other reasons. These other audits identified approximately 5.2 misclassified employees per audit in fiscal year 2010. In fiscal year 2012, the non-DOL audits identified approximately 14.1 misclassified employees per audit.

Figure 6 shows the major industry groups audited by TWC during fiscal years 2010 through 2012 and the number of misclassified workers found within those industries.

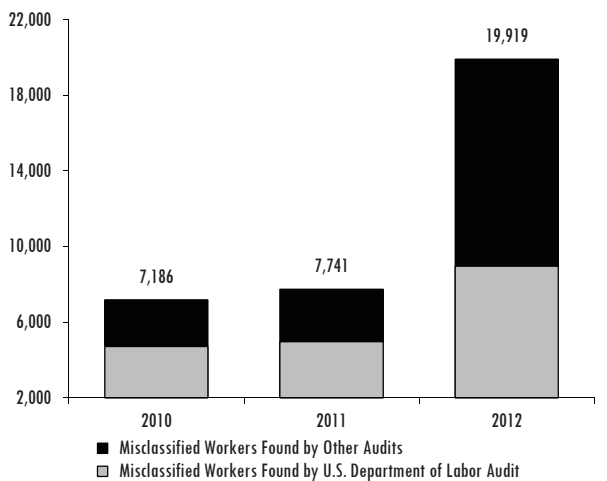
House Bill 2015, Eighty-third Legislature, Regular Session, 2013, established a penalty for worker misclassification that applies to contractors and subcontractors who provide

FIGURE 4
TEXAS WORKFORCE COMMISSION EMPLOYER AUDITS
FISCAL YEARS 2010 TO 2012



SOURCE: Texas Workforce Commission.

FIGURE 5
MISCLASSIFIED WORKERS BY TYPE OF AUDIT, FISCAL
YEARS 2010 TO 2012



SOURCE: Texas Workforce Commission.

FIGURE 3
RESULTS OF TEXAS WORKFORCE COMMISSION EMPLOYER AUDITS, FISCAL YEARS 2010 TO 2012

FISCAL YEAR	AUDITS	MISCLASSIFIED WORKERS FOUND	MISCLASSIFIED WORKER WAGES	ADDITIONAL TAX DUE
2010	9,142	7,186	\$37,996,404	\$226,957
2011	9,156	7,741	\$46,668,585	\$539,451
2012	6,979	19,919	\$145,421,713	\$1,632,328
TOTAL	25,277	34,846	\$229,086,702	\$2,398,737

SOURCE: Texas Workforce Commission.

**FIGURE 6
MISCLASSIFIED WORKERS FOUND BY TEXAS WORKFORCE
COMMISSION AUDITS, FISCAL YEARS 2010 TO 2012**

NAICS CATEGORY	AUDITS	MISCLASSIFIED WORKERS FOUND
Management and Remediation Services	1,572	5,233
Construction	1,640	4,313
Health Care and Social Assistance	2,810	4,095
Accommodation and Food Services	3,989	3,588
Other Services (except Public Administration)	2,123	2,916
Services	5,592	2,699
Mining	474	1,942
Retail Trade	1,999	1,486
Transportation and Warehousing	400	1,415
Wholesale Trade	1,531	1,345
Manufacturing	806	1,174
No NAICS Code Listed	106	1,137
Real Estate Rental and Leasing	667	1,094
Educational Services	175	796
Agriculture, Forestry, Fishing, and Hunting	264	691
Arts, Entertainment, and Recreation	199	492
Information	167	214
Finance and Insurance	682	167
Utilities	47	31
Management of Companies and Enterprises	33	9
Public Administration	1	9
TOTAL	25,277	34,846

NOTE: NAICS: North American Industry Classification System.
SOURCE: Texas Workforce Commission.

services to government entities. The bill requires that these employers properly classify their employees and independent contractors. Failing to do so is punishable by a \$200 penalty per misclassified employee. Penalty revenue accrues to the Unemployment Compensation Special Administration Fund (General Revenue–Dedicated Funds). The statute took effect January 1, 2014. The bill did not establish penalties for misclassification in the private market.

LEGISLATION IN OTHER STATES

Since calendar year 2008, 27 state legislatures and the District of Columbia have passed bills taking action against worker misclassification. Nineteen states and the District of Columbia clarified definitions of employee or independent contractor, authorized penalties for misclassifying, or otherwise prohibited or penalized misclassification (sometimes via multiple bills during more than one legislative session). Eleven state legislatures passed bills penalizing misclassification in specific industries thought to be more at-risk (including construction, trucking, and temporary staffing services). Another common policy response has been for states to establish a task force to estimate and report on the scale of misclassification within a state or an economy and recommend remedies. Since calendar year 2008, 14 states have established commissions either legislatively or by executive order. An additional six states have passed bills excluding specific industries (including trucking and private security) from the state’s definition of employee, meaning that workers in those sectors are more likely to be treated as independent contractors. **Figure 7** shows states that have passed bills or otherwise taken action relating to worker misclassification.

In addition, since calendar year 2011 at least three states (Rhode Island, Texas, and Virginia) have passed laws increasing enforcement on employers with public works contracts.

DEFINE WORKER MISCLASSIFICATION AND ADD A PENALTY

To prevent misclassification resulting from a lack of understanding of the legal distinction between an employee and independent contractor, Recommendation 1 would amend the Texas Labor Code to clarify the definitions of employee and independent contractor by including a rebuttable presumption of employee status. Employers seeking to overcome this presumption would use the test of direction and control established in rule by TWC to demonstrate that an independent contractor relationship exists. TWC’s rule as of fiscal year 2014 uses 20 common law factors to determine whether an employer has the right to direct and control when, where, and how labor or services are performed.

Recommendation 2 would amend the Texas Labor Code to establish a penalty for misclassification in the private market. This fee could match the penalty for misclassification that

**FIGURE 7
OTHER STATES' ACTIONS ON WORKER MISCLASSIFICATION, CALENDAR YEARS 2008 TO 2013**

CALENDAR YEAR	LEGISLATION AFFECTING ALL INDUSTRIES	INDUSTRY-SPECIFIC REGULATIONS OR PENALTIES	TASK FORCE	INDUSTRY-SPECIFIC EXCLUSIONS FROM DEFINITIONS
2008–2010	Connecticut, Delaware, Illinois, Indiana, Maryland, Massachusetts, Minnesota, Nebraska, New Hampshire, New York, Washington, Wisconsin	Delaware, Maryland, Minnesota, Nebraska, New York, Wisconsin	Connecticut, Iowa, Maine, Massachusetts, Michigan, New Hampshire, New Jersey, Nevada, New York, Rhode Island, Vermont, Washington	None
2011	California, Florida, Kansas, Nevada	None	Maine, Nevada, Virginia	Maine, Nebraska
2012	Arizona, Delaware, Maine, Maryland, Minnesota, New Hampshire, Rhode Island	Louisiana	North Carolina, Vermont	Louisiana
2013	District of Columbia	Illinois, New Jersey, New York, Oregon, Tennessee	None	Arkansas, Connecticut, Delaware

NOTE: Legislation affecting all industries includes bills to clarify statutory definitions, increase investigative authority, and/or penalize misclassification.
SOURCE: National Conference of State Legislatures.

applies to employers with government contracts, which is \$200 per misclassified employee.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 would have no fiscal impact on the General Revenue Fund. To the extent that it results in fewer misclassified workers, revenue from the increased UI contributions would be deposited in the state’s account in the UCF. Because UI contributions vary by industry and employer, any increase in revenue resulting from this recommendation cannot be estimated at this time. Employers that pay an initial rate make UI contributions at a rate of at least 2.6 percent on wages up to \$9,000. Employers that pay a general rate make contributions at rates that vary according to the amount of UI benefits paid to former employees.

Recommendation 2 would establish a penalty for misclassification in the private market. Penalty revenue would accrue to the Unemployment Compensation Special Administration Fund (General Revenue–Dedicated Funds). It is not possible to estimate the amount of increased revenue that would result from this recommendation at this time because it is not known how many cases of misclassification would be identified, nor what the amount of the penalty would be.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

IMPROVE ACCOUNTABILITY OF LOCAL WORKFORCE BOARD AND JOB TRAINING PROGRAMS

Texas' local workforce development boards promote and oversee employment and human resource services for job seekers and employers. To ensure the quality of these services, the Texas Workforce Commission holds local boards accountable by monitoring their program and fiscal functions. Although the agency has developed comprehensive monitoring systems, its online local board ratings offer insufficient information to allow oversight entities and job seekers to assess the performance of local boards. To maximize the utility of the Texas Workforce Commission's board ratings, information should be added showing whether local boards are successful in providing effective workforce services such as employment placement and training.

Job training programs give job seekers the skills needed to obtain employment. Federal law requires state and local workforce agencies to maximize consumer choice in selecting the appropriate job training program. The same law supports this consumer-oriented approach by requiring state workforce agencies to maintain an online database showing local board- and state agency-approved training programs. The Texas Workforce Commission's job training program database, however, does not contain training outcomes data for each training program. As a result, job seekers cannot make an informed decision about which training programs will most effectively meet their needs. To maximize the utility of the job training program public access database, job training providers should be required to assist the Texas Workforce Commission in showing performance data in the database to enable adequate consumer choice.

By amending statute to strengthen workforce system accountability, job seekers, stakeholders and policy makers would receive better information about the effectiveness of local boards and job training providers. The Texas Workforce Commission, local boards, and job training providers could implement these recommendations with no significant fiscal impact.

FACTS AND FINDINGS

- ◆ The 28 local workforce development boards received almost \$750 million in Federal Funds in federal fiscal year 2014 to operate eight local workforce programs across Texas. The boards are held accountable by the

Texas Workforce Commission for attaining annual targets associated with ten performance measures.

- ◆ In addition to the federal annual performance target accountability system, the Texas Workforce Commission is required by state law to evaluate each local board's capacity to oversee and manage local funds and the delivery of local workforce services. Results from the evaluation, as well as local board performance information, must be displayed on the agency website in a format that is readily understandable to the public.
- ◆ Since 2005, the Texas Workforce Commission has used a rating process based on the percentage of annual measure targets achieved by each local board and significant findings from fiscal monitoring reviews. Those indicators are then compared to certain standards. Based on those comparisons, local boards are assigned a rating of above standards, within standards, or below standards. As of November 2014, the agency indicated it was developing new rules to improve the criteria used to evaluate local boards. However, it is unknown whether the revised evaluation adopted by the agency will show a comparison of actual to targeted performance for each local board.
- ◆ Local boards and the Texas Workforce Commission have approved 4,633 job training programs as of February 2014, from which job seekers can use federal Workforce Investment Act funds to receive occupational training. These programs are listed in the agency's online Statewide List of Certified Training Providers.

CONCERNS

- ◆ The local board ratings report available online is of limited use to policy makers, employers, and the public because it does not display a comparison of performance outcomes to established targets, clearly summarize material audit findings, or sufficiently explain what the report contains. In addition, the report is not readily understandable and is based on outdated information.

- ◆ Contrary to the federal Workforce Investment Act principle of maximizing consumer choice, the Texas Workforce Commission's online Statewide List of Certified Training Providers database does not include program completion and training-related employment data for 77.4 percent of programs, information that job seekers need to identify the best training source for their needs.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require the Texas Workforce Commission to report annual performance measure results compared to established targets, and material findings from current financial monitoring reviews for each local workforce board. The report should be featured prominently on the agency's website in a format that includes explanations, where necessary, and is readily understandable by the public.
- ◆ **Recommendation 2:** Amend statute to require that each local workforce board's website provides a prominent link to the Texas Workforce Commission's performance and funds management report web page.
- ◆ **Recommendation 3:** Amend statute to require all local workforce boards, and job training providers in the statewide list of certified training providers database to provide the Texas Workforce Commission with sufficient data to determine program completion rates, employment rates, and average starting wages.
- ◆ **Recommendation 4:** Amend statute to require the Texas Workforce Commission to supplement the online Statewide List of Certified Training Providers with program performance data that would improve the information consumers use to choose a job training provider.

DISCUSSION

The Texas Workforce Commission (TWC) administers the financial, programmatic, and accountability functions associated with several workforce development programs. These include the federal Wagner-Peyser Act Employment Services program, and three programs authorized pursuant to the federal Workforce Investment Act (WIA). To implement these programs locally and ensure delivery of workforce development services across the state, TWC

partners with 28 local workforce development boards (local boards) and their approximately 200 workforce solutions centers and satellite centers. TWC allocates federal grant funds to local boards, provides them support services, and holds them accountable for regulatory compliance and performance outcomes. Local boards are responsible for meeting the needs of employers and job seekers using an array of resources and programs. **Figure 1** shows these programs, target populations, services, and federal fiscal year 2014 local board allocations. The primary goals of these programs and services are to place job seekers in employment and to help employers address their workforce needs. Local boards contract with and oversee non-profit, for-profit, or governmental providers of direct job seeker services. These are the entities that operate workforce solutions centers. Local businesses make up the majority of a local board's membership, in addition to economic development and various community-based program representatives. For federal fiscal year 2014, the agency allocated \$749.2 million in federal funds to local boards for programs shown in **Figure 1**.

LOCAL BOARD ACCOUNTABILITY SYSTEM

As directed by WIA, the U.S. Department of Labor (DOL) requires state workforce agencies to administer a system for holding local boards accountable. WIA requires these state agencies to report statewide performance outcomes to DOL using a core set of measures. Although the objective of WIA is a workforce development system in which services are integrated and easily accessible to job seekers, its required core measures are tied to the specific programs listed in **Figure 1**. According to TWC, the WIA requirement to track and report on core measures unnecessarily silos service delivery and may limit service integration.

To address this issue, TWC obtained a waiver from DOL in 2005 that allows TWC to hold local boards accountable with a set of ten measures that highlight service delivery across multiple programs, instead of using the WIA core measures. **Figure 2** shows these measures, their definitions, and whether they apply to all programs system-wide, or specific programs. Six system-wide measures are used to indicate the effectiveness of local boards in helping job seekers find and retain employment, and providing workforce services to employers. These measures apply to all programs. Four other program-specific measures were retained, such as the work participation rate of TANF clients and the level of child care services provided by local boards. DOL staff has indicated that TWC's approach has been successful in encouraging a

**FIGURE 1
TEXAS WORKFORCE DEVELOPMENT PROGRAMS, FEDERAL FISCAL YEAR 2014**

PROGRAM	TARGET POPULATION	SERVICES	LOCAL BOARD ALLOCATIONS (IN MILLIONS)
WIA–Adult	All adult job seekers, except when insufficient funds require priority of service to low-income and public assistance recipients.	Job search assistance, introduction to job search tools, labor market information, computer access, résumé writing courses, financial planning, and referral to vocational skills training. Support services such as child care, transportation, and work-related expenses.	\$47.6
WIA–Dislocated Worker	Laid-off workers and displaced homemakers.	Same services as those provided in the WIA–Adult program, but with a focus on challenges confronting laid-off workers and displaced homemakers.	53.3
WIA–Youth	Economically disadvantaged youth ages 14 to 21.	Year-round employment and training services for those who work toward educational and career goals. Services include an objective assessment, an individual service strategy plan, and activities connecting academic and occupational learning.	49.9
TANF Choices	Low-income parents of children age 19 or younger who receive TANF benefits.	Job search and job readiness classes, basic skills training, education, and vocational training. Support services such as child care, transportation, and funds to pay for work-related expenses that enable job seekers to participate in the program.	78.4
Supplemental Nutrition Assistance Program (SNAP) Employment and Training	SNAP recipients	Job search and job readiness activities, skills training, and support services such as transportation.	12.3
Trade Adjustment Assistance Act	People who lose jobs due to foreign imports or shifts in production to foreign countries.	Reemployment services such as occupational training, remedial education, English as a Second Language, and prerequisite training.	13.5
Wagner-Peyser Employment Services	All job seekers and employers.	Comprehensive services that bring together employers seeking workers and individuals seeking employment. Employment counseling services and referrals to employment openings, and assistance with using TWC’s labor exchange website, WorkinTexas.com, which allows employers and job seekers to connect electronically.	23.2
Child Care	Children age 13 or younger in low-income families, TANF recipients, in protective services. Local boards may have additional eligibility criteria.	Subsidized child care enabling parents to work or attend workforce training or education activities.	471.0
TOTAL LOCAL BOARD PROGRAM ALLOCATIONS			\$749.2

NOTE: Local board allocation amounts reflect funding for federal fiscal year 2014. Trade Adjustment Act allocations may be amended during the fiscal year based on recent events such as lay-offs.

SOURCE: Texas Workforce Commission.

**FIGURE 2
LOCAL BOARD PERFORMANCE MEASURES, FISCAL YEAR 2014**

MEASURE	DEFINITION	APPLICABLE PROGRAM
Claimant Re-employment Within 10 Weeks	Percentage of registered initial unemployment compensation claimants subject to work search requirement reemployed within 10 weeks.	All Programs
Job Postings Filled Rate	Percentage of job postings received by the system that are filled by hiring a job seeker.	All Programs
Employer Workforce Assistance	Percentage of employer locations receiving workforce services from local boards' contract workforce solutions centers.	All Programs
Staff-Guided Entered Employment	Percentage of program participants who were unemployed when initially served by workforce solutions center staff that are employed by the end of the first calendar quarter after program exit.	All Programs
Employment Retention	Percentage of program participants who were employed in the first calendar quarter after program exit that are employed in the subsequent second and third calendar quarters.	All Programs
Educational Achievement	Percentage of participants in education programs designed to result in a recognized degree or credential who achieved it by the end of the third calendar quarter after program exit.	All Programs
WIA Youth Placement in Employment or Education	Percentage of WIA Youth program participants not employed or in post-secondary education when initially served who are employed or in post-secondary education in the first calendar quarter after program exit.	WIA Youth
WIA Youth Literacy and Numeracy Gains	Percentage of out-of-school WIA Youth who are basic skills deficient who increase one or more Educational Functioning Levels by the end of a year of participation in the WIA Youth program.	WIA Youth
TANF Choices Full Work Rate	Percentage of TANF Choices families that meet their work rate participation goal exclusively through paid employment or school attendance for teenagers.	TANF Choices
Average Number of Children Served per Day	Average number of children in workforce program-related child care during the reporting period.	Child Care

NOTE: WIA = Workforce Investment Act; TANF = Temporary Assistance for Needy Families.
SOURCE: Texas Workforce Commission.

system-wide focus and still meet federal targets established for program-specific performance measures.

TWC's system of local board accountability includes ongoing assistance to all boards, establishing annual performance measure targets, monthly monitoring of expenditures and performance, overseeing technical assistance plans, and annual subrecipient monitoring. The agency provides assistance to local boards on an ongoing basis to improve their performance and program administration functions. To hold local boards accountable for performance outcomes, agency staff negotiate with the boards to identify annual targets for the applicable measures shown in **Figure 2**. On a monthly basis, TWC staff review actual performance compared to targets, as well as expenditure activity. If a local board is not meeting its targets, or its expenditure data indicates problems, such as spending funds at a faster rate than expected, agency staff initiate a technical assistance plan (TAP) for the board. The TAP may identify a series of tasks and goals the local board must meet for a certain number of months. For example, a

TAP may require a board to meet specific service and expenditure benchmarks in future months, or the plan may provide workforce center staff training to improve program services. If the board successfully fulfills the plan's requirements, it can return to its usual operations. If not, the agency may impose more stringent tasks.

Another TWC oversight function, subrecipient monitoring, can also identify local board fiscal and program administration problems. Subrecipient monitoring is required by the federal government to ensure that subrecipients (local boards) use funds in accordance with relevant laws and regulations. If problems such as questionable costs are identified during a monitoring review, TWC staff will provide the local board several opportunities to correct the problem. If a local board does not resolve the issue during the subrecipient monitoring on-site visit, or as directed by a TWC administrative judge, the matter may be referred to a State Office of Administrative Hearing (SOAH) judge. If the matter reaches that level, the local board may be required to refund a portion of TWC

funding. According to TWC, most findings are resolved before they are heard by a SOAH judge.

LBB staff conducted a survey in fall 2013 of select local board directors and found that many support TWC’s accountability system. Many surveyed local board directors said the ongoing technical assistance provided by TWC staff was beneficial, especially the training activities provided to workforce center contract staff. Many local board directors also said TWC’s system for negotiating and monitoring performance targets was beneficial. Most directors reported, however, that the agency’s implementation of the statutorily required local board evaluation through its online local board ratings limits its usefulness.

USEFULNESS OF ONLINE LOCAL BOARD RATINGS

In addition to federal requirements regarding local board performance measures, state law requires TWC to evaluate each local board’s capacity to oversee and manage local funds and service delivery. This requirement stems from a 2003 Sunset Advisory Commission report that found a need for more efficient oversight of local boards and their contractors. State statute requires TWC to provide information on its website to indicate the extent to which local boards adequately manage workforce development funds and perform based on measures established by the agency. TWC addresses this requirement by posting local board ratings on its website.

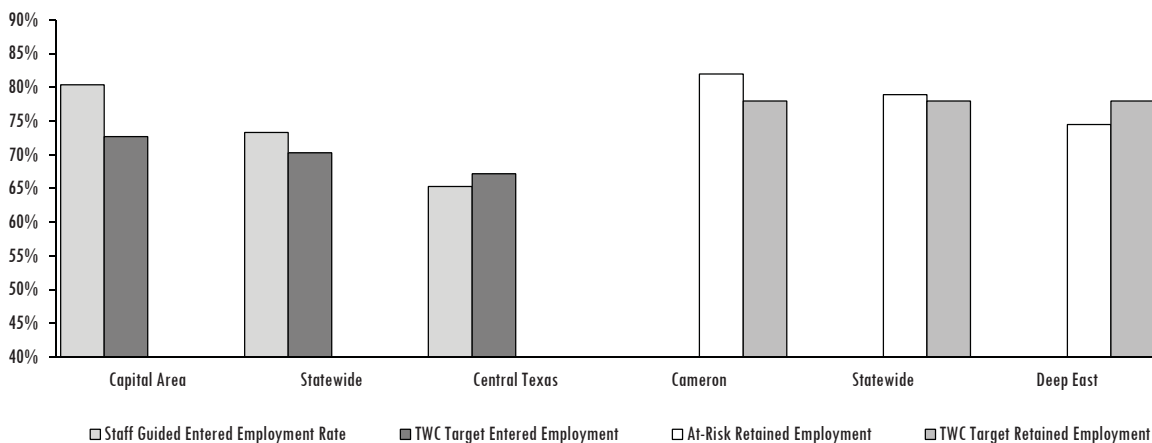
However, instead of showing specific performance outcomes, TWC’s online local board ratings indicate the percentage of annual measure targets achieved by each local board and

significant findings from fiscal monitoring reviews. Users cannot identify the actual performance levels which local boards achieve because data for specific performance measures are not provided. For example, performance measures such as the percentage of job seekers who entered employment through workforce center assistance are not specified or reported in the local board ratings. In addition, the existing online local board ratings posted on the board evaluation and rating website have not been updated since January 2011; those posted ratings lack enough explanatory information to make them readily understandable to the public.

The limited usefulness of the online local board ratings is reflected in opinions expressed by local board directors. None of the local board directors surveyed indicated they have used or referred to the local board ratings. Several directors were unaware the online local board ratings existed. All of the directors surveyed reported that instead they use the electronic performance measure reports generated by TWC, which show their actual performance compared to TWC targets on a quarterly basis.

Providing local board performance information online makes differences in workforce program outcomes more apparent. **Figure 3** shows local board actual data and targets for two employment performance measures: the percentage of adult program job seekers assisted by workforce center staff that entered employment by the end of the first quarter after they exited the program, and the percentage of at-risk job seekers (those who have disabilities and other barriers) who retained

**FIGURE 3
SELECTED LOCAL BOARD PERFORMANCE
YEAR ENDING SEPTEMBER 30, 2013**



SOURCE: Legislative Budget Board.

employment for three consecutive quarters after program exit. This is data that is not available in the local board ratings. For the period ending September 30, 2013, the entered employment rate varied from a high of 80.4 percent for the Capital Area (Austin) local workforce development board to a low of 65.3 percent for the Central Texas local workforce development board (Belton). The at-risk retained employment rate ranged from 82.0 percent for the Cameron local workforce development board to 74.5 percent for the Deep East local workforce development board (Lufkin). Overall, all local boards met or exceeded their annual targets for these two measures within a 5 percent range (95 percent to 105 percent). Without this type of statewide and board-specific information, the public cannot see how well local boards compare in performing important employment functions and how well the boards serve their customers and communities.

Recommendation 1 would address this concern by amending the Texas Labor Code to require TWC to display annual performance measure results compared to TWC-established targets for each local board, as well as significant findings from the most recent subrecipient monitoring reviews. With input from local boards, TWC should establish a new board assessment policy that clearly shows performance measures and fiscal monitor findings. The report should be featured prominently on the TWC website in a format that includes sufficient content and explanations to make it readily understandable by the public. It should be made available on the TWC website by May 2016.

As of November 2014, the agency indicated it is in the process of developing new agency rules intended to improve the criteria used to evaluate local board oversight capacity. However, it is unknown whether the rules ultimately adopted by the agency will address the concerns noted above.

To ensure that the public can access outcomes and significant monitoring findings for a local board, Recommendation 2 would amend the Texas Labor Code to require each local board's website to provide a prominent link to TWC's funds management and performance report web page. Linking to the TWC page would allow local board members, job seekers, employers, and other stakeholders to see a local board's performance and fiscal management monitoring results in one report, as well as to compare those results to other boards statewide. Prominently displaying comparisons of performance on measures, such as job postings filed or entered employment rates, would improve the quality of

information available to stakeholders and policy makers and increase transparency.

ELIGIBLE JOB TRAINING PROVIDER SYSTEM

One of the services offered by workforce solutions centers is subsidized job training. Eligibility requirements for WIA-funded training opportunities are less restrictive than for other funding sources. To qualify for job training funded by WIA, a job seeker must be unable to obtain employment after using basic/core services, such as staff-assisted job search or advanced/intensive services such as job seeker skills assessments. The training services funded by WIA are occupational in nature and are provided by both public and private providers. Workforce solutions centers can coordinate WIA funding with other federal grants to provide additional training, such as on-the-job training, adult education, and entrepreneurial training.

Once a job seeker qualifies for training, workforce solutions center staff provide the job seeker a training subsidy stipend, known as an individual training account (ITA). The job seeker may spend the ITA only for training related to specific occupations, and may enroll in programs approved by both the local board and TWC. Local boards annually determine targeted occupational training programs eligible for ITA use by first identifying occupations in demand in their local workforce development areas. The boards may also use other eligibility criteria, such as labor market demand in a specific industry cluster. This determination is aided by TWC's automated labor market analysis tools. These tools provide local boards with information such as regional long-term projected employment by industry.

Referrals to job training are also part of the TANF Choices, Supplemental Nutrition Assistance Employment and Training (SNAP E&T) program, and the Trade Adjustment Act Services (TAA) programs. Eligibility for these programs, however, is more restrictive than WIA-Adult, and they serve very specific populations, such as those receiving TANF or SNAP benefits.

QUALIFYING JOB TRAINING PROVIDERS AND PROGRAMS

TWC oversees a job training provider and program approval process that places local boards in a central role. During this process, local boards review job training program applications from providers in the board's workforce development area. Once the local board and TWC approve the providers, they are added to TWC's Statewide List of Certified Training

Providers. Local boards and job seekers use this database to identify providers and programs eligible for ITA funding.

TWC delineates three types of job training programs:

- exempt programs—those that lead to a credential such as a skill certificate or a degree offered by training providers that are eligible to receive federal higher education funding, and those that are apprenticeship programs;
- non-exempt programs—those that do not meet the two aforementioned criteria; and
- excluded programs—those that are offered as on-the-job training or customized training for specific employers. These programs are not eligible for ITA funding pursuant to WIA and do not have to follow the initial eligibility process.

In accordance with WIA and TWC regulations, non-exempt programs, such as those offered by technical training schools, must submit performance information with their initial eligibility applications. Performance information includes training program completion rates, post-completion entered-employment rates, and average starting hourly wages. In June 2013, TWC set these minimum performance standards for eligibility: training program completion rate and entered employment rate of at least 60 percent, an average starting wage exceeding the federal minimum wage, and 80 percent of the average starting wage for the occupation related to the training program. Local boards can either apply these minimum standards or set higher standards for their approval process.

Exempt programs, such as those offered at community colleges, receive automatic initial eligibility. As such, these job training providers are not required to have their training programs initially approved based on the performance standards mentioned previously. The exempt programs also do not have to submit performance information with their applications for initial eligibility review by local boards and TWC.

Federal law requires both exempt and non-exempt training providers to seek subsequent eligibility for each year following initial eligibility. Responding to training providers' concerns that the subsequent eligibility process is burdensome, TWC obtained a federal waiver in 2005 allowing the agency to extend eligibility for existing providers and programs through 2017. The waiver, combined with the automatic eligibility for exempt providers, has resulted in TWC not having

performance information for many of the WIA-funded job training programs statewide.

AVAILABILITY OF TRAINING PROVIDER PERFORMANCE INFORMATION

A key principle of WIA is that job seekers should have access to sufficient information to help them choose the job training program that best meets their needs. To enable this consumer choice, TWC maintains a searchable database, the Statewide List of Certified Training Providers, which contains information on providers and programs approved by local boards and TWC that offer ITA-funded training. The database allows job seekers to identify local training providers and programs that align with their occupational goals. Job seekers can search by training program, area of study, occupational category, city or workforce area, and provider name. Search results show provider and program descriptions, area of study, cost information, program length in contact hours, and the certificate offered.

The database does not include performance information about many training programs. An objective of WIA is that job seekers benefit from seeing current data on the percentage of former students who completed the program and entered employment, and their average starting wage level. Yet because of the federal waiver granted to TWC, the database does not contain performance information for 77.4 percent of all training programs. In these cases, data fields for performance information are blank. Furthermore, most of the performance information in the database is outdated as of November 2014. Of the 1,113 programs in the database showing any form of performance information, only 15.5 percent were approved and added to the list after August 31, 2008.

Recommendation 3 would amend the Texas Labor Code to require all local boards and training providers in the database to furnish TWC with data sufficient to indicate the program completion rate, and to calculate the entered employment rate and average starting wage. These data would include the number of job seekers entering and completing training for each provider and training program. To address job training provider concerns about reporting performance for all job seekers in their programs, TWC should have the flexibility to require performance-related data only for WIA-funded students enrolled in a program. To ensure the data from providers is available to job seekers, Recommendation 4 would amend the Texas Labor Code to direct the Texas Workforce Commission to supplement the current Statewide List of Certified Training Provider database with performance

information on all training provider programs. Performance information would include the percentage of students who completed the program, percentage who entered employment, and their average starting wage level.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would have no significant fiscal impact. It is expected that TWC could implement the recommendations with existing resources. There would be no significant fiscal impact to local workforce boards associated with any of the recommendations because the recommendations do not require a substantial increase in data collection or maintenance. Job training providers would have to begin reporting job seeker participation data to TWC. However, the providers currently collect this data; therefore, there would not be a significant fiscal impact to them.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

MODIFY EQUITY APPEALS FOR PROPERTY APPRAISALS TO ENSURE UNIFORMITY

Property taxes are one of the primary funding sources for public school districts in Texas. Property tax assessments and collections are based upon the property appraisals completed by central appraisal districts. The Texas Constitution requires property appraisals to be equal, uniform, and based on market value. The state's interest in local property valuations and the related tax assessments by school districts ties to the Foundation School Program. Typically, higher property valuation and related local revenue collections reduce state revenue needed to fund the Foundation School Program entitlement. As property values and related local revenue collections are lowered, more state resources are needed to fund the entitlement.

Property owners in Texas have the right to protest property appraisals if they believe their property has been appraised above market value, or if they believe they have been impacted negatively by appraisals that are not equal and uniform. For equity appeals, the Texas Tax Code provides three bases for relief. Two of these relief provisions require equity to be determined using market value and standards consistent with generally accepted appraisal standards. However, one provision specifies that a property owner is entitled to relief if the appraised property value exceeds the median appraisals of a reasonable number of comparable properties with appropriate adjustments. Neither statute nor professional standards define what constitutes a reasonable number of properties, what makes properties comparable, or what constitutes appropriate adjustments. Modifying this relief provision for equity appeals and providing more consistent guidance for property owners and appraisal districts to determine property values for unique properties would help to ensure that appeals of equal and uniform appraisals are considered consistently across the state.

FACTS AND FINDINGS

- ◆ The Texas Constitution requires that property appraisals be based on market value and be equal and uniform.
- ◆ The appraisal profession uses state and national standards to appraise property. The Texas Comptroller of Public Accounts adheres to generally accepted appraisal standards when evaluating whether or not

appraisal districts meet the constitutional standard for equal and uniform appraisal.

- ◆ In fiscal year 2012, more than 270,000 equity appeals were filed with appraisal review boards statewide. During the same year, 6,200 equity lawsuits were filed in district court.
- ◆ Equity appeals do not necessarily result in reduced total tax revenue; instead these appeals may affect the distribution of who pays taxes. To generate the revenue lost by successful equity appeals, local governments typically raise the tax rate, effectively redistributing the tax burden to other property owners.
- ◆ In a sample of six appraisal districts, the loss in appraised value due to litigation of equity appeals increased the state's Foundation School Program obligation by \$70 to \$80 million per year.

CONCERNS

- ◆ The Texas Tax Code establishes three standards to determine whether an appraisal is equal and uniform. One standard is inconsistent with the standards found elsewhere in the Texas Tax Code and those used by the Texas Comptroller of Public Accounts to evaluate appraisal district performance. This provision provides relief to a taxpayer if the taxpayer's property is appraised at a higher value than other properties, independently of the market values of those properties or the appraisal district in which they are located.
- ◆ In equity appeals against appraisal districts, property owners are not required to use the same appraisal standards or to stay within the district when selecting comparable properties. As a result, some owners use properties from different districts, states, and countries that are not comparable based on location, age, size, condition, and potential income.
- ◆ Appraisal districts and property owners lack guidance on the appropriate methods to appraise and adjust values for unique properties, such as petrochemical refineries. This can lead to expensive court

proceedings to determine parameters that should be applied during appraisals.

- ◆ Statute requires an appraisal district that loses a lawsuit to pay the property owner’s attorney fees. An owner is not subject to the same requirement. This disparity in attorney fees being paid by the appraisal district but not the owner may provide some owners an incentive to sue.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to use deviation from the median appraisal ratio instead of median appraised value as the basis to determine equal and uniform appraisal.
- ◆ **Recommendation 2:** Amend statute to establish standards for what defines comparable property, limit comparable properties to those in the same appraisal district, require adjustments to be based on general appraisal standards, and establish which appraised value is used at each stage of protest and appeal.
- ◆ **Recommendation 3:** Amend statute to require the Texas Comptroller of Public Accounts to establish standards for development and calibration of adjustments for industrial, petrochemical refining and processing, utility properties, and other unique properties by rule.
- ◆ **Recommendation 4:** Amend statute to require a property owner who loses an equity lawsuit to pay an appraisal district’s attorney fees to make this requirement consistent for both property owners and appraisal districts.

DISCUSSION

Property taxes are locally assessed taxes that are used to fund the operations of local government entities and pay for schools, streets, roads, police, and other locally provided services. According to the Texas Comptroller of Public Accounts (CPA), property taxes are the largest source of tax revenue in the state. In fiscal year 2011, more than \$40.0 billion in property tax revenue was collected, representing almost half of total state and local tax revenues.

The Texas Constitution, Article VIII, includes the following basic parameters for property taxes:

- taxes must be equal and uniform;

- property must be assessed at its fair cash market value, or the price for which it would sell when both buyer and seller seek the best price and neither is pressured to buy or sell;
- each property in a county must have a single appraised value that is used by all of the taxing entities within the county;
- all property is taxable unless federal or state law exempts it from the tax; these exemptions may exclude all or part of a property’s value from taxation; and
- owners have a right to reasonable notice of increases in the appraised value of and tax estimates for their property.

The property tax is levied on several types of properties. Appraisal districts may define different subcategories of property depending upon local needs, but CPA provides guidelines for classifying property in the *Texas Property Tax Assistance Property Classification Guide*. **Figure 1** shows tax year 2011 taxable and market value in the CPA’s property categories.

**FIGURE 1
MARKET AND TAXABLE PROPERTY VALUES IN TEXAS
TAX YEAR 2011**

PROPERTY	MARKET VALUE	TAXABLE VALUE
A: Single-Family Residences	\$944.9	\$752.6
B: Multifamily Residences	\$85.5	\$85.3
C: Vacant Lots	\$39.5	\$39.2
D1: Qualified Agricultural Land	\$219.9	\$12.9
D2: Non-Qualified Agricultural Land	\$18.0	\$18.0
E: Farm and Ranch Improvements	\$49.3	\$49.3
F1: Commercial Real	\$278.8	\$278.8
F2: Industrial Real	\$95.0	\$70.4
G: Oil, Gas, and Minerals	\$106.0	\$106.0
H: Vehicles	\$0.1	\$0.1
J: Utilities	\$50.1	\$50.1
L1: Commercial Personal	\$120.6	\$120.6
L2: Industrial Personal	\$95.1	\$72.9
M: Mobile Homes and Other Personal	\$5.8	\$5.8
O: Residential Inventory	\$7.7	\$7.7
S: Special Inventory	\$4.0	\$4.0
TOTAL	\$2,120.4	\$1,673.9

NOTE: Amounts shown in billions.
SOURCE: Texas Comptroller of Public Accounts.

Unlike other local government entities that also can collect sales taxes and fees, school districts' only source of tax revenue is the property tax.

FOUNDATION SCHOOL PROGRAM AND LOCAL REVENUES

In Texas, the responsibility for public school funding is shared between the state and the local school district. Funding is guaranteed on a per student basis. The difference between local tax collections and the guaranteed amount per student is provided by the state. The Foundation School Program (FSP) is the state's primary program to provide funding to public school districts and allow them to meet required educational standards for kindergarten through grade 12 education.

Because of the shared school funding relationship, the state has a vested interest in local property tax collections, and the local property appraisals upon which school district property tax assessments are based. When property values decrease, the result is a cost to the state. If property values are lower than they otherwise might be due to market conditions, appraisal appeals, tax exemptions, or applying special appraisal methods, the financial responsibility of the state increases.

APPRAISAL DISTRICTS OVERVIEW

Property taxes are based on the appraised value for a given property. To simplify property appraisals and ensure uniform appraisals, the Texas Legislature established a system of central appraisal districts in 1981. According to CPA, before the Legislature established appraisal districts, thousands of governmental taxing entities appraised property and imposed taxes independently, resulting in wide disparities in value. As property tax levies increased, and the state began to base more aid to school districts on property values, centralized local appraisal became necessary. The Eightieth Legislature, Regular Session, 2007, passed legislation that requires an appraisal district to appraise only the properties in its county.

The Texas Tax Code, Chapter 6, requires appraisal districts to appraise all property subject to taxes. Unless otherwise provided by law, appraised values are required to represent market value, which is defined as the value for which the property would likely sell on January 1 of a given tax year.

Market value is determined using three standard approaches:

- The market approach uses sales of similar properties to estimate the value of properties that have not sold. For instance, sales in a residential neighborhood can

be used to estimate the value of all properties in the neighborhood, assuming the sales are adjusted for differences in property characteristics such as size, age, location, etc.

- The income approach uses the net income from a property used for business purposes to estimate the price a potential buyer would pay for commercial property.
- The cost approach first determines the cost necessary to replace the property and then depreciates that value based on the age and condition of the property to arrive at an estimate of the market value.

One approach may be used, or all three may be calculated and reconciled to arrive at a single value.

Appraisal districts are required to reappraise all property at least once every three years, but districts may have to reappraise more often to ensure that values represent market value as of January 1 each year.

The property appraisal process operates on a regular, annual schedule as provided by statute:

- January 1 to April 30: appraisal districts complete appraisals and process applications for exemptions;
- April 1: last day for chief appraiser to mail notices of appraised value for single-family residence homestead properties;
- April 30: last day for property owners to file protest with the appraisal review board for single-family residence homesteads;
- May 1: last day for chief appraiser to mail notices of appraised value for all properties other than single-family residence homesteads;
- May 31: last day for property owners to file protest with the appraisal review board for all properties other than single-family residence homesteads; and
- July 20: date appraisal review boards must approve appraisal records.

RESPONSIBILITIES OF THE COMPTROLLER OF PUBLIC ACCOUNTS

CPA has several responsibilities in relation to local property appraisal and tax assessment. Within CPA, the Property Tax Assistance Division (PTAD) conducts and publishes a property value study (PVS) of all school districts and

appraisal districts every other year. The PVS determines the value on which Texas school districts receive state funding. PTAD also conducts the Methods and Assistance Program (MAP) to review the governance, taxpayer assistance, operating procedures, and the appraisal standards, procedures, and methodology of each central appraisal district every two years.

Statute requires CPA to measure appraisal district performance at least once every two years and publish the results. To comply with this requirement, PTAD measures the level and uniformity of property appraisals. The level of appraisal shows whether districts are appraising property at 100 percent of the legally required level. In Texas, the constitutional standard is market value. PTAD uses an appraisal ratio study to assess whether districts are meeting the market value standard. An appraisal ratio is the ratio of a property's appraised value as shown on the appraisal roll compared to its market value. For example, if a single-family homestead is appraised by the district at \$80,000, but an independent appraiser values the property at \$100,000, the property has an individual appraisal ratio of 0.8. To measure how well districts meet the equal and uniform appraisal standard, PTAD calculates the coefficient of dispersion (COD) of the appraisal ratios. COD is the average percent difference from the median appraisal ratio. This measure indicates how closely the appraisal ratios in a property category are to each other. The higher the COD, the less uniformity there is in the appraisal district. The COD is a primary measure used by CPA to evaluate the uniformity of appraisals in a district.

To conduct the appraisal ratio study, PTAD:

- selects a sample of properties in each appraisal district;
- appraises those properties;
- compares the PTAD values with appraisal district values;
- calculates appraisal ratios for each property;
- groups properties by common features, including CPA's property categories; and
- performs statistical analysis.

PTAD administers statewide binding arbitration for property owners who qualify. It also provides training for newly appointed appraisal review board (ARB) members, and annual continuing education training for existing ARB members. PTAD provides information including

publications, online videos, webinars, and other education tools regarding property tax issues to taxpayers, property owners, appraisal districts, ARBs, taxing units, other state agencies, and the Legislature.

APPRAISAL PROTESTS AND APPEALS

Property owners have the right to protest appraisals. A property owner who is unsatisfied with an appraised value may submit a notice of protest with the ARB. After a protest, the ARB sets a formal hearing. At the formal hearing, the property owner and chief appraiser each presents the case to the ARB. Frequently, appraisal districts informally review appraisal protests with property owners to resolve owner concerns before a formal hearing. After the ARB rules on a protest, it notifies the property owner. The property owner may accept the ARB's findings, pursue binding arbitration, appeal to the State Office of Administrative Hearings (SOAH), or appeal the decision in district court. Property owners may pursue appeals based on the property being appraised above market value or being appraised unequally.

The Texas Tax Code includes provisions in two chapters that govern appeals. Chapter 41 applies to local appeals, and Chapter 42 applies to judicial appeals. According to these provisions, if a property owner is pursuing an appeal of unequal appraisal, the owner is entitled to relief through the following subsections:

- Subsections 41.43(b)(1) and 42.26(a)(1): the property's appraisal ratio exceeds by at least 10 percent the median appraisal ratio of a reasonable and representative sample of properties in the district;
- Subsections 41.43(b)(2) and 42.26(a)(2): the property's appraisal ratio exceeds by at least 10 percent the median appraisal ratio of a sample of properties in the district; the sample consists of a reasonable number of properties similarly situated to, or of the same kind as, the property subject to the appeal; or
- Subsections 41.43(b)(3) and 42.26(a)(3): the appraised property value exceeds the appropriately adjusted, median appraised value of a reasonable number of comparable properties.

In fiscal year 2012, appraisal districts reported 278,936 equity appeals filed with ARBs and 6,207 equity appeal lawsuits filed with district courts.

BINDING ARBITRATION

Binding arbitration is available if the property is:

- a residential homestead, regardless of value; or
- a property with an appraised value of \$1.0 million or less.

A property owner files for binding arbitration with the appraisal district and submits a \$500 deposit. The appraisal district notifies CPA, which maintains a list of available arbitrators from which the property owner and appraisal district may select. The arbitrator applies remedies established in Chapter 41. If the arbitrator's decision is closer to the value proposed by the property owner, the appraisal district pays the arbitrator's fee. If the arbitrator's decision is closer to the value proposed by the appraisal district, the fee will be paid from the property owner's deposit.

STATE OFFICE OF ADMINISTRATIVE HEARINGS

If the ARB-determined value is more than \$1 million, the property owner may file an appeal with SOAH. The owner files a notice of appeal with the chief appraiser and submits a \$1,500 deposit. The chief appraiser forwards the notice to SOAH and requests an appointment with an administrative law judge to hear the appeal. The administrative law judge applies the remedies established in Chapter 42. If the decision is closer to the value proposed by the appraisal district, the cost of the hearing is paid from the property owner's deposit. If the judge's decision is closer to the value proposed by the property owner, the appraisal district pays the cost of the hearing. The court also may award attorney's fees to the property owner if the decision is closer to the owner's proposed value.

APPEALS TO DISTRICT COURT

If a property owner chooses to appeal the ARB decision to district court, under Texas Tax Code, Chapter 42, the owner must file a petition for review with the district court within 60 days of receiving the written order from the ARB. At district court, the property owner can pursue nonbinding arbitration, trial by jury, or trial by a judge. If the court finds that appraised value exceeds market value, the appraisal roll value is adjusted to the court's determination.

If a property owner is entitled to relief pursuant to Subsection 42.26(a)(1), the property's appraised value is changed to the value as calculated by multiplying the median appraisal ratio in the appraisal district by the property's market value. If a property owner is entitled to relief pursuant to Subsection 42.26(a)(2), the property's appraised value is changed to the value as calculated by multiplying the property's market

value by the median appraisal ratio of its property category in the appraisal district. If a property owner is entitled to relief pursuant to Subsection 42.26(a)(3), the property's appraised value is changed to the value based on the median appraised value of comparable properties. If a property owner is entitled to relief pursuant to more than one subsection, then the court is required to set the value to the one that results in the lowest appraised value.

For example, if the owner of a grocery store with a market value of \$6.0 million and an appraised value of \$5.7 million pursued an equity appeal of appraised value pursuant to Subsection 42.26(a)(1), the ratio of appraised value to market value would be compared to the median ratio of appraised to market values of all properties in the district. In this example, the grocery store has an appraisal ratio of 0.95, and the median appraisal ratio in the appraisal district is 0.85. The property owner would be entitled to relief and the appraised value of the grocery store would be set at \$5.1 million.

If the grocery store owner in this example pursued an appeal pursuant to Subsection 42.26(a)(2), the ratio of appraised to market values would be compared to the median ratio of appraised to market values of all category F1: commercial real properties in the district. The median ratio of similarly situated properties in the appraisal district is 0.81. The property owner would be entitled to relief, and the appraised value of the grocery store would be set at \$4.86 million.

In the same example, if the store owner pursued an appeal pursuant to Subsection 42.26(a)(3), the appraised property value would be compared to the median appraised value of a selection of other properties. The appraised value of the comparable properties typically is adjusted to reflect differences in size or other characteristics. The value for comparison could be appraised value per square foot, if size is the primary adjustment. In this example, the grocery store appraises for \$95 per square foot, and the median appraised value per square foot of comparable properties is \$70 per square foot. The property owner would be entitled to relief, and the appraised value of the grocery store would be set at \$4.2 million. If the property owner protested under all three subsections, the appraised value of the grocery store would be set at the lowest appraised value of \$4.2 million. This is a 27 percent reduction in appraised value. The ratio of appraised to market values of this property would now be 0.7. This ratio is well below the median ratios for all properties in the appraisal district or for commercial properties in the appraisal district. **Figure 2** shows the outcomes of equity appeals of property appraisals in this example.

**FIGURE 2
ILLUSTRATION OF OUTCOMES IN EQUITY APPEALS OF
APPRAISED VALUE**

Category	F1: Commercial Real
Property Use	Grocery Store
Appraised Value	\$5,700,000
Market Value	\$6,000,000
Square Footage	60,000
Appraisal Ratio	0.95
Appraised Value per Square Foot	\$95
Appraisal District: All Property Appraisal Ratio	0.85
Appraisal District: Commercial Property Appraisal Ratio	0.81
Median Appraised Value per Square Foot of Comparable Properties	\$70
Value pursuant to Texas Tax Code, Section 42.26, Subsection (a)(1)	\$5,100,000
Value pursuant to Texas Tax Code, Section 42.26, Subsection (a)(2)	\$4,860,000
Value pursuant to Texas Tax Code, Section 42.26, Subsection (a)(3)	\$4,200,000
New Appraised Value	\$4,200,000
New Appraisal Ratio	0.7
SOURCE: Legislative Budget Board.	

Subsection 42.26(a)(1) and (a)(2) and the similar provisions in Texas Tax Code, Section 41.43 provide relief to a taxpayer if the property is appraised at a higher percentage of market value than other properties within the appraisal district's jurisdiction. Subsections 41.43(b)(3) and 42.26(a)(3) provide relief if the taxpayer's property is appraised at a higher value than other properties, independently of the market values of those properties or the appraisal districts in which they are located.

The COD of appraisal ratios is the state's official measure of equal and uniform appraisal in the PVS, and it is consistent with the standards set by the International Association of Assessing Officers, a non-profit professional organization. COD measures deviation from the median of a group of properties to determine whether or not any individual property is treated unequally. Texas Tax Code, Subsections 41.43(b)(3) and 42.26(a)(3) use an appraisal standard of equal and uniform appraisal that is inconsistent with the standard that CPA uses to evaluate appraisal district performance. The standard for relief in Subsections 41.43(b)(3) and 42.26(a)(3) is not based on a generally accepted

standard for equity. As the example above shows, the results of Subsection 42.26(a)(3) appeals can result in a decrease in equity across an appraisal district and reduce the ability of appraisal districts to appraise properties at market value. Recommendation 1 would amend the Texas Tax Code, Chapters 41 and 42, to use deviation from the median appraisal ratio of a group of comparable properties as the basis of determining equal and uniform appraisal, instead of using deviation from the properties' median appraised values.

Several terms in Subsections 41.43(b)(3) and 42.26(a)(3) are not defined clearly; as a result, different jurisdictions have interpreted and implemented the statute inconsistently. Neither statute nor professional standards define what constitutes a reasonable number of properties, what criteria make properties comparable, or what constitutes appropriate adjustments. Similarly, statute does not specify which appraised value is to be used at each stage of appeal. The lack of guidelines of the appropriate value to use results in an incentive to file protests as close to the deadline as possible which results in an administrative burden for appraisal districts. There is a financial benefit to being the last property to go through a review because it is possible that the comparable properties will have had the opportunity to have their values lowered during protest. The appraisal of a property in a successful appeal is directly related to the appraisals of comparable properties. In addition, in a Subsections 41.43(b)(3) and 42.26(a)(3) appeal, a property owner may include properties located outside of the appraisal district in the group of comparable properties. These properties may not be subject to the same market forces that exist within the appraisal district where the appealed property is located. Local appraisal districts, with CPA's guidance, are responsible for ensuring that appraisals meet the Texas Constitution's equal and uniform appraisal standard because the property tax is administered locally. Authorizing the use of appraised property values from other districts as the basis for relief in an appeal reduces local appraisal districts' authority and impedes districts in ensuring that appraisals meet the equal and uniform standard. Authorizing these outside districts' properties to be compared is also inconsistent with legislation passed by the Eightieth Legislature, Regular Session, 2007, that restricted appraisal districts from appraising properties outside of their jurisdictions.

Recommendation 2 would amend the Texas Tax Code, Chapters 41 and 42, to establish guidance as to what constitutes a comparable property. This recommendation would establish that comparable properties are similar based

on physical characteristics such as age, location, size, condition, highest and best use, and any local restrictions on use. This recommendation would require that any adjustments follow accepted appraisal standards. The recommendation would establish that the appraised value to be used during a protest to an ARB is the notice value and the appraised value used during appeals of ARB orders is the certified, post-ARB value. Recommendation 2 also would restrict comparable properties to those located within the same appraisal district as the property subject to appeal. These changes would help to ensure that properties are treated equally in the appeals process, and that appraisal districts have sufficient guidance to make appropriate adjustments.

UNIQUE PROPERTIES

Some properties are particularly difficult for districts to appraise because there are few comparable properties, or information about the income generated by the properties is difficult to obtain. These are typically highly valuable parcels of land, such as refineries and other industrial properties. For example, approximately half of the taxable value in Jefferson County is industrial property. This property includes several refineries that have been subject to several equity appeals. The Jefferson Central Appraisal District reports losing almost 7 percent, or \$1.8 billion, in taxable value during tax year 2013 due to equity appeals out of a total value of approximately \$25.9 billion. These unique properties are difficult to appraise, and property owners and districts disagree on the proper appraisal methodology; therefore, these properties are often subject to litigation that is expensive for property owners and taxpayers. Recommendation 3 would amend the Texas Tax Code, Chapters 41 and 42, to require CPA to establish standards for the development and calibration of adjustments for industrial, petrochemical refining and processing, utility properties, and other unique properties by rule. This recommendation would provide for consistent standards and limit the risk of unnecessary lawsuits.

ATTORNEY'S FEES

The Texas Tax Code requires an appraisal district that loses a lawsuit or administrative hearing to pay the property owner's attorney fees. The amount of attorney's fees awarded to the property owner has a ceiling of \$100,000. A property owner is not subject to the same requirement, thus creating an unequal obligation. This disparity may provide an incentive for some owners to sue. Appraisal districts indicate that they

typically settle cases, rather than defend appraisals in court, in order to avoid the risk of being ordered to pay attorney's fees. Recommendation 4 would amend the Texas Tax Code, Chapter 42, to require a property owner who loses an equity lawsuit or SOAH hearing to pay an appraisal district's attorney fees, subject to the same ceiling. This requirement would apply the risk of the cost of filing suit to property owners as it applies to appraisal districts.

EFFECTS ON TAXPAYERS AND LOCAL GOVERNMENTS

Reduced valuations that result from equity appeals affect local governments other than school districts. Property taxes are a primary revenue source for cities, counties, and other local governments. Equity appeals can result in forgone revenue for each taxing entity as well as a redistribution of the tax burden to other property owners who do not receive an appraisal adjustment. Forgone revenue can be estimated by applying the current tax rate to the property value reduction that results from appeals. The overall level of redistribution can be estimated by:

- calculating the tax rate necessary to generate the same amount of revenue if none of the appealed value was removed from the appraisal rolls;
- applying that tax rate to the appraised value of property that was not subject to appeal; and
- comparing the total taxes paid by property owners who did not protest at the current rate and the total levy from those properties at the rate that would have been needed if there had not been any protests.

Similarly, the tax burden is shifted to property owners whose property is appraised unequally. Harris County provides an example of these principles.

In 2012, Harris County generated approximately \$1.2 billion in property tax revenue, with a \$0.4002 per \$100 property tax rate on total taxable value of approximately \$290.0 billion. According to an analysis of data provided by the Harris Central Appraisal District, in 2012, the county lost \$14.2 billion in value from the appraisal roll as a result of equal and uniform protests and litigation. Had that \$14.2 billion been subject to taxation, Harris County would have generated an additional \$57.0 million at the same tax rate. If no equity appeals had been filed and that value had remained on the appraisal rolls, Harris County would have needed a lower tax rate of \$0.3815 per \$100 to generate the same \$1.2 billion of tax revenue. The amount of the tax burden redistributed to taxpayers who did not appeal based on equal

and uniform standards is the difference between the taxes levied on those properties at the rates of \$0.4002 per \$100 and \$0.3815 per \$100. This methodology results in an estimated redistribution of the tax burden for county taxes in Harris County of \$33.1 million for tax year 2012. **Figure 3** shows the redistribution of the tax burden from this example. Note, however, that some level of valuation reduction is appropriate because some properties would still merit relief using a more appropriate standard. This example is only intended as an illustration of redistribution.

FISCAL IMPACT OF THE RECOMMENDATIONS

The fiscal impact from these recommendations cannot be determined for the 2016–17 biennium. Due to incomplete data, it is not possible to estimate the impact of equity appeals on the state’s FSP obligation. However, several appraisal districts have provided information on individual appeals, and Legislative Budget Board staff estimated the cost to the state of equity appeals in Collin, Harris, Jefferson, Tarrant, Travis, and Williamson counties. The total FSP

appropriation is split between the state and school districts. Increasing levies from school districts will reduce the state’s FSP obligation. Reducing school district levies increases the state’s obligation. Successful litigation pursuant to Subsection 42.26(a)(3) in the six appraisal districts reduced taxable value for maintenance and operations purposes by \$5.9 billion to \$7.5 billion per year in tax years 2011 to 2013. Taxable value for interest and sinking purposes decreased by \$7.1 billion to \$8.0 billion per year in tax years 2011 to 2013 as a result of successful litigation. The decrease in taxable value reduces the total FSP obligation of the 101 school districts with parcels in the six appraisal districts and increased the state’s FSP obligation by \$71.0 million to \$81.5 million in fiscal years 2013 to 2015.

These recommendations would help ensure that appeals of equal and uniform appraisals are considered consistently across the state.

**FIGURE 3
HYPOTHETICAL REDISTRIBUTION OF COUNTY PROPERTY TAX BURDEN DUE TO EQUAL AND UNIFORM APPRAISAL PROTESTS AND LITIGATION IN HARRIS COUNTY, TAX YEAR 2012**

	TAXES CONSIDERING EQUITY APPEALS		TAXES WITHOUT EQUITY APPEALS		DIFFERENCE	
	TAXABLE VALUE	LEVY	TAXABLE VALUE	LEVY	TAXABLE VALUE	LEVY
A: Single-Family Residences	\$117,881.4	\$471.8	\$119,157.2	\$454.6	(\$1,275.8)	\$17.2
B: Multifamily Residences	\$19,981.2	\$80.0	\$22,315.1	\$85.1	(\$2,333.9)	(\$5.2)
C: Vacant Lots	\$7,002.2	\$28.0	\$7,002.2	\$26.7	\$0.0	\$1.3
D1: Qualified Agricultural Land	\$26.0	\$0.1	\$26.0	\$0.1	\$0.0	\$0.0
D2: Non-Qualified Agricultural Land	\$1,842.6	\$7.4	\$1,842.6	\$7.0	\$0.0	\$0.3
E: Farm and Ranch Improvements	\$107.4	\$0.4	\$107.4	\$0.4	\$0.0	\$0.0
F1: Commercial Real	\$69,165.8	\$276.8	\$78,591.9	\$299.8	(\$9,426.1)	(\$23.0)
F2: Industrial Real	\$16,192.4	\$64.8	\$17,394.6	\$66.4	(\$1,202.3)	(\$1.6)
G: Oil, Gas, and Minerals	\$275.4	\$1.1	\$275.4	\$1.1	\$0.0	\$0.1
J: Utilities	\$4,175.0	\$16.7	\$4,175.0	\$15.9	\$0.0	\$0.8
L1: Commercial Personal	\$23,416.9	\$93.7	\$23,416.9	\$89.3	\$0.0	\$4.4
L2: Industrial Personal	\$28,104.3	\$112.5	\$28,104.3	\$107.2	\$0.0	\$5.3
M: Mobile Homes and Other Personal	\$350.2	\$1.4	\$350.2	\$1.3	\$0.0	\$0.1
O: Residential Inventory	\$668.0	\$2.7	\$668.0	\$2.5	\$0.0	\$0.1
S: Special Inventory	\$1,024.8	\$4.1	\$1,024.8	\$3.9	\$0.0	\$0.2
TOTAL	\$290,213.6	\$1,161.5	\$304,451.7	\$1,161.5	(\$14,238.1)	\$0.0
TAX RATE	\$0.4002 PER \$100 VALUE		\$0.3815 PER \$100 VALUE		\$0.0187 PER \$100 VALUE	

NOTE: Amounts shown in millions, unless otherwise noted.
SOURCE: Legislative Budget Board.

Recommendation 3, relating to CPA providing standards for appraising refineries and industrial properties, could be implemented using existing CPA resources.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

MODIFY AGRICULTURAL LAND APPRAISAL PROTOCOLS

Property taxes are one of the primary funding sources for public school districts in Texas. Property tax assessments and collections are based upon the property appraisals completed by each central appraisal district. The state's interest in local property valuations and the related tax assessments by school districts ties to the Foundation School Program. Typically, the higher the property valuation and related local revenue collection, the less state revenue will be needed to fund the Foundation School Program entitlement. As property values and related local revenue collections are lowered, more state resources are needed to fund the entitlement.

The Texas Constitution permits a reduction in property valuation for agricultural and open space land uses. These provisions were added to ensure that farmers could afford to retain land for agricultural use as the state became more urbanized in the 1960s and 1970s, and land values increased. The Texas Tax Code requires that the land eligible for the alternative valuation be devoted principally to agricultural use at the intensity that is accepted generally in the area. This is based on an acreage that is necessary for economically viable production. Qualifying properties receive a special appraisal method that results in a productivity value. Productivity value incorporates income from the land, nets out expenses, and is divided by a statutorily set capitalization rate. The lower of the productivity value or market value is used for tax assessment purposes. Modifying the agricultural special appraisal protocols for open space land would update state policy to accurately reflect agricultural policy and the economic environment in which agriculture producers operate.

FACTS AND FINDINGS

- ◆ Texas is a major producer in U.S. agriculture, ranking number one in cattle, cotton, hay, wool, and mohair production.
- ◆ According to the Texas Comptroller of Public Accounts, the statewide market value of qualified agricultural land in 2013 was \$229.0 billion, representing 10 percent of total market value of all land. The taxable value of this land was \$13.1 billion, representing 0.7 percent of total taxable value.
- ◆ According to the Texas Comptroller of Public Accounts, agricultural open space special appraisals reduced school district property tax collections in fiscal year 2013 by \$2.8 billion.
- ◆ The minimum acreage and intensity standard for beekeeping is set in statute. For all other agricultural uses, the appraisal district may set minimum acreage and degree of intensity standards locally.
- ◆ The Texas Comptroller of Public Accounts published an agricultural appraisal manual that includes information and requirements on appraisal method procedures for completing productivity appraisals, such as degree of intensity standards and rollback calculations. The Texas Tax Code requires appraisal districts to adhere to this manual in completing related appraisals. The agriculture appraisal manual was published by the State Property Tax Board and later adopted by the Comptroller of Public Accounts. A 2014 appellate court ruling found that because the State Property Tax Board no longer exists, the manual is no longer in existence and cannot be used by an appraisal district as the basis for denying a property owner's application for open space appraisal.

CONCERNS

- ◆ Appraisal districts that include smaller tracts have difficulty defending a disapproval of an open space application, because there is no statewide minimum acreage requirement for most open space land classifications. As a result, properties that are primarily residential may qualify for agricultural productivity valuations.
- ◆ The Texas Comptroller of Public Accounts agricultural appraisal manual has not been revised since 1990 and does not reflect current state and federal laws, market conditions, and federal government programs. This outdated information results in a lack of guidance and conflicting requirements for appraisal districts as they attempt to implement the special appraisal method.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require the Texas Comptroller of Public Accounts to establish minimum acreage requirements by land classification and region to qualify as open space land through rule.
- ◆ **Recommendation 2:** Amend statute to require the Texas Comptroller of Public Accounts to update the *Texas Property Tax Manual for the Appraisal of Agricultural Land* by December 31, 2016, and at least once every 10 years thereafter and remove certain approval requirements.

DISCUSSION

Property taxes are locally assessed taxes. Local government entities, including school districts, levy property taxes to fund their operations and pay for schools, streets, roads, police, and other locally provided services. According to the Texas Comptroller of Public Accounts (CPA), property taxes are the largest source of tax revenue in Texas. In fiscal year 2011, more than \$40.0 billion in property tax revenue was collected, representing almost half of total state and local tax revenues.

The Texas Constitution, Article VIII, includes basic parameters for property taxes:

- taxes must be equal and uniform;
- property must be assessed at its fair cash market value, or the price for which it would sell when both buyer and seller seek the best price and neither is pressured to buy or sell;
- each property in a county must have a single appraised value that is used by all of the taxing entities within the county;
- all property is taxable unless federal or state law exempts it from the tax; these exemptions may exclude all or part of a property's value from taxation; and
- owners have a right to reasonable notice of increases in the appraised value of and tax estimates for their property.

Unlike other local government entities that also can collect sales taxes and fees, school districts' only source of local tax revenue is the property tax.

FOUNDATION SCHOOL PROGRAM AND LOCAL REVENUES

In Texas, the responsibility for public school funding is shared between the state and the local school district. Funding is guaranteed on a per student basis. The difference between local tax collections and the guaranteed amount per student is provided by the state. The Foundation School Program (FSP) is the state's primary program to provide funding to public school districts and allow them to meet required educational standards for kindergarten through grade 12 education.

Because of the shared school funding relationship, the state has a vested interest in local property tax collections and the local property appraisals upon which school district property tax assessments are based. When property values decrease, the result is a cost to the state. If property values are lower than they otherwise might be due to market conditions, appraisal appeals, tax exemptions, or applying special appraisal methods, the financial responsibility of the state increases.

APPRAISAL DISTRICTS OVERVIEW

Property taxes are based on the appraised value for a given property. To simplify property appraisals and ensure uniform appraisals, the Texas Legislature established the system of central appraisal districts in 1981.

According to CPA, before the Legislature established appraisal districts, thousands of governmental taxing entities appraised property and imposed taxes independently, resulting in wide disparities in value. As property tax levies increased, and the state began to base more aid to school districts on property values, centralized local appraisal became necessary.

The Texas Tax Code, Chapter 6, makes appraisal districts responsible for appraising all property subject to taxes. Unless otherwise provided by law, appraised values are required to represent market value, which is defined as the value for which the property would likely sell on January 1 of a given tax year.

Market value is determined using three standard approaches:

- The market approach uses sales of similar properties to estimate the value of properties that have not sold. For instance, sales in a residential neighborhood can be used to estimate the value of all properties in the neighborhood, assuming the sales are adjusted for

differences in property characteristics such as size, age, and location.

- The income approach uses the net income from a property used for business purposes to estimate the price a potential buyer would pay for commercial property.
- The cost approach first determines the cost necessary to replace the property and then depreciates that value based on the age and condition of the property to arrive at an estimate of the market value.

One approach may be used, or all three may be calculated and reconciled to arrive at a single value.

Appraisal districts are required to reappraise all property at least once every three years, but districts may have to reappraise more often to ensure that values represent market value as of January 1 each year.

ROLE OF THE COMPTROLLER’S OFFICE

The CPA has several duties in relation to local property appraisal and tax assessment. Within CPA, the Property Tax Assistance Division (PTAD) conducts and publishes a property value study (PVS) of all school districts and appraisal districts every other year. Appraisal districts set values for local tax collections, and the PVS uses local appraisal information to determine the value on which Texas school districts receive state funding. PTAD also conducts the Methods and Assistance Program (MAP) to review the governance, taxpayer assistance, operating procedures, and the appraisal standards, procedures, and methodology of each county’s central appraisal district every two years.

PTAD administers statewide binding arbitration for property owners who qualify for arbitration. It also provides training for newly appointed appraisal review board (ARB) members, and annual continuing education training for existing ARB members. PTAD provides information including publications, online videos, webinars, and other education tools regarding property tax issues to taxpayers, property owners, appraisal districts, ARBs, taxing units, other state agencies, and the Legislature.

SPECIAL APPRAISAL METHODS FOR TEXAS AGRICULTURE

According to the Texas Department of Agriculture, rural lands in the state total 144 million acres or 86 percent of the state’s total land area. Texas has the highest number of farms and ranches in the U.S., totaling 130.4 million acres, and it has the highest value of farm real estate. Texas produces the

most cattle, cotton, hay, sheep and wool, and goats and mohair in the U.S. According to data from CPA, agriculture has represented 1.5 percent or less of the total gross state product since 1971 and is forecasted to remain at those levels for the foreseeable future. According to the federal Bureau of Economic Analysis, as of January 2014, agriculture represents about 1.3 percent of the nation’s gross domestic product.

Until 1966, Texas farm and ranch land was appraised based on market value. As the state became more urbanized, the value of these lands could increase substantially, especially in developing areas. Even in cases where a farmer or rancher did not intend to develop the land, it could be subject to higher property taxes because of the potential for development. Based on concerns that farmers and ranchers would be forced to sell property due to higher taxes, the Legislature has established two special appraisal methods for rural property. These are the agricultural use appraisal, referred to as Section 1-d, and the open space appraisal, referred to as Section 1-d-1. If a property or property owner is eligible, these appraisal methods result in lower appraised values and therefore lower property tax assessments for the owner.

According to the Real Estate Center at Texas A&M University, the value of rural land per acre has increased. In 1966, rural land in Texas sold at an average of \$151 an acre. The average value increased to \$518 in 1979 (just after the open space land appraisal was approved); and in 2013, the average market value increased to \$2,160 per acre.

The agricultural use appraisal was added to the state constitution in 1966 and requires property to be appraised based on its agricultural production capacity, not its market value. This appraisal method is used for landowners whose primary occupation and income source is agriculture, so both the property and its owner must meet the eligibility requirements. The property or ownership requirements include:

- property must have been devoted to agriculture during the past three years;
- owner’s primary income source must be agriculture;
- owner intends to use the land for agriculture and as an occupation or business for profit during the coming year; and
- owner files an application by sworn statement with the chief appraiser before May 1 of each year with all the documentation required to determine the validity of the claim.

The open space appraisal method is intended to preserve open space land and was added to the state constitution in 1978. Wildlife management was added as a valid category for the open space land appraisal in 1995. To qualify, the owner files with the appraisal office information to determine the validity of the claim. To be eligible for the open space appraisal method, the property:

- must be currently devoted principally to agriculture to a degree generally accepted in the area; and
- has been devoted principally to agricultural use or production of timber or forest products for five of the seven preceding years.

If land has qualified for either of these appraisal methods, tax penalties are levied when it is removed from agricultural use. A property that is removed from agricultural use owes a rollback tax, which is the difference between the taxes paid on the land's agricultural value and the taxes that would have been paid if the land had been taxed on its market value for each of the previous five years, plus 7 percent interest. According to multiple chief appraisers, almost all properties that qualify for the agricultural-related special appraisal methods do so in accordance with the 1-d-1 open space appraisal rather than the 1-d agricultural use method. Appraisers have indicated that, due to the less stringent standards and easier application process, property owners prefer to apply for the special appraisal method in accordance with the 1-d-1 category.

PRODUCTIVITY VALUE

To apply a special appraisal method, land productivity has to be assessed. To accomplish this task, an appraisal district takes two steps. First, the district develops a land classification system. Major land classes are described in state law, and appraisal districts are required to develop subclasses based on soil type, soil capacity, and general topography. In Texas, 65 percent of the land qualifying for special appraisal is native pastureland, 18 percent is croplands, 8 percent is improved pastureland, 5 percent is timberland, and the remaining 4 percent is a mix of wasteland or barren land, wildlife management, orchards, and land for other agricultural uses. Next, the appraisal district determines per acre land values typical for the area using a methodology that incorporates per acre net-to-land and converts net-to-land to a value by using a prescribed capitalization rate. Net-to-land is the average annual net income that a class of land would be likely to have generated during the five-year base period. A capitalization rate is the relationship between income and

land value. As required by statute, the rate is based on the Farm Credit Bank of Texas interest rate plus 2.5 percent. The actual formula for per acre value is net-to-land income divided by the capitalization rate.

Productivity values typically differ from market values. Depending on the region, land use, soil type, and commodity the land supports, market value can be higher or lower than the productivity value. **Figure 1** shows statewide productivity value and the value lost due to productivity valuation from fiscal years 2004 to 2013.

ESTABLISH MINIMUM ACREAGE REQUIREMENTS

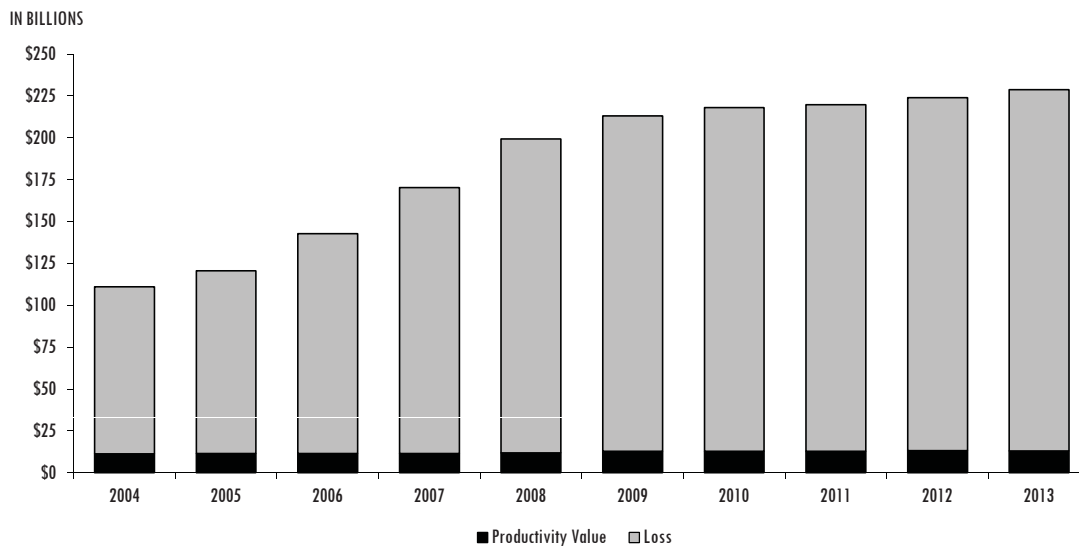
To qualify for the special appraisal method for land in agricultural use, a property owner has to demonstrate a sufficient intensity of agricultural use. Acreage and degree of intensity standards are important considerations in assessing the agricultural efficiency of a property. The Texas Tax Code, Chapter 6, gives appraisal districts the authority to set local minimum acreage standards and degree of intensity standards to ensure efficiency.

Agricultural land in Texas has various uses, including grazing pasture for raising livestock and crop cultivation. Within each land class there can be several variations and features of land specific to the regions.

For example, in Texas, pasture is used for grazing livestock, especially cattle. The state has two basic types of pasture, improved and native. Improved pasture often has additional grasses on it and provides a more robust food source than native pasture. The number of acres needed to meet the needs of cattle grazing on native pasture land varies. In East Texas, the Smith County Appraisal District requires five acres for grazing on native pasture. Williamson County, located in a drier region of the state with less grass, requires 10.0 to 18.0 acres for grazing on native pasture, depending upon soil type. Wichita County, further north and located in a dry area, requires 20.0 acres for native pasture grazing. Similar variances for all types of land classifications, soil, and use exist among the state's diverse ecological and topographical regions. **Figure 2** shows a sample of minimum acreage requirements for several appraisal districts.

To determine minimum acreage and degree of intensity standards, appraisal districts use data and feedback from a variety of sources. These sources include: the district's agricultural advisory committee, which often includes rural property owners and agricultural operators; the USDA, Farm Service Agency; the Texas A&M AgriLife Extension Service;

FIGURE 1
TEXAS PROPERTY VALUE LOSS DUE TO PRODUCTIVITY VALUATION, FISCAL YEARS 2004 TO 2013



SOURCE: Texas Comptroller of Public Accounts.

FIGURE 2
LOCAL MINIMUM ACREAGE REQUIREMENT FOR SELECT APPRAISAL DISTRICTS IN TEXAS, MARCH 2014

DISTRICT	LAND CLASS OR USE	ACRES REQUIRED
Brown	Cropland	5.0
	Orchard	3.0
	Pasture (Improved)	12.0–18.0
	Pasture (Native)	60.0–90.0
Smith	Cropland	1.0
	Pasture (Improved)	2.0
	Pasture (Native)	5.0
	Timber	10.0
Wichita	Wildlife	12.6
	Dry Cropland	15.0
	Pasture (Improved)	15.0
Williamson	Pasture (Native)	20.0
	Orchard	5.0–10.0
	Pasture (Improved)	8.0–16.0
	Pasture (Native)	10.0–18.0

SOURCE: Legislative Budget Board.

and surveys of local farmers and owners of recently sold agricultural property.

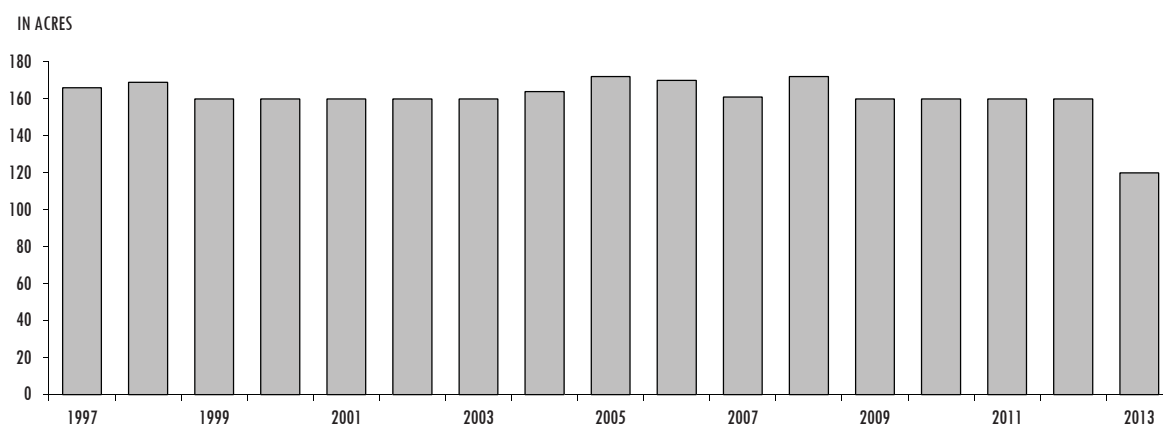
The Real Estate Center at Texas A&M University indicates that the median acreage of rural property parcels sold had

remained relatively constant until decreasing in 2013. As recently as 1997, the average size of a rural property tract sold was 166 acres. In 2013, the average size was 120 acres. **Figure 3** shows median tract size of rural property sold in Texas from 1997 to 2011.

The state does not set a minimum acreage for any type of agricultural use except beekeeping, which represents a small percentage of agricultural use. The majority of the state’s agricultural use is for pasture and cropland. According to appraisal district staff, districts that have increased urban and suburban demographic pressures, or are within commuting distance of such areas, are seeing smaller land tracts used for agricultural or open space uses. In some cases, this decrease in tract size means that properties that are not large enough for efficient agricultural use are being approved for special appraisal methods. Multiple appraisal districts have requested a state minimum acreage requirement to help assess whether a property should be approved for open space appraisal, category 1-d-1.

Recommendation 1 would amend the Texas Tax Code to require CPA to establish minimum acreage requirements by land classification and region to qualify for open space land through rule for appraisal districts’ use. The acreage requirements would consider the type of agricultural use and the amount of land necessary to be economically viable. CPA could consider the state’s 33 localized land market areas or similar geographic boundaries for regional differences.

FIGURE 3
MEDIAN TRACT SIZE OF SOLD RURAL LAND IN TEXAS, CALENDAR YEARS 1997 TO 2013



SOURCE: Real Estate Center at Texas A&M University.

UPDATE THE AGRICULTURAL APPRAISAL MANUAL

The Texas Tax Code, Section 23.52, requires CPA to develop rules and distribute manuals to each appraisal office that specify methods of appraising qualified open space land. Districts are required to use the manuals to appraise qualified open space land. To amend the appraisal manual, a majority of the following elected officials must approve changes to the manual: the Governor, the Comptroller, the Attorney General, the Commissioner of Agriculture, and the Commissioner of the Texas General Land Office (GLO).

The *Texas Property Tax Manual for the Appraisal of Agricultural Land* covers a variety of topics, including:

- determining property eligibility;
- calculating net to land values;
- considering lease methods; and
- developing an appraisal schedule.

This manual last was updated in April 1990, before the duties of the State Property Tax Board were absorbed into CPA. A 2014 appellate court ruling questioned the validity of the manual because it was published by a board that no longer exists. The court rejected an appraisal district's claim that a parcel can have only one use, which is based on the *Texas Property Tax Manual for the Appraisal of Agricultural Land*. The 24-year gap in updates has resulted in some problems for appraisal districts, because the manual does not reflect federal programs, such as crop rotation, and how such programs might affect the appraisal process nor does it reflect current state law.

As an example, in the Panhandle, Lamb County's primary agricultural product is cotton. In recent years, cotton's commodity price has increased significantly. At the same time, a number of Lamb County farmers participate in federal crop rotation programs, which produce a flat income during a lengthy period, typically 10 years. The difference in commodity prices versus crop rotation income has produced an unfavorable net-to-land value for farmers who utilize crop rotation. But the district's chief appraiser is unable to address that result due to the requirements of the state's agricultural appraisal manual, which does not reflect federal practice.

To address this issue, Recommendation 2 would amend the Texas Tax Code to require CPA, in consultation with the Commissioner of Agriculture and the Commissioner of GLO, to update the *Texas Property Tax Manual for the Appraisal of Agricultural Land* by December 31, 2016, and at least once every 10 years thereafter. The recommendation also would remove the requirement for approval by a majority of the Governor, the Comptroller, the Attorney General, the Commissioner of Agriculture, and the Commissioner of the GLO to update the manual.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would have no fiscal impact for the 2016–17 biennium because it is expected that the recommendations would not be implemented fully until the following biennium. The fiscal impact from the recommendations after the 2016–17 biennium cannot be determined because it is unknown how many properties that

qualify for the special appraisal method would be excluded if the recommendations were implemented.

The recommendations could result in a cost savings to the state if the minimum acreage requirements adopted by CPA result in fewer properties qualifying as open space. This would increase total taxable value, which would increase property tax levies for school districts. Increasing school district property tax levies would reduce the state's FSP obligation.

Recommendation 2 could be implemented within existing CPA resources.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

INCREASE FUNDING TO IMPROVE LONG-TERM DISASTER RECOVERY

In the past decade, Texas has responded to many large-scale disasters. From 2005 to 2008, hurricanes Katrina, Rita, Dolly, and Ike caused great damage to the Gulf Coast. More recently, extreme drought, wildfires, and an explosion at a West fertilizer plant gained national attention. These events negatively impacted the state's economy and increased the need for state services and federal aid. Local entities requested state and federal aid to recover from various disasters. Given Texas' geography, weather patterns, and population growth, the state should plan for future disaster recovery.

Texas has disaster funding mechanisms, but they could be more effective and efficient. The state model relies heavily on supplemental appropriations and federal reimbursement—in effect, reimbursing costs months or years after the disaster. Sources of immediate recovery funds are limited. Local entities face additional challenges. For example, many do not receive federal aid when a disaster does not meet a federally required loss threshold. A new, revolving state disaster recovery fund could provide small-scale disaster aid such as grants or loans to local entities. It could also provide state agencies with greater flexibility to manage disaster costs.

FACTS AND FINDINGS

- ◆ The Governor of Texas issued an Emergency Disaster Proclamation for wildfires and drought in all 254 counties in December 2010.
- ◆ The Federal Emergency Management Agency issued four Major Disaster Declarations, one Emergency Declaration, and 57 Fire Management Assistance Declarations in Texas from 2011 to 2014.
- ◆ Twelve state agencies estimated \$385.6 million in total wildfire costs from September 2010 to March 2014.
- ◆ The Eighty-third Legislature, Regular Session, 2013, appropriated \$168.7 million from the Economic Stabilization Fund to state agencies for wildfire costs. It also appropriated \$15.0 million to Trusteed Programs within the Office of the Governor for disaster recovery.

CONCERNS

- ◆ The state's ability to evaluate local entities' need for aid is limited. Local entities may lack the resources or training to administer federal disaster grants properly.
- ◆ The state funds disaster response efforts but could do more to fund long-term recovery efforts, particularly for local entities that face certain challenges.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Appropriate \$1.9 million in General Revenue Funds directly to the Texas Department of Public Safety in the introduced 2016–17 General Appropriations Bill to continue a Regional Recovery Coordination Program.
- ◆ **Recommendation 2:** Amend statute to establish a new General Revenue–Dedicated account for disaster recovery.
- ◆ **Recommendation 3:** Adopt one of these options to fund a new General Revenue–Dedicated account for disaster recovery and appropriate funds to the Texas Department of Public Safety, the account's proposed administering agency, in the 2016–17 General Appropriations Bill:
 - **Option 1:** Amend statute to allow funds from the Volunteer Fire Department Assistance Fund to be used for disasters and transfer \$30.0 million to a new General Revenue–Dedicated account for disaster recovery. Include a contingency rider in the Texas Department of Public Safety's bill pattern in the 2016–17 General Appropriations Bill to appropriate \$30.0 million from the new General Revenue–Dedicated account for disaster recovery.
 - **Option 2:** Of the \$70.6 million recommended reduction to 2016–17 appropriations to Trusteed Programs within the Office of the Governor, Strategy A.1.1, Disaster Funds, appropriate \$30.0 million to the new General Revenue–Dedicated account for disaster recovery. Include a contingency rider in the Texas Department of Public Safety's bill pattern in the 2016–17 General

Appropriations Bill to appropriate \$30.0 million from the new General Revenue–Dedicated account for disaster recovery.

- ◆ **Recommendation 4:** Include a contingency rider in the 2016–17 General Appropriations Bill that requires the Texas Department of Public Safety to submit any expenditure of at least \$1.0 million from a new General Revenue–Dedicated account for disaster recovery to the Legislative Budget Board and the Office of the Governor for approval.

DISCUSSION

Recent disasters have strained state and local budgets. The Legislative Budget Board (LBB) estimated state agencies had \$385.6 million in total wildfire costs as of March 31, 2014. The Insurance Council of Texas reported that the 2011 Bastrop wildfire caused \$360.0 million in insured losses. The 2011 Possum Kingdom wildfire caused \$150.0 million in insured losses. State agencies expended an estimated \$4.1 million to respond to the 2013 fertilizer plant explosion in West, Texas. That explosion caused \$100.0 million in insured losses.

Historically, the state has paid for disaster costs with General Revenue Funds, supplemental appropriations, Federal Funds, and Other Funds. When possible, state agencies apply to the Federal Emergency Management Agency (FEMA) for reimbursement. FEMA grants, however, can take months or years to receive. In the meantime, agencies may request disaster grants from the Office of the Governor or supplemental appropriations.

Local entities also pay for disaster costs. They face certain challenges. Some pay for costs after disasters negatively affect their tax bases, depriving revenue when it is most needed. Some do not receive federal disaster aid because the disaster does not cause \$35 million in federally-required, uninsured loss. If they qualify for FEMA aid, reimbursements can take months or years to receive. Local entities must also pay the non-federal match. In addition, administering federal disaster grants can be a challenge for local officials. There are extensive rules and procedures. Managing cash flow under these circumstances may be a burden for some local entities.

In recent years, local governments such as the City of West and Bastrop County requested state disaster aid. While a formal process exists for local entities to apply for federal disaster recovery funds, Texas does not currently have a comparable process in which local entities can apply for state

disaster recovery funds. The state could also benefit from more objective measures to evaluate local need. There can be delays between when a disaster occurs and when supplemental funds become available. The state should consider options to reform disaster recovery to address these critical issues.

RECENT WILDFIRE RESPONSE

The 2011 wildfire season broke state records. More than 30,000 wildfires burned 4 million acres, according to the Texas A&M Forest Service (TFS). Six of the largest recorded wildfires in Texas occurred in April 2011. Other records broken include the most homes destroyed by one wildfire (Bastrop Complex: 1,660 homes); most acres burned in one season (4 million); and the largest East Texas wildfire (Bear Creek: 41,050 acres).

The state also experienced the worst drought in its history in 2011. The Governor issued a disaster proclamation for drought and wildfire conditions in all Texas counties in December 2010. By September 2011, 96 percent of the state had extreme or exceptional drought conditions. By August 2012, drought conditions persisted in 90 percent of the state.

Besides drought, other factors may have contributed to wildfire damage. Due to rain from prior tropical storms, more grass in the plains served as kindling. In addition, TFS reported that there are more Texans living in rural areas. About 40 percent now live in the “wildland urban interface,” areas where there is property and development near forests and other wildlife.

Wildfires had a significant fiscal impact on the state budget. LBB staff surveyed state agencies that had wildfire-related costs. As of March 31, 2014, twelve agencies estimated \$385.6 million in total costs. TFS accounted for 78 percent of this total. As shown in **Figure 1**, agencies provided many types of assistance.

The federal government also played a role. Federal agencies such as the U.S. Fish and Wildlife Service and U.S. Forest Service provided staff and equipment to suppress wildfires. Since 2011, FEMA issued 57 Fire Management Assistance Declarations in Texas. FEMA also declared two Major Disaster Declarations that allowed Individual and Public Assistance grants in dozens of counties.

RESPONSE TO WEST EXPLOSION

In April 2013, a fertilizer plant exploded in West, Texas. The blast killed 15 people and directly injured 252 others, according to a report by the Waco-McLennan County Public

FIGURE 1
WILDFIRE ASSISTANCE BY STATE AGENCY, SEPTEMBER 1, 2010, TO MARCH 31, 2014

AGENCY	ASSISTANCE PROVIDED
Texas A&M Forest Service	Wildfire suppression that involved federal agencies.
Texas General Land Office	Community Development Block Grant – Disaster Recovery (80% dedicated to Bastrop recovery).
Texas Department of Public Safety	Texas Intrastate Fire Mutual Aid System (TIFMAS), salary, and personnel.
Texas Parks and Wildlife Department	Bastrop and other state parks: salaries, repairs, and administrative costs.
Texas Military Department	Wildfire response and suppression.
Texas Department of Transportation	Assistance to firefighters and data for coordination efforts.
Health and Human Services Commission	Other Needs Assistance (FEMA).
Texas Department of Housing and Community Affairs	Housing tax credits, HOME Investment Partnerships Program, Community Services Block Grant, and other federal programs.
Texas Workforce Commission	Employment Services, National Emergency Grants, and Disaster Unemployment Assistance.
Texas Department of State Health Services	Public Assistance (FEMA): medical response and shelter.
Texas Department of Agriculture	State of Texas Agriculture Relief Fund and Community Development Block Grant.
Trusted Programs within the Office of the Governor	Disaster grants.

SOURCES: Legislative Budget Board; Texas A&M Forest Service; Texas General Land Office; Texas Department of Public Safety; Texas Parks and Wildlife Department; Texas Military Department; Texas Department of Transportation; Health and Human Services Commission; Texas Department of Housing and Community Affairs; Texas Workforce Commission; Texas Department of State Health Services; Texas Department of Agriculture; Trusted Programs within the Office of the Governor.

Health District and Texas Department of State Health Services. It registered 2.1 on the Richter scale and left a crater 10 feet deep and 90 feet wide. According to a KUT-FM news report, three of the city's four schools were "destroyed or irreparably damaged, with the intermediate school completely flattened by the blast."

State agencies responded and expended an estimated \$4.1 million, according to the Texas Department of Public Safety (DPS), including \$1.8 million for 3,356 personnel. Other key costs were contracts (\$1.5 million), travel (\$337,343), and equipment (\$236,343). **Figure 2** shows the types of assistance agencies provided.

FEMA issued an Emergency Declaration on April 19, 2013. The declaration allowed Public Assistance grants for debris removal and emergency protective measures. In June 2013, FEMA denied the Governor's request for a Major Disaster Declaration. The President of the United States later declared a Major Disaster in West. This declaration allowed federal funding for long-term recovery.

PREPARING FOR DISASTER RECOVERY

In a state as geographically large, diverse, and populated as Texas, disasters are likely to have a significant impact. The weather conditions that caused hurricanes, tropical storms,

drought, and wildfires are common occurrences. For example, TFS said in its report that wildfire conditions may be the "new normal." "Experts warn that drought and the other causal factors...could result in repeats of 2011 with widespread fire activity and extended, yearlong wildfire seasons," TFS noted.

After a disaster, there are two phases: response and recovery. Disaster response includes short-term actions such as putting out fires, evacuating homes, or removing debris. Disaster recovery includes long-term actions such as restoring homes, parks, utilities, public buildings, and infrastructure.

Although the state provides many response services, it does not provide as many for recovery. Recovery is often left to local entities and federal agencies. During an interim Senate committee hearing, a Texas Division of Emergency Management (TDEM) official said Texas was "number one" in response but could do more for recovery.

UNMET LOCAL NEEDS

Many communities recover from disasters without FEMA aid. For example, in December 2013, a severe winter storm caused more than \$48.0 million in estimated damage to 15 North Texas counties, according to a disaster appeal letter the Governor sent the President. FEMA denied this request. As a

**FIGURE 2
WEST EXPLOSION ASSISTANCE BY STATE AGENCY, JANUARY 30, 2014**

AGENCY	ASSISTANCE PROVIDED
Texas Department of Public Safety	Personnel, travel, and other costs across several divisions
Texas Commission on Environmental Quality	Personnel, emergency protective measures, hazardous materials assessment and removal, and air quality monitoring
Texas A&M Engineering Extension Service	Texas Task Force 1 and Public Works Response Team
Texas Parks and Wildlife Department	Personnel, law enforcement/wardens, vehicles, and travel
Texas Department of State Health Services	Personnel, travel, medical services, Rapid Assessment team, Mobile Medical Unit, and Disaster Portable Morgue Unit
Texas A&M Forest Service	Personnel and Incident Management Team
Texas Department of Insurance	Personnel, travel, Texas State Fire Marshal's Office, and Disaster Consumer Response Teams
Texas Department of Transportation	Personnel, equipment, and fuel
Office of the Texas State Chemist	Personnel, travel, and equipment
Texas Animal Health Commission	Personnel
Texas Military Department	Personnel
Health and Human Services Commission	Personnel

SOURCES: Legislative Budget Board; Texas Department of Public Safety; Texas Commission on Environmental Quality; Texas Parks and Wildlife Department; Texas A&M Engineering Extension Service; Texas A&M Forest Service; Texas Department of State Health Services; Health and Human Services Commission; Texas Department of Insurance; Texas Department of Transportation; Texas Department of Housing and Community Affairs; Office of the Texas State Chemist; Animal Health Commission; Texas Military Department; Texas Workforce Commission.

result, many counties had significant costs. Grayson County's emergency coordinator told a news station that the storm cost the county more than \$2.0 million.

If a local entity qualifies for FEMA aid, it may still face challenges. It may lack the means to pay the non-federal match; require funds for projects FEMA denied; or have cash flow issues due to the time it takes for FEMA to reimburse costs. The City of West and Bastrop County both requested and received state aid for recovery. By April 2014, the Office of the Governor granted \$8.0 million to the City of West and \$4.4 million to Bastrop County. When damage is as extensive as it was in West or Bastrop, the local tax base is compromised. Local entities pay for disaster costs at the same time their revenues decrease. The City of West lost an estimated \$40.0 million of its property tax base, Reuters reported.

SOURCES OF DISASTER AID

Disaster aid includes state and Federal Funds. **Figure 3** shows two federal agencies that administer disaster funds: FEMA and the U.S. Department of Housing and Urban Development. At the state level, DPS and the Office of the Governor administer disaster aid. The other source of state disaster aid is supplemental appropriations.

DISASTER CONTINGENCY FUND

DPS administers the Disaster Contingency Fund. Established in 1975, the General Revenue–Dedicated account receives appropriated funds, gifts, grants, and loans. As of August 31, 2014, its balance was \$814,004. State agencies and local entities may request funds for:

- prevention measures and repairs in an area where the Governor declared a state of disaster;
- agriculture producers recovering from natural disasters;
- pre-disaster measures such as emergency/temporary housing or debris removal;
- disaster risk financing; and
- local matching funds for FEMA projects.

DISASTER GRANTS FROM THE OFFICE OF THE GOVERNOR

The Office of the Governor provides disaster grants. The Eighty-third Legislature, 2013, appropriated \$63.3 million in General Revenue Funds to Trusteed Programs within the Office of the Governor for disasters for the 2014–15 biennium. It also made a \$15.0 million supplemental appropriation from the Economic Stabilization Fund for

**FIGURE 3
FEDERAL DISASTER PROGRAMS BY AGENCY, AUGUST 2014**

AGENCY	PROGRAM	ELIGIBILITY/QUALIFICATIONS	ASSISTANCE AVAILABLE/ALLOWABLE USES
Federal Emergency Management Agency (FEMA)	Individual Assistance	Individuals and households.	Temporary housing; home repair/replacement; Other Needs Assistance; Small Business Administration loans; Disaster Unemployment Assistance; legal services; tax assistance; and crisis counseling.
	Public Assistance	State and local governments. The disaster must meet state and county loss thresholds. For fiscal year 2014, Texas' statewide threshold was approximately \$35.0 million. FEMA typically reimburses 75% of costs. The non-federal share is 25%.	Categories: A – debris removal; B – emergency protective measures; C – roads systems and bridges; D – water control facilities; E – public buildings and contents; F – public utilities; and G – parks, recreational, and other.
	Hazard Mitigation	State and local governments. Grants help prevent and reduce the risk of future disasters. FEMA reimburses 75% of costs. The non-federal share is 25%. FEMA may make 15% of the total it spent on disaster recovery available to a state for mitigation.	Projects may include wildfire protection, acquiring or demolishing flood-damaged property, or relocating structures.
	Fire Management Assistance Grants	State and local governments. Grants help mitigate, manage, and control fires. FEMA reimburses 75% of costs. The non-federal share is 25%. Costs must meet or exceed the individual threshold for single fires or the cumulative threshold for multiple fires in one state. For fiscal year 2014, Texas' individual threshold was \$1.7 million. The cumulative threshold was \$5.2 million.	Categories: B – emergency protective measures; and H – firefighting activities.
U.S. Department of Housing and Urban Development	Community Development Block Grant –Disaster Recovery	State and local governments that recover from a presidentially declared disaster. These noncompetitive, formula funds supplement other disaster aid and typically benefit low- to moderate-income persons.	Buying damaged properties in flood plains; relocation; debris removal; home and building rehabilitation; buying, constructing, or rehabilitating public facilities; code enforcement; home-ownership assistance; public services; job creation or retention; and matching funds for other federal grants (under certain conditions).

SOURCES: Federal Emergency Management Agency; U.S. Department of Housing and Urban Development; Texas Department of Public Safety.

disaster recovery. In recent years, the Office of the Governor provided disaster grants to the Adjutant General (now the Texas Military Department), DPS, TFS, Bastrop County, and the City of West.

SUPPLEMENTAL APPROPRIATIONS

Historically, the Legislature has provided supplemental appropriations to state agencies to pay for disaster costs. As shown in **Figure 4**, the Legislature has provided an estimated \$799.7 million in supplemental appropriations related to disasters since 2003.

TEXAS DISASTER RELIEF FUND

After Hurricane Rita, the Texas Disaster Relief Fund was established. The Office of the Governor oversees the fund, but it is not funded with state funds. The nonprofit fund accepts donations. According to the fund's website, it

“complements rather than duplicates existing relief resources.” As of August 2014, approximately \$6.0 million in cash donations and \$2.2 million from in-kind donations had been collected. The balance was \$854,053, according to the Office of the Governor.

CONTINUE REGIONAL RECOVERY COORDINATION PROGRAM

To improve disaster grant management at the local level, TDEM proposed a Regional Recovery Coordination Program in 2014. TDEM planned to send coordinators to eight DPS regions to train local officials how to administer federal disaster grants. According to TDEM, this training would help “eliminate negative audit findings” and “ensure Texas entities are completely reimbursed in accordance with federal guidelines.” TDEM noted “there has been insufficient emphasis on teaching federal grant rules and a general

**FIGURE 4
SUPPLEMENTAL APPROPRIATIONS RELATED TO
DISASTERS, FISCAL YEARS 2003 TO 2013**

LEGISLATURE	AMOUNT (IN MILLIONS)
Seventy-eighth Legislature, Regular Session, 2003	\$7.9
Seventy-ninth Legislature, Third Called Session, 2006	\$34.0
Eightieth Legislature, Regular Session, 2007	\$63.2
Eighty-first Legislature, Regular Session, 2009	\$430.0 (1)
Eighty-second Legislature, Regular Session, 2011	\$81.0
Eighty-third Legislature, Regular Session, 2013	\$183.7
ESTIMATED TOTAL	\$799.7

NOTES:

- (1) In 2009, The Texas Department of Criminal Justice (TDCJ) was appropriated \$164.2 million for various operations costs, including some resulting from disaster damage. The disaster-related appropriation was not defined in House Bill 4586. For fiscal year 2009, TDCJ reported \$25.1 million in General Revenue Funds expenditures in Homeland Security Schedule 6G: Natural/Man-Made Disasters. This amount is estimated as TDCJ's supplemental disaster appropriation.
- (2) Estimated total sums less than amounts listed due to rounding.

SOURCE: Legislative Budget Board.

misunderstanding that normal grant rules do not apply to disaster funding.” As a result, grantees have kept substandard records and encountered other issues that may result in the denial or de-obligation of Federal Funds.

In May 2014, the Office of the Governor approved disaster grants to implement this program. The Office of the Governor granted \$772,252 for fiscal year 2014 and \$1.5 million for fiscal year 2015. It is anticipated the Office of the Governor will not continue to fund the program beyond fiscal year 2015. To ensure continuity, Recommendation 1 would fund the program for the 2016–17 biennium through DPS’s budget, not grants from the Office of the Governor. Recommendation 1 would appropriate \$1.9 million in General Revenue Funds to DPS in the introduced 2016–17 General Appropriations Bill to continue the Regional Recovery Coordination Program. The appropriation would pay for nine full-time-equivalent positions and continuing education.

ESTABLISH A DISASTER RECOVERY FUND

The state pays for disaster response, but there is no immediate, dedicated source of disaster recovery funds. The Disaster

Contingency Fund may be used for disaster preparation, recovery, and risk-financing. The Legislature, however, has not appropriated funds to the account since it was transferred from the Office of the Governor to TDEM in 2009. In effect, it is not being used as a disaster finance mechanism. At this time, there is no defined process for local entities to request recovery funds. Local entities may request disaster grants from the Office of the Governor, wait for FEMA aid, seek donations, or absorb costs.

Recommendation 2 would amend statute to establish a General Revenue–Dedicated account for disaster recovery. TDEM would administer the account. It would be a revolving account that receives local, state, or Federal Funds including FEMA reimbursements. Funds would be more readily available; applicants would not have to wait for supplemental appropriations. Although state agencies could request funds, the fund’s main purpose would be to help local entities. For example, funds may be used by cities or counties to pay the non-federal match for federal disaster grants. Funds may also pay for projects in areas where the Governor declares a disaster but FEMA does not. TDEM would make need-based grants or loans. The division would establish a formal application process, evaluate applicant need, and set terms for receiving and repaying aid. To ensure fiscal responsibility, TDEM’s evaluation should include a thorough review of applicants’ finances and disaster plans.

FUND A DISASTER RECOVERY FUND

Recommendation 3 proposes two methods of finance to fund a disaster recovery fund. Recommendation 3, Option 1 would amend the Texas Government Code, Chapter 614, to allow funds from the Volunteer Fire Department Assistance Fund to be used for disasters. This General Revenue–Dedicated account, currently funded by an annual assessment on insurers that write fire and other insurance policies, had a balance of \$83.4 million as of August 31, 2014. This option would transfer \$30.0 million of the account balance to the proposed General Revenue–Dedicated account for disaster recovery. This transfer of funds is not intended to increase the assessment; statute may be amended to ensure funds are exempt from the assessment’s calculation.

Recommendation 3, Option 2, would use \$30.0 million of the \$70.6 million recommended reduction to Trusted Programs within the Office of the Governor, Strategy A.1.1., Disaster Funds, and appropriate that amount to the proposed General Revenue–Dedicated account for disaster recovery. Although this option would not change how the Office of

the Governor administers disaster grants, it would permit TDEM to make grants or loans for disaster recovery.

PROVIDE DISASTER RECOVERY FUND OVERSIGHT

Recommendation 4 would include a contingency rider in the 2016–17 General Appropriations Bill to require DPS to submit any intended expenditure of at least \$1.0 million from the proposed General Revenue–Dedicated account for disaster recovery to the LBB and the Office of the Governor for approval. Any expenditure not disapproved in writing within 30 days would be approved.

FISCAL IMPACT OF RECOMMENDATIONS

Figure 5 shows the costs and full-time equivalent positions related to implementing Recommendation 1. The Regional Recovery Coordination Program is anticipated to cost \$1.9 million in General Revenue Funds for the 2016–17 biennium. This fiscal impact assumes the Office of the Governor will not fund the program in the 2016–17 biennium. The impact does not account for any potential gains/savings in local, state, or Federal Funds that may result from training local entities in grant management. It does not account for any Federal Funds that may be used for federal disaster grant administration.

Recommendation 2 has no anticipated cost. Recommendation 3 has different fiscal impacts depending on the method of finance adopted. As shown in Figure 6, the first option would reduce General Revenue–Dedicated Account 5064 by \$30.0 million for the 2016–17 biennium and increase the proposed General Revenue–Dedicated account for disaster recovery by \$30.0 million. The second option would use part of the \$70.6 million recommended reduction to 2016–17 appropriations to Trusteed Programs within the Office of the Governor, Strategy A.1.1, Disaster Funds. As shown in Figure 7, this would reduce General Revenue by \$30.0 million and increase the proposed General Revenue–Dedicated account for disaster recovery by \$30.0 million for the 2016–17 biennium. Both options would increase appropriations to DPS by \$30.0 million. It is anticipated that Recommendation 4 could be implemented within existing state resources. The introduced 2016–17 General Appropriations Bill includes an appropriation that implements Recommendation 1.

**FIGURE 5
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 1
FISCAL YEARS 2016 TO 2020**

YEAR	PROBABLE SAVINGS/ (COSTS) IN GENERAL REVENUE FUNDS	PROBABLE ADDITION/ (REDUCTION) IN FULL- TIME EQUIVALENT POSITIONS
2016	(\$952,500)	9
2017	(\$952,500)	9
2018	\$0	0
2019	\$0	0
2020	\$0	0

NOTES:

- (1) Impact assumes the Office of the Governor will not fund the program in the 2016–17 biennium.
- (2) Impact does not include any Federal Funds dedicated to the administration of federal disaster grants.

SOURCES: Legislative Budget Board; Texas Department of Public Safety.

FIGURE 6
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 3, OPTION 1, FISCAL YEARS 2016 TO 2020

YEAR	PROBABLE REVENUE GAIN/(LOSS) TO GENERAL REVENUE–DEDICATED ACCOUNT 5064	PROBABLE REVENUE GAIN/(LOSS) TO PROPOSED GENERAL REVENUE–DEDICATED DISASTER RECOVERY FUND	PROBABLE SAVINGS/(COST) TO PROPOSED GENERAL REVENUE–DEDICATED DISASTER RECOVERY FUND
2016	(\$15,000,000)	\$15,000,000	(\$15,000,000)
2017	(\$15,000,000)	\$15,000,000	(\$15,000,000)
2018	\$0	\$0	\$0
2019	\$0	\$0	\$0
2020	\$0	\$0	\$0

SOURCE: Legislative Budget Board.

FIGURE 7
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 3, OPTION 2, FISCAL YEARS 2016 TO 2020

YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS	PROBABLE REVENUE GAIN/(LOSS) TO PROPOSED GENERAL REVENUE–DEDICATED DISASTER RECOVERY FUND	PROBABLE SAVINGS/(COST) TO PROPOSED GENERAL REVENUE–DEDICATED DISASTER RECOVERY FUND
2016	(\$15,000,000)	\$15,000,000	(\$15,000,000)
2017	(\$15,000,000)	\$15,000,000	(\$15,000,000)
2018	\$0	\$0	\$0
2019	\$0	\$0	\$0
2020	\$0	\$0	\$0

SOURCE: Legislative Budget Board.

IMPROVE OVERSIGHT OF FUNDS RELATED TO THE DEEPWATER HORIZON OIL SPILL

In April 2010, after an explosion, the Deepwater Horizon oil rig sank in the Gulf of Mexico. The rig was located in the Macondo prospect, southeast of the Louisiana coast. By the time it was capped nearly three months later, the rig released nearly five million barrels of oil. There were many responsible parties, according to the Congressional Research Service. Some of the parties include BP, an energy company that had leased and operated the rig; MOEX Offshore 2007 LLC, a partial investor in the well; and Transocean, an offshore drilling company that owned the rig.

Due to the oil spill, the state of Texas will receive funds from various sources. Five main sources will provide funds for ecological or economic projects. Although they stem from the same event, each source is different. They differ by amounts, funding mechanisms, and rules. Oil spill-related funds represent a new, significant source of revenue. Given the influx of funds to Texas and unresolved legal and procedural issues, greater legislative oversight is needed to ensure a high degree of accountability and transparency from agencies that administer these funds.

FACTS AND FINDINGS

- ◆ MOEX Offshore 2007 LLC provided \$6.5 million to Texas: \$3.25 million for a civil penalties direct payment, and \$3.25 million for Supplemental Environmental Projects.
- ◆ Texas may receive up to \$100.0 million in early restoration funds through an agreement with BP, federal agencies, and Texas natural resource agencies.
- ◆ The National Fish and Wildlife Foundation will provide \$203.5 million to Texas from April 2013 to February 2018.
- ◆ In 2012, the U.S. Congress passed legislation that directs certain spill-related penalties to a trust fund. Texas may receive portions of this fund.
- ◆ In September 2010, BP agreed to pay the state of Texas \$5.0 million for costs the state incurred due to the spill.

CONCERNS

- ◆ Greater transparency is needed with regard to receipt, negotiation, and use of oil spill-related funds.
- ◆ Legal and procedural issues that may affect the amount of funds the state may receive are outstanding. Further monitoring will be required until these issues are resolved.
- ◆ There is no formal process in place for state agencies that administer oil spill-related funds to provide reports or status updates to the Legislature or legislative agencies.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Include a rider in Article IX of the introduced 2016–17 General Appropriations Bill that requires agencies that receive, expend, or conduct projects using Deepwater Horizon oil spill-related funds to submit quarterly reports to the Legislative Budget Board. These reports will identify amounts, funding sources, and projects.
- ◆ **Recommendation 2:** Include a rider in Article IX of the introduced 2016–17 General Appropriations Bill that requires any agency that intends to expend at least \$1.0 million for a project or program using Deepwater Horizon oil spill-related funds deposited to the state Treasury to submit an expenditure request to the Legislative Budget Board and the Office of the Governor for approval.
- ◆ **Recommendation 3:** Within each chamber's finance or appropriations committee, the Legislature should consider establishing a standing subcommittee to provide oversight for exceptional fiscal or policy matters such as the influx of oil spill-related funds. The subcommittees could meet with relevant policy committees as necessary to receive testimony and updates from agencies.

DISCUSSION

The Deepwater Horizon (DWH) oil spill was unprecedented. It resulted in a great deal of media attention, litigation, and legislation. Nearly five million barrels of oil leaked into the

Gulf, according to the National Oceanic and Atmospheric Administration. There are five main sources that will provide funds to Texas. Although some sources may fund similar activities, each has a distinct purpose and means of funding and distribution. The sources in **Figure 1** are:

- MOEX Offshore 2007 LLC settlement;
- Natural Resource Damage Assessment (NRDA);
- National Fish and Wildlife Foundation (NFWF);
- Resources and Ecosystems Sustainability, Tourist Opportunities, and Revived Economies of the Gulf Coast States Act (RESTORE Act); and
- An agreement between the state of Texas and BP.

MOEX OFFSHORE 2007 LLC SETTLEMENT

In February 2012, MOEX Offshore 2007 LLC (MOEX), a partial investor in the well, agreed to a \$90.0 million settlement. In accordance with settlement terms, the company agreed to \$70.0 million in civil penalties. As shown in **Figure 2**, \$45.0 million was deposited to the federal Oil Spill Liability Trust Fund; \$25.0 million was distributed among the Gulf states based upon amounts set in the court settlement. MOEX also funded an additional \$20.0 million in Supplemental Environmental Projects (SEPs) in four Gulf states. In total, Texas received \$6.5 million from the MOEX settlement: \$3.25 million for a civil penalties direct payment and \$3.25 million for SEPs.

CIVIL PENALTIES DIRECT PAYMENT

In the final judgment, MOEX paid \$3.25 million directly to the state of Texas. The Texas Comptroller of Public Accounts

**FIGURE 1
DEEPWATER HORIZON OIL SPILL-RELATED FUNDS, SEPTEMBER 2010 TO JULY 2014**

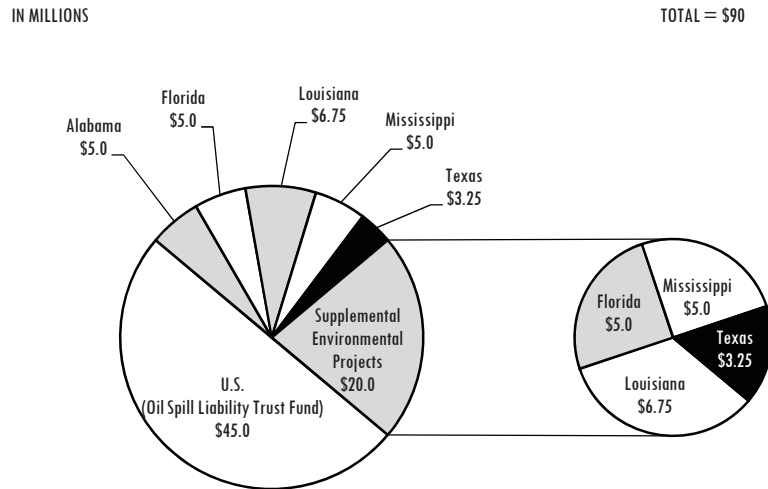
SOURCE	TYPE	AMOUNT AVAILABLE TO TEXAS	ALLOWABLE USES
MOEX Offshore 2007 LLC	Settlement	\$6.5 million	<ul style="list-style-type: none"> • Supplemental Environmental Projects: Land acquisition and habitat protection. • Civil Penalties Direct Payment: General Revenue Fund; Coastal Protection Fund (General Revenue–Dedicated Fund); and attorney fees.
Natural Resource Damage Assessment: Early Restoration	Framework agreement	Up to \$100.0 million	<ul style="list-style-type: none"> • Restore, rehabilitate, or replace injured natural resources. • Address an injury due to the spill.
National Fish and Wildlife Foundation: Gulf Environmental Benefit Fund	Criminal plea agreements	\$203.5 million	<ul style="list-style-type: none"> • Remedy harm and eliminate or reduce risk of future harm to natural resources. • Remedy resources that were injured, destroyed, lost, or lost use due to the spill.
Resources and Ecosystems Sustainability, Tourist Opportunities, and Revived Economies of the Gulf Coast States Act (RESTORE Act)	Federal Funds	To be determined	<ul style="list-style-type: none"> • Direct Component: Restoring and protecting natural resources; mitigating damage; implementing a marine, coastal, or conservation management plan; workforce development/job creation; state park improvements; infrastructure; flood protection; tourism and seafood promotion; and planning/administration. • Spill Impact Component: Similar to Direct Component. Projects must contribute to Gulf economic and ecological recovery. • Comprehensive Plan Component: Projects must meet Comprehensive Plan objectives. • Centers of Excellence: Science and research related to coastal issues at select institutions.
BP-State of Texas Agreement	Agreement	\$5.0 million	Costs related to the spill.

NOTES:

- (1) Due to pending regulations and litigation, RESTORE Act funding cannot be determined.
- (2) Not all funds available to Texas will be deposited to the state Treasury.

SOURCES: Legislative Budget Board; U.S. Department of Justice; Gulf Coast Ecosystem Restoration Council; National Fish and Wildlife Foundation; Resources and Ecosystems Sustainability, Tourist Opportunities, and Revived Economies of the Gulf Coast States Act; Office of the Governor.

FIGURE 2
MOEX OFFSHORE 2007 LLC SETTLEMENT FUNDS DISTRIBUTION, FEBRUARY 2012



SOURCES: U.S. Department of Justice; Environmental Law Institute.

(CPA) received the payment into the state Treasury and transferred \$1.0 million to the Texas General Land Office’s (GLO) Coastal Protection Fund, a General Revenue–Dedicated fund. By July 2014, GLO had expended or encumbered nearly this entire amount. In addition, \$2.15 million was deposited into the General Revenue Fund. The remaining \$95,000 was deposited to the Office of the Attorney General for attorney’s fees.

SUPPLEMENTAL ENVIRONMENTAL PROJECTS

According to the settlement’s consent decree, the goals of the SEPs are to preserve and protect SEP properties in their natural state and provide environmental benefits to the properties’ ecological resources. The U.S. Environmental Protection Agency states SEPs must satisfy these legal requirements:

- relationship exists between the violation and SEP’s benefits;
- SEP must improve, protect, or reduce risks to public health or the environment; and
- SEP is part of a settlement and is something the violator is not otherwise legally required to perform.

MOEX funded two SEPs in Texas. The Nature Conservancy, a nonprofit, received \$2.0 million to acquire Big Tree Ranch near Goose Island State Park in Aransas County. The organization then donated the land to the Texas Parks and

Wildlife Department (TPWD). The U.S. Fish and Wildlife Service worked with The Conservation Fund, another nonprofit, to add 186 acres to the Laguna Atascosa National Wildlife Refuge on South Padre Island in Cameron County. This SEP totaled \$1.2 million.

NATURAL RESOURCE DAMAGE ASSESSMENT

According to the Congressional Research Service (CRS), the Oil Pollution Act of 1990 permits state and federal governments to seek compensation for the costs of restoring damaged natural resources from the parties responsible for an oil spill. This process is known as the Natural Resource Damage Assessment (NRDA). State and federal agencies serve as trustees. Trustees assess damages to natural resources and implement a restoration plan. **Figure 3** shows the Texas and federal members of the Deepwater Horizon NRDA Trustee Council.

According to CRS, the NRDA has several stages. In the Preassessment Phase, trustees “determine that there are injuries, that those injuries have not been remedied, and that there are feasible restoration actions available to fix the injuries.” In the Restoration Planning Phase, trustees conduct an Injury Assessment and develop restoration alternatives. Trustees weigh different options such as “restoring, replacing, rehabilitating, or acquiring the equivalent” natural resource. They also consider “compensatory restoration.” After trustees finalize a Restoration Plan, they move to the Restoration

**FIGURE 3
DEEPWATER HORIZON NATURAL RESOURCE DAMAGE
ASSESSMENT TRUSTEE COUNCIL, OCTOBER 2014**

TEXAS TRUSTEES	FEDERAL TRUSTEES
Texas Parks and Wildlife Department	National Oceanic and Atmospheric Administration
Texas Commission on Environmental Quality	U.S. Department of the Interior
Texas General Land Office	U.S. Environmental Protection Agency
	U.S. Department of Agriculture

SOURCE: National Oceanic and Atmospheric Administration.

Implementation Phase. Although trustees ask the responsible party to implement the plan, the trustees oversee this process.

EARLY RESTORATION

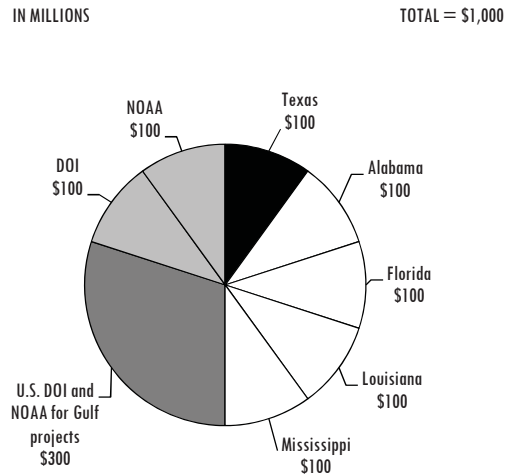
NRDA is ongoing. At some point, a federal court may decide total damages or a settlement could be reached with the responsible party. CRS notes there are many responsible parties in the DWH oil spill, but BP was the only participant involved in the “cooperative NRDA process,” as of April 2012. In the meantime, BP agreed to fund \$1.0 billion in early restoration projects. In April 2011, BP entered into a framework agreement with certain state and federal trustees. The early restoration trustees include many of the same agencies as the Deepwater Horizon NRDA Trustee Council.

According to the agreement, early restoration projects must restore, rehabilitate, or replace injured natural resources and address an injury associated with the spill. Examples include dunes, marshes, barrier islands, oyster reefs, wildlife habitats, beaches, and recreational access. Early restoration funds are held in the Deepwater Horizon Oil Spill Trust, an escrow account. Project funds transfer to an account specified by the trustees.

As shown in **Figure 4**, five Gulf states, including Texas, may receive up to \$100.0 million each. The two federal trustees, the U.S. Department of Interior (DOI) and National Oceanic and Atmospheric Administration (NOAA), may receive \$300.0 million jointly for state-proposed Gulf projects. DOI and NOAA may also receive \$100.0 million each.

The early restoration process has different phases. No Phase I or II projects were funded in Texas. For Phase III, five Texas projects shown in **Figure 5** were proposed. They total \$18.6 million. In June 2014, all trustees except Texas agreed to 44 Phase III projects in Texas and other states. According to the

**FIGURE 4
NATURAL RESOURCE DAMAGE ASSESSMENT EARLY
RESTORATION FUNDS DISTRIBUTION, APRIL 2011**



NOTES:
 (1) DOI=U.S. Department of the Interior; NOAA=National Oceanic and Atmospheric Administration.
 (2) Texas may receive up to \$100 million.
 SOURCES: National Conference of State Legislatures; U.S. Department of Justice.

**FIGURE 5
NATURAL RESOURCE DAMAGE ASSESSMENT EARLY
RESTORATION PHASE III PROJECTS IN TEXAS, OCTOBER
2014**

PROJECT	ESTIMATED COST (IN MILLIONS)
Galveston Island State Park Beach Redevelopment	\$10.7
Matagorda Artificial Reef	\$3.6
Freeport Artificial Reef	\$2.2
Mid-Upper Texas Coast Artificial Reef Ship Reef	\$1.9
Sea Rim State Park Improvements	\$.2
TOTAL	\$18.6

SOURCE: Deepwater Horizon Natural Resource Damage Assessment Trustee Council.

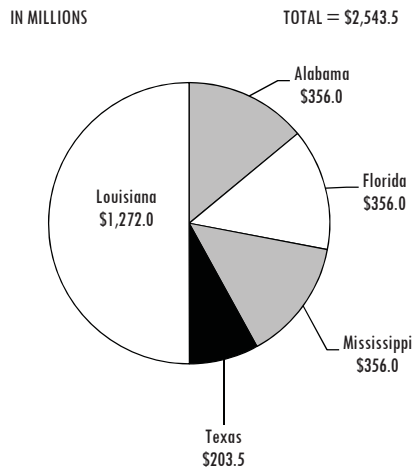
Federal Register, the Texas trustees did not join the Phase III Early Restoration Plan and final environmental impact statement at that time. In October 2014, however, Texas agreed to the plan and impact statement.

NATIONAL FISH AND WILDLIFE FOUNDATION

In 2013, a federal court approved criminal plea agreements from BP, which had leased and operated the DWH rig, and Transocean, the drilling company that owned the rig. The

companies will pay \$2.5 billion to the National Fish and Wildlife Foundation (NFWF). NFWF is a congressionally chartered, conservation nonprofit. It established the Gulf Environmental Benefit Fund to make payments to the five Gulf states. The plea agreements define how much funding each state will receive and how funds can be used. NFWF maintains accounts for each state. As shown in **Figure 6**, Texas will receive \$203.5 million from April 2013 to February 2018. **Figure 7** shows the availability schedule. NFWF will work with Texas natural resource agencies (TPWD, GLO, and the Texas Commission on Environmental Quality) to select and fund projects.

**FIGURE 6
NATIONAL FISH AND WILDLIFE FOUNDATION GULF ENVIRONMENTAL BENEFIT FUND DISTRIBUTION, APRIL 2013 TO FEBRUARY 2018**



Source: National Fish and Wildlife Foundation.

**FIGURE 7
NATIONAL FISH AND WILDLIFE FOUNDATION GULF ENVIRONMENTAL BENEFIT FUNDS AVAILABLE TO TEXAS APRIL 2013 TO FEBRUARY 2018**

DATE	AMOUNT AVAILABLE (IN MILLIONS)
April 2013	\$12.6
February 2014	\$28.2
February 2015	\$27.1
February 2016	\$24.0
February 2017	\$40.0
February 2018	\$71.5
TOTAL	\$203.5

NOTE: Amounts sum less than actual total due to rounding.
SOURCE: National Fish and Wildlife Foundation.

The plea agreements state that projects must remedy harm and eliminate or reduce the risk of future harm to Gulf natural resources. Projects must remedy harm to resources where there has been injury to, destruction of, loss of, or loss of use of those resources due to the spill. According to NFWF, priorities include coastal habitats, barrier islands, beaches, marshes, coastal bays and estuaries, and fish and marine wildlife.

Since November 2013, NFWF has awarded \$43.3 million for six Texas projects. TPWD is the award recipient for four projects. Two conservation organizations are the recipients for the other projects, but TPWD will serve as a partner. **Figure 8** shows a list of awarded projects. According to NFWF, future projects are expected to be approved in late 2014.

RESTORE ACT

In 2012, Congress passed the Resources and Ecosystems Sustainability, Tourist Opportunities, and Revived Economies of the Gulf Coast States Act (RESTORE). The law directs 80 percent of civil and administrative Clean Water Act penalties related to the DWH oil spill to the Gulf Coast Restoration Trust Fund. As shown in **Figure 9**, the fund’s components have different uses and formulas. Coastal zones that border the Gulf and lands or watersheds within 25 miles of a zone are eligible to receive funds. In general, this means all Texas coastal counties (i.e. Chambers, Harris) are eligible.

**DIRECT COMPONENT
(35 PERCENT OF RESTORATION TRUST FUND)**

From the Restoration Trust Fund, 35 percent is split evenly among the five Gulf states. Texas will receive 7 percent of the Restoration Trust Fund directly. The direct component is the most discretionary component. Funds may be used for the following activities:

- restoration and protection of natural resources;
- mitigation of damage;
- implementation of a federally-approved marine, coastal, or conservation management plan;
- workforce development and job creation;
- state park improvements in coastal areas;
- infrastructure that benefits the economy or ecological resources;
- coastal flood protection;
- tourism and seafood promotion; and
- planning assistance and administration.

**FIGURE 8
NATIONAL FISH AND WILDLIFE FOUNDATION PROJECTS AWARDED IN TEXAS, AUGUST 2014**

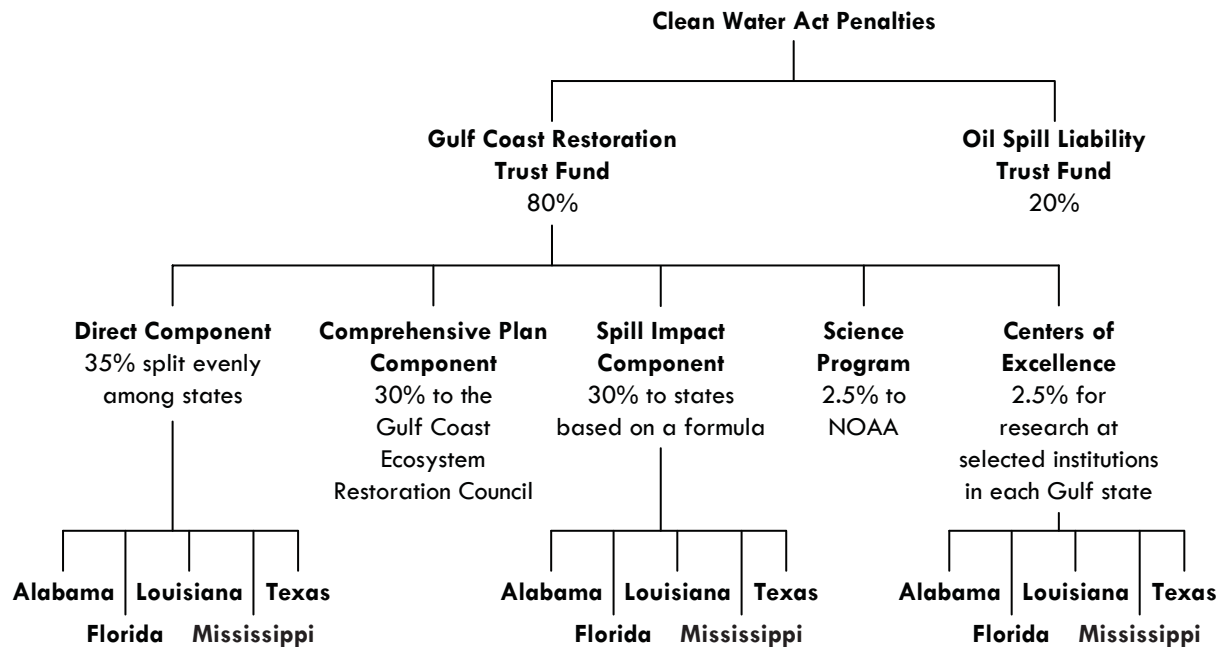
PROJECT	RECIPIENT	PARTNERS	AWARD AMOUNT (IN MILLIONS)
Powderhorn Ranch Land Acquisition	Texas Parks and Wildlife Department	Texas Parks and Wildlife Department (1) The Conservation Fund The Nature Conservancy	\$34.5
West Galveston Bay Conservation Corridor Habitat Preservation	SCENIC GALVESTON, Inc.	Galveston Bay Estuary Program Galveston Bay Foundation Texas Parks and Wildlife Department	\$4.1
Galveston Island State Park Marsh Restoration and Protection	Texas Parks and Wildlife Foundation	Texas General Land Office	\$2.5
Gulf Coast Migratory Waterfowl Habitat Enhancement	Ducks Unlimited	Texas Parks and Wildlife Department Natural Resource Conservation Service U.S. Fish and Wildlife Service	\$1.3
East Bay Oyster Reef Restoration	Texas Parks and Wildlife Department	Coastal Conservation Association Texas	\$0.8
Sea Rim State Park Coastal Dune Restoration	Texas Parks and Wildlife Department	None	\$0.2
TOTAL			\$43.3

NOTES:

- (1) The Texas Parks and Wildlife Foundation will raise matching funds for the Powderhorn Ranch project.
- (2) Award amounts do not include leveraging/matching amounts.
- (3) Award amounts sum greater than actual total due to rounding.

SOURCE: National Fish and Wildlife Foundation.

**FIGURE 9
RESTORE ACT DISTRIBUTION FORMULA, JULY 2012**



NOTE: NOAA = National Oceanic and Atmospheric Administration.

SOURCES: Ocean Conservancy; Gulf Coast Ecosystem Restoration Council; U.S. Department of the Treasury.

**COMPREHENSIVE PLAN COMPONENT
(30 PERCENT OF RESTORATION TRUST FUND)**

The RESTORE Act establishes a council of state and federal representatives called the Gulf Coast Ecosystem Restoration Council. The law names the Governor of Texas as a council member, along with the governors of other Gulf states and representatives from six federal entities. The Governor may designate a representative to the council. The council creates a comprehensive plan; selects and funds projects for this plan; approves state expenditure plans; and performs other duties.

The comprehensive plan component is 30 percent of the Restoration Trust Fund. It is more restrictive than the direct or spill impact components. The comprehensive plan objectives are:

- restore, enhance, and protect habitats;
- restore, improve, and protect water resources;
- protect and restore living coastal and marine resources;
- restore and enhance natural processes and shorelines;
- promote community resilience;
- promote natural resource stewardship and environmental education; and
- improve science-based decision-making processes.

**SPILL IMPACT COMPONENT
(30 PERCENT OF RESTORATION TRUST FUND)**

The spill impact component is divided among states, using a formula. The formula takes into account the proportion of oiled shoreline, distance from the DWH rig, and population of coastal counties. Texas will receive no less than 5 percent of this component. Funds may be used for projects similar to those in the direct component. Projects must contribute to the Gulf’s economic and ecological recovery and complement the comprehensive plan. In addition, each state must submit a state expenditure plan for council approval.

**SCIENCE AND RESEARCH
(5 PERCENT OF RESTORATION TRUST FUND)**

The RESTORE Act also established science and research initiatives to benefit the Gulf. NOAA will receive 2.5 percent of the Restoration Trust Fund to operate a Gulf Coast Ecosystem Restoration Science, Observation, Monitoring, and Technology Program. The Gulf states will share another 2.5 percent evenly for Centers of Excellence research grants. Through a competitive process, each state will select centers

to conduct research. These can be public or private institutions. Grants fund science, technology, and monitoring related to:

- coastal sustainability, restoration, and protection;
- coastal fisheries and wildlife ecosystems;
- offshore energy;
- economic development; and
- observing, mapping, or monitoring the Gulf.

RULES AND FUNDING STATUS

In January 2013, Transocean pled guilty to Clean Water Act violations and agreed to \$1.0 billion in civil fines. The company must pay \$800.0 million of these fines into the Restoration Trust Fund. As of July 2014, Transocean had deposited approximately \$653.0 million. The company is anticipated to make its last payment by March 2015, according to the U.S. Department of the Treasury. As shown in **Figure 10**, the department estimates \$800.6 million will be available from the Restoration Trust Fund as of March 31, 2015 due to Transocean’s settlement. Amounts available to Texas are estimated to be \$56.1 million for the direct component and \$4.0 million for Centers of Excellence.

**FIGURE 10
GULF COAST RESTORATION TRUST FUND TOTAL
ALLOCATIONS RELATED TO THE TRANSOCEAN
SETTLEMENT, MARCH 31, 2015**

COMPONENT	ESTIMATED AMOUNTS (IN MILLIONS)
Direct	\$280.5
Comprehensive Plan	\$239.5
Spill Impact	\$240.4
NOAA Science Program	\$20.1
Centers of Excellence	\$20.1
TOTAL	\$800.6

NOTES:

(1) Estimated amounts include anticipated payments from Transocean as of March 31, 2015.

(2) Amounts are for the entire trust fund.

SOURCE: U.S. Department of the Treasury.

In September 2013, U.S. Department of the Treasury proposed a rule to regulate RESTORE funds. The department issued an Interim Final Rule that went into effect in October 2014. Based on the rule, RESTORE funds will be treated as grants. **Figure 11** shows how each component may be administered.

**FIGURE 11
FEDERAL REGULATIONS FOR THE RESTORE ACT, OCTOBER 2014**

COMPONENT	HOW ADMINISTERED
Direct	U.S. Department of Treasury administers. Awards are made directly to the Office of the Governor or the governor's appointee.
Comprehensive Plan	Gulf Coast Ecosystem Restoration Council administers. The council may establish the project selection process and fund projects.
Spill Impact	Gulf Coast Ecosystem Restoration Council administers. The Office of the Governor or the governor's appointee develops a state expenditure plan.
Centers of Excellence	U.S. Department of Treasury administers. The Office of the Governor or the governor's appointee carries out the state's duties.

SOURCE: U.S. Department of the Treasury.

In September 2014, a federal judge ruled that BP was grossly negligent in the DWH oil spill. Finding gross negligence increases the maximum penalty for Clean Water Act violations. However, litigation that could impact RESTORE funding is ongoing. With rules and lawsuits pending, it is difficult to estimate the amount of funds Texas may receive.

BP-STATE OF TEXAS AGREEMENT

In September 2010, BP agreed to pay the state of Texas \$5.0 million for costs the state incurred due to the spill. This agreement is not tied to the other oil spill sources or to any law. It is not in lieu of any other settlement or litigation. According to the agreement, the Office of the Governor has discretion regarding how to expend funds.

BP transferred \$5.0 million to CPA in September 2010. Funds are held in General Revenue Account 5149: BP Oil Spill Texas Response Grant. In September 2013, the Office of the Governor granted \$1.0 million to TCEQ. According to TCEQ, these funds will pay for developing the RESTORE plan, website, and other administrative expenses. As of October 2014, the agency had expended \$51,500 on a contract to develop the RESTORE plan.

BP requested that the state return the \$5.0 million in November 2013, *The Texas Tribune* reported in July 2014. According to Trusteed Programs within the Office of the Governor, these funds will be expended completely in fiscal year 2015.

OVERSIGHT AND MONITORING

DWH oil spill-related funds are a new, significant source of revenue for Texas. While the state may benefit from this influx of funds, there are several issues to keep in mind as state agencies administer these funds. First, oil spill-related funds stem from the same event, but they are different. Each source has specific rules, allowable uses, and methods of finance. Second, legal and procedural issues that could affect the amount of funds Texas may receive are still outstanding.

Further monitoring will be required until these issues are resolved. Third, multiple state and federal agencies are involved in project selection, funding, and administration. Given these issues, it is important that the Legislature is aware how DWH oil spill-related funds are being used. Greater legislative oversight may ensure a high degree of accountability and transparency from agencies administering these funds.

Recommendation 1 proposes a rider in Article IX of the introduced 2016–17 General Appropriations Bill to require any agency that receives, expends, or conducts projects using DWH oil spill-related funds to submit quarterly reports to the Legislative Budget Board (LBB). Reports will identify award amounts, funding sources, projects, and other information in a format prescribed by the LBB.

Recommendation 2 proposes a rider in Article IX of the introduced 2016–17 General Appropriations Bill that requires any agency that intends to expend at least \$1.0 million for a project or program using DWH oil spill-related funds deposited to the state Treasury to submit an expenditure request to the LBB and the Office of the Governor for approval prior to making any such expenditure. Any request not disapproved in writing in 30 days would be approved.

Recommendation 3 proposes establishing standing committees within the Senate Finance Committee and the House Appropriations Committee to provide oversight for exceptional fiscal or policy matters such as the influx of oil spill-related funds. The subcommittees could meet with relevant policy committees as necessary to receive testimony and updates from agencies.

FISCAL IMPACT OF RECOMMENDATIONS

These recommendations could be implemented within existing state resources. The introduced 2016–17 General Appropriations Bill includes a rider implementing Recommendations 1 and 2.

OVERVIEW OF THE ECONOMIC STABILIZATION FUND

The Texas Economic Stabilization Fund, commonly referred to as the Rainy Day Fund, was established by the passage of a constitutional amendment in 1988. Since its establishment, deposits to the fund have totaled \$19.1 billion. The Texas Legislature has passed seven bills appropriating \$10.7 billion from the fund. The fund balance was \$8.5 billion on December 15, 2014. This is one of the highest balances among state stabilization funds nationwide, both as an absolute amount and a percentage of spending.

The accumulation of significant balances is a recent development. Before fiscal year 2008, the balance of the Economic Stabilization Fund had never reached 5 percent of annual General Revenue Funds spending. The recent increase in the Economic Stabilization Fund balance is linked to historically high oil production tax and natural gas tax receipts generated by enhanced oil and natural gas recovery methods.

This report provides an overview of the structure of the Economic Stabilization Fund, revenue sources deposited to the fund, and appropriations made from the fund since its establishment.

FACTS AND FINDINGS

- ◆ The ending fiscal year 2014 balance of the Economic Stabilization Fund was \$6.7 billion. Between the end of fiscal year 2014 and December 15, 2014, the Comptroller of Public Accounts transferred a net of \$1.7 billion to the fund, increasing the balance to \$8.5 billion, equivalent to 17.5 percent of the fiscal year 2015 General Revenue Funds budget.
- ◆ Transfers from the General Revenue Fund to the Economic Stabilization Fund linked to oil production tax and natural gas tax collections have contributed 86.8 percent of all revenue deposited to the fund. Within the current structure of the fund, future deposits to the fund are highly dependent on oil and natural gas tax collections.
- ◆ The transfer to the Economic Stabilization Fund based on the unencumbered General Revenue Fund balance at the end of each biennium has not been a reliable source of revenue due to high levels of encumbrances against the General Revenue Fund balance and the

counting of General Revenue–Dedicated account balances toward certification of appropriations from General Revenue Funds.

- ◆ The Economic Stabilization Fund cap for the 2014–15 biennium is \$14.1 billion, equivalent to 29.1 percent of the fiscal year 2015 General Revenue Funds budget. The redirection of federal funds from special funds to the General Revenue Fund, coupled with an increase in federal funds, has increased the Economic Stabilization Fund cap. If federal funds were excluded from the calculation of the cap, it would be \$10.0 billion, equivalent to 20.7 percent of the fiscal year 2015 General Revenue Funds budget.
- ◆ Appropriations from state stabilization funds during economic downturns do not necessarily affect state bond ratings. During the last recession, states that had the highest bond ratings and appropriated significant portions of their stabilization funds did not receive lower bond ratings.
- ◆ A constitutional amendment adopted in November 2014 redirects to the State Highway Fund as much as half of the oil and natural gas tax-related General Revenue Fund transfers that previously would have been transferred to the Economic Stabilization Fund.

DISCUSSION

During the 1980s, the state experienced two major revenue shortfalls. The first, in 1983, was caused by slumping oil prices and falling sales tax revenue. Between September 1982 and April 1983, the Comptroller of Public Accounts (CPA) reduced the revenue estimate for the 1984–85 biennium by \$3.2 billion, 15.0 percent of the biennial General Revenue Funds budget. These revenue reductions prompted a special session in which the Legislature passed the first major tax increase since 1971. The second budget deficit occurred in 1986. In late 1985, Saudi Arabia increased its oil production, flooding the market with oil and causing the price of oil to decrease from \$32 per barrel to \$15 per barrel by February 1986. After the decrease in oil prices, CPA made a series of revenue estimate reductions totaling \$2.9 billion, 12.0 percent of the biennial revenue. The reductions led to two special legislative sessions.

Against this backdrop of budget shortfalls, in 1987, the Legislature proposed a constitutional amendment to establish the Economic Stabilization Fund (ESF), commonly known as the Rainy Day Fund. The constitutional amendment was ratified November 8, 1988. The ballot language read: “The constitutional amendment establishing an economic stabilization fund in the state treasury to be used to offset unforeseen shortfalls in revenue.” However, neither the constitution nor statute includes language describing the purpose of the ESF.

The amendment was adopted with 61.6 percent of the popular vote. The Texas Constitution, Article III, Section 49-g, which relates to the ESF, has been amended twice. An amendment adopted in 1995 made technical changes related

to abolishing the office of State Treasurer. In 2014, voters adopted an amendment that authorized the redirection of a portion of the revenue previously designated to be deposited into the ESF to instead be deposited into the State Highway Fund.

Figure 1 shows a history of ESF revenue, expenditures, ending balances, and the maximum amount of revenue that can be in the fund (ESF cap).

More detailed information is available on this subject at the Interactive Graphics link of the Legislative Budget Board’s website <http://www.lbb.state.tx.us/Interactive.aspx>.

The CPA administers the fund pursuant to requirements set in the Texas Constitution. The constitution prescribes how

**FIGURE 1
ECONOMIC STABILIZATION FUND, AMOUNTS IN MILLIONS, FISCAL YEARS 1990 TO 2015**

FISCAL YEAR	OIL PRODUCTION TAX-RELATED TRANSFER	NATURAL GAS PRODUCTION TAX-RELATED TRANSFER	UNENCUMBERED BALANCE TRANSFER	INTEREST	EXPENDITURES	ENDING BALANCE	ECONOMIC STABILIZATION FUND CAP
1990		\$18.5		\$0.8		\$19.3	\$2,591.0
1991		\$7.8		\$1.9	(\$29.0)	\$0.0	\$2,591.0
1992	\$118.0	\$18.4	\$20.2	\$6.8		\$163.4	\$2,957.4
1993				\$7.4	(\$119.0)	\$51.7	\$2,957.4
1994		\$31.0		\$3.0	(\$56.6)	\$29.1	\$4,135.0
1995				\$0.6	(\$21.5)	\$8.1	\$4,135.0
1996				\$0.4	(\$0.5)	\$8.0	\$4,788.9
1997				\$0.4		\$8.5	\$4,788.9
1998		\$47.5		\$2.3		\$58.3	\$5,701.8
1999		\$17.9		\$3.8		\$80.0	\$5,701.8
2000				\$4.7		\$84.7	\$6,674.9
2001		\$103.1		\$8.7		\$196.5	\$6,674.9
2002		\$685.8		\$21.6		\$903.9	\$7,475.6
2003		\$83.6		\$19.4	(\$446.5)	\$560.5	\$7,475.6
2004		\$352.6		\$5.5	(\$553.0)	\$365.6	\$7,451.3
2005		\$594.5		\$17.3	(\$970.5)	\$6.9	\$7,451.3
2006	\$112.1	\$793.0		\$21.5	(\$528.3)	\$405.2	\$9,182.5
2007	\$247.3	\$1,304.5		\$65.8	(\$691.5)	\$1,331.4	\$9,182.5
2008	\$226.9	\$971.8	\$1,779.9	\$136.0	(\$90.5)	\$4,355.4	\$10,847.7
2009	\$678.3	\$1,563.7		\$128.8	(\$0.4)	\$6,725.7	\$10,847.7
2010	\$263.9	\$606.0		\$97.0		\$7,692.6	\$11,883.9
2011	\$357.2	\$94.3		\$67.0	(\$3,198.7)	\$5,012.4	\$11,883.9
2012	\$705.2	\$382.5		\$33.3		\$6,133.4	\$12,126.3
2013	\$1,177.9	\$701.1		\$29.6	(\$1,871.8)	\$6,170.2	\$12,126.3
2014	\$1,843.3	\$671.6		\$24.5	(\$2,006.0)	\$6,703.5	\$14,086.0
2015	\$1,252.7	\$487.4		\$31.1	(\$11.8)	\$8,462.9	\$14,086.0

NOTE: The ending balance in fiscal year 2015 and interest income in fiscal year 2015 are estimated.

SOURCE: Comptroller of Public Accounts, Annual Cash Report, 2015; Comptroller of Public Accounts, Certification Revenue Estimate, December 2013.

revenue is deposited to the fund, how money can be appropriated from the fund, and the maximum amount of revenue that can be in the fund.

REVENUE DEPOSITED TO THE ECONOMIC STABILIZATION FUND

The Texas Constitution specifies seven ways revenue can be deposited to the ESF, as shown in **Figure 2**.

Details and historical information regarding the revenue sources that make up the majority of the ESF’s balance are further described in the following sections.

OIL- AND NATURAL GAS-RELATED DEPOSITS

Two sources of revenue deposited to the ESF are transfers linked to oil and natural gas severance taxes. As a result of a constitutional amendment adopted in 2014, these transfers are divided between the ESF and the State Highway Fund. If oil production tax collections in a fiscal year exceed collections of that tax in fiscal year 1987 (\$531.9 million), CPA allocates revenue from the General Revenue Fund to the ESF and the State Highway Fund. The allocation is equal to 75 percent of the amount of collections in excess of fiscal year 1987 collections. The ESF receives at least half of the allocation, an amount equal to 37.5 percent of oil tax collections in excess of the threshold. A transfer linked to natural gas tax collections works the same way. If natural gas tax collections

**FIGURE 2
HOW REVENUE IS DEPOSITED TO THE ECONOMIC STABILIZATION FUND, FISCAL YEARS 2014 TO 2025**

PROVISION OF THE TEXAS CONSTITUTION, ARTICLE III, SECTION 49-G		SUBSECTION	CIRCUMSTANCE	AMOUNT	WHEN/NOT LATER THAN
1	Oil Tax-Related	(d)	When oil tax collections in a fiscal year exceed fiscal year 1987 collections	General Revenue Fund transfer equal to at least 37.5 percent of the amount above fiscal year 1987 collections	90th day of the next fiscal year
2	Natural Gas Tax-Related	(e)	When natural gas tax collections in a fiscal year exceed fiscal year 1987 collections	General Revenue Fund transfer equal to at least 37.5 percent of the amount above fiscal year 1987 collections	90th day of the next fiscal year
3	Unencumbered Balance	(b)	When there is a General Revenue Fund unencumbered balance at the end of a biennium	One-half of any General Revenue Fund unencumbered balance	90th day of the biennium
4	Appropriations to the Fund	(f)	When the Texas Legislature makes an appropriation to the fund	Amount appropriated	Effective date of appropriation or as directed by the appropriation
5	Interest on Deposits	(i and j)	When there is a cash balance in the fund and ESF balance is less than the cap	Interest earned on average daily balance (calculated as if no interfund borrowing from ESF has occurred)	Monthly
6	Repayment of Interfund Borrowing	(j)	After revenue is borrowed from the ESF to prevent or eliminate a temporary cash deficiency in the General Revenue Fund	Amount borrowed	Not later than August 31 of each odd-numbered year
7	Recoupment of Excess Appropriation	(l)	When the actual biennium-to-biennium decrease in revenue is less than appropriations made pursuant to subsection (l)	Amount by which appropriations pursuant to subsection (l) exceed the actual biennium-to-biennium decrease in revenue	After the end of the fiscal year

NOTES:

(1) ESF = Economic Stabilization Fund.

(2) The allocation pursuant to subsections (d) and (e) can be increased to as high as 75 percent through legislative actions, pursuant to the Texas Government Code, Section 316.092. By statute, the allocation to the ESF increases to 75 percent after fiscal year 2025.

SOURCE: Legislative Budget Board.

in a fiscal year exceed collections of that tax in fiscal year 1987 (\$599.8 million when adjusted to reflect 12 months of collections), CPA transfers an amount from the General Revenue Fund to the ESF and the State Highway Fund. This amount is equal to 75 percent of collections in excess of \$599.8 million. The ESF receives at least half the allocation. The oil tax-related transfer and natural gas tax-related transfer to the ESF occur by the 90th day following the end of the fiscal year.

OIL- AND NATURAL GAS-RELATED DEPOSITS BEFORE THE 2014 CONSTITUTIONAL AMENDMENT

Before the constitutional amendment adopted in 2014, CPA transferred from the General Revenue Fund to the ESF an amount equal to 75 percent of oil production tax collections or natural gas tax collections in excess of the 1987 thresholds. **Figure 3** shows the oil and natural gas tax-related transfer before fiscal year 2015.

The 2014 constitutional amendment redirects as much as half of the oil- and natural gas tax-related transfers to the State Highway Fund. In addition, a temporary provision of the amendment dealt with the fiscal year 2015 oil- and natural gas-related transfers. It required the CPA to reverse fiscal year 2015 transfers to the ESF made before the effective date of the amendment, then allocate revenue to the ESF and State Highway Fund as if the November 2014 amendment had been in effect.

The amendment also required a process to ensure a sufficient ESF balance for the purpose of determining transfers to the State Highway Fund. House Bill 1, Eighty-third Legislature, Third Called Session, 2013, established this procedure. Before each regular session of the Legislature, the Speaker of the House and the Lieutenant Governor are to each appoint

five members to a select committee. This committee is required to adopt an amount considered to be a sufficient balance for the ESF, and to submit the amount to each legislative chamber as a concurrent resolution for approval or amendment. If the Legislature does not adopt a balance, the amount submitted by the select committee becomes the sufficient balance. The CPA is required to reduce the allocation of oil- and natural gas tax-related transfers to the State Highway Fund to maintain the sufficient ESF balance, as adopted by the committee. If neither the committee nor the Legislature adopts a sufficient balance, CPA is required to make the entire allocation to the ESF, and there would be no allocation to the State Highway Fund. Pursuant to provisions of House Bill 1, Third Called Session, allocations to the State Highway Fund will end after fiscal year 2025, and the oil- and natural gas tax-related transfers to the ESF will revert to 75 percent of the amounts greater than the respective 1987 thresholds.

A temporary provision governs the transfers in fiscal years 2015, 2016, and 2017. In fiscal year 2015, the committee had 30 days after final canvass of the election to adopt the sufficient balance. CPA made a \$3.5 billion oil- and natural gas-related transfer from the General Revenue Fund to the ESF in November 2014. The select committee met on December 11, 2014 and set the sufficient balance for the ESF at \$7.0 billion for fiscal year 2015 and \$7.0 billion for 2016–17 biennium, thus allowing the maximum transfer to the State Highway Fund in fiscal year 2015.

After the actions of the committee, CPA transferred \$3.5 billion from the ESF back to the General Revenue Fund. The CPA then transferred \$1.7 billion from the General Revenue Fund to each the ESF and State Highway Fund, bringing the ESF balance to \$8.5 billion on December 15, 2014.

**FIGURE 3
CONSTITUTIONAL PROVISION GOVERNING OIL AND NATURAL GAS TAX-RELATED TRANSFERS BEFORE FISCAL YEAR 2015
AND AFTER FISCAL YEAR 2025**

PROVISION THE TEXAS CONSTITUTION, ARTICLE III, SECTION 49-G	SUBSECTION	CIRCUMSTANCE	AMOUNT	NOT LATER THAN
Oil Tax-Related (Changed)	(d)	When oil tax collections in a fiscal year exceed fiscal year 1987 collections	General Revenue Fund transfer equal to 75 percent of the amount above fiscal year 1987 collections	90th day of each fiscal year
Natural Gas Tax-Related (Changed)	(e)	When natural gas tax collections in a fiscal year exceed fiscal year 1987 collections	General Revenue Fund transfer equal to 75 percent of the amount above fiscal year 1987 collections	90th day of each fiscal year

NOTE: Pursuant to current law, the transfers to the Highway Fund end after fiscal year 2025.
SOURCE: Legislative Budget Board.

OIL PRODUCTION TAX-RELATED TRANSFERS

Oil production tax-related transfers to the ESF have been made 11 times. The first oil tax-related transfer was made in fiscal year 1992, based on fiscal year 1991 tax collections. From fiscal years 1992 to 2004, oil tax receipts were less than receipts in fiscal year 1987. As a result, no oil tax-related transfers were made in fiscal years 1993 to 2005. The CPA has made an oil tax-related transfer each fiscal year since 2005. **Figure 4** shows oil production tax collections and the 1987 collection threshold used to calculate General Revenue Fund transfers to the ESF.

With the introduction of enhanced recovery techniques such as hydraulic fracturing and horizontal drilling in the oil-rich Eagle Ford Shale and Permian Basin coupled and declining in drilling activity in the natural gas-rich Barnett Shale, the oil tax-related transfer has become the primary source of revenue to the ESF in recent years. Oil tax-related transfers have accounted for 67.8 percent of deposits since fiscal year 2012.

The production decline rate in individual enhanced recovery wells is precipitous. One study indicates that production from the average well in the Eagle Ford decreases by 60 percent in the first year and by 96 percent in the first three years. As a result, the continuation of current levels of oil production tax-related deposits to the ESF is dependent on new drilling activity which, in turn, is dependent on oil prices sufficient to keep production profitable. In 2013, Baker Hughes estimated the breakeven oil price in the liquid-rich areas of the Eagle Ford play is between \$50 and \$57 per barrel. Similarly, a publication by the Texas Taxpayer and Research Association estimated that drilling will be viable in

the Eagle Ford and Permian Basin unless oil prices drop below \$60 per barrel for a sustained period. Standard and Poors estimated that to be economically viable the U.S. tight oil plays require a sustained price of West Texas Intermediate (WTI) Crude Oil ranging from \$46 per barrel in the most cost-effective areas to \$73 per barrel in less cost-effective areas.

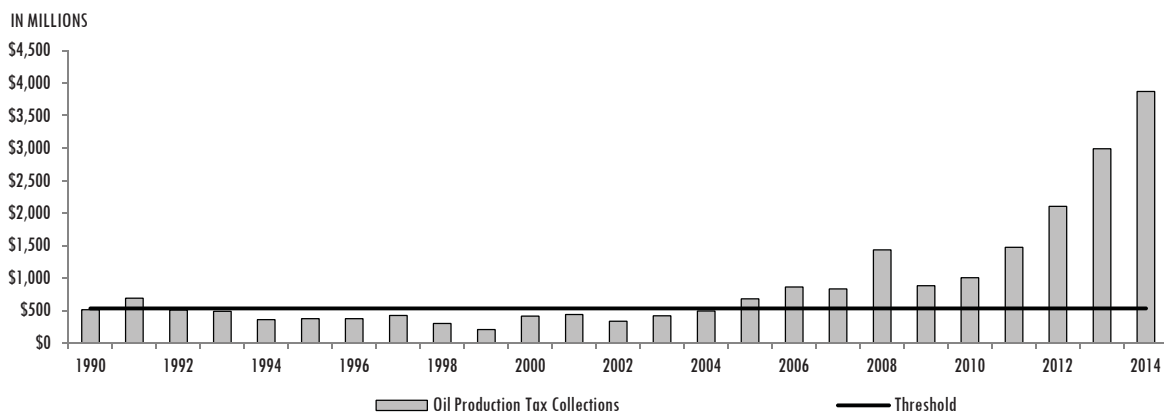
Between June 20, 2014 and December 1, 2014, the price of West Texas Intermediate Crude declined from \$107.95 to \$68.98 a barrel. In the Short-term Energy Outlook, December 2014, the Energy Information Agency (EIA) forecasts WTI crude oil prices to average \$62.75 in calendar year 2015. EIA expects 2015 drilling activity to decline in some areas, but expects oil prices to remain high enough to support drilling in proven areas of the Eagle Ford and Permian Basin.

NATURAL GAS TAX-RELATED TRANSFERS

Natural gas tax-related transfers to the ESF have totaled \$9.5 billion, 50.0 percent of all deposits to the ESF. In 21 of the 26 fiscal years since fiscal year 1988, natural gas tax collections have exceeded the 1987 collections threshold, as shown in **Figure 5**.

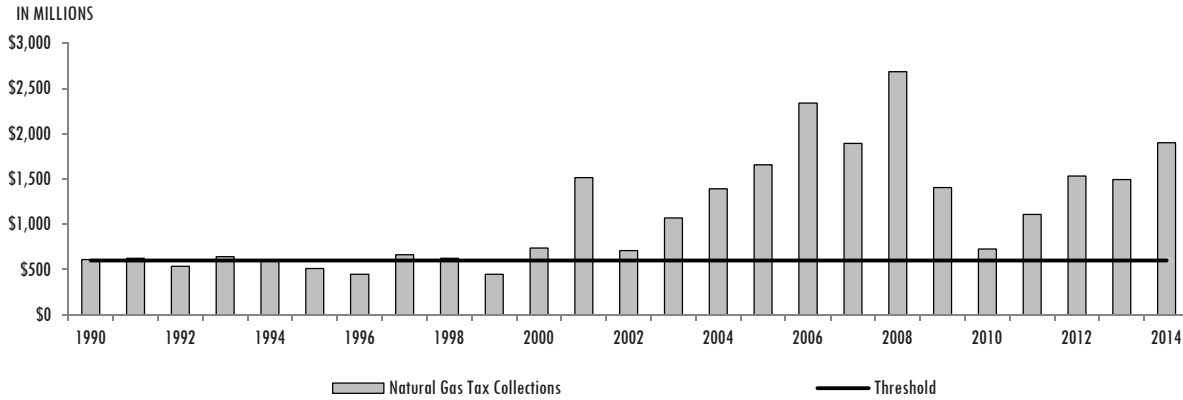
The emergence of natural gas production from shale coupled with a spike in the natural gas price is responsible for historically high natural gas tax collections in 2006 to 2008. Natural gas tax collections peaked at \$2.7 billion in fiscal year 2008, but collections decreased as natural gas well-head prices decreased from \$8.51 per thousand cubic feet (Mcf) in calendar year 2008 to \$3.81 per Mcf in calendar year 2009. As natural gas prices decreased to near or below the breakeven

**FIGURE 4
OIL PRODUCTION TAX COLLECTIONS AND ECONOMIC STABILIZATION FUND THRESHOLD, FISCAL YEARS 1990 TO 2014**



SOURCE: Comptroller of Public Accounts.

FIGURE 5
NATURAL GAS TAX COLLECTIONS AND ECONOMIC STABILIZATION FUND THRESHOLD
FISCAL YEARS 1990 TO 2014



SOURCE: Comptroller of Public Accounts.

point, the number of new wells drilled in the Barnett Shale decreased. Drilling in the Barnett Shale peaked in 2009, with 3,594 wells completed. In 2013, completions in the Barnett Shale totaled approximately 800 wells, a decrease of 77.7 percent. However, natural gas tax collections have remained greater than the ESF transfer threshold. This maintained collections rate is in part because the Eagle Ford has yielded significant amounts of dry natural gas, condensates, and other natural gas liquids. Condensates, liquid hydrocarbon recovered from gas by a separator, are taxed pursuant to the natural gas tax statutes. Revenue from the tax on condensate is considered natural gas tax. The tax rate for condensate is the same as the tax rate for crude oil, 4.6 percent of market value. Natural gas tax revenue from condensates, which accounted for only 5.0 percent of natural gas tax collections in 2004, accounted for 29.0 percent of natural gas tax collections in fiscal year 2014. As with oil, the decline rate for individual enhanced gas wells is precipitous. Continued deposits to the ESF from transfers linked to natural gas tax collections are dependent on continued drilling activity for natural gas or natural gas liquids, or on natural gas production from wells drilled primarily for oil. Some drilling for dry gas is continuing at current prices. The Bureau of Economic Geology, a research unit at The University of Texas at Austin, has conducted a detailed study of the Barnett Shale. The researchers estimate that, at a price of \$4.00 per Mcf, drilling would remain economically viable in the most productive areas of the Barnett Shale. **Figure 6** shows the number of oil and gas wells completed from 1960 through 2013.

EFFECT OF INFLATION ON THE OIL AND GAS TAX THRESHOLDS

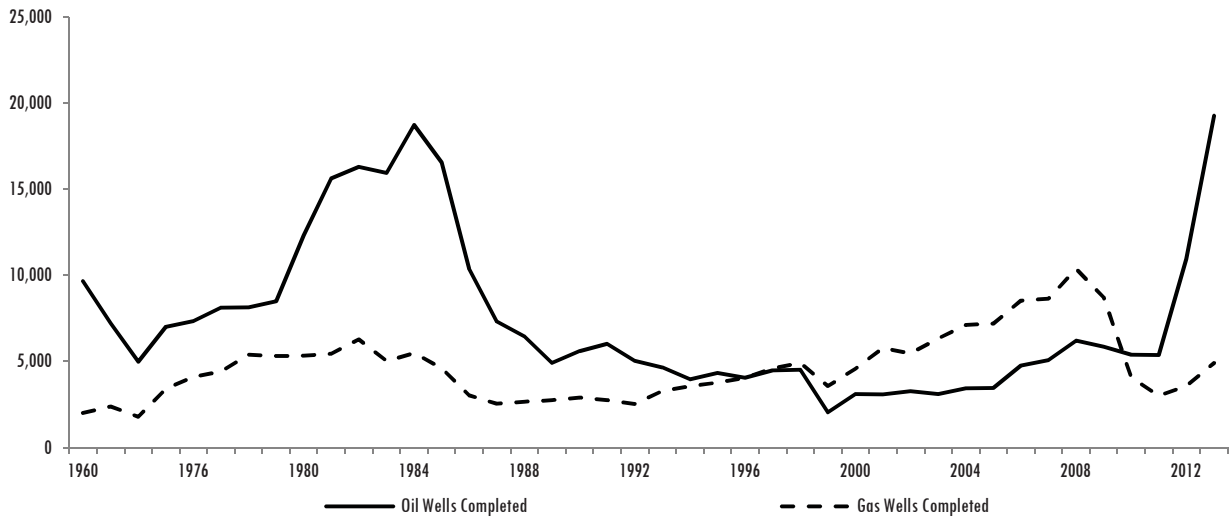
The calculation of the transfers linked to the natural gas tax and the oil production transfer are based on 1987 collection levels. The thresholds are not adjusted for inflation. Oil- and natural gas-related transfers to the ESF would have been approximately half of what actually has been transferred if the bases had been adjusted for inflation, using the Consumer Price Index, to maintain the purchasing power of General Revenue Funds.

UNENCUMBERED BALANCE TRANSFER

If, at the end of any biennium, the General Revenue Fund shows an unencumbered balance, the CPA transfers half of the unencumbered balance to the ESF by the 90th day of the next biennium. An encumbrance is a liability, contract, purchase order, payroll due, or other obligation to pay that has not yet been paid.

The transfer of one-half of the unencumbered General Revenue Fund balance to the ESF has been a relatively minor source of revenue, accounting for only \$1.8 billion or 9.4 percent of all deposits to the fund. The ending Consolidated General Revenue Balance, which consists of the General Revenue (Fund 1, Account 1) cash balance and the cash balances in General Revenue–Dedicated Accounts, has been positive at the end of each biennium since the ESF was established. The General Revenue Fund (Fund 1, Account 1) had a positive ending cash balance at the end of 9 of the 12 biennia since transfers to the ESF began, as shown in **Figure 7**.

FIGURE 6
OIL AND NATURAL GAS WELLS COMPLETED IN TEXAS, CALENDAR YEARS 1960 TO 2013



SOURCE: Texas Railroad Commission.

FIGURE 7
GENERAL REVENUE CONSOLIDATED AND GENERAL REVENUE FUND (FUND 1, ACCOUNT 1) BIENNIAL ENDING BALANCES, 1990 TO 2013

BIENNIUM	CONSOLIDATED GENERAL REVENUE ENDING BALANCE (IN MILLIONS)	GENERAL REVENUE, FUND 1, ACCOUNT 1, ENDING BALANCE (IN MILLIONS)
1990–91	N/A	\$1,006.4
1992–93	\$1,633.5	\$448.8
1994–95	\$2,110.8	\$668.3
1996–97	\$2,685.5	\$1,055.9
1998–99	\$4,336.5	\$1,654.2
2000–01	\$4,963.1	\$2,257.9
2002–03	\$409.0	(\$1,975.8)
2004–05	\$4,801.2	\$1,365.9
2006–07	\$12,406.5	\$7,985.3
2008–09	\$3,907.7	(\$1,005.2)
2010–11	\$2,637.3	(\$2,694.6)
2012–13	\$8,565.6	\$2,755.4

SOURCE: Comptroller of Public Accounts.

Despite the positive balances, there have been only two unencumbered balance transfers to the ESF. General features of the state’s accounting and budgeting practices make achieving an unencumbered balance difficult. Certification of the state budget, pursuant to the Texas Constitution, Article III, Section 49a, “Pay As You Go Limit,” is on a cash

basis. The CPA can certify an appropriations bill if the appropriations contained in the bill will not cause a cash deficit in the Consolidated General Revenue Fund at the end of the biennium. For purposes other than certification, the state uses a modified accrual method of accounting, which records encumbrances. Certification on a cash basis can allow high levels of encumbrances against the General Revenue Fund. In addition, the inclusion of General Revenue–Dedicated balances in the amount available for General Revenue Funds certification allows appropriations to exceed the amount of revenue in General Revenue (Fund 1, Account 1). Furthermore, the timing of some payments and allocation of some revenues from the General Revenue Fund add to the amount of encumbrances. Factors affecting the level of encumbrances include:

- state employees’ August salaries are paid in September and therefore count as an encumbrance against the ending balance;
- the ending General Revenue Fund balance typically includes revenue from one month of constitutionally dedicated motor fuel taxes to be allocated to the State Highway Fund and the Available School Fund, which is transferred in September;
- the ending General Revenue Fund balance includes one month of oil production tax, natural gas tax, utility tax, insurance tax, and other occupations taxes; 25 percent of these are dedicated to education

and transferred to the Foundation School Fund in September;

- the CPA considers the set-asides for transfers to the ESF from oil and natural gas tax collections as encumbrances; and
- unappropriated balances in General Revenue–Dedicated accounts are included in the Consolidated General Revenue Fund balance as a result of fund consolidation, and the CPA deducts them from the consolidated balance because of the statutory dedication of the revenue in those accounts.

Figure 8 shows the calculation of the unencumbered balance at the end of the 2012–13 biennium, illustrating the high level of encumbrances compared to the ending balance. Although the ending General Revenue Fund consolidated balance was \$8.6 billion, deductions totaled \$14.6 billion, exceeding the cash balance by \$6.1 billion.

Fund consolidation has limited the occurrence of the unencumbered balance transfer to the ESF. Since 1991, General Revenue–Dedicated account balances have been counted toward certification of appropriations from the General Revenue Fund. Counting General Revenue–Dedicated balances as available for certification allows appropriations from the General Revenue Fund (Fund 1, Account 1) to exceed the amount of revenue estimated to be in the fund. As a result, if the CPA’s revenue estimates are accurate, and the Legislature appropriates all or nearly all the revenue available for certification, there will be no positive cash balance in the General Revenue Fund and no balance transfer to the ESF. The positive General Revenue Fund cash

balances since 1995 are primarily attributable to revenue collections exceeding CPA estimates.

The Eighty-third Legislature, Regular Session, 2013, enacted several changes that reduced the amount of General Revenue–Dedicated account balances available for certification of the General Revenue Funds budget; the available General Revenue–Dedicated balances were reduced from \$4.9 billion in the 2012–13 biennium to \$4.2 billion in the 2104–15 biennium. The Legislature also initiated a process to further reduce reliance on General Revenue–Dedicated Fund accounts during the next three biennia. If the reliance on General Revenue–Dedicated Fund balances is reduced, unencumbered balance transfers could become more likely.

STABILIZATION FUND INTEREST

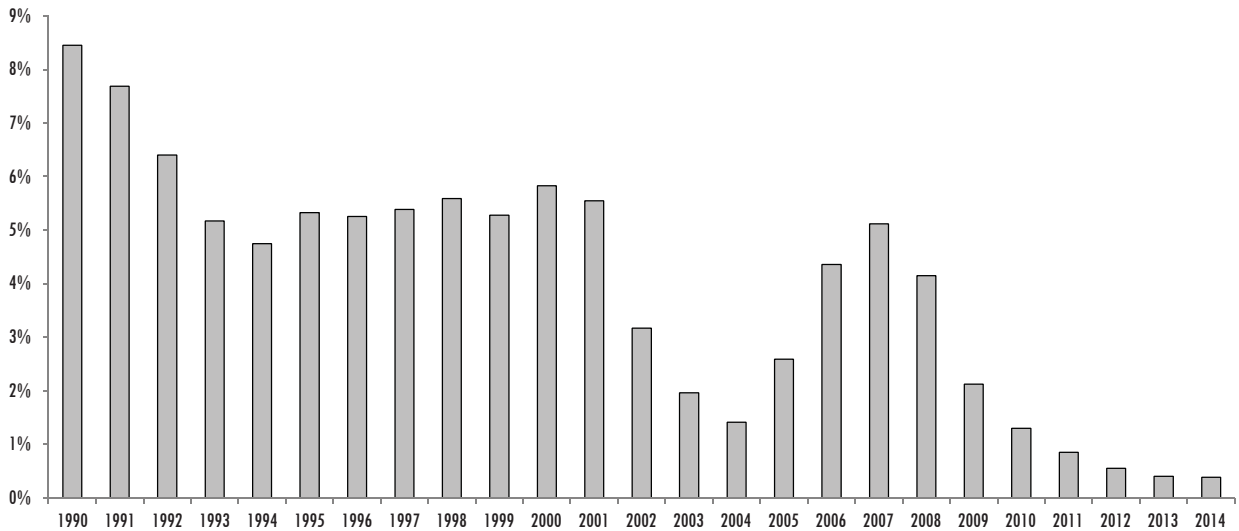
Interest deposits to the ESF totaled \$708.1 million through fiscal year 2014. The CPA invests the ESF balance in the Texas Treasury Pool. The investment objectives of the pool are: preservation of capital and protection of principal; maintenance of sufficient liquidity to meet the state’s operating needs; and maximization of return. Liquid assets consist primarily of U.S. Treasury securities; debt of government-sponsored entities; repurchase transactions; high-quality corporate debt; and asset-backed securities. In the current low interest rate environment, interest deposits to the ESF have been modest considering the multibillion dollar balance in the fund. **Figure 9** shows the annual average of the monthly rates of return on the Texas Treasury Pool. House Bill 2770, Eighty-third Legislature, Regular Session, 2013, would have authorized the CPA to invest one-third of

**FIGURE 8
CALCULATION OF UNENCUMBERED BALANCE TRANSFER TO THE ECONOMIC STABILIZATION FUND
AUGUST 31, 2013**

Consolidated General Revenue Fund Balance, August 31, 2013	\$8.6
DEDUCTIONS	
General Revenue–Dedicated Account Balances	(\$5.8)
Motor Fuel Tax for Allocation	(\$0.3)
Occupation Taxes for Allocation	(\$0.7)
August Payroll (Paid September 1)	(\$0.5)
Accounts Payable	(\$2.4)
Other Encumbrances	(\$2.5)
Set-Aside for Transfer to ESF	(\$2.5)
TOTAL DEDUCTIONS	(\$14.6)
AMOUNT BY WHICH ENCUMBRANCES EXCEED THE ENDING BALANCE	\$6.1

SOURCE: Comptroller of Public Accounts.

FIGURE 9
TEXAS' TREASURY POOL RATES, FISCAL YEARS 1990 TO 2014



SOURCE: Comptroller of Public Accounts.

the ESF balance in assets other than bonds, securities, and other assets that are issued or otherwise guaranteed by the U.S. government or its agencies or instrumentalities of the United States. The bill did not pass.

INTERFUND BORROWING AND REPAYMENT, APPROPRIATIONS TO THE ECONOMIC STABILIZATION FUND, AND RECOUPMENT OF EXCESS APPROPRIATIONS

The Texas Constitution authorizes CPA to transfer money from the ESF to the General Revenue Fund to prevent or eliminate a temporary cash deficiency and sets forth requirements for interfund borrowing and repayment. The CPA has borrowed from the ESF in three different fiscal years to eliminate temporary cash shortfalls in the General Revenue Fund. The CPA borrowed \$150 million in December 1991 and repaid the ESF in February 1992. The CPA borrowed \$151 million in March 1992, repaid \$1 million in the same month, and the remainder in August 1992. The CPA borrowed \$100 million from the ESF in January 1993 and repaid the ESF in March 1993. In August 2003, the CPA borrowed \$500 million from the ESF and repaid the ESF the same month.

The Legislature is authorized by the Texas Constitution to appropriate revenue to the ESF, but has never done so. There has never been a recoupment of an excess appropriation as authorized by Texas Constitution, Article 49-g, Subsection (l).

APPROPRIATIONS FROM THE ECONOMIC STABILIZATION FUND

Pursuant to the Texas Constitution, appropriations may be made from the ESF in three circumstances, as shown in **Figure 10**.

An appropriation may be made pursuant to the Texas Constitution, Article III, Section 49-g, Subsection (k), if the CPA certifies that appropriations from General Revenue Funds made by the preceding legislature for the current biennium exceed available revenues and cash balances. This requires approval by a three-fifths vote of the members present in each house. Appropriations in a regular session pursuant to this subsection can be made only for a purpose for which an appropriation from General Revenue Funds was made by the preceding legislature. In a special session, appropriations pursuant to Subsection (k) can be made only for a purpose for which an appropriation from General Revenue Funds was made in an earlier session of the same legislature. The amount of the appropriations pursuant to Subsection (k) cannot exceed the estimated deficit and can only be for the then current biennium. Since 1992, there have been two biennia (2004–05 and 2012–13) in which the CPA’s Biennial Revenue Estimate projected a negative balance. The Texas Legislature appropriated funds from the ESF pursuant to this provision one time, in 2011.

Pursuant to the Texas Constitution, Article III, Section 49-g, Subsection (l), when the CPA estimates the amount of

**FIGURE 10
CONSTITUTIONAL PROVISIONS GOVERNING APPROPRIATIONS FROM THE ECONOMIC STABILIZATION FUND
AS OF FISCAL YEAR 2015**

SUBSECTION	CIRCUMSTANCE	RESTRICTION	VOTE
(k)	Deficit in current biennium	<ul style="list-style-type: none"> Not greater than deficit Regular Session: only for a purpose funded by previous Legislature Special Session: for a purpose funded by earlier session of same Legislature Only for the current biennium 	3/5 of members present
(l)	CPA estimates that revenue decreases from current biennium to the next biennium	Not greater than revenue decrease/recoupment of over-appropriation	3/5 of members present
(m)	Any time, any purpose	None	2/3 of members present

NOTE: CPA = Texas Comptroller of Public Accounts.
SOURCE: Legislative Budget Board.

revenue, adjusted for tax rate or base changes, in the upcoming biennium will decrease relative to the amount available in the then current biennium, the Texas Legislature may make appropriations from the ESF with a three-fifths vote of the members present in each house. This section has a recoupment clause; if the actual biennial revenue decrease is less than the amount appropriated pursuant to Subsection (l), the CPA transfers the difference from the General Revenue Fund to the ESF. This calculation and transfer occurs after the end of each fiscal year. Since 1992, there have been three Biennial Revenue Estimates in which the CPA estimated biennium-to-biennium revenue to decrease.

In addition, the Texas Constitution, Article III, Section 49-g, Subsection (m), authorizes the Legislature to make

appropriations from the ESF at any time for any purpose with a two-thirds vote of the members present in each house.

ACTS MAKING APPROPRIATIONS FROM THE ECONOMIC STABILIZATION FUND

The Texas Legislature has passed seven bills appropriating revenue from the ESF, as shown in **Figure 11**. Appropriations from the fund total \$10.7 billion to date.

SENATE BILL 11, SEVENTY-FIRST LEGISLATURE, SIXTH CALLED SESSION, 1990

In 1989, the Texas Supreme Court ruled the state’s school funding mechanism unconstitutional and set a May 1, 1990, deadline for the Texas Legislature to establish a constitutional funding mechanism. Senate Bill 11, Seventy-first Legislature,

**FIGURE 11
ACTS MAKING APPROPRIATIONS FROM THE ECONOMIC STABILIZATION FUND
FISCAL YEARS 1990 TO 2013**

ACT	APPROPRIATION (IN MILLIONS)	ESF AVAILABLE	PERCENTAGE OF AVAILABLE
Senate Bill 11, Seventy-first Legislature, Sixth Called Session, 1990	\$29.0	\$29.0	100%
Senate Bill 171, Seventy-third Legislature, Regular Session, 1993	\$125.8	\$197.8	100%
Senate Bill 532, Seventy-third Legislature, Regular Session, 1993	\$72.0		
House Bill 7, Seventy-eighth Legislature, Regular Session, 2003	\$1,260.5	\$1,297.6	97%
House Bill 10, Seventy-ninth Legislature, Regular Session, 2005	\$2,030.1	\$2,013.2	101%
House Bill 275, Eighty-second Legislature, Regular Session, 2011	\$3,198.7	\$9,405.3	34%
House Bill 1025, Eighty-third Legislature, Regular Session, 2013	\$3,936.2	\$11,756.4	33%
TOTAL	\$10,652.3		

NOTES:
 (1) Total may not sum due to rounding.
 (2) \$100 million of the House Bill 10 appropriation was contingent on transfers to the Economic Stabilization Fund exceeding the estimate.
 SOURCE: Legislative Budget Board.

Sixth Called Session, 1990, appropriated the entire ESF balance, almost \$29 million, to the Texas Education Agency (TEA) for distribution to school districts in accordance with the Foundation School Program. The ESF appropriation was part of a \$528.0 million increase in funds appropriated to TEA during that special session.

SENATE BILL 171, SEVENTY-THIRD LEGISLATURE, REGULAR SESSION, 1993

Senate Bill 171, Seventy-third Legislature, Regular Session, 1993, appropriated \$125.8 million to the Texas Department of Criminal Justice (TDCJ) from the ESF for fiscal year 1993. The appropriations were for the operation of additional prison capacity, and the operation of intermediate sanction facilities, grants, and court-ordered payments to counties.

SENATE BILL 532, SEVENTY-THIRD LEGISLATURE, REGULAR SESSION, 1993

Senate Bill 532, Seventy-third Legislature, Regular Session, 1993, appropriated the balance of the ESF, not to exceed \$72.0 million, to TDCJ for the implementation and operation of the new state jail system in the 1994–95 biennium. This appropriation was in response to litigation.

HOUSE BILL 7, SEVENTY-EIGHTH LEGISLATURE, REGULAR SESSION, 2003

The Seventy-eighth Legislature, Regular Session, 2003, faced an estimated \$1.8 billion deficit for fiscal year 2003 and an estimated \$5.9 billion revenue decrease from the 2002–03 biennium to the 2004–05 biennium. House Bill 7, the supplemental appropriations bill, appropriated \$1.3 billion from the ESF as follows:

- \$516.0 million to the Teacher Retirement System (TRS) for funding the TRS-Care retiree health insurance program;
- \$406.7 million to the state Health and Human Services Commission (HHSC) for the Medicaid acute care program for fiscal year 2003;
- \$295.0 million from the ESF to the Texas Enterprise Fund (TEF) to provide economic development initiatives, contingent on legislation establishing the fund. Of this appropriation, \$10.0 million was appropriated to the Special Events Trust Fund (now called the Other Events Trust Fund), contingent on the passage of legislation establishing that fund;
- \$26.4 million to HHSC for the Children’s Health Insurance Program;

- \$6.9 million to the Texas Department of Health for Medicaid programs, 2003;
- \$6.4 million to the Texas Department of Human Services (DHS) as reimbursement for disaster assistance payments;
- \$3.0 million to the CPA for payment of a judgment in *State of Texas v. U.S. Department of Health and Human Services*; and
- \$0.04 million to the State Commission on Judicial Conduct for conducting misconduct proceedings.

HOUSE BILL 10, SEVENTY-NINTH LEGISLATURE, REGULAR SESSION, 2005

House Bill 10, the supplemental appropriations bill, appropriated \$2.0 billion from the ESF as follows:

- \$560.0 million to TEA to fund the Foundation School Program;
- \$339.6 million to TEA for the purchase of textbooks;
- \$316.1 million to TEA for the Student Success Initiative;
- \$265.3 million to the Department of Family and Protective Services (DFPS) for foster homes and residential treatment;
- \$200.0 million to the Department of Family and Protective Services (DFPS) for the Child Protective Services program;
- \$126.0 million to DFPS for adoption subsidies; and
- \$100.0 million for 2006–07 to the Office of the Governor for deposit into the Texas Emerging Technology Fund, contingent on transfers to the ESF in excess of estimates;
- \$92.4 million to the HHSC for the state Medicaid program, including making supplemental hospital payments and restoring eligibility for Medicaid benefits to pregnant women with incomes of up to 185 percent of the federal poverty level; and
- \$30.7 million to TRS for funding the employee pass-through program.

HOUSE BILL 275, EIGHTY-SECOND LEGISLATURE, REGULAR SESSION, 2011

In 2011, the CPA estimated that the 2010–11 biennium would end with a \$4.3 billion deficit. House Bill 275 appropriated \$3.2 billion for CPA to make expenditures previously authorized by appropriations from General Revenue Funds for the 2010–11 biennium. House Bill 275 was enacted pursuant to the Texas Constitution, Article III, Section 49-g, Subsection (k), which applies only in a deficit situation and requires a three-fifths vote of the members present in each house.

HOUSE BILL 1025, EIGHTY-THIRD LEGISLATURE, REGULAR SESSION, 2013

House Bill 1025, the supplemental appropriations bill, addressed the cost of wildfires, restored the August 2013 Foundation School Fund transfer that had been delayed by the prior legislature, and funded the state water plan. House Bill 1025 appropriated \$3.9 billion from the ESF as follows:

- \$161.1 million to the Texas A&M Forest Service for costs related to wildfires;
- \$15.0 million to the Trusteed Programs within the Office of the Governor for wildfire recovery, remediation, and mitigation activities related to wildfires; recovery activities related to the plant explosion in West; and other disaster-related expenses;
- \$4.9 million to the Parks and Wildlife Department for costs related to wildfires at Bastrop State Park and the Bastrop regional park office;
- \$2.7 million to the Department of Public Safety for costs related to wildfires;
- \$2.0 billion to the State Water Implementation Fund of Texas for use by the Texas Water Development Board to finance projects in the state water plan. This appropriation was contingent on adoption of a constitutional amendment establishing the State Water Development Fund and State Water Implementation Revenue Fund. Texas voters adopted the amendment in November 2013;
- \$1.8 billion to TEA to fund the August 2013 Foundation School Program payment to school districts;
- \$1.7 million to the Texas A&M Engineering Extension Service to reimburse the agency for deployments for natural disasters; and

- \$0.9 million to the Texas Parks and Wildlife Department for state park operation.

Figure 12 shows appropriations from the ESF by purpose. Appropriations have not only addressed revenue shortfalls; appropriations have been made in response to court mandates, to respond to natural and human-made disasters, and to fund economic development initiatives.

**FIGURE 12
APPROPRIATIONS FROM THE ECONOMIC STABILIZATION FUND BY PURPOSE, FISCAL YEARS 1990 TO 2013**

PURPOSE	APPROPRIATION (IN MILLIONS)
Public Education	\$3,541.4
General Deficit Reduction	\$3,198.7
Economic Development	\$2,395.0
Health and Human Services	\$1,126.8
Corrections	\$197.8
Disaster Relief	\$192.6
Judicial	\$0.0
TOTAL	\$10,652.3

NOTE: Economic Development includes the \$2 billion State Water Implementation Fund.
SOURCE: Legislative Budget Board.

EFFECT OF APPROPRIATIONS FROM THE ESF ON THE LIMIT ON CERTAIN APPROPRIATIONS

The Texas Constitution, Article VIII, Section 22, Limit on Certain Appropriations, is commonly referred to as the “Spending Limit.” Section 22 states that in no biennium shall the rate of growth in appropriations from state tax revenue not dedicated by the constitution exceed the estimated rate of growth of the state’s economy.

The provision in the Texas Constitution relating to the ESF, which was adopted after the Article VIII spending limit, does not explicitly exempt ESF appropriations from the limit. The Legislative Budget Board (LBB), the agency charged by the Texas Constitution with calculating and adopting the Article VIII limit, has historically included appropriations of tax revenue from the ESF in the calculation of the limit.

In *Hendee v. Dewhurst*, the plaintiff contended that appropriations for the 2008–09 biennium exceeded the limit. In establishing the 2006–07 biennial appropriations base used to establish the limit, the LBB included appropriations from tax revenue in the ESF made in House Bill 10, Seventy-ninth Legislature, Regular Session, 2005.

The court upheld the LBB limit calculation, which included the ESF appropriations.

During the Eighty-third Legislature, Regular Session, 2013, the chairman of the House Committee on Appropriations asked the Office of the Attorney General for advice on the issue. In May 2013, the Attorney General released a letter giving informal advice on the application of the Article VIII, Section 22, Limit on Certain Appropriations, to appropriations from the ESF. The Attorney General advised that the constitution’s plain terms lead to the conclusion that funds in the ESF are not “dedicated” by the Texas Constitution and therefore must be counted toward the constitutional spending limit. The Attorney General’s letter reasoned that because ESF funds may be used “at any time and for any purpose” with a two-thirds vote of both houses, the funds are not “dedicated,” as that term is commonly understood. In addition, the Attorney General advised that only a constitutional amendment approved by Texas voters could remove ESF funds from the spending limit calculations.

ECONOMIC STABILIZATION FUND CAP

The Texas Constitution, Article III, Section 49-g, Subsection (g) limits the ESF balance, as follows:

“During each fiscal biennium, the amount in the economic stabilization fund may not exceed an amount equal to 10 percent of the total amount, excluding investment income, interest income, and amounts

borrowed from special funds, deposited in general revenue during the preceding biennium.”

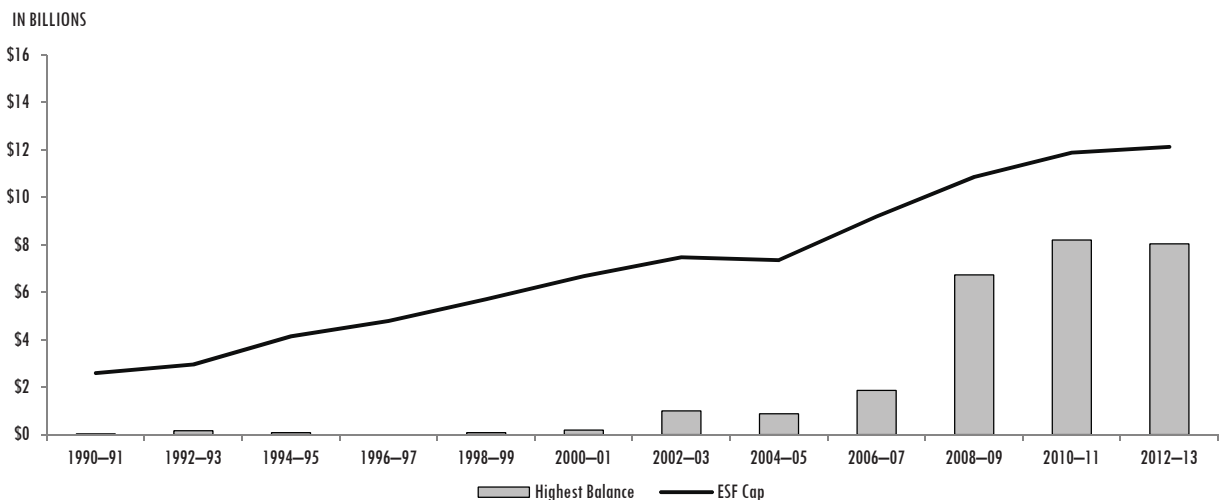
If the ESF reaches or approaches the cap, the CPA is required to eliminate or reduce transfers to the ESF to prevent the balance from exceeding the limit. Also, if the balance reaches or approaches the cap, the CPA is required to credit excess interest earned on the ESF balance to the General Revenue Fund. The Texas Constitution does not address a situation in which the ESF balance exceeds the cap because the cap decreases from one biennium to the next.

The ESF balance has never exceeded 72 percent of the cap. The cap for the 2014–15 biennium is \$14.1 billion. The highest balance during fiscal year 2014 was \$6.7 billion, 47.6 percent of the cap. **Figure 13** shows the ESF cap each biennium compared to the highest balance in the ESF that occurred at any point during that biennium.

The ESF cap has increased faster than General Revenue Funds spending. In fiscal year 1990, the ESF cap was 18.7 percent of General Revenue Funds spending. The cap for the 2012–13 biennium was 28.8 percent of fiscal year 2013 General Revenue Funds spending. **Figure 14** shows the ESF cap as a percentage of annual General Revenue Funds spending.

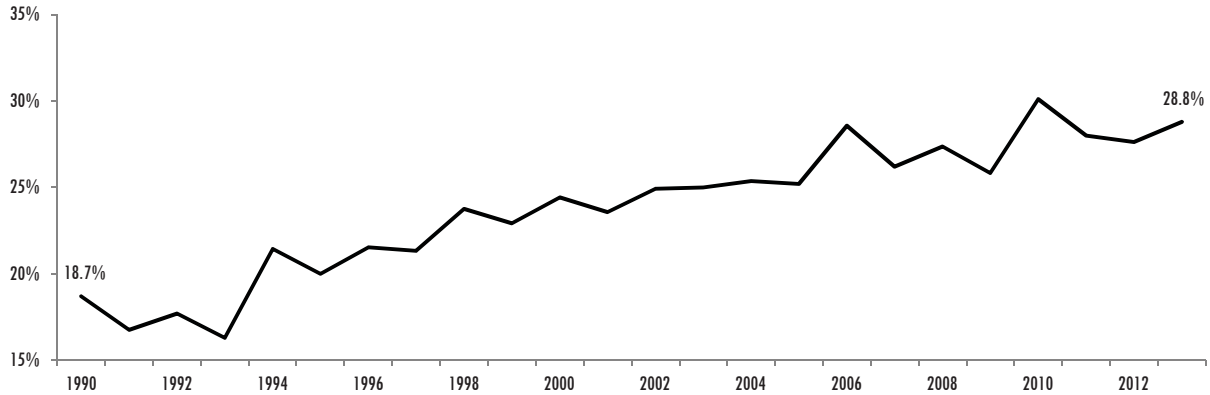
The ESF cap for the 2014–15 biennium is equivalent to 29.1 percent of fiscal year 2015 General Revenue Funds appropriations. This limit is well in excess of most state caps

**FIGURE 13
ECONOMIC STABILIZATION FUND CAP COMPARED TO THE MAXIMUM BALANCE, 1990–91 TO 2012–13 BIENNA**



SOURCE: Comptroller of Public Accounts.

FIGURE 14
ECONOMIC STABILIZATION FUND CAP AS A PERCENTAGE OF ANNUAL GENERAL REVENUE SPENDING
FISCAL YEARS 1990 TO 2013



SOURCE: Legislative Budget Board.

and many public policy groups’ recommendation for stabilization fund balances or caps.

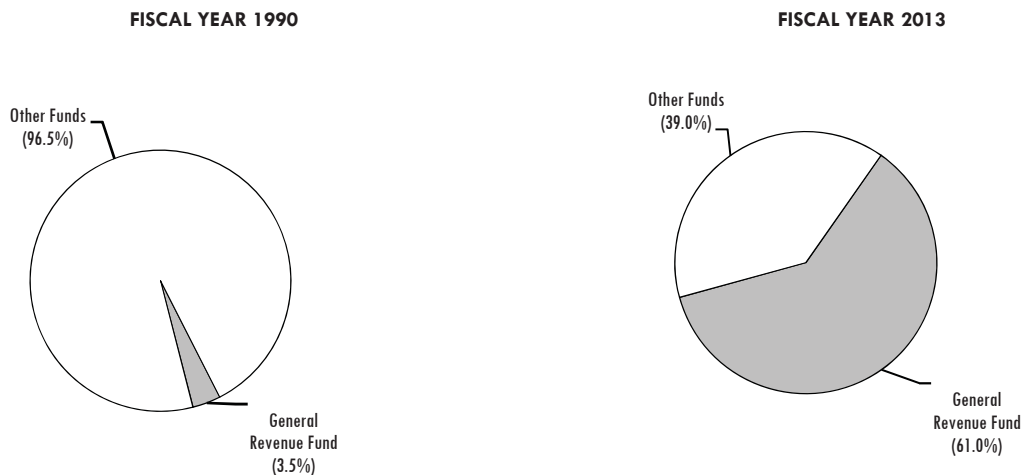
The cap has grown relative to General Revenue Funds spending for two reasons: the deposit of federal funds directly into the General Revenue Fund, and an increase in federal funds. Prior to fund consolidation, most federal funds were deposited in special funds outside the General Revenue Fund. In fiscal year 1990, 3.5 percent of federal funds were deposited to the General Revenue Fund. Since fund consolidation, a greater amount and percentage of the federal funds received by the state have been deposited to the General Revenue Fund. In fiscal year 2013, 61.1 percent of Federal Funds were deposited to the General Revenue Fund.

Figure 15 shows a comparison of the percentage of federal funds deposits to General Revenue in fiscal years 1990 and 2013.

The amount of revenue deposited to the General Revenue Fund attributable to federal funds increased from \$207.5 million in fiscal year 1990 to \$20.8 billion in fiscal year 2013. Much of this increase is attributable to the increase in federal revenue for Medicaid. Medicaid spending of federal funds increased from \$2.0 billion in federal fiscal year 1990 to \$15.2 billion in federal fiscal year 2013.

In fiscal year 1990, federal funds accounted for 1.5 percent of deposits to the General Revenue Fund. In fiscal year 2013,

FIGURE 15
PERCENTAGE OF FEDERAL FUNDS DEPOSITED TO THE GENERAL REVENUE FUND, FISCAL YEARS 1990 AND 2013



SOURCE: Comptroller of Public Accounts.

federal funds accounted for 28.7 percent of deposits to the General Revenue Fund. **Figure 16** compares the percentage of General Revenue Funds attributable to federal funds in fiscal years 1990 and 2013.

If federal funds had not been deposited to the General Revenue Fund during the 2012–13 biennium, the ESF cap for the 2014–15 biennium would be \$10.0 billion rather than \$14.1 billion. An ESF cap of \$10.0 billion for the 2014–15 biennium would represent 20.7 percent of General Revenue Fund appropriations for fiscal year 2015.

EFFECT OF THE ESF ON THE “PAY AS YOU GO LIMIT”

In preparing the biennial revenue estimate required by Texas Constitution, Article III, Section 49a, commonly referred to as the “Pay As You Go Limit,” the CPA deducts the estimated amount of General Revenue Fund transfers to the ESF from the amount available for General Revenue Funds appropriation. The CPA deducts from the amount available for appropriation as if the transfers were made in the fiscal year that the estimated unencumbered balance, excess oil tax, or excess natural gas tax collections occurred. For example, in the January 2013 Biennial Revenue Estimate, the CPA estimated that oil and natural gas tax collections in fiscal year 2013 would exceed their respective thresholds. Although the related transfers from the General Revenue Fund to ESF would not occur until fiscal year 2014, the CPA deducted the amount of the transfers from the amount available for certification in fiscal year 2013. This practice leaves a pool of revenue that cannot be appropriated from the General

Revenue Fund in the then current fiscal year and cannot be appropriated from the ESF until the next fiscal year.

STABILIZATION FUNDS IN OTHER STATES

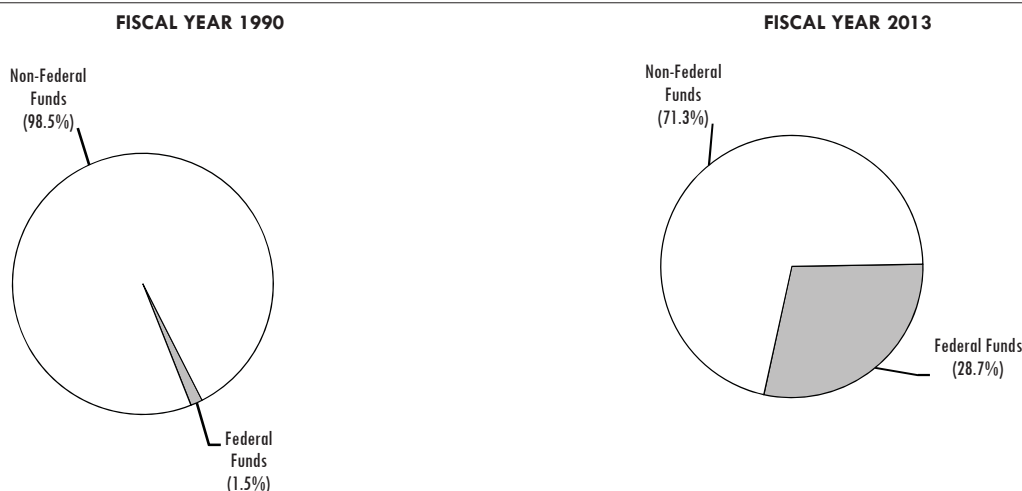
According to a 2014 National Conference of State Legislatures report, 46 states and the District of Columbia now have stabilization funds. Colorado, Kansas, Montana, and New Mexico do not have official stabilization funds that meet the NCSL definition. Colorado has a required reserve, and New Mexico has a restricted reserve, which some analysts count as stabilization funds.

The structures of state stabilization funds vary. Twelve states, including Texas, have constitutionally established stabilization funds. Forty states cap their stabilization fund balances. Seven states require supermajority (greater than 50 percent) votes to appropriate revenue from their stabilization funds. Five states have automatic withdrawal requirements. Fifteen states have automatic replenishment rules. In several states with stabilization funds, the transfer of surpluses is the primary source of revenue to their stabilization funds.

There is no consensus on the proper level of state stabilization fund balances. Before the last recession, many states considered balances of five percent of spending to be an adequate reserve. The experiences of the recent recession have prompted states and public policy groups to re-evaluate the adequacy of stabilization fund balances.

Prior to the recession beginning in December 2007, the Government Finance Officers Association (GFOA) recommended a minimum reserve of 5 percent to 15 percent

**FIGURE 16
FEDERAL FUNDS AS A PERCENTAGE OF GENERAL REVENUE FUND DEPOSITS, FISCAL YEARS 1990 AND 2013**



SOURCE: Comptroller of Public Accounts.

of regular general fund operating revenues, or one to two months of regular general fund operating expenditures. GFOA now recommends that governments have reserves of no less than two months of spending. The Center for Budget and Policy Priorities (CBPP) currently recommends that states build balances of 15 percent of their general revenue budgets.

CBPP also recommends that states with overly restrictive caps either remove the cap or increase it to a more adequate level, such as 15 percent of the budget. Several states have recently increased their stabilization fund caps. Nevada increased its cap from 10 percent to 20 percent of general fund appropriations. Georgia, Oklahoma, and Virginia increased their caps to 15 percent of their annual general revenue budgets. Mississippi, Rhode Island, South Carolina, and West Virginia also have increased their stabilization fund caps.

Recent scholarly research has studied past recessions to develop best practices regarding stabilization fund balances based on average revenue shortfalls during an economic downturn. One study found that states can expect a revenue shortfall of 13 percent to 18 percent of revenue during a normal downturn. The study attempted to determine the amount of revenue states would need to set aside so that there is a high probability that the combination of revenue collections and reserves would not decrease in any year during a shortfall. The study estimated that to achieve this goal, states would need to save between 2.5 percent and 2.8

percent of revenue each year during periods of economic expansion.

A similar calculation can be made using Texas' revenue stream during the period in which the state has had a stabilization fund. Since 1990, collections in General Revenue Funds have decreased in three different fiscal years, as shown in **Figure 17**.

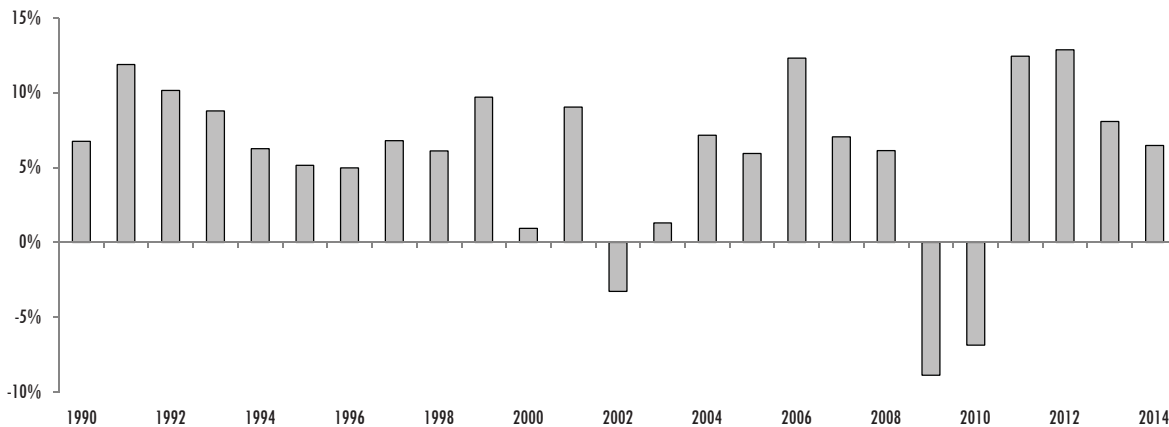
Revenue decreased in fiscal year 2002, returning to the fiscal year 2001 level in fiscal year 2004. In fiscal years 2009 and 2010, the state experienced two consecutive years of decreasing revenue. Collections did not return to fiscal year 2008 levels until fiscal year 2012. From fiscal years 2009 to 2011, revenue was \$11.9 billion less than it would have been had collections remained at fiscal year 2008 levels, as shown in **Figure 18**.

To prevent a decrease in revenue, including the ESF balance, in any fiscal year during the period of fiscal years 1990 to 2013, the state would have needed to set aside a minimum of 2.2 percent of General Revenue Funds collections starting in fiscal year 1991. Prior to fiscal year 2002, the state had never deposited 2.2 percent of revenue to the ESF, as shown in **Figure 19**.

Such a deposit mechanism could supplement existing deposits to the ESF in years when the current revenue streams do not produce the target.

On December 15, 2014, the balance in the Texas ESF was \$8.5 billion, 17.5 percent of the fiscal year 2015 General

FIGURE 17
GENERAL REVENUE FUNDS REVENUE COLLECTIONS, PERCENTAGE CHANGE FROM PRIOR FISCAL YEAR
FISCAL YEARS 1990 TO 2014



NOTE: Adjusted for changes in disposition of revenue caused by fund consolidation.
 SOURCE: Comptroller of Public Accounts.

**FIGURE 18
GENERAL REVENUE FUNDS COLLECTIONS, IN BILLIONS
FISCAL YEARS 2009 TO 2011**

YEAR	AMOUNT LESS THAN 2008 LEVEL
2009	\$3.7
2010	\$6.3
2011	\$1.9
TOTAL	\$11.9

SOURCE: Legislative Budget Board.

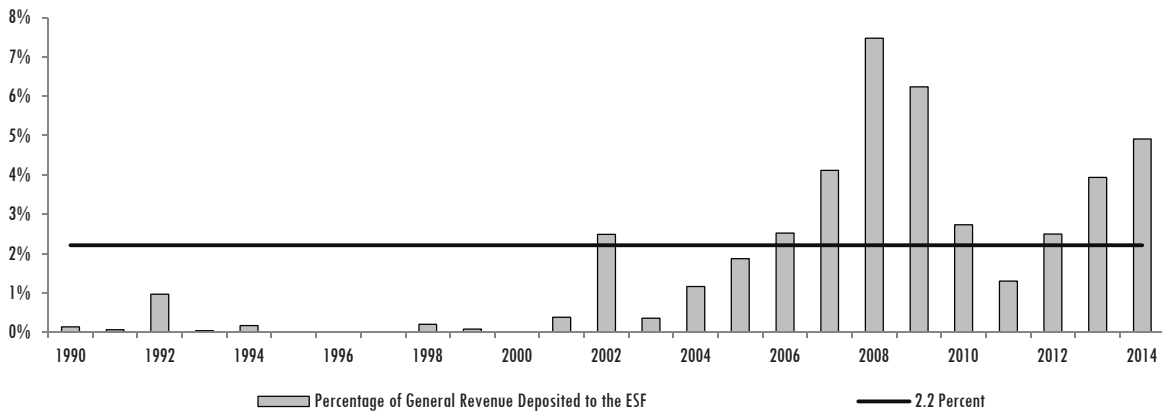
Revenue Funds budget. The 2014–15 ESF cap is equivalent to 29.1 percent of fiscal year 2015 General Revenue Funds appropriations. **Figure 20** shows the history of ESF balances as percentages of General Revenue Funds spending.

In fiscal year 2012, Texas’ ESF balance ranked second among the states in absolute terms and fifth as a percentage of the general fund spending. Alaska ranked first in both categories with a \$15.9 billion stabilization fund balance, 226 percent of general fund spending. **Figure 21** shows fiscal year 2014 state stabilization fund balances as percentages of their general fund spending. The figure excludes Mississippi and Oklahoma because data was not available and Alaska to allow visual comparison among the remaining states.

BOND RATINGS AGENCIES

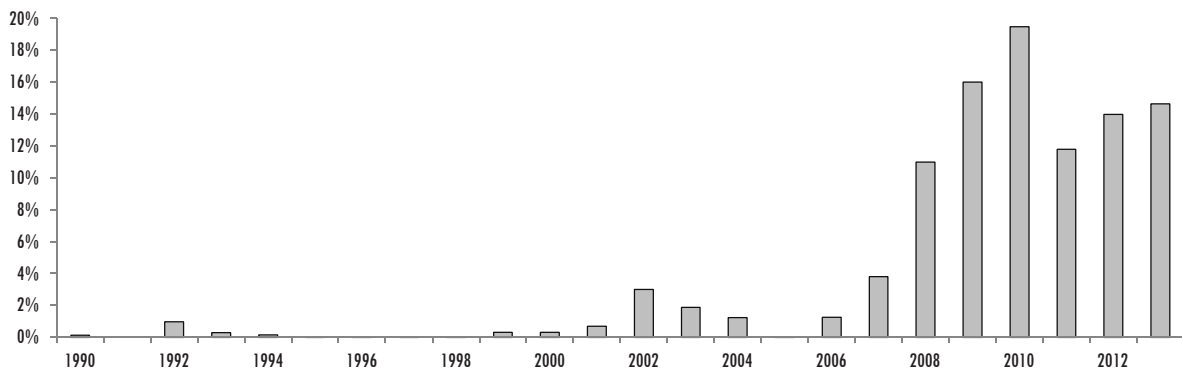
Stabilization fund balance is one factor used by bond rating agencies when evaluating state credit worthiness. The three major rating agencies—Moody’s Investors Service, Standard and Poor’s (S&P), and Fitch Ratings—each have different

**FIGURE 19
PERCENTAGE OF GENERAL REVENUE FUNDS COLLECTIONS DEPOSITED TO THE ECONOMIC STABILIZATION FUND
FISCAL YEARS 1990 TO 2014**



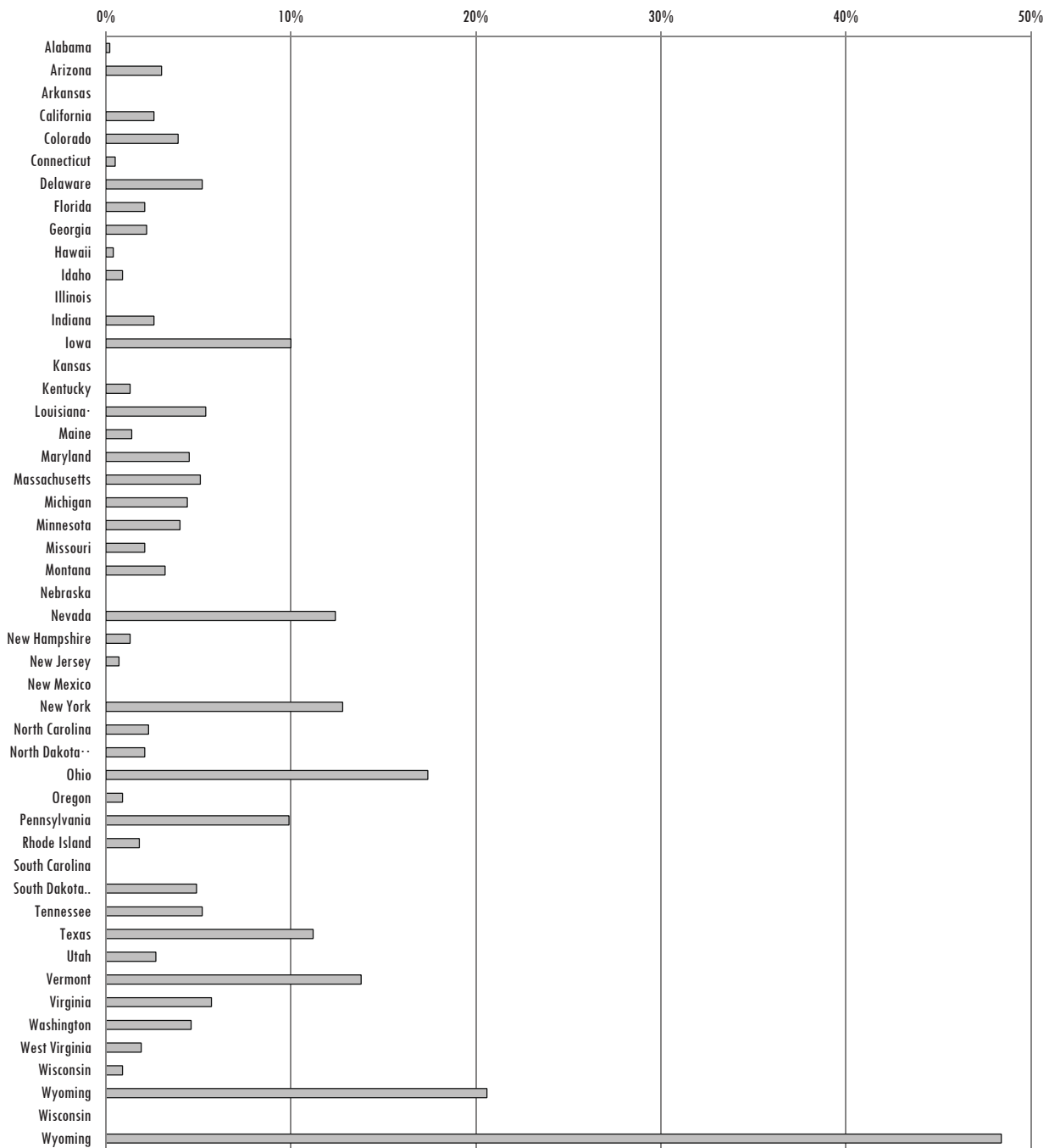
SOURCE: Legislative Budget Board.

**FIGURE 20
ECONOMIC STABILIZATION FUND BALANCE AS A PERCENTAGE OF GENERAL REVENUE FUNDS SPENDING
FISCAL YEARS 1990 TO 2013**



SOURCE: Legislative Budget Board.

FIGURE 21
STATE STABILIZATION FUNDS AS PERCENTAGES OF GENERAL REVENUE SPENDING, 2012



NOTE: Alaska (226.0%) omitted.
 SOURCE: National Association of State Budget Officers.

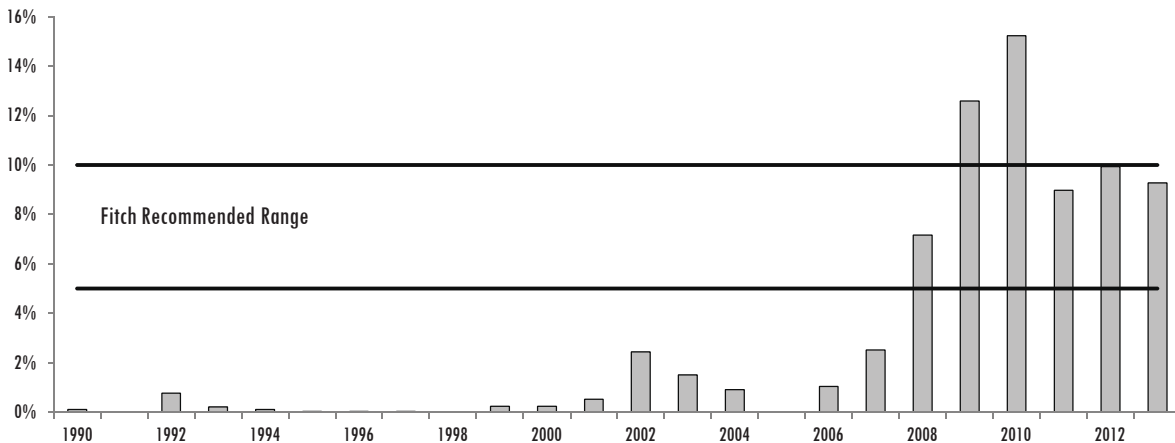
standards for evaluating the health of state stabilization funds. In 2008, one criterion for receiving Moody's highest bond rating (Aaa) was a stabilization fund available balance greater than 10 percent of average operating revenue in the prior five years. In the five years ending in fiscal year 2013, General Revenue Funds averaged \$41.3 billion in revenue collections; 10 percent of that amount is \$4.1 billion. The ESF balance at the end of 2013 was \$6.2 billion, 1.5 times the Moody's standard for balances. Moody's also prefers that states have a requirement to rebuild the balance if it is drawn upon. Texas does not have a requirement to rebuild the balance, but does have automatic funding sources.

S&P suggests that states should have a formal budget-based reserve relative to revenue or spending that is greater than 8 percent. In addition, S&P recommends that there be a formal process or a demonstrated record of restoring the reserve following depletion. Before fiscal year 2008, Texas' ESF balance had not reached the S&P recommended level. The ESF balance has been greater than 8 percent of General Revenue Funds spending each fiscal year since 2008.

Fitch, in 2009, recommended an established stabilization reserve fund with automatic funding sources and limits on its use. According to Fitch, a general target for reserve levels is 5 percent to 10 percent of recurring non-federal revenue. Texas first exceeded the 5 percent threshold in fiscal year 2008 and has been in or above Fitch's recommended range each year since. **Figure 22** shows the Texas ESF balance as a percentage of non-federal revenue and the range recommended by Fitch.

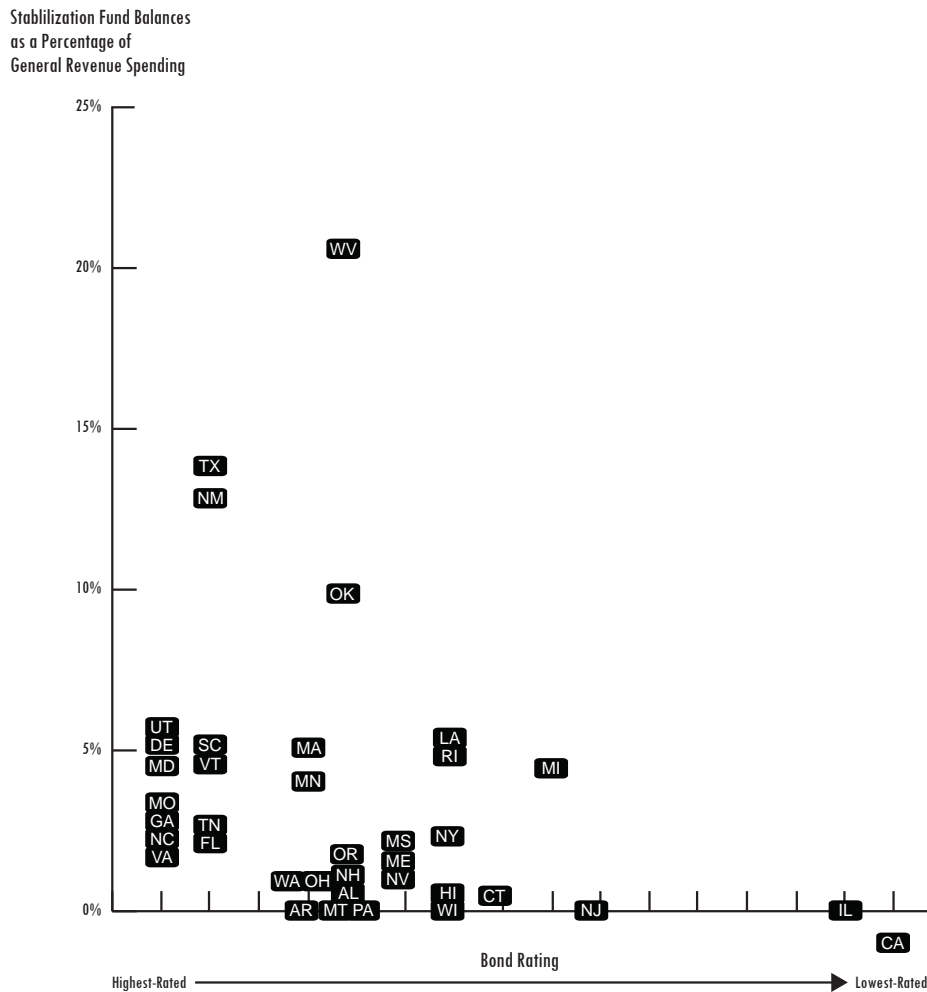
Spending from stabilization funds during economic downturns does not necessarily negatively affect a state's bond rating. S&P notes that reserves are clearly in place to be used, and balanced use of budget reserves is not a sign of credit weakness. According to a 2007 University of Tennessee study of the recession in the early 2000s, seven of the 10 states with the highest bond rating as of March 2007 used one-third or more of their stabilization funds in 2002. Three of these states—Minnesota, North Carolina, and South Carolina—used their entire rainy day funds in 2002. Similarly, following the most recent recession, five of the seven states that received the highest bond ratings from all three rating agencies in 2007 spent significant portions of their stabilization fund balances between 2007 and 2012. None of the states had their bond ratings lowered during that period. Recent spending from the Texas ESF has not reduced Texas' ratings. Between fiscal years 2002 and 2005, appropriations reduced the ESF balance from \$1 billion to \$6.9 million. None of the three major rating agencies reduced the state's bond rating during that period. **Figure 23** shows the relationship between state stabilization fund balances as a percentage of general fund spending and state bond ratings in 2012. The chart excludes Alaska and those 11 states with no general obligation debt. States that received the highest bond rating from all three rating agencies are in the leftmost group. States, such as Texas in 2012, that received the highest rating from two rating agencies and the next highest rating from the third rating agency are aligned in the group second from the left, and so on. (In 2013, Texas received the highest rating from all three agencies.)

FIGURE 22
ECONOMIC STABILIZATION FUND BALANCE AS A PERCENTAGE OF OWN-SOURCE REVENUE, FISCAL YEARS 1990 TO 2013



SOURCE: Legislative Budget Board.

FIGURE 23
COMPARISON OF STATE BOND RATINGS TO STABILIZATION FUND BALANCES, 2014



NOTE: The chart excludes Alaska and states with no general obligation debt: Arizona, Colorado, Idaho, Indiana, Iowa, Kansas, Kentucky, Nebraska, North Dakota, South Dakota, and Wyoming.
 SOURCES: National Association of State Budget Officers; Texas Bond Review Board.

Texas’ bond ratings have improved since 2008. S&P increased the state’s rating in 2009, and Moody’s increased the rating in 2010. The potential redirection of ESF revenue to the State Highway Fund did not cause the rating agencies to reduce the state’s rating. S&P improved the state’s rating to its highest rating, AAA, in 2013 after the Legislature appropriated \$2 billion from the ESF for the state water plan and passed a joint resolution that redirected as much as half of the future ESF deposit stream to the State Highway Fund. **Figure 24** shows the history of Texas bond ratings.

While many features of the Texas ESF are not unique among state reserve funds, the recently accumulated ESF balance is significant in terms of dollar amount and percent of General

Revenue Fund spending and presents important policy choices for the Legislature. Changes approved by voters modified revenue deposited to the ESF and will likely affect, among many other variables, the availability of future reserves.

FIGURE 24
TEXAS BOND RATING, 1961 TO 2014

YEARS	MOODY'S	STANDARD AND POOR'S	FITCH RATINGS
1961	*	AAA	*
1962 to 1985	Aaa	AAA	*
1986	Aaa	AA+	*
1987	Aa	AA	*
1993 to 1996	Aa	AA	AA+
1997 to 1998	Aa2	AA	AA+
1999 to 2008	Aa1	AA	AA+
2009	Aa1	AA	AA+
2010 to 2012	Aaa	AA+	AAA
2013 to 2014	Aaa	AAA	AAA

NOTE: Moody's bond rating from 1978 to 1998 and 2010 to 2014 were recalibrated.

SOURCE: Texas Bond Review Board.

THE AFFORDABLE CARE ACT'S EFFECTS ON TEXAS EMPLOYERS

According to the U.S. Agency for Healthcare Research and Quality, there were more than 490,000 private-sector employers in Texas with more than 7 million employees in 2012. The term private-sector employer excludes government entities and self-employed individuals with no employees. The State of Texas had more than 223,000 full-time-equivalent positions in 2012. Other employer groups in Texas include institutions of higher education, school districts, counties, and other local government entities.

The State of Texas, public institutions of higher education and school districts in Texas provide health insurance coverage options for active employees, their dependents, and retirees. In the private sector, 46.5 percent of employers in Texas offered their employees health insurance in 2012.

The federal Patient Protection and Affordable Care Act of 2010 affects employers through reforms to the health insurance market, tax provisions, the expansion of health insurance coverage, and reporting requirements. While some of the provisions in the law took effect immediately upon its enactment, several provisions did not take effect until January 1, 2014. Some provisions have implementation dates as late as 2018, such as the excise tax on high-cost health plans. Subsequent legislation and federal rules have changed and delayed provisions of the law. These factors have limited the immediate availability of data and information on the effects of the Affordable Care Act on employers.

This report identifies and discusses key Affordable Care Act provisions that affect employers. The report also includes cost estimates related to the effects of some provisions on the State of Texas as an employer.

FACTS AND FINDINGS

- ◆ Provisions of the Affordable Care Act, such as the insurance market reforms, tax-related provisions, and employer-shared responsibility, affect employers based on their size, characteristics of their workforce, and the types of coverage offered.
- ◆ In September 2014, the state employee benefit systems identified the fiscal impact of the following three insurance market reforms to be \$100.1 million in All Funds in fiscal year 2016: expansion of coverage to dependent children up to age 26, coverage of

preventive care at 100 percent, and coverage of contraceptives at 100 percent.

- ◆ In September 2014, the state employee benefit systems identified the costs of the following tax and fee provisions to be \$75.2 million in All Funds in fiscal year 2016: Patient-Centered Outcomes Research Fee, the Transitional Reinsurance Program, and the Annual Fee on Health Insurance Providers.
- ◆ It is important for Texas employers to monitor and assess the effects of the Affordable Care Act on their businesses and employees. As more data and information on the effects of the law become available, employers could respond by modifying factors such as: health insurance coverage options, health benefit plan designs, hiring practices, employee cost-sharing policies, and other strategies to address the effects of the law.

DISCUSSION

The ACA defines a full-time equivalent (FTE) as employment for an average of at least 30 hours per week. The ACA defines large businesses as an employer that has 50 or more FTEs. According to a 2012 survey conducted by the Agency for Healthcare Research and Quality, 28.9 percent of private-sector businesses in Texas had 50 or more employees. An estimated 94 percent of these large businesses in Texas offered health insurance to their employees in 2012. **Figure 1** shows some characteristics of Texas private-sector businesses in 2012.

The effects of the federal Affordable Care Act (ACA) on Texas businesses vary by the size of the employer, characteristics of their workforce, and the types of coverage offered. For example, starting in January 2015, the Employer Shared Responsibility provision of the ACA requires employers that have more than 100 FTEs to provide affordable health coverage that meets federal requirements for the employees, or to pay a penalty. This requirement also will be placed on all employers that have more than 50 FTEs, starting in 2016.

Four systems in Texas government provide employee and retiree health benefits: the Employees Retirement System (ERS), the Teacher Retirement System (TRS), The University of Texas System (UT System), and the Texas A&M University

FIGURE 1
CHARACTERISTICS OF TEXAS PRIVATE-SECTOR BUSINESSES, 2012

DESCRIPTION	EMPLOYERS OF LESS THAN 50 EMPLOYEES	EMPLOYERS OF 50 OR MORE EMPLOYEES
Number of Employers (Total: 491,413)	349,571	141,842
Percentage of private-sector establishments	71.1%	28.9%
Number of employees	1,657,132	5,441,292
Percentage of employees that are full-time	23.3%	76.7%
Percentage of employers that offered health insurance benefits for employees	27.2%	94.0%

NOTES:

- (1) Private-sector refers to economic activity other than that of government. In this survey, the private sector excludes the unincorporated, self-employed with no employees. However, the self-employed with employees and the incorporated, self-employed with no employees are included.
- (2) The definition of full-time employee was determined by the respondent.

SOURCE: Agency for Healthcare Research and Quality, Medical Expenditure Panel Survey.

System (TAMU). Federal guidelines indicate that retiree-only health plans, such as TRS-Care, are not subject to most of the ACA requirements. In contrast, health benefits provided through the other systems are subject to many of the ACA provisions. For example, the insurance market reforms could result in the need for higher premiums from plan participants or more funds from other sources. ERS covered 534,762 employees, retirees, and dependents through its healthcare plan in August 2013. TRS estimates it covered more than 455,000 employees and dependents in its healthcare plan for active employees in August 2013. The UT-System and TAMU covered 31,503 and 15,219 employees, respectively, in fiscal year 2012 using Higher Education Employees Group Insurance (HEGI) appropriations (99 percent General Revenue Funds). Another 63,033 higher education employees outside the UT System and TAMU received coverage funded with HEGI appropriations through ERS in 2012. HEGI provides state contributions for group insurance premiums for employees and retirees of higher education institutions, including community colleges.

The ACA requires considerable reforms to the health insurance market. Most plans must provide minimum essential health benefits as defined by the U.S. Department of Health and Human Services (HHS). The implementation dates for the ACA-mandated insurance market reforms ranged from September 1, 2010, to January 1, 2014.

The law provides for the establishment of Health Insurance Marketplaces by January 1, 2014. The Marketplace is a structured virtual platform where individuals and small business can compare, select and purchase health insurance. The Marketplace provides federal subsidies for individuals whose family income is more than 100 percent but less than

400 percent of the federal poverty level. Individuals are ineligible for premium tax credits if they are eligible for affordable coverage through an employer. Large employers could be subject to a penalty if one or more of their employees receive a premium tax credit through the Marketplace.

The ACA includes a mandate requiring individuals of all ages, including children, to: have basic health insurance coverage (also known as minimum essential health coverage); qualify for an exemption; or make an individual shared responsibility payment when federal income tax returns are filed. This provision became effective January 1, 2014. According to ERS, the UT System and TAMU, there is no evidence to date that the individual shared responsibility provision has affected enrollment or premium costs in the group benefit plans. TRS is not the employer with respect to active members and retirees; however, neither enrollment nor premium costs have been affected by the individual shared responsibility requirement.

The ACA contains various tax and fee provisions that are imposed on insurance issuers and self-insured group health plans. Insurance issuers typically pass these fees on to the consumer by increasing premium amounts. The ACA requires HHS in partnership with states to review all proposed health insurance premium rate increases of 10 percent or more in certain insurance markets.

Other ACA provisions such as the transition of eligible children from the State Kids Insurance Program to the Children's Health Insurance Program have affected the state as an employer.

More than 125 employers in Texas received reimbursements from the Early Retiree Reinsurance Program. This was a temporary program that reimbursed employment-based

health insurance plans for high medical expenses of retirees age 55 and older who were not eligible for Medicare.

The ACA also requires employers to submit certain notices to employees and information to the Internal Revenue Service.

HEALTH INSURANCE MARKET REFORMS AND THE HEALTH INSURANCE MARKETPLACE

The ACA affects private health insurance plans by the implementation of various reforms to the health insurance market. The Health Insurance Marketplace is a structured virtual platform where individuals and small employers can compare, select and purchase plans from multiple options of health coverage. This section discusses health insurance market reforms and the Marketplace in greater detail.

MARKET REFORMS

The health insurance market reforms establish minimum requirements related to access to coverage, premiums, benefits, cost sharing, and consumer protections. Some reforms apply to the individual, small group, and large group markets. Other reforms only apply to the individual and small group markets. Group health plans such as health reimbursement arrangements, health flexible spending arrangements, and employer payment plans must also meet market reform requirements. These types of plans cannot be integrated with individual policies to satisfy the market reforms. Grandfathered plans and retiree-only health plans are not subject to many of the health insurance market reform requirements. **Figure 2** shows some key insurance terms and their definitions.

**FIGURE 2
KEY INSURANCE TERMS**

TERM	DEFINITION
Group Health Plan/Group Coverage/ Group Insurance	Insurance that is provided to a group of individuals who are brought together by an employer or other organization, such as a trade union.
Plan Sponsor	In the group market, the entity that purchases health insurance on behalf of a group is referred to as the plan sponsor.
Large Group Insurance Market	Before the enactment of the Affordable Care Act (ACA), large groups were defined as groups with more than 50 employees. For plan years beginning before January 1, 2016, a state may keep the previous definition of large groups or change it to include those groups with more than 100 employees. For plan years beginning on or after January 1, 2016, large groups must be defined as a group with more than 100 employees.
Small Group Insurance Market	Before ACA, small groups were defined as groups of 2 to 50 employees. For plan years beginning before January 1, 2016, a state may elect to keep this definition of small groups or change it to include those groups of 1 to 100 employees. For plan years beginning on or after January 1, 2016, small groups must be defined as a group of 1 to 100 employees.
Individual (nongroup) Insurance Market	Consumers who are not associated with a group can obtain coverage by purchasing it directly from an insurance carrier.
Self-Insured/Funded Plan	Health coverage that is provided directly by the organization seeking coverage for its members. Such organizations set aside funds and pay for health benefits directly. In accordance with self-insurance, the organization bears the risk for covering medical claims.
Grandfathered Plan	Refers to an existing group health plan or a health insurance plan or policy in which at least one individual was enrolled since March 23, 2010. To maintain grandfathered status, a plan must avoid certain changes to benefits, cost sharing, employer contributions, and access to coverage.
Health Reimbursement Arrangements	An arrangement that is funded solely by an employer and that reimburses an employee for medical care expenses incurred by the employee and his/her spouse and dependents.
Health Flexible Spending Arrangements	A benefit designed to reimburse employees for medical care expenses, other than premiums, incurred by the employee and his/her spouse and dependents.
Employer Payment Plans	An employer reimburses an employee's substantiated premiums for non-employer-sponsored hospital and medical insurance.

SOURCE: Congressional Research Service.

Some plans do not have to comply with applicable ACA market reforms until 2017. The Centers for Medicare and Medicaid Services (CMS) extended a transitional policy in March 2014. This policy allows health insurance issuers offering non-grandfathered coverage in the individual and small group markets to continue coverage that otherwise would be cancelled (for reasons such as noncompliance with the market reforms). Coverage renewed for a plan year between January 1, 2014, and October 1, 2016, does not have to comply with certain ACA market reforms. CMS outlined other conditions that these health insurance issuers must follow.

Figure 3 shows many of the changes that affect the health insurance market. Most of the changes became effective at the beginning of the plan year on or after the date listed, unless noted otherwise. Employers could be affected by the

ACA's health insurance reforms, depending on factors such as employer size, characteristics of the workforce, and the types of coverage offered.

Various ACA insurance market reforms (such as those that expand coverage and limit the variation in premium setting) will affect the availability of coverage, the percentage of those eligible who actually enroll in coverage, and the premium rates charged to those who currently have employer-sponsored insurance.

INSURANCE MARKET REFORMS AND THE STATE AS AN EMPLOYER

Of the insurance market reforms shown in **Figure 3**, the state employee benefits systems identified the following reforms as having fiscal impacts on their systems:

FIGURE 3 AFFORDABLE CARE ACT HEALTH INSURANCE MARKET REFORMS 2010 TO 2014

September 23, 2010

- Prohibits policy rescissions except in the case of fraud.
- Prohibits imposition of lifetime limits on benefits.
- Prohibits denying coverage to children based on a pre-existing condition, unless the plan is a "grandfathered" plan.
- Prohibits imposition of annual limits on essential benefits for new plans.
- Requires carriers that cover dependent children to cover them up to age 26.
- Requires simplification of administrative and health insurance forms.
- Prohibits cost sharing for coverage of contraceptives, except for "grandfathered" plans.
- Prohibits cost sharing for preventive health coverage, except for "grandfathered" plans.

September 1, 2011

- Requires the U.S. Department of Health and Human Services in partnership with states to review all proposed health insurance premium rate increases of 10 percent or more in the individual and small group markets.

January 1, 2011 (actual date)

- Requires carriers in the individual or small group markets to spend at least 80 percent and carriers in the large group market to spend at least 85 percent of premium dollars on medical care.

January 1, 2014

- Prohibits imposition of annual limits on the cost of essential benefits for all plans.
- Limits the waiting period after enrolling in a plan to 90 days.
- Prohibits denying coverage to adults based on a pre-existing condition, unless the plan is a "grandfathered" plan.
- Limits the amount of deductibles in the small group market to \$2,000 for an individual or \$4,000 for a family, unless the plan is a "grandfathered" plan or is a low-cost catastrophic-only plan for adults age 29 or younger.
- Requires most plans in the individual or small group markets to include essential benefits and comply with one of the four benefit categories, unless the plan is a "grandfathered" plan or is a low-cost catastrophic-only plan for adults age 29 or younger or is otherwise exempt.
- Limits variation in setting premium rates to age, location, family status, and tobacco use.
- Guarantees issuance to employers and individuals.

January 1, 2014 (actual date)

- Limits out-of-pocket spending (i.e., deductibles, coinsurance, and copayments) for families with income up to 400 percent of the Federal Poverty Level.

NOTE: Unless noted, these changes are effective at the beginning of the plan year on or after the date listed.

SOURCE: Legislative Budget Board.

- expanding coverage to dependent children up to age 26: Beginning in fiscal year 2012, all private health insurance plans were required to allow coverage of young adults up to age 26. Children can remain on parent’s plan even if they are: married, not living with their parent, attending school, not financially dependent on their parent, or if they are eligible to enroll in their own employer’s plan;
- coverage of preventive care at 100 percent: Non-grandfathered plans in the large group, small group, and individual markets must cover a set of preventive services, such as shots and screening tests, without charging the consumer a copayment or coinsurance. Preventive health services for women, such as breast cancer screenings and well-woman visits, must also be covered at no cost to the consumer; and
- coverage of contraceptives at 100 percent: Non-grandfathered plans in the large group, small group, and individual markets must cover contraceptive methods and counseling for all women, as prescribed by a healthcare provider. All Food and Drug Administration-approved contraceptive methods prescribed by a doctor are covered. Plans are not required to cover drugs to induce abortions or cover

services related to men’s reproductive capacities. Certain religious employers and nonprofit religious organizations are exempt from this requirement.

The cost of these insurance market reforms for ERS, TRS, UT System, and TAMU are shown in **Figure 4**.

On June 30, 2014, the Supreme Court of the United States ruled in a 5–4 decision, that for-profit businesses could assert a religious objection to the health law’s contraception coverage requirements. The court’s majority ruled that the companies named in the suit did not have to offer women employees all U.S. Food and Drug Administration-approved contraceptives as part of a package of preventive services that must be covered at 100 percent. Houses of worship are exempt from the requirement to provide contraceptive services at no cost to employees by federal regulations published in July 2013. Non-profit religious organizations that object to contraceptive coverage will not have to pay for contraceptive coverage. An insurer or third party administrator will make separate payments for contraceptive coverage.

The ACA limits the waiting period after enrolling in a health insurance plan to 90 days. This provision became effective on January 1, 2014. ERS indicated additional costs associated with this provision and estimates the fiscal impact of this

FIGURE 4
SELECTED ANTICIPATED COSTS TO TEXAS STATE EMPLOYEE BENEFIT SYSTEMS FOR AFFORDABLE CARE ACT HEALTH INSURANCE MARKET REFORMS (IN MILLIONS)
FISCAL YEARS 2013 TO 2016

PROVISION	SYSTEM	2013 EXPENDED	2014 BUDGETED	2015 ESTIMATED	2016 ESTIMATED
Expanding coverage to dependent children up to age 26	Employees Retirement System	\$5.9	\$4.7	\$5.2	\$5.6
	Teacher Retirement System	\$9.8	\$9.5	\$10.2	\$10.9
	The University of Texas System	\$1.7	\$2.0	\$2.2	\$2.4
	Texas A&M System	\$1.3	\$1.4	\$1.5	\$1.7
Coverage of preventive care at 100 percent	Employees Retirement System	\$23.2	\$15.9	\$17.3	\$18.3
	Teacher Retirement System	\$33.4	\$32.5	\$34.7	\$37.2
	The University of Texas System	\$3.7	\$4.2	\$4.3	\$4.6
	Texas A&M System	\$1.8	\$1.9	\$2.1	\$2.3
Coverage of contraceptives at 100 percent	Employees Retirement System	\$7.3	\$5.5	\$6.0	\$6.5
	Teacher Retirement System	\$5.0	\$5.5	\$5.9	\$6.3
	The University of Texas System	\$3.0	\$3.1	\$3.4	\$3.8
	Texas A&M System	\$0.5	\$0.5	\$0.5	\$0.5

NOTE: Amounts are in All Funds. ERS amounts include State Agencies and Higher Education Group Insurance. Fiscal Year 2015 and 2016 amounts are agency and institution estimates.

SOURCES: Employees Retirement System; Teacher Retirement System; The University of Texas System; Texas A&M University System.

provision to be \$13.2 million in All Funds in fiscal year 2015 and \$14.1 million in All Funds in fiscal year 2016. The University of Texas System also reported a cost of \$4.3 million (All Funds) for fiscal year 2015 and \$4.5 million (All Funds) in fiscal year 2016 for the waiting period limitation requirement. The Texas A&M University System estimates the cost of the waiting period limitation to be \$1.3 million (All Funds) in fiscal year 2015 and \$1.4 million (All Funds) in fiscal year 2016.

A 2013 survey by the International Foundation of Employee Benefit Plans (IFEBP) found that extending coverage to dependent children until age 26 was identified by employers as the top ACA-related cost driver. In the same survey, 9.9 percent of employers identified coverage of preventive care as a provision that would increase their costs.

The ACA increases Medicare's share of the cost of prescription drugs for Medicare-eligible retirees. Before the ACA, there was a gap, referred to as the "donut hole," in which Medicare did not directly provide funding for prescription drugs. However, Medicare provided a subsidy to employers for 28 percent of the cost of prescription drugs within certain ranges, including the donut hole. TRS and ERS had been receiving the 28 percent retiree prescription drug subsidy. The ACA created the Coverage Gap Discount Program which requires pharmaceutical manufacturer's to reimburse plan sponsors for 50 percent of the cost of brand drugs for members in the donut hole. TRS now offers a Medicare Part D prescription drug plan to access this reimbursement for prescription drugs. TRS reports receiving \$24.1 million in fiscal year 2013 and \$57.2 million in fiscal year 2014 from the Coverage Gap Discount Program (CGDP). ERS provides prescription drug benefits for Medicare-primary participants through a self-funded Employer Group Waiver Plan (EGWP) and receives payments from drug manufacturers under the CGDP, which offset a portion of the EGWP cost. ERS reports an estimated \$18.8 million in fiscal year 2013 and \$26.8 million in fiscal year 2014 from the CGDP.

HEALTH INSURANCE MARKETPLACE

The ACA required that every state have an operational Health Insurance Marketplace (Marketplace) by January 1, 2014. The Marketplace was included in the ACA as a means to increase access to health insurance. Health insurance companies can sell health insurance plans through the Marketplace if they meet standards outlined in the ACA. Insurers participating in the Marketplace are required to offer various tiers of coverage.

The Marketplace provides a platform for eligible individuals of all income levels to compare, select and purchase health insurance coverage. To be eligible for enrollment in a qualified health plan through the Marketplace, an individual must meet the following criteria:

- be a citizen, national, or noncitizen who is lawfully present in the U.S.;
- not be incarcerated, other than pending the disposition of a charge; and
- meet applicable state residency standards.

The ACA required employers that are covered by the Fair Labor Standards Act (FLSA) to provide written notice to their employees about the Health Insurance Marketplace by October 1, 2013. The FLSA prescribes standards such as basic minimum wage and overtime pay, and it affects most private and public employment. Employers had to provide a written notice informing employees (regardless of full-time or part-time status) of the following:

- about the Health Insurance Marketplace;
- that, depending on any coverage offered, they may be able to get lower costs on private insurance in the Marketplace based on their income; and
- that, if they buy insurance through the Marketplace, they may lose the employer contribution (if any) to their health benefits.

The ACA does not establish a fine or penalty to employers that fail to provide the notice.

HEALTH INSURANCE PREMIUM TAX CREDITS AND COST-SHARING REDUCTIONS

Individuals with household incomes between 100 percent and 400 percent of the federal poverty level (FPL), with no access to employer-sponsored insurance or public insurance coverage, are eligible for premium assistance credits for Marketplace-purchased coverage. Some lawfully present immigrants with incomes below 100 percent may be eligible for premium assistance credits. Additionally, eligible individuals with household incomes between 100 percent and 250 percent FPL qualify for cost-sharing reductions (deductibles, copayments, and coinsurance) for Marketplace-purchased coverage.

Because Texas opted not to expand Medicaid, most adult U.S. citizens in Texas with incomes less than 100 percent FPL do not qualify for Medicaid or subsidies through the Marketplace. **Figure 5** shows the 2013 and 2014 federal

**FIGURE 5
FEDERAL POVERTY GUIDELINES, 2013 AND 2014**

PERCENTAGE OF FEDERAL POVERTY LEVEL	INDIVIDUAL		FAMILY OF FOUR	
	2013	2014	2013	2014
100%	\$11,490	\$11,670	\$23,550	\$23,850
250%	\$28,725	\$29,175	\$58,875	\$59,625
400%	\$45,960	\$46,680	\$94,200	\$95,400

SOURCE: U.S. Department of Health and Human Services.

poverty guidelines for the 48 contiguous states and the District of Columbia. **Figure 6** shows eligibility criteria for individuals to receive premium assistance credits. For 2014 coverage, FPL values from 2013 were used to calculate eligibility for lower costs on private insurance plans in the Marketplace. In 2015, FPL values from 2014 will be used.

**FIGURE 6
KEY ELIGIBILITY CRITERIA FOR PREMIUM ASSISTANCE
CREDITS THROUGH THE HEALTH INSURANCE
MARKETPLACE, JANUARY 2014**

ADVANCED PAYMENT OF PREMIUM TAX CREDITS

- Purchased health insurance through the Health Insurance Marketplace
- Ineligible for coverage through an employer or government plan
- Has a household income that either is: between 100 and 400 percent of the Federal Poverty Level (FPL); or an income that is not greater than 100 percent of the FPL and is a lawfully present immigrant (but not eligible for Medicaid because of immigration status)
- Has not been claimed as a dependent by another individual
- Has not filed a married filing separately tax return, with a few exceptions

SOURCES: Internal Revenue Service; Center on Budget and Policy Priorities.

The amount of tax credit that an individual receives is based on income and the cost of insurance. Individuals eligible for the tax credit can choose to have the estimated credit paid in advance directly to the insurance company, or wait to get a credit when tax returns are filed. These credits lower the amount an individual owes in monthly premiums.

Individuals are ineligible for premium tax credits if they are eligible for affordable coverage through an employer. When applying for subsidies, individuals must report on their access to employer coverage on the application. The Marketplace uses electronic data sources to verify whether an applicant for tax credits is eligible for affordable employer coverage. If data is not available, the Marketplace conducts random samplings of employers to confirm an individual's eligibility starting in 2015.

Large employers could be subject to a penalty if one or more employees receive a premium tax credit through the Marketplace. See the Large Employer Shared Responsibility section of this report for more details about penalties.

**SMALL BUSINESS TAX CREDITS AND THE
SMALL BUSINESS HEALTH OPTIONS PROGRAM**

The ACA defines small businesses as those with 50 or fewer full-time equivalents. Small businesses make up 96 percent of all employers in the United States. According to the U.S. Small Business Administration, in 2013, small businesses paid on average 18 percent more than large businesses for health insurance coverage.

Starting in 2010, the ACA provided eligible small businesses with a tax credit worth up to 35 percent of premium contributions to help pay for health insurance coverage for employees. The maximum credit for small tax-exempt employers such as charities was 25 percent of premiums paid. Eligible businesses had to meet the following criteria:

- employ fewer than 25 full-time equivalents;
- have employees with an average annual wage of \$50,000 or less; and
- contribute at least 50 percent of full-time employees' self-only premium costs.

In 2014, the maximum credit amount increased to 50 percent for small business employers and to 35 percent for small tax-exempt employers. The tax credit amount that a small business qualifies for is based on a sliding scale. In general, the tax credit is highest for businesses with fewer than 10 employees who are paid an average of \$25,000 or less per year. From 2010 to 2013, more than \$1 billion in tax credits were provided to small businesses. Starting in 2014, the tax credit became available to eligible businesses that purchased coverage through the Small Business Health Options Program (SHOP). The credit can be claimed for any two consecutive taxable years beginning in 2014 through SHOP.

SHOP is a component of the Health Insurance Marketplace that: offers employers a choice of qualified health plans from different private health insurers; provides a comparison between plans; and allows employers to work with a broker or independently. In 2014, businesses with up to 50 FTEs had access to SHOP. Self-employed individuals with no employees are not eligible for coverage through SHOP.

The online enrollment function of the federally facilitated SHOP was delayed until November 2014 because of technical difficulties. Small businesses still had the option to purchase a SHOP plan through a broker or agent by filing a paper application. SHOP enrollment began on October 1, 2013, for January 1, 2014, coverage. SHOP users must offer coverage to all full-time employees. In general, Texas insurance companies require at least 75 percent of a small employer's eligible employees to participate in the health plan.

Starting in 2016, employers with up to 100 FTEs will be eligible to participate in SHOP. An employer can remain in SHOP once it has enrolled, even if it surpasses 100 FTEs.

Employees of SHOP-enrolled businesses will have access to more choices among qualified health plans across multiple health insurance companies starting in 2015.

INDIVIDUAL AND EMPLOYER SHARED RESPONSIBILITY PROVISIONS

The ACA requires most individuals to have basic health insurance coverage, effective January 1, 2014. Starting in January 2015, the Employer Shared Responsibility provision of the ACA requires employers that have more than 100 FTEs to provide these employees with affordable health coverage that meet federal requirements, or to pay a penalty. This requirement will also be placed on all employers that have more than 50 FTEs, starting in 2016. This section discusses the ACA's individual and employer shared responsibility provisions.

INDIVIDUAL SHARED RESPONSIBILITY

The ACA's individual shared responsibility provision requires that individuals of all ages, including children: have basic health insurance coverage (also known as minimum essential health coverage); or qualify for an exemption; or make an individual shared responsibility payment when the federal income tax return is filed. Any adult who claims a child or individual as a dependent on a federal income tax return is responsible for ensuring that the dependent has coverage or qualifies for an exemption, or that adult must pay the shared responsibility payment for the dependent.

Employer-sponsored coverage, including self-insured plans, COBRA coverage, and retiree coverage, qualify as minimum essential coverage.

Figure 7 shows the types of coverage that qualify as minimum essential coverage. Coverage providing only limited benefits,

FIGURE 7
MINIMUM ESSENTIAL COVERAGE, 2014

- Employer-sponsored coverage, including self-insured plans, COBRA coverage, and retiree coverage
- Coverage purchased in the individual market, including a qualified health plan offered by the Health Insurance Marketplace
- Medicare Part A coverage and Medicare Advantage plans
- Most Medicaid coverage, Children's Health Insurance Program (CHIP) coverage
- Certain types of veterans health coverage administered by the Veterans Administration
- Most TRICARE (Military Health System) coverage pursuant to United States Code
- Coverage provided to Peace Corps volunteers
- Coverage pursuant to the Nonappropriated Fund Health Benefits Program
- Refugee Medical Assistance supported by the U.S. Department of Health and Human Services (HHS), Administration for Children and Families
- Self-funded health coverage offered to students by universities for plan or policy years that begin on or before December 31, 2014
- State high-risk pools for plan or policy years that begin on or before December 31, 2014
- Other coverage recognized by HHS as minimum essential coverage

SOURCE: Internal Revenue Service.

such as stand-alone vision or dental care, or worker's compensation, does not qualify as minimum essential coverage.

There are nine statutory exemptions from the requirement to obtain minimum essential coverage. For example, the affordability exemption refers to when the amount that an individual pays in premiums is more than 8 percent of their household income. Exemptions can be claimed during the annual filing of federal income tax returns or identified by the Marketplace. Individuals who are not required to file income taxes because their gross incomes are below the tax return filing threshold do not need to take any other steps to secure an exemption. The 2014 minimum tax return filing threshold ranged from \$10,150 to \$22,700 and was dependent on filing status (single, married filing jointly, etc.) and age. HHS can determine whether an individual has suffered a hardship with respect to the ability to obtain coverage through a qualified health plan. During the 2014 open enrollment period, HHS established multiple new hardship exemptions.

If an individual does not have minimum essential coverage or does not qualify for one of the exemptions, they must pay an individual shared responsibility payment. After 2016,

payment amounts will be adjusted for inflation. Payments are made on the year's federal income tax return. If an individual is uninsured for part of the year, one-twelfth of the yearly penalty applies to each month the individual is uninsured. For more details on the exemption groups and payment amounts for the individual shared responsibility, see the *2015 Healthcare Reform, Legislative Primer*.

According to ERS, the UT System and TAMU, the individual shared responsibility provision to date has not affected enrollment or premium costs in the group benefit plans. TRS is not the employer with respect to active members and retirees (school districts are); however, neither enrollment nor premium costs have been affected by the individual shared responsibility requirement.

LARGE EMPLOYER SHARED RESPONSIBILITY

The ACA defines large businesses as an employer with 50 or more FTEs. According to a 2012 survey conducted by the federal Agency for Healthcare Research and Quality, 28.9 percent of private-sector businesses in Texas had 50 or more employees. An estimated 94 percent of these large businesses in Texas offered health insurance to their employees in 2012. Starting in January 2015, the employer shared responsibility provision of the ACA requires employers with 100 or more FTEs to provide affordable health coverage that is of a specified minimum value or pay a penalty. This requirement will include employers with more than 50 FTEs starting in 2016.

Affordable employer-sponsored health insurance coverage is defined as coverage that is less than 9.5 percent of an individual's annual household income. The affordability test applies to the lowest-cost coverage that the employer makes available. Coverage that is of minimum value covers at least 60 percent of the total allowed cost of benefits that are expected to be incurred through the plan.

Large employers will be penalized if they do not offer affordable health coverage of minimum value to at least 95 percent of full-time employees. Additionally, if more than one full-time employee receives a premium tax credit through the Marketplace to help pay for coverage, the employer could be penalized. The ACA requires employers of more than 200 employees to automatically enroll employees into health insurance plans offered by the employer. Employees may opt out of enrolling in the coverage.

The Eighty-third Texas Legislature, 2013, amended Chapter 1551 of the Texas Insurance Code to define a full-time

employee as one who is employed at least 30 hours per week. This definition parallels the definition in the ACA. The change became effective September 1, 2013. ERS does not anticipate a risk of having to pay penalties associated with the employer shared responsibility provision because of the following reasons:

- the state pays for 100 percent of the cost for Member-Only coverage;
- the definition of a full-time employee in state statute aligns with the ACA definition; and,
- the health plans offered through the ERS Group Benefit Plan would be classified as exceeding the essential health benefits required in the ACA.

TRS is not the employer with respect to active members (school districts are) and, therefore, would not be liable for any penalties associated with the employer shared responsibility provision of the ACA.

The provision could impact the UT and TAMU systems because Chapter 1601 of the Texas Insurance Code, which governs these systems' health plans, provides health coverage at no cost to an employee who works 40 hours per week. Based on this statutory language, the penalty could apply for some employees who work 30 to 39 hours per week.

Figure 8 shows the employer shared responsibility payment that large employers will have to pay if they do not offer coverage during the calendar year to at least 95 percent of full-time employees. If an employer offers coverage for some months out of the calendar year, the payment is computed separately for each month for which coverage was not offered. The payment amount is calculated differently if an employer offers coverage to at least 95 percent of its employees, but at least one of the full-time employees receives a premium tax credit through the Marketplace.

If a large employer has 60 FTEs and does not offer coverage to at least 95 percent of its FTEs for six months of the year, the employer would owe \$30,000 for the year [(60 FTEs – 30 FTE disregard) X (1/12)(\$2000)(6 months)]. Transitional relief is available to employers who offer health coverage through a plan that operates on a fiscal year versus a calendar year. These employers will not be subject to any penalties related to the employer shared responsibility provision until the first day of the business' fiscal plan year starting in 2015.

Employers that provide health coverage to employees are required to submit information such as the employer

**FIGURE 8
EMPLOYER SHARED RESPONSIBILITY PAYMENT AMOUNTS FOR CALENDAR YEAR 2015**

SCENARIO	CALCULATION
An employer does not offer coverage to at least 95 percent of its full-time equivalents during the entire calendar year.	$(\text{Number of full-time equivalents}) - (30 \text{ FTEs}) \times (\$2,000)$
An employer does not offer coverage to at least 95 percent of its full-time equivalents for some months of the calendar year.	$(\text{Number of full-time equivalents}) - (30 \text{ FTEs}) \times (1/12) (\$2,000) \times (\text{number of months that no coverage was provided})$
An employer offers coverage to at least 95 percent of its full-time equivalents, but one or more employees receive a premium tax credit for any calendar month.	$(\text{Number of full-time equivalents who received a premium tax credit}) - (30 \text{ FTEs}) \times (1/12) (\$3,000)$

SOURCE: Internal Revenue Service.

identification number and the portion of the premium (if any) required to be paid.

The employer shared responsibility provision has caused some employers to drop coverage of employees who work fewer than 30 hours a week. According to an October 2013 National Public Radio article, these employers assumed that part-time employees could find coverage through the Marketplace. According to the 2013 IFEBP survey, employers of fewer than 50 individuals are more likely to make workforce adjustments due to the ACA. These adjustments include: reducing hiring to maintain the ACA's 50 FTE threshold for small employers; adjusting hours so that fewer employees qualify for the full-time employee medical insurance requirement; and reducing the number of workers due to costs directly associated with the ACA.

ACA KEY TAX AND FEE PROVISIONS

The ACA contains various tax and fee provisions that are required of insurance issuers and self-insured group health plans. Insurance issuers typically pass these fees on to the consumer by increasing premium amounts. ACA-related taxes and fees that have had an effect on state employee benefit systems include the following:

- Patient-Centered Outcomes Research Institute Fee: This fee helps fund the Patient-Centered Outcomes Research Institute (PCORI) which was authorized by Congress as part of the ACA. Health insurance plans pay the PCORI fee to the federal government to fund research on evidence-based medicine. The fee is assessed for policy and plan years ending after September 30, 2012, and before October 2019. The fee per covered individual is \$1 in 2013; \$2 in 2014; and adjusted thereafter for inflation through 2019.
- Transitional Reinsurance Program Fee (TRPF): The ACA requires health insurance issuers and self-funded group health plans to fund a three-year (2014, 2015,

and 2016) Transitional Reinsurance Program. The law specifies the total amounts of the fee that must be collected: \$12 billion in 2014, \$8 billion in 2015, and \$5 billion in 2016. For 2014, the fee was \$5.25 per member per month (\$63 annually). Payment of the fee for 2014 is due by January 15, 2015. This fee reimburses insurers in the non-grandfathered individual insurance marketplaces for 80 percent of the cost of claims amounts between \$60,000 and \$250,000. HHS has not set the fee amounts for 2015 and 2016.

- Annual Fee on Health Insurance Providers (AFHIP): The fee began in 2014. The IRS will send each insurer its estimated fee each year. The total fees from all health insurers are supposed to raise \$8 billion in 2014, \$11.3 billion in each year for 2015 and 2016, \$13.9 billion in 2017, and \$14.3 billion in 2018.

Figure 9 shows the estimated fiscal impact that these ACA tax and fee provisions have had and are projected to have on ERS, TRS, the UT System, and TAMU for fiscal years 2013 to 2016. Differences in system estimates can be attributed to the number of individuals covered by each system.

Milliman, a large international, independent actuarial consulting firm, prepared a comprehensive assessment of ACA factors that will affect individual market premiums in 2014. According to the assessment, the PCORI will add about \$3 per year to premiums. Similarly, the TRPF will add 1 percent to 2 percent to the average premium rate. The Congressional Budget Office projects that the AFHIP will likely be passed through to the premiums charged for coverage. The Milliman report projects that the AFHIP will increase premiums in 2014 by about 2 percent.

Employers or insurers who provide health plans that exceed an annual limit of \$10,200 for an individual or \$27,500 for a family will be assessed an excise tax. The tax would be equal

**FIGURE 9
SELECTED ANTICIPATED COSTS FOR TEXAS STATE EMPLOYEE BENEFIT SYSTEMS FROM AFFORDABLE CARE ACT TAX
PROVISIONS, FISCAL YEARS 2013 TO 2016
(IN MILLIONS)**

PROVISION	SYSTEM	2013	2014	2015	2016
Patient-Centered Outcomes Research Institute Fee	Employees Retirement System	\$0.4	\$0.6	\$0.6	\$0.7
	Teacher Retirement System	\$0.6	\$1.1	\$1.3	\$1.4
	The University of Texas System	\$0.2	\$0.3	\$0.4	\$0.4
	Texas A&M System	\$0.05	\$0.1	\$0.1	\$0.1
Transitional Reinsurance Program Fee	Employees Retirement System	\$0.0	\$12.9	\$8.3	\$2.3
	Teacher Retirement System	\$0.0	\$20.9	\$25.3	\$17.4
	The University of Texas System	\$0.0	\$5.9	\$7.2	\$4.8
	Texas A&M System	\$0.0	\$1.7	\$2.1	\$1.3
Annual Fee on Health Insurance Providers	Employees Retirement System	\$0.0	\$10.6	\$11.7	\$13.5
	Teacher Retirement System	\$0.0	\$14.8	\$26.9	\$33.1
	The University of Texas System	\$0.0	\$0.0	\$0.0	\$0.0
	Texas A&M System	\$0.0	\$0.1	\$0.2	\$0.2

NOTE: Amounts in All Funds. ERS amounts include State Agencies and Higher Education Group Insurance.
SOURCES: Employees Retirement System; Teacher Retirement System; The University of Texas System; Texas A&M University System.

to 40 percent of the amount over than that limit. The tax will take effect in 2018. In 2013, the International Foundation of Employee Benefit Plans reported that 17 percent of employers were making changes to their employee benefit plans to circumvent the tax. ERS, TRS, TAMU, and the UT System do not anticipate being affected by the excise tax because: current plan costs are well below the 2018 threshold for the tax; and state and institutional state budgetary limitations are expected to require cost management strategies, including benefit revisions that will keep plan costs below the threshold after 2018.

**OTHER ACA PROVISIONS
AFFECTING TEXAS EMPLOYERS**

This section of the report discusses other ACA provisions affecting Texas employers including the transition of eligible children of state employees from the State Kids Health Insurance Program (SKIP) to the Children’s Health Insurance Program (CHIP), and the Early Retiree Reinsurance Program (ERRP) and the amounts reimbursed to state benefit systems. This section of the report also discusses some of the key reporting requirements of the ACA, and medical loss ratio rebates that health insurance companies must pay customers if the company does meet certain spending requirements on medical care.

The ACA allows eligible children of state employees to enroll in the CHIP. Prior to the enactment of this ACA provision in

March 2010, children of state employees were prohibited from enrolling in CHIP.

The ERRP was a temporary program established by the ACA that reimbursed employment-based health insurance plans for high medical expenses of retirees age 55 and older who were not eligible for Medicare.

STATE KIDS INSURANCE PROGRAM

The State Kids Insurance Program (SKIP) was a state-funded premium subsidy program for children age 18 and younger of state employees with incomes less than 200 percent of the federal poverty level who did not qualify for Medicaid. The subsidies helped employees pay for dependent coverage through the state’s group health insurance policy. SKIP subsidies were fully funded from General Revenue Funds.

Before 2010, federal law prohibited children of state employees from enrolling in CHIP. The ACA removed this prohibition, and children of state employees are now allowed to enroll in CHIP. This provision of the ACA became effective in March 2010.

The Eighty-second Legislature, First Called Session, 2011, passed legislation that eliminated SKIP and allowed children previously enrolled in SKIP to enroll in CHIP. The bill also required the Texas Health and Human Services Commission (HHSC) to establish a process to automatically enroll SKIP-eligible children in CHIP, and to modify administrative

procedures to ensure that these children receive continuous health coverage while transitioning programs.

The transition of children from SKIP to CHIP was projected to result in savings to the state of \$2.9 million in All Funds in fiscal year 2012, and \$3.0 million in All Funds in fiscal year 2013. The average monthly caseload of SKIP clients who were moved to CHIP as the program transferred in fall 2011 was 6,868. In fiscal year 2014, HHSC did not have any information on clients who may have been eligible for SKIP, and therefore could not provide savings amounts for fiscal year 2014 and beyond. The administrative costs associated with the automatic enrollment of eligible children in CHIP could not be separated from larger health information technology costs at the agency.

EARLY RETIREE REINSURANCE PROGRAM

ERRP was a temporary program that reimbursed employment-based health insurance plans for high medical expenses of retirees age 55 and older who were not eligible for Medicare. The reinsurance covered annual health expenses between \$15,000 and \$90,000 for each individual during the plan year. For the first year, only plan year expenses exceeding \$15,000 on or after June 1, 2010, were considered. Insurance plans must have had programs in place that generated cost savings for high-cost or chronic conditions to be eligible for the reinsurance. Reimbursements could not be deposited into the General Revenue Fund, but were required to be used in the health insurance programs. For example, the TRS reimbursements were deposited into its healthcare trust fund.

The program provided \$5 billion in funding nationwide, and the amounts that were provided to any given plan depended on the total amount requested by all plans. In Texas, ERS,

TRS, the UT System, and TAMU were approved to receive this funding. **Figure 10** shows the amounts requested by and granted to these systems. Note that these systems were not guaranteed the amounts they requested. Reimbursements received could be used to support the health insurance offered by these plans. For example, ERS used ERRP reimbursements to reduce employer and subscriber premium contributions. Although the program was established through December 31, 2013, the Centers for Medicare and Medicaid Services announced in early 2012 that the available funding had been exhausted.

In February 2012, 124 plan sponsors in Texas had received reimbursements for high medical expenses of retirees ages 55 and older who are not eligible for Medicare. Plan sponsors in Texas included private businesses, local government entities, and state government entities.

MEDICAL LOSS RATIO REBATES

The ACA requires insurance companies serving the individual and small group markets to spend at least 80 percent of premium dollars on medical care. Insurance companies in the large group market must spend at least 85 percent of premium dollars on medical care. Insurance companies that fail to meet these standards will have to provide rebates to their customers, as of 2012. Texas consumers received \$46.3 million in rebates in 2012.

FIGURE 10
EARLY RETIREE REINSURANCE PROGRAM REIMBURSEMENTS REQUESTED BY OR GRANTED TO STATE BENEFIT SYSTEMS
FISCAL YEARS 2011 AND 2012
(IN MILLIONS)

BENEFIT SYSTEM	2011		2012	
	REQUESTED	GRANTED	REQUESTED	GRANTED
Employees Retirement System	\$30.2	\$30.2	\$42.8	\$40.7
Teacher Retirement System	\$70.6	\$67.7	\$81.0	\$0.0
The University of Texas System	\$5.4	\$5.4	\$8.3	\$0.0
Texas A&M System	\$3.0	\$1.4	\$0.0	\$0.0
2011 and 2012 Total	\$109.2	\$107.6	\$132.1	\$40.7

NOTE: Early Retiree Reinsurance Program funds were depleted in early 2012 and claims incurred before December 31, 2011 were considered in the order received.

SOURCES: Employees Retirement System; Teacher Retirement System; The University of Texas System; Texas A&M System.

ACA REPORTING REQUIREMENTS FOR EMPLOYERS

The ACA places reporting requirements on employers. **Figure 11** shows some of the key requirements.

The ACA required employers covered by the Fair Labor Standards Act to provide a written notice to employees about the Health Insurance Marketplace by October 1, 2013.

Employers are required to provide employees with a summary of their health insurance coverage and its cost. The purpose of the summary is to help employees better understand and evaluate their health insurance options. Penalties may be assessed for non-compliance.

Starting in January 2013, most employers were required to begin reporting the aggregate annual cost of employer-provided coverage for each employee on the W-2 Form. This reporting requirement is informational and does not apply to employers with fewer than 250 W-2 Forms in the previous calendar years.

Beginning in 2015, the ACA requires that employers that sponsor self-insured plans submit a report to IRS detailing information for each covered individual. Self-funded employers, issuers, and other parties that provide health coverage must also submit these reports to the IRS.

The ACA has and will affect employers through reforms in the health insurance market, tax provisions, the expansion of health insurance coverage, and reporting requirements. In 2013, a survey by the International Foundation of Employee Benefit Plans found that 70 percent of employers surveyed were developing strategies to deal with the implication of the ACA. The impact of the ACA on Texas employers varies by the size of the employer, characteristics of their workforce, and the types of coverage they offer. It will be essential for employers to continue to monitor the affects of various ACA provisions and modify strategies in order to deal with the implications of the law.

FIGURE 11
AFFORDABLE CARE ACT REPORTING REQUIREMENTS FOR EMPLOYERS

REQUIREMENT	EMPLOYERS OF FEWER THAN 25 EMPLOYEES	EMPLOYERS OF UP TO 50 EMPLOYEES	EMPLOYERS OF MORE THAN 50 EMPLOYEES
Employer notice to employees regarding the Health Insurance Marketplace	X	X	X
Summary of Benefits and Coverage Disclosure	X	X	X
Health Insurance Coverage Reporting	X	X	X
W-2 Reporting of Aggregate Health Care Costs			X

SOURCE: U.S. Small Business Administration.

OVERVIEW OF STATE OFFICE SPACE PLANNING

The State of Texas employs more than 300,000 persons in more than 250 towns and cities throughout the state. While public higher education institutions and certain other state entities may purchase, build, or lease their own office space, the Texas Facilities Commission assists most state agencies in locating office space for their employees. Statute requires the commission to give preference to state-owned offices when finding space for agencies. However, as of calendar year 2014, approximately 60 percent of the Texas Facilities Commission's state office space is leased.

It is common for the federal and state governments to both own and lease office space. Jurisdictions use owned and leased space to perform mandated functions, conduct administrative work, and provide services to the public. Efficiently and effectively placing agencies in office space generally requires knowledge of agencies and their functions, an understanding of the real estate market and projected changes to the market, and an understanding of current and projected needs in the state.

This report provides an overview of the history of the state's procurement of owned and leased space, the methodologies the Texas Facilities Commission uses when determining how to meet space needs, and a synopsis of how other jurisdictions perform facility acquisition functions. The Legislature demonstrated interest in and appropriated funds for building in the Austin area in the 2014–15 biennium, however, these appropriations were vetoed. Therefore, this report focuses primarily on office space in the Austin area, including the Capitol Complex.

FACTS AND FINDINGS

- ◆ The Texas Facilities Commission manages more than 28 million square feet of owned and leased real estate assets on behalf of the state at a total annual cost of \$218 million. This space includes property ranging from offices to cemeteries to laboratories.
- ◆ The state owns approximately 100 buildings, covering nearly 11 million square feet spread throughout 8 cities. More than 18,000 employees work in these buildings.
- ◆ The Texas Facilities Commission maintains more than 800 leases, covering more than 10 million square

feet spread throughout 253 cities and providing office space for 41,209 employees. Since 1989, state-leased office space has increased by 14 percent, and the cost of leased space has increased 138 percent.

- ◆ Many state employees work in office space not acquired or managed by Texas Facilities Commission. State institutions of higher education, the Texas Department of Transportation, and the Employees Retirement System of Texas are examples of entities with employees who office in other facilities.
- ◆ Although state office buildings are at capacity, no new state office buildings have been built since 2000. In 2013, the Legislature appropriated funds to begin building office space in the Capitol Complex and North Austin, but appropriations were vetoed. The Governor's proclamation stated the veto was due to plans for the Capitol Complex not being made with input from other agencies as required by new legislation. The Texas Facilities Commission has requested appropriations for buildings in the Capitol Complex and North Austin in its Legislative Appropriations Request for fiscal years 2016 and 2017.
- ◆ When agencies request additional office space, statute requires the Texas Facilities Commission to first consider the availability of existing state-owned space in which to place the agency, as well as historical buildings. If none are available or appropriate, the commission considers leased space. Texas Facilities Commission utilizes a best value standard when obtaining leases.
- ◆ Experts contend that changing work schedules and alternative work strategies will continue to change organizations' office space needs.

DISCUSSION

The Thirty-sixth Legislature, 1919, established the State Board of Control, which served as the purchasing agent for state departments, institutions, and agencies and provided other services to the state. The Sixty-sixth Legislature, 1979, abolished the State Board of Control and transferred many of the Board's powers to a new agency, the Texas State Purchasing

and General Services Commission. Subsequent legislatures restructured and renamed iterations of the agency over time; most recently the Eightieth Legislature, 2007, named the agency the Texas Facilities Commission (TFC) and transferred all non-facilities-related functions that were under the agency’s purview to the Comptroller of Public Accounts (CPA). While the entity charged with overseeing state property has been restructured over time, the Legislature has consistently demonstrated interest in efficiently managing state space needs. As early as the 1920s, the Legislature observed that no particular plan or methodology seemed to exist for providing state government with office space. The Forty-seventh Legislature, 1941, believed more state office buildings needed to be built and the buildings should be constructed using a plan that provided maximum efficiency for state agencies with the least expense. In the 1944 *Capitol Plan Report*, the Capitol Planning Commission stated that building according to a good plan would outweigh temporary expediency in building on smaller tracts, and that purchasing or building without a plan would increase future costs. TFC now routinely develops strategic facilities plans to guide state infrastructure development and to inform the Legislature and state leadership. These plans are statutorily required to continuously analyze office space use and needs and make recommendations to the Legislature regarding how to best meet the state’s space needs.

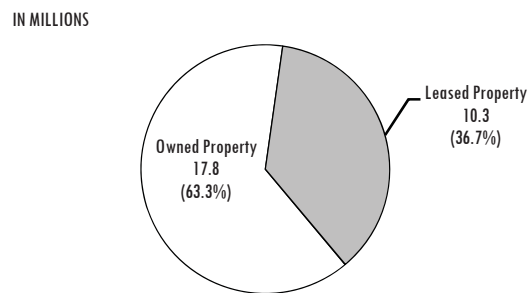
OVERVIEW OF TEXAS FACILITIES COMMISSION PROPERTY

TFC supports the office space needs of approximately 100 agencies and has charge and control of most state office buildings, grounds, and property. Public institutions of higher education and select other entities are responsible for their own office space needs. Outside of those exceptions, TFC is responsible for the proper care and protection of state property. Currently, TFC manages more than 28 million square feet of state-owned property and leased space for other agencies. Statute requires TFC to prioritize the placement of agencies in state-owned buildings; however state-owned buildings are at 100 percent capacity and have continuously been so since 1959. Therefore, non-state-owned office space accommodations are leased for several agencies. Owned property includes office buildings, warehouse and storage buildings, parking garages and lots, land, and cemeteries. Leased property includes office space, laboratories, printing facilities, and parking.

In fiscal year 2013, office space comprised 86 percent of all state leased space. Leased office space includes offices in 253 cities throughout the state and in New York, California,

Illinois, Oklahoma, and Washington, D.C. Many out of state leases relate to the CPA’s auditing duties for companies doing business in Texas. State entities such as the Governor’s Office, Texas Workforce Commission, and Texas Department of Transportation maintain office space in Washington, D.C. Some leases in Texas are interlocal, meaning with local governments or nonprofit organizations. For example, TFC may help an agency lease office space in a county courthouse. In fiscal year 2013 the average cost per square foot of interlocal or nonprofit leases was \$5.30. The state generally pays some portion of building operating or finish-out expenses for these leases. Due to economic conditions and population growth, TFC expects many of these arrangements will be cancelled or prices will increase in the future as local governments seek to increase revenue or need additional space for their operations. **Figure 1** shows TFC’s overall property portfolio in fiscal year 2013 and **Figure 2** shows TFC’s office property portfolio in the same year. While TFC owns the majority of the property it oversees, the majority of TFC’s state office space is leased.

**FIGURE 1
TEXAS FACILITIES COMMISSION'S PROPERTY BY SQUARE FOOTAGE, FISCAL YEAR 2013**

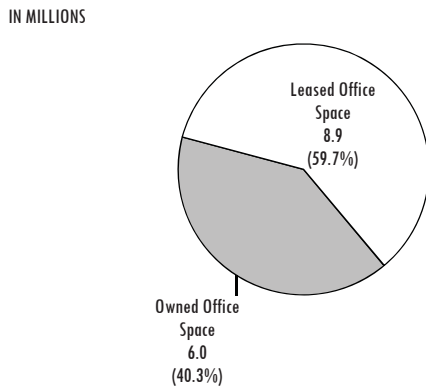


SOURCE: Texas Facilities Commission.

In 1989, TFC leased 7.8 million square feet of office space at an All Funds cost of \$57.9 million. In fiscal year 2013, TFC leased 8.9 million square feet of office space at a cost of \$138 million in All Funds. **Figure 3** shows the ratios of state-owned to leased property by square footage in fiscal years 1959, 1989, and 2013.

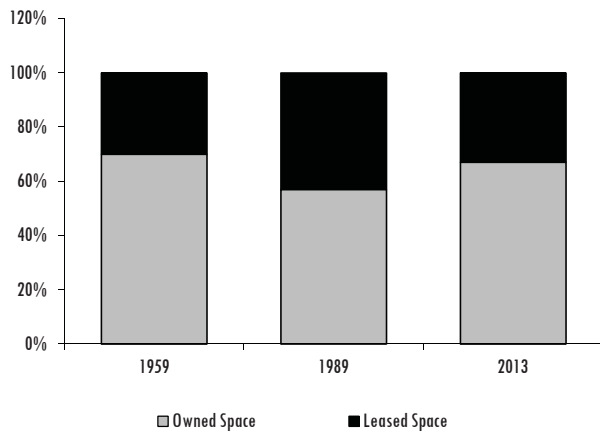
The average operating cost per square foot of office space in fiscal year 2013 was \$8.96 in owned space and \$15.56 in leased space. TFC defines operating costs in state-owned buildings as utilities, maintenance, janitorial services, and bond debt payments. These costs in leased buildings include rent, utilities, and custodial services.

FIGURE 2
TEXAS FACILITIES COMMISSION'S OFFICE SPACE BY
SQUARE FOOTAGE, FISCAL YEAR 2013



SOURCE: Texas Facilities Commission.

FIGURE 3
PERCENTAGE OF TEXAS FACILITIES COMMISSION'S
OWNED AND LEASED OFFICE SPACE IN TRAVIS COUNTY
CALENDAR YEARS 1959, 1989, AND 2013



SOURCE: Texas Facilities Commission.

According to TFC, state full-time-equivalent (FTE) employee hiring and needs have traditionally increased according to population growth, but population is not the only factor correlated with FTE growth in state government. Due to recent agency budget reductions, while the state's population has increased more than 3 percent from fiscal years 2011 to 2013, state FTE population in TFC office space has decreased by 1 percent. Although TFC's client agencies project minimal FTE growth in the next three biennia, numerous foreseen and unforeseen factors could affect FTE trends. Factors that could affect FTE trends include: appropriation changes for specific agencies;

legislative directives to cut agency spending or FTE positions; abolishment or combining of agencies; or revenue shortfalls.

RECENT ACTIVITY IN THE CAPITOL COMPLEX AND NORTH AUSTIN

TFC generally cannot build or buy new buildings without authorization from the Legislature. The Legislature has considered expanding TFC's portfolio of owned assets in an effort to more efficiently use state funds. TFC and the Legislature have worked to assess and update the state's office space portfolio by adding space in the Capitol Complex and the North Austin area.

For TFC's planning purposes, the Capitol Complex is defined in statute as property owned or controlled by the state in Austin, Texas and bounded on the north by the inside curb of Martin Luther King, Jr., Boulevard, on the east by the outside curb of Trinity Street, on the south by the outside curb of 10th Street, and on the west by the outside curb of Lavaca Street. Also included are the William P. Clements State Office Building located at 300 West 15th Street and any other location approved by the Director of the Department of Public Safety as under the jurisdiction of the capitol police district. TFC includes the E.O. Thompson building located at 920 Colorado Street. **Figure 4** shows the Capitol Complex.

2013 MULTI-PHASE PLAN

In February 2013, TFC proposed a three phase plan to construct new office space and parking in the Capitol Complex and North Austin. As shown in **Figure 5**, this plan was estimated to cost approximately \$900 million in All Funds over 7 years.

The February 2013 plan included more than 4 million square feet of space and 7,000 parking spaces. It would have resulted in 38 leases being retired and 8,700 FTEs and 22 agencies moving from leased spaced to state-owned space. Approximately 90 percent of TFC's leased inventory in Austin would have been eliminated. The \$896.4 million cost would have been funded through revenue bonds issued by the Texas Public Finance Authority (TPFA) on behalf of TFC. These bonds would be not self-supporting debt because they would be backed by debt service payments (General Revenue Funds). The total revenue bond debt for all phases of the February 2013 multi-phase plan would have increased the state's Constitutional Debt Limit ratio by 0.20 percent.

The Eighty-third Legislature, Regular Session, 2013, passed legislation which appropriated funds to begin work on the

FIGURE 4
THE CAPITOL COMPLEX AS DEFINED BY STATUTE AND THE TEXAS FACILITIES COMMISSION, CALENDAR YEAR 2014

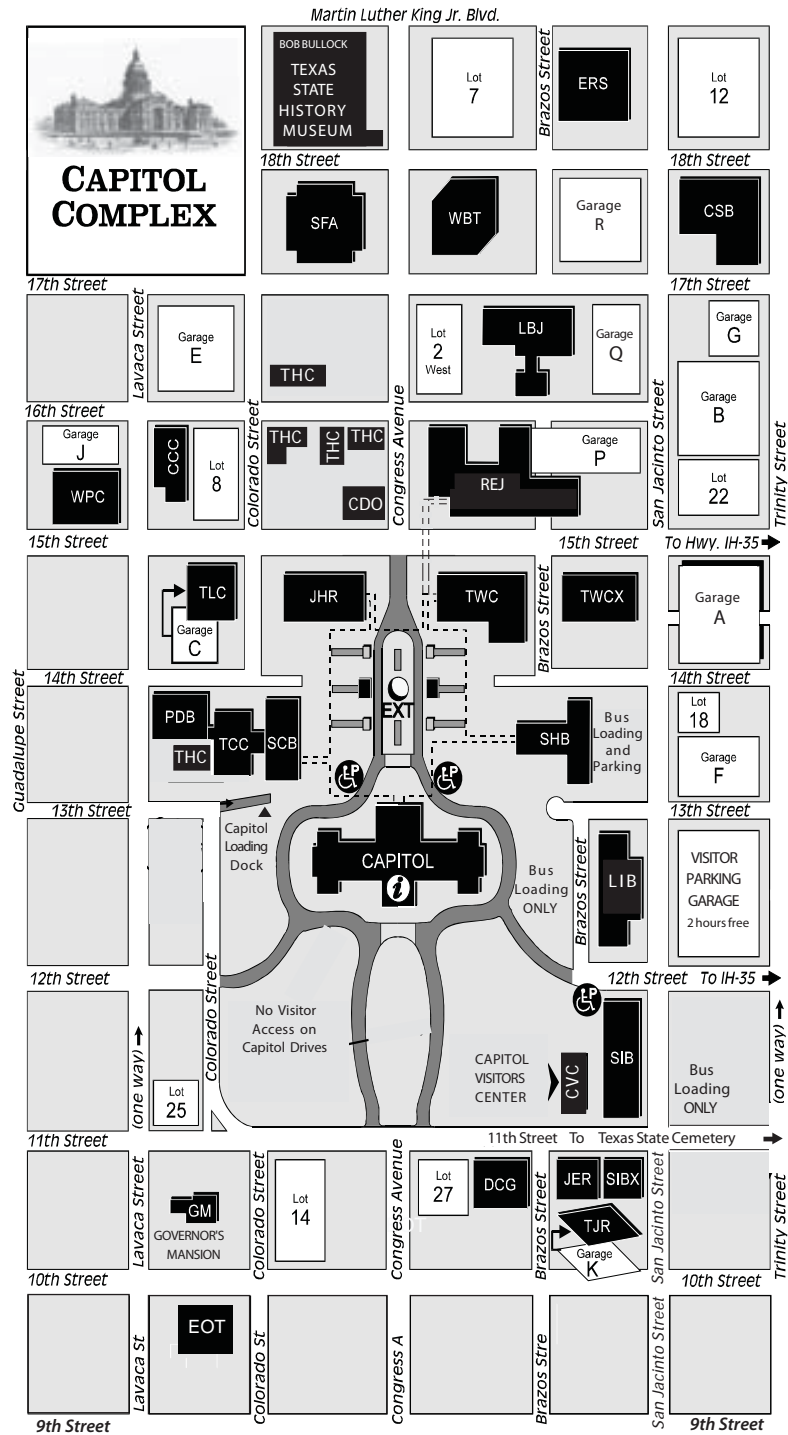


FIGURE 4 (CONTINUED)
THE CAPITOL COMPLEX AS DEFINED BY STATUTE AND THE TEXAS FACILITIES COMMISSION, CALENDAR YEAR 2014

NOTE: Below is the legend for the map.

CCC Capitol Complex Child Care	JHR John H. Reagan Building	TCC Tom C. Clark Building
CVC Capitol Visitors Center	LBJ Lyndon B. Johnson Building	TJR Thomas Jefferson Rusk Building
CDO Capitol District Office (DPS)	LIB Lorenzo de Zavala State Archives and Library	TRS Teacher Retirement System
CSB Central Services Building	PDB Price Daniel Sr. Building	THC Texas Historical Commission
DCG Dewitt C. Greer Building	REJ Robert E. Johnson Building	TSHM Bob Bullock Texas State History Museum
EOT Ernest O. Thompson Building	SCG Supreme Court Building	TWC Texas Workforce Commission
ERS Employee Retirement System	SFA Stephen F. Austin Building	TWCX Texas Workforce Commission Annex
EXT Capitol Extension (underground)	SHB Sam Houston Building	TLC Texas Law Center
GM Governor's Mansion	SIB State Insurance Building	WBT William B. Travis Building
JER James Earl Rudder Building	SIBX State Insurance Building Annex	WPC William P. Clements, Jr. Building

SOURCE: Legislative Budget Board.

FIGURE 5
SUMMARY OF TEXAS FACILITIES COMMISSION'S MULTI-PHASE PLAN, FEBRUARY 2013

PROJECT PHASE	PROJECT	TOTAL COST (IN MILLIONS)	PROJECTED OCCUPANCY DATE	ANNUAL RETIRED LEASE EXPENSES (IN MILLIONS)
1	1 Capitol Complex building 1 North Austin Complex building 1 North Austin Complex parking structure	\$325.6	2018	\$13.8
2	1 Capitol Complex Building 1 Capitol Complex underground parking structure	\$298.7	2019-2020	\$8.8
3	1 Capitol Complex building 1 North Austin Complex building 1 North Austin Complex parking structure	\$272.1	2021	\$7.9
TOTAL	3 Capitol Complex buildings 2 North Austin Complex buildings 1 Capitol Complex underground parking structure 1 North Austin Complex parking structure	\$896.4		\$30.5

SOURCE: Legislative Budget Board.

plan through supplemental appropriations provided in House Bill 1025. The legislation directed TPFA to issue revenue bonds in an amount not to exceed \$325.6 million. It also appropriated these bond proceeds and an additional \$5.2 million in General Revenue Funds for debt service to TFC. The amount of revenue bonds TPFA was directed to issue was equivalent to the amount TFC requested for phase one of the Austin area plan.

The Eighty-third Legislature, Regular Session, also passed Senate Bill 211. This legislation was the result of the Texas Sunset Commission's review of TFC. The legislation incorporated several of the Sunset Commission's recommendations for TFC. These recommendations include requiring TFC to prepare a Capitol Complex Master Plan and include the General Land Office, the State Preservation Board, the Texas Historical Commission, and other relevant interested parties in each stage of the master plan's

development. Since TFC's building plan for Austin-area space was not developed in coordination with the State Preservation Board or other entities named in Senate Bill 211, the Governor line-item vetoed funding for phase one of the Austin plan. Without funding, the plan could not proceed.

2014 MULTI-PHASE PLAN

While TFC's February 2013 plan will not be implemented, TFC has begun work on a new multi-phase plan to relocate state agencies and their FTEs from leased space to state-owned space. This new Capitol Complex Master Plan is being developed in coordination with the General Land Office, State Preservation Board, Texas Historical Commission, and members of the Partnership Advisory Commission. TFC estimates that real estate values in the Austin area will continue to rise, leading to increased lease

costs for the state. Relocating agencies to state-owned office space remains a focus for TFC.

In the 2014 *Master Facilities Plan Report* and TFC’s exceptional item requests submitted as part of its Legislative Appropriations Request for fiscal years 2016 and 2017, TFC outlines the new multi-phase plan to address office space in the Capitol and North Austin areas. **Figure 6** shows a summary of the plan.

TFC estimates the new plan would save the state more than \$270 million in occupancy costs by 2045. The agency projects a full return on investment (ROI) for the state from the project by fiscal year 2050. Building new office space would also upgrade facilities from Class B and C buildings to Class A buildings. Class B and C buildings have fair to good finishes and adequate systems, or functional space and systems, respectively. Class A buildings have high quality, standard finishes and state of the art building systems. TFC contends housing state agencies in higher rated buildings would be more appropriate than where they currently reside. Class A buildings are of a higher level of quality and durability. According to TFC, higher quality buildings will last longer than Class B buildings. The cost difference between the two buildings is minimal. The largest cost difference between classes comes between Class B and C buildings.

TEXAS FACILITIES COMMISSION REPORTS AND DECISION-MAKING TOOLS

Statute requires TFC to generate and submit two reports regarding office space to the Governor, Lieutenant Governor, Speaker of the House of Representatives, Comptroller, and Legislative Budget Board. The *Capitol Complex Master Plan* includes the agency’s analyses and plans related to the Capitol Complex and is generated with required input from other state entities such as the State Preservation Board. The *Master Facilities Plan Report* includes the results of a number of analyses required by law, as well as TFC’s recommendations for how the state can meet future office space needs. The information in this report satisfies multiple statutory reporting requirements for TFC.

CAPITOL COMPLEX MASTER PLAN

While the State Building Commission adopted a Capitol Area Master Plan in 1955 and the State Preservation Board adopted a similar plan in 1989, the requirement for a TFC Capitol Complex Master Plan (CCMP) was not codified in statute until the passage of Senate Bill 211, Eighty-third Legislature, Regular Session.

By April of 2016, TFC is required to complete the Capitol Complex Master Plan. The CCMP must be reviewed by the Partnership Advisory Commission. The State Preservation Board, the Texas Historical Commission, the General Land Office, and other relevant interested parties must be included

**FIGURE 6
CAPITOL COMPLEX AND NORTH AUSTIN BUILDING PLAN, CALENDAR YEAR 2014**

PROJECT PHASE	PROJECT	TOTAL COST	RETIRED LEASES (AT COMPLETION OF PROJECT)	RETIRED LEASE EXPENSES (ANNUAL)
1	1 Capitol Complex building	\$174.5 million (Capitol Complex)	5 (Capitol Complex)	\$4.4 million (Capitol)
	1 Capitol Complex parking structure	\$186.5 million (North Austin)	6 (North Austin)	\$6.0 million (North Austin)
	1 North Austin building			
	1 North Austin parking structure			
2	1 Capitol Complex building with underground parking		2 (Capitol Complex)	\$3.8 million (Capitol)
	3 North Austin buildings		7 (North Austin)	\$5.0 million (North Austin)
	1 North Austin parking structure			
Future Phases (as necessary)				
TOTAL	2 Capitol Complex buildings (1 with underground parking)		20 leases	\$19.2 million
	1 Capitol Complex parking structure			
	4 North Austin buildings			
	2 North Austin parking structures			

NOTE: Information relating to costs of Phase 2 and specific details of additional phases are not yet available.
SOURCE: Texas Facilities Commission.

in each stage of development. Once the first CCMP is approved, TFC must work with these agencies to update the CCMP each even-numbered year.

The plan must include:

- an overview of previous Capitol Complex plans;
- strategic vision and long-term goals for the Capitol Complex;
- analysis of state property in the Complex and how it meets state needs;
- analysis of and recommendations for building guidelines;
- analysis of and recommendations for Complex infrastructure needs;
- analysis of and recommendations for financing projects mentioned in the plan;
- detailed proposals for state property in the Complex;
- timeframes for implementing the plan; and
- consideration of non-Complex options for meeting state space needs.

The CCMP must harmonize with the Master Facilities Plan and the two plans must together comprehensively address the space needs of state agencies.

Although the first CCMP is not due until April 2016, TFC began work on the plan with required agencies in 2013 and, based on collaboration with required agencies, created a high-level CCMP. Capitol Complex buildings proposed in

TFC’s Legislative Appropriations Request for fiscal years 2016 and 2017 are included in the high-level CCMP.

MASTER FACILITIES PLAN REPORT

TFC issues its *Master Facilities Plan Report* each even-numbered year. The Texas Government Code, Section 1062.102, requires the long-range, six-year report that primarily focuses on Travis County office space and specifies the report must include space needs projections, the use of leasing, economic and market conditions impacting leasing and construction, and other items. Additionally several other reports or summaries of areas outside of Travis County are included in the report. **Figure 7** shows selected reports included in the master facilities plan and the corresponding statutory reference.

COUNTIES WITH OVER 50,000 SQUARE FEET OF OFFICE SPACE NEEDS

TFC is required to continuously survey the state’s office space needs. It is also required to identify counties in which more than 50,000 square feet of usable state office space is needed and to make recommendations for meeting that need.

While TFC must prioritize placement in state-owned buildings, it may also consider leasing, buying and renovating, or building new buildings. Statute authorizes TFC to buy or build office space if projected total space occupancy costs of the purchased or constructed space will not exceed, over the term of bond indebtedness, the projected annual total space occupancy costs of meeting the same needs through leased space. In this context, total space occupancy costs include lease payments or payments related to owning buildings,

**FIGURE 7
SELECTED REPORTS, STUDIES AND ANALYSES INCLUDED IN THE MASTER FACILITIES PLAN REPORT
CALENDAR YEAR 2014**

ITEM	STATUTORY REFERENCE (TEXAS GOVERNMENT CODE)
Report on improvements and repairs	Section 2165.055
Study of efforts to colocate administrative office space in counties with a population of greater than 75,000	Section 2165.1061(f)
Study of office space locations in Travis County that exceed space limitations	Section 2165.1061(h)
Compilation of construction and maintenance information	Section 2166.101
Long-range plan for state agency office space needs in Travis County	Section 2166.102(b)
Report on space needs in counties in which more than 50,000 square feet of office space is needed by state agencies	Section 2166.103
Summary of requested projects	Section 2166.104
Plan on comprehensive capital improvements and deferred maintenance	Section 2166.108

SOURCE: Legislative Budget Board.

renovations, and operating costs, including maintenance costs for owned buildings.

Since buying or building is required to be financed by Texas Public Finance Authority (TPFA) and TPFA bonds for this purpose are typically 20 years, projections are generally for 20 years. This means that the cost of building or buying and renovating may be greater than the cost of leasing in the specified period. TFC contends that state buildings' structural system and exterior should last 100 years rather than 20 to 30 years; meaning more than half the life of the building is not included in this cost analysis. Over time, beyond the period of debt payment, the state would avoid costs from not leasing office space.

In the 2014 *Master Facilities Plan Report*, TFC identified 28 counties with state office space needs of at least 50,000 usable square feet. To determine how to best meet state needs, TFC performs a build versus buy and renovate versus lease (BBL) analysis for each county. This analysis, which has been approved by the State Auditor's Office, includes five evaluations:

- Lease data is evaluated to determine need, including all client service and administrative functions, and whether 50,000 square feet of administrative space is necessary.
- Market evaluation information is surveyed to determine market conditions, current lease rates and projected increases, and the availability of land and buildings.
- Renovation and new construction costs are evaluated using RS Means, a construction industry standard cost estimating tool, and include locational adjustments as necessary. Cost calculations are used to generate square footage costs used in later steps of analyses.
- Building versus buying and renovating is also evaluated. This evaluation takes into account acquisition costs (for either purchasing a building or land), space needs, parking spaces needed, projected move in dates for buying and building, furniture and installation costs, telecommunications costs, and indirect expenses such as architectural, engineering, and legal fees.
- TFC performs a lease-to-own cost evaluation, with an assumed 20-year lease period, divided by two 10-year leases. Full-service lease rates are projected to account for inflation and other increases, and are compared

to previously mentioned buy and build projections over 20-year periods. The total cost of buying versus building versus leasing over a 20-year period are compared.

If, during the above analysis, TFC determines owning would be less expensive than leasing or provide savings in a city, the agency performs a more detailed analysis for that city to help inform potential recommendations.

LEASE CONSOLIDATION IN COUNTIES WITH POPULATIONS OF OVER 75,000

State agencies located in a county with a population of over 75,000 are required to submit to TFC an on-site space analysis and a space allocation plan. TFC uses the plans to identify areas in the state where more than one agency leases space and where cost savings are potentially available. Once these areas have been identified, the feasibility of colocating agencies in one place is evaluated based on the following criteria:

- Two or more leases exist in a city;
- The expiration dates of current leases in the area are similarly aligned;
- Consolidation will allow for the achievement of efficiencies, such as reducing the number of conference rooms; and
- Adequate facilities exist, such as those that meet the space needs of the state agencies.

State agencies that are candidates for colocation work together with TFC to develop a transition plan to colocate office space. The plans must include detailed costs and benefits of colocating. Lease consolidation differs from the space needs evaluation described above because rather than making recommendations requiring action on the part of the Legislature, TFC can implement the colocation process in collaboration with state agencies.

Although consolidating lease space may reduce space requirements or decrease costs, several factors may be included in the cost-benefit analysis that result in overall costs which outweigh benefits. Consolidating into available larger space may result in agencies paying more per square foot than they pay in their current location. Agencies may have such different missions that colocation may not be advantageous because of needs, or an agency may need to be near a certain area to best perform its mission. Reducing or sharing space, such as a conference room, may cause

inefficiencies in practice. For these and other unique reasons, TFC sometimes issues requests for proposals (RFPs) but later cancels the RFPs if it is determined that colocation and consolidation is not advantageous.

TFC is required to include the results of its efforts to colocate agencies in the master facilities plan. In the 2014 *Master Facilities Plan Report*, TFC identified 34 counties and 43 cities as the initial evaluation field. After analysis, TFC identified eight cities as candidates for lease consolidations by calendar year 2017 using the collocation process. TFC has also been working since 2011 to transition 131 expiring leases into 17 consolidated leased sites.

REQUESTING ADDITIONAL SPACE

TFC continually analyzes the state's office space needs. It provides agencies with an online tool, the Texas Facilities Serving Center, which agencies use to request additional office space. If the request is for leased space, the request may be to either move or add space in the lease. For owned space, the request may involve reconfiguring current space to accommodate additional FTEs or other needs, or moving locations.

TFC's Planning and Portfolio Manager (P&PM) reviews the request to make sure that the request is justified. The justification process involves the agency utilizing the Texas Facilities Serving Center, providing information on current and projected FTEs, and completing a space programming form. The P&PM and requesting agency will also likely review the agency's required on-site space analysis and space allocation plan.

If a request is not justified, TFC will work with the requesting agency to modify the request until the request is appropriate for the need. If an agency is noncompliant with leasing requirements, TFC is required to report the noncompliance to the agency's governing body and state leadership.

If the request is justified, the P&PM will first consider placing the agency in state-owned space as required by law. If state-owned space is available that is nearby the requested space, the agency will be placed there. If state-owned space is not available, the request moves to TFC's Leasing Division.

The Leasing Division first seeks space available through other government bodies and attempts to place the agency in that leased space, if available. If that space is not available, the Leasing Division procures space under the provisions of the Texas Government Code, Section 2167. Historical structures

are considered first when seeking leased space. TFC uses a best value standard to acquire space.

Depending on the value of the lease, TFC may review and approve the lease. Agency moving costs are generally the responsibility of the moving agency, as are its lease payments. Agencies address landlord-tenant issues directly with landlords if possible, but TFC can work with landlords to resolve issues that remain unaddressed.

ADDITIONAL CONSIDERATIONS OF OWNING VERSUS LEASING

There are several general considerations stakeholders may weigh when deciding whether to own or lease office space. Additionally, the private sector, the federal government, and other states have differing models of managing office space and may consider additional factors when determining whether to build, buy, or lease office space.

BENEFITS AND DRAWBACKS OF OWNING AND LEASING OFFICE SPACE

While operating costs and FTEs are factors in determining how to meet state agencies' office space needs, they are not the only factors that the Legislature, TFC, and agencies consider when determining whether to build, buy, or lease space. **Figure 8** shows benefits and drawbacks to owning office space.

Once TFC receives funds to begin constructing a new building, the agency estimates it takes on average four and a half years to reach the point of project completion and occupancy. Occupation of a purchased building generally takes less time but can still take years due to mandated processes and renovation time. Alternatively, leased space is available in a shorter time frame. Space is generally leased to the state in five- to ten-year terms with options to renew the lease. TFC contends that lessors see state agencies as desirable tenants because they take care of property and generally remain tenants for 15 to 30 years, or until space requirements necessitate a move. State agencies may be especially desirable tenants in times of poor economic conditions because agencies are less likely than private-sector tenants to miss payments or cease operations. **Figure 9** shows benefits and drawbacks of leasing office space.

PRIVATE SECTOR CONSIDERATIONS

When performing an own versus lease analyses, private entities may emphasize certain factors, or consider factors not as relevant to the public sector. Public and private entities

**FIGURE 8
BENEFITS AND DRAWBACKS OF OWNING OFFICE SPACE, FISCAL YEAR 2015**

BENEFITS	DRAWBACKS
Stability of debt payments provides budget certainty	Lack of flexibility in location
Colocating agencies with functional interrelationships	Lack of responsiveness to changing needs such as agency realignment or reductions in appropriations
Space may be funded from lease cost avoidance over time	Statutory limitations on sales may not provide maximum profitability when property is leased or sold
Unnecessary properties may be leased or sold at a profit	
Efficient in areas where the state will have a continuous presence, such as the Capitol Complex	

SOURCE: Legislative Budget Board.

**FIGURE 9
BENEFITS AND DRAWBACKS OF LEASING OFFICE SPACE, FISCAL YEAR 2015**

BENEFITS	DRAWBACKS
Inventory can grow or shrink as necessary	Divisions within agencies, or interrelated agencies, may be separated due to the location(s) of available space, creating inefficiencies
In fiscal year 2013, the average lease cost was 13 percent below market value	Colocating agencies may necessitate large spaces that are limited; which is unfavorable for negotiations and flexibility
Consistent lease criteria across the state provides predictability and stability for agencies and property owners	Volatility of real estate markets and properties may necessitate unexpected and costly relocations
Agencies have flexibility to locate space in targeted areas to efficiently provide services. Locations can shift as targeted areas shift	

SOURCE: Legislative Budget Board.

exist for different purposes and therefore needs and goals will likely differ. Additionally, the private sector is not subject to statutory requirements and prohibitions that control public sector decision making.

Both public and private-sector decision makers may consider return on investment (ROI) of real property, although the private sector may focus particularly on the period necessary for ROI and how it relates to profitability and survivability. The private sector may also focus more on how real property fits into the overall business strategy and model. For example, a private sector business in the market for real estate may prefer leasing space if space requirements are planned to grow over time, making the purchase of a building impractical. Private sector decision makers may also leverage incentives offered by state and local governments, such as reduced taxes, to make decisions regarding owning versus leasing property

While public sector buyers such as the state may plan for limited expansion, expansion is generally not a goal of an agency. The private sector may consider purchasing a building too large for current purposes and leasing out additional space, while the public sector may be statutorily or legislatively limited in using facilities for such purposes. Private sector decision makers may have more purchasing power for real

property than the public sector, depending on legislative preferences and available funds.

FEDERAL AND STATE PRACTICES

The federal Public Building Service (PBS) maintains nearly 365 million square feet of rentable space and maintains a presence in all 50 states. Since fiscal year 2008, the majority of PBS’ space has been leased. The federal General Services Administration (GSA) owns the non-leased properties in PBS’ portfolio. The goal of the PBS is to create and maintain a self-sustaining portfolio of assets that meets the long-term needs of its federal customers. To meet this goal PBS assesses its customers, markets, and assets. To better understand customer needs, PBS proactively communicates with clients regarding their missions, space and security needs, and budgets. Market conditions are assessed using appraisals and analyses. Assets are tracked on a monthly basis using financial indicators including revenue, funds from operations, and net operating income. Other factors considered include vacancies, the physical condition of properties, energy efficiency, and historic designation.

The State of Washington’s budget for fiscal years 2013 to 2015 requires the state’s Office of Financial Management to review and recommend policies relating to leases. The Office of Financial Management, in response, conducted a national survey of states’ leasing practices. Participants from 43 states

participated in the survey. Eighty-eight percent of respondents provide leasing assistance to state agencies. Lease portfolios ranged from 150 leases to 1,742 leases. Square footage of leased space ranged from 2 million square feet to 15 million square feet. The survey identified centralized, decentralized, and hybrid methods of managing leased space across states. In states with a centralized model (for example Minnesota and Nebraska), a single authority managed leases statewide. In states with a decentralized model (for example Arizona), agencies handled their own space needs. In states with a hybrid model (for example Florida, Texas, and Washington), various levels of authority were provided statewide and specifically to agencies.

The survey results showed several trends and observations across states, including:

- advanced planning is useful for timely and effective negotiations for space;
- consistent application of real estate policies and practices provides certainty for both agencies and private real estate owners; however, transparency in policies and practices is varied;
- agencies and private-sector property owners both benefit from flexibility to address changing market conditions and legislative appropriation levels; and
- private brokers can be effective in space location and negotiation.

CHANGING WORKSPACE PRACTICES

In the U.S. and Europe, workspace utilization during normal business hours is at or less than 50 percent, meaning more than half of workspace is not used from 8 AM to 5 PM on Monday through Friday. Since office space is the second highest business expense for many organizations, efforts are underway to more efficiently utilize resources.

According to survey results included in the U.S. General Services Administration's 2012 *Workspace Utilization and Allocation Benchmark*, corporate real estate professionals showed that more than two-thirds had implemented alternative work strategies (AWS) in the past year, and nearly two-thirds of the professionals expected their real estate portfolios to shrink in the next year. Alternative work strategies include home offices, telecommuting, desk sharing and satellite offices. The same report states that mobile work will continue to grow in both the public and private sectors. In addition to more efficiently meeting real property needs,

AWS may also improve organizational efficiency by reducing absenteeism, improving recruiting, and reducing turnover.

AWS may change how agencies and TFC project space needs and use in the future.

ALIGN NEW GRADUATE MEDICAL EDUCATION FUNDING WITH THE HEALTHCARE NEEDS OF THE STATE

Graduate medical education, also known as residency training, is the supervised training medical school graduates enter to gain clinical skills, practical knowledge, and in-depth experience in a specific field of medicine before becoming licensed doctors.

Because the location of residency training influences where doctors practice, it is important that more residency slots are established so that the state retains its educational investment in medical students and not lose them to other states. Three new Texas medical schools (two public and one private) are expected to begin accepting students in 2016. According to the Texas Higher Education Coordinating Board, by 2016 more than 100 Texas medical school graduates will not have an opportunity to remain in state for their residency training due to a lack of first-year residency positions.

Federal and state funding for graduate medical education is not optimally aligned with the healthcare needs of the state. Texas is facing an imbalance of the mix of physicians and where they practice; in part because funding mechanisms are designed to favor residency programs that produce more specialist than primary care doctors. Despite almost 70 percent of Texas counties wholly or partially designated as a primary care Health Professional Shortage Areas, Texas may soon be losing doctors to other states that could help to address this shortage. Without a sufficient number of residency training programs, doctors graduating from medical school in Texas may not return.

Graduate medical education is financed through multiple funding sources and intricate and varied arrangements between institutions like medical schools and hospitals. The federal government is the largest supporter of graduate medical education through the Medicare program. The ability to influence graduate medical education programs within a state using this funding is limited. However, state funding can be used to create additional residency programs and contribute to the types and location of doctors statewide. Implementing the recommendations in this report at an estimated cost of \$59.3 million for the 2016–17 biennium would better align new state funding with the current and future healthcare needs of Texans.

FACTS AND FINDINGS

- ◆ The Texas population is growing rapidly, and the number of healthcare providers is not keeping pace with the rate of growth.
- ◆ Many teaching hospitals emphasize research and specialty procedural care training over primary care training despite research identifying that the current mix of physicians exiting training is not aligned with the needs of an efficient, high-quality, high-value healthcare system.
- ◆ Since the creation of the state Health-Related Institution graduate medical education formula, a greater proportion of state graduate medical education funding is directed solely to health-related institutions that produce more specialty and sub-specialty doctors than primary care doctors.

CONCERNS

- ◆ Texas continues to experience a major geographic maldistribution of healthcare practitioners across the state. Sixty-nine percent of Texas counties are designated as whole or partial Primary Care Health Professional Shortage Areas. Research demonstrates that a reduced primary care physician supply is associated with worse health outcomes and reduced life span for populations.
- ◆ The state Health-Related Institution graduate medical education formula does not encourage a balanced geographic distribution and mix of specialty and primary care physicians to meet the current and future healthcare needs of the state.
- ◆ No national or state government or independent workforce entity exists to guide policymakers and stakeholders about the appropriate physician mix needed to meet the population's current and future healthcare needs.
- ◆ State appropriations have decreased or been eliminated for primary care residency programs. Reduced funding limits the state's ability to incentivize organizations to continue to train doctors who will practice in primary care specialties.

- ◆ Texas medical school graduation increased 31 percent from 2002 to 2012, and more medical school graduates are expected with the opening of additional medical schools. According to the Texas Higher Education Coordinating Board, by 2016 more than 100 Texas medical school graduates will have to leave the state for resident training due to a lack of first-year residency positions.
- ◆ Few Texas programs exist to train doctors to serve as teaching faculty to medical residents. A shortage of well-trained teachers can constrain the number and location of new medical residency programs established and the quality of the training.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to establish a critical shortage physician program at the Texas Higher Education Coordinating Board.
- ◆ **Recommendation 2:** Include a contingency rider in the 2016–17 General Appropriations Bill to appropriate \$19.8 million in All Funds to the Texas Higher Education Coordinating Board to implement a critical shortage physician program.
- ◆ **Recommendation 3:** Increase appropriations by \$500,000 in General Revenue Funds to the Department of State Health Services and include a rider in the 2016–17 General Appropriations Bill to direct the Health Professions Resource Center to conduct research about the appropriate mix of primary care to specialty physicians to meet current and future needs of the state, to identify shortages of specialty or sub-specialty physicians and their geographic location in the state, and other issues related to the physician workforce.
- ◆ **Recommendation 4:** Increase funding to the Texas Higher Education Coordinating Board for the Primary Care and Family Medicine Residency programs by \$15.4 million in All Funds.
- ◆ **Recommendation 5:** Amend statute to establish a teaching health center graduate medical education program at the Texas Higher Education Coordinating Board.
- ◆ **Recommendation 6:** Include a contingency rider in the 2016–17 General Appropriations Bill to appropriate \$16.2 million in All Funds to the Texas

Higher Education Coordinating Board to establish a teaching health center graduate medical education program.

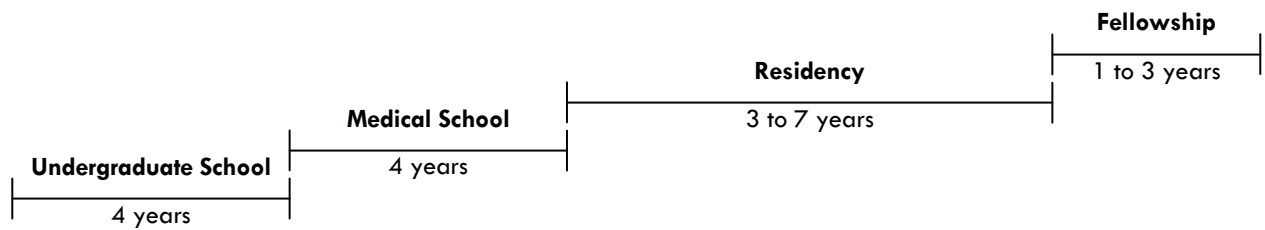
- ◆ **Recommendation 7:** Amend statute to establish a graduate medical education partnership grant program at the Texas Higher Education Coordinating Board for community health clinics to receive guidance from medical schools or other established institutions when beginning the accreditation process for a new medical residency program.
- ◆ **Recommendation 8:** Include a contingency rider in the 2016–17 General Appropriations Bill to appropriate \$6.0 million in All Funds to the Texas Higher Education Coordinating Board to implement a graduate medical education partnership grant program.
- ◆ **Recommendation 9:** Increase appropriations by \$1.4 million in All Funds to the Texas Higher Education Coordinating Board to develop physician faculty.
- ◆ **Recommendation 10:** Include a rider in the 2016–17 General Appropriations Bill to require the Texas Higher Education Coordinating Board to develop a report about the impact of new funding for graduate medical education and submit this report to the Legislative Budget Board and the Office of the Governor.

DISCUSSION

Graduate Medical Education (GME), also known as residency training, is the supervised training physicians enter after medical school to gain clinical skills, practical knowledge, and in-depth experience in a specific field of medicine. Graduates of allopathic medical schools earn a Medicine Degree (M.D.) and graduates of osteopathic medical schools earn a Doctor of Osteopathy degree (D.O.). Both medical school graduates enter residency training.

GME training occurs primarily in hospitals; but may also occur in other in-patient settings as well as out-patient sites such as hospital clinics, community health clinics, and federally qualified health centers (FQHC). As shown in **Figure 1**, the length of residency training varies by medical specialty and ranges from three to seven years. Residencies for family medicine and pediatrics are three years, while residencies for surgical specialties (e.g., general surgery, neurosurgery) are five years or more. To be licensed,

FIGURE 1
MEDICAL EDUCATION TIMELINE, AS OF FISCAL YEAR 2014



NOTE: Some medical specialties require training beyond residency, also called fellowship training.
SOURCE: Council on Graduate Medical Education.

physicians must complete at least one year of residency training, yet most doctors complete a full residency program to become board certified in their specialty. A specialty is training in a specific area of the medical field, like family medicine, anesthesiology, or pediatrics. Some medical specialties (e.g., cardiologist, oncologist, pediatric surgeon) require more advanced training beyond the initial residency period, also called fellowship training, which averages two to three years but varies depending on the subspecialty.

The Accreditation Council for Graduate Medical Education (ACGME) accredits GME residency programs for allopathic residencies and the American Osteopathic Association (AOA) accredits osteopathic residencies. A residency program may also be dually accredited by both entities. Accreditation by either entity provides assurance that a given residency program and its sponsoring institutions meet an accepted set of educational standards. Before practicing medicine, all states require physicians to complete a minimum number of years of training through an accredited residency program. Additionally, the Centers for Medicare and Medicaid Services (CMS) require residency programs to be accredited to receive Medicare funds.

Organizations accredited through ACGME that assume the ultimate financial and academic responsibility for a GME program are called sponsoring institutions. The sponsoring institution (e.g., a university, a medical school, a hospital, a school of public health, a health department, a public health agency, an organized healthcare delivery system, a medical examiner's office, a consortium, or an educational foundation) provides educational programs and/or healthcare services for residents. Organizations accredited through AOA need to be affiliated with an Osteopathic Postdoctoral Training Institution (OPTI). An OPTI is a community-based consortium comprised of at least one college of osteopathic medicine and one hospital, and may include additional hospitals and ambulatory training facilities. Within an

OPTI, the entity with operational and financial responsibility for the GME program is called a base institution and may include hospitals, federally qualified health centers, teaching health centers, and colleges of osteopathic medicine.

CHALLENGES OF DETERMINING RESIDENCY COSTS

Determining the cost of a residency program is difficult, in part, due to variance among GME programs. In 2010, the Medicare Payment Advisory Commission (MedPAC) reported that because of the variance in costs and benefits between specialties, some specialties may be more profitable and therefore more appealing to hospitals and medical schools to sponsor than other residency types. MedPAC is the independent congressional agency established to advise the U.S. Congress on issues affecting the Medicare program.

According to MedPAC, faculty salaries vary by specialty as does the cost of supervision and loss of productivity by supervising physician. Program administrators' salaries also vary by specialty because some disciplines require more scheduling and coordination across multiple training sites and first-year residents typically require more supervision until they gain more experience. Complicating the issue further, no two GME residency sites' costs are consistent because of the negotiations and intricate arrangements made between institutions (e.g., medical school and hospital) about which entity will be responsible for the costs of residents' salary, teaching faculty's compensation, and other activities that result in costs.

Research that has attempted to identify costs of GME has not always considered the offsetting benefits that GME programs bring to a healthcare setting. While doctors new to residency training are a cost to hospitals because of the need for intensive supervision, by the second and third years of residency training, they may work efficiently and inexpensively in a role the hospital would otherwise have to pay more to fill with experienced physicians. Residents are

still regarded as an inexpensive source of labor even with recent changes limiting residents' duty hours and accreditation entities' shift to emphasizing education over clinical services.

In 2013, the RAND Corporation, a nonprofit research institution, studied how the costs and benefits of a residency program differed by the program's size, specialty, type of sponsor, training venue, and geographic location across six types of residency programs. Smaller residency programs with high malpractice insurance costs and faculty compensation levels were found to have higher direct GME costs per resident than other programs. However in hospital-operated facilities, attending physicians in specialties with high compensation are more able to support residency programs from patient revenues than primary care residency programs because of lower patient revenues and care that is typically provided in an ambulatory setting, (e.g., clinic). Patient revenues and other hospital departments can subsidize primary care residencies in large academic health centers; however, this is not an option for smaller community hospitals and ambulatory sites. Program size, attending physician compensation levels, and malpractice insurance are key factors affecting the variation in direct costs across residency programs.

The Texas Higher Education Coordinating Board (THECB) estimates the cost to train a medical resident in Texas across all specialties to be \$150,000 per year. This cost is based on data provided by the family medicine residency program in their annual financial report to THECB. A family medicine residency program is considered by GME researchers and stakeholders to be one of the most expensive residency programs to maintain because training occurs in ambulatory clinics and not in a hospital. Texas family medicine residency programs receiving THECB grants must document expenditures and revenue for the residency program to demonstrate its funding needs and submit annual reports. Cost and expenditure data for Texas family medicine residency programs has been collected by THECB since fiscal year 2003, per the Texas Administrative Code.

FINANCING GRADUATE MEDICAL EDUCATION

Financing GME programs is complex due to the diversity of funding sources, the individual requirements of each source, and the unique administration and organization of each residency program. Multiple entities participate in a GME program. Medical schools, teaching health centers, hospitals, community centers, and others may participate as a sponsor

and/or training sites for medical residents. Contractual agreements are used to identify each participating site's academic and financial responsibilities and are required by accreditation entities. Negotiations may occur between these entities which results in differences in the administration and financing of each GME program. The funding of GME consists of federal, state, and nongovernmental funds. Much of the federal and state funding for GME is provided to hospitals because at the time when government financing was developed, hospitals were the main location where doctors were trained.

FEDERAL FUNDING

While GME is financed by several sources, the primary payer is the federal government through the Medicare program. Medicare is the federal health insurance program for people who are age 65 or older, certain younger people with disabilities, and people with End-Stage Renal Disease. The federal government spends approximately \$10 billion annually to support GME through payments to teaching hospitals to offset their higher patient care costs and the inefficiencies resulting from training new doctors. Medicare GME payments are paid to hospitals through two payment methodologies: Direct Graduate Medical Education (DGME) payments and Indirect Medical Education (IME) payments. DGME payments are for Medicare's portion of a hospital's direct costs of training residents such as: resident salaries and benefits, supervisory physician salaries, and some administrative overhead expenses. The payments are based on a "per resident amount" (PRA) that is specific to each hospital. DGME payments are calculated by multiplying the hospital-specific PRA by the number of the hospital's full-time-equivalent (FTE) residents and by the hospital's Medicare inpatient utilization.

The purpose of IME payments are to compensate a hospital for Medicare's portion of indirect costs a residency program can present; for example, an increased amount of testing and use of emerging technologies is associated with teaching residents, as well as higher patient acuity. The IME payment is a percentage increase or an "add on" paid on a per-claim basis. The Medicare IME payment is based on a formula in federal statute that uses the ratio of medical interns and residents-to-beds (IRB) and a multiplier set by Congress. The amount of the IME adjustment is affected by a hospital's Medicare patient volume, case mix, and number of residents.

Since 2000, the amount of Medicare's IME payment being used to offset indirect costs of residency-related programs has

been questioned. The IME payment to teaching hospitals accounts for approximately 68 percent of Medicare GME funding. The MedPAC analysis found that less than half of the total amount spent, 40 percent to 45 percent, on IME payments could be empirically justified. MedPAC contends that an estimated \$3.5 billion is received by teaching hospitals with limited accountability in regards to how the funds are used.

Most of the Medicare funds (DGME and IME) are distributed to teaching hospitals because that is where most residency training across the country occurs. While teaching hospitals, medical schools, educational consortium, and other entities may be a sponsoring institution for a residency program, Medicare funds are paid to the site where clinical training occurs. These entities have control over the use of the funds whether they are a sponsoring institution or only a training site that “hosts” resident clinical rotations. According to the Institute of Medicine (IOM), approximately 70 percent of Medicare GME funds are distributed to acute care hospitals. Non-hospital training sites may receive DGME payments if they incur most of the cost of a residency program and hospitals may continue to receive DGME payments for residents rotating to non-hospital setting sites if the hospital pays for all or most of the residency training costs. Consequently, the IOM pointed out that community-based ambulatory care sites and other non-hospital sites are eligible for significantly less funding than teaching hospitals.

STATE FUNDING

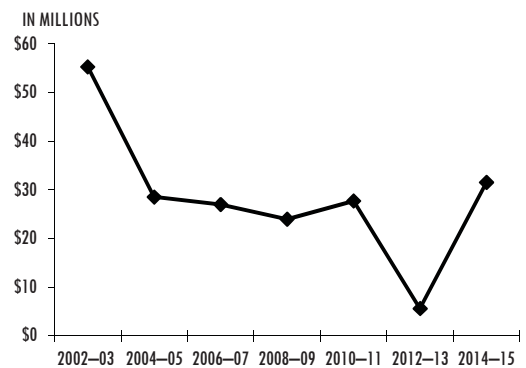
State funding supporting GME is distributed through three funding mechanisms: (1) General Revenue Funds trustee to THECB for GME-related grant programs, (2) General Revenue Funds allocated through GME formula funding to health-related institutions (HRIs), and (3) Medicaid payments to certain state-owned teaching hospitals.

The Texas Legislature has appropriated funds to THECB to support GME through multiple programs since 1977. These funds have been directed to residency programs specializing in primary care, family medicine, emergency and trauma care, and rural and public health. These programs were established to increase the number of residents and fellows in those residency types.

Funding levels for THECB trustee GME programs have fluctuated since fiscal year 2002. Appropriations to THECB for GME programs reached their lowest level in the 2012–13 biennium. The Eighty-third Legislature, appropriated approximately \$16.4 million to expand GME through the

enactment of House Bill 2550 and House Bill 1025, Regular Session, 2013. The legislation established new programs to help entities plan for new GME programs, fill unfilled GME positions, establish new residencies, develop innovative programs to increase the number of primary care physicians, and appropriated an additional \$7.8 million to the Family Medicine Residency program. **Figure 2** shows the historical trend in total biennial appropriations to THECB for GME programs from the 2002–03 to 2014–15 biennia; GME formula funding is not included in the totals.

FIGURE 2
BIENNIAL APPROPRIATIONS FOR TRUSTEED GRADUATE
MEDICAL EDUCATION PROGRAMS
2002–03 TO 2014–15 BIENNIA



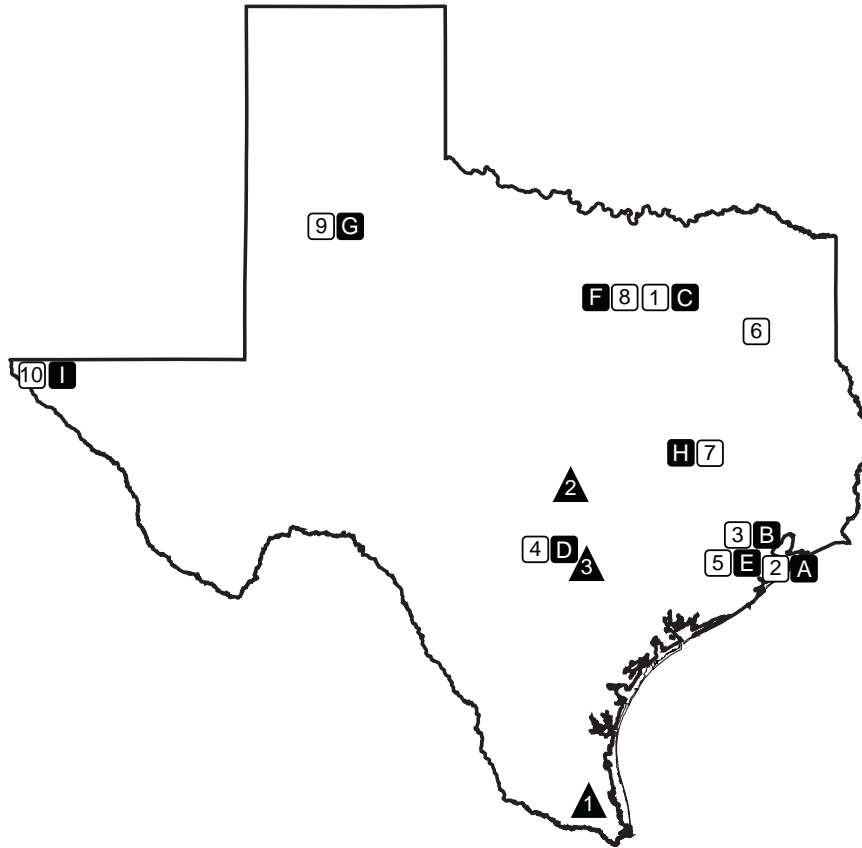
NOTE: Graduate Medical Education Formula Funding is not included.


SOURCE: Legislative Budget Board.

HEALTH-RELATED INSTITUTION FORMULA FUNDING

State funds are appropriated to the 10 HRIs and Baylor College of Medicine through GME formula funding. The GME formula is one of six funding formulas the Legislature uses to allocate funds among the HRIs to adequately support higher education. The Seventy-Ninth Legislature, Regular Session, 2005, established the GME formula to increase the total number of residency slots in the state and to support faculty costs related to GME at the HRIs and Baylor College of Medicine. There are four university health science systems that include a total of 10 HRIs located across Texas. Each HRI provides training and/or education (e.g., medical, nursing, or dental schools) in various health-related fields to its respective region of the state. **Figure 3** shows the location of each HRI and the Baylor College of Medicine, each of which receive GME formula funding, as well as the location of two planned public medical schools, and one private medical school, which may eventually sponsor GME programs.

FIGURE 3
TEXAS HEALTH-RELATED INSTITUTIONS AND MEDICAL SCHOOLS, AS OF FISCAL YEAR 2014



	MEDICAL SCHOOLS	LOCATION
A	The University of Texas Medical Branch at Galveston, School of Medicine	Galveston
B	Baylor College of Medicine	Houston
C	The University of Texas Southwestern Medical Center at Dallas, School of Medicine	Dallas
D	The University of Texas Health Science Center at San Antonio, Medical School	San Antonio
E	The University of Texas Health Science Center at Houston, School of Medicine	Houston
F	University of North Texas Health Science Center at Fort Worth, Texas College of Osteopathic Medicine	Fort Worth
G	Texas Tech University Health Sciences Center, Medical School	Lubbock (Amarillo, Permian Basin) (1)
H	Texas A&M University System Health Science Center, College of Medicine	College Station (Temple) (1)
I	Texas Tech University Health Sciences Center, El Paso, Paul L. Foster School of Medicine	El Paso


	MEDICAL SCHOOLS OPENING 2016	LOCATION
1	The University of Texas Rio Grande Valley Medical School	Rio Grande Valley
2	The University of Texas at Austin Dell Medical School	Austin
3	University of the Incarnate Word Medical School	San Antonio

FIGURE 3 (CONTINUED)
TEXAS HEALTH-RELATED INSTITUTIONS AND MEDICAL SCHOOLS, AS OF FISCAL YEAR 2014

	HEALTH-RELATED INSTITUTIONS	LOCATION
1	UT Southwestern Medical Center (2)	Dallas
2	UT Medical Branch at Galveston (2)	Galveston
3	UTHSC (3) at Houston (2)	Houston
4	UTHSC (3) at San Antonio (2)	San Antonio
5	UT M.D. Anderson Cancer Center (2)	Houston
6	UTHSC (3) at Tyler of Medicine (2)	Tyler
7	Texas A&M University System Health Science Center	Bryan/College Station
8	University of North Texas Health Science Center at Fort Worth	Fort Worth
9	Texas Tech University Health Sciences Center	Lubbock
10	Texas Tech University Health Sciences Center at El Paso	El Paso

NOTES:

- (1) Locations in parentheses are additional campuses that offer certain courses.
- (2) The University of Texas Health System Institutions.
- (3) UTHSC = The University of Texas Health Science Center.

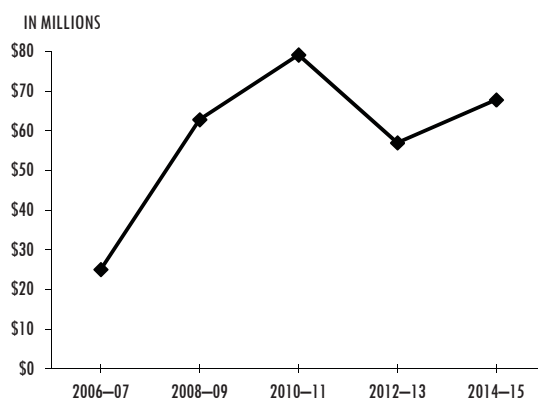
SOURCE: Legislative Budget Board.

Since the 2006–07 biennium, the General Appropriations Act has required that the GME formula provide funding on a per medical resident basis. For the 2014–15 biennium, the annual per resident amount is \$5,122. The GME formula is based only on the number of residents multiplied by the GME per resident amount. In practice, the Legislature has set the GME per resident amount based on available funding. As shown in **Figure 4**, the biennial GME formula funding was \$25 million for the 2006–07 biennium and has since ranged between \$57 million and \$79 million per biennium.

MEDICAID FUNDING

Medicaid programs help fund a portion of GME costs incurred by teaching hospitals and other entities. As of 2012, 42 states and the District of Columbia use Medicaid GME payments to support residency training. From 1986 to 2004, Medicaid GME funding provided additional support to public and private teaching hospitals in Texas that operated GME programs. Medicaid is a joint federal and state health insurance program for low-income families, older adults, and persons with disabilities. The federal government matches each state’s Medicaid spending at a pre-determined rate that varies by state. The rate is known as the Federal Medical Assistance Percentage (FMAP) and is calculated by a formula based in federal law. Currently, Medicaid GME funding is available only to five state-owned hospitals that have the option to contribute local funds as the non-federal match for Medicaid funds. General Revenue Funds have not been

FIGURE 4
GRADUATE MEDICAL EDUCATION FORMULA FUNDING
2006–07 TO 2014–15 BIENNIA



SOURCE: Legislative Budget Board.

appropriated to support Medicaid GME since fiscal year 2004.

Prior to fiscal year 2004, the Health and Human Services Commission (HHSC) made Medicaid GME payments to public and private teaching hospitals. State appropriations of General Revenue Funds were used to provide the non-federal share of GME Medicaid payments. Beginning in fiscal year 2004, General Revenue Funds were no longer used for the non-federal portion, and GME funding would only be available to these teaching hospitals if unclaimed state lottery proceeds were generated in excess of what was estimated by

the Texas Comptroller of Public Accounts in the 2004–05 Biennial Revenue Estimate.

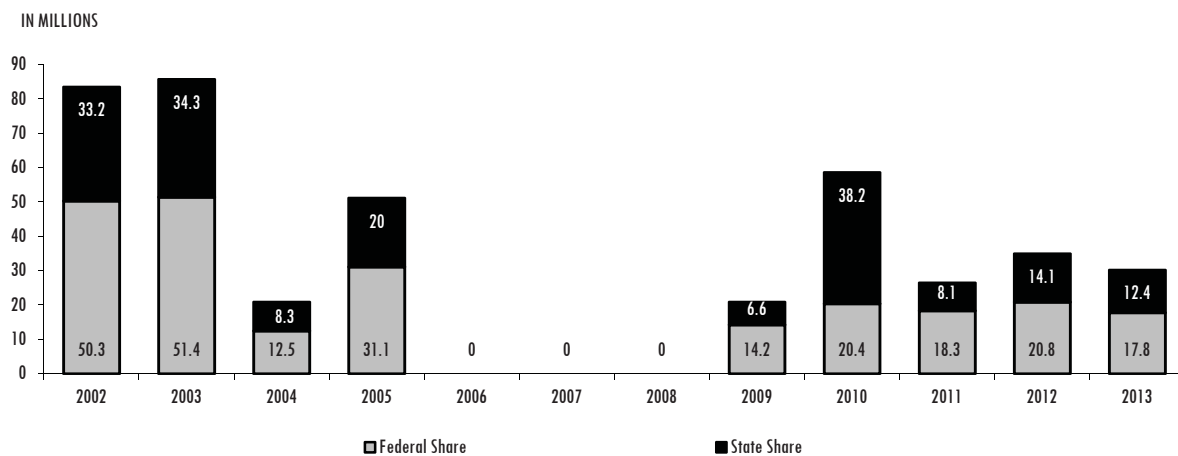
For the 2006–07 biennium, the Legislature did not make unclaimed state lottery proceeds available for GME. However, the Legislature did authorize HHSC, the state Medicaid agency, to expend up to \$80.9 million in the biennium, contingent upon receipt of intergovernmental transfers (IGT) from public teaching hospitals that would be used as the non-federal portion of the Medicaid GME payment. HHSC reported at the time that the teaching hospitals did not have an interest in this plan. Public teaching hospitals did not transfer local funds to HHSC in fiscal years 2006 to 2008.

In 2008, CMS approved a Medicaid state plan amendment allowing the state to make GME payments to five state-owned teaching hospitals beginning in fiscal year 2009. The non-federal share for the payments would come from the hospital’s state appropriations or local revenues that would be transferred to HHSC. The five hospitals are: The University of Texas Medical Branch in Galveston, The University of Texas M.D. Anderson Cancer Center in Houston, The University of Texas Southwestern St. Paul Hospital in Dallas, The University of Texas Southwestern Zale Lipshy Hospital in Dallas, and The University of Texas Health Science Center in Tyler. Currently, only state-owned or state-operated teaching hospitals are eligible for Medicaid DGME payments. **Figure 5** shows the Medicaid GME payments to Texas teaching hospitals for fiscal years 2002 to 2013.

The impact of Medicaid funding on state GME programs is variable. Of the eight states that do not provide Medicaid GME payments, all of them at one time did support GME through their Medicaid program. According to the Association of American Medical Colleges (AAMC), three states, Michigan, New York, and Pennsylvania have some of the largest number of teaching hospitals and medical residents in the country and receive some of the largest amounts of Medicaid GME payments. However, California, Illinois, and Massachusetts, who have a comparable number of teaching hospitals and medical residents, provide no Medicaid GME payments. In Illinois and Massachusetts, the consequence of not receiving Medicaid GME funding is different than in Texas. Both states have more robust Medicaid programs than Texas and they have lower rates of persons without health insurance, 14 percent and 4 percent respectively, compared to Texas’ rate of 24 percent. As a result, teaching hospitals in Illinois and Massachusetts have less uncompensated care and the financial support of more payers to sustain GME programs.

Despite the number of states using Medicaid to support GME programs, the federal government has taken steps to disallow this practice. In 2007, a proposed rule would have clarified that cost and payments associated with GME programs are not federally reimbursable expenditures in the Medicaid program; however, this rule has not been implemented to date.

FIGURE 5
GRADUATE MEDICAL EDUCATION MEDICAID PAYMENTS TO TEXAS TEACHING HOSPITALS, FISCAL YEARS 2002 TO 2013



NOTE: Public teaching hospitals did not transfer local funds to the Health and Human Services Commission for fiscal years 2006 to 2009. Payments from 2009 to 2013 are only to The University of Texas System hospitals. In 2010 a payment was made to a certain hospital district to settle a lawsuit.
SOURCE: Legislative Budget Board.

NON-GOVERNMENTAL FUNDING

GME programs receive additional funding from non-governmental sources like foundations, endowments, medical school affiliations, and research grants. Private insurers contribute to GME program funding indirectly by paying higher rates for services provided at teaching hospitals. Also, hospital clinical practice plans and patient care revenue are available sources of revenue that institutions may use to support a GME program.

INFLUENCES AND LIMITATIONS OF FEDERAL FUNDING ON GRADUATE MEDICAL EDUCATION

Although never intended to be a permanent funding source for GME, Medicare's impact on GME has been significant. As the single largest source of funding of GME, Medicare's payment structure has shaped the GME system. Consequently, the limitations and incentives in the current funding system impact multiple policy issues that states have limited ability to influence. Medicare payment methodology shapes the number of state residency slots, the geographic distribution of federal funding, and the physician mix of generalists and specialists.

In its current form, Medicare's payment system favors procedural care, and volume, not quality. According to healthcare researchers, there is not a direct relationship between most of the funds supporting GME and the costs of GME educational activities because Medicare bases its payment on services and utilization. MedPAC indicates that neither is a good basis for encouraging hospitals to foster educational programs and environments because hospitals are influenced by financial incentives in Medicare payments that may conflict with educational goals. Medicare rates paid for various services influence providers' perceptions about what types of care are most valued.

FEDERAL LIMITS ON RESIDENT POSITIONS AT HOSPITALS

At various points in time, the federal government has sought to control GME costs and ensure an adequate supply of doctors. In 1997, the federal Balanced Budget Act set limits or caps on the number of residents a hospital can claim for its Medicare DGME and IME payments. The caps are based on the number of residents counted in hospitals' 1996 Medicare cost reports. These caps were readjusted in 2002 and 2005 on a national redistribution formula. With very limited exceptions, residency programs do not receive any federal funding for resident slots above their Medicare caps and must find funding to support the excess slots from other sources. According to THECB, in 2010 Texas hospitals

exceeded Medicare resident caps by 13 percent. Other states exceeding their caps include California, Ohio, and Illinois; each is 13 percent over their limit. Florida and North Carolina exceed theirs by 20 percent and 17 percent, respectively.

States can use an exception allowed by Medicare to increase the number of residency slots eligible for Medicare payments. To do this, a residency program may be established at a hospital that did not have a program before January 1, 1995. If other CMS criteria are satisfied, then the hospital has five years to establish their resident cap. At the end of the fifth year, the cap would be based on the number of residents in all GME programs.

DISTRIBUTION OF MEDICARE GRADUATE MEDICAL EDUCATION FUNDING

Nationwide the number of doctors in residency training and practicing medicine is affected by the distribution of Medicare GME funding because the location of residency training influences where doctors practice. Doctors are more likely to practice in the states where they received their training. In 2012, AAMC reported that after completing training in an ACGME-accredited residency program, 47.4 percent of physicians either stayed or returned to the state where they completed their most recent GME training.

New research about the geographic distribution of Medicare funds has identified inherent and historical imbalances in the current payment system. Due to states' dependence on federal support for residency training, the distribution of funds is a significant concern for many states. Medical schools nationwide are on track to increase enrollment by 30 percent by 2017, as recommended by the AAMC. Southern and Western states that have established more medical schools and increased enrollment since 2000 now face a substantial barrier to expanding residency programs quickly without additional Medicare funding.

According to research published in the *Health Affairs* in November 2013, from 2000 to 2010 the populations of California, Florida, and Texas grew by 10 percent, 17.6 percent, and 20.6 percent, respectively. However, these states ranked 28th, 42nd, and 35th, respectively in the Medicare GME cap per 100,000 population. In comparison, East Coast states like New York, Massachusetts, and Pennsylvania with long-established GME programs experienced single digit population growth during the same period and rank second, third, and fifth, respectively, in the GME cap per 100,000 population. States with increased population

growth during the last decade have borne the costs of adding more residency slots and have not received additional federal funding to expand training capacity to accommodate the population growth experienced since 1997, when resident caps were set.

NATIONAL PHYSICIAN MIX IMBALANCE

Teaching hospitals continue to add and self-fund new residency slots above federal limits despite the federal restriction on the number of residents a hospital can claim for Medicare payments. MedPAC identified that some residency programs may be financially self-sustaining given the number of teaching hospitals that continue to train more residents than Medicare supports. Their analysis of Medicare data shows that hospitals that have exceeded the capped number of residents subsidized by Medicare tend to have more subspecialty residents than those that are under the cap. Nationally, the majority of the new positions added by hospitals are fellowships in subspecialty disciplines, rather than primary care, and cannot be filled by entry-level doctors. At present, Medicare GME payments do not incentivize training in primary care disciplines (e.g., family medicine, general internal medicine, general pediatrics, and obstetrics/gynecology). Medicare GME payments have increased and improved the delivery of complex specialty care.

The Council on Graduate Medical Education (COGME) and MedPAC have called for a more balanced mix of primary care and specialty care physicians nationwide; however, no national government or independent workforce entity exists to guide policymakers and stakeholders about the appropriate physician mix. The federal government has not taken action to lift the Medicare GME caps because there is not agreement among stakeholders or policymakers about how to reform GME funding or how to pay for it. Many stakeholder groups, like teaching hospitals, support increased federal funding and lifting of the caps on Medicare resident positions at hospitals. However, key stakeholder groups like MedPAC, COGME, and others indicate doing so without changing the system will simply produce more of the same—an imbalance of generalist and specialist physicians. MedPAC reports that the mix of physicians produced by the current GME system will not be able to meet the needs of the future U.S. population.

In the past, teaching hospitals have taken actions to self-fund new residency slots. They indicate this strategy may become a less viable option because of increased pressure on hospital teaching faculty to focus on revenue-generating activities and

less on teaching and administration of residency programs. Teaching hospitals also cite declining revenues, payment cuts from recent changes in laws, and a shift from a volume-based payment system to one that pays based on quality and value as rationale for more federal funding.

COGME and MedPAC agree that more primary care physicians are needed to manage a convergence of circumstances and events that are impacting the healthcare system. The enactment of the federal Patient Protection and Affordable Care Act of 2010 combined with a sizeable aging population, and the number of doctors approaching retirement generates concern that a physician shortage may be on the horizon. Determining the appropriate mix of physicians and ratios of physicians to the general population is challenging because of disagreement about the roles of nurse practitioners and physician assistants in the healthcare workforce. New models of care are being introduced into the healthcare system that will also influence the amount and types of healthcare providers needed. Current projections predicting a physician shortage do not take into account the role or prevalence of new models of care, like patient-centered medical homes and nurse-managed health centers. Research suggests that estimating future provider demand is very sensitive to changes in primary care delivery models and shows the potential for a shortage or a surplus of certain provider types.

FEDERAL ACTIONS TO REFORM GRADUATE MEDICAL EDUCATION SYSTEM

The transformation of the GME system to ensure its ability to produce well-trained physicians and meet the evolving needs of society is beginning to occur at a national level. Research from IOM provided policymakers and stakeholders with five major recommendations to modernize the GME system. Several of their recommendations are already being implemented in the establishment of the federal Teaching Health Centers program.

The IOM convened a committee to study and recommend a redesign and repurposing of the current GME financial and governance systems. The IOM is an independent, nonprofit organization that provides unbiased and authoritative advice to U.S. decision makers and the public. IOM's report on issues impacting GME, *Graduate Medical Education That Meets the Nation's Health Needs*, was released in July 2014. **Figure 6** highlights the issues and recommendations contained in the report.

FIGURE 6
INSTITUTE OF MEDICINE ISSUES AND RECOMMENDATIONS TO REFORM GRADUATE MEDICAL EDUCATION , JULY 2014

ISSUE	RECOMMENDATION	ANTICIPATED OUTCOME
1. Transforming Medicare's role in GME will be a complex, multi-year effort requiring thorough planning.	Maintain Medicare GME funding at current aggregate levels, adjusted for inflation, for the next decade while reform occurs.	Reliable funding is required to lessen the impact redesigning GME will have on residents' training, patient care, and multiyear commitments and contractual arrangements with training sites.
2. A mismatch exists between the health needs of the population, the specialty makeup of the physician workforce, and the geographic distribution of physicians.	Build a federal GME policy and financing structure to address distribution of funding, workforce planning, and establish data collection for transparent reporting.	Establishment of a Medicare GME policy development and decision making body and a separate operations center to administer GME payment reforms.
3. Medicare funding is limited to teaching hospitals that are capped at the number of medical residents eligible to be claimed for payments.	Establish one Medicare GME fund that contains two subsidiary funds with different purposes. The subsidiary funds would support current approved residency positions and finance initiatives to innovate GME programs.	Funding will be distributed on a per-resident amount directly to GME sponsoring entities. Establishment of a separate fund to finance initiatives to develop and evaluate innovative GME programs and to award new GME training positions to priority disciplines and geographic areas.
4. Current Medicare GME funding methodology inhibits transparent reporting and tracking outcomes.	Modernize Medicare GME payment methodology.	Separate IME and DGME payment methodologies would be replaced with one payment to all GME sponsoring entities. Performance-based payments will be implemented.
5. Information on states' Medicaid GME funding is scarce.	Maintain states' discretion to use Medicaid funds for GME, but mandate the same level of transparency and accountability proposed for Medicare GME funding.	Improved transparency and knowledge how states achieve policy objectives with Medicaid GME funds.

NOTE: GME = Graduate Medical Education.
SOURCE: Institute of Medicine.

In its first recent investment in GME, the U.S. Congress established the Teaching Health Center program in 2010 to align funding with the workforce goal of increasing the number of primary care physicians. The establishment of the Teaching Health Center GME program is recognition of an inherent limitation of the current GME funding system. Because mostly hospitals receive Medicare GME funding, the growth of GME programs in ambulatory settings is inhibited. The Teaching Health Center program provides federal funding for the development of GME programs in community-based sites where the majority of healthcare is provided and representative of the environment in which many residents will eventually practice. Eligible community-based sites must be a non-hospital, ambulatory patient care center that operates a primary care residency program in family medicine, internal medicine, pediatrics, internal medicine-pediatrics, psychiatry, geriatrics, or general and pediatric dentistry.

Teaching Health Center funding differs in two important ways from Medicare GME funding. First, the program is specifically for supporting primary care training programs in

community settings. Funding comes from the federal Health Resources and Services Administration (HRSA) and flows directly to the community-based site. The second significant difference is that specific healthcare workforce goals are expected to be met by funding recipients. The Teaching Health Center program is a five-year (2011 to 2015) \$230 million initiative. To date, one Texas Federally Qualified Health Center (FQHC) was awarded Teaching Health Center program funding, the Lone Star Family Clinic in Conroe. Reauthorization of funding for the Teaching Health Center program is proposed in the President's 2015 budget proposal to the U.S. Congress.

FACTORS SHAPING THE TEXAS GRADUATE MEDICAL EDUCATION SYSTEM

The national imbalance of specialist and primary care physicians exists in Texas and is also reflected in its residency programs. Texas residency programs offer medical school graduates more training opportunities for non-primary care specialties than primary care. In addition, the state HRI GME formula is not designed to incentivize the training of physicians who are in short supply and who will practice in

underserved areas. Moreover, the GME formula covers a small amount of the estimated residency cost causing HRIs to seek additional funding from other sources. And, because HRIs have received an increasing amount of the total state funding for GME, they have greater influence regarding the types of residency training offered in the state.

PHYSICIAN AND RESIDENCY IMBALANCES

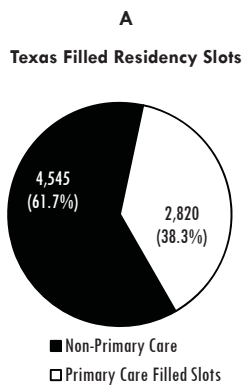
The federal government has identified many areas in Texas that are experiencing a shortage of primary care practitioners. The U.S. Department of Health and Human Services identifies annually Health Professional Shortage Areas (HPSA). HPSA is a federal designation to identify areas that lack providers and areas that are eligible to participate in federal programs designed to assist states in recruiting providers to these areas. Sixty-nine percent of Texas counties are designated as whole or partial Primary Care HPSA. In 2009, according to the Texas Statewide Health Coordinating Council, 27 counties had no primary care physicians. The council identified primary care physician ratios were lowest in 32 border counties and areas of west Texas and the Panhandle. The highest primary care physician ratios were found in Central or East Texas. Research demonstrates that a reduced primary care physician supply is associated with worse health outcomes and reduced life span for populations. According to Texas Medical Board data, about one-third of Texas physicians practice in one of the following primary care fields: family medicine, general internal medicine, obstetrics/gynecology, or general pediatrics.

An imbalance between primary care and non-primary care residency programs exists in the state. According to Legislative

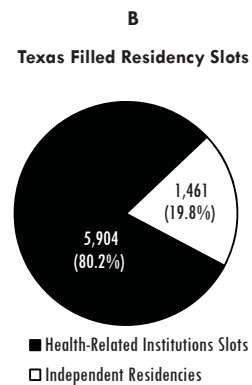
Budget Board (LBB) staff analysis, as of April 2014, Texas had 583 residency programs and 7,365 residency slots. Despite the shortage of primary care doctors, almost 90 percent of residency programs in Texas are not devoted to primary care. More than three-quarters of all Texas residency programs and almost 70 percent of all primary care residency programs are based at an HRI. For purposes of this report, primary care is defined as residency training in: family practice, general internal medicine, general pediatrics, and obstetrics and gynecology per the Texas Education Code, Section 58.008 and a residency slot is defined as one year of training for one person.

LBB staff analysis of Texas GME programs and their capacity is shown in **Figures 7(A) to 7(D)**. Specifically, **Figure 7(C)** shows that of the HRI-based residency filled slots, 64 percent or 3,791 are for non-primary care disciplines and 36 percent or 2,113 are for primary care. In contrast, residency programs not based at an HRI, also referred to as independent programs, have a larger percentage of their total residency slot capacity for primary care. Independent entities are defined as residency programs not administered by an HRI and are identified by ACGME as the sponsoring institution. **Figure 7(D)** shows that of the independent programs' filled residency slots, almost half or 48 percent (707) provided primary care training and 52 percent (754) provided non-primary care training. Independent residency programs rely on funding from THECB Trusteed GME programs like the Family Medicine Residency and Primary Care Residency programs since they are not eligible for GME formula funding.

**FIGURE 7
ANALYSIS OF TEXAS RESIDENCY PROGRAMS, APRIL 2014**

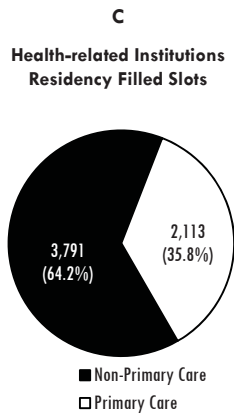


Of all filled residency slots in Texas, approximately two-thirds are devoted to training programs in specialty care other than primary care, while slightly more than one-third are focused on primary care.



Of the more than 7,000 filled residency slots, more than 80 percent are located at HRIs.

FIGURE 7 (CONTINUED)
ANALYSIS OF TEXAS RESIDENCY PROGRAMS, APRIL 2014

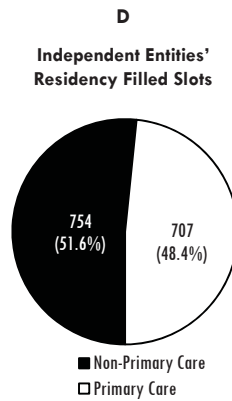


The HRIs are responsible for more than 80 percent of the residency slots in Texas, yet less than half of the HRIs' residency slot capacity (35.8%) is for primary care training.

NOTES:

- (1) Primary care is defined as Family Practice, General Internal Medicine, General Pediatrics, and Obstetrics/Gynecology per Texas Education Code, Chapter 58.008.
- (2) Independent Entities are defined as residency programs not administered by an HRI and are identified by the Accreditation Council for Graduate Medical Education as the sponsoring institution responsible for the training curriculum, maintaining accreditation standards, and other key responsibilities.

SOURCE: Legislative Budget Board.



Unlike HRIs, independent entities have almost half of their slot capacity for primary care training.

GRADUATE MEDICAL EDUCATION FORMULA'S IMPACT

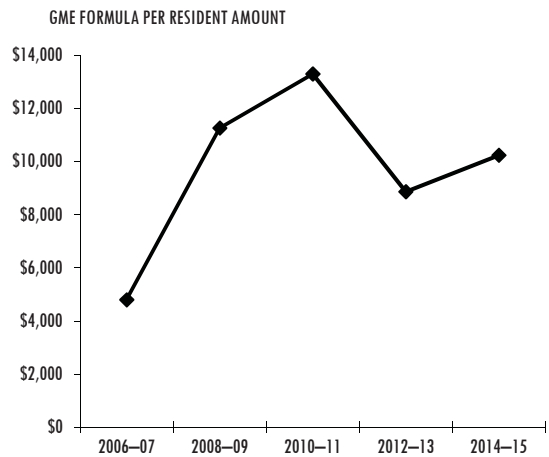
At least three outcomes from the development of the HRI GME formula have influenced Texas GME programs. First, the GME formula does not encourage a balanced geographic distribution and mix of specialty and primary care physicians to meet the current and future healthcare needs of the state. Second, the amount of GME formula covers a small amount of the estimated residency cost causing HRIs to seek additional funding from other sources. Third, the GME formula shifted a larger proportion of state funds to HRIs, where two-thirds of filled residency slot capacity is for specialized care training, other than primary care.

The GME formula is an additional and separate funding source exclusively for HRI-based residency programs. Each HRI and the Baylor College of Medicine receive an amount of the GME formula based on the number of residents. No other factors are considered in the allocation of funding. The allocation of GME formula funding is not designed to incentivize HRIs to produce the types of physicians that are in short supply and who could practice in underserved areas.

According to THECB, to educate a medical resident in Texas it is estimated to cost \$150,000 per year. Historically, the GME formula per resident amount equates to between 2 percent and 4 percent of this total estimated cost. At present,

the GME formula per resident amount equates to 3.5 percent of the estimated cost of residency education. At this level, the GME formula is limited in its influence on the types of doctors produced in Texas because HRIs must rely on other sources of funding which can cause their priorities to shift towards research and procedural inpatient care that generate revenue for the institution and will support GME. **Figure 8**

FIGURE 8
GRADUATE MEDICAL EDUCATION FORMULA BIENNIAL PER RESIDENT AMOUNT, 2006-07 TO 2014-15 BIENNIA



SOURCE: Legislative Budget Board.

shows the biennial GME formula per resident amount allocated to HRIs and Baylor College of Medicine from fiscal years 2006 to 2015.

HRIs administer most of the GME programs in the state; consequently, they receive a larger share of state funding. Prior to the 2006–07 biennium, the GME formula did not exist. As **Figure 9** shows, since fiscal year 2006 and the implementation of the GME formula, the proportion of total state GME funding dedicated to the HRIs has increased, reaching 91 percent in the 2012–13 biennium.






Because HRIs have received an increasing amount of the total state funding for GME, they have greater influence regarding the types of residency training offered in the state. HRIs are responsible for more than 80 percent of the

residency slots in Texas, yet just over one-third of their slot capacity is for primary care training.

ALIGNING NEW STATE FUNDING WITH STATE HEALTHCARE NEEDS

Most teaching hospitals (public and private) in the state cannot receive additional federal funding for new residency slots because they already exceed their Medicare GME resident caps. Consequently, the cost of any new residency slots is borne solely by the sponsoring institution of the residency program and state and local governments. Compounding the situation, the number of Texas medical school graduates outpaces the available first-year GME slots. And, due to the addition of three new medical schools opening in Texas by 2016, the state is in immediate need of

FIGURE 9
ARTICLE III STATE APPROPRIATIONS FOR GRADUATE MEDICAL EDUCATION, 2002–03 TO 2014–5 BIENNIA

BIENNIUM	THECB GME TRUSTEED PROGRAM FUNDING	GME FORMULA FUNDING	GME TOTAL FUNDING	PERCENTAGE OF GME FUNDING DEDICATED TO HRI (2)	
2002–03	\$55,278,604	N/A (3)	\$55,278,604	N/A (3)	
2004–05	\$28,536,445	N/A (3)	\$28,536,445	N/A (3)	
2006–07	\$26,995,844	\$25,000,000	\$51,995,844	48%	
2008–09	\$23,959,040	\$62,785,588	\$86,744,628	72%	
2010–11	\$27,709,040	\$79,093,876	\$106,802,916	74%	
2012–13	\$5,600,000	\$56,916,442	\$62,516,442	91%	
2014–15	\$31,530,000 (4)	\$67,782,980 (5)	\$99,312,980	68%	

NOTES:

- (1) GME = Graduate Medical Education.
- (2) ■ = GME Formula funding; □ = GME Trustee Program funding.
- (3) The GME Formula funding was not in existence prior to the 2006–07 biennium.
- (4) Includes funding from Family Medicine residency program, House Bill 1025, House Bill 2550 and Trauma Care appropriations.
- (5) Includes funding from GME Formula, Baylor College of Medicine GME Formula, and Primary Care Innovation Grants (House Bill 2550) appropriations.

SOURCE: Legislative Budget Board.

more residency programs to retain its investment in medical school graduates. Investing in the creation of more opportunities for doctors to train in Texas is beneficial to the state because doctors educated and trained in Texas tend to stay here. According to the AAMC, 58 percent of physicians who complete GME in Texas establish their practice here. Moreover, 80 percent of doctors who attend medical school and complete residency training in Texas remain in the state to practice medicine.

To incentivize all teaching hospitals to create and maintain residency programs for physicians who are in high demand throughout the state, Recommendation 1 would amend statute to establish a critical shortage physician program at THECB. All teaching hospitals that exceed their Medicare caps and create new residency programs or expand the number of current slots in primary care (family medicine, general internal medicine, general pediatrics, and obstetrics/gynecology) and other medical specialties and subspecialties determined to be at critical shortage levels would receive a per resident amount of \$132,000 to incentivize their growth. This per resident amount is an average cost based on information reported by HRIs. The per resident amount is meant to compensate hospitals over their Medicare GME resident caps for the federal funding they would otherwise receive. Teaching hospitals would be required to report outcomes annually to ensure state funds are used for the purpose of increasing the number of physicians determined to be at a critical shortage level.

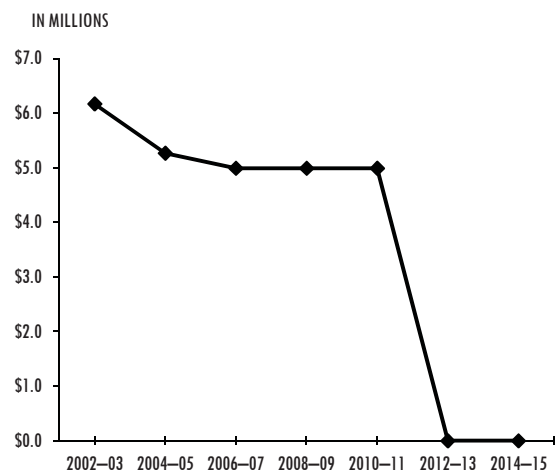
The critical shortage physician program funding would also be available for teaching hospitals to assist with the costs of starting a new residency program in a critical shortage specialty. The amount allowed for start up costs would be a percentage of the total start-up costs and requirements and milestones would be established to ensure the funding is used for its intended purpose. Recommendation 2 would include a contingency rider in the 2016–17 General Appropriations Bill to appropriate \$19.8 million in All Funds for the biennium to THECB for disbursement to teaching hospitals through the critical shortage physician program. The determination of which types of doctors are at critical shortage levels would be evaluated biennially by the Legislature based on data reported by the Health Profession Resource Center (HPRC) at the Department of State Health Services (DSHS).

As noted previously, no national or state government or independent workforce entity exists to guide policymakers and stakeholders about the appropriate physician mix needed

to meet the population’s current and future healthcare needs. Recommendation 3 would increase appropriations by \$500,000 in General Revenue Funds for the biennium and include a rider in the 2016–17 General Appropriations Bill to add one full-time equivalent (FTE) to the HPRC at DSHS. The additional FTE at HPRC would be used to research, recommend, and report information about the supply of physicians, an appropriate mix of primary care and non primary care physicians, identify shortages of specialty and sub-specialty physicians and their geographic location in the state, and other related topics impacting the state’s current and future healthcare needs. The HPRC would report their findings biennially to the LBB, the House Committee on Appropriations, the Senate Finance Committee, and the Office of the Governor, and THECB.

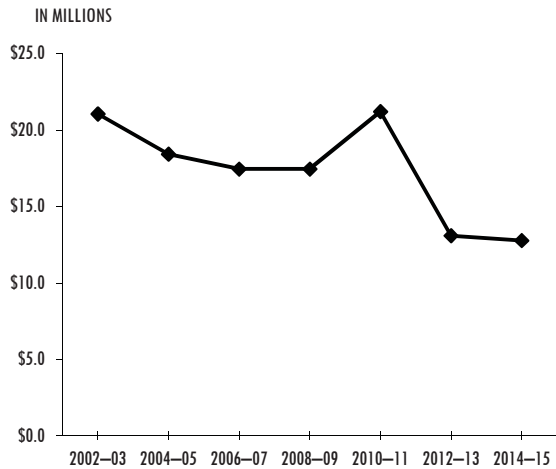
The decline in state appropriations supporting residencies that are not based at a health-related institution is a contributing factor that limits the number of doctors trained in primary care medicine. **Figure 10** shows the history of appropriations for the Primary Care Residency strategy from 2002 to 2015 and **Figure 11** shows the same data for the Family Practice Residency Program strategy. Funding for the Primary Care Residency strategy decreased in the 2004–05 biennium and then remained steady until it was eliminated in fiscal year 2012. The program’s goal was to increase the number of primary care physicians trained in the state. As required by statute, THECB was assisted by the Primary Care Residency Advisory Committee in determining the

FIGURE 10
STATE APPROPRIATIONS FOR THE PRIMARY CARE RESIDENCY STRATEGY, 2002–03 TO 2014–15 BIENNA



SOURCE: Legislative Budget Board.

FIGURE 11
STATE APPROPRIATIONS FOR THE FAMILY PRACTICE
RESIDENCY PROGRAM STRATEGY
2002–13 TO 2014–15 BIENNIA



NOTE: \$7.8 million appropriated in House Bill 1025, Eighty-third Legislature is included in the 2014–15 biennium.
 SOURCE: Legislative Budget Board.

appropriate distribution of funds among the eligible residency programs. The primary care residency programs funds were limited to family practice (not supported by the Family Practice Residency Program), general internal medicine, general pediatrics, and obstetrics/gynecology residency programs. Funding was provided to residency programs based on residency program directors’ identification and designation of resident physicians who will be most likely to remain in Texas to practice.

The Family Practice Residency Program continues to receive funding, but appropriations to the program have not returned to the funding levels of fiscal year 2010. From the 2010–11 to the 2012–13 biennia, residency programs funded through the Family Practice Residency Program strategy sustained on average a 70 percent funding decrease. The funding loss resulted in a negative impact to almost all programs through reduced residency slots and resident rural rotations, discontinued educational resources for residents, and unfilled faculty positions. Restoring funding to previous levels would allow both primary care training programs to add additional slots and restore residency slots to previous levels. Recommendation 4 would increase the appropriation to the THECB by \$15.4 million in All Funds for the biennium in the 2016–17 General Appropriations Bill for the Primary Care and Family Practice Residency programs.

The number of Texas medical school graduates has increased 31 percent from 2002 to 2012 and more medical school graduates are expected with the opening of three new medical schools in the future. According to THECB, by 2016 more than 100 Texas medical school graduates will not have the option to remain in state to train due to a lack of first-year residency positions. Fifteen medical specialties, including family medicine, accept first-year medical school graduates. In addition to a shortage of primary care physicians, Texas continues to experience a significant geographic maldistribution of healthcare practitioners across the state. Sixty-nine percent of Texas counties are designated as whole or partial Primary Care Health Professional Shortage Areas. Research demonstrates that a reduced primary care physician supply is associated with worse health outcomes and reduced life span for populations.

To address the increased number of medical school graduates and the shortage of primary care doctors, Recommendation 5 would amend statute to establish a teaching health center GME program at THECB. It would be modeled after the federal program, Teaching Health Centers. Since the creation of the federal Teaching Health Center program in 2011, more than 300 physicians are in primary care training at community health centers across the country primarily located in rural and underserved areas. Research demonstrates that doctors who train in community health centers are almost three times more likely to work in underserved settings. Texas is in need of primary care physicians to work in HPSA designated areas. This recommendation would establish and expand resident training that is solely focused on primary care in underserved areas and rural communities. Recommendation 6 would include a contingency rider in the 2016–17 General Appropriations Bill to appropriate \$16.2 million in All Funds for the biennium to THECB to implement the teaching health center GME program.

During the Eighty-third Legislature, Regular Session, 2013, THECB was appropriated \$1.8 million in General Revenue Funds to provide one-time planning grants to entities considering establishing a residency program; 9 grants were awarded. To further assist both community-based entities and regional or rural hospitals establish new accredited residency programs, Recommendation 7 would amend statute to establish a GME partnership grant program at THECB for community health clinics and other non-HRI entities to receive guidance from medical schools or other established institutions when beginning the accreditation process for a new medical residency program. Gaining

approval from the appropriate accreditation entity can be a complex and resource intensive process that requires extensive criteria and requirements to be met. Working with an already accredited institution to assist a new applicant navigate this process would be mutually beneficial to the applying entity and to the mentoring organization by building relationships that can further the growth and knowledge of residency programs at both institutions. Recommendation 8 would include a contingency rider in the 2016–17 General Appropriations Bill to appropriate \$6.0 million in All Funds for the biennium to THECB to implement the GME partnership grant program. Recommendations 7 and 8 would assist entities with the planning process for accreditation and the implementation of a new residency program.

If the Legislature chooses to provide additional funding for the establishment of new slots in the GME system, the state will need to ensure well-trained and experienced faculty are available to teach residents. A shortage of well-trained teachers can constrain the number and location of new medical residency programs established. Few doctors who are not medical school faculty receive training before supervising residents. Faculty from accredited Texas GME programs expressed that there is a strong need for additional resources to train the next generation of doctors, especially for those working in community-based residency programs (i.e., outpatient-based setting) not affiliated with a medical school. To teach medical residents, faculty of an accredited residency program must have earned a doctor of philosophy degree or a degree in medicine. Prior to 2011, the Family Practice Faculty Development Center was appropriated General Revenue Funds to train medical faculty for Texas residency programs through a 10-month training program. Funding was eliminated in fiscal year 2011. The University of North Texas (UNT) took over some of the responsibilities since the center's closure, but the length and intensity of the UNT program is less than the training provided by the Family Practice Development Center. Recommendation 9 would increase appropriations to THECB in the 2016–17 General Appropriations Bill by \$1.4 million in All Funds to develop physician faculty.

To understand the influence these recommendations and what results the legislature's investment of new funding has had on the Texas GME system, Recommendation 10 would include a rider in the 2016–17 General Appropriations Bill to require the THECB to report about the impact of new funding for graduate medical education. This report would

be prepared in a format specified by the LBB and submitted to the LBB and the Office of the Governor by October 1, 2016.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would have a total cost of \$59.3 million in All Funds for the 2016–17 biennium. Recommendation 1 would amend statute to establish a critical shortage physician program at THECB to provide funding to teaching hospitals to create and/or expand current residency slots in medical disciplines that are in critical supply. Recommendation 2 would include a contingency rider in the 2016–17 General Appropriations Bill to provide THECB with an appropriation of \$19.8 million in All Funds for the biennium contingent on enactment of legislation relating to Recommendation 1. This appropriation is based on a per resident cost of \$132,000 and assumes 150 residency slots would be funded for the biennium.

Recommendation 3 would increase appropriations for the biennium by \$500,000 in General Revenue Funds in the 2016–17 General Appropriations Bill to DSHS for one FTE to conduct research for the Health Professions Research Center. It is assumed \$300,000 could be used for contract research services to assist state staff to identify physician shortages in the state. The rider would also direct DSHS to report the center's findings regarding the recommended mix and supply of physicians to meet the state's healthcare needs. The report would be submitted to the LBB, the House Committee on Appropriations, the Senate Finance Committee, the Office of the Governor, and THECB so that it informs the decision-making process regarding future appropriations for the critical shortage physician program.

Recommendation 4 would appropriate \$15.4 million in All Funds to the THECB for the 2016–17 biennium to restore funding to the Primary Care and Family Practice Residency programs. It is assumed the cost per resident would be \$15,000 for each residency program. This amount is based on a recommendation by the Primary Care Residency Advisory Committee. It is assumed the Primary Care Residency Program would support 200 residency slots at a cost of \$6.0 million for the 2016–17 biennium. It is further assumed the increased funding would continue to support 730 residency slots in the Family Practice Residency Program. The introduced 2016–17 General Appropriations Bill continues base funding for the Family Practice Residency Program at the per resident amount of \$8,504 and appropriates \$12.4 million to maintain 730 resident slots.

The difference between the base amount and the recommended increased per resident amount (e.g., \$15,000) would result in a cost of \$9.4 million for the biennium.

Recommendation 5 would amend statute to establish a teaching health center program at THECB. It would be based on a federal program of similar name and would fund the establishment of primary care residency programs at community health clinics. Recommendation 6 would include a contingency rider in the 2016–17 General Appropriations Bill to provide THECB with an appropriation of \$16.2 million in All Funds for the biennium upon enactment of legislation relating to Recommendation 5. Based on a cost estimate by THECB to educate residents, it is assumed the cost per resident to be \$150,000 and that 108 residency slots would be added for the biennium.

Together funds appropriated through Recommendations 1 to 6 would add an estimated 458 new residency slots.

Recommendation 7 would amend statute to establish a GME partnership grant program. The program would allow community clinics or rural hospital-based residency programs to partner with established residency programs to mentor them through the accreditation process and build working relationships for the future.

Recommendation 8 would include a contingency rider in the 2016–17 General Appropriations Bill to appropriate \$6.0 million In All Funds for the biennium upon enactment of legislation implementing Recommendation 7. Both new and established residency programs would be eligible for funding. During the 2014–15 biennium THECB awarded planning grants to entities considering the establishment of a new residency program, each grant was limited to \$150,000. It is assumed grants awarded as a result of Recommendation 8 would also be limited to \$150,000 per organization and 20 grants would be awarded annually.

Recommendation 9 would appropriate \$1.4 million in All Funds for the biennium to THECB to develop physician faculty. Until 2011, the Family Practice Faculty Development Center in Waco trained doctors how to be teachers to residents. It is assumed based on past appropriations of \$700,000 annually and for six staff will be needed to operate the center.

Recommendation 10 is anticipated not to have a significant fiscal impact on THECB because it is assumed the required report could be produced within the agency’s existing resources.

House Bill 7, Eighty-third Legislature, 2013, expanded the allowable use of the Dedicated Trauma Facility and Emergency Medical Services Account (General Revenue–Dedicated Account 5111) to include GME. To the extent authorized by law, this or other General Revenue–Dedicated accounts could be appropriated in lieu of General Revenue Funds to support these recommendations, thereby further reducing reliance on dedicated revenue for certification of the state budget. For more information on reducing reliance on General Revenue–Dedicated Funds, including funding recommendations contained in this report, please see the Legislative Budget Board publication *Further Reduce Reliance on General Revenue–Dedicated Accounts for Certification of the State Budget*.

These recommendations would allocate new state GME appropriations between the HRIs and independent-based residency programs to increase the number of GME training slots overall and specifically in the medical disciplines in which the state is experiencing a critical shortage. Fostering collaboration among new residency training sites and established ones as well as guaranteeing a supply of well-trained teaching faculty to teach residents are also recommended. **Figure 12** shows the five-year fiscal impact to the state if Recommendation 1 through 10 were implemented.

FIGURE 12
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATIONS
FISCAL YEARS 2016 TO 2020

YEAR	PROBABLE SAVINGS/ (COST) IN ALL FUNDS	PROBABLE ADDITION/ (REDUCTION) OF FULL- TIME-EQUIVALENT POSITIONS
2016	(\$23,692,080)	1.0
2017	(\$35,692,080)	1.0
2018	(\$47,692,080)	1.0
2019	(\$47,692,080)	1.0
2020	(\$47,692,080)	1.0

SOURCE: Legislative Budget Board.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

STRENGTHEN THE RETURNED VALUE FUNDING APPROACH FOR THE TEXAS STATE TECHNICAL COLLEGE SYSTEM

The Eighty-third Legislature, Regular Session, 2013, amended how the state allocates instruction and administration formula funds to the Texas State Technical College system. In the 2014–15 biennium, the Legislature appropriated \$89.8 million to the state’s only technical college system through a method known as returned value. Returned value seeks to reward performance by funding the system based on the total wages and job placement of a select group of former students. Previously, the appropriation was based on contact hours, which refers to the hours of scheduled academic and technical instruction provided to students during a semester.

The new funding approach aligns Texas State Technical College’s funding with the system’s primary mission of meeting the high-tech challenges of today’s economy and placing students into well-paying jobs. However, there are consequences as a result of this approach. The returned value funding approach: discourages the colleges from providing dual-credit programs, which are important to helping the state reach its public education goals; penalizes the colleges for students who transfer to four-year institutions; disproportionately rewards the colleges for admitting students who had previously graduated from a four-year institution; provides funding for the colleges based largely on factors outside of the colleges’ control and does not consider the institution’s cost of providing training services, which limits the state’s ability to realize savings if costs decrease.

Amending the Texas State Technical College’s funding formula so that funding is based on time in instruction and the number of degrees and certificates awarded would ensure that the system’s funding is better aligned with the state’s policy goals.

FACTS AND FINDINGS

- ◆ Total contact hours reported for Texas State Technical College system institutions decreased by 16 percent from fiscal years 2004 to 2013.
- ◆ Dual-credit students make up 12 percent of the total enrollment at the Texas State Technical College system.

CONCERNS

- ◆ The returned value funding approach does not fund dual-credit programs and penalizes institutions for students who transfer to four-year institutions. Texas State Technical College institutions therefore reduced the number of dual-credit programs offered in anticipation of the funding formula change and are considering additional reductions.
- ◆ Institutions are funded based on a percentage of the total earnings of a previous cohort of students, not on the current student enrollment, which weakens the incentive to make programmatic changes that will improve student outcomes.
- ◆ The returned value funding approach does not consider the institution’s cost of providing training services, which limits the state’s ability to realize savings if costs decrease.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend the allocation of appropriations through the Texas State Technical College instruction and administration funding formula so that half of the funding is based on contact hours and the other half is based on the number of current-year graduates with certificates and degrees.
- ◆ **Recommendation 2:** Amend the Special Provisions Relating Only to Components of Texas State Technical College System rider on returned value funding in the 2016–17 General Appropriations Bill to remove the restrictions on funding time in instruction.

DISCUSSION

The Texas State Technical College (TSTC) system is the state’s only state-supported technical college system. TSTC includes four colleges—Harlingen, Waco, Marshall, and West Texas—and several satellite campuses. TSTC was established in 1965 as a part of the Texas A&M system. In 1969, TSTC became an independent system. TSTC’s mission is to help Texas meet the high-tech challenges of today’s global economy, in partnership with business and

industry, government agencies, and other educational institutions.

Figure 1 shows associates degrees and certificate programs offered by TSTC. TSTC–Harlingen and TSTC–Waco offer the most programs.

In fiscal year 2013, TSTC enrolled approximately 17,000 students. As **Figure 2** shows, system enrollment has decreased steadily since fiscal year 2007. Total annual enrollment at TSTC institutions peaked at 27,145 students in fiscal year 2007. In fiscal year 2013, TSTC enrollment decreased 36 percent from the 2007 peak.

Figure 3 shows total TSTC system enrollment by college. Most of the decrease in enrollment since fiscal year 2007 can be attributed to an 84 percent decrease in enrollment at TSTC–West Texas. In fiscal year 2007, TSTC–West Texas had an enrollment of 10,648 students. By fiscal year 2013 enrollment at the West Texas college was 1,739 students. TSTC–West Texas’ share of total system enrollment decreased from 33 percent to 10 percent during that period. TSTC

indicated that the enrollment decrease is in part a result of the institutions transferring general academic programs to community colleges in preparation for the returned value funding approach. According to TSTC, enrollment in the system is countercyclical and tends to decline as the economy improves. TSTC–Harlingen has the highest enrollment of the system’s colleges and is the only TSTC campus to have a higher enrollment in fiscal year 2013 than it did in fiscal year 2007.

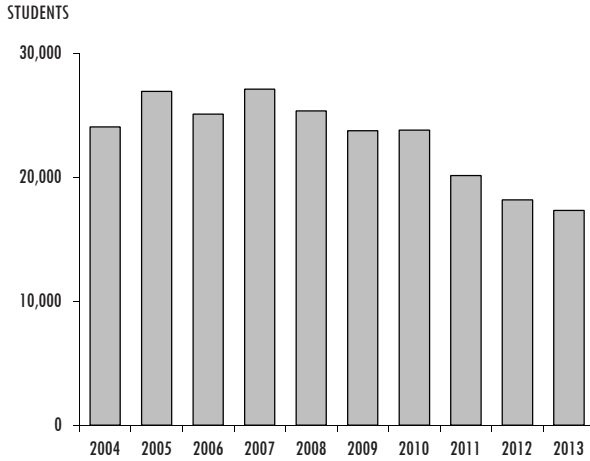
Enrollment represents the number of students attending an institution and does not reflect the amount of work required by faculty to provide instruction for those students. A contact hour is a standard unit of measure that represents an hour of scheduled academic and technical instruction provided to a student during a semester. Before the 2014–15 biennium, TSTC’s funding was based on contact hours. Community colleges and the Lamar State Colleges are also funded based on contact hours.

**FIGURE 1
AVAILABLE PROGRAMS AT TEXAS STATE TECHNICAL COLLEGE INSTITUTIONS
FISCAL YEAR 2014**

PROGRAM	HARLINGEN	MARSHALL	WACO	WEST TEXAS	SYSTEM TOTAL
Agriculture	1	0	3	0	4
Communication	1	0	0	0	1
Communications Technologies	0	0	1	0	1
Computer and Information Sciences	1	2	4	1	8
Personal and Culinary Services	1	0	1	1	3
Education	1	0	1	0	2
Engineering	1	0	0	0	1
Engineering Technology	6	4	15	7	32
Biological and Biomedical Sciences	1	0	0	0	1
Mathematics and Statistics	1	0	0	0	1
Physical Sciences	1	0	0	0	1
Science Technologies/Technicians	1	0	2	0	3
Construction Trades	0	1	4	0	5
Mechanic and Repair Technologies	2	1	3	2	8
Precision Production	2	2	0	1	5
Transportation and Materials Moving	0	0	2	0	2
Visual and Performing Arts	1	0	1	2	4
Health Professions	11	0	2	7	20
Business, Management, Marketing	3	2	0	2	7
TOTAL	35	12	39	23	109

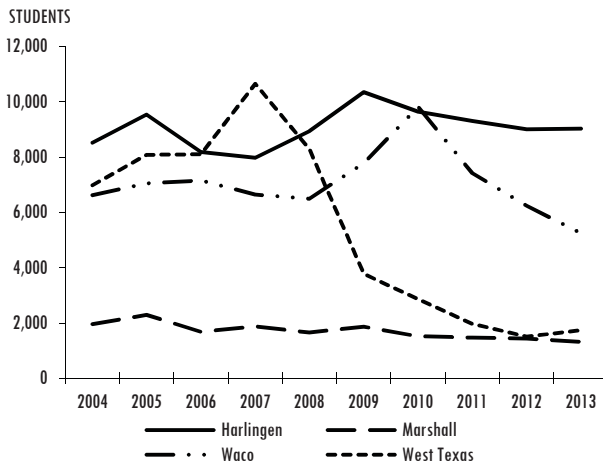
SOURCE: Texas Higher Education Coordinating Board.

FIGURE 2
TEXAS STATE TECHNICAL COLLEGE SYSTEM ENROLLMENT
FISCAL YEARS 2004 TO 2013



SOURCE: Texas Higher Education Coordinating Board.

FIGURE 3
TEXAS STATE TECHNICAL COLLEGE ENROLLMENT BY
COLLEGE
FISCAL YEARS 2004 TO 2013

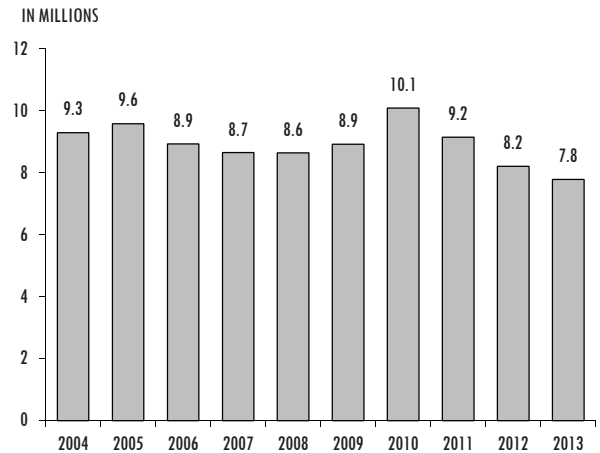


SOURCE: Texas Higher Education Coordinating Board.

As **Figure 4** shows, contact hours for TSTC peaked in fiscal year 2010 when system colleges reported 10.1 million contact hours. Total contact hours decreased by 23 percent, to 7.8 million contact hours, from fiscal years 2010 to 2013.

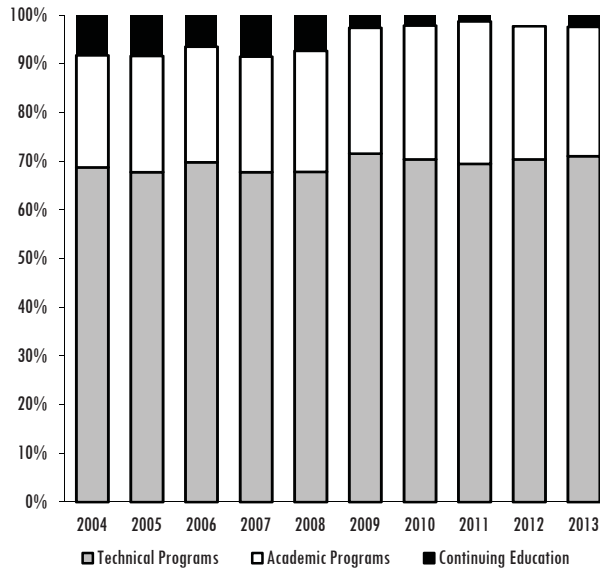
Technical programs account for more than 70 percent of the TSTC system's contact hours. The goal of these programs is to provide mastery of the skills needed in order for students to gain entry-level employment in high-skill, high-wage fields. As **Figure 5** shows, this ratio has remained stable during the past decade.

FIGURE 4
TEXAS STATE TECHNICAL COLLEGE SYSTEM TOTAL
CONTACT HOURS
FISCAL YEARS 2004 TO 2013



SOURCE: Texas Higher Education Coordinating Board.

FIGURE 5
TEXAS STATE TECHNICAL COLLEGE PERCENTAGE OF
TOTAL CONTACT HOURS BY PROGRAM TYPE
FISCAL YEARS 2004 TO 2013



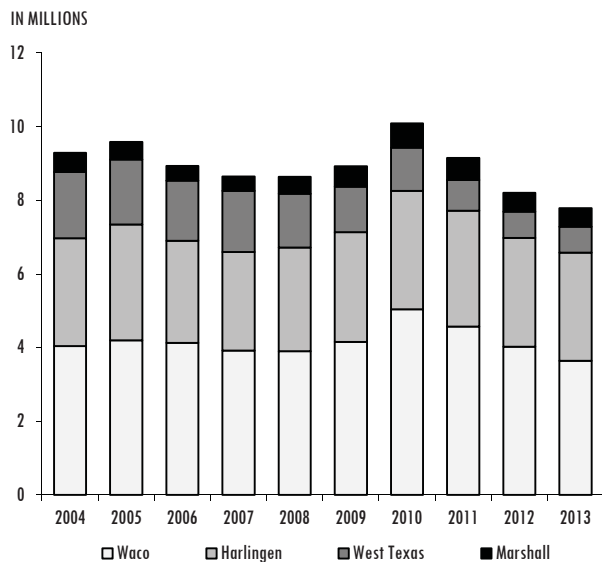
SOURCE: Texas Higher Education Coordinating Board.

TRENDS IN TEXAS STATE TECHNICAL COLLEGE CONTACT HOURS

Several factors caused TSTC to consider funding criteria other than contact hours. During the past decade, total contact hours reported by TSTC colleges decreased by 16 percent, primarily due to the decrease in enrollment. **Figure**

6 shows contact hours for each of the system colleges. TSTC–Harlingen had approximately the same amount of contact hours in fiscal year 2013 as it did in fiscal year 2004. TSTC–Waco and TSTC–Marshall had decreases of 10 percent and 5 percent, respectively. TSTC–West Texas had a significant decrease in contact hours. From fiscal years 2004 to 2013, contact hours at TSTC–West Texas decreased by 61 percent. This trend represents 72 percent of the system’s total decrease in contact hours.

FIGURE 6
TEXAS STATE TECHNICAL COLLEGE SYSTEM CONTACT HOURS BY COLLEGE FISCAL YEARS 2004 TO 2013



SOURCE: Texas Higher Education Coordinating Board.

STATE ACTIONS RELATED TO RETURNED VALUE

Before the 2014–15 biennium, TSTC received state funds through the instruction and administration (I&A) formula for two-year colleges, which is based on contact hours. The Eighty-third Legislature, Regular Session, 2013, authorized the allocation of funds to TSTC through a method known as returned value. Returned value is intended to reward performance by funding TSTC based on the total wages and job placement of a select group of former students.

Several actions during the past several biennia have led to the current funding approach for TSTC.

In 2008, the Perryman Group released *The Impact of the Texas State Technical College System on Business Activity in Texas*. The report was commissioned by TSTC in support of its

proposed outcomes-based funding approach. The study recommended tying TSTC’s funding to economic and revenue contributions of former TSTC students.

The Eighty-first Legislature, Regular Session, 2009, required the Texas Comptroller of Public Accounts (CPA) to conduct a feasibility study of basing a portion of all public postsecondary technical training program funding on the economic benefit of the program. The report showed that data is inconsistent across programs and in some cases insufficient. However, it also showed that outcomes-based funding of these programs would be feasible if data issues were addressed.

The Eighty-second Legislature, Regular Session, 2011, directed TSTC to work with the Texas Higher Education Coordinating Board (THECB), Legislative Budget Board (LBB), and other relevant agencies to develop a new I&A funding formula for the TSTC colleges. This formula, which was implemented for the 2014–15 biennium, was required to reward job placement and graduate earnings projections instead of time in training or contact hours.

For the 2012–13 biennium, TSTC colleges received approximately \$85 million in All Funds (General Revenue Funds and General Revenue–Dedicated Funds) through the I&A formula. This funding was based on 9.4 million contact hours at a rate of \$9.09 per contact hour. For the 2014–15 biennium, TSTC colleges received \$89.8 million in All Funds based on I&A formula funding that used the returned value approach. This amount was a 6 percent increase in formula funding. Although this funding approach is not based on contact hours, it is significant to note that contact hours at TSTC decreased 17 percent from the previous biennium.

GOALS OF RETURNED VALUE

The returned value approach is intended to align TSTC’s funding more closely with its primary mission of placing students in high-skill, high-wage jobs in as little time as is practicable. Because the returned value approach only funds outcomes, the approach incentivizes TSTC to get students into jobs. TSTC administrators have indicated that, as a result of the previous contact hours-based funding system, the school did not have strong incentives to re-evaluate programs to ensure that students were not spending more time in instruction than they needed.

In response to the returned value approach, TSTC has implemented a competency-based learning (CBL) model in

some programs. CBL is an outcomes-focused model of training. Training is designed to help students master industry-specific skills. A student demonstrates mastery of a particular skill or competency, then moves on to the next skill. This approach is intended to ensure that students have mastered all of the skills necessary to succeed in their fields of choice. Because this approach is based on demonstrating mastery, students move through the process at different paces. TSTC staff indicated that CBL is particularly helpful for students who have some relevant training or work experience but lack credentials, citing the example of military veterans with practical experience, but no relevant credentials. These students are able to move through the process of earning a certificate or degree more quickly than in traditionally structured courses.

RETURNED VALUE APPROACH

The returned value approach is simple in concept, but complex in implementation. The approach is intended to fund TSTC based on economic contributions to the state, as measured by increased state tax revenue attributable to the TSTC institutions. THECB describes this approach as a four-step process:

1. calculate student wages;
2. calculate TSTC value-add, student wages due to attending TSTC;
3. calculate the workers' additional impact on the state; and
4. allocate funding.

CALCULATE STUDENT WAGES

To calculate student wages, THECB determines the timeframe for the analysis and selects the cohort of former TSTC students. To determine 2014–15 biennial funding, THECB used 2007 to 2012 wage data for fiscal years 2006 and 2007 TSTC graduates, leavers, and transfers. This is the most recent cohort of students for which there are the five years of wage data after leaving TSTC that is needed for this approach. Graduates are students who earned a degree or certificate at TSTC. Leavers are students who left TSTC without earning a degree or certificate and who did not enroll in another institution of higher education. Transfers are students who enrolled in another institution of higher education after leaving TSTC. The following groups of students were excluded from the analysis:

- students who had fewer than nine semester credit hours at TSTC;

- dual-credit students who did not receive a degree or certificate from TSTC; and
- students who returned to TSTC within 24 months of leaving.

The data for the remaining group of former students was matched with the Texas Workforce Commission's Unemployment Insurance (UI) wage database. Any students found working in fewer than three quarters in any given year were also excluded from the analysis.

CALCULATE TSTC VALUE-ADD

THECB adjusted all wage data for inflation to calculate adjusted annual wages. Annual adjusted wages were calculated for each subgroup of leavers, graduates, and transfers for each TSTC institution for the five-year period. The annual average for each subgroup was compared to a base wage. The base wage was equivalent to a full-time salary earned at the current minimum wage, or \$15,080 per year. The base wage was subtracted from the average annual wage of each subgroup to calculate the TSTC annual value-add. The model assumed that all of the difference between the average annual wage and the base wage was due to TSTC. This means that if the TSTC programs were not available, all of the students would have earned no better than the minimum wage. THECB multiplied the TSTC annual value-add by five to account for the five-year scope of the analysis, resulting in the total incremental inflation-adjusted wage.

CALCULATE THE WORKERS' ADDITIONAL IMPACT TO THE STATE OF TEXAS

THECB then calculated both a direct and indirect impact to the state. THECB calculated the direct impact by multiplying the total incremental inflation-adjusted wage by an estimated effective annual state tax rate of 7 percent. This estimate is based on a CPA calculation of total state sales tax receipts as a share of total state income in 2009. The indirect impact to the state was calculated by multiplying the direct impact by 1.5. The economic multiplier of 1.5 was based on a U.S. Department of Commerce study of the local economy impacts of university activity. THECB summed the direct and indirect impact for each subgroup.

During the Eighty-third Legislature, Regular Session, 2013, the Legislature funded the TSTC system at 32.6 percent of the estimated total direct and indirect impacts to the state.

ALLOCATE FUNDING

THECB allocated each college's funding proportionate to its estimated share of the total direct and indirect impacts to the state. Each college's reported contact hours from the previous biennium were used to divide the funding between the technical and academic funding strategies.

ISSUES WITH RETURNED VALUE APPROACH

CPA, THECB, and LBB staff have identified multiple limitations and potential problems in the current returned value approach. The agencies are concerned with the quality and completeness of the data used in this analysis.

DATA IS INCOMPLETE

The wage data reported in the UI wage database shows the total wage information for each worker. There is no information about the number of hours worked or the type of work performed. There is also no way to know if an individual is employed in an occupation related to that individual's training. In addition, there are several reasons why data would be missing from the UI wage database. An individual could be unemployed, employed out of state, an independent contractor, a private business owner, or a misclassified worker. Because wage information is not reported to TWC, in these cases, TSTC does not get credit for these individuals' wages for funding purposes. With the current approach, TSTC's funding is more likely to be negatively affected by underemployed workers than by unemployed workers because the underemployed are less likely to be excluded from the analysis than the unemployed.

PRIOR WAGE INFORMATION IS NOT USED

To calculate TSTC's value-add, an employee's actual wage data is compared with the minimum wage based on the assumption that all TSTC students would be qualified for minimum wage occupations without attending TSTC. The minimum wage is used even in situations in which a student's wage data from the years before enrolling at TSTC is available. THECB uses the minimum wage in an effort to be consistent because student wage data is not available for all students. This decision can cause the model to produce counterintuitive results. For instance, the students who see the largest wage increases as a result of attending TSTC are students who earned undergraduate degrees before enrolling at TSTC.

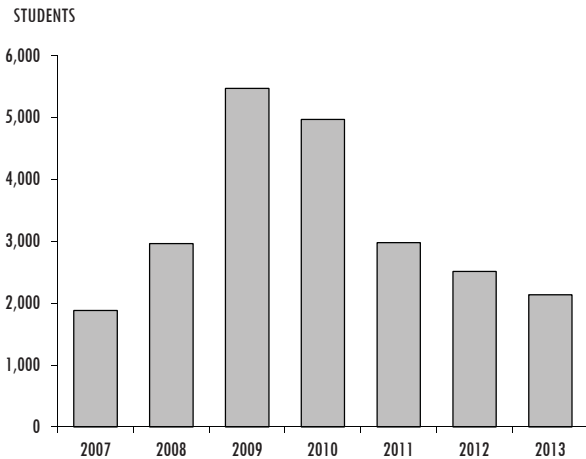
According to THECB's analysis, the most valuable student to a college with the returned value approach is a university graduate. A university graduate is a TSTC student who

earned a degree at a university before enrolling at a TSTC college and who otherwise meets the criteria for inclusion in the returned value model. System wide, TSTC receives 32 percent more funding for a university graduate than for a TSTC student who graduates with an associate's degree. TSTC receives 61 percent more for a university graduate than for a TSTC student who graduates with a certificate. TSTC–Waco is the only college in the system that does not receive at least 50 percent more funding for a university graduate than a graduate with an associate's degree. University graduates are treated the same as all other subgroups in the returned value model. As a result, the model assumes that in the absence of attending TSTC, students who have degrees from four-year institutions would be earning the minimum wage. According to the U.S. Department of Education, the median salary for individuals who have a bachelor's degree is \$44,970, approximately three times the base salary used in the returned value model. University graduates account for 2.4 percent of the returned value funding, despite making up only 1.0 percent of the cohort included in the study.

DUAL-CREDIT STUDENTS ARE EXCLUDED

The returned value model specifically excludes dual-credit students unless they have received degrees or certificates. Dual-credit students are students who take courses at an institution of higher education for both college and high school credit. In 2006, the Legislature required all local education agencies to implement a program through which students could earn the equivalent of at least 12 semester credit hours of college credit in high school. As **Figure 7** shows, dual-credit enrollment at TSTC grew from 1,884 students in 2007 to a peak of 5,469 in 2009. This was nearly a quarter of TSTC's enrollment. In 2013, dual-credit students made up 12 percent of TSTC's enrollment. Because these students are not considered in the returned value formula, TSTC reduced the number of dual-credit courses available in anticipation of changing to a returned value funding approach.

FIGURE 7
DUAL-CREDIT ENROLLMENT IN THE TEXAS STATE
TECHNICAL COLLEGE SYSTEM
FISCAL YEARS 2007 TO 2013



SOURCE: Texas Higher Education Coordinating Board.

In 2013, more than two-thirds of the dual-credit students enrolled at a TSTC college were enrolled at TSTC–Harlingen. However, as **Figure 8** shows, TSTC–Marshall had a higher percentage of dual-enrollment students as a share of total enrollment than any of the other TSTC colleges. TSTC–Marshall had 13 percent of the system’s dual-credit students despite having less than 8 percent of the system’s total enrollment.

Legislation passed by the Eighty-third Legislature, Regular Session, 2013, is likely to increase demand for dual-credit programs. House Bill 5, Eighty-third Legislature, Regular Session, 2013, requires all school districts to ensure that each student entering grade nine indicates an endorsement choice. Endorsements are specialized pathways to graduation. There are five endorsement options:

- Science, Technology, Engineering, and Mathematics (STEM);

- Business and Industry;
- Public Services;
- Arts and Humanities; and
- Multidisciplinary.

High school students may comply with the curriculum requirements for an endorsement by successfully completing courses in the core curriculum at an institution of higher education. Students pursuing the business and industry endorsement are required to complete a coherent sequence of four career and technical education (CTE) courses with at least two in the same CTE cluster and one advanced CTE course. House Bill 5 requires school districts to provide “to the greatest extent possible, to a student participating in a CTE program, opportunities to enroll in dual-credit courses designed to lead to a degree, license, or certification as part of the program.”

TSTC has indicated that the system anticipates a large increase in demand for dual-credit courses and a large increase in dual-credit enrollment at its colleges. TSTC has also indicated that because the returned value funding formula does not provide funding for dual-credit programs, the system might wind down its current programs.

INSTITUTIONS ARE PENALIZED FOR TRANSFER STUDENTS
 Students who enroll at four-year universities in the fall following their last semester at a TSTC institution are classified as transfers in the returned value model. These students are included in the returned value calculation if their UI wage data is available. Transfers are unlikely to be full-time employees and are unlikely to serve as a significant source of revenue for TSTC because they are likely to be students for at least one to two years. According to THECB’s analysis, transfers included in the returned value model earn less than the base salary in their first year out of TSTC, resulting in a cost to the TSTC institution from which they

FIGURE 8
DUAL CREDIT ENROLLMENT AS A SHARE OF TOTAL ENROLLMENT, FISCAL YEAR 2013

INSTITUTIONS	DUAL-CREDIT ENROLLMENT	TOTAL ENROLLMENT	DUAL-CREDIT AS PERCENTAGE OF TOTAL ENROLLMENT
TSTC–Harlingen	1,433	9,024	15.9%
TSTC–Marshall	277	1,331	20.8%
TSTC–Waco	206	5,252	3.9%
TSTC–West Texas	218	1,739	12.5%
TSTC–System	2,134	17,346	12.3%

SOURCE: Texas Higher Education Coordinating Board.

transferred. On average, a TSTC college will receive one-third the funding for a transfer as it would for a graduate with a certificate and one-quarter of what it would receive for a graduate who earns an associate's degree. Eighty-two percent of the transfer students included in the analysis used to calculate 2014–15 funding attended TSTC–Harlingen.

INCENTIVES ARE WEAK

The returned value approach is intended to affect the behavior of TSTC institutions; however, funding is based on factors outside of the institution's control. The funding that TSTC receives through the returned value approach is based on the wages earned by former students who have not attended TSTC in seven years. The majority of returned value funding that TSTC receives is a result of the wages of leavers, students who did not receive a degree or certificate from TSTC. The 2014–15 biennial funding is based on the earnings of students who last attended TSTC in fiscal years 2005 and 2006. As a result, TSTC cannot influence its outcomes-based funding in the current year. This approach does not encourage TSTC to engage in activities now that will result in more or better job placements for current TSTC students.

The current returned value model does not account for the different job markets that students at TSTC colleges will enter after they leave the system. The model assumes that the differences in student wages at the TSTC colleges are due to program differences. According to THECB, the average TSTC–Marshall student returns 40 percent more value to the state of Texas than the average TSTC system student. TSTC–Marshall is located in Harrison County in East Texas. The Railroad Commission of Texas identifies Harrison County as a core county of the Haynesville/Bossier Shale formation. Oil and gas production in the county has resulted in higher-paying jobs for workers with technical training (e.g., TSTC–Marshall students). Assigning the value to a single college is problematic because it is difficult to determine if the students' wage differences are due to the colleges' locations or the quality of the programs offered.

The majority of the funding TSTC receives through the returned value approach is a result of the wages earned by the group of students identified as leavers. These students did not receive a certificate or a degree from TSTC, yet they are responsible for 53 percent of the economic returns to the state that are attributable to TSTC.

STRENGTHEN RETURNED VALUE FUNDING APPROACH

TSTC would benefit from a funding approach that accounts for outcomes as well as inputs. Such an approach would ensure that TSTC is funded for the instruction of dual-credit students or students who go on to attend four-year institutions. An outcome-inclusive funding approach also would reward TSTC for economic contributions to the state made by students who complete the system's programs. To minimize the impact of data concerns, outcome-based funding should only be used for program completers; it is more likely that TSTC is a major contributor to financial gains for students who complete the system's programs.

To address limitations in the current formula, Recommendation 1 would amend the allocation of appropriations through the TSTC instruction and administration funding formula by replacing half of the returned value funding with contact hour-based funding. The other half of TSTC's funding would still be based on the economic return to the state due to its programs. This funding approach would ensure TSTC institutions are not discouraged from providing services that are state priorities, such as dual-credit courses. It would also ensure that TSTC is not penalized in the funding formula for students who transfer to a four-year institution.

This recommendation would modify the returned value portion of TSTC's funding by basing the funding amount on the expected future earnings of current-year graduates. The expected future earnings would be based on the earnings of previous graduates in their first five years after leaving TSTC. The returned value approach would continue to be used to create this estimate. If this approach had been used in the 2014–15 biennium, the TSTC colleges would have received \$9,800 for each graduate with a degree and \$7,850 for each graduate with a certificate. The current approach offers approximately \$6,000 for each graduate with a degree and \$4,900 for each graduate with a certificate. **Figure 9** shows how TSTC's I&A funding would have been allocated among TSTC colleges in the 2014–15 biennium as proposed in Recommendation 1.

Recommendation 2 would amend Rider 11, Special Provisions Relating Only to Components of Texas State Technical College System, in the 2016–17 General Appropriations Bill, to remove the restrictions on funding time in instruction. TSTC would still be required to work with THECB, the LBB, and other affected agencies to amend the formula used to calculate the returned value estimates. This formula will be used to calculate the expected value of a

FIGURE 9
DISTRIBUTION OF TEXAS STATE TECHNICAL COLLEGE INSTRUCTION AND ADMINISTRATION FUNDS
2012–13 AND 2014–15 BIENNIA

	2012–13 WEIGHTED SEMESTER CONTACT HOURS	2014–15 WEIGHTED SEMESTER CONTACT HOURS	2012–13 ACTUAL FUNDING	2014–15 ACTUAL FUNDING	2014–15 FUNDING IN ACCORDANCE TO RECOMMENDATION 1
TSTC–Harlingen	3,224,233	2,926,734	\$27,846,950	\$26,317,261	\$29,233,902
TSTC–Marshall	602,465	499,972	\$5,306,800	\$6,477,092	\$6,350,431
TSTC–Waco	4,576,785	3,659,730	\$43,209,016	\$42,344,120	\$44,047,320
TSTC–West Texas	950,874	714,700	\$8,624,495	\$14,669,302	\$10,176,124
TSTC System	9,354,357	7,801,136	\$84,987,261	\$89,807,776	\$89,807,776

SOURCE: Legislative Budget Board.

graduate with a degree or certificate that will be used in the updated funding approach. The agencies will determine strategies to mitigate the data concerns identified in this report.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would not have a fiscal impact to the state. Instead, the recommendations would redistribute the current level of funding appropriated to TSTC among the system's institutions. This redistribution would ensure that the funding of the TSTC system is aligned with the state's policy goals.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

CLARIFY ELIGIBILITY FOR PROFESSIONAL NURSING SHORTAGE REDUCTION PROGRAM FUNDS TO INCREASE AWARDS FOR TEXAS STUDENTS

Texas has a shortage of registered nurses. According to the Texas Center for Nursing Workforce Studies, the demand for nursing services is expected to increase as the Texas population ages and as more of the aging nurse population retires. The Professional Nursing Shortage Reduction Program was established to provide institutions funding to prepare more students for initial licensure as registered nurses. From fiscal years 2010 to 2015, the Texas Legislature appropriated approximately \$89 million in General Revenue Funds to the program to incentivize institutions to expand nursing education in Texas. Since the program was enacted, the number of nursing degrees and certificates granted from professional nursing programs in Texas has increased by 113 percent.

Some institutions that receive funds offer online nursing degree programs. The online programs have been valuable for many nurses who must remain employed during their education. However, online programs may include students who reside outside of Texas and who do not intend to practice nursing in Texas. Unlike methodologies used to distribute formula funding for electronic distance education, funding methodologies used to distribute funds from the Professional Nursing Shortage Reduction Program do not consider the location at which students enrolled in online courses reside. Including nonresident students residing outside of Texas in data that is used to distribute awards prevents the state from maximizing funds to address Texas' nursing shortage. Clarifying that online nonresident students residing in other states should be excluded from award calculations and improving data collection would maximize funding available to meet the Legislature's goal of reducing the state's nursing shortage.

CONCERN

- ◆ The Texas Higher Education Coordinating Board has awarded Professional Nursing Shortage Reduction Program funds to institutions based on outcomes for students who reside both in-state and outside of Texas. Given data limitations, the extent to which these awards were granted to nonresident students residing in other states cannot be determined. Including out-of-state students who are enrolled in online professional nursing programs in the award allocation

methodology reduces the program's effectiveness at meeting its statutory goal of addressing Texas' nursing shortage.

RECOMMENDATION

- ◆ **Recommendation 1:** Amend the Professional Nursing Shortage Reduction Program rider in the introduced 2016–17 General Appropriations Bill to prohibit nonresident students who are enrolled in online professional nursing programs while residing out-of-state from being included in methodologies used to calculate program awards.

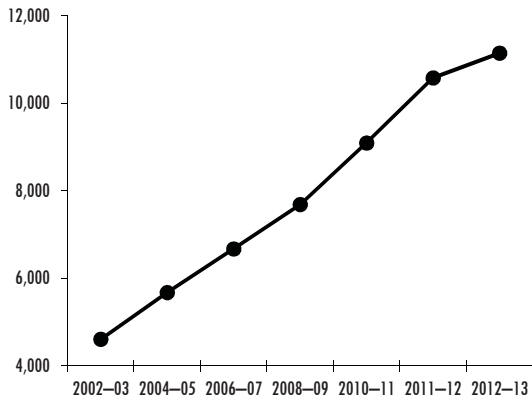
DISCUSSION

In 2001, the Texas Legislature established the Professional Nursing Shortage Reduction Program (PNSRP) to help address the state's nursing shortage. The program's focus has been expanded to increase the number of graduates from professional nursing programs, and to increase the number of master's and doctoral program graduates that can become professional nursing program faculty. Nursing schools eligible for available funds can use the money to:

- enroll additional students;
- provide nursing faculty enhancement;
- encourage innovation in the recruitment and retention of students;
- share curriculum and administrative or instructional personnel, facilities, or responsibilities between two or more professional nursing programs located in the same region; and
- engage practicing nurses who agree to train and mentor students in the work setting to expand faculty capacity.

According to the Texas Center for Nursing Workforce Studies (TCNWS), the number of graduates from professional nursing programs has increased steadily during the past 10 years, as shown in **Figure 1**. A total of 11,150 students graduated from professional nursing programs during fiscal year 2013. This total is more than a 5 percent increase from fiscal year 2012, and a 113 percent increase since fiscal year 2003.

**FIGURE 1
TEXAS PROFESSIONAL NURSING PROGRAM GRADUATES
BY BIENNIUM, FISCAL YEARS 2002 TO 2013**



SOURCE: Texas Center for Nursing Workforce Studies.

PROGRAM FUNDING METHODOLOGY

Statute establishes broad guidelines for the Texas Higher Education Coordinating Board (THECB) to allocate funds appropriated for the PNSRP. The Texas Education Code, Chapter 61, directs THECB to provide funds:

to professional nursing programs and other entities involved with a professional nursing program in the preparation of students for initial licensure as registered nurses in order to increase the number and types of registered nurses to meet the needs for registered nurses in the state.

Statute establishes three award categories within the program, and riders in the General Appropriations Act (GAA) allocate appropriations among the programs. THECB promulgated rules that authorize institutions to apply for two of the three award categories. **Figure 2** shows appropriations of General Revenue Funds to THECB for each PNSRP award category since fiscal year 2010. Regular and Under 70 awards encourage institutions to enroll additional students each year, because funding is based on the net increase in nursing

graduates between fiscal years. Funding for the Over 70 category is awarded to institutions in advance of increased enrollment.

THECB staff base funding methodologies on parameters provided in statute and rider to award funds for all three PNSRP categories to institutions. These methodologies do not address the state in which the students reside, and THECB does not track the residency location of enrolled students in its calculations.

Some institutions that receive PNSRP awards offer online nursing degree programs. This enrollment option has been valuable for many nurses who must remain employed during their education and are unable to enroll in face-to-face programs. However, online programs allow for the enrollment of nonresident students residing in other states who may not intend to practice nursing in Texas. Including these online nonresident students living outside of Texas in data used to distribute awards prevents the state from maximizing PNSRP funds to address Texas’ nursing shortage.

REGULAR AWARDS

In fiscal year 2014, THECB awarded approximately \$5.3 million to 40 institutions in the PNSRP Regular category. Funding is based on increases in nursing graduates from fiscal years 2012 to 2013, and it is weighted for graduates of certain nursing educator programs. The 2014–15 GAA requires these funds to be distributed in an equitable manner to institutions with nursing programs, including institutions graduating their first nursing classes, based on increases in nursing graduates.

THECB rules for this award category require that institutions submit required nursing graduation data for consideration. Required data includes academic year 2013 nursing graduates at all levels, excluding certificates, which lead to RN licensure or require licensure for degree program admission. THECB guidance provided in the *Reporting and Procedures Manual*

**FIGURE 2
APPROPRIATIONS OF GENERAL REVENUE FUNDS TO THE PROFESSIONAL NURSING SHORTAGE REDUCTION PROGRAM
FISCAL YEARS 2010 TO 2015**

AWARD CATEGORIES	2010	2011	2012	2013	2014	2015
Regular	\$7,350,000	\$7,350,000	\$4,933,500	\$4,933,500	\$5,550,187	\$5,550,187
Under 70	\$6,985,200	\$2,496,912	\$3,181,500	\$3,181,500	\$3,579,188	\$3,579,188
Over 70	\$8,014,800	\$12,503,088	\$6,885,000	\$6,885,000	\$7,745,625	\$7,745,625
TOTAL	\$22,350,000	\$22,350,000	\$15,000,000	\$15,000,000	\$16,875,000	\$16,875,000

SOURCE: Legislative Budget Board.

for Texas Public Universities does not specify whether PSNRP nursing graduate data should include or exclude nonresident graduates who do not reside in Texas.

As shown in **Figure 3**, some of the institutions that received Regular award funding in fiscal year 2014 offer online nursing education programs. A Legislative Budget Board (LBB) staff review of some PNSRP recipients’ websites found eight professional nursing programs that offer programs that can be completed entirely online. At least one of these universities included online nonresident students residing in other states in the data used to calculate award amounts. The inclusion of these students resulted in the institution being awarded funding that is intended to address Texas’ nursing shortage while its enrollment data was based partially on online nonresident students. Data is not available to determine whether the seven remaining institutions with online programs also had nonresident graduates residing in other states.

OVER 70 PERCENT GRADUATION RATE AWARDS

In fiscal year 2013, THECB awarded approximately \$1.0 million to three state universities in the PNSRP Over 70 award category. Awards in this category are targeted to institutions that have achieved a graduation rate of 70 percent or more in professional nursing programs; awards are based on an increase in new enrollees. THECB awards funds in this category in advance, and any unearned funding must be returned by the institutions upon determination of actual enrollment. To receive funds in this category, the 2014–15 GAA required that institutions achieve an increase in new enrollees equal to 12 percent in fiscal year 2012 and 18 percent in fiscal year 2013 of the first-year enrollments for

the 2011–12 academic year. Public and private professional nursing programs may apply for and receive funding, and each fiscal year is awarded separately. The three institutions shown in **Figure 4** offered online nursing degree programs and received Over 70 award funds in fiscal year 2013.

The 2014–15 GAA requires that TCNWS data be used for PSNRP distribution. Similar to Regular awards, this data does not exclude online nonresident students not residing in Texas. TCNWS data for this calculation is collected annually from nursing programs statewide through the Nursing Education Program Information Survey (NEPIS). Operational definitions in the NEPIS 2013 survey do not exclude online nonresident students residing out-of-state from the total enrollment calculation. According to TCNWS staff, total enrollment is the headcount number for all pre-licensure RN students, including new admissions and returning students, enrolled at all program sites, including extensions and the main campus. Therefore, the calculation used to distribute over 70 award funds may include students who do not reside in Texas while completing their studies. Due to the lack of data, the extent to which this practice occurs cannot be determined.

UNDER 70 PERCENT GRADUATION RATE AWARDS

In fiscal year 2014, THECB awarded approximately \$1.1 million to seven institutions in the PNSRP Under 70 award category. Funding for the Under 70 category is awarded to institutions that have not achieved a graduation rate of 70 percent in professional nursing programs. Funds are distributed in advance, and any unearned funding must be returned after determination of actual enrollment. For the 2014–15 biennium, the Legislature required that institutions

**FIGURE 3
TEXAS PROFESSIONAL NURSING SHORTAGE REDUCTION PROGRAM REGULAR AWARD ALLOCATION, FISCAL YEAR 2014**

INSTITUTION	ONLINE NURSING PROGRAMS	GRADUATES 2012	GRADUATES 2013	INCREASE IN GRADUATES	2014 AWARD
Angelo State University	RN to BSN	255	299	44	\$174,807
Midwestern State University	MSN, RN to BSN	165	182	17	\$64,403
Texas A&M International University	RN to BSN	70	82	12	\$44,162
Texas Woman’s University	RN to BSN, MSN, DNP, Ph.D.	668	716	48	\$176,647
The University of Texas at Arlington	RN to BSN, BSN, MSN	1,888	2,347	459	\$1,689,192
The University of Texas at Brownsville	BSN, MSN	52	87	35	\$128,805
The University of Texas at El Paso	RN to BSN, MSN	283	392	109	\$401,137
The University of Texas at Tyler	RN to BSN, MSN, Ph.D.	354	388	34	\$125,125

NOTE: RN = registered nurse. BSN = bachelor of science in nursing. MSN = master of science in nursing. DNP = doctorate of nursing practice. Ph.D. = doctorate of philosophy.
SOURCE: Legislative Budget Board.

FIGURE 4
TEXAS PROFESSIONAL NURSING SHORTAGE REDUCTION PROGRAM OVER 70 AWARD ALLOCATION, FISCAL YEAR 2013

INSTITUTION	ONLINE NURSING PROGRAMS	ACADEMIC YEAR 2010–11 ENROLLMENT	YEAR 2013 TARGET ENROLLMENT	BASE YEAR 2012–13 ENROLLMENT	AWARD
Stephen F. Austin State University	RN to BSN	143	165	150	\$70,000
Texas A&M University – Corpus Christi	eLine Military, RN to BSN, RN to MSN, MSN	256	297	294	\$380,000
The University of Texas at Arlington	RN to BSN, BSN, MSN	355	413	463	\$580,000

NOTES:
 (1) RN = registered nurse; BSN = bachelor of science in nursing; MSN = master of science in nursing; eLine Military = online program.
 (2) Award column represents actual amounts awarded based on actual enrollment.
 SOURCE: Legislative Budget Board.

receive \$20,000 for each additional initial RN graduate in two-year programs and \$10,000 for those in one-year programs. One of these institutions that received an Under 70 award offered online nursing degree programs. It is not known whether any of the students counted in the allocation methodology for this category resided out-of-state while enrolled in the online program.

THECB rules require that institutions submit nursing enrollment data for Classification of Instructional Program (CIP) codes, which the agency uses to calculate Under 70 award distributions. This data does not provide the location at which students’ reside.

CLARIFY ELIGIBILITY FOR PNSRP FUNDING

Considering students who are not likely to practice nursing in Texas in the funding calculations for PNSRP awards reduces the program’s effectiveness in meeting the state’s goal of reducing the nursing shortage. At least one institution has included online nonresident students residing outside of Texas in data used to allocate PNSRP awards. Data about the location at which online nursing students at other institutions reside was not available to determine the extent to which other programs enrolled such students. Recommendation 1 would amend the PNSRP rider in the introduced 2016–17 General Appropriations Bill to prohibit award distribution methodologies from including online nonresident students not residing in Texas. This amendment would ensure funding calculations are based solely on Texas residents and non-resident students who reside in Texas. Funding for online programs would continue to be considered to the extent that a student lived in Texas while enrolled.

This recommendation would improve the program’s effectiveness at meeting its statutory goal of addressing Texas’ nursing shortage. Nursing students are more likely to seek

employment close to where they graduate. According to academic research, approximately 88 percent of nurses took their first job in the state where they received their first nursing degree. This change would also be consistent with the way in which formula funding for distance education is provided. THECB rules prohibit semester credit hours taken by nonresident students located out-of-state through online courses from inclusion in methodologies for determining state formula funding for electronic distance education.

FISCAL IMPACT OF THE RECOMMENDATION

It is expected that any costs associated with this recommendation could be implemented within existing resources. Recommendation 1 clarifies that PNSRP eligibility does not include students who reside and complete coursework from out-of-state while enrolled, and these students should not be included in data required to calculate awards for the program. Removing eligibility for nonresident students who reside outside of Texas during their enrollment from the award allocation methodology would not reduce funding for the program but would instead increase award amounts available for in-state students. As a result, this incentive would be based solely on outcomes for students who are Texas residents or reside in Texas.

The introduced 2016–17 General Appropriations Bill includes a rider implementing this recommendation.

EVALUATE THE NURSING FIELD OF STUDY CURRICULUM TO INCREASE THE NUMBER OF NURSES WITH ADVANCED DEGREES

From fiscal year 2007 to 2014, the number of registered nurses in Texas who have earned a diploma, associate degree, or bachelor's degree in nursing grew by 42 percent. While the number of nurses available to meet the state's healthcare needs is increasing, trends are shifting toward registered nurses with baccalaureate degrees. As of 2014, approximately 209,000 positions for registered nurses were available in the state, and the demand is expected to grow 33 percent by 2020. Nationally there has been a call for 80 percent of the nursing workforce to hold at least a bachelor's degree by 2020, and the Texas Team Advancing Health Through Nursing action coalition, which includes several state agencies and institutions of higher education, has been working to implement these recommendations in Texas.

Encouraging registered nurses with associate degrees to obtain advanced degrees is one strategy to increase the number of registered nurses with baccalaureate degrees in Texas. However, a majority of registered nurses who have associate degrees do not obtain baccalaureate degrees. Differences in nursing education program curricula are one obstacle that hinders students from transitioning between nursing education levels. To facilitate the transfer of students' credits between two-year and four-year institutions, a nursing field of study curriculum was developed by the Texas Higher Education Coordinating Board in 2002. However, it is offered by few Texas institutions and may be obsolete. To facilitate student transfers in other academic discipline areas, institutions have jointly developed, using the Texas Tuning Project, voluntary agreements to accept transferred credits. Applying a similar process to nursing curricula could refine and expand implementation of Texas' field of study curriculum in nursing. This would address one of the factors that prevent nursing students from continuing their education to obtain baccalaureate degrees.

FACTS AND FINDINGS

- ◆ A 2011 statewide survey of Texas students enrolled in associate degree in nursing programs, nurse educators, and administrators identified the variety of general education prerequisites among colleges and universities and the lack of institutional flexibility in accepting transfers as two impediments for students enrolling in a bachelor of science in nursing program.

- ◆ The state's field of study curriculum in nursing includes fully transferable lower-division academic courses that are common to most baccalaureate nursing programs. However, only 6 out of 50 community colleges reported students who completed this field of study in fiscal year 2013.
- ◆ The Texas Tuning Project, a Texas Higher Education Coordinating Board pilot program from 2009 to 2013, developed voluntary agreements to transfer credits between institutions based on course-level alignment work from stakeholders statewide.

CONCERN

- ◆ The Texas Higher Education Coordinating Board adopted the nursing field of study curriculum to reduce differences in curricula that make transferring between programs or levels in nursing education a barrier. However, most community colleges have not fully implemented the curriculum. As a result, this remains a barrier to transferring from associate degree to advanced degree nursing programs.

RECOMMENDATION

- ◆ **Recommendation 1:** Include a rider in the introduced 2016–17 General Appropriations Bill to direct the Texas Higher Education Coordinating Board to evaluate the nursing field of study curricula using processes developed by the Texas Tuning Project and best practices in nursing curriculum to enhance the effectiveness of field of study curricula in reducing barriers for students who transfer between nursing programs.

DISCUSSION

Bachelor of Science in Nursing (BSN) graduates bring additional skills to their work that allow them to play an important role in the delivery of safe patient care and contribute to reduced patient mortality levels. In 2011, the Institute of Medicine, a branch of the National Academy of Sciences, called for 80 percent of the nursing workforce to hold at least a bachelor's degree by 2020. As a result, the Texas Team Advancing Health Through Nursing Action Coalition (Texas Team AC) has made it a priority to prepare

nurses at this level. This coalition consists of stakeholders from the private and public sectors, including community colleges and universities with nursing programs, the Texas Board of Nursing, and the Texas Center for Nursing Workforce Studies (TCNWS) at the Texas Department of State Health Services.

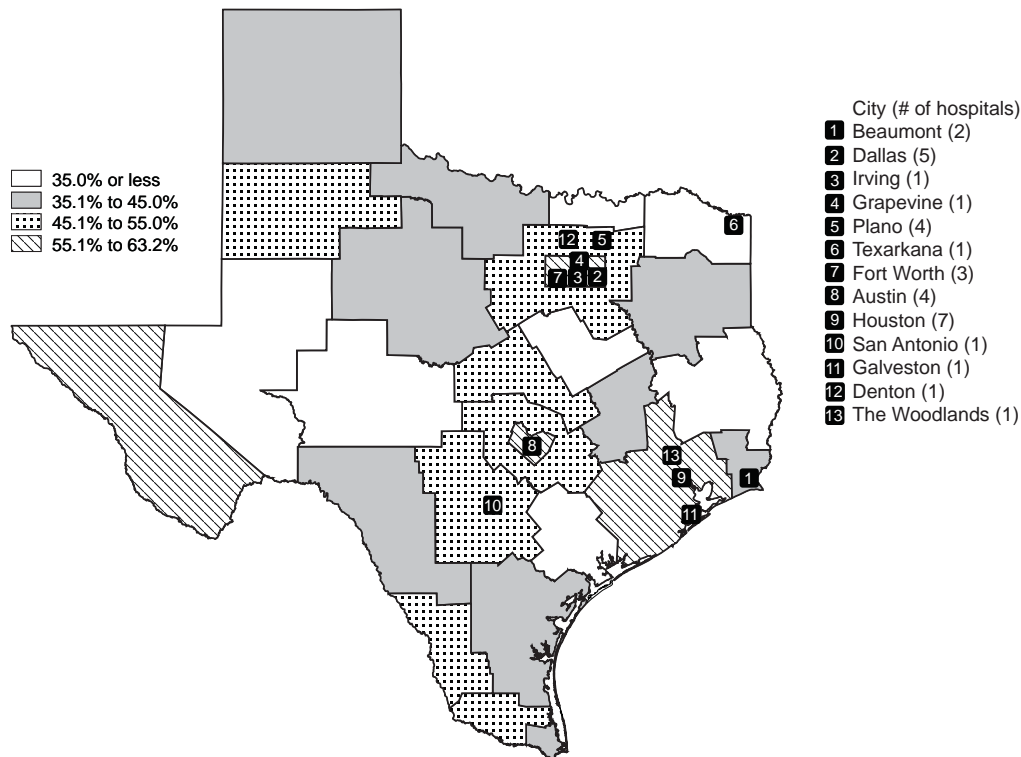
Another reason for increased demand for registered nurses (RN) with a baccalaureate degree in Texas is the Magnet Recognition Program of the American Nurses Credentialing Center. Hospitals with magnet status are recognized for quality patient care, nursing excellence, and innovations in nursing practice. To qualify for magnet status, hospitals must have nursing staff that is made up of 80 percent BSNs or have plans to meet the 80 percent threshold by 2020. There are 32 magnet hospitals in Texas, with the majority located in the Gulf Coast and Dallas/Fort Worth areas. The rate of BSN nurses in areas of Texas with magnet hospitals varies; however, none of these areas have achieved a rate of 80 percent of BSN nurses as shown in **Figure 1**. In these areas, the supply of BSN nurses does not meet the growing demand from factors such as magnet hospitals. As of 2014, approximately 209,000

positions were available for RNs in the state. The demand is expected to grow by 33 percent by 2020. To reach the 80 percent target for BSN-level nurses by 2020, the number of BSN nurses who enter the workforce in Texas must be much greater.

More than 7,000 students graduate annually from BSN programs in Texas. However, the need for BSNs outpaces what could be produced by enrolling only new nursing students in BSN programs. Part of this increase in graduates will need to be met by providing existing associate-degreed nurses with the additional 12 months to 18 months of coursework needed to obtain BSNs. To achieve this goal, the Texas Nurses Association, a statewide professional organization, concluded that Texas professional nursing programs must simultaneously accomplish the following:

- graduate a total of 55,235 new associate degree in nursing (ADN) or diploma holders;
- enroll one-half of the new ADN graduates (a total of 27,616) in RN to BSN programs upon graduation; and

FIGURE 1
PERCENTAGE OF REGISTERED NURSES WHO HOLD BACHELOR OF SCIENCE DEGREES BY TEXAS WORKFORCE DEVELOPMENT AREAS, AND TEXAS MAGNET HOSPITAL LOCATIONS BY CITY, FISCAL YEAR 2013



SOURCE: Legislative Budget Board.

- graduate 6,687 practicing ADN-prepared RNs with BSNs annually.

NURSING EDUCATION IN TEXAS

While the number of RNs is growing, Texas continues to have more ADN graduates from initial licensure nursing programs than BSN programs. ADN programs offered by community colleges and four-year institutions play an important role in meeting the state’s healthcare needs.

Four types of initial RN licensure nursing programs are offered in Texas. Of those programs, 68 institutions offer initial RN licensure associate degrees, and 43 institutions offer baccalaureate degrees, as of academic year 2013. **Figure 2** shows the majority of Texas’ initial RN licensure students graduated with ADNs; only 43 percent graduated with BSNs. Approximately 17 percent of ADN graduates obtain BSNs. To achieve the goal of 80 percent of nurses earning baccalaureate degrees by 2020, Texas would need a 37 percent increase in the percentage of BSN nurses.

A 2011 statewide survey, “Transitioning Associate Degree in Nursing Students to the Bachelor of Science and Beyond: A Mandate for Academic Partnerships,” supports national research that suggests entry into nursing practice at the BSN level as the most efficient way to address the need for nursing practitioners. Given the number of Texas’ associate-degree program graduates, promoting the ADN-to-BSN transition is one strategy to increase the number of BSNs in Texas. Texas nursing education programs can encourage students in

associate degree programs to continue their education and earn bachelor’s degrees.

BSN programs encompass all of the coursework taught in associate-degree and diploma programs, and a more in-depth treatment of the physical and social sciences, nursing research, public and community health, nursing management, and the humanities. According to the American Association of Colleges of Nursing, this additional coursework enhances nursing students’ professional development; prepares nurses for broader scopes of practice; and provides them with a better understanding of patient and healthcare delivery issues.

BARRIERS TO BACHELOR OF SCIENCE IN NURSING PROGRAM ADMISSION

Despite institutional efforts and existing state initiatives to accelerate educational progression, a majority of ADN-degreed registered nurses do not obtain advanced degrees. According to TCNWS, only 16.7 percent of initially ADN-trained RNs earned BSNs; 4.6 percent completed master of science in nursing degrees, and 0.3 percent completed doctorate degrees in 2011. This lack of educational progression is linked to a variety of factors, one of which is the lack of seamless credit transfer from one educational level to the next.

A 2011 survey of Texas students enrolled in ADN programs, nurse educators, and administrators found that one of the top reasons ADN nurses did not earn BSN degrees was the number of prerequisite courses institutions required. At least

**FIGURE 2
INITIAL LICENSURE NURSING PROGRAMS IN TEXAS, ACADEMIC YEAR 2012–13**

PROGRAM	REQUIREMENTS	APPROVED PROGRAMS	GRADUATES	PERCENTAGE OF TOTAL GRADUATES
Diploma	Hospital-based; three years of study	1	134	1.2%
Associate Degree (ADN)	Prerequisites; two years of study at a community college	68	6,193	55.5%
Baccalaureate Degree (BSN)	Four years of study, with nursing curricula occurring during the last two years at a university or academic health science center	43	4,768	42.7%
Alternate Entry Graduate Degree (MSN)	Accelerated, second-degree programs; usually offered at a university or academic health science center	1	55	<1.0%
TOTAL		113	11,150	

NOTE: Licensed vocational nursing to registered nurse programs traditionally require one year of study after a student has completed a certificate program and is licensed as a vocational nurse. Persons licensed as a registered nurse through this program are reported as ADN graduates.

SOURCE: Texas Center for Nursing Workforce Studies.

25 percent of the survey responses identified barriers related to university admission processes. For most students, the diversity of required courses and the lack of clarity during the admissions process hindered enrollment in RN-to-BSN programs.

In Texas, initial licensure programs for nursing education can develop and implement their own curricula to teach the same broad nursing concepts. Colleges and universities have a variety of general education prerequisites, and institutions can be inflexible in accepting transfer courses. These factors make moving to a BSN program difficult when the programs do not officially recognize all of the knowledge that students acquired during their associate-level studies, thus requiring students to re-enroll in courses they already completed.

According to THECB, creative partnerships between nursing programs and hospitals have been shown to effectively leverage scarce resources, increase enrollments, and improve educational experiences for students. However, these kinds of successful partnerships have not been adopted uniformly among many of the state's initial licensure programs. Differences in program curricula can make it difficult for nursing faculty to partner with other schools to use available resources more efficiently.

Two of the mechanisms that have been designed to facilitate the transfer of credits between two-year and four-year institutions are fields of study (FOS) and voluntary transfer compacts. These can be used to address issues with transition between education levels in nursing studies.

FIELD OF STUDY CURRICULUM

THECB's approved FOS curricula allow students to complete courses that satisfy lower-division requirements for bachelor's degrees in specific academic areas, or fields, and transfer those course credits to Texas public higher education institutions. Approved FOS curricula transfer in the same manner as the state-approved core curriculum. If a student satisfactorily completes an FOS curriculum and transfers to another institution for a baccalaureate degree in the same major, the courses transfer as a block and substitute for the major's lower-division requirements at the receiving institution. Students who satisfactorily complete part of a FOS curriculum can transfer the courses completed and receive credit in the field of study. However, the receiving institution can require these latter students to complete the remaining lower-division courses.

THECB's nursing FOS curriculum, established in 2002, includes 28 semester credit hours of transferable and applicable lower-division academic courses, and an additional set of applied nursing courses. Courses selected for inclusion in the FOS curriculum are those that are common to most baccalaureate nursing programs. Students completing the FOS should not be required to repeat courses that they have completed successfully.

Despite the benefits of completing a FOS to coordinate and enhance nursing education, only 16.0 percent of community college districts have reported students who completed the nursing FOS from fiscal years 2009 to 2013. Although THECB is responsible for developing and approving academic courses that fulfill the lower-division requirements for majors that correspond to the FOS, public community colleges and universities are not required to offer all the FOS courses, as they are for the state core curriculum. As shown in **Figure 3**, eight community colleges reported 482 FOS graduates in fiscal year 2009. In fiscal year 2013, six community colleges reported 293 FOS graduates—a 39.2 percent decrease since fiscal year 2009.

According to THECB recommendations to the Eighty-fourth Legislature, 2015, FOS are obsolete or rapidly becoming so. Many institutions do not use them and may not have heard of them. The Texas Administrative Code, Title 19, Rules 4.32 and 4.33, directs each public institution of higher education to review and evaluate its policies and practices regarding the acceptance and application of credit earned as part of a THECB-approved FOS curriculum. The statute also requires institutions to report the results of those evaluations to THECB following the same timetable as the regular reports of core curriculum evaluations. Based on limited statewide implementation of the FOS, THECB recommended a statewide evaluation in its 2008 *A New Curriculum Model for Initial RN Licensure Programs* report; however, the evaluation has not been conducted.

VOLUNTARY TRANSFER COMPACTS

Voluntary transfer compacts are statewide articulation agreements between institutions of higher education in Texas. These transfer compacts, resulting from the Texas Tuning Project that was conducted between 2009 and 2013, streamline the transfer process for students pursuing bachelor's degrees in various disciplines. The agreements also increase the number and preparedness of students matriculating from Texas public community colleges into bachelor's degree programs at Texas public universities. The

FIGURE 3
FIELD OF STUDY COMPLETERS IN NURSING AT TEXAS COMMUNITY COLLEGES, FISCAL YEARS 2009 TO 2013

COLLEGE	2009	2010	2011	2012	2013
Alvin Community College	59	57	52	45	70
Del Mar College	185	177	135	N/A	N/A
Hill College	N/A	N/A	4	5	1
Kilgore College	27	41	25	39	47
Panola College	10	14	18	9	12
Tyler Community College	1	N/A	N/A	N/A	N/A
Collin County Community College	19	12	18	1	4
South Texas College	181	188	183	141	159
TOTAL GRADUATES	482	489	435	240	293

NOTE: N/A indicates data not reported for certain colleges.
 SOURCE: Texas Higher Education Coordinating Board.

transfer compacts provide students with guidance about the courses that offer the best pathways to bachelor’s degrees. The transfer compacts eliminate the need for multiple one-to-one articulation agreements between community colleges and universities.

The Texas Tuning Project evaluated statewide course-level alignment and course transferability for selected academic disciplines by developing a faculty-led process. This was intended to develop a shared understanding of the subject-specific knowledge and transferable skills that students must demonstrate upon completing degree programs.

The Tuning Project process also resulted in establishing a transfer compact committee to implement enhanced transfer processes for certain disciplines. THECB has continued to review specific courses since the pilot period, but the nursing discipline has not been included in its review. Chancellors or presidents of 14 universities and 31 community and technical colleges or systems have agreed to participate in the transfer compact, eliminating the need for potentially more than 400 articulation agreements among these signatory institutions.

Alongside Texas’ efforts to smooth articulation and align curricula, other states are pursuing ways to improve educational opportunities for students. As of June 2014, 32 states and the District of Columbia maintain broad articulation agreements that describe how courses will transfer between ADN and BSN programs. Eight states mandate credit transfer between programs at public institutions. Most agreements were developed through statewide collaborations among nurse educators, boards of nursing, and other stakeholders.

Recommendation 1 would include a rider in the introduced 2016–17 General Appropriations Bill directing THECB to evaluate the nursing FOS curricula using processes developed by the Tuning Project’s transfer compact committee, and to consider best practices in nursing curricula to enhance the FOS curriculum’s effectiveness at reducing barriers for students who transfer between nursing programs. THECB would be directed to complete this evaluation no later than January 1, 2017.

Applying the Tuning Project process to the nursing FOS and degree programs could: ensure transparency in communicating with education stakeholders; facilitate retention, especially among students from underserved groups, by establishing clear pathways to degree completion; simplify the process for students transferring credits between institutions; increase student engagement in the learning process; and establish the relevance of post-secondary programs to the state and workforce’s goal of increasing BSNs.

When evaluating the nursing FOS, THECB should consider findings of the Consortium to Advance Baccalaureate Nursing Education in Texas and the Texas Team AC to identify best practices and curriculum changes and make recommendations regarding the FOS as required by Recommendation 1. The consortium was developed as a model to increase the number of RN-to-BSN program graduates in the state. The consortium is funded through a grant from THECB, and it supports institutions that are establishing nursing programs to streamline pathways for students. Findings on the effectiveness of the consortium’s newly developed curricula and the National Council

Licensure Examination for Registered Nurses pass rates are expected in January 2016.

FISCAL IMPACT OF THE RECOMMENDATION

Recommendation 1 is based on existing practices at THECB and could be implemented using existing resources.

The introduced 2016–17 General Appropriations Bill includes a rider implementing this recommendation.

OVERVIEW OF CURRENT PRACTICES AND ALTERNATIVES FOR HIGHER EDUCATION CAPITAL FUNDING

Texas uses tuition revenue bonds as a state-supported funding source for capital projects at public higher education institutions. Public universities, health-related institutions, Texas State Technical Colleges, and Lamar State Colleges are eligible to issue these types of bonds. Bonds are authorized by the Legislature in statute and are backed by tuition, fees, and other revenue collected by the institutions. The Legislature typically appropriates General Revenue Funds to reimburse institutions for their debt service on the bonds.

Tuition revenue bond debt is backed by tuition and fees from institutions, and General Revenue Funds are used to reimburse the institutions; therefore, the program is not subject to the provision in the Texas Constitution that restricts use of General Revenue Funds to finance higher education capital projects. Tuition revenue bonds also are not subject to the state's constitutional debt limit, which limits the amount of general obligation debt that the state can authorize. This report includes an overview of current practices regarding tuition revenue bonds and several alternative options to finance higher education capital projects.

FACTS AND FINDINGS

- ◆ A total of \$4.7 billion in tuition revenue bond debt has been authorized by the Texas Legislature since the program's inception in the early 1970s. According to the Texas Bond Review Board, as of August 31, 2014, \$2.2 billion of this amount was outstanding. For the 2014–15 biennium, the Legislature appropriated \$587.8 million in General Revenue Funds for debt service on outstanding tuition revenue bond debt.
- ◆ Texas institutions have requested \$5.6 billion in new tuition revenue bond authorizations for the 2016–17 biennium. Debt service for these authorizations would total an additional \$960.5 million for the 2016–17 biennium.
- ◆ No new tuition revenue bonds have been authorized since fiscal year 2009, when the Texas Legislature authorized \$155.0 million, mostly for repairs at The University of Texas Medical Branch at Galveston due to damage from Hurricane Ike. The last major statewide authorization occurred in fiscal year 2006,

when \$1.9 billion was authorized for 63 projects at 47 institutions.

- ◆ The Texas Legislature has several options that it could implement as an alternative to the current practice of tuition revenue bonds for higher education capital funding. These options include: enacting a General Obligation bond program for higher education capital funding; merging the Permanent University Fund and the Higher Education Fund; prioritizing tuition revenue bonds for projects at institutions that do not have access to Permanent University Fund-backed bonds; reimbursing institutions for only a portion of their tuition revenue bond debt service; and establishing a cap on tuition revenue bond debt service.

DISCUSSION

Public universities in Texas have a range of capital project needs. Capital projects involve the purchasing and construction of assets with a useful life of several years. Typically this includes major property acquisition, building construction, and renovation projects. Public entities, including universities, often choose to finance capital projects with the issuance of debt, so that funds for major projects are available immediately, and payments can be distributed across the useful life of the assets.

Texas public colleges and universities finance capital projects in a variety of ways, including:

- pay as you go;
- Permanent University Fund (PUF) Bonds;
- Higher Education Fund (HEF) Bonds;
- institution-supported bonds, which includes university revenue bond debt that does not require legislative authorization; and
- tuition revenue bonds.

Debt service is the expenditure required to pay the principal and interest on debt issued by an entity. Debt service for tuition revenue bonds (TRBs) is funded largely from General Revenue Funds; as a result, TRBs are the capital financing mechanism for which the Legislature has the most discretion

and oversight. The other four financing mechanisms shown previously are either governed by the Texas Constitution (PUF and HEF bonds), administered directly by the institutions and their systems (pay as you go and university-supported bonds), or are very small in scope (HEF bonds).

The TRB program was established by the Legislature in the early 1970s to comply with the Texas Constitution, Article VII, Sections 17(j) and 18(i), prohibition of using General Revenue Funds for higher education capital projects. Tuition revenue bonds are authorized in statute pursuant to the Texas Education Code, Chapter 55. Authorizations require approval by a majority of the members of each house. Unlike General Obligation (GO) bonds, TRB authorizations do not require ratification by voters.

Even though institutions are reimbursed for TRB debt service with General Revenue Funds, TRBs are backed legally by tuition, fees, and other revenue collected by the institutions. Therefore, TRBs are not subject to the Texas Constitution, Article III, Section 49(j), which limits the authorization of additional state debt in any fiscal year within certain circumstances. The state’s constitutional debt limit (CDL) restricts the authorization of additional state debt that is repaid with unrestricted General Revenue Funds to an amount that ensures annual debt service payments do not exceed 5 percent of the average annual unrestricted General Revenue Fund revenues from the previous three fiscal years.

A total of \$4.7 billion in tuition revenue bond debt has been authorized by the Legislature since the program was established. The first TRB authorizations in Texas occurred in fiscal years 1971 and 1973. TRBs were not authorized again until 1991. TRBs were regularly issued during the 1990s and 2000s, but the bonds have not been issued since fiscal year 2009, when \$155.0 million was authorized for repair of facilities at The University of Texas Medical Branch at Galveston and Texas A&M University at Galveston, mostly for damage caused by Hurricane Ike in 2008. **Figure 1** shows the history of TRB authorizations.

The Texas Bond Review Board, which supports the state of Texas’ debt management functions, includes information about TRB debt in its annual report. According to the agency, as of August 31, 2014, \$2.2 billion in TRB debt is outstanding. For the 2014–15 biennium, the Eighty-third Legislature, 2013, appropriated \$587.8 million for debt service on outstanding TRB debt.

More detailed information is available on the subject at the Interactive Graphics link of the Legislative Budget Board’s website <http://www.lbb.state.tx.us/Interactive.aspx>.

REQUESTING TUITION REVENUE BONDS

When seeking TRB authority, institutions request debt service for previously authorized TRB projects in their base Legislative Appropriations Requests (LARs) and request debt

**FIGURE 1
TUITION REVENUE BONDS AUTHORIZATIONS FOR TEXAS INSTITUTIONS, FISCAL YEARS 1971 TO PRESENT**

LEGISLATION	AUTHORIZATION
House Bill 1657, Sixty-second Legislature, Regular Session, 1971	\$185.0
Senate Bills 2 and 129, Sixty-third Legislature, Regular Session, 1973	57.5
House Bill 2102, Seventy-second Legislature, Regular Session, 1991	30.0
Senate Bill 3, Seventy-second Legislature, First Called Session, 1991	30.0
House Bill 2058, Seventy-third Legislature, Regular Session, 1993	352.4
House Bill 2747, Seventy-fourth Legislature, Regular Session, 1995	9.0
House Bill 1235, Seventy-fifth Legislature, Regular Session, 1997	638.5
House Bill 658, Seventy-seventh Legislature, Regular Session, 2001	1,081.8
House Bills 1941 and 2522, and Senate Bill 800, Seventy-eighth Legislature, Regular Session, 2003	220.4
House Bill 28, Seventy-eighth Legislature, Third Called Session, 2003	48.5
House Bill 153, Seventy-ninth Legislature, Third Called Session, 2006	1,858.8
House Bill 1775, Eightieth Legislature, Regular Session, 2007	13.0
House Bill 51, Eighty-first Legislature, Regular Session, 2009	155.0
TOTAL	\$4,679.8

NOTE: Amounts shown in millions.
SOURCE: Legislative Budget Board.

service for new TRB-financed projects as exceptional items. The Legislature typically enacts separate legislation that specifies authorizations for each institution, rather than doing so in the General Appropriations Act.

Upon the Legislature's request, the Texas Higher Education Coordinating Board (THECB) reviews TRB proposals from institutions before each legislative session. THECB evaluates proposals using a range of criteria, including an institution's need for the facility; space usage efficiency; deferred maintenance needs; progress toward state higher education goals; and extraordinary circumstances, such as accreditation requirements or effects from natural disasters. Prior to the Eighty-fourth Legislature, Regular Session, 2015, THECB solicited feedback from institutions regarding these criteria, and made changes, including the elimination of subjective measures and weighting new construction and renovation project more evenly.

THECB reports the results of its project evaluation to the Legislature at the beginning of each regular session. The agency lists all TRB projects submitted by institutions from highest- to lowest-scoring. Throughout the legislative session, the agency prepares additional information upon request, including ranking of each institution's projects from highest- to lowest-scoring. THECB'S project evaluation is advisory in nature, and the Legislature is not bound by the rankings.

ISSUING TUITION REVENUE BONDS

After the Legislature authorizes a project, institutions issue bonds and make debt service payments from tuition, fees, and other revenue. Institutions that are a part of a university system issue TRBs as part of the system's Revenue Financing System (RFS). The RFS is a program in which all revenue-backed debt, TRB or otherwise, for a university system is issued together.

In accordance with an RFS, a university system is able to pledge all system revenues, funds, and balances and combine projects from all of its institutions into a single issuance. This arrangement allows each system to achieve a higher bond rating than the component institutions would be able to receive if they issued debt individually. The RFS also minimizes costs by including issuances from multiple institutions in a single, systemwide issuance. Not all institutions are part of a system. The Texas Public Finance Authority (TPFA) issues TRBs for Midwestern State University and Texas Southern University. Stephen F. Austin State University and Texas Woman's University also have the option of using TPFA as an issuer.

The LBB directs institutions to base debt service requests for previously issued debt on bond documents and related debt service schedules. For new TRB debt authority, institutions base their debt service requests on TPFA guidelines that stipulate a 6.0 percent interest rate assumption and a 20-year term. Because the final financing terms for issued bonds may differ from these assumptions, actual debt service payments may be less than the amount appropriated. The Eighty-third Legislature, 2013, adopted a rider requiring that any unexpended General Revenue Funds appropriated for TRB debt service payments lapse at the end of each fiscal year.

TUITION REVENUE BOND REQUESTS FOR THE 2016–17 BIENNIUM

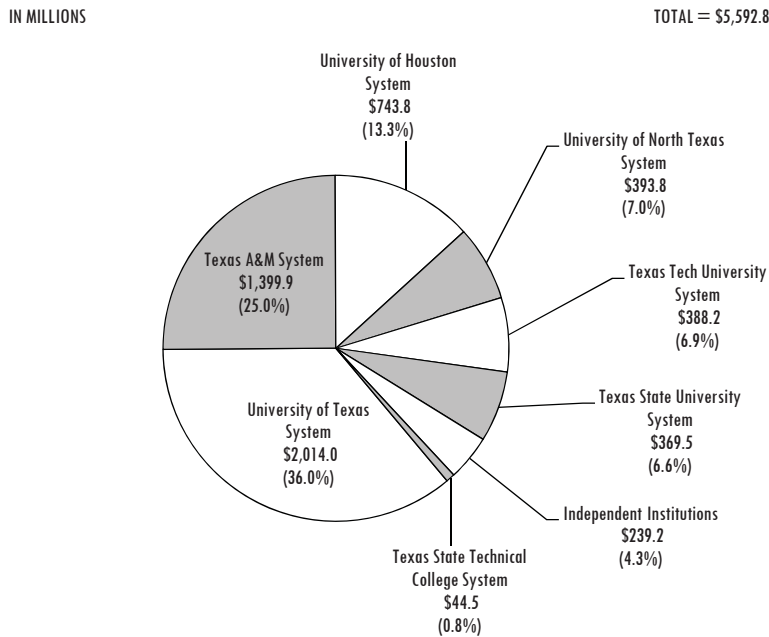
For the 2016–17 biennium, institutions have requested \$5.6 billion in new TRB authority for 87 projects. This total is a 17.5 percent increase from the \$4.8 billion requested for the 2014–15 biennium, when no new TRBs were authorized. Debt service on these TRBs would total \$960.5 million for the biennium. Institutions have requested \$571.8 million for debt service on previously issued TRBs. This requested amount would be a 3 percent decrease from the 2014–15 biennium, when institutions were appropriated \$587.8 million for TRB debt service. If all requests were approved, debt service for TRBs for the 2016–17 biennium, including new TRB authorizations, would total \$1.5 billion, which represents a 161 percent increase from institutions' 2014–15 TRB debt service appropriations.

The University of Texas (UT) System institutions have requested about \$2.0 billion in new TRB authorizations, the largest request of any university system. Texas A&M University (TAMU) System institutions have requested the second-largest dollar amount by system, with requests of \$1.4 billion. **Figure 2** shows TRB requests by system for the 2016–17 biennium.

POLICY CONSIDERATIONS RELATED TO TUITION REVENUE BONDS

Policymakers and stakeholders have deliberated several policy issues relating to TRBs and higher education capital funding. Some critics have contended that TRBs are misleading to taxpayers. Although General Revenue Funds are appropriated to pay for the cost of TRB debt service, neither the state's constitutional debt limit nor the constitutional prohibition on using General Revenue Funds for university facilities funding apply to the program. Furthermore, TRBs do not have to meet the same requirement of a GO bond authorization, including a vote of two-thirds in both houses

FIGURE 2
TUITION REVENUE BOND REQUESTS BY TEXAS UNIVERSITY SYSTEMS, 2016–17 BIENNIUM



SOURCE: Legislative Budget Board.

of the Legislature and voter ratification. Some stakeholders have noted that, because the program is supported through General Revenue Funds, it is misleading to suggest that TRB debt is supported by an institution’s funds, and therefore the same requirements that apply to GO bond authorizations should apply to TRBs.

Critics of TRBs point out that the amount of TRB debt that can be authorized is not constitutionally or statutorily restricted. In recent legislative sessions, the disparity between the amount of TRB authorizations requested by institutions and the amount authorized has been significant, as shown in **Figure 3**. Some stakeholders contend that a statutory cap on the amount of TRB debt that can be authorized would provide more certainty for policymakers and provide guidance to institutions about the amount of TRBs that could be authorized each session.

As **Figure 3** shows, no major, statewide TRBs have been authorized since the 2006–07 biennium, and the number of project requests is growing. Consequently, higher education institutions have expressed concern about the state’s lack of support for capital improvements. Legislative Budget Board (LBB) staff interviewed representatives from university systems who stated that TRB financing is vital to support

enrollment growth and an expanding research mission. Institutions typically seek TRB authorizations for projects that would not be possible without this funding source and follow internal review processes by the institutions and systems. Debt service for capital expansion and renovation would not be feasible within current resource constraints or would require significant tuition increases unless the Legislature authorized new TRBs, according to the university system staff interviewed.

ALTERNATIVE POLICY OPTIONS

Several alternatives to the TRB program have been proposed and considered in recent years. Each of these alternatives has advantages, challenges, and limitations. Alternative actions include: authorizing a GO bond program; merging the PUF and HEF; prioritizing TRBs based on access to other capital funding options; partially reimbursing debt service; or capping TRB authorizations. These options—or some combination of them—could be considered as an alternative to the TRB program.

AUTHORIZE GENERAL OBLIGATION BONDS

One alternative to TRBs would be a GO bond program for university capital needs. Proponents of a GO bond program

FIGURE 3
TUITION REVENUE BOND REQUESTS, AUTHORIZATIONS, AND DEBT SERVICE FOR TEXAS INSTITUTIONS
2006–07 TO 2016–17 BIENNIA



NOTES:

(1) Data for the 2006–07 biennium includes tuition revenue bond (TRB) requests and authorizations from the Seventy-ninth Legislature, Third Called Session, 2006. All other request and authorization data are from regular legislative sessions.

(2) TRB authorizations and debt service amounts for the 2016–17 biennium are yet to be determined by the Eighty-fourth Legislature, 2015.

SOURCE: Legislative Budget Board.

contend that such an approach would address concerns related to transparency and good government while facilitating the funding that institutions request. GO bond authority would require a two-thirds vote of the Legislature for approval of the debt and a constitutional amendment to allow the use of General Revenue Funds for university capital projects. These provisions also would require voter approval. TRBs require approval by a majority of the members of each legislative house; therefore, a higher education GO bond program would have a higher standard for authorization than TRBs.

A GO bond program also would allow institutions to benefit from the state’s bond rating, which is higher than the ratings for many institutions and university systems. Institutions that are a part of a university system issue TRBs using their system’s RFS. RFS bonds are rated based on the system’s long-term rating. Bonds issued by an independent institution are rated based on the institution’s long-term rating. Entities with lower bond ratings typically have access to less favorable interest rates and can have higher bond issuance costs. These factors can increase those entities’ costs of issuing debt. In addition, small institutions and systems with lower revenues may have to restrict the size of debt issuances so that their bond ratings are not affected negatively.

Figure 4 shows the bond ratings for the state and for Texas’ independent institutions and university systems. Currently, both the state and the UT System have the highest ratings possible from all three rating agencies. All other entities could benefit from the state’s higher bond rating.

Authorizing a GO bond program for higher education capital spending would require several policy changes. If new debt were authorized as GO bonds rather than TRBs, the estimated debt service on any new GO debt would have to be within the CDL. According to the Bond Review Board’s 2014 Annual Report, as of August 31, 2014, the CDL was at 1.20 percent for outstanding debt and 2.71 percent for both outstanding and authorized but unissued debt. Based on these amounts, the Legislature could authorize up to \$11.8 billion in new GO debt, which is almost \$6.3 billion more than the \$5.6 billion in TRB authorizations that institutions have requested for the 2016–17 biennium.

The Bond Review Board includes in its annual *Debt Affordability Study* an estimate of TRB debt service as a percentage of General Revenue Funds, allowing policymakers to see the effect that TRBs would have if these bonds were subject to the CDL. Although the CDL has capacity to fund all TRB authorizations requested, other state priorities for

FIGURE 4
TEXAS STATE AND HIGHER EDUCATION BOND RATINGS, FISCAL YEAR 2013

ENTITY	LONG-TERM RATING BY BOND-RATING AGENCY		
	MOODY'S INVESTORS SERVICE	STANDARD & POOR'S	FITCH RATINGS
State of Texas	Aaa	AAA	AAA
The University of Texas	Aaa	AAA	AAA
Texas A&M University	Aaa	AA+	AA+
Texas Tech University	Aa2	AA	AA+
University of Houston	Aa2	AA	Not Rated
Texas State University	Aa2	AA	AA
University of North Texas	Aa2	A+	AA
Texas Woman's University	Aa3	A	Not Rated
Midwestern State University	A1	Not Rated	AA-
Stephen F. Austin State University	A1	Not Rated	AA-
Texas State Technical College	A1	A-	Not Rated
Texas Southern University	Baa1	Not Rated	BBB+

SOURCE: Texas Bond Review Board.

GO bond support would be in direct competition with university capital financing if TRBs were included within the limit. Capital needs requests at state agencies, as of October 2014, total \$1.7 billion for the 2016–17 biennium. This amount would total less than the remaining CDL capacity of \$11.8 billion when combined with the total TRB authorization request of \$5.6 billion.

MERGE HIGHER EDUCATION FUNDS

In addition to TRBs, the Texas Constitution authorizes two dedicated sources of capital financing for higher education institutions: the Permanent University Fund (PUF) and the Higher Education Fund (HEF). Merging these two funds, increasing the “corpus,” or principal, of the fund, and making the merged fund available to all institutions would provide an alternative financing option to TRBs. Such a change would require a constitutional amendment.

The PUF is the larger of the two funds and was established through the Texas Constitution in 1876 by appropriating land grants in West Texas to the fund. Surface income generated on PUF lands is deposited into the Available University Fund (AUF). Mineral income and any income from the sale of lands must remain in the PUF and is invested in securities. The University of Texas Investment Management Company (UTIMCO) manages the PUF and oversees its investments.

Proceeds from the PUF deposited into the AUF can be used to support bonds for capital projects and other initiatives.

Certain institutions in the TAMU and UT systems are eligible for PUF bonds, as shown in **Figure 5**. Two-thirds of the AUF is allocated to UT System institutions, and one-third is allocated to TAMU institutions. The AUF is used to pay for debt service on PUF-backed bonds. The governing boards of the TAMU and UT systems allocate PUF bond proceeds among eligible institutions.

The UT System can issue bonds up to an amount that is no more than 20 percent of the book value of the PUF, and the TAMU System can issue up to 10 percent of the value of the fund. “Book value” refers to all assets, reinvested income, and realized gains or losses from the sale of investments in an endowment. This is in contrast to “market value,” which includes unrealized gains or losses on the endowment’s book value.

For the fiscal 2014–15 biennium, the PUF is estimated to support debt service payments of \$517.7 million on bonds. Residual income from the PUF is used for system office operations and for “excellence” (i.e., support and maintenance) programs at The University of Texas at Austin, Texas A&M University at College Station, and Prairie View A&M University. AUF excellence funding supports a variety of activities, including instructional services, recruitment and retention of faculty and students, institutional needs, and scholarships. For fiscal year 2012, excellence funding for UT Austin, Texas A&M, and Prairie View A&M totaled \$284.4 million.

**FIGURE 5
TEXAS INSTITUTIONS ELIGIBLE FOR PERMANENT
UNIVERSITY OR AVAILABLE UNIVERSITY FUNDS, AS OF
FISCAL YEAR 2015**

EXCELLENCE AND DEBT SERVICE FUNDS

Texas A&M University System
 Texas A&M University
 Prairie View A&M University
 The University of Texas System
 The University of Texas at Austin

DEBT SERVICE FUNDS ONLY

The University of Texas System
 The University of Texas at Arlington
 The University of Texas at Dallas
 The University of Texas at El Paso
 The University of Texas of the Permian Basin
 The University of Texas Rio Grande Valley
 The University of Texas at San Antonio
 The University of Texas at Tyler
 The University of Texas Southwestern Medical Center at Dallas
 The University of Texas Medical Branch at Galveston
 The University of Texas Health Science Center at Houston
 The University of Texas Health Science Center at San Antonio
 The University of Texas Health Science Center at Tyler
 The University of Texas M.D. Anderson Cancer Center

Texas A&M University System
 Tarleton State University
 Texas A&M University at Galveston
 Texas A&M University – Central Texas
 Texas A&M University – San Antonio
 Texas A&M University System Health Science Center
 Texas A&M AgriLife Extension Service
 Texas A&M AgriLife Research
 Texas A&M Engineering Experiment Station
 Texas A&M Engineering Extension Service
 Texas A&M Forest Service
 Texas A&M Transportation Institute

SOURCE: Legislative Budget Board.

The HEF provides funding to institutions that are not eligible for the PUF, which are shown in **Figure 6**. The HEF is funded with an annual appropriation from General Revenue Funds. Funds are dedicated by the Texas Constitution to support capital purposes at HEF-eligible institutions.

**FIGURE 6
TEXAS INSTITUTIONS ELIGIBLE FOR THE HIGHER
EDUCATION FUND, AS OF FISCAL YEAR 2015**

Texas A&M University System
 Texas A&M International University
 Texas A&M University – Commerce
 Texas A&M University – Corpus Christi
 Texas A&M University – Kingsville
 Texas A&M University – Texarkana
 West Texas A&M University

University of Houston System
 University of Houston
 University of Houston – Clear Lake
 University of Houston – Downtown
 University of Houston – Victoria

Independent Institutions
 Midwestern State University
 Stephen F. Austin State University
 Texas Southern University
 Texas Woman's University

University of North Texas System
 University of North Texas
 University of North Texas at Dallas
 University of North Texas Health Science Center

Texas Tech University System
 Angelo State University
 Texas Tech University
 Texas Tech University Health Sciences Center (all campuses)

Texas State University System
 Lamar Institute of Technology
 Lamar State College – Orange
 Lamar State College – Port Arthur
 Lamar University
 Sam Houston State University
 Sul Ross State University
 Sul Ross State University – Rio Grande College
 Texas State University

Texas State Technical College System
 Texas State Technical College – Harlingen
 Texas State Technical College – Marshall
 Texas State Technical College – Waco
 Texas State Technical College – West Texas

SOURCE: Legislative Budget Board.

Appropriations from the HEF are allocated to institutions through a formula that is administered by THECB. Allocation amounts to HEF-eligible institutions are set in the Texas Education Code, Section 62.021. For the 2014–15 biennium, the Legislature appropriated \$525.0 million in General Revenue Funds that were allocated to institutions through the HEF. HEF-eligible institutions may use up to 50 percent of the allocation for debt service on HEF-backed bonds. However, few HEF-backed bonds are issued because the Texas Constitution, Article 7, Section 17 (e), requires an amortization schedule of no more than 10 years for HEF-backed bonds.

The Texas Constitution requires the Legislature to review the formula used for HEF allocations every 10 years. In addition, with a two-thirds vote in each house, the Legislature can increase or reallocate HEF allocations every five years. The Eighty-fourth Legislature, 2015, will have the opportunity to revise the allocation and increase funding for eligible institutions.

The Legislature established a constitutionally dedicated corpus known as the Permanent Higher Education Fund to support HEF allocations in 1995; however, that policy has been suspended. With the passage of the constitutional amendment Proposition 4 in 2009, the balance of the fund was redirected to the National Research University Fund, which is intended to support emerging research universities in the state.

If the Legislature merged the PUF and the HEF to support more higher education capital funding needs, the corpus of the new fund would have to be larger than the current value of the two funds to be self-sustaining. **Figure 7** shows the corpus that would be required to support debt service on

outstanding TRBs and requested TRBs for fiscal year 2016, and debt service on PUF and HEF bonds for the current fiscal year. It also shows an estimate of the corpus required to support AUF excellence funding.

From 2004 to 2013, the PUF’s average annual growth rate was 7.5 percent. Assuming a 7.5 percent annual rate of return and a 2.5 percent inflation rate, a corpus of \$9.5 billion would be required to support debt service on TRBs requested by institutions for fiscal year 2016. A corpus of \$31.3 billion would be required to support AUF excellence funding and support debt service on all issued TRB, PUF, and HEF bonds and on requested TRBs.

As a comparison, the PUF’s market value as of August 31, 2013 was \$14.9 billion. Therefore, considering the previously discussed assumptions, the corpus of any new fund would need to be more than \$16.4 billion greater than the PUF’s market value to support estimated debt service on existing and requested bonds and AUF excellence funding. To support additional bond authorizations in the future, either the corpus would need to grow or debt service payments would need to decrease.

A benefit of consolidating all higher education capital funds is that the new fund would provide a more stable source of debt service funding. This consolidation would provide more reliability and predictability about the funding for higher education capital projects. However, as **Figure 7** shows, the funds required for such a strategy would be significant. Furthermore, the financial impact to individual institutions would depend on how the Legislature chose to allocate future capacity.

**FIGURE 7
ESTIMATED CORPUS REQUIRED TO SUPPORT TUITION REVENUE BONDS, PERMANENT UNIVERSITY FUND, AND HIGHER EDUCATION FUND DEBT SERVICE AND EXCELLENCE FUNDING, FISCAL YEARS 2015 AND 2016**

FUNDING	DEBT SERVICE	CORPUS REQUIRED (2)
Debt Service: Issued TRBs (fiscal year 2016)	\$286,898,735	\$5,737,974,700
Debt Service: Requested TRBs (fiscal year 2016)	474,751,162	9,495,023,240
Debt Service: Issued PUF Bonds (fiscal year 2015)	272,860,214	5,457,204,280
Debt Service: Issued HEF Bonds (fiscal year 2015)	14,561,261	291,225,220
AUF Excellence Funding (fiscal year 2015) (3)	513,689,790	10,273,795,800
TOTAL	\$1,562,761,162	\$31,255,223,240

NOTES:

- (1) TRB = tuition revenue bond; PUF = Permanent University Fund; HEF = Higher Education Fund; AUF = Available University Fund.
- (2) Assumes a 7.5 percent rate of return and a 2.5 percent rate of inflation.
- (3) AUF excellence funding is based on the amount allocated for fiscal year 2015, not the amount expended. It does not include the August 2014 one-time AUF distribution of \$131.6 million.

SOURCE: Legislative Budget Board.

PRIORITIZE INSTITUTIONS THAT DO NOT HAVE ACCESS TO PERMANENT UNIVERSITY FUND-BACKED BONDS

Another alternative to the current TRB program is to prioritize TRB requests from institutions that do not have access to PUF-backed bonds. This change would benefit HEF-eligible institutions, because HEF allocations typically are insufficient to support debt service on large-scale capital projects.

Supporters of this approach point out that PUF-eligible institutions already have access to a significant source of capital funding through the PUF and AUF. University systems with institutions that are not PUF-eligible reported that TRBs are of particular importance, because HEF funds are insufficient to cover infrastructure needs, and HEF funds limit institutions’ renovation and expansion plans.

The Legislature would have several options if it prioritizes HEF institutions in the TRB process. The Legislature could favor projects from HEF institutions when considering TRB requests or make PUF-eligible institutions ineligible for TRBs altogether. Alternatively, the Legislature could approve TRBs for PUF-eligible institutions but only reimburse those institutions for a portion of their debt service on TRB projects.

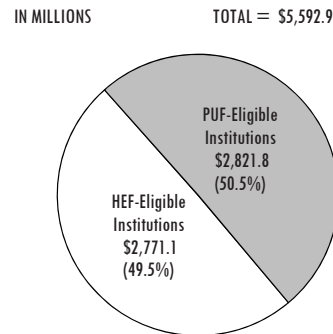
Depending on how the change would be implemented, such a policy could decrease the size and scope of the TRB program, lowering the cost to fund it. TRB requests from PUF-eligible institutions make up nearly 50 percent of institution’s TRB requests for the 2016–17 biennium, as shown in **Figure 8**.

Critics of this approach contend that TRBs are an important funding source for capital projects by PUF-eligible institutions, including the state’s two research universities, TAMU and UT Austin. In addition, the PUF does not have sufficient capacity to fund TRB requests from eligible institutions, because institutions can issue PUF-backed bonds only up to constitutional limits. PUF-eligible institutions in both the UT and TAMU systems have requested TRBs that exceed the amount available within the PUF capacity as of January 31, 2014. Furthermore, staff from these systems contend that most PUF-eligible institutions do not have access to excellence funding from the PUF and have extensive capital needs.

PARTIALLY REIMBURSE DEBT SERVICE

Another option for the Legislature would be to authorize new TRBs but appropriate only a portion of the debt service

**FIGURE 8
TEXAS INSTITUTIONS’ TUITION REVENUE BOND
REQUESTS, 2016–17 BIENNIUM**



NOTE: HEF = Higher Education Fund; PUF = Permanent University Fund.
SOURCE: Legislative Budget Board.

for the newly authorized bonds. Such an approach would reduce expenditures of General Revenue Funds for the state and require institutions to contribute a portion of the debt service required to pay off the bonds.

Partial debt service reimbursement for TRBs has some precedent. The Seventy-eighth Legislature, Regular Session, 2003, authorized \$268.9 million in new TRBs, but appropriated General Revenue Funds in an amount to pay only the interest costs associated with some of those bonds (approximately \$14.0 million). For fiscal year 2005, the Legislature reversed this practice and appropriated General Revenue Funds for all TRB debt service, including those authorized for fiscal year 2003. Had the Legislature continued the policy of only appropriating General Revenue Funds for interest on TRBs authorized for fiscal year 2003, the state would have saved an estimated \$57.7 million for the 2006–07 biennium.

An alternative approach to the fiscal year 2003 policy would be to split debt service on new TRBs with institutions on a 50–50 basis or some other ratio. This approach would result in less of a reduction in state support than the interest-only approach, and this transition could be more manageable for institutions. If the state evenly divided debt service costs for all TRBs requested for the 2016–17 biennium, the state’s portion of the debt service would be \$480.3 million in General Revenue Funds, rather than the full debt service cost of \$960.5 million. A final alternative, discussed previously, would be to reimburse PUF-eligible institutions for a lower percentage of the debt service associated with their newly authorized TRBs than is provided for HEF-eligible institutions.

Several challenges are associated with partial debt service reimbursement. Reimbursement would increase financial pressure on institutions. This pressure could lead to higher tuition for students at some schools. Small and regional institutions might not be able to fund the difference, particularly if their students were unable to pay for tuition increases. Institutions could choose not to issue bonds for which they did not receive full debt service appropriation, choosing instead to put the proposed projects on hold.

Opponents of the partial reimbursement approach contend that the state benefits from a strong higher education system, and the state should continue to fully support TRB projects financially. Opponents also contend that long-term capital costs should not be passed on to current students who may not see most of the benefit of those projects.

ESTABLISH A CAP ON TUITION REVENUE BOND DEBT SERVICE

The Texas Legislature could reform the TRB program by instituting a cap on the amount of TRB debt that may be authorized. Such a cap could be defined, like the CDL, so that new TRBs could not be approved if doing so would mean that total TRB debt service would be greater than a specified percentage of the three-year average of unrestricted General Revenue Fund revenues. Such a policy would provide certainty to policymakers with respect to the total amount of debt that could be issued in accordance with the TRB program. A cap on the amount of TRB debt could be implemented in statute and would not require a constitutional amendment.

By limiting the amount of TRBs that could be authorized, a cap would provide additional incentive for institutions to prioritize their most critical capital projects in their LARs. As General Revenue Fund receipts grow and as TRB debt is paid

down, additional TRB capacity would be available, providing the potential for new TRB authorizations in the future.

An LBB staff report in the 2013 *Texas State Government Efficiency and Effectiveness Report* recommended a statutory cap on TRB debt service of 1.25 percent of the three-year average of unrestricted General Revenue Fund revenues. Based on outstanding TRB debt, such a cap would restrict new authorizations to \$3.1 billion (based on the amount of outstanding debt for fiscal year 2014). This limit would be less than the amount requested by institutions for the 2016–17 biennium. **Figure 9** shows how much additional TRB debt could be authorized in accordance with various TRB debt service thresholds.

If policymakers choose to provide funding for higher education capital projects but adopt a different approach, two or more of the options discussed previously could be combined. For example, policymakers could establish a statutory cap on TRB debt service, require institutions to pay a portion of the debt service on TRBs, and allow HEF-eligible institutions to have priority for TRB projects. As Texas’ population grows and enrollment and research activity at public higher education institutions increases, capital needs will continue to require consideration. Whether and how to fund these projects will remain an important issue for the state.

**FIGURE 9
ESTIMATED TUITION REVENUE BOND CAPACITY IN ACCORDANCE WITH VARIOUS DEBT SERVICE THRESHOLDS (IN MILLIONS)
FISCAL YEAR 2014**

DEBT SERVICE LIMIT	TOTAL DEBT SERVICE CAPACITY	TOTAL TRB CAPACITY	ADDITIONAL DEBT SERVICE CAPACITY	ADDITIONAL TRB CAPACITY
1.00%	\$450.4	\$5,172.3	\$159.5	\$1,829.0
1.25%	\$563.7	\$6,465.4	\$272.2	\$3,122.1
1.50%	\$676.4	\$7,758.5	\$384.9	\$4,415.2
1.75%	\$789.2	\$9,051.6	\$497.7	\$5,708.3
2.00%	\$901.9	\$10,344.6	\$610.4	\$7,001.4

NOTES:
 (1) Assumes a 6.0% interest rate and a 20-year term.
 (2) TRB = tuition revenue bonds.
 SOURCE: Legislative Budget Board.

OVERVIEW OF RESEARCH ACTIVITIES AT EDUCATION RESEARCH CENTERS

The K–12 educational system prepares young adults for the workplace and higher education. Understanding how effective these systems are requires the analysis of data from across the public education, higher education, and workforce systems. However, federal educational privacy laws restrict the exchange of data among state agencies and make these analyses difficult or impossible to achieve.

As a result, in 2007, the Texas Legislature established three Education Research Centers to function as federally approved central data repositories that allow researchers to examine education policy and program effectiveness. As required by statute, the Texas Higher Education Coordinating Board selected three universities—Texas A&M University, The University of Texas at Austin, and The University of Texas at Dallas—as Education Research Centers. In 2013, following changes to their authorizing statute, the centers at The University of Texas at Austin and The University of Texas at Dallas were granted continuation contracts for an additional 10 years. This report describes the legislative history that led to the establishment of these centers as well as provides a quantitative analysis of their research activities to date.

FACTS AND FINDINGS

- ◆ The Education Research Center structure appears to be an effective mechanism for dealing with data linkage limitations imposed by federal privacy laws.
- ◆ The three Education Research Centers initiated 107 projects from the time they were established in 2007 through August 2014.
- ◆ A majority of initiated projects (84.1 percent) used data from the Texas Education Agency. A majority of projects also used data from the Texas Higher Education Coordinating Board (57.9 percent). Use of other datasets, such as those from the Texas Workforce Commission, was less common. Almost half of projects that used data linked multiple data sources.
- ◆ Of initiated projects, 60 fit in one of the four areas of research included in the Request for Proposal (56.1 percent) for the Education Research Centers. All of the remaining projects fit within both the statutory authorization for the centers and the additional areas

of research detailed by the Texas Higher Education Coordinating Board in the Request for Proposal.

- ◆ The University of Texas at Austin and The University of Texas at Dallas Education Research Centers reported publishing 22 book chapters, 11 dissertations, and 76 research reports tied to initiated projects, with several journal articles in pre-publication stages and expected to be published in the future.

DISCUSSION

Data needed to evaluate the effectiveness of education programs is collected by different state agencies, and federal privacy laws limit to whom data may be disclosed. The Texas Education Agency (TEA) maintains data on students in the K–12 system which may be linked through common student identifiers with student-level higher-education data collected by the Texas Higher Education Coordinating Board (THECB). These data can also be linked by Social Security numbers with unemployment insurance (UI) wage data collected by the Texas Workforce Commission (TWC). Because the K–12 educational system delivers young adults into the workplace and higher education, these linkages could help policymakers understand how this system affects both the success of students in future higher education as well as their ability to function in the labor market.

The separation of responsibility for maintaining student-level data records between TEA and THECB complicates the linking of datasets under the Federal Educational Rights and Privacy Act of 1974 (FERPA), as interpreted by the U.S. Department of Education (USDE). FERPA generally prohibits the release, without student consent, of data that may identify an individual student. Student-level data—even stripped of directly identifying information such as names and Social Security numbers—may nevertheless often be traced back to individuals when there are small numbers of persons in the group and several cross-linking categories, particularly across different databases.

In 2001, a letter from USDE gave state workforce agencies broad latitude under FERPA to link UI wage data to education records given their role as authorized representatives in statute to investigate the labor-market value of vocational education. In Texas, with the separation of education

responsibilities between TEA and THECB, this latitude also provided support for the linkage of higher education and K–12 data. In 2003, however, a second USDE letter reversed the initial guidance and explicitly required that authorized officials be under the direct control of the educational agency holding the data. Because of this change in guidance, research activities linking education and workforce data in Texas were effectively halted.

CREATION OF EDUCATION RESEARCH CENTERS

To comply with FERPA requirements, in 2005 the Texas Legislature passed legislation (Seventy-Ninth Legislature, Third Called Session) that established research centers and a data warehouse to link key datasets under the joint control of TEA and THECB. Researchers at universities were then able to use these data, under controls which were FERPA-compliant, while maintaining the USDE-required protection of the linked data at all times.

The Texas Education Code, Section 1.005, authorizes THECB and TEA to create this data warehouse and to establish up to three Education Research Centers (ERCs) that could access it. Beyond a requirement that such research benefit the state, no limitations on research topics were established in the statute; however it did identify several research areas that were specifically authorized including educator preparation, public school finance, classroom instruction, bilingual education, special language programs, and business practices.

In December 2006, THECB (the implementing agency in the statute) issued a Request for Proposals (RFP) that condensed these topics into three areas of emphasis—(1) Educator Preparation; (2) School Finance, Facilities, and Organization; and (3) Curriculum and Teaching Methods. The agency also included language about the importance of research that addressed *Closing the Gaps*, the state's strategic plan on increasing enrollment in and completion of higher education.

The Legislature appropriated \$3 million in General Revenue Funds to THECB for the first year of operations of the centers with the expectation that they become self-sufficient through gifts, grants, and contracts for independent research. THECB also received a Bill and Melinda Gates grant to provide funding for TEA and THECB staff support and data storage for the first four years of the grant and that allowed SAT and ACT test data to be linked for several years. In

addition to appropriated start-up funding, the chosen ERCs would have the data warehouse made available to them at no cost for the first year (with the possibility of it operating on a cost-recovery basis in future years). Applicants were expected to demonstrate both research expertise in pre-kindergarten through higher education (P–16) as well as resources to run the research center for a minimum of five years. The RFP required descriptions of specific projects that would be undertaken, including objectives, methodologies, staff member biographies, budget justifications, and literature references.

Direct supervision over the ERCs was provided by a joint advisory board co-chaired by the Commissioner of Education and the Commissioner of Higher Education. Among other responsibilities, the joint advisory board was responsible for developing minimum privacy standards (with procedures submitted to the USDE for comment on their compliance with FERPA) and for approving or rejecting any proposed new research topics beyond those specified in the initial response to the RFP. THECB sought guidance from the Family Policy Compliance Office of USDE on how well the structure of the ERCs met FERPA requirements. That office stated that TEA and THECB had developed a model approach that would become the preferred method for longitudinal student research. Thus, Texas' ERC structure appears to be an effective mechanism for dealing with data linkage limitations imposed by federal privacy laws.

The initial RFP closed in January 2007. In April 2007, THECB received eight applications and selected three institutions for ERC contracts: Texas A&M University, The University of Texas at Austin (UT Austin), and The University of Texas at Dallas (UT Dallas). Each of the selected universities also had another university as partner for specific research topics (Texas A&M International University for Texas A&M, Texas State University for UT Austin, and Stephen F. Austin University for UT Dallas). Interagency contracts for the ERCs were signed in July and August 2007 and contained provisions that the selected institutions comply with the interagency contract between THECB and TEA on the sharing of educational data.

As the initial contracts were for a five-year period, in May 2012 THECB issued a Request for Qualifications (RFQ) to continue the ERCs. UT Austin and UT Dallas elected to seek additional years of access, and by May 2012, draft continuation agreements were in place. The Texas A&M ERC contract ended on August 31, 2012. The ERC was granted an extension through November 30, 2012 to

complete all ERC research activities involving access to the data warehouse. These renewal contracts, however, were rendered moot by the passage of House Bill 2103 (Eighty-third Legislature, Regular Session) which amended the provisions of Section 1.005. The primary change made by this legislation was the removal of TEA as a joint partner with THECB in the administration of the ERCs. The former Joint Advisory Board, co-chaired by TEA and THECB, was turned into an advisory board chaired by the Commissioner of THECB (and with another formal THECB representative). TEA and TWC, in contrast, were granted a single representative on the advisory board. The advisory board also contains a representative from K–12 education—selected by the THECB Commissioner—as well as any other members the THECB Commissioner elects to appoint. In addition, each ERC has a member on the advisory board.

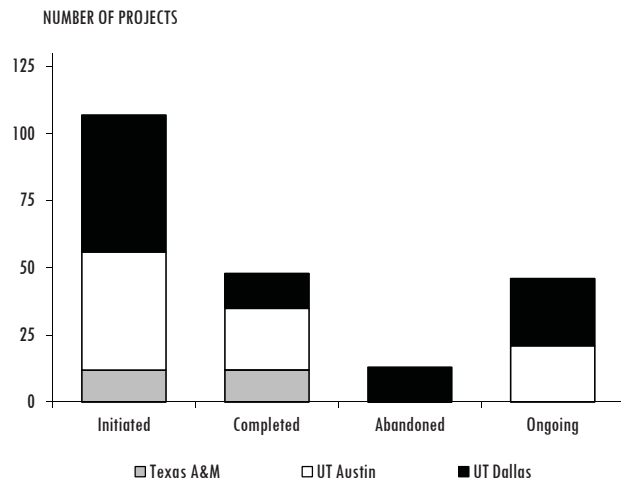
Concurrent with the progress of House Bill 2013 through the Legislature, THECB began the process for awarding contracts for a second round of ERC activity. Three proposals for this second round of contracts were received by May 15, 2013—Texas A&M not among them—and the THECB selected UT Austin and UT Dallas from these applicants. The two universities signed ten-year contracts for the continuation of ERC activities on September 26, 2013 and May 17, 2013 respectively. Pursuant to House Bill 2103, THECB retains authority to choose a third ERC in the future.

QUANTITATIVE ANALYSIS OF ERC ACTIVITY

Since the three ERCs were established, each has conducted research to fulfill the requirements of their contract. **Figure 1** shows projects by ERC. Research activities can be measured in terms of productivity—how many studies were initiated, completed, abandoned, or are ongoing. Initiated studies are those for which data was obtained. Studies which were proposed but not accepted or which were withdrawn prior to data being generated are not included in the following analysis.

The three ERCs initiated 107 research projects over both contract periods. UT Dallas initiated 51 of these projects (47.7 percent), UT Austin initiated 44 (41.1 percent), and (over the first contract period) Texas A&M initiated 12 (11.2 percent). Neither Texas A&M nor UT Austin reported any projects that were initiated and then abandoned, although both did have projects that were proposed but not initiated. Of the 13 projects UT Dallas reported as abandoned, eight were as a result of a policy change regarding the use of

FIGURE 1
QUANTITY OF ERC PROJECTS INITIATED, COMPLETED, ATTEMPTED, AND ONGOING
AUGUST 2007 TO AUGUST 2014



NOTE: ERC = Education Research Centers.
 SOURCES: Texas A&M University; The University of Texas at Austin; The University of Texas at Dallas.

external data. This policy change was required after TEA objected to linking secondary sources of education data required for the research through the data warehouse.

The purpose of the ERCs was to enable researchers to access and use large student-level databases and to match these on student identifiers. Accordingly, Legislative Budget Board (LBB) staff requested the ERCs to identify which databases were used for each project. **Figure 2** shows these responses for the all ERCs. A large majority of projects used data from TEA—90 of 107 initiated projects (84.1 percent). Many projects also used data from THECB—62 of 107 initiated projects (57.9 percent). Use of other datasets was less common, and the relatively low usage of TWC data suggests

FIGURE 2
DATA SOURCES USED BY ERC PROJECTS
AUGUST 2007 TO AUGUST 2014

DATA SOURCE	PROJECTS
Texas Education Agency	90
Texas Higher Education Coordinating Board	62
Texas Workforce Commission	17
State Board for Educator Certification	10
National Student Clearinghouse	9
Other	14

NOTE: ERC=Education Research Centers.
 SOURCES: Texas A&M University; The University of Texas at Austin; The University of Texas at Dallas.

that educational linkages with the workforce have not been one of the primary research activities of the ERCs to date. Ten of the 107 projects (9.3 percent) reported using no student-level data from any of these sources. Of the 97 projects that reported some data use, 47 of 97 (48.5 percent) linked multiple data sources. The ERC initiated-project list supports the need for centers that are able to access and integrate these disparate data sources.

While the statute authorizing the ERCs was not proscriptive in establishing the research that they were authorized to perform, in the initial RFP THECB established four areas of emphasis for research—educator preparation; school finance, facilities, and organization; curriculum and teaching methods; and access to and success in higher education. Using the title of each project and the project description where available, LBB staff assigned each project to one of these four groupings. Of the 107 initiated projects, 60 fit in one of the four areas of emphasis (56.1 percent).

The remaining projects were grouped into four additional project types. Other Policy Research includes policies above the school district level that did not involve school finance. An example of this research was the project entitled Assessing the Role of School Discipline in Disproportionate Minority Contact with the Juvenile Justice System. The second LBB-assigned project type was Other Program Evaluations. This category includes evaluation projects that did not examine a pedagogical or school-level policy. An example of this type was the Evaluation of the 2009–2010 Regional P–16 Council Enhancement Grants. The third LBB-assigned project type was Other Student Level Research, for research into specific student populations that did not fit into another category. An example of this research was Determinants of

Heterogeneity in Math Skill Development. Finally, LBB staff identified a group of projects that were technical and/or methodological in nature. An example of this type of research was On-track for High School Graduation Indicator for Texas School Districts.

While projects in these additional groupings were not in the areas of emphasis identified by THECB in the RFP, all were within both the statutory authorization as well as RFP guidelines for research by the ERCs. Since the start of the second contract period, the number of projects that focused on both other student-level research and technical and/or methodological research has decreased. **Figure 3** shows all categories by project count.

Finally, LBB staff requested each ERC to provide the number of publications that each research project generated. While UT Austin and UT Dallas provided these data, Texas A&M did not report any publication activity, and any publications by this ERC are not included in **Figure 4**. These counts are presented in four categories: (1) chapters in academic books, (2) dissertations, (3) non-peer reviewed policy research published externally to the ERC, and non-peer reviewed policy research published internally by the ERC. (LBB staff also requested peer-reviewed journal articles that had been accepted for publication; the ERCs did not report any instances of this research product. This is not unexpected, however, given the long lag times involved in completion of research through final publication in an academic journal.) Collectively, the 22 book chapters, 11 dissertations, and 76 research reports represent a substantial level of research publication.

FIGURE 3
ERC-INITIATED PROJECTS BY LBB-ASSIGNED PROJECT TYPE, AUGUST 2007 TO AUGUST 2014

PROJECT TYPE	INITIAL CONTRACT	SECOND CONTRACT	TOTAL
Educator Preparation	9	6	15
School Finance, Facilities, and Organization	8	2	10
Curriculum and Teaching Methods	14	5	19
Access to and Success in Higher Education	10	6	16
Other Policy Research	7	4	11
Other Program Evaluations	3	8	11
Other Student Level Research	11	1	12
Technical and/or Methodological	11	2	13

NOTES:

(1) Categories assigned by Legislative Budget Board.

(2) ERC = Education Research Centers; LBB = Legislative Budget Board.

SOURCES: Texas A&M University; The University of Texas at Austin; The University of Texas at Dallas.

FIGURE 4
PUBLICATIONS BY UT AUSTIN AND UT DALLAS
EDUCATION RESEARCH CENTERS
AUGUST 2007 TO AUGUST 2014

PUBLICATION TYPE	COUNT
Book Chapters	22
Dissertations	11
Non-Peer Reviewed External Research Reports	29
Non-Peer Reviewed Internal Research Reports	47

SOURCES: The University of Texas at Austin; The University of Texas at Dallas.

The future 5 to 10 years should see significant levels of journal and other publications as both universities identified articles in pre-publication stages. Finally, both UT Austin and UT Dallas reported large counts of public and professional engagement activities (such as community presentations) related to their research that were not included in the counts in **Figure 4**.

IMPROVE THE EVALUATION AND ADMINISTRATION OF THE MEDICAID ADULT SUBSTANCE USE DISORDER TREATMENT BENEFIT

A substance use disorder is a maladaptive pattern of substance use that leads to clinically significant impairment or distress. Substance use disorders increase the risk of illness and result in greater use of medical care, including services paid for by the Texas Medicaid program. According to the National Institutes of Health, these disorders can be managed successfully, similarly to diseases such as diabetes, asthma, or heart disease.

The Legislature directed the Texas Health and Human Services Commission to use existing Medicaid funds to implement a comprehensive Medicaid substance use disorder benefit for adults. This benefit was intended to decrease Texas Medicaid program spending associated with adults with substance use disorders. The agency began implementing the benefit on September 1, 2010, with full implementation on January 1, 2011. The benefit is available to all adults who have full Medicaid coverage, meet treatment requirements, and are enrolled in either the Medicaid fee-for-service system or managed-care programs. One measure of access to care is the adult Medicaid substance use disorder treatment penetration rate. This is a measure of the percentage of adult Medicaid clients with an identified substance use disorder who received treatment services funded by Medicaid. The rate in Texas for fiscal years 2011 and 2012 was 2.2 percent.

The General Appropriations Act (2014–15 Biennium), Rider 48, page II–101, specifies that the Texas Health and Human Services Commission may not provide Medicaid substance use disorder treatment services if the Legislative Budget Board determines that the treatment services have resulted in an increase in overall Medicaid spending. Several factors prevent a definitive assessment of whether the adult Medicaid substance use disorder benefit has resulted in an increase in overall Medicaid spending, or whether the cost has been offset by reductions in other healthcare spending. To maximize the services' effectiveness and allow for an evaluation of the benefit, the Texas Health and Human Services Commission should improve the administration of these services. Increasing awareness of these services, improving the collection and analysis of data, streamlining the process used to authorize treatment, and reviewing the use of treatment limitations would help ensure that Medicaid clients who have a substance use disorder receive appropriate high-quality services and provide the data needed to evaluate the impact of the benefit on overall Medicaid spending and client outcomes.

CONCERNS

- ◆ Data limitations prevent a definitive evaluation of the adult Medicaid substance use disorder treatment benefit. As a result, it is currently not possible to determine the efficacy of the benefit and whether it has resulted in an increase in overall Medicaid spending or whether the cost has been offset by reductions in other healthcare spending.
- ◆ The state may not experience a significant decrease in healthcare utilization and spending during and after adult Medicaid clients start receiving substance use disorder treatment services because of the benefit's low penetration rate. Thus, the potential for cost savings associated with these services is diminished.
- ◆ The state lacks a consistent process for authorizing Medicaid substance use disorder treatment services for adult clients. The different authorization processes used across the Texas Medicaid program may adversely affect clients and providers.
- ◆ There are quantitative limitations on the amount of Medicaid substance use disorder treatment services provided to adult clients even though these limitations are in conflict with the Medicaid state plan and the Uniform Managed Care Contract. Furthermore, there is potential for the quantitative limitations, which are applied regardless of medical necessity, to limit the effectiveness of these treatment services.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend the existing rider on Medicaid Substance Abuse Treatment in the introduced 2016–17 General Appropriations Bill to require the Texas Health and Human Services Commission to evaluate the impact of the adult Medicaid substance use disorder benefit on overall Medicaid spending and client outcomes.
- ◆ **Recommendation 2:** Amend statute to require the Texas Health and Human Services Commission to implement efforts to increase awareness of Medicaid substance use disorder treatment services.

- ◆ **Recommendation 3:** Amend statute to require the Texas Health and Human Services Commission to streamline the process used to authorize Medicaid substance use disorder treatment services.
- ◆ **Recommendation 4:** Amend statute to require the Texas Health and Human Services Commission to determine whether quantitative limitations on the amount of substance use disorder treatment services can and should apply to adult clients in the Texas Medicaid program. If the agency determines that limitations can and should be applied, the limitations should be properly established in the Medicaid state plan and the Uniform Managed Care Contract by September 1, 2015.

DISCUSSION

According to the current edition of the American Psychiatric Association's *Diagnostic and Statistical Manual of Mental Disorders* (DSM-5), a substance use disorder (SUD) is a maladaptive pattern of substance use that leads to clinically significant impairment or distress. In the previous diagnosis manual (DSM-IV), substance use disorders encompassed two subcategories, substance abuse and substance dependence. Substance use disorder in the DSM-5 combines the DSM-IV categories of substance abuse and substance dependence into a single disorder measured on a continuum from mild to severe. A SUD diagnosis requires that a person manifest 2 or more of 11 symptoms within a 12-month period. Each specific substance is addressed as a separate use disorder.

According to the National Institutes of Health (NIH), a substance use disorder is a chronic, relapsing brain disease that is characterized by compulsive drug seeking and use, despite harmful consequences to the individuals who are addicted and to those around them. A substance use disorder is considered a brain disease because the abuse of drugs leads to changes in the structure and function of the brain. NIH reports that brain imaging studies from drug-addicted individuals show physical changes in areas of the brain that are critical to judgment, decision making, learning, memory, and behavior control. Scientists believe that these changes alter the way the brain works, and this alteration may help explain the compulsive and destructive behaviors of addiction.

Similar to other chronic, relapsing diseases, such as diabetes, asthma, or heart disease, SUD can be managed successfully. According to NIH, research shows that combining treatment medications with behavioral therapy is the best way to ensure success for most patients. As with other chronic diseases, a

person may relapse and begin abusing substances again. For the addicted patient, lapses back to substance abuse indicate that treatment needs to be reinstated or adjusted, or that alternate treatment is needed.

IMPLEMENTATION OF SUD TREATMENT SERVICES FOR ADULT MEDICAID CLIENTS IN TEXAS

Substance use disorders increase the risk of illness and result in greater use of medical care, including services paid by the Texas Medicaid program. Research has found significantly higher medical utilization and costs among individuals with SUDs. Specifically, research studies supported by NIH in 1998 and the Robert Wood Johnson Foundation in 2005 found that untreated individuals have double the medical costs of those without a SUD. Substance use disorders increase Medicaid costs in the following ways:

- people become ill or injured as a result of their own substance abuse and receive health care services related to the illness;
- substance abuse complicates other illnesses or injuries, resulting in more frequent and severe episodes of sickness, such as influenza; or
- substance abuse injures third parties, including children born to mothers who abused alcohol or drugs during pregnancy. These injuries increase Medicaid costs upon the child's birth and may increase Medicaid expenditures throughout the child's life.

To decrease Texas Medicaid program spending related to SUDs among adults, the Legislature directed the Texas Health and Human Services Commission (HHSC) to use existing Medicaid funds to implement a comprehensive treatment benefit for adults beginning January 1, 2010. The legislation allowed the agency to delay implementation pending federal approval. Based on studies in other states and preliminary analysis conducted by Legislative Budget Board (LBB) staff, it was expected that the cost to provide comprehensive treatment would be offset by reductions in other Texas Medicaid program spending in the same year that treatment services were provided. These reductions were expected due to decreases in the use of medical services for clients receiving SUD treatment. The legislation specified that HHSC may not provide Medicaid SUD treatment services if the LBB determines that the treatment services have resulted in an increase in overall Medicaid spending.

Before the establishment of the SUD benefit in the Texas Medicaid program, access to comprehensive SUD treatment

for adult clients in the program was limited. With the exception of SUD treatment services provided by some managed-care organizations (MCO) participating in Medicaid, the Medicaid-funded SUD treatment services available to adults were limited to inpatient hospital detoxification, mental health services, and prescription drugs. Inpatient detoxification services were only available as part of an overall treatment plan for a separate acute condition requiring inpatient hospitalization. Adult clients in the Texas Medicaid program could have received SUD treatment through the federal Substance Abuse Prevention and Treatment (SAPT) block grant program administered by the Texas Department of State Health Services (DSHS); but limited grant funds and set-aside requirements limited the number of clients who received SAPT-funded treatment. In fiscal year 2006, only 17 percent of adult Medicaid clients with an identified substance use disorder received SAPT block grant-funded SUD treatment and/or SUD services paid by Medicaid.

HHSC began implementing the Medicaid SUD benefit on September 1, 2010, with full implementation on January 1, 2011. Of the approximately 900,000 adults currently enrolled in the Texas Medicaid program who have full coverage, the benefit is available to clients who meet SUD treatment requirements and are enrolled in the fee-for-service (FFS) system or the STAR and STAR+PLUS managed-care programs. Medicaid clients include individuals who are eligible for full coverage of acute care services, prescription drugs, and long-term services and supports, depending on need. Medicaid clients who have limited benefits include individuals eligible for time-limited or specific services only. Medicaid clients can self-refer (i.e., a referral from a primary care physician is not required) or be referred by a physician or other entity to receive an assessment at a licensed chemical dependency treatment facility to determine if they qualify for SUD treatment services.

The Medicaid claims administrator, Texas Medicaid and Healthcare Partnership (TMHP), administers the benefit for clients enrolled in FFS. HHSC amended existing managed-care contracts to require that the MCOs participating in the Medicaid STAR and STAR+PLUS programs offer comprehensive substance abuse services to clients enrolled in their programs. STAR+PLUS clients who are Medicaid Qualified Medicare Beneficiaries will have their SUD treatment services paid through TMHP, unless the service is covered by Medicare. Medicaid Qualified Medicare Beneficiaries are dually eligible for both Medicaid and

Medicare and qualify for full Medicaid benefits. The NorthSTAR managed-care program is not affected by the SUD benefit because comprehensive SUD treatment services had previously been implemented in that program.

Figure 1 shows the SUD treatment services that are a benefit of the Texas Medicaid program and their implementation dates by delivery model. MCOs that participate in the Medicaid STAR and STAR+PLUS programs may, at their own discretion, provide additional SUD treatment services on a case-by-case basis beyond those required by law or contract. Medicaid MCOs do not receive additional reimbursement for provision of these additional services. The type of additional SUD treatment services offered by Medicaid MCOs varies. Also, certain adult Medicaid clients may receive additional services funded through DSHS that wrap around the Medicaid-funded services. Specifically, Medicaid clients who receive Specialized Female category residential treatment services receive up to 35 days of residential treatment funded through HHSC and additional residential and other specialized services funded through DSHS. Similarly, Medicaid clients who receive HIV category residential services receive up to 35 days of residential treatment funded through HHSC and additional residential and other specialized services funded through DSHS.

To ensure no duplication of payment between the Texas Medicaid program and the SAPT block grant program for SUD treatment services provided to Medicaid clients, HHSC has established requirements related to use of SAPT block grant funds for Medicaid clients. These requirements state that the Texas Medicaid program is the primary payer of Medicaid-covered SUD treatment services for Medicaid clients seeking SUD treatment, and the SAPT block grant program is the payer of last resort for these clients. If a Medicaid client has exhausted Medicaid coverage for SUD treatment, the client may be served through the SAPT block grant program if he or she meets clinical eligibility for the SAPT-covered service, services are provided by a SAPT block grant-funded provider, and the provider is funded for that level of service. SAPT block grant-funded providers can also bill the SAPT block grant program for SUD treatment services provided to a client before Medicaid eligibility determination; however, if the individual enrolls in Medicaid and has retroactive Medicaid coverage, any Medicaid-covered SUD treatment services that were billed to SAPT should be reversed and re-billed to Medicaid.

**FIGURE 1
TEXAS MEDICAID ADULT SUBSTANCE USE DISORDER TREATMENT SERVICES BY DELIVERY MODEL AND IMPLEMENTATION
DATE, FISCAL YEAR 2014**

SERVICE	FEE-FOR-SERVICE SYSTEM	STAR AND STAR+PLUS
Assessment by a chemical dependency treatment facility	9/1/2010	9/1/2010
Detoxification services when provided in a general acute care hospital, residential, or ambulatory (outpatient) chemical dependency treatment facility setting	1/1/2011	9/1/2010 (ambulatory detoxification) 1/1/2011 (residential detoxification)
Ambulatory (outpatient) treatment services, including individual and group counseling, provided by a chemical dependency treatment facility	9/1/2010	9/1/2010
Medication-assisted therapy administered by a chemical dependency treatment facility, a physician, or physician group in an outpatient setting	9/1/2010	9/1/2010
Residential treatment services provided by a chemical dependency treatment facility	1/1/2011	1/1/2011

NOTES:

- (1) Only chemical dependency treatment facilities licensed by the Texas Department of State Health Services are eligible to participate in the Texas Medicaid program. Medicaid clients in a fee-for-service (FFS) system must be assessed by a Medicaid-enrolled chemical dependency treatment facility for substance use disorder (SUD) treatment services to begin. Medicaid clients in managed care must visit a chemical dependency treatment facility in their managed care organization’s (MCO) provider network for assessment.
- (2) In Medicaid FFS, the clinical services portion of residential treatment services is funded by state and federal Medicaid funds, and the room and board portion is funded solely from General Revenue Funds. In the STAR and STAR+PLUS programs, the entire residential treatment benefit is funded with state and federal Medicaid funds.
- (3) This figure does not include SUD treatment services that may be provided by MCOs in the Medicaid STAR and STAR+PLUS programs on a case-by-case basis that are in addition to Medicaid state plan services.

SOURCE: Legislative Budget Board.

EFFECTS OF FEDERAL LAW ON THE TEXAS MEDICAID SUD BENEFIT

The federal Affordable Care Act (ACA) requires that health plans in the individual and small group markets cover 10 categories of essential health benefits, including substance use disorder services. As a result, all health insurance products sold on Health Insurance Exchanges or provided by Medicaid to certain newly eligible adults defined in ACA starting in 2014 must include SUD treatment services. Because Texas chose not to expand Medicaid coverage to the newly eligible adult population, the ACA requirement that Medicaid include SUD treatment services does not apply to the Texas Medicaid program.

The federal Mental Health Parity and Addiction Equity Act of 2008 (MHPAEA) prevents group health plans and health insurance issuers that provide mental health and SUD benefits from imposing less favorable benefit limitations on those benefits than on medical and surgical coverage. MHPAEA requires a general equivalence in the way mental health, SUD, medical, and surgical benefits are treated with respect to annual and lifetime dollar limits, financial requirements, and treatment limitations. However, the law does not require large group health plans and their health insurance issuers to cover mental health and SUD benefits. As a result, MHPAEA requirements apply only to large

group health plans and their health insurance issuers that choose to include mental health and SUD benefits in their benefit packages. As long as the Texas Medicaid program chooses to contract with MCOs to provide both medical/surgical and mental health or SUD benefits, MHPAEA requirements apply to these MCOs. MHPAEA requirements do not apply to the Medicaid fee-for-service program.

SPENDING AND UTILIZATION OF TEXAS MEDICAID SUD TREATMENT SERVICES FOR ADULT CLIENTS

Spending on Medicaid-funded SUD treatment services for adults totaled \$5.9 million in All Funds in fiscal years 2011 and 2012. The average monthly amount spent per adult Medicaid client on SUD treatment services was \$111. **Figure 2** shows the estimated percentage of adult Medicaid clients with an identified substance use disorder who received Medicaid-funded SUD treatment services during fiscal years 2011 and/or 2012. This percentage, which is referred to as the penetration rate, is one measure of access to care. During fiscal years 2011 and 2012, the estimated number of adults in the Texas Medicaid program with an identified substance use disorder totaled 189,513. This number includes adult Medicaid clients who had either received a Medicaid-funded SUD treatment service and/or who had an SUD diagnosis listed on a Medicaid claim or encounter. Of the adult clients enrolled in the Texas Medicaid program with an identified

FIGURE 2
TEXAS MEDICAID SUBSTANCE USE DISORDER TREATMENT PENETRATION RATE FOR ADULT CLIENTS,
FISCAL YEARS 2011 AND 2012

CLIENT DESCRIPTION	CLIENTS
Received a Medicaid-funded SUD treatment service (A)	4,141
Have a SUD diagnosis listed on a Medicaid claim or encounter (B)	189,506
Have a SUD diagnosis listed on a Medicaid claim or encounter and also received a Medicaid-funded SUD treatment service (C)	4,134
Adult Medicaid clients with an identified SUD (D = [A+B]-C)	189,513
Penetration Rate: Estimated percentage of adult Medicaid clients with an identified SUD who received Medicaid-funded SUD treatment (E = A/D)	2.2%

NOTE: This figure includes data on clients enrolled in Medicaid fee-for-service, STAR, and/or STAR+PLUS. This figure does not include data on clients who may have received substance use disorder (SUD) treatment services that may be provided by managed care organizations in the Medicaid STAR and STAR+PLUS programs on a case-by-case basis that are in addition to Medicaid state plan services. The number of adult Medicaid clients with an identified substance use disorder includes a relatively small number of Medicaid clients who would not have been eligible for treatment services because they do not have full Medicaid coverage.

SOURCE: Legislative Budget Board.

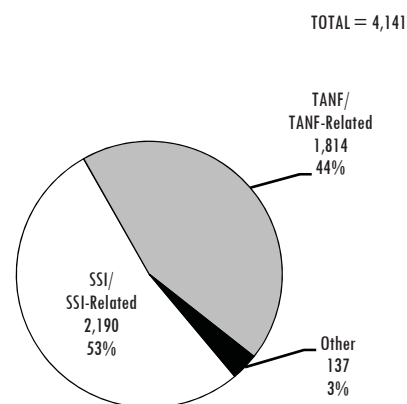
substance use disorder, 4,141, or 2.2 percent, received Medicaid-funded SUD treatment services during fiscal years 2011 and/or 2012. As shown in **Figure 3**, of the 4,141 adult clients who received Medicaid-funded SUD treatment services during fiscal years 2011 and/or 2012, a slightly greater percentage of these clients, 53 percent, were in the Supplemental Security Income (SSI)/SSI-related client group compared to other client groups.

POTENTIAL FOR ADULT SUD TREATMENT TO REDUCE MEDICAID SPENDING

Studies on the cost-effectiveness of SUD treatment have found that SUD treatment affects future healthcare spending for treated individuals and can result in significant decreases in medical utilization and spending after individuals entered SUD treatment programs. Furthermore, the cost of treatment may be more than offset by reductions in other healthcare spending, resulting in net Medicaid cost savings.

One example of the effects of Medicaid-funded SUD treatment on healthcare spending is in the state of Washington. In 2005, the Washington Legislature expanded funding for SUD treatment for persons enrolled in Medicaid and General Assistance-Unemployable (GA-U) medical coverage (renamed Disability Lifeline in 2010) to a total of \$32 million for adults and \$6.7 million for children in the 2005–07 biennium. SUD treatment for adult Medicaid and GA-U clients was increased to about \$40 million in the 2007–09 biennium. The adult expansion funds were used to provide services to three categories of clients: Medicaid Aged, Blind, and Disabled; other Medicaid clients in the Pregnant Women and

FIGURE 3
TEXAS MEDICAID SUBSTANCE USE DISORDER TREATMENT FOR ADULTS, FISCAL YEARS 2011 AND 2012



NOTES:

- (1) SSI = Supplemental Security Income; TANF = Temporary Assistance for Needy Families. Client counts are unduplicated. The other category includes selected non-SSI and non-TANF client type Medicaid programs.
- (2) This figure does not include data on clients who may have received substance use disorder (SUD) treatment services that may be provided by managed care organizations in the Medicaid STAR and STAR+PLUS programs on a case-by-case basis that are in addition to Medicaid state plan services.

SOURCE: Legislative Budget Board.

Temporary Assistance for Needy Families-related (TANF) Family Medical coverage groups; and GA-U clients.

The Washington Department of Social and Health Services studied the SUD treatment expansion through fiscal year 2009 and found that the expansion has delivered a significant increase in SUD treatment penetration. Among adults in the

Medicaid Blind and Disabled category, the SUD treatment penetration rate increased from 23.7 percent in fiscal year 2004 to 33.5 percent in fiscal year 2009. The rate also increased for other client groups during the same time period. The rate increased from 24.5 percent to 30 percent for other Medicaid clients and from 32 percent to 50 percent for GA-U clients. The study did not focus on Medicaid Aged clients. The increase in SUD treatment penetration has coincided with a significant reduction in the rates of growth of healthcare costs for Medicaid Blind and Disabled category and GA-U clients with a SUD. These reductions in growth rates have resulted in medical and nursing facility spending that is less than what would have been expected if the cost growth rates observed before the SUD treatment expansion had been maintained.

Medical and nursing facility spending in Washington was less than expected; therefore, the SUD treatment expansion achieved a significant return on investment. During the first four years of implementation (fiscal years 2006 through 2009), two dollars in medical and nursing facility costs were saved per dollar invested in expanded SUD treatment. Specifically, medical and nursing facility cost savings for the Medicaid Blind and Disabled category and GA-U client groups totaled \$107.4 million in All Funds during fiscal years 2006 through 2009, while expanded SUD treatment costs totaled \$51.8 million during this period.

In Texas, Rider 48 in HHSC’s bill pattern in the 2014–15 General Appropriations Act specifies that HHSC may not provide Medicaid SUD treatment services if the LBB determines that the treatment services have resulted in an

increase in overall Medicaid spending. An initial analysis by LBB staff of client-level data related to the provision of the adult Medicaid SUD benefit found that the average monthly amount spent per client on all Medicaid services for clients who received Medicaid-funded SUD treatment was lower after receiving treatment. As shown in **Figure 4**, the average monthly amount spent per client on all Medicaid services before Medicaid-funded SUD treatment was \$900, compared to \$818 after treatment. These amounts include Medicaid spending before and after Medicaid-funded SUD treatment for all 4,141 clients who received treatment at some point during fiscal years 2011 and 2012. However, it is not possible to conclude that the lower spending amount after treatment is due to the effectiveness of the Medicaid-funded SUD treatment because there are months during the study period when some of the 4,141 clients were not enrolled in Medicaid and had no Medicaid spending. Depending on a client’s reason for Medicaid disenrollment, the lack of spending in the months following treatment may or may not be due to the effectiveness of the Medicaid-funded SUD treatment. For example, death or incarceration as a reason for Medicaid disenrollment would result in a lack of Medicaid spending not attributed to Medicaid-funded SUD treatment. Alternatively, a client who received Medicaid-funded SUD treatment might disenroll from Medicaid because treatment helped them recover and secure employment.

Furthermore, the average monthly amount spent per client on all Medicaid services for adult clients who were identified as having a SUD diagnosis and who did not receive any type of SUD treatment was lower (\$777) than the spending amounts for clients who received Medicaid-funded SUD

**FIGURE 4
ESTIMATED INITIAL IMPACT OF TEXAS MEDICAID SUBSTANCE USE DISORDER TREATMENT SERVICES FOR ADULTS ON TEXAS MEDICAID SPENDING, FISCAL YEARS 2011 AND 2012**

GROUPS	AVERAGE MONTHLY PER-CLIENT SPENDING (NON-SUD SERVICES)	AVERAGE MONTHLY PER-CLIENT SPENDING (SUD TREATMENT)	TOTAL AVERAGE MONTHLY PER-CLIENT SPENDING
Untreated: Adult clients with an identified substance use disorder, but no SUD treatment	\$777	N/A	\$777
Treated: Adult clients who received a Medicaid-funded SUD treatment service			
Before SUD treatment	\$900	N/A	\$900
After SUD treatment	\$707	\$111	\$818

NOTES:

- (1) SUD = Substance use disorder.
- (2) The numbers in this figure are initial estimates. Several factors prevent a definitive assessment of whether the adult Medicaid SUD benefit has resulted in an increase in overall Medicaid spending or whether the cost has been offset by reductions in other healthcare spending.

SOURCE: Legislative Budget Board.

treatment (\$818). However, the analysis did not control for severity-adjustment for substance use disorder diagnosis and other client characteristics that could affect comparability between the treated and untreated groups.

Several factors prevent a definitive assessment of whether the adult Medicaid SUD benefit has resulted in an increase in overall Medicaid spending or whether the cost of Medicaid SUD treatment has been offset by reductions in other healthcare spending. The factors described below, which primarily exist due to data limitations, prevent a definitive evaluation of the adult Medicaid SUD treatment benefit:

- At the time of review (August 2013), complete client-level data for the adult Medicaid SUD treatment benefit was only available for the first two fiscal years of program implementation—2011 and 2012.
- Not all SUD treatment services were available at initial implementation (See **Figure 1**).
- The Medicaid data system is not structured to track clients across time, including the time period before implementation of the Medicaid SUD treatment benefit. Furthermore, due to differences in the claims/encounter data systems and the Vendor Drug Program data system, utilization data for a given client's episode of care cannot be reliably linked across time. This prevents a comprehensive accounting of program services provided.
- The analysis did not control for severity-adjustment for substance use disorder diagnosis and other client characteristics that could affect comparability between the treated and untreated groups.
- Reliability of the client-level data is potentially affected by significant data cleaning and assembly, the existence of clients with both FFS and MCO data within the analytic time period, lack of certainty about financial variables for MCO encounter data, and the existence of non-uniform procedure coding.

IMPROVE THE EVALUATION AND ADMINISTRATION OF THE MEDICAID ADULT SUBSTANCE USE DISORDER TREATMENT BENEFIT

As discussed previously, data limitations prevent a definitive evaluation of the adult Medicaid SUD treatment benefit. As a result, it is currently not possible to determine the efficacy of the benefit and whether it has resulted in an increase in overall Medicaid spending or whether the cost has been offset by reductions in other healthcare spending. Furthermore,

HHSC has not developed client outcome measures specific to the Medicaid SUD treatment benefit. The Eighty-third Legislature, 2013, passed Senate Bill 126, which requires DSHS, in collaboration with HHSC, to establish and maintain a public reporting system of performance and outcome measures relating to mental health and substance abuse services. The system allows the public to compare performance and outcome measures among community centers that provide mental health services; Medicaid MCOs that provide mental health services; and entities contracted with the state to provide SUD services. However, the system does not include client outcome measures for the adult Medicaid SUD treatment benefit.

Recommendation 1 would amend the existing rider on Medicaid Substance Abuse Treatment in the introduced 2016–17 General Appropriations Bill to require HHSC to evaluate the impact of the adult Medicaid substance use disorder benefit on overall Medicaid spending and client outcomes, including taking the following steps: (1) develop a methodology for the evaluation; (2) improve and analyze data necessary to complete the evaluation; (3) submit progress reports that include the evaluation methodology to the LBB and the Office of the Governor by December 1, 2015; and (4) submit a report on the evaluation findings if complete, or another status report if the evaluation is incomplete, to the LBB and the Office of the Governor by December 1, 2016.

As shown in **Figure 5**, DSHS tracks outcome data for individuals receiving services funded by the SAPT block grant program. Also, SUD treatment providers who receive funding through the Texas Healthcare Transformation and Quality Improvement Program Waiver (Texas Medicaid 1115 waiver) to transform their service delivery practices are required to track and report on client outcomes. For example, one SUD treatment provider who is participating in the Texas Medicaid 1115 waiver tracks data on emergency department visits, patient satisfaction scores, jail admissions, and functional status. In the evaluation required in Recommendation 1, HHSC should consider adopting client outcome measures for the adult Medicaid SUD treatment benefit that are similar to those tracked for the SAPT block grant program and for SUD services provided through the Texas Medicaid 1115 waiver.

The penetration rate for adult Medicaid SUD treatment services is low. The Medicaid SUD treatment penetration rate is defined as the percentage of adult Medicaid clients with an identified substance use disorder who received SUD

**FIGURE 5
ADULT CLIENT OUTCOME MEASURES FOR SAPT-FUNDED SUBSTANCE USE DISORDER TREATMENT SERVICES
FISCAL YEAR 2014**

OUTCOME MEASURE	INTENSIVE RESIDENTIAL SERVICES	SUPPORTIVE RESIDENTIAL SERVICES	OUTPATIENT SERVICES	OPIOID SUBSTITUTION THERAPY
Percent who successfully complete treatment	X	X	X	
Percent abstinent at discharge	X	X	X	
Percent abstinent at six months of service				X
Percent discharged to stable housing	X	X	X	
Percent with no arrest since admission	X	X	X	X
Percent employed at discharge		X	X	

NOTES:

- (1) SAPT = Substance Abuse Prevention and Treatment block grant program.
- (2) This figure does not include client outcome measures tracked for detoxification services and other client populations (e.g., HIV, Specialized Female Treatment Services, Co-occurring services, Women and Children) served through DSHS.

SOURCE: Legislative Budget Board.

treatment services funded by Medicaid. As shown in **Figure 2**, the adult Medicaid SUD treatment penetration rate during fiscal years 2011 and 2012 was 2.2 percent.

The short time since implementation of adult Medicaid SUD treatment services, limited efforts to increase awareness about these services, and resulting low penetration rate may prevent the state from experiencing a significant decrease in healthcare utilization and spending during and after clients start receiving treatment. As a result, the potential for cost savings associated with Medicaid SUD treatment services for adult clients is diminished. According to the State of Washington, the funding of its SUD treatment expansion was based on a research-based prediction that increasing SUD treatment penetration rates would dampen the rate of growth of medical and nursing home costs in the target populations. A September 2010 report by the State of Washington concluded that its SUD treatment expansion has delivered a significant increase in SUD treatment penetration that has coincided with a significant reduction in the rates of growth of healthcare costs for target populations.

Increasing awareness of Medicaid SUD treatment services could contribute toward increasing the services' penetration rate. Efforts in the Texas Medicaid program to increase awareness have been limited primarily to educating SUD treatment providers. HHSC's communication and outreach activities about Medicaid SUD treatment services provided directly to clients has been limited to mailing a handout describing these services during 2010. While some MCOs participating in the Texas Medicaid program have implemented efforts to educate primary care physicians (PCPs) about Medicaid SUD treatment services, there has

been no organized effort by HHSC to educate PCPs other than announcements by TMHP. At least one behavioral health organization (BHO) contracted by some of the MCOs participating in the STAR and STAR+PLUS programs has developed a toolkit and training for PCPs that provides detailed information for treating and referring clients to Medicaid SUD treatment services. MCO case managers could also help to increase awareness of SUD treatment services. For example, one MCO reported that increased efforts to educate health plan case managers about substance use disorders has led to increased identification of clients with these disorders.

Recommendation 2 would amend the Texas Government Code to require HHSC to implement efforts to increase awareness of Medicaid SUD treatment services. HHSC should consider implementing the following strategies in an effort to increase the Medicaid SUD treatment penetration rate: (1) increasing notification about treatment services to adult Medicaid clients; and (2) increasing communication to PCPs about screening and referring clients with substance use disorders to treatment. HHSC should identify strategies implemented by MCOs that participate in the STAR and STAR+PLUS programs to increase awareness of Medicaid SUD treatment services (e.g., the PCP toolkit developed by one BHO) and consider implementing these strategies across the Texas Medicaid program.

The state lacks a consistent process for authorizing Medicaid SUD treatment services for adult clients. The process varies between the fee-for-service system and managed care programs, and by MCO. As shown in **Figure 6**, three main components of the authorization process vary: (1) the list of

**FIGURE 6
AUTHORIZATION PROCESS FOR ADULT TEXAS MEDICAID SUBSTANCE USE DISORDER TREATMENT SERVICES BY PAYER
FEBRUARY 2014**

PAYER	SERVICES THAT REQUIRE PRIOR AUTHORIZATION	FORMS SUBMITTED BY PROVIDERS TO OBTAIN PRIOR AUTHORIZATION	MEDICAL NECESSITY CRITERIA USED BY PAYER TO AUTHORIZE CARE
Fee-For-Service system	Ambulatory Detoxification Residential Detoxification Residential Treatment	Texas Medicaid and Healthcare Partnership-specific forms	The Texas Administrative Code, Title 28, Part 1, Chapter 3, Subchapter HH
Aetna Better Health Texas	All SUD Treatment Services except Assessment	Aetna-specific forms	American Society of Addiction Medicine (ASAM) criteria
Amerigroup	Ambulatory Detoxification Residential Detoxification Residential Treatment	Amerigroup-specific forms	McKesson's InterQual product and ASAM criteria
Blue Cross/ Blue Shield	Medication-Assisted Therapy Residential Detoxification Residential Treatment	Magellan BHO-specific forms for Medication-Assisted Therapy; Telephonic pre-authorization for Residential Detoxification and Treatment	The Texas Administrative Code, Title 28, Part 1, Chapter 3, Subchapter HH
Christus	All SUD Treatment Services except Assessment	Telephonic pre-authorization	The Texas Administrative Code, Title 28, Part 1, Chapter 3, Subchapter HH
Cigna HealthSpring	Ambulatory Detoxification Ambulatory Treatment Services Residential Detoxification Residential Treatment	Cigna HealthSpring-specific forms	The Texas Administrative Code, Title 28, Part 1, Chapter 3, Subchapter HH
Community First	Ambulatory Detoxification Ambulatory Treatment Services Residential Detoxification Residential Treatment	Community First-specific forms	McKesson's InterQual product
Community Health Choice	All SUD Treatment Services except Assessment	Telephonic pre-authorization	The Texas Administrative Code, Title 28, Part 1, Chapter 3, Subchapter HH
Cook Children's Health Plan	Ambulatory Detoxification Residential Detoxification Residential Treatment	Beacon BHO-specific forms	Beacon criteria
Driscoll	Residential Detoxification Residential Treatment	Driscoll-specific forms	McKesson's InterQual product
El Paso First	All SUD Treatment Services except Assessment	El Paso First-specific forms	The Texas Administrative Code, Title 28, Part 1, Chapter 3, Subchapter HH, and Milliman Care Guidelines
First Care	Medication-Assisted Therapy Residential Detoxification Residential Treatment	Magellan BHO-specific forms for Medication-Assisted Therapy; Telephonic pre-authorization for Residential Detoxification and Treatment	The Texas Administrative Code, Title 28, Part 1, Chapter 3, Subchapter HH
Molina	All SUD Treatment Services except Assessment	Molina-specific forms	May use any of, or a combination of, more than 10 types of criteria
Scott and White	Ambulatory Detoxification Residential Detoxification Residential Treatment	Beacon BHO-specific forms	Beacon criteria
Sendero	Ambulatory Detoxification Residential Detoxification Residential Treatment	Beacon BHO-specific forms	Beacon criteria

FIGURE 6 (CONTINUED)
AUTHORIZATION PROCESS FOR ADULT TEXAS MEDICAID SUBSTANCE USE DISORDER TREATMENT SERVICES BY PAYER
FEBRUARY 2014

PAYER	SERVICES THAT REQUIRE PRIOR AUTHORIZATION	FORMS SUBMITTED BY PROVIDERS TO OBTAIN PRIOR AUTHORIZATION	MEDICAL NECESSITY CRITERIA USED BY PAYER TO AUTHORIZE CARE
Seton	Ambulatory Detoxification Residential Detoxification Residential Treatment	Beacon BHO-specific forms	Beacon criteria
Superior	Ambulatory Detoxification Residential Detoxification Residential Treatment	Cenpatico BHO-specific forms for Ambulatory Detoxification and Residential Detoxification; Telephonic pre-authorization for Residential Treatment	The Texas Administrative Code, Title 28, Part 1, Chapter 3, Subchapter HH
Texas Children's	Ambulatory Detoxification Ambulatory Treatment Services Residential Detoxification Residential Treatment	Texas Children's-specific forms	McKesson's InterQual product and ASAM criteria
United	All SUD Treatment Services except Assessment	United-specific forms	The Texas Administrative Code, Title 28, Part 1, Chapter 3, Subchapter HH

NOTES:

- (1) BHO = behavioral health organization; SUD = substance use disorder. This figure does not include information on SUD treatment services that may be provided by managed care organizations (MCOs) in the Medicaid STAR and STAR+PLUS programs on a case-by-case basis that are in addition to Medicaid state plan services.
- (2) As defined in the Medicaid Behavioral Health, Rehabilitation, and Case Management Services Handbook, ambulatory/outpatient treatment services include intensive outpatient (IOP) services and include only group counseling and individual counseling. Other types of IOP services that do not meet this definition are not included in this figure.
- (3) Some MCOs in the Medicaid STAR and STAR+PLUS programs require that providers submit supporting clinical documentation in addition to MCO-specific prior authorization forms.
- (4) Community Health Choice contracted with Beacon toward the end of fiscal year 2014. Before the Beacon contract, Community Health Choice used the Texas Administrative Code, Title 28, Part 1, Chapter 3, Subchapter HH, as the medical necessity criteria used to authorize care.

SOURCE: Legislative Budget Board.

Medicaid SUD treatment services that require prior authorization; (2) the forms submitted by providers to request prior authorization; and (3) the type of medical necessity criteria used by TMHP or a given MCO or BHO to authorize care. Also, the steps taken by providers, TMHP, or an MCO during the prior authorization process may vary. For example, some MCOs require providers to submit their prior authorization requests by phone, while others require fax transmission. Another example is variation in the use of specialized software products used by some MCOs or BHOs to determine the type and amount of service to authorize.

Differences in the processes used across the Texas Medicaid program to authorize Medicaid SUD treatment services for adult clients may adversely affect clients and providers. For example, different authorization processes may result in clients with similar needs receiving different types and amounts of service which may in turn affect treatment goals and outcomes. Some providers of Medicaid SUD treatment services, who may contract with multiple MCOs to provide SUD treatment to managed-care clients, reported to LBB

staff that variations in the prior authorization process are burdensome. For example, one provider of Medicaid SUD treatment services reported contracting with five MCOs, each of which requires a different authorization process. Additionally, while most Medicaid SUD treatment providers use the standardized assessment tool contained within the Clinical Management for Behavioral Health Services (CMBHS) system, some providers have had to develop their own additional assessment forms to collect information needed to complete the unique prior authorization forms required by each MCO. CMBHS is a web-based clinical record-keeping system for state-contracted community mental health and substance abuse service providers; but the assessment tool contained within CMBHS is also used by many providers of Medicaid SUD treatment services.

Recommendation 3 would amend the Texas Government Code to require HHSC to streamline the process used in the Medicaid fee-for-service system and managed care to authorize Medicaid SUD treatment services. HHSC should consider standardizing the following components:

(1) Medicaid SUD treatment services that require prior authorization; (2) forms completed by providers to request prior authorization and the process for submitting forms; (3) type of medical necessity criteria used to authorize care; and (4) specialized tools and products used to determine the type and amount of service to authorize.

In September 2013, HHSC first added language regarding the provider protection plan required by Senate Bill 1150, Eighty-third Legislature, Regular Session, 2013, to the Uniform Managed Care Contract (UMCC). The UMCC is the contract between MCOs participating in the Texas Medicaid program and HHSC. The purpose of the provider protection plan is to reduce administrative burdens placed on providers participating in Medicaid managed care. The provider protection plan includes components related to prior authorization processes. HHSC may need to consider adjusting the plan to ensure that modifications to the process used to authorize Medicaid SUD treatment services proposed in Recommendation 3 are addressed. Also, the Eighty-third Legislature, 2013, passed Senate Bill 1216, which directs the Texas Department of Insurance to establish a standardized prior authorization request form required to be used by all health benefit plan issuers, including the Texas Medicaid program. It is expected that the standardized prior authorization request form will be used for Medicaid SUD treatment services. However, Medicaid MCOs may require more information or additional forms to process prior authorization requests. As a result, there is still potential for variation in the forms completed by providers to request prior authorization of SUD treatment services that Recommendation 3 should address. Recommendation 3 may also help increase the penetration rate by reducing provider burden and increasing provider enrollment.

There are quantitative limitations on the amount of Medicaid SUD treatment services provided to adult clients even though these limitations are in conflict with the Medicaid state plan and the UMCC. The UMCC lists the services that MCOs are responsible for providing to Medicaid clients enrolled in managed care. The Medicaid state plan is approved by the federal government and describes the Medicaid benefits in the Medicaid fee-for-service system. Most Medicaid MCOs have applied a limit on certain SUD treatment services for adults regardless of medical necessity. However, the UMCC states that SUD treatment services are not subject to quantitative treatment limitations. Likewise, in the Medicaid fee-for-service system, HHSC has applied limits on certain SUD treatment services for adults that are

not contained in the Medicaid state plan. Furthermore, there is potential for the quantitative limitations, which are applied regardless of medical necessity, to limit the effectiveness of SUD treatment services.

Recommendation 4 would amend the Texas Government Code to require HHSC to determine whether quantitative limitations on the amount of SUD treatment services can and should apply to adult clients in the Texas Medicaid program. HHSC should determine if limitations can be applied in accordance with federal regulations and guidance. HHSC should also consider the impact of the limitations on the cost effectiveness of SUD treatment services. If the agency determines that limitations can and should be applied, the limitations should be properly established in the Medicaid state plan and the UMCC by September 1, 2015.

FISCAL IMPACT OF THE RECOMMENDATIONS

The recommendations in this report direct HHSC to maximize the effectiveness of Medicaid SUD treatment services for adult clients by improving the evaluation and administration of these services, including efforts to increase the Medicaid SUD treatment penetration rate, streamline authorization processes, and review the application of quantitative treatment limitations. The agency is also directed to improve data collection and evaluate the impact of the adult Medicaid substance use disorder benefit on overall Medicaid spending and client outcomes. The recommendations are intended to help ensure that adult Medicaid clients with substance use disorders receive appropriate high-quality services, thus reducing non-treatment Medicaid spending and improving the state's ability to monitor program performance and make system improvements. The recommendations give HHSC flexibility to determine which service delivery improvement strategies to implement. It is assumed that the recommendations would have no significant fiscal impact and could be implemented using existing resources.

The introduced 2016–17 General Appropriations Bill includes a modification to an existing rider to implement Recommendation 1.

EVALUATE PAY FOR QUALITY MEASURES IN THE TEXAS MEDICAID PROGRAM

In an effort to improve patient safety, Texas has implemented a variety of pay for quality programs that gather data on adverse medical events. These programs are intended to provide incentives to hospital providers and managed care organizations to reduce their rates of these events by improving healthcare delivery. First, the Texas Medicaid program adopted the federal Medicare program's policy of partially denying payment of claims that are coded with healthcare-associated infections and preventable adverse events. Then, the Texas Health and Human Services Commission adjusted Medicaid payment to hospitals and managed care organizations based on self-reported data regarding potentially preventable readmissions and potentially preventable complications. The Pay-for-Quality program in Medicaid, introduced in 2014, bases a percentage of payment to managed care organizations on rates of these and other healthcare metrics of patient safety and potentially preventable care.

By evaluating the pay for quality initiatives operating in the Texas Medicaid program, policymakers and healthcare administrators could improve their understanding of the effect of payment incentives on healthcare provider behavior. Isolating changes in healthcare delivery can help trace the relationship between state policy and clinical health outcomes.

CONCERN

- ◆ Studies suggest pay for performance initiatives may improve patient outcomes along some health dimensions, but more information is needed to inform further implementation and expansion of pay for quality methods.

RECOMMENDATION

- ◆ **Recommendation 1:** Include a rider in the introduced 2016–17 General Appropriations Bill to direct the Texas Health and Human Services Commission to evaluate how Texas Medicaid providers and managed care organizations use existing pay for quality measures to improve healthcare delivery and whether the measures result in a higher quality of care and improved health outcomes. Require the Commission to report findings to the Governor, the Legislative

Budget Board, and the appropriate standing committees of the Legislature by December 1, 2016. The report should also indicate (1) efforts undertaken to make the current pay for quality methods more effective, and (2) how the Commission will apply improvements in pay for quality methods if they are expanded into outpatient settings.

DISCUSSION

Recent statutory changes have led to a number of data collection and payment reform mandates related to improving patient safety and reducing unnecessary care in hospital settings in Texas. These reforms are driven by an effort to contain Medicaid spending while ensuring a high quality of care. Some practices were introduced by the federal Medicare program, while others were developed by the private healthcare industry.

HEALTHCARE-ASSOCIATED INFECTIONS AND PREVENTABLE ADVERSE EVENTS

The Eightieth Legislature, Regular Session, 2007, enacted Senate Bill 288, adding Chapter 98 to the Texas Health and Safety Code to require hospitals and ambulatory surgical centers to report healthcare-associated infections (HAI) to the Texas Department of State Health Services (DSHS). HAIs include, among other things, surgical-site infections following colon surgeries, hip and knee arthroplasties, abdominal and vaginal hysterectomies, coronary artery bypass grafts, and vascular procedures. DSHS publicly reports this data.

The Eighty-first Legislature, Regular Session, 2009, enacted Senate Bill 203, adding preventable adverse events (PAE) to the statewide data collection and public reporting requirements. PAEs are defined as a list of events that includes HAIs and other medical errors that have serious and adverse impacts on patients, are preventable, and are within a healthcare provider's span of control. Pursuant to this change, the Texas Medicaid fee-for-service program adopted Medicare's payment policy with regard to some HAIs and PAEs. This policy prevents hospitals from adding some complications considered HAIs and PAEs to the diagnosis related group (DRG) when billing Medicaid. Normally, a DRG coded with a complication results in higher payment. Medicaid is thus providing incentives to promote patient

safety through its reimbursement policy. Subsequent reforms extended this policy to the Medicaid managed care STAR and STAR+PLUS programs.

All statutory requirements for data collection and reporting have been implemented for HAIs. Development and implementation of PAE reporting is on schedule, and DSHS expects to begin collecting data in January 2015. DSHS does not manage the collection of HAI data. Instead, DSHS uses data collected by the National Healthcare Safety Network (NHSN), a voluntary system that collects data on HAI at the Centers for Disease Control and Prevention (CDC), to meet its HAI reporting requirements. DSHS cannot use the CDC or NHSN to collect data on PAE, because those entities do not collect all of the PAE data that DSHS is required to collect.

POTENTIALLY PREVENTABLE READMISSIONS AND POTENTIALLY PREVENTABLE COMPLICATIONS

The Eighty-second Legislature, First Called Session, 2011, enacted Senate Bill 7, requiring the Texas Health and Human Services Commission (HHSC) to collect hospital data on potentially preventable readmissions (PPR), potentially preventable complications (PPC), and present on admission (POA) indicators that match healthcare complications to the admission stage to determine preventability. PPRs are return hospitalizations that may result from deficiencies in care or treatment provided during a previous hospital stay. PPRs also can result from inadequate post-hospital discharge follow-up but not from unrelated events that occur post-discharge. PPCs are harmful events or negative outcomes, such as septicemia or pneumonia, that occur after a patient is admitted to a hospital and result from the process of care and treatment, rather than from a natural progression of underlying disease. PPCs are assumed to be reasonably preventable according to accepted standards of care. The PPC metric includes 65 events or outcomes, some of which are considered HAI or PAE.

The legislation also required that Medicaid adjust hospital reimbursements to reward or penalize hospitals based on PPR and PPC rates. Accordingly, Medicaid fee-for-service hospital claims are adjusted based on the hospital's performance on actual-to-expected ratios. Similarly, Medicaid managed care capitation rates in the STAR and STAR+PLUS programs are adjusted based on risk-adjusted, in-network hospital performance on PPR and PPC rates. Risk adjustment is a methodology that accounts for the fact that some hospitals treat patients who are in need of more care.

THE PAY-FOR-QUALITY PROGRAM IN THE TEXAS MEDICAID PROGRAM

The Texas Medicaid program's new approach to managed care organization (MCO) payment incentives, the Pay-for-Quality (P4Q) program, began in January 2014. It is based on a model developed by 3M, a consulting company that developed the health information systems software that HHSC uses. The model targets potentially preventable events (PPE), or unnecessary health services that could be avoided through more effective care and coordination. This model assumes that the following types of healthcare encounters or events may lead to unnecessary services: PPCs, PPRs, potentially preventable admissions (PPA), and potentially preventable emergency department visits (PPV).

PPAs are admissions to a hospital or long-term care facility that reasonably could be prevented if care and treatment were provided according to accepted standards of care. High PPA rates are assumed to represent a failure of the ambulatory care and care coordination provided to the patient. PPVs are emergency department visits for conditions that could otherwise be treated by a care provider in a non-emergency setting. High PPV rates are assumed to reflect a lack of adequate or effective ambulatory care, including follow-up and care coordination. While the PPC metric will be included in the Texas Medicaid P4Q program beginning in 2015, the other metrics already have been incorporated.

The Texas Medicaid P4Q program places 4.0 percent of the MCO capitation rate at risk. Payment of the at-risk portion of the capitated payment to MCOs is based on a methodology that considers risk-adjusted rates of these metrics (PPC, PPA, PPR, and PPV) and improvement toward a stated rate. The at-risk portion of the capitation payment denied to low-performing MCOs that do not meet their set rates is reallocated among higher performing MCOs that do.

PAY FOR QUALITY MEASURES IN OUTPATIENT SETTINGS

Existing pay for quality initiatives in the Texas Medicaid program, including the P4Q program, do not directly target patient safety or unnecessary care in outpatient settings. Although the state collects information on HAIs and PPCs in ambulatory surgical centers and will soon collect PAE data, outpatient facilities are not subject to pay for quality policies. In fiscal year 2013, Texas Medicaid paid ambulatory surgical centers \$240.7 million in All Funds. The program does not use any measures that reflect patient safety in other outpatient settings, including freestanding emergency and imaging facilities, federally qualified health centers, rural

health clinics, and physician offices. The fifth metric in 3M's model, potentially preventable ancillary services (PPS), is the only metric in the model intended to reduce unnecessary care that is provided in outpatient settings. PPSs are ancillary services that may be redundant or are not reasonably necessary for care or treatment. Primary care physicians or specialists may provide or order PPSs that include diagnostic tests, laboratory tests, therapy services, radiology services, and pharmaceuticals.

As of December 2014, HHSC had not included the PPS metric in the P4Q program. However, HHSC is authorized to expand policies that increase patient safety and reduce costly, unnecessary care in ambulatory surgical centers and is considering using the PPS metric in this setting.

EVALUATE PAY FOR QUALITY MEASURES IN THE TEXAS MEDICAID PROGRAM

In a 2013 letter to state health officials and Medicaid directors, the federal Centers for Medicare and Medicaid Services (CMS) issued guidance on designing and implementing healthcare delivery and payment reforms that focus on paying for quality. CMS states that selected interventions should be supported by a strong evidence base suggesting that the desired effects are achievable and can be replicated. CMS instructs that in planning reforms, Medicaid programs should identify the relationship between payment incentives and the changes in healthcare delivery that ultimately will drive progress toward program goals. The agency also encourages "a broad cross section of metrics beyond the scope of the intervention-specific goals...to indicate how specific improvements are affecting quality across the program, and...indicate if there is any slippage where quality improvement resources are not presently focused." CMS instructs states to consider small-scale reforms and evaluations before enacting program-wide measures that can complicate efforts to isolate and expand desired effects.

A 2012 national evaluation of the effect of the 2008 policy by CMS to reduce additional Medicare payments for preventable hospital complications did not find any effect on rates of targeted healthcare-associated infections. The study authors noted that when billing data is used as the metric, hospitals may focus greater effort on improving documentation and coding of infections as present on admission than on preventing infections. In such cases, billing data may not reflect the underlying quality of care at

an institution, and policies that rely on such data may be less effective.

Figure 1 summarizes findings from several studies and systemic reviews of published research evaluating the effects of pay for performance in healthcare. Taken together, these studies suggest that pay for performance may improve patient outcomes along some health dimensions, but more information about the relationship between payment incentive and provider behavior is needed.

Although the P4Q payment incentives directly affect only the capitated payments paid by HHSC to Medicaid MCOs, HHSC's initiatives are intended to direct MCOs to adjust hospital reimbursement according to their individual performance on these measures. The *Texas Medicaid Provider Procedures Manual* and HHSC's *Uniform Managed Care Manual* instruct Medicaid MCOs to deny provider reimbursement for healthcare-acquired conditions (largely a subset of PPCs) and PPCs that were not present at the time of admission. However, HHSC does not provide guidance on MCO payment policies with respect to other metrics. It is not clear, therefore, whether MCOs are modifying payment in a way that causes hospitals, and ultimately hospital physicians, to improve their performance on these measures. According to HHSC, many ongoing initiatives related to quality and efficiency improvement in the Texas Medicaid program may complicate efforts to attribute the effect of any one initiative. If the agency cannot trace provider performance to quality incentives, it is unclear whether hospitals are adjusting healthcare delivery to meet quality targets in a way that improves health outcomes.

The success of pay for quality initiatives also rests on the capacity of MCOs to coordinate and manage patients' care. While these measures reflect quality of inpatient care, HHSC's initiatives rely on the assumption that better performance requires improved coordination of and access to outpatient care. Without coordination across inpatient and outpatient settings, for example, hospital readmissions are more likely. Although for some programs MCOs must submit annual reports of care management efforts, HHSC has no independent source that verifies the quality of service coordination.

Furthermore, an assumption underlying pay for quality is that metrics such as PPEs accurately and validly reflect quality of care and not patient characteristics or manipulated codes and billing procedures. Performance on these metrics is risk adjusted to account for the fact that some hospitals

FIGURE 1
STUDIES ON THE IMPACT OF PAY FOR QUALITY IN HEALTHCARE, CALENDAR YEARS 2008 TO 2012

DATE	SOURCE DATA	DESCRIPTION	FINDINGS
2010	128 studies published from 1990 to 2009	The study summarizes evidence from a systematic review of 128 evaluations of the impact of pay for performance in primary care and acute hospital care on clinical effectiveness, access and equity, coordination and continuity, patient-centeredness, and cost-effectiveness.	The effects of pay for performance on clinical effectiveness ranged from negative or absent to positive (1 to 10% improvement) or very positive (above 10%) depending on the target and program. Negative results were found in three studies, meaning less quality improvement compared to non pay for performance use (not a quality decline). Efforts to improve minimal standards were successful in most studies, but performance improvement across all providers was confirmed for only a number of specific targets, such as for diabetic care. Across the 128 studies, pay for performance most frequently failed to affect acute care. As a target measure, process indicators yielded higher improvement rates than outcome measures. Programs aimed at the individual provider level and/or team level generally reported positive results, whereas those aimed at the hospital level were more likely to have a smaller effect.
2008	4.3 million inpatient admissions from 234 Florida hospitals during 2004 and 2005	The study describes a method to identify PPRs using claims data and identifies several factors that influence the risk of readmission.	The probability of a readmission is related to the reason for admission, severity of illness, the presence of comorbid mental health or substance abuse problems, and the patient's age at the time of the initial admission, suggesting that risk adjustment for each of these factors is necessary. Because it relies on claims codes, the PPR method is limited by related issues like the completeness and consistency of coding and the lack of clinical detail. The success of the method hinges on its capacity to contribute to performance-improving behavior change based on the identification of quality problems.
2011	34 studies published between 1966 and 2010	The study summarizes evidence from a systematic review of 34 studies that measured the proportion of readmissions deemed avoidable.	The median proportion of readmissions deemed avoidable was 27.1 percent, while variation ranged from 5 to 79 percent. The true proportion of hospital readmissions that are potentially avoidable remains unclear and there was a lack of consensus on the appropriate methods to estimate potentially preventable readmissions.
2012	Discharge data from 2003 to 2009 for 6 million Medicare patients in 12 states	The study evaluated the six-year impact of Medicare's hospital pay for performance pilot program, known as Premier Hospital Quality Incentive Demonstration (HQID), on patient outcomes on the 30-day mortality indicator. The study compared the effects of HQID payment incentives with the effects of public reporting alone.	Mortality rates during the study period declined at similar rates among both hospitals participating in HQID and hospitals not participating. HQID hospitals were not associated with declines in mortality beyond those reported for hospitals that participated in public reporting alone. The study found no difference in trends in mortality between conditions for which outcomes were linked to payment incentives and conditions for which outcomes were not linked to incentives.
2011	New York hospital discharge data	The study evaluated a simulated pay for performance program similar to payment incentives in Medicare and the New York Medicaid program aimed at reducing hospital readmissions. The simulation assumes a revenue-maximizing hospital that would compare the direct and indirect costs of participation in pay for performance with the financial benefit of reducing its rate of readmission.	The study simulation estimated that 7 percent of hospitals in New York would have an overriding financial incentive to implement an intervention to reduce readmissions in response to a payment penalty, resulting in 1,200 to 2,000 fewer readmissions per year (a .5 to 1 percent reduction). The costs of implementing a healthcare delivery intervention to reduce readmissions combined with the lost revenue from reduced readmissions are likely to exceed the simulated 1 percent payment penalty for high rates of readmissions for the vast majority of hospitals.

SOURCE: Legislative Budget Board.

might treat patients who are in need of more care. However, at a practical level, risk adjustment is difficult and can be driven by provider coding and diagnostic practices that may exaggerate illness severity and artificially raise risk-adjusted quality scores.

Recommendation 1 would include a rider in the introduced 2016–17 General Appropriations Bill directing HHSC to study how Texas Medicaid providers and MCOs use existing pay for quality measures to improve healthcare delivery and whether these initiatives result in higher-quality care and improved health outcomes. Questions that HHSC could include in its research plan are shown in **Figure 2**.

FIGURE 2
PAY FOR QUALITY EVALUATION RESEARCH QUESTIONS

1. Are Medicaid managed care organizations employing provider reimbursement models that incentivize high-quality care and improved health outcomes, as defined by the PPE metrics (PPAs, PPRs, PPCs, PPVs)?
2. What factors in healthcare delivery at the provider level drive performance on quality indicators?
3. Is care coordination occurring, and can it be linked to improved patient safety and reduced levels of unnecessary care, as defined by the PPE metrics?
4. Are pay for quality initiatives affecting access to care among Medicaid clients?
5. Is there evidence of manipulating behavior in provider coding of clinical outcomes?

SOURCE: Legislative Budget Board.

Recommendation 1 also would require HHSC to prepare and submit a report of the study’s findings to the Governor, the Legislative Budget Board, and the appropriate standing committees of the Legislature by December 1, 2016. HHSC should indicate in the report efforts undertaken to use the information from the study to make the current pay for quality measures more effective, and how the agency will use that information if pay for quality measures are expanded into outpatient settings.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendations 1 would require HHSC to study its existing pay for quality measures. It is assumed that Recommendation 1 would have no significant fiscal impact and could be implemented using existing resources.

The introduced 2016–17 General Appropriations Bill includes a rider implementing Recommendation 1.

IMPROVE TRANSPARENCY IN STAR MANAGED CARE PAYMENT RATE SETTING

In Medicaid managed care programs, the state contracts with private insurers who assume risk to provide and manage medical care for eligible clients. An estimated 82 percent of Texas Medicaid clients received services through managed care in fiscal year 2014; 57 percent of managed care clients were in the State of Texas Access Reform (STAR) managed care program, which provides acute care benefits primarily to eligible pregnant women and low-income children.

The process by which STAR payment rates are set is complex, includes dozens of factors that directly and indirectly affect rates, and changes over time. While the federal Centers for Medicaid and Medicare Services requires that states' managed care rates be actuarially sound, the Texas Health and Human Services Commission and its actuaries have significant discretion in developing the rate-setting methodology. More transparent documentation of the methodology, calculations, and assumptions used in the STAR rate-setting process would provide policymakers and stakeholders more information with which to understand the factors that affect program costs, deliberate program funding needs, and assess the efficacy of the rate-setting process.

FACTS AND FINDINGS

- ◆ The primary criterion for managed care payment rates is that they be actuarially sound, as defined in federal regulation.
- ◆ STAR payment rates vary significantly across regions, risk groups, and health plans.

CONCERN

- ◆ The Texas Health and Human Services Commission and its actuaries have significant discretion in establishing the rate-setting function for STAR payment rates. The process Texas uses lacks transparency and is poorly documented in the actuarial reports that are prepared to certify and provide supporting evidence for the rates. As a result, it is difficult to evaluate whether rates are reasonable and appropriate.

RECOMMENDATION

- ◆ **Recommendation 1:** Amend statute to require the Texas Health and Human Services Commission to more clearly describe and demonstrate the methodology by which STAR payment rates are set.

DISCUSSION

The State of Texas Access Reform (STAR) program is a capitated Medicaid service delivery model that provides acute care benefits to eligible pregnant women and low-income children through managed care. Managed care refers to a healthcare delivery model in which the state contracts with private managed care organizations (MCOs) to provide and manage medical care for eligible clients. Managed care is an alternative to the fee-for-service delivery model wherein providers are reimbursed for each unit of service performed. Managed care is, in part, a response to concerns that payment for each service encouraged over-utilization and therefore unnecessarily increased costs. The Texas Health and Human Services Commission (HHSC) estimates 82 percent of Texas Medicaid clients received services through managed care in fiscal year 2014, and 57 percent of Medicaid clients are in the STAR program. While much of the information that follows may generally apply to other managed care programs in Texas, this report pertains to the STAR program.

HHSC contracts with MCOs throughout the state to deliver STAR managed care in 13 geographic regions, called Service Delivery Areas (SDAs). MCOs may contract to deliver care in multiple regions, and HHSC has contracted with at least 2 MCOs in each of the state's 13 SDAs. MCOs are responsible for establishing, enrolling, and managing a network of providers to ensure that enrolled Medicaid clients have access to coordinated, sufficient care. In managing provider networks, MCOs are responsible for negotiating payment rates for services and compensating providers for the care provided to Medicaid clients. MCOs must submit encounter data (claims information describing services provided) monthly to the Texas Medicaid and Healthcare Partnership (TMHP), the Medicaid claims administrator.

The state pays contracted MCOs a set amount for each enrolled person, whether or not that person seeks care. This capitated, per-member, per-month rate differs for each MCO and SDA. Historically, HHSC has contracted with an

outside actuarial firm to perform rate-setting services. The agency also contracts with the Institute for Child Health Policy (IHP) at the University of Florida to serve as the External Quality Review Organization (EQRO) and to perform certain aspects of the rate calculations. STAR payment rates are determined by a complex, multi-step methodology that includes several factors. Texas’s Medicaid managed care is considered an administered program, one that dictates the rates to MCOs.

Capitated rates are first determined for a SDA; this is called the community rate. **Figure 1** shows the community rates for each of 8 risk groups for all 13 SDAs in fiscal year 2014. Risk groups are categories of enrolled populations based upon age and other eligibility criteria. Once community rates are set, the rates are further tailored to each MCO based upon an acuity risk adjustment. The acuity risk adjustment accounts for the health status of each MCO’s enrollment.

There are 45 unique MCO-SDA combinations and, therefore, 45 rate combinations in the STAR program. For example, a MCO is paid an amount per-member, per-month for its clients in the Bexar SDA and a different amount for its clients in the Lubbock SDA, while a different MCO is paid another amount for its clients in the Bexar SDA and still another for its clients in the Travis SDA. While all of these rates are different, the rates in the Bexar SDA for both MCOs

are based upon the same community rate; the MCO-specific rates only vary because of a MCO-specific acuity risk adjustment applied to the community rate.

Managed care rates and methodologies are published annually in actuarial reports for each managed care program, including STAR. The rates, and their methodologies, must be actuarially certified and meet certain federal requirements. Actuarial reports demonstrating compliance with these requirements are posted on HHSC’s website.

CRITERIA USED FOR RATE SETTING

According to federal law, payment rates for Medicaid managed care must be actuarially sound, meaning they should be appropriate for the populations and services involved, certified by a qualified actuary, and must adhere to generally accepted actuarial principles and practices. While the definition of actuarially sound is broad, the Centers for Medicare and Medicaid Services (CMS) provides a 19-page checklist that describes specific criteria for the types of data and adjustments used in managed care rate setting. This checklist is not always applied to rates that states submit for CMS approval. In August 2010, the Government Accountability Office found that CMS has been inconsistent in reviewing states’ rate setting for compliance with the Medicaid managed care actuarial soundness requirements.

**FIGURE 1
STAR MEDICAID ADJUSTED COMMUNITY RATES PER-MEMBER, PER-MONTH, BY RISK GROUP, FISCAL YEAR 2014**

SERVICE DELIVERY AREA	UNDER AGE 1	AGES 1 TO 5	AGES 6 TO 14	AGES 15 TO 18	AGES 19 TO 20	TANF ADULTS	PREGNANT WOMEN	SSI
Bexar	\$637.57	\$152.73	\$94.09	\$121.16	\$220.15	\$366.88	\$477.42	N/A
Dallas	\$499.65	\$159.56	\$96.36	\$112.00	\$184.93	\$267.39	\$394.53	N/A
El Paso	\$461.45	\$119.83	\$78.86	\$94.74	\$164.84	\$232.48	\$285.07	N/A
Harris	\$587.41	\$142.41	\$91.01	\$122.19	\$232.02	\$369.43	\$430.33	N/A
Hidalgo	\$403.18	\$207.87	\$118.63	\$110.51	\$214.49	\$251.38	\$318.60	N/A
Jefferson	\$604.17	\$124.89	\$82.50	\$113.20	\$289.10	\$302.25	\$406.61	N/A
Lubbock	\$521.10	\$118.30	\$74.73	\$106.06	\$235.20	\$252.47	\$356.03	N/A
Nueces	\$623.91	\$183.00	\$118.19	\$160.75	\$215.76	\$301.68	\$447.24	N/A
Tarrant	\$507.72	\$158.53	\$100.65	\$121.23	\$211.13	\$318.82	\$336.86	N/A
Travis	\$546.75	\$153.75	\$89.85	\$110.39	\$170.45	\$287.33	\$508.60	N/A
MRSA Central	\$480.56	\$121.77	\$77.58	\$110.11	\$162.35	\$222.58	\$336.24	\$584.67
MRSA Northeast	\$492.51	\$117.71	\$77.29	\$99.19	\$200.24	\$276.35	\$391.43	\$587.65
MRSA West	\$523.59	\$110.03	\$77.76	\$99.78	\$201.50	\$272.75	\$386.35	\$564.84

NOTES:

- (1) Capitated rates shown do not include Delivery Supplemental Payments for pregnancy and delivery-related costs.
- (2) STAR = State of Texas Access Reform; TANF = Temporary Assistance for Needy Families; SSI = Supplemental Security Income; MRSA = Medicaid Rural Service Area.

SOURCE: Texas Health and Human Services Commission.

The Actuarial Standards Board issued a proposed standard of practice in December 2013 regarding the actuarial definitions and rules for managed care rate setting; as of October 2014 the proposal has not been adopted by the Board. The proposal discusses the role of base data, risk adjustments, rebasing, and documentation in rate setting. In response, HHSC indicated the proposed standard may be prescriptive and unnecessary. Previously a standard of practice did not exist.

HHSC satisfies CMS's actuarial requirements by working with contracted actuaries and annually publishing actuarial reports for each managed care program. HHSC's annual actuarial reports discuss, at a high level, the process actuaries use to set the rates for a given fiscal year, explain adjustments or changes, and contain the final rates that are certified by the actuary.

While federal law requires that managed care rates be actuarially sound, Texas statute does not provide specific criteria to be used for the development of managed care rates. The Texas Government Code, Section 533.013, addresses managed care payment rate determination, but only requires HHSC to consider several factors such as the number of recipients and MCOs in a SDA, as well as the ability of the MCO to meet the costs of operation under the proposed premium rates.

THE STAR MANAGED CARE RATE-SETTING PROCESS

The process for setting STAR payment rates is complex and includes several procedures and many components that directly and indirectly affect final rates. **Figure 2** shows the STAR rate-setting process at a high level.

To determine the capitated rate for each MCO, actuaries look at base year encounter data, in the form of enrollee claims. This data is collected from MCOs, the EQRO, HHSC, and other sources. Generally, base year data is adjusted to account for (1) any possible lags in claims accounting and (2) distortions in the data including unusually large claims. The resulting data is referred to as experience data, the information from which rates are determined.

Several additional adjustments are applied to experience data, including trend factors, rate adjustments, administrative fees, risk margin, and reinsurance. These adjustments are made for each MCO within each SDA. Other adjustments may be made, if needed, for specific timing or regional considerations such as variations in service delivery methods and seasonal fluctuations to account for data limitations.

Actuaries then calculate the weighted average of each MCO's projected year's anticipated experience within a SDA, which results in the unadjusted premium rate or community rate. Maternity-related costs are subtracted from community rates in order to separately calculate delivery supplemental payments, the rate MCOs in each SDA are paid for each birth. Finally, actuaries apply an MCO-specific acuity risk adjustment to reflect the health status of each MCO's enrollment. The resulting rates are considered the projected year's capitated rates, per-member, per-month, for each of the MCO-SDA combinations.

The methodology for applying these adjustments can change from year to year. Some changes may occur because of routine factors, such as:

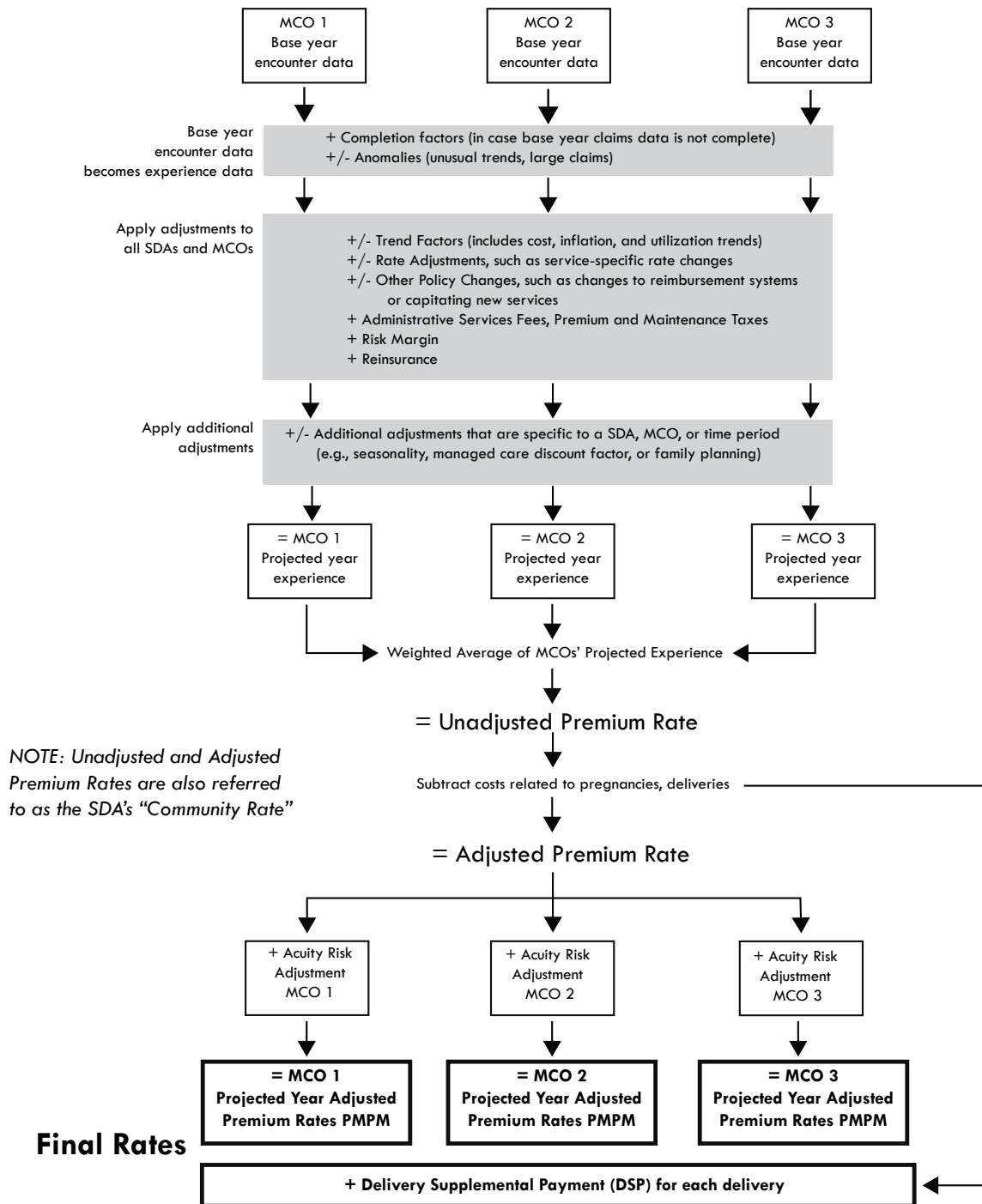
- service-specific rate adjustments, for example reducing reimbursement for ambulance services;
- new policies, for example incorporating hearing and audiology services into capitated rates; or
- changes to the maintenance tax rate.

In the regular course of the rate-setting process, actuaries use their professional judgment regarding which of these types of changes to incorporate and how. More significant changes to the overall rate-setting methodology are less common and require more review and consideration by actuaries and HHSC. For example, fiscal year 2015 rates were limited to 110 percent of actual costs in order to prevent excess profits to the lower-cost plans. According to HHSC, this essentially achieves the same result as the previous method of experience rebate recoupments, but the substantive nature of the change required additional scrutiny by HHSC staff. Actuaries communicate regularly with an informal workgroup, composed of MCO representatives, regarding preliminary and final processes and rates.

HHSC is required to describe both routine and significant changes in the actuarial report. The 2014–15 General Appropriations Act, Section 44, Special Provisions Relating to all Health and Human Services Agencies, pages II-132–133, authorizes the Legislative Budget Board to approve or disapprove rate changes under certain circumstances.

Three specific components—experience data, trend factors, and acuity risk adjustments—are among the components of the STAR rate-setting process that have a substantial and direct effect on final rates:

FIGURE 2
PROCESS FOR SETTING STAR PAYMENT RATES IN EACH SERVICE DELIVERY AREA (SDA), FISCAL YEAR 2014



NOTE: STAR = State of Texas Access Reform; MCO = Managed Care Organization; PMPM = Per-member, per-month.
 SOURCE: Legislative Budget Board.

- experience data—a voluminous dataset comprised of historical claims and related data, which acts as the starting point for Medicaid managed care rates;
- trend factors—an adjustment made to quantify and apply cost and utilization growth as well as inflation, which have historically contributed to rate increases; and
- acuity risk adjustment—an adjustment made to MCOs’ rates in order to account for the health status of their specific enrollment.

These three components are described in **Figure 2** and in the following sections.

EXPERIENCE DATA

Experience data is the collective summary of claims and incidents for a given period in managed care. This summary-level information is the starting point for calculating future payment rates. Applying trend factors, adjustments, and other components to experience data allows actuaries to project future experience and, ultimately, derive STAR rates.

MCOs are required to report each patient’s claims, called encounter data, to TMHP every 30 days. These claims are consolidated into collective experience data. In STAR, MCOs sometimes provide services such as vision or behavioral health through subcapitated arrangements, which are networks within the existing MCOs’ networks for certain specialty services. Claims for services provided through subcapitated arrangements are not included in encounter data, but are included in experience data.

Each encounter or claim record contains dozens of fields, including patient information, diagnosis, and services provided. Records also include fields that indicate how much the provider was paid by the MCO for a given claim. This amount is proprietary information and negotiated between MCOs and providers. While the state’s Medicaid program has no direct role in setting the amount of reimbursement to providers in a MCO’s provider network, payment rates often reflect rates previously set by HHSC under the legacy fee-for-service system.

Claims are sometimes removed from encounter data to prevent distortion when projecting experience data. For example, high-cost services provided to an eligible client that result in unusually high-dollar claims may be omitted from encounter data. There are no documented criteria for removing anomalous claims.

Due to reporting periods and the lags between incurring and paying a claim, sometimes a month’s or year’s claims data is not complete when the baseline for projections is set. In such cases, actuaries look at past years’ complete data to calculate completion factors. These factors are applied to the existing data to predict what the whole month and year would have been. The actuarial report includes a description of projecting base year experience data including the use of completion factors; however, the calculation of these completion factors is not clearly described.

HHSC staff and contracted actuaries verify the accuracy of experience and encounter data by comparing it to audited financial statistical reports and supplemental information provided by the MCOs. All three of these sources are provided by the MCOs; an objective third-party data source is not available for comparison.

TREND FACTORS

Another component that directly affects managed care payment rates are trend factors, which are applied in the STAR rate-setting process to account for inherent changes in cost, inflation, and utilization. The purpose of trend factors is to adjust the base period claims cost to the projection period. Actuaries use experience data, after completion factors are applied, both as a baseline in projecting future year’s costs as described above but also to calculate growth trends. For each risk group in each MCO in each SDA, actuaries compare the per-member cost growth in a month to that of the same month in the previous year. Similarly, per member costs are compared from each fiscal year to the next and the MCOs’ annual growth factors are eventually combined within a SDA to calculate statewide trend factors for each risk group. In addition to the arithmetic growth calculations, actuaries also apply a separate adjustment factor to incorporate other policy, benefit, or reimbursement changes made elsewhere in the process; these separate adjustment factors are not described in the actuarial report.

Actuaries use actual and projected experience data to calculate and project trend factors. Because complete experience data is only available through December of the current fiscal year, actuaries proportionally weight the actual experience data available to project a trend factor for the fiscal year’s final eight months. Once the current fiscal year’s data is complete, with both actual experience data for the first four months and projected experience data for the final eight months, actuaries project the next fiscal year’s trend factor by averaging the previous fiscal years’ trend factors. This methodology is

repeated in future fiscal years as more data becomes available. For example, in the fiscal year 2014 report, actual experience data was available for the first four months of fiscal year 2013 (September through December 2012) and actuaries could arithmetically calculate that trend factor. The trend factor for January through August of fiscal year 2013 however had to be

projected, using experience data from fiscal years 2010, 2011, 2012, and the first four months of fiscal year 2013. This example and others are shown in **Figure 3**.

The calculation of trend factors has varied in recent STAR rate-setting methodologies. For example, actuaries weighted

**FIGURE 3
METHODOLOGY FOR CALCULATING TREND FACTORS IN ACTUARIAL REPORTS, FISCAL YEARS 2014 TO 2016**

YEAR	ACTUARIAL REPORT FOR FISCAL YEAR 2014 RATES (1) (PUBLISHED JULY 2013)	ACTUARIAL REPORT FOR FISCAL YEAR 2015 RATES (PUBLISHED JULY 2014)	ACTUARIAL REPORT FOR FISCAL YEAR 2016 RATES (TO BE PUBLISHED IN JULY 2015) (2)
2010	Adjusted trend factors for 2010 were carried forward from calculations in the report on 2013 rates. Factors were applied to multiple new risk groups where necessary.		
2011	Adjusted trend factors for 2011 were carried forward from calculations in the report on 2013 rates. Factors were applied to multiple new risk groups where necessary.	Adjusted trend factors for 2011 were carried forward from calculations in the report on 2014 rates.	
2012	Trend factors for 2012 were calculated from arithmetic growth factors and adjustment factors.	Trend factors for 2012 were calculated from arithmetic growth factors and adjustment factors. These figures were very similar to those in the 2014 report, with some slight revisions.(3)	Adjusted trend factors for 2012 will be carried forward from calculations in the report on 2015 rates.
2013	Trend factors for the first portion of 2013 were calculated from arithmetic growth factors and adjustment factors. Trend factors for remaining months of 2013 were projected using actual data from 2010, 2011, and 2012 and partial 2013.	Trend factors for 2013 were calculated from arithmetic growth factors and adjustment factors.	Trend factors for 2013 will be carried forward from calculations in the report on 2015 rates, possibly with some slight revisions. (3)
2014	Trend factors for 2014 were projected using actual and projected trend factors for 2010, 2011, 2012, and 2013.	Trend factors for the first portion of 2014 were calculated from arithmetic growth factors and adjustment factors. Trend factors for remaining months of 2014 were projected using actual data from 2011, 2012, and 2013 and partial 2014.	Trend factors for 2014 will be calculated from arithmetic growth factors and adjustment factors.
2015		Trend factors for 2015 were projected using actual trend factors for 2010, 2011, 2012, and 2013.	Trend factors for the first portion of 2015 will be calculated from arithmetic growth factors and adjustment factors. Trend factors for remaining months of 2015 will be projected using actual data from 2012, 2013, and 2014 and partial 2015.
2016			Trend factors for 2016 will be projected using actual trend factors for 2011, 2012, 2013, and 2014.

NOTES:

- (1) Fiscal year 2014 was the first year of newly categorized risk groups.
- (2) Anticipated methodology.
- (3) Slight revisions might include changes to claims such as reclassifications or additional recoveries.
- (4) All years above refer to fiscal years.

SOURCE: Legislative Budget Board.

previous years' trend factors differently in calculations for the fiscal year 2014 rates than for the fiscal year 2015 rates. In addition, when calculating the trend factors for the fiscal year 2015 rates, historical trends for fiscal years 2010 to 2013 were limited to no less than 0.0 percent, another deviation from the fiscal year 2014 methodology. Adjustments such as these are made by actuaries to better model future trend factors and rates based on their professional judgment.

As is the case for experience data, portions of the actuarial report relating to data sources and methodologies used in trend factors are unclear and difficult to understand. Attachments and exhibits in the actuarial report contain both actual and sample data that attempt to demonstrate the calculation of trend factors, but the report does not identify the source data or clearly explain how they are used within the overall equation.

ACUITY RISK ADJUSTMENT

Once a SDA's community rate has been determined, an acuity risk adjustment factor is applied. The purpose of an acuity risk adjustment is to account for the health status of each MCO's enrollment. This adjustment allows for plans whose members are less healthy, and will therefore likely be utilizing more services, to be compensated at greater payment rates than plans whose members are less likely to require medical services.

The state's EQRO uses a methodology called chronic illness and disability payment system (CDPS) to provide a case mix figure for each risk group in each MCO. Specifically, CDPS looks at the diagnosis codes and other factors relating to each SDA's and each MCO's population to predict a per-member, per-month payment for each MCO and SDA, independent of procedures or costs already associated with that population. CDPS divides the MCO's predicted per-member, per-month payment by that SDA's predicted per-member, per-month payment to arrive at the final case mix figure. If the resulting figure is greater than one, that MCO has a proportionally less healthy population within that SDA; if the case mix is less than one, the MCO's population is healthier than the average of the SDA.

The adjusted community rate for each region is multiplied by this case mix figure to arrive at the final per-member, per-month rate for each MCO. **Figure 4** shows select examples of how acuity risk adjustments are applied.

Rates vary significantly across SDAs, risk groups, and health plans. Fiscal year 2014 adjusted community rates ranged

from \$74.73 per-member, per-month for children ages 6 to 14 in Lubbock to \$637.57 for infants in Bexar. After applying the acuity risk adjustment, the lowest per-member, per-month rate in fiscal year 2014 was \$70.28 for children ages 6 to 14 for a MCO in the Rural Service Area West and the highest per-member, per-month rate was \$798.46 for infants for a MCO in the Jefferson region.

Acuity risk adjustment is based upon two years' previous data; for example fiscal year 2014 STAR rates used acuity risk adjustment factors developed based on fiscal year 2012 data.

In the STAR actuarial report, the case mix figure provided is the arithmetical calculation described above, before any adjustments are made to accommodate differences between the base and projection periods. In fiscal year 2014 rates, actuaries applied only 50 percent of the acuity risk adjustment factor for health plans new to a region in order to not penalize them because of that population's likely low acuity. Although case mix factors are a mathematical computation, methods of applying the factors to community rates vary.

Generally, in STAR, 100 percent of the acuity risk adjustment factor is applied to the community rate. Other states weight the acuity risk adjustment factor; for example, California applies 20 percent of its risk adjustment factors to community rates.

While the STAR actuarial report includes data from ICHP's CDPS analysis relating to case mix and other factors for the acuity risk adjustment, the source and methodology for the data and results provided are not described clearly and do not correlate with other data provided. Specifically, the actual mathematical relationships between case mix factors, adjusted community rates, and final MCO rates are not clearly explained.

OTHER FACTORS AFFECTING STAR PAYMENT RATES

In addition to the components that directly affect rates, some of which are described above, other factors can have a significant effect on the rate-setting process and resulting rates, such as:

- contract arrangements with actuaries, MCOs, and the EQRO;
- financial statistical reports that MCOs submit to HHSC quarterly;
- HHSC's review, audit, and reconciliation of those financial reports;

FIGURE 4
EXAMPLES OF ACUITY RISK ADJUSTMENT APPLICATION, FISCAL YEARS 2014 AND 2015

SERVICE DELIVERY AREA/RISK GROUP/FISCAL YEAR	COMMUNITY RATE (1)	CASE MIX (2)	MCO PAYMENT RATE (3)
Harris/Ages 6 to 14/Fiscal Year 2014	\$91.01		
Amerigroup		0.96	\$87.15
Community Health Choice		0.90	\$81.74
Molina Healthcare of Texas, Inc.		1.01	\$92.12
Texas Children's Health Plan		1.08	\$98.15
UnitedHealthCare Community Plan		0.96	\$87.82
Jefferson/Ages 6 to 14/Fiscal Year 2014	\$82.50		
Amerigroup		0.90	\$74.49
Community Health Choice		0.95	\$78.30
Molina Healthcare of Texas, Inc.		0.92	\$75.66
Texas Children's Health Plan		1.10	\$90.97
UnitedHealthCare Community Plan		0.98	\$80.89
Jefferson/Pregnant Women/Fiscal Year 2014	\$406.61		
Amerigroup		1.02	\$414.05
Community Health Choice		0.99	\$402.17
Molina Healthcare of Texas, Inc.		0.99	\$402.18
Texas Children's Health Plan		0.97	\$394.17
UnitedHealthCare Community Plan		1.06	\$429.41
Lubbock/Pregnant Women/Fiscal Year 2014	\$356.03		
Amerigroup (4)		0.72	\$311.63
FirstCare		1.00	\$361.42
Superior HealthPlan		1.03	\$372.92
Travis/Ages 1 to 5/Fiscal Year 2015	\$141.72		
Blue Cross Blue Shield of Texas		0.86	\$122.59
Sendero Health Plans		1.31	\$186.07
Seton Health Plan		0.87	\$124.34
Superior HealthPlan		1.00	\$141.94

NOTES:

- (1) Community Rate is calculated from experience data and other adjustments.
- (2) Case Mix is calculated and provided by the Institute for Child Health Policy using the chronic illness and disability payment system methodology.
- (3) MCO Payment Rate is the amount paid to the managed care organization per-member, per-month.
- (4) Because Amerigroup was new to the region, only 50 percent of the case mix, or the average of the case mix and 1, was applied to the community rate.

SOURCE: Texas Health and Human Services Commission.

- roles of data brokers and suppliers, such as TMHP;
- experience rebates, payments from MCOs back to HHSC if their profits exceed certain amounts;
- quality and pay-for-performance measures; and
- actuarial standards, which continue to evolve.

The extent to which these components affect rates depends on a number of factors, such as timing, current methodologies, regulations and requirements, technical issues, and turnover.

BEST PRACTICES IN RATE-SETTING METHODOLOGY

A review of literature regarding states' approaches to managed care rate setting revealed that Texas has implemented several best practices in its processes. The Government Accountability

Office reported in June 2014 that risk adjustment, tailoring rates to specific demographic groups and geography, reinsurance, and separately calculating costs for maternity-related services are methods for more accurately calculating Medicaid managed care rates. Texas has implemented these methods. The Urban Institute, in December 2012, surveyed 20 states and found that Texas was using five of six adjustment factors listed, including separating out maternity costs, adjusting for age and geography, and applying risk adjustment factors. In addition, Deloitte reported on approaches taken elsewhere and recognized that Texas publishes performance data and has implemented pay-for-performance measures and capitation withholds.

IMPROVE RATE-SETTING TRANSPARENCY

Texas has implemented several best practices in its managed care rate-setting methodology, but the process, particularly its transparency, could be improved. Without strong, clear, and accessible criteria, policymakers and stakeholders must rely upon actuarial reports to understand how payment rates are developed. However, the rate-setting process and methodology are not clearly described in the actuarial reports or elsewhere, making it difficult to understand the mathematical calculations and logic behind the rates.

Throughout the STAR actuarial reports for both fiscal years 2014 and 2015, which are intended to provide supporting evidence for the rates, several factors, sources, methodologies and formulae are unclear or omitted, such as those noted above relating to trend factors and acuity risk adjustments. In addition, the methodology itself for setting managed care rates is not transparent. Actuaries use their professional judgment to implement most routine changes and larger decisions are discussed among actuaries, executive staff, and stakeholders and not shared publicly until they are resolved.

Recommendation 1 would amend statute to require HHSC to provide more transparency in the STAR rate-setting process by more clearly describing and demonstrating the methodology by which managed care payment rates are set. Actuarial reports should be published in a format that allows for tracing data and formulae across attachments, exhibits, and examples. Reports should more clearly identify and describe data sources and assumptions, particularly multipliers and factors used throughout. For example, HHSC could show the methodology, data sources, and formulae for one SDA's rates through the entire rate-setting process. Actuaries should describe the source and purpose of factors and multipliers. In particular, actuaries should

identify the components that are assumptions and how those assumptions were developed.

FISCAL IMPACT OF THE RECOMMENDATION

The recommendation would improve transparency surrounding managed care rate setting to allow policymakers to better evaluate the reasonableness and appropriateness of managed care rates. It is assumed that requiring HHSC to provide clearer documentation of data sources, methodologies, and assumptions would have no significant fiscal impact and could be implemented within existing resources.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of this recommendation.

IMPROVE RATE SETTING AND DATA TO ALLOW COMPARISON OF PACE TO STAR+PLUS

The Program of All-inclusive Care for the Elderly (PACE) is a capitated managed care program that integrates Medicare and Medicaid financing and is designed to help people age 55 or older who would otherwise need nursing facility care continue to live in the community. The program, which the Texas Department of Aging and Disability Services administers, features a comprehensive medical and social service delivery system and provides all preventative, primary, acute, and long-term care services. The PACE model in Texas began in 1987 with creation of Bienvivir All-Inclusive Senior Health in El Paso. Three PACE programs in Texas serve four Texas counties—El Paso, Potter, Randall, and Lubbock. The Texas Medicaid program funds a fixed number of PACE slots at each site for Medicaid clients. The alternative community-based long-term care option for Texas Medicaid clients age 55 and older is the STAR+PLUS managed care program. STAR+PLUS, which has been expanded statewide, integrates the delivery of acute care and long-term services and supports and serves most of Texas’ aged Medicaid clients. In March 2015, Medicaid clients receiving nursing facility services will also be enrolled in STAR+PLUS.

The Texas PACE program has operated for many years as a less expensive alternative to the Medicaid fee-for-service system for certain Medicaid clients who live in a PACE service area and require long-term care services. PACE may also provide a cost-effective alternative to STAR+PLUS. However, the state has not determined whether the PACE model can operate at a cost equal to or less than serving a person in STAR+PLUS. PACE Medicaid rates are currently set at an amount less than the cost of providing services to a comparable population in the Medicaid fee-for-service system, not managed care. As a result, provisions in the General Appropriations Act and in statute that allow the transfer of funds from STAR+PLUS to serve more clients in PACE if certain conditions are met could increase costs to the state. Furthermore, although national evaluations have shown that PACE enrollees have better outcomes than non-PACE populations, current data does not allow the state to compare Medicaid client outcomes across PACE and STAR+PLUS.

The Texas Health and Human Services Commission should modify the Texas Medicaid rate-setting process for PACE to make certain that the program is cost neutral relative to

servicing a person enrolled in STAR+PLUS, and that PACE Medicaid rates are adequate and reasonable. This modification would provide more certainty about the fiscal impact of any approved transfer of funds from STAR+PLUS to PACE. Data collection efforts for PACE and STAR+PLUS should also be modified to allow for a comparison of Medicaid client outcomes across these models. The agency should evaluate how PACE Medicaid costs and client outcomes compare to STAR+PLUS, including an assessment of future cost implications of the PACE model in Texas if the agency cannot make recommended changes to its rate-setting process.

FACTS AND FINDINGS

- ◆ The Texas PACE program has operated for many years as a less expensive alternative to the Medicaid fee-for-service system for certain Medicaid clients who live in a PACE service area and require long-term care services. The current Texas Medicaid rate-setting process for PACE ensures that PACE rates will be less than the estimated cost to serve a comparable Medicaid population in the fee-for-service system.
- ◆ National evaluations have shown that PACE enrollees have better outcomes than non-PACE populations. Specifically, PACE enrollees have lower rates of nursing facility use and in-patient hospitalizations, better reported health status and quality of life, and lower mortality rates.

CONCERNS

- ◆ The Texas Medicaid rate-setting process for PACE is not structured to ensure it is cost neutral to serve an individual in PACE instead of STAR+PLUS. As a result, transferring funds from STAR+PLUS to PACE could increase costs to the state.
- ◆ Current data maintained by the Texas Health and Human Services Commission and the Department of Aging and Disability Services does not allow the state to compare Medicaid client outcomes in PACE and STAR+PLUS.
- ◆ If the Texas Health and Human Services Commission cannot ensure it is cost neutral to serve an individual

in PACE instead of STAR+PLUS, and that PACE Medicaid rates are adequate and reasonable, the PACE model in Texas may not provide a cost-neutral long-term care option for Texas Medicaid clients.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to direct the Texas Health and Human Services Commission to modify the Texas Medicaid rate-setting process for PACE to ensure: (1) PACE Medicaid rates are adequate to sustain the program; (2) PACE Medicaid rates do not exceed the reasonable and necessary costs to operate PACE; and (3) the program is cost neutral relative to serving a person in the Medicaid STAR+PLUS managed care program.
- ◆ **Recommendation 2:** Amend statute to direct the Texas Health and Human Services Commission and the Department of Aging and Disability Services to modify data collection for PACE and STAR+PLUS to allow for a comparison of Medicaid client outcomes across these models.
- ◆ **Recommendation 3:** Amend statute to direct the Texas Health and Human Services Commission, in collaboration with the Department of Aging and Disability Services, to evaluate how PACE Medicaid costs and client outcomes compare to STAR+PLUS and to submit a report to the Legislative Budget Board and the Office of the Governor by December 1, 2016.

DISCUSSION

The Program of All-inclusive Care for the Elderly (PACE) is a capitated managed care program that integrates Medicare and Medicaid financing and is designed to help people age 55 or older who would otherwise need nursing facility care continue to live in the community. Capitation is a prospective payment method that pays a managed care organization (MCO) a uniform amount on a monthly basis for each enrolled member for the provision of covered services. The program features a comprehensive medical and social service delivery system and coordinates or provides all preventative, primary, acute, and long-term care services. **Figure 1** shows major events in the history of the PACE program.

Each PACE program has an interdisciplinary team that assesses participant needs and then plans and directly delivers all services using PACE program staff or through contracts

**FIGURE 1
PACE HISTORY HIGHLIGHTS
CALENDER YEARS 1971 TO 1997**

DATE	EVENT
1971	The PACE model of care began with the creation of On Lok Senior Health Services in San Francisco.
1979	On Lok received a four-year grant from the U.S. Department of Health and Human Services to develop a consolidated model of delivering care to persons with long-term care needs.
1983	Federal law authorized the original demonstration waiver for On Lok and allowed it to test a capitated funding model using Medicare and Medicaid funds.
1986	Federal law allowed 10 additional organizations to replicate the On Lok service delivery and capitated funding model in other parts of the country
1987	Private foundations provided start-up grants to the first replication sites and in 1990, these sites also received federal demonstration waivers.
1997	PACE operated as a demonstration program until the federal Balanced Budget Act of 1997 established PACE as a permanently recognized provider type under both the Medicare and Medicaid programs.

SOURCE: Legislative Budget Board.

with other providers. At a minimum, the interdisciplinary team is composed of a primary care physician, registered nurse, master’s level social worker, physical therapist, occupational therapist, recreational therapist or activity coordinator, dietitian, PACE center manager, home care coordinator, personal care attendant or designee, and driver or designee.

PACE programs provide all services covered by Medicare and Medicaid as well as additional services that are determined necessary by the interdisciplinary team to improve and maintain the participant’s overall health status. PACE organizations must offer the Medicare Part D pharmacy benefit to individuals who are dually eligible for Medicaid and Medicare as well as Medicare only participants. **Figure 2** shows a list of PACE services as of fiscal year 2014.

A PACE organization is a not-for-profit private or public entity and must meet certain eligibility criteria to operate a PACE program. A PACE organization must enter into a program agreement with the federal Centers for Medicare and Medicaid Services (CMS) and the state agency responsible for administering the PACE program. The PACE center, which is operated by the PACE organization, is the focal point of the program and combines the services of an adult day health center, primary care clinic, and rehabilitation facility into a single location. All services are coordinated at

FIGURE 2
PACE SERVICES, FISCAL YEAR 2014

Primary Care (including doctor and nursing services)	Occupational therapy
Hospital Care	Adult Day Care
Medical Specialty Services	Recreational therapy
Prescription Drugs	Meals
Skilled Nursing Facility Care	Dentistry
Emergency Services	Nutritional Counseling
Home Care	Social Services
Physical therapy	Laboratory/X-ray services
Social work counseling	Transportation

NOTE: PACE organizations may provide other services not listed in this figure that are determined necessary by the interdisciplinary team of health care professionals.

SOURCE: Centers for Medicare and Medicaid Services.

the PACE center level. Outpatient services are provided through the PACE center, while inpatient services (i.e., hospital and nursing facility care) and physician specialist services are typically provided through contractual agreement with community providers.

Enrollment in the PACE program is voluntary and participants can choose to leave the program at any time. PACE enrollees may be enrolled in Medicare only, Medicaid only, both Medicare and Medicaid, or neither. To be eligible to be a PACE participant, federal law requires that a person must:

- be age 55 or older,
- live in the service area of a PACE organization,
- be certified by the state in which the participant lives as meeting the medical necessity for nursing facility admission, and
- be able to reside safely in the community at the time of joining the program.

The PACE financing model combines pre-paid payments from Medicare, Medicaid, or private pay sources into one flat-rate, or capitated monthly payment, to provide the entire range of services. Each PACE organization bears 100 percent of the financial risk for all services needed by its participants. Most PACE participants are eligible for both Medicare and Medicaid, and PACE programs receive a monthly capitation payment from both payer sources for each participant. Individuals without Medicare or Medicaid can pay privately for PACE.

In general, national evaluations have shown that PACE enrollees have lower rates of nursing facility use and inpatient hospitalizations than non-PACE populations. PACE enrollees have also reported better health status and quality of life than non-PACE populations. Finally, participating in PACE has also been associated with lower mortality rates. The benefits of PACE are greater for enrollees with high levels of physical impairment.

OVERVIEW OF THE PACE PROGRAM IN TEXAS

The PACE model in Texas began in 1987 with the creation of Bienvenir All-Inclusive Senior Health in El Paso. Bienvenir, which began as a federal demonstration project, was one of the first organizations in the country to replicate the On Lok model. In 2001, the Legislature required the Texas Health and Human Services Commission (HHSC) to develop and implement the PACE program statewide in Texas. The state agency administering the PACE program in Texas, currently the Texas Department of Aging and Disability Services (DADS), was directed to use its best efforts to have 6 PACE program sites in operation in fiscal year 2002, 11 sites in fiscal year 2003, and 16 sites in fiscal year 2004. As of the end of fiscal year 2014, three PACE organizations operate three programs in Texas. The estimated amount to be expended on Medicaid-financed PACE services at these programs is \$38.2 million in All Funds in fiscal year 2014, and the appropriated amount for fiscal year 2015 is \$36.1 million in All Funds. As shown in **Figure 3**, the Texas Medicaid program funds a fixed number of PACE slots at each site for Medicaid clients.

To be eligible for Texas Medicaid-financed PACE services, a PACE participant must meet the federal PACE eligibility requirements and be eligible for full Medicaid benefits through one of the following methods:

- be eligible for Supplemental Security Income (SSI) benefits;
- have been eligible for and received SSI benefits, and continue to be eligible for Medicaid as a result of coverage mandated by federal law; or
- be eligible for Medicaid benefits using the institutional income and resource limits (i.e., have a monthly income within 300 percent of the SSI monthly income limit and have countable resources of no more than \$2,000).

The vast majority of Texas PACE participants are female Hispanics age 65 or older. The majority of these clients live at home and are eligible for both Medicare and Medicaid.

**FIGURE 3
TEXAS PACE PROGRAMS, FISCAL YEAR 2014**

PROGRAM	LOCATION	SITES	STATE CONTRACT DATE	ALLOCATED SLOTS FOR MEDICAID CLIENTS	FILLED MEDICAID SLOTS	FILLED MEDICAID SLOTS (MONTHLY AVERAGE)	FILLED MEDICAID SLOTS (ANNUAL UNDUPLICATED)	COST PER FILLED MEDICAID SLOT (AVERAGE MONTHLY)
Bienvivir All-Inclusive Senior Health	El Paso County	3 sites in El Paso	February 1992	881	860	848	1,020	\$2,940
The Basics at Jan Werner	Potter and Randall Counties	1 site in Amarillo	March 2004	150	136	139	162	\$2,343
Silver Star Health Network	Lubbock County	1 site in Lubbock	May 2010	115	99	87	117	\$2,737

NOTE: The number of filled slots is as of the end of fiscal year 2014.
SOURCE: Legislative Budget Board.

According to the Texas PACE Association, participants in the Texas PACE programs are frailer than PACE participants across the country as measured by the following:

- Average Medicare Hierarchical Condition Category Risk Score (2.565 in Texas compared to 2.409 in all PACE sites);
- acute hospital admissions per member per year (0.81 in Texas compared to 0.65 in all PACE sites);
- average number of diagnoses (23 in Texas compared to 13 in all PACE sites);
- prevalence of diabetes diagnosis (55 percent in Texas compared to 36 percent in all PACE sites);
- prevalence of dementia diagnosis (55 percent in Texas compared to 50 percent in all PACE sites); and
- average number of prescription medications per member per month (nine in Texas compared to eight in all PACE sites).

The 2014–15 General Appropriations Act (GAA), Article II, Special Provisions, Section 48 authorizes DADS to serve up to 96 additional participants across all existing PACE sites beginning in fiscal year 2014. According to DADS, the agency used funding for 47 of the 96 new slots to finance the difference between the amount appropriated for 1,050 slots in fiscal years 2014 and 2015 and the number of individuals enrolled in PACE at the end of fiscal year 2013 (i.e., 1,097 individuals enrolled). According to HHSC and DADS, the remaining 49 new slots were used to increase the number of slots at existing PACE sites for fiscal years 2014 and 2015. Based on current PACE enrollment and interest list data at each site, the 49 slots were allocated as follows: 30 to Silver

Star Health Network (Lubbock), and 19 to Bienvivir All-Inclusive Senior Health (El Paso).

The GAA also authorizes DADS to use funds appropriated to PACE to add three new PACE sites with up to 150 participants per site beginning in fiscal year 2015. DADS has completed the Request for Proposals (RFP) process for the new PACE sites and has tentatively awarded three organizations with designation as a PACE site. The organizations include Volunteers of America to serve portions of Dallas County, Bienvivir All-Inclusive Senior Health to serve portions of San Antonio, and Kissito PACE of Houston, Inc. to serve portions of Harris County. The agency plans to submit the new PACE organization applications to CMS for review in January 2015. The estimated start date for the new contracts is either August or October 2015 depending on site, but is contingent on CMS approval.

DADS was not appropriated additional funds in the 2014–15 GAA to serve additional participants at new or existing sites. Rather, if funds appropriated for the PACE program for the 2014–15 biennium are not sufficient to pay for the additional clients, HHSC is directed to transfer up to \$369,839 in General Revenue Funds in fiscal year 2014 and \$3.4 million in General Revenue Funds in fiscal year 2015 from Medicaid to PACE. If the \$3.8 million is insufficient to serve the increase (i.e., 150 clients each at three new PACE sites and 96 additional clients at existing PACE sites), HHSC is directed to request approval from the Legislative Budget Board (LBB) and the Governor to transfer additional funds from Medicaid.

MEDICAID PACE RATE-SETTING PROCESS

Under a PACE program agreement, the administering state agency makes a prospective monthly Medicaid capitation

payment (i.e., PACE Medicaid rate) to each PACE organization for each Medicaid client. CMS requires that the PACE Medicaid rate-setting process include setting upper payment limits (UPLs) and Medicaid rates. The UPL is the estimated amount that Medicaid would have paid for a comparable population under the Medicaid state plan and is calculated using the methodology set forth by CMS. The Medicaid rate is the actual capitated amount that Medicaid pays the PACE organization on a per-member, per-month (PMPM) basis. While states can choose their own methodology for setting rates, federal regulations still require that the rate be less than the UPL. In sum, the rate paid to a PACE provider must be below the estimated costs for a comparable population under the Medicaid state plan. Federal regulations specify that the amount of each PACE Medicaid rate must meet the following requirements:

- be less than the amount that would otherwise have been paid under the Medicaid state plan if the participants were not enrolled under the PACE program (i.e., the UPL);
- take into account the comparative frailty of PACE participants;
- be a fixed amount regardless of changes in the participant's health status; and
- can be renegotiated on an annual basis.

The Texas Medicaid rate-setting process for the PACE program includes two general steps. First, HHSC calculates three upper payment limits for each PACE contract—one for clients eligible only for Medicaid services (i.e., Medicaid-only clients), one for clients eligible for both Medicare and Medicaid services (i.e., dual-eligible clients), and one for clients eligible for only Medicare services (i.e., Qualified Medicare Beneficiaries—QMBs). The UPLs for Medicaid-only clients and dual-eligible clients are currently calculated using historical costs derived from fee-for-service claims data for clients age 55 and older receiving nursing facility services or Community-based Alternatives (CBA) services in the counties served by each PACE contract. The UPL for QMBs is determined on a statewide basis using the average cost incurred by Medicaid for Medicare co-insurance and deductibles. Second, the Medicaid rates for the three client categories for each PACE contract are determined by multiplying the UPLs for each PACE contract by a factor no greater than 0.95. The factor may be reduced as necessary to establish rates that are consistent with available funds. The UPLs and Medicaid rates are set each biennium.

IMPROVE RATE SETTING AND DATA TO ALLOW COMPARISON OF PACE TO STAR+PLUS

Most Texas Medicaid clients age 55 and older who require community-based long-term care services are served in the Medicaid STAR+PLUS managed care program (STAR+PLUS). STAR+PLUS is a capitated Medicaid managed long-term services and supports (MLTSS) program in Texas that integrates the delivery of acute and long-term care services and supports. Enrollment in STAR+PLUS is mandatory for adults age 21 and older who have a disability and qualify for Supplemental Security Income (SSI) benefits or Medicaid based on income level or who meet the nursing facility level of care and qualify for Medicaid because they receive STAR+PLUS home and community-based waiver-like services. Most acute and long-term care services provided to these clients, including nursing facility services as of March 1, 2015, are provided through STAR+PLUS MCOs.

Adults with incomes at or below the level required to receive SSI benefits may receive home and community-based waiver-like services through STAR+PLUS if they meet medical necessity and financial criteria. Adults with incomes greater than the level required to receive SSI benefits (i.e., Medical Assistance Only—MAO) who meet medical necessity and financial criteria may only receive home and community-based waiver-like services through STAR+PLUS if funding is available.

If SSI or MAO clients prefer to receive services through PACE instead of STAR+PLUS, they may be unable to do so because the number of PACE slots is limited. There are only three PACE programs in Texas that together serve four Texas counties—El Paso, Potter, Randall, and Lubbock.

As discussed previously, the 2014–15 GAA directed HHSC to transfer additional funds from the Texas Medicaid program to PACE if needed to serve more clients at new or existing sites. Also, Senate Bill 7, Eighty-third Legislature, 2013, included a provision that authorizes HHSC to transfer funds from the Texas Medicaid program to DADS to serve persons in PACE who otherwise would have been eligible to receive home and community-based waiver-like services through STAR+PLUS and have incomes at or below the level of income required to receive SSI benefits if allowed by the GAA. However, transferring funds from STAR+PLUS to PACE could increase costs to the state because the current Texas Medicaid rate-setting process for PACE is not structured to ensure it is cost neutral to serve an individual in PACE instead of STAR+PLUS. Specifically, historical fee-for-service data for certain Medicaid clients, not data for

clients enrolled in STAR+PLUS, is used to develop the upper payment limit component of the PACE rate-setting process. The current Texas Medicaid rate-setting process for PACE ensures that PACE rates will be less than the estimated cost to serve a comparable Medicaid population in the fee-for-service system, but not necessarily less than the cost to serve a comparable Medicaid population in STAR+PLUS.

HHSC could ensure cost neutrality by using data on the cost of services provided to certain clients enrolled in STAR+PLUS to calculate the UPL component of the PACE Medicaid rate-setting process. The cost of services provided to certain clients enrolled in STAR+PLUS includes the monthly capitated payments paid by HHSC to Medicaid MCOs and the amount spent on a fee-for-service basis for services provided to STAR+PLUS clients that are carved-out, or not included in, the capitation payment. Federal regulations require that the PACE Medicaid rate be less than the UPL. As a result, using data on the cost of services provided to certain clients enrolled in STAR+PLUS to calculate the UPL would result in PACE Medicaid rates that are less than the estimated cost to serve a comparable Medicaid population in STAR+PLUS.

In addition, the statewide expansion of STAR+PLUS has increased the number of people served in managed long-term care programs while the number of people served in the fee-for-service system has decreased. It has become difficult for HHSC to use clients served in the fee-for-service system as the comparison group when calculating the PACE UPLs because availability of historical fee-for-service claims data is diminished. As a result, the STAR+PLUS population has become a more appropriate comparison group for calculating the PACE UPLs. CMS permits states with diminished fee-for-service data to use managed care data to set UPLs. According to HHSC, the agency will use a combination of fiscal year 2013 fee-for-service claims data for certain clients receiving nursing facility services and managed care data for clients receiving home and community-based waiver like services in STAR+PLUS to calculate the PACE UPLs for fiscal years 2016 and 2017. Fiscal year 2013 fee-for-service data for services provided to STAR+PLUS clients that are carved-out of the capitation payment will also be used. However, it is unknown whether this planned modification to the PACE Medicaid rate-setting process will ensure that rates are adequate and reasonable.

Recommendation 1 would amend the Texas Human Resources Code to direct HHSC to modify the Texas Medicaid rate-setting process for PACE to ensure that (1) PACE Medicaid rates are adequate to sustain the program;

(2) PACE Medicaid rates do not exceed the reasonable and necessary costs to operate PACE; and (3) the program is cost neutral relative to serving a person in the Medicaid STAR+PLUS managed care program. The requirement that modification to the PACE Medicaid rate-setting process result in rates that are adequate to sustain the program and do not exceed reasonable and necessary costs to operate PACE is intended to ensure that PACE rates are appropriate even when linked to STAR+PLUS costs. For example, if STAR+PLUS rates increase, PACE rates should not rise unless PACE costs demonstrate that an increase is warranted. Similarly, if STAR+PLUS rates decrease, PACE rates should not fall so low that they are not adequate to sustain the PACE program. In this case, the agency may need to consider adjustments to increase the managed care cost basis when setting the UPL.

Currently, PACE providers are not required to submit historical cost and utilization data to HHSC or DADS. HHSC should consider obtaining historical cost and utilization data from PACE providers to ensure that PACE Medicaid rates are adequate to sustain the program and do not exceed the reasonable and necessary costs to operate PACE. There are existing cost-reporting structures governed by state and federal rules for other programs administered by HHSC. These structures could be modified to allow HHSC to obtain cost and utilization data from PACE providers. HHSC would also need to determine which PACE costs are considered reasonable and necessary when evaluating whether PACE Medicaid rates exceed these amounts.

LBB staff analyzed fiscal year 2013 Texas PACE and STAR+PLUS Medicaid data to calculate a range of the potential cost or savings from serving certain individuals enrolled in STAR+PLUS in the Texas PACE program instead. The analysis found that the potential cost or savings varies depending on client type and the PACE Medicaid capitation rate used in the calculation. As shown in **Figure 4**, the potential savings from serving STAR+PLUS clients identified as potentially eligible for PACE in the PACE program during fiscal year 2013 totaled \$1.1 billion if the lowest current PACE capitation rate were used. However, there would be a cost of \$718.8 million if the highest current PACE capitation rate were used. Also, the potential cost or savings may vary by service delivery area due to differences in the number of clients of a certain type in a given area and because the Medicaid capitation rates for both programs vary depending on service delivery area and client type.

**FIGURE 4
POTENTIAL (COST)/SAVINGS FROM SERVING CERTAIN STAR+PLUS CLIENTS IN PACE, FISCAL YEAR 2013**

IN MILLIONS	NON- SUPPLEMENTAL SECURITY INCOME				AT OR BELOW SUPPLEMENTAL SECURITY INCOME				TOTAL
	MEDICAID ONLY		DUAL		MEDICAID ONLY		DUAL		
	AGED	DISABLED	AGED	DISABLED	AGED	DISABLED	AGED	DISABLED	
Amount spent serving clients in STAR+PLUS who could have potentially been served in PACE	\$3.2	\$19.7	\$373.5	\$89.3	\$91.7	\$3,111.7	\$4,020.0	\$580.6	\$8,289.8
Estimated cost to serve potentially PACE eligible STAR+PLUS clients in PACE (using lowest fiscal year 2013 PACE capitation rate)	\$2.3	\$15.5	\$353.6	\$95.5	\$65.2	\$2,094.6	\$3,986.7	\$626.0	\$7,239.4
POTENTIAL (COST)/SAVINGS	\$0.9	\$4.2	\$19.9	(\$6.2)	\$26.5	\$1,017.1	\$33.4	(\$45.4)	\$1,050.4
Estimated cost to serve potentially PACE eligible STAR+PLUS clients in PACE (using highest fiscal year 2013 PACE capitation rate)	\$3.0	\$20.4	\$433.2	\$117.3	\$85.9	\$2,735.5	\$4,850.5	\$762.7	\$9,008.6
POTENTIAL (COST)/SAVINGS	\$0.2	(\$0.7)	(\$59.6)	(\$28.0)	\$5.7	\$376.2	(\$830.5)	(\$182.2)	(\$718.8)

NOTE: A STAR+PLUS client is considered to be potentially eligible for PACE if they are age 55 and older and received STAR+PLUS home and community-based waiver-like services. There are other PACE eligibility criteria that might make a STAR+PLUS client ineligible for PACE. The amount spent serving clients in STAR+PLUS who could have potentially been served in PACE includes the STAR+PLUS capitation rate for a given service delivery area multiplied by the member months for certain STAR+PLUS clients plus all acute and long-term care fee-for-service spending for those clients. The acute and long-term care fee-for-service amounts include spending on services that were not a covered benefit in the STAR+PLUS program in fiscal year 2013, but were provided to these clients on a fee-for-service basis. The estimated cost to serve potentially PACE eligible STAR+PLUS clients in PACE is calculated by multiplying the PACE capitation rate by the member months for certain STAR+PLUS clients. The PACE capitation payment rates vary depending on client type and site. This analysis provides a range of the potential cost or savings from serving potentially PACE eligible STAR+PLUS clients in PACE using the lowest and highest fiscal year 2013 PACE capitation rates.

SOURCE: Legislative Budget Board.

The ability of the state to set PACE Medicaid rates at an amount equal to or less than the estimated cost to serve a comparable Medicaid population in STAR+PLUS depends on future rates set for both programs. Fiscal year 2013 cost comparison data cannot be used to determine definitively whether it will be cost neutral to serve a client in PACE instead of STAR+PLUS in future years. Changes will occur to STAR+PLUS rates to reflect programmatic changes. For example, future STAR+PLUS rates will change from what was used for this analysis to account for the inclusion of nursing facility services as a covered benefit in the STAR+PLUS program beginning March 1, 2015.

LBB staff surveyed the 12 states identified by CMS as having implemented both a PACE program and a Medicaid capitated MLTSS program as of June 2012 to collect information on their PACE rate setting practices. The PACE Medicaid rate-setting practices of the seven states that responded to our survey are shown in **Figure 5**. Only two of the responding states—Delaware and New Mexico—operate a non-PACE Medicaid MLTSS program statewide that provides comprehensive acute and long-term care services to

most of the state’s long-term care population similar to Texas. These states report that they are attempting to identify a new data source for calculating PACE UPLs since fee-for-service data is no longer available due to managed care expansion.

The seven responding states have taken one of two approaches to calculating PACE Medicaid rates. The first approach is to rely on the UPL to set the rate as is currently done in Texas where the PACE Medicaid rate is set as a percentage of the corresponding UPL. The second approach is to develop an actuarial rate that estimates the cost of operating a PACE program. When using this approach, the state calculates the rate based upon an estimate of the cost of operating a PACE program. PACE Medicaid rates must still be below UPLs. Four of the seven responding states—Massachusetts, New Mexico, New York and Wisconsin—use an actuarial rate-setting approach to develop Medicaid PACE rates that is based in part on cost report data provided by PACE providers. One additional responding state—Michigan—uses cost report data provided by PACE providers to evaluate the adequacy of the Medicaid PACE rates that are set as a percentage of the PACE UPLs.

**FIGURE 5
PACE MEDICAID RATE SETTING PRACTICES IN SELECTED STATES, FISCAL YEAR 2014**

STATE	DATA SOURCE FOR CALCULATING PACE UPPER PAYMENT LIMIT	APPROACH FOR CALCULATING MEDICAID PACE RATE	OVERVIEW OF NON-PACE MEDICAID MLTSS PROGRAMS
Texas	Historical costs for all Medicaid services derived from fee-for-service claims data for clients age 55 and older receiving Medicaid nursing facility services or Community-based Alternatives (CBA) waiver services in the counties served by each PACE contract.	Rates are set at a percentage of the upper payment limits.	Operates statewide and provides comprehensive acute and long-term care services to most of the state's long-term care population. Rates are developed using an actuarial rate-setting approach.
Delaware	Historical costs for all Medicaid services derived from fee-for-service claims data for clients age 55 and older receiving Medicaid nursing facility services or home and community-based waiver services in the county served by the PACE contract.	Rates are set at a percentage of the upper payment limit.	Operates statewide and provides comprehensive acute and long-term care services to most of the state's long-term care population. Rates are developed using an actuarial rate-setting approach.
Additional Notes: New data source will be identified for calculating PACE UPL for next PACE rate determination since fee-for-service data is no longer available due to managed care expansion.			
Massachusetts	Historical costs for all Medicaid services derived from fee-for-service claims data for clients age 55 and older receiving Medicaid nursing facility services or home and community-based waiver services in the counties served by each PACE contract.	Rates are developed using an actuarial rate-setting approach. PACE provider cost report data is used to set rates.	Two programs operate almost statewide and provide comprehensive acute and long-term care services to most long-term care client categories. However, most of the state's long-term care population remains in the fee-for-service system. Rates are developed using an actuarial rate-setting approach.
Additional Notes: PACE provider cost report data has historically been used to evaluate the adequacy of the PACE rate.			
Michigan	Historical costs for all Medicaid services derived from fee-for-service claims data for clients age 55 and older receiving Medicaid nursing facility services or home and community-based waiver services in the counties served by each PACE contract.	Rates are set at a percentage of the upper payment limits.	Operates statewide and provides community-based long-term care services to most long-term care client categories. However, most of the state's long-term care population remains in the fee-for-service system. Rates are developed using an actuarial rate-setting approach.
Additional Notes: Cost report data from providers has historically been used to evaluate the adequacy of the PACE rate.			
New Mexico	Historical costs for all Medicaid services derived from fee-for-service claims data for clients age 55 and older receiving Medicaid nursing facility services or home and community-based waiver services in the county served by the PACE contract.	Rates are developed using an actuarial rate-setting approach. PACE provider cost report data is used to set rates.	Operates statewide and provides comprehensive acute and long-term care services to most of the state's long-term care population. Rates are developed using an actuarial rate-setting approach.
Additional Notes: New data source will be identified for calculating PACE UPL for next PACE rate determination since fee-for-service data is no longer available due to managed care expansion.			

FIGURE 5 (CONTINUED)
PACE MEDICAID RATE SETTING PRACTICES IN SELECTED STATES, FISCAL YEAR 2014

STATE	DATA SOURCE FOR CALCULATING PACE UPPER PAYMENT LIMIT	APPROACH FOR CALCULATING MEDICAID PACE RATE	OVERVIEW OF NON-PACE MEDICAID MLTSS PROGRAMS
New York	Historical costs for Medicaid services included in the PACE benefit package derived from fee-for-service claims data for clients deemed eligible for PACE age 55 and older, in need of at least 120 days of community-based long-term care and meet nursing facility level of care requirement. Additional Notes: Cost report data from providers has historically been used to evaluate the adequacy of the PACE rate and is used in rate development.	Rates are developed using an actuarial risk-adjusted rate-setting approach based on client acuity.	Operates statewide and covers mainly long-term care services for most of the state’s long-term care population. Rates are developed using an actuarial risk-adjusted rate-setting approach. In 2015, the dually-eligible population will be transitioned into a new Fully Integrated Duals Advantage (FIDA) program.
Washington	Historical costs for all Medicaid services derived from fee-for-service claims data for clients age 55 and older receiving Medicaid nursing facility services or home and community-based waiver services in the county served by the PACE contract.	Rates are set at a percentage of the upper payment limits.	Operates in one county and provides comprehensive acute and long-term care services to most long-term care client categories. Rates are developed using an actuarial rate-setting approach.
Wisconsin	Historical costs for all Medicaid services derived from fee-for-service claims data for clients age 55 and older receiving Medicaid nursing facility services or home and community-based waiver services in the county served by the PACE contract.	Rates are developed using an actuarial rate-setting approach. PACE provider cost report data is used to set the acute and primary care portion of the rate. Cost data from another Medicaid managed care program is used to set the long-term care portion of the rate.	One program (Family Care) operates in 57 counties and provides comprehensive long-term care services to most of the state’s long-term care population. A second program (Family Care Partnership) operates in 9 counties and provides comprehensive acute and long-term care services to younger disabled adults. Rates for both programs are developed using an actuarial rate-setting approach.

NOTE: Medicaid MLTSS is a general term that includes capitated Medicaid managed long-term services and supports programs. MLTSS programs are very diverse. They include programs that make capitated payments to contractors primarily for long-term services and supports, programs that make capitated payments to contractors for all or most Medicaid services, and fully integrated Medicare-Medicaid programs that include all Medicaid and Medicare services. The upper payment limit (UPL) is the estimated amount that Medicaid would have paid for a comparable population under the Medicaid state plan. The rate setting practice for Massachusetts is for calendar year 2015.

SOURCE: Legislative Budget Board.

Furthermore, although national evaluations have shown that PACE enrollees have better outcomes than non-PACE populations, current data maintained by HHSC and DADS does not allow the state to compare Medicaid client outcomes across PACE and STAR+PLUS. Specifically, there are differences in the way various types of outcome data are collected for the two programs that prevent meaningful comparison. For example, the PACE program uses a different survey instrument than STAR+PLUS to measure client experience. Also, complaint, disenrollment and appeal data for each of the two programs are collected in a manner that prevents comparison. Both programs collect data on hospital admissions and readmissions, but data for STAR+PLUS clients excludes certain conditions while PACE tracks all admissions and readmissions. Recommendation 2 would

amend the Texas Human Resources Code to direct HHSC and DADS to modify data collection for PACE and STAR+PLUS to allow for a comparison of Medicaid client outcomes across these models.

Federal regulations specify that PACE Medicaid rates must be less than the amount that would otherwise have been paid under the Medicaid state plan if the participants were not enrolled under the PACE program. Due to the statewide expansion of the STAR+PLUS managed care program in Texas, if PACE Medicaid clients were not in PACE, they would most likely be enrolled in STAR+PLUS. As a result, if HHSC cannot ensure it is cost neutral to serve an individual in PACE instead of STAR+PLUS, and that PACE Medicaid rates are adequate and reasonable, the PACE model in Texas may not provide a cost-neutral long-term care option for

Texas Medicaid clients. Recommendation 3 would amend the Texas Human Resources Code to direct HHSC, in collaboration with DADS, to evaluate how PACE Medicaid costs and client outcomes compare to STAR+PLUS and to submit a report to the LBB and the Office of the Governor by December 1, 2016. To allow for a meaningful comparison between PACE and STAR+PLUS, the agencies should design the evaluation in a manner that compares similar client types across models and controls for geographic differences. The report should include an assessment of the future cost implications of the PACE model in Texas if the agency cannot modify the Texas Medicaid rate-setting process for PACE in a manner that ensures the program is cost neutral relative to serving a person in STAR+PLUS and that rates are adequate and reasonable. This would allow the Legislature to weigh the benefits of PACE against potential cost relative to STAR+PLUS.

FISCAL IMPACT OF THE RECOMMENDATIONS

The recommendations would help ensure that the Texas PACE program both has positive client outcomes and is a cost-effective model in Texas for Medicaid clients. This would provide more certainty about the fiscal impact of any approved transfer of funds from STAR+PLUS to PACE. If modifications to the Texas Medicaid rate-setting process for PACE, as directed in Recommendation 1, result in new PACE rates that are higher than current PACE rates, there could be a cost for serving existing PACE clients that may result in an increase in state and federal Medicaid spending. This potential increase in spending cannot be determined because it is unknown whether PACE rates will increase and by what amount. However, if the recommendations are adopted, Medicaid clients served in PACE would not cost more overall, than if they were served in the alternative Medicaid long-term care option for existing PACE clients (i.e., STAR+PLUS) because the new PACE rates would be equal to or less than the cost to serve these clients in STAR+PLUS.

It is estimated that Recommendations 2 and 3 to modify data collection for PACE and STAR+PLUS and evaluate Medicaid costs and client outcomes between the programs would have no significant fiscal impact and could be implemented using existing resources.

The introduced 2016–17 General Appropriations Bill does not include adjustments as a result of these recommendations.

COORDINATE NURSING FACILITY RESIDENT COMPLAINT DATA TO ENHANCE THE QUALITY OF CARE

As of 2014, 26 states have added nursing facility services to Medicaid managed care initiatives. With the enactment of legislation in 2013 to reform the Medicaid program, Texas nursing facility residents will receive their services from a managed care organization that contracts with the state. Starting March 1, 2015, nursing facility residents enrolled in Medicaid will receive their services through STAR+PLUS managed care. STAR+PLUS is the state Medicaid managed care program through which people who have disabilities or are age 65 or older receive health care services. Placing a managed care organization between the state and nursing facility residents adds a new layer of complexity that may be challenging for consumers to navigate when reporting a complaint about care.

With this change, two state agencies, the Texas Health and Human Services Commission and the Texas Department of Aging and Disability Services, and managed care organizations may receive nursing facility resident complaints. Multiple avenues to accept complaints are beneficial; however, without inter-agency coordination to track and exchange resident complaint data, some complaints may go unresolved and critical trends may go unnoticed. Designating one entity to analyze and report nursing facility complaint data would ensure a comprehensive record and picture of residents' concerns exists. Collecting sufficiently detailed complaint data from managed care organizations will allow the state to analyze the frequency and nature of complaints so it can recommend continuous improvements to enhance the quality of nursing facility services in Medicaid managed care. Furthermore, distributing the analysis of resident complaint data to consumers and advocates would ensure nursing facility residents can make informed choices regarding their care.

FACTS AND FINDINGS

- ◆ Federal and state statute requires the Texas Department of Aging and Disability Services Office of the Long-term Care Ombudsman to investigate reported complaints, report findings of the investigation, and help achieve resolutions for residents in board and care homes and nursing and assisted living facilities. To be eligible to receive federal funds through the Older American Act, states must establish and operate an

Office of the Long-term Care Ombudsman overseen by the State Long-term Care Ombudsman.

- ◆ During fiscal years 2011 and 2012, more than 33,000 nursing facility complaints were reported to the Texas Department of Aging and Disability Services Office of the Long-term Care Ombudsman for investigation, and 92 percent were verified to exist and found to be generally accurate by an ombudsman through observation, interviews, or record inspection.
- ◆ Beginning March 1, 2015, nursing facility services will be included in the Medicaid managed care service array. Because the Texas Health and Human Services Commission administers state Medicaid managed care services, Medicaid beneficiaries receiving nursing facility care will also be able to report complaints to the Texas Health and Human Services Commission Office of the Ombudsman.
- ◆ Reporting processes for consumer complaints of all health and human services may be affected by the Eighty-fourth Legislature's consideration of Sunset Advisory Commission staff recommendations for these agencies. According to Sunset Advisory Commission staff, the Texas Health and Human Services Commission's Office of the Ombudsman lacks basic authority and clear guidance needed to identify problems through accurate complaints data.

CONCERNS

- ◆ The addition of nursing facility services to the Medicaid STAR+PLUS managed care program will result in multiple entities receiving resident complaint data. A coordinated effort to collect and monitor the data is lacking among the state's health and human services agencies; which could result in residents' issues remaining unresolved.
- ◆ Medicaid managed care organizations are not required to report consumer complaints and issues to the state in a sufficiently detailed manner to allow for trend identification and analysis. Without detailed data about the types of issues raised by beneficiaries, critical trends in service delivery and quality will remain unidentified and opportunities to implement

continuous quality improvement strategies will be missed.

- ◆ The Texas Health and Human Services Commission Office of the Ombudsman does not disseminate consumer complaint information to external audiences. Providing this information would enable stakeholders to make more informed health care choices and advocate for systemic changes.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Include a rider in the introduced 2016–17 General Appropriations Bill to designate the Office of the Long-term Care Ombudsman as the state entity responsible for coordinating, collecting, monitoring, and analyzing data about all nursing facility complaints, regardless of payer. The Long-term Care Ombudsman should include in its annual report information or other metrics about the quality of services in nursing facilities that will allow stakeholders to monitor and compare managed care organizations performance related to service delivery and complaint resolution.
- ◆ **Recommendation 2:** Include a rider in the introduced 2016–17 General Appropriations Bill to require the Texas Health and Human Services Commission and the Texas Department of Aging and Disability Services to form an interagency workgroup to share nursing facility resident complaint data and to determine standard definitions for the data to be shared between the two state agencies.
- ◆ **Recommendation 3:** Include a rider in the introduced 2016–17 General Appropriations Bill to direct the Texas Health and Human Services Commission to collect certain consumer complaint information and data from Medicaid managed-care organizations and to share the data with the Texas Department of Aging and Disability Services.
- ◆ **Recommendation 4:** Include a rider in the introduced 2016–17 General Appropriations Bill to require the Texas Health and Human Services Commission's Office of the Ombudsman to report certain consumer complaint data no less than annually to the Texas Health and Human Services Commission's Executive Commissioner, the Health and Human Services Council, and consumers of the respective health and human services programs.

DISCUSSION

The older adult population nationwide will continue to grow for the foreseeable future, according to the U.S. Administration on Aging. As adults live longer, their healthcare needs increase. Long-term care services and supports (LTSS) are generally provided either in nursing facilities or in-home and community-based settings. In Texas, the nursing facility population has increased 6.6 percent to almost 94,000 residents from fiscal years 2011 to 2013. According to the National Center for Health Statistics, the majority of LTSS users are aged 65 and older. By 2020 the Texas State Data Center estimates that the number of Texas adults age 65 and older will be slightly more than 4 million, a 30 percent increase from the 2014 population.

Nationally, nursing facility residents are a vulnerable population because of their reliance on others for assistance with activities of daily living (ADL); such as getting in and out of bed, dressing, bathing, eating, and toileting. More than 90 percent will require assistance with at least two ADLs. Moreover, almost 50 percent of nursing facility residents have a diagnosis of Alzheimer's disease or other dementia or depression. **Figure 1** shows demographic information about nursing facility residents nationwide.

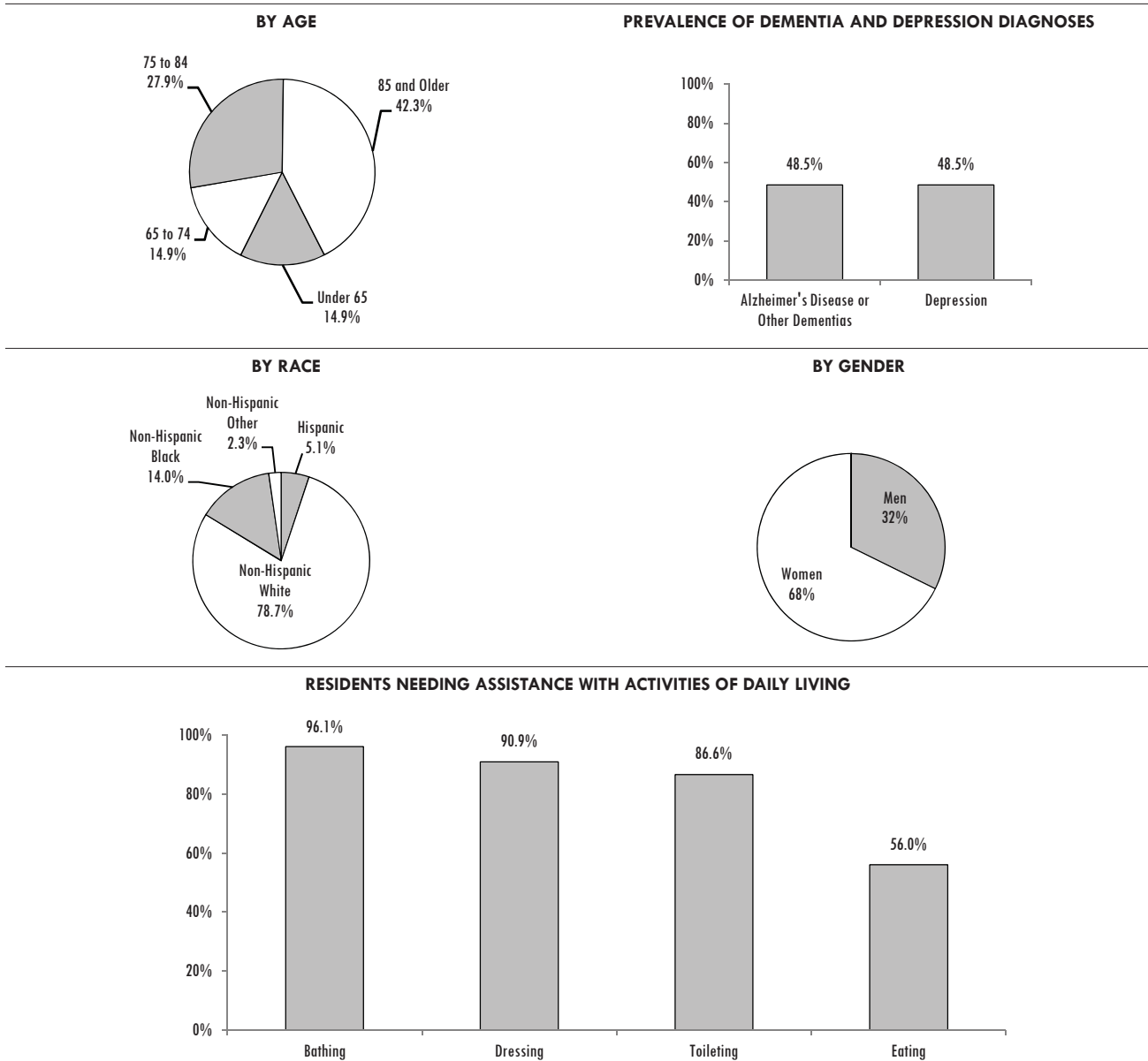
To receive Medicaid nursing facility services in Texas, a person must live in a Medicaid-certified facility for 30 consecutive days; be eligible for Supplemental Security Income (SSI) or be determined by the Texas Health and Human Services Commission (HHSC) to be financially eligible; and meet medical necessity requirements.

RESIDENT COMPLAINT REPORTING OPTIONS

Historically, all Texas nursing facility residents reported complaints to the Office of the Long-term Care Ombudsman at the Texas Department of Aging and Disability Services (DADS). Beginning March 1, 2015, nursing facility services will be included in Medicaid managed care services. Because HHSC administers state Medicaid managed care health services, Medicaid beneficiaries receiving nursing facility care will also be able to report complaints to HHSC's Office of the Ombudsman. For purposes of this report, a complaint is defined as an expression, either spoken or written, of dissatisfaction about an issue affecting a resident's quality of care or quality of life that is not related to abuse, neglect, or exploitation. **Figure 2** shows the various entities nursing facility residents may contact to resolve a complaint.

The Office of the Long-term Care Ombudsman at DADS advocates for residents of nursing facilities, board and care

**FIGURE 1
NATIONWIDE DEMOGRAPHIC CHARACTERISTICS OF NURSING FACILITY RESIDENTS, CALENDAR YEAR 2012**



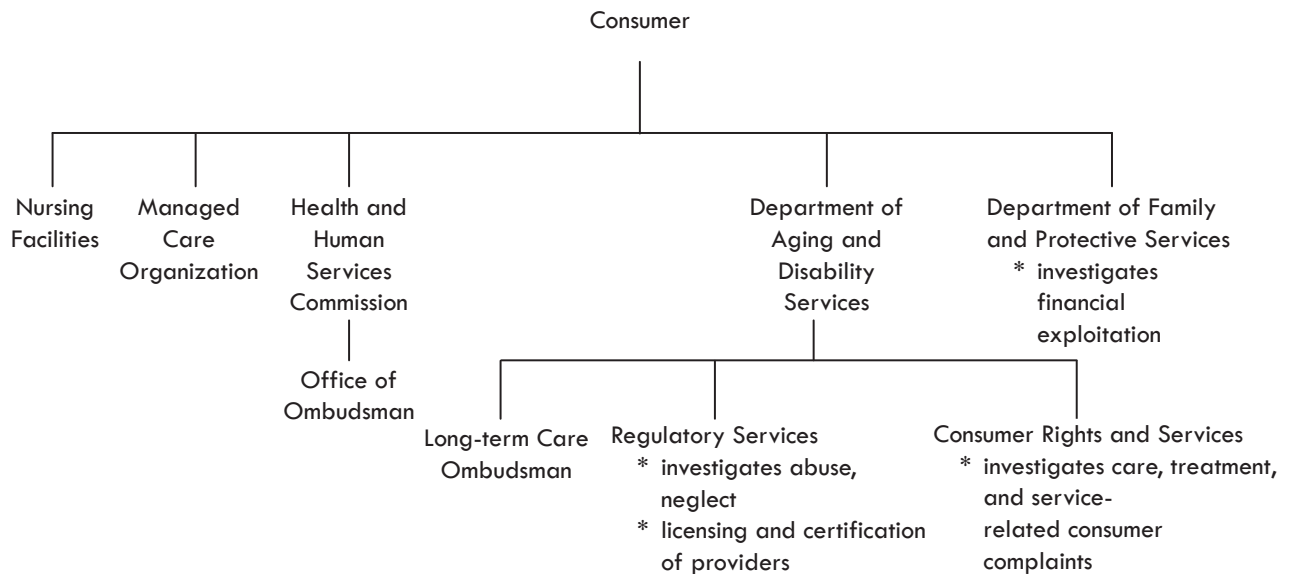
SOURCE: National Center for Health Statistics.

homes, and assisted living facilities. It is a federally mandated program authorized under amendments to the Older Americans Act in 1978. To receive federal funds, states must establish and operate an Office of the State Long Term Care Ombudsman and employ an individual to be known as the state Long Term Care Ombudsman to oversee the office and its responsibilities. The DADS Office of the Long-term Care (LTC) Ombudsman employs 74 full-time-equivalent (FTE) positions (6.0 in the state office, and 68.0 in the regions) and oversees more than 600 volunteers. The office's annual

budget is \$4.9 million as of fiscal year 2014. The office is primarily funded with Federal Funds (82 percent) through the Older American Act, and the remaining funding (18 percent) is provided from state General Revenue Funds.

State office staff support operations and develop systemic approaches to problems, but do not directly serve residents living in facilities. Volunteers and paid staff work across the state through the local offices of the Area Agencies on Aging. Volunteers and staff are trained as ombudsman to work with

**FIGURE 2
TEXAS ENTITIES RECEIVING NURSING FACILITY RESIDENT COMPLAINTS, FISCAL YEAR 2013**



SOURCE: Legislative Budget Board

and assist nursing facility residents to resolve their concerns. To be a trained ombudsman, volunteers receive 30 hours of training and complete a three-month internship. Once trained, ombudsman must complete 12 hours of continuing education annually. The training emphasizes the importance of meeting with nursing facility residents in person. Ombudsman staff and volunteers strive to visit every Texas nursing facility on a monthly or quarterly basis, as resources allow.

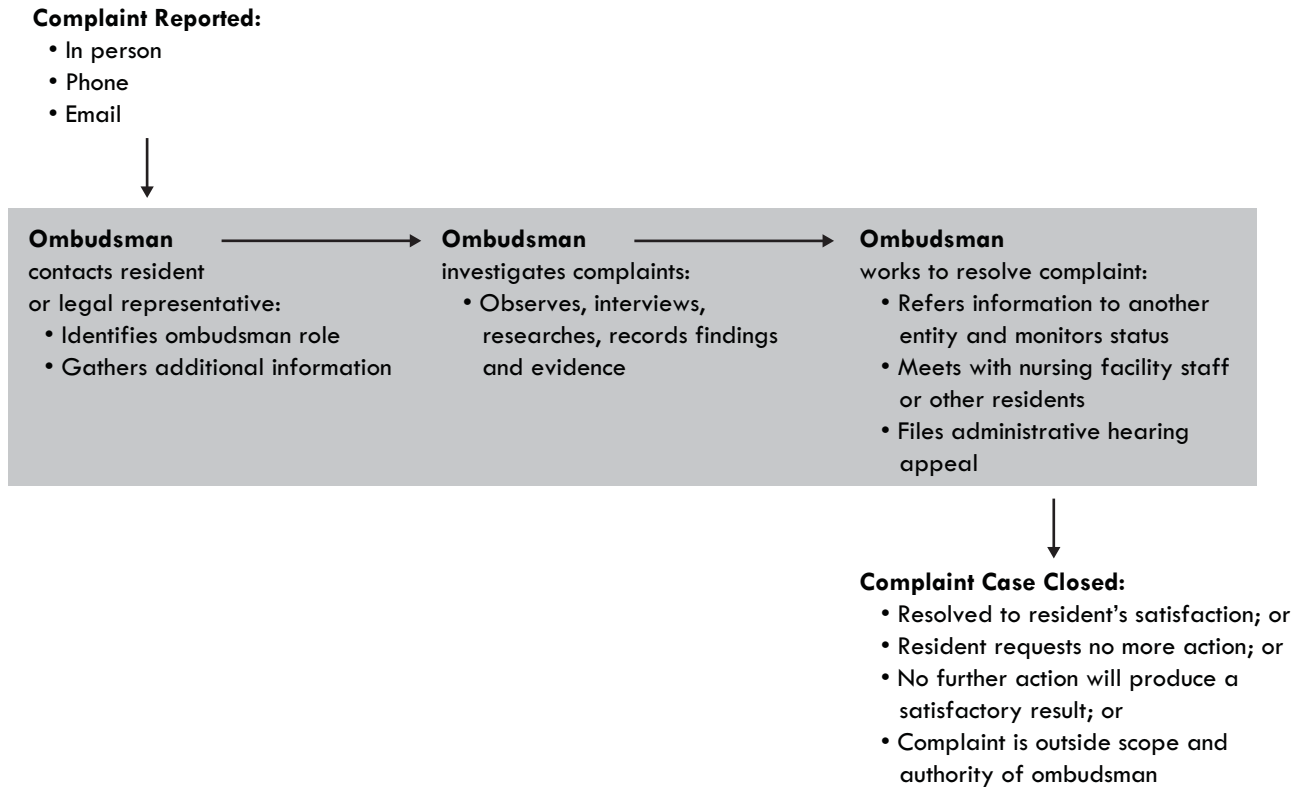
Complaints may be reported to the Office of the LTC Ombudsman when an ombudsman visits a nursing facility or via email or telephone. The person reporting the complaint is informed about the ombudsman’s role as a resident advocate, and the ombudsman may gather additional information regarding the complaint, if necessary. If the complaint is related to a regulatory violation, information about how to contact DADS Consumer Rights and Services is provided to the resident, the complainant, or their legally authorized representative (LAR). Regardless of the source of a complaint, the ombudsman represents and follows the wishes of the nursing facility resident. The ombudsman contacts the person with the complaint within two business days or sooner if circumstances dictate.

The ombudsman investigates the complaint to determine the facts and gather relevant information and evidence to understand what to address and how to resolve the issues.

Verification of a complaint occurs when the ombudsman determines through interviews, observations, consultations, and/or record inspection that circumstances described in the complaint exist or are generally accurate. After a complaint is verified the ombudsman attempts to resolve the complaint to the satisfaction of the resident. If a resolution requires referral to another agency with jurisdiction or expertise to resolve the complaint, the resident’s permission to share information is requested. External entities for which a referral may be appropriate are: legal services, regulatory agencies, or a managed care organization (MCO) service coordinator or other MCO representative. A complaint is closed when an ombudsman’s follow up work indicates that no further action on a complaint is needed and a disposition of the case is determined. **Figure 3** shows the current complaint process for issues reported to the Office of the LTC Ombudsman.

The Office of the LTC Ombudsman also addresses complaints of assisted living facility residents with the enactment of Senate Bill 1318, Eightieth Legislature, 2007. This legislation requires the office to issue an annual report about findings relating to the problems and complaints of residents and recommend policy, regulatory, and legislative changes to improve the quality of care and complaint resolution processes. The report is not statutorily required to provide analysis of complaint reporting or identification of trends. According to its annual report for fiscal years 2011 and 2012 combined, the Office of the LTC Ombudsman received

**FIGURE 3
PROCESS FOR REPORTING A NURSING FACILITY COMPLAINT TO LONG-TERM CARE OMBUDSMAN, FISCAL YEAR 2014**



SOURCE: Department of Aging and Disability Services.

more than 33,000 complaints; more than 90 percent were verified by an ombudsman. The top 10 most frequent complaints are shown in **Figure 4**.

FAIR HEARINGS APPEALS

The Office of the LTC Ombudsman assists nursing facility residents navigating an appeal through the fair hearing process. Medicaid beneficiaries who have had a service denied, reduced, or terminated by HHSC or a MCO may appeal the decision by requesting a fair hearing from HHSC. A fair hearing is an informal proceeding held before a neutral HHSC hearings officer in which a beneficiary appeals, or formally challenges, an HHSC or MCO decision. A beneficiary who believes and demonstrates that a delay in receiving a Medicaid fair hearing could seriously put his or her life or health at risk may request an expedited fair hearing. However, Medicaid clients receiving services through a MCO must exhaust their MCO's expedited appeal process before making a request for an expedited fair hearing from HHSC.

**FIGURE 4
TOP 10 RESIDENT COMPLAINTS REPORTED TO THE LONG-TERM CARE OMBUDSMAN FISCAL YEARS 2011 TO 2012**

COMPLAINT	TOTAL
Failure to respond to requests for help, including call light	2,682
Food service: quantity, quality, variation, or choice	2,036
Dignity, respect, or poor staff attitudes	1,549
Building cleanliness, pests, or housekeeping	1,442
Personal hygiene: nail and oral care, dressing and grooming	1,299
Equipment or building: disrepair, hazard, or fire safety	1,291
Symptoms unattended or unnoticed	1,275
Medication: administration or organization	1,229
Odors	953
Resident unable to exercise choice or preference	939

SOURCE: Department of Aging and Disability Services.

HEALTH AND HUMAN SERVICES COMMISSION OMBUDSMAN

Another state-operated ombudsman program is overseen by HHSC, the state Medicaid agency. The HHSC Office of the Ombudsman, established in 2003 through statute, helps consumers resolve complaints pertaining to health and human service programs administered by the commission. HHSC ombudsmen conduct independent reviews of complaints regarding commission policy or practices, ensure policies and practices are consistent with the commission's goals, and ensure individuals are treated fairly and respectfully. For consumer issues related to Medicaid managed care services, HHSC operates the Medicaid Managed Care Helpline. The helpline is designed to help people who have Medicaid coverage but need help accessing services. Complaints received via the helpline are resolved by ombudsman staff. Information provided via the helpline includes: benefit coverage, how to access services, and referral assistance.

The HHSC Office of the Ombudsman employs 66 FTE positions, who work in four organizational areas. These areas are:

- the Hotline staff whose responsibilities include managing a telephone hotline to respond to general questions and complaints about HHSC programs;
- the Medicaid Managed Care Helpline staff who coordinate resolutions of complaints with MCOs and respond to inquiries;
- the Special Services staff who perform complex complaint resolution; and
- the Operations and Reporting staff who provide administrative support, analysis, and quality assurance.

The HHSC Office of the Ombudsman 2014–15 biennial budget of \$5.7 million is funded with Federal Funds, General Revenue Funds, and Other Funds. Unlike the DADS Office of the LTC Ombudsman staff who meet in-person with nursing facility residents about their complaint, HHSC Office of the Ombudsman staff assist consumers through phone calls and correspondence. At present, the HHSC Office of the Ombudsman refers persons with a nursing facility complaint to the DADS Office of the LTC Ombudsman.

The HHSC Office of the Ombudsman receives consumer complaints relating to services provided by Medicaid MCOs

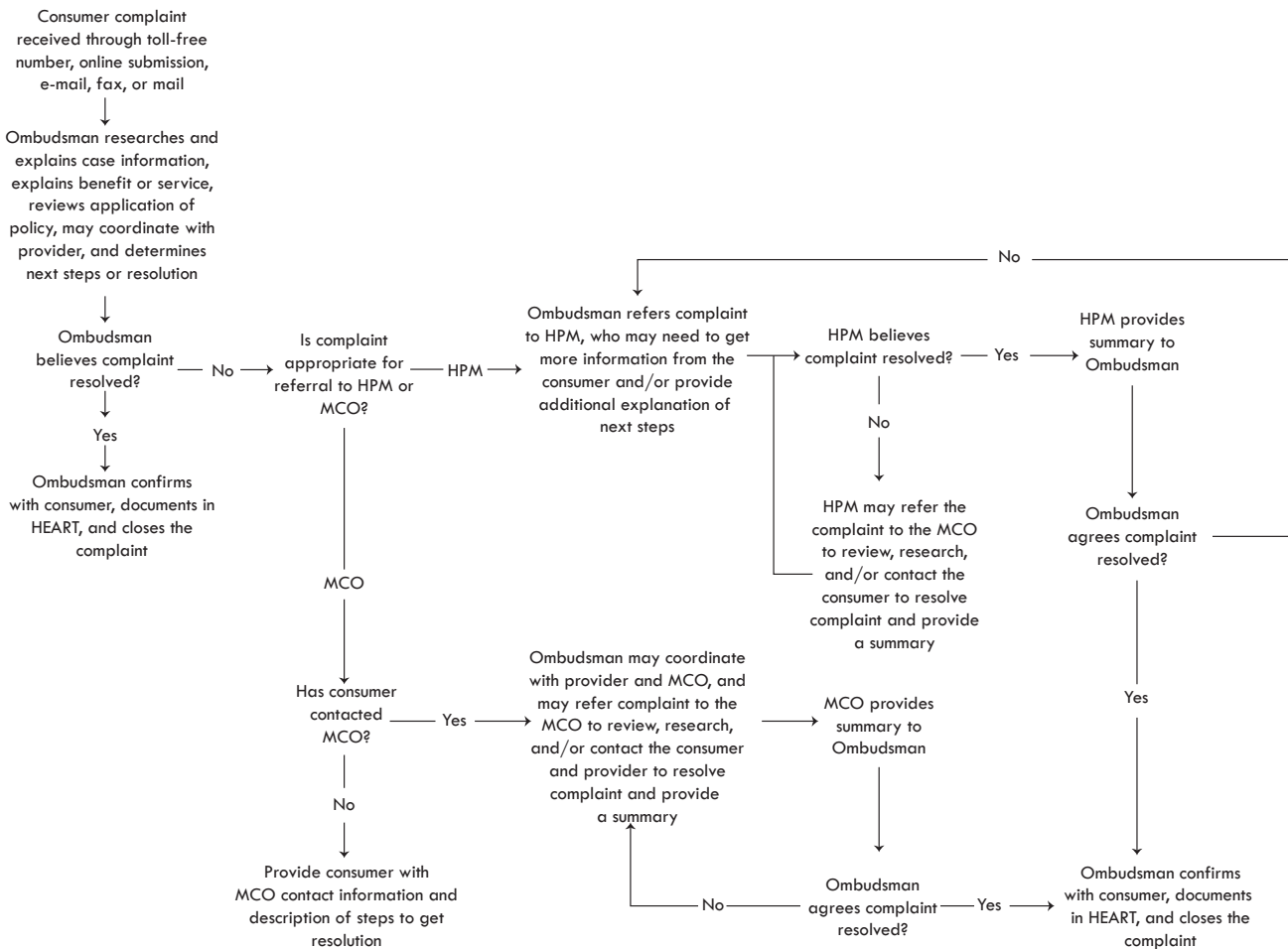
through a toll-free number, online submission, email, fax, or mail. If the HHSC Office of the Ombudsman is not able to resolve a complaint, it is referred to the appropriate MCO or the Health Plan Management (HPM) division in HHSC. HPM is responsible for monitoring MCOs' compliance with the managed care contracts; the Uniform Managed Care Manual; the Texas Government Code, Chapter 533; and the Texas Administrative Code, Chapter 353. HPM's primary activities include monitoring service delivery, collecting information about provider networks and their capacity, claims processing, marketing, and other administrative requirements. If HPM is not able to resolve an issue, the complaint may be referred to the appropriate MCO, or the ombudsman may coordinate with the provider, the MCO, and the consumer to resolve the complaint. To comply with the Texas Government Code, Section 531.0213(d), the HHSC Office of the Ombudsman internally provides quarterly reports to HPM staff that identify the number of calls received, trends in delivery and access problems, recurring barriers in the Medicaid system, and other problems identified with Medicaid managed care. Despite collecting complaint data about managed care services, the HHSC Office of the Ombudsman does not disseminate this information to external parties such as consumers and advocates. **Figure 5** shows the process the HHSC Office of the Ombudsman uses to manage a consumer complaint.

The Medicaid STAR and STAR+PLUS programs are healthcare programs in which eligible individuals and families receive healthcare services through a MCO. More than 8,000 complaints related to the Medicaid STAR and STAR+PLUS programs were reported to the HHSC Office of the Ombudsman in fiscal years 2011 and 2012. A complaint is substantiated when HHSC staff research and determine that HHSC policy was violated or expectations were not met. The average substantiation rate for complaints received in fiscal years 2011 and 2012 was 25 percent for the STAR program and 23 percent for the STAR+PLUS program. **Figure 6** shows the top 10 most frequent consumer complaints the HHSC Office of the Ombudsman received for fiscal years 2011 and 2012 for the STAR and STAR+PLUS Medicaid managed healthcare programs.

ADDITION OF NURSING FACILITY SERVICES TO MEDICAID MANAGED CARE

An increasing number of states have added long-term care services and supports (LTSS) into their Medicaid managed care programs. According to the U.S. Health and Human Services Department, from 2004 to 2012 the number of

**FIGURE 5
PROCESS FOR REPORTING A MANAGED CARE COMPLAINT TO THE HEALTH AND HUMAN SERVICES COMMISSION
OMBUDSMAN, FISCAL YEAR 2014**



NOTE: HEART = Health and Human Services Enterprise Administration Report Tracking system.
SOURCE: Health and Human Services Commission.

states with Medicaid managed LTSS programs doubled from 8 to 16, and 10 more states were scheduled to add LTSS to their Medicaid managed care programs in 2014.

Moving from a fee-for-service model to a managed care model for LTSS services has implications for entities that provide these services, such as nursing facilities and providers of home and community-based services, and for Medicaid enrollees. Under a fee-for-service model, LTSS providers contracted directly with state or local governments, received referrals for new clients from these governmental agencies, and were paid for services through state Medicaid claims processing systems. In a managed care model, LTSS providers (e.g., nursing facilities) are required to negotiate contracts

with the managed care organizations selected by the state to operate their Medicaid programs

The enactment of Senate Bill 7, Eighty-third Legislature, Regular Session, 2013, added nursing facility services to the STAR+PLUS Medicaid managed care program. The STAR+PLUS program is a Texas Medicaid managed care program for people who have disabilities or are age 65 or older. People in STAR+PLUS receive Medicaid healthcare and LTSS through a medical plan that they choose. This change will be effective for nursing facility services beginning March 1, 2015.

With this change, a MCO-related complaint will first be addressed by a resident’s MCO service coordinator. An MCO service coordinator is an individual assigned to a

**FIGURE 6
TOP 10 MOST FREQUENTLY REPORTED CONSUMER
COMPLAINTS FOR THE STAR AND STAR+PLUS PROGRAMS
FISCAL YEARS 2011 TO 2012**

COMPLAINT	TOTAL
STAR Medicaid Program	
Case Information Error	804
Access to Prescription	769
Medicaid Card	754
Client Billing	325
Third-Party Resources (Other Insurance)	296
Ineffective Communication or Guidance	212
Access to Provider	185
Application/Case Denied	165
Access to Transportation	97
Authorization Process/Denial	82
STAR+PLUS Medicaid Program	
Access to Prescription	707
Case Information Error	410
Medicaid Card	409
Access to Transportation	291
Client Billing	247
Access to Provider	285
Access to Care Coordination	193
Ineffective Communication/Guidance	192
Access to Long-term Services	133
Access to Durable Medical Equipment (DME)	120

SOURCE: Health and Human Services Commission.

nursing facility resident to support the care the resident receives at the facility. Service coordinators will have key responsibilities for a resident’s care, such as approving or disapproving add-on services (e.g., rehabilitative therapies, emergency dental services, customized power wheelchairs, and audio communication devices) for residents. All nursing facility residents will be assigned a service coordinator. The service coordinators will be required to visit their assigned members no less than quarterly; however, no ratio of coordinators to residents has been established by HHSC or MCOs. According to HHSC, MCO service coordinators will play a vital role in the delivery of services and ensuring nursing facility residents’ complaints are addressed. Complaints not resolved by a service coordinator will be directed to various MCO Consumer Hotline numbers, depending on the nature, severity, and urgency of the complaint.

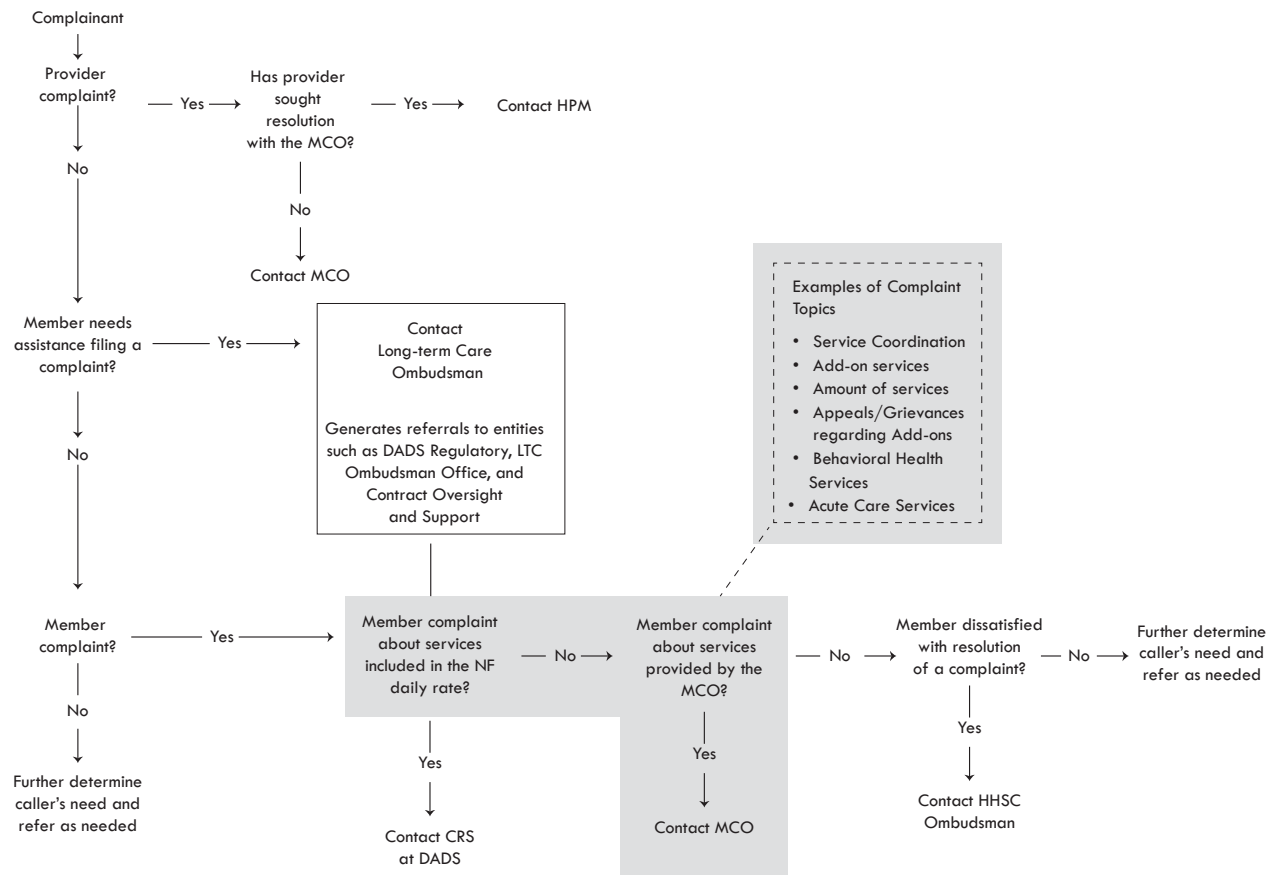
Using a MCO to provide LTSS adds complexity to the resident complaint reporting process and another layer between the state and nursing facility residents which may be challenging to navigate. In the proposed new process, the nature of the complaint will dictate which entity will receive and work to resolve it. Nursing facility resident complaints regarding a MCO service or service coordination would be reported to the MCO. Complaints about the nursing facility itself would be reported to DADS. However, nursing facility residents may not easily distinguish whether the source of their complaint is the nursing facility or the MCO. According to the Office of the LTC Ombudsman, examples of some anticipated complaints resulting from the switch to a managed care model may include loss of providers and the loss or difficulty in obtaining add-on services (i.e., services provided in the nursing facility but not included in the daily rate). **Figure 7** shows the process HHSC is proposing, as of October 2014, for how the HHSC Office of the Ombudsman will manage nursing facility resident complaints after March 1, 2015. The highlighted area in the figure represents the new layer managed care adds to the complaint reporting process for nursing facility residents.

COORDINATION AMONG STATE AGENCIES NEEDED FOR NURSING FACILITY RESIDENT COMPLAINT DATA

Reporting processes for consumer complaints of all health and human services may be affected by the Eighty-fourth Legislature’s consideration of Sunset Advisory Commission (SAC) staff recommendations for these agencies. In October 2014, SAC staff found the HHSC Office of the Ombudsman lacks basic authority and clear guidelines needed to identify problems through accurate complaints data. SAC staff recommended clarifying the role and authority of the HHSC Office of the Ombudsman as a point of escalation for complaints throughout the health and human services system and of collection of standard complaint information.

HHSC and DADS have met to discuss process changes that may occur as a result of nursing facility services added to Medicaid managed care; however, there are no formal plans for an ongoing exchange of information about nursing facility resident complaint data. Identifying one state entity to coordinate and track nursing facility complaint data regardless of payer is the first step to ensuring an organized structure that will allow for data analysis of reported complaints. Recommendation 1 would include a rider in the introduced 2016–17 General Appropriations Bill to designate the Office of the LTC Ombudsman as the state entity responsible for coordinating, collecting, monitoring,

**FIGURE 7
PROPOSED PROCESS FOR REPORTING NURSING FACILITY RESIDENT COMPLAINTS TO THE HEALTH AND HUMAN SERVICES COMMISSION, AS OF OCTOBER 2014**



NOTES:

- (1) This process would take effect March 1, 2015.
- (2) The highlighted area represents the addition of managed care to the complaint reporting process for nursing facility residents.
- (3) CRS = Consumer Rights and Services; HPM = Health Plan Management; NF = nursing facility; LTC = long-term care; MCO = Managed Care Organization; DADS = Department of Aging and Disability Services.

SOURCE: Health and Human Services Commission.

and analyzing data about all nursing facility resident complaints regardless of payer.

The mission of the Office of the LTC Ombudsman is federally mandated and funded. One of the primary functions of an ombudsman program is to be an unbiased entity that investigates concerns regarding the operation of a program to improve it. This responsibility includes identifying opportunities for the program to improve the accountability and transparency of its operations and to allow stakeholders to voice their concerns without fear of retaliation. It is important for the ombudsman function to remain independent from the function that oversees nursing facility services. This separation ensures ombudsmen are objective, and all nursing facility residents' complaints are

coordinated and addressed. If the Legislature chose to adopt the SAC staff recommendations to consolidate the health and human services agencies, it would still need an independent entity to investigate consumer complaints in nursing facilities across all payers. This could be done as part of a consolidated ombudsman office.

The rider proposed under Recommendation 1 would also direct the Office of the LTC Ombudsman to include in its annual report information or other metrics about the quality of services in nursing facilities that will allow stakeholders to monitor and compare MCOs performance related to service delivery and complaint resolution. In-depth analysis of complaint data could illustrate how efficient and effective managed care is working in this new setting.

Nursing facility resident complaint reporting will be decentralized with the switch to managed care. When nursing facility services were provided under a fee-for-service model, the DADS LTC Office of the Ombudsman was the sole entity managing complaints related to nursing facilities. However, once Medicaid MCOs begin to provide nursing facility services, two state entities (HHSC and DADS) and MCOs will receive nursing facility resident complaints. Without coordination or tracking, the complaints reported to these different entities may be duplicated, go unresolved, or result in multiple entities engaging in similar work. Therefore, establishing a process for HHSC and DADS to communicate and share information about complaint data reported by residents and MCOs is central to ensuring complaints are resolved. This will also help maximize efficiency and ensure opportunities to implement continuous quality improvement practices are recognized. Recommendation 2 would include a rider in the introduced 2016–17 General Appropriations Bill to require HHSC and DADS to form an interagency workgroup to determine standard definitions for Medicaid managed care complaint data and develop a process for nursing home complaint data to be shared across the health and human services enterprise.

Current reporting requirements do not require Medicaid MCOs to report consumer complaints and issues to the state in a sufficiently detailed manner for trend identification and analysis. MCOs report complaints in aggregate and in high level categories such as quality of care, plan administration, claims processing, and enrollee services. They do not include more specificity about the complaints. Without detailed data regarding the types of issues raised by managed care beneficiaries, critical trends about service delivery, such as maintaining an adequate provider network and access to ancillary services, as well as quality issues, will likely remain unidentified and opportunities to implement continuous quality improvement strategies will be missed. Recommendation 3 would include a rider in the introduced 2016–17 General Appropriations Bill to direct HHSC to collect certain consumer complaint information and data from Medicaid MCOs and to share it with the Office of the LTC Ombudsman so it could be used to implement continuous quality improvement efforts. Recommendations 2 and 3 are consistent with and would augment SAC staff recommendations that the HHSC Office of the Ombudsman collect standard complaint information from all system agencies.

The HHSC Office of the Ombudsman does not disseminate consumer complaint information to external parties such as consumers and advocates. This limits consumers and advocates' ability to make more informed health care choices and to promote systemic changes, respectively. Disseminating consumer complaint information to advisory councils, such as the Health and Human Services Council, could improve service quality because the council regularly makes recommendations regarding the management and operations of HHSC. Regularly distributing information to more external audiences would be another method for the HHSC Office of the Ombudsman to fulfill its statutorily required consumer protection function as required by the Texas Government Code, Sections 531.008 and 531.011. Recommendation 4 would include a rider in the introduced 2016–17 General Appropriations Bill to require the HHSC Office of the Ombudsman to report certain consumer complaint data no less than annually to the HHSC executive commissioner, the Health and Human Services Council, and consumers of the respective health and human services programs from which complaint data is collected. This recommendation would provide enrollees of STAR and STAR+PLUS managed care programs not receiving nursing facility services with comparable information about an MCO's complaint resolution performance that the Office of the LTC Ombudsman will provide to persons receiving nursing facility services per Recommendation 1. It would also ensure that issues and emerging trends in the delivery of managed care services that could affect nursing facility residents are identified.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would not have a significant fiscal impact in the 2016–17 biennium. Recommendation 1 would designate the Office of the LTC Ombudsman as the state entity responsible for maintaining data about nursing facility resident complaints regardless of the payer and direct the LTC Ombudsman to identify nursing facility resident complaint trends and recommend systemic changes based on the data.

Recommendation 2 would establish an interagency workgroup between DADS and HHSC to facilitate the regular exchange of nursing facility managed care complaint data and identify standard definitions to be used between the two agencies for the shared data. There would be no fiscal impact to implement this recommendation because it relates to existing activities at the agencies.

Recommendation 3 would have no fiscal impact because it directs HHSC to collect certain consumer complaint information from Medicaid MCOs and to share it with DADS. It is assumed because HHSC already receives MCO complaint data that they could request more specific information from the MCOs regarding all consumer complaint data, not solely nursing facility residents.

Recommendation 4 would require the HHSC Ombudsman to report certain consumer complaint data no less than annually to the HHSC executive commissioner, the Health and Human Services Council and to consumers of the respective health and human service programs. It is assumed HHSC could distribute consumer complaint data to respective health program beneficiaries in scheduled mailings that would also include annual or updated health program information. It is assumed HHSC could produce and distribute this information within existing agency resources because the agency already mails information to beneficiaries regularly.

The introduced 2016–17 General Appropriations Bill includes a rider to implement Recommendations 1 to 4.

IMPROVE DATA AND OVERSIGHT TO REDUCE THE PREVALENCE OF EARLY ELECTIVE DELIVERIES OF NEWBORNS

Early elective deliveries of infants occur after 37 but before 39 completed weeks of gestation and are not medically necessary. Nonmedical reasons for an early elective delivery may include wanting to schedule the birth of the infant on a specific date, living far away from a hospital, or relief of discomfort in the last weeks of pregnancy. Early elective deliveries may occur either by induction of labor that results in a vaginal or cesarean delivery, or by a scheduled cesarean delivery. Research has shown that early deliveries without medical or obstetrical indication are linked to maternal and infant complications. Since 1979, the American College of Obstetricians and Gynecologists has promoted a clinical guideline discouraging deliveries before 39 weeks of gestation without medical or obstetrical need.

State health and human service agencies in Texas have implemented strategies to reduce early elective deliveries. However, data sources used by the state to estimate the rate of early elective deliveries have limitations and may over- or underestimate the rate. As a result, it is difficult for the state to evaluate the effects of efforts to reduce these deliveries. In 2014, the Texas Department of State Health Services began disseminating hospital-specific performance data to hospital administrators to educate them about their hospital's performance on early elective deliveries compared to regional and state summary data. However, the agency does not publicly report its summary or facility-level data on these deliveries, due in part to restrictions on the primary data source used to estimate the rate of early elective deliveries. Furthermore, the Texas Health and Human Services Commission does not regularly audit Medicaid claims for early deliveries and may fail to identify provider payments that should be recouped. To improve maternal and infant health outcomes and reduce associated healthcare spending, the state should strengthen efforts to reduce early elective deliveries by improving the quality and reporting of related data and increasing audits of Medicaid claims.

CONCERNS

- ◆ State health and human service agencies in Texas have implemented strategies to reduce early elective deliveries. However, data sources used by the state to estimate the rate of early elective deliveries have methodological limitations and yield different results.

As a result, it is difficult for the state to evaluate the effects of efforts to reduce these deliveries.

- ◆ The Texas Department of State Health Services does not publicly report its summary data on the rate of early elective deliveries. Furthermore, the state cannot publicly report the rate of these deliveries by facility because the primary data source used by the state to estimate this rate is restricted. The state's lack of public reporting limits access to objective information that could promote transparency, accountability, and continuous improvement.
- ◆ The Texas Medicaid program denies payment of physician claims for obstetric delivery procedures before 39 completed weeks of gestation if the procedures are not medically necessary or properly documented. As a result, there is potential for physicians who submit Medicaid claims for these early deliveries to incorrectly report that they were medically indicated. The Texas Health and Human Services Commission does not regularly audit these claims and therefore may fail to identify payments that should be recouped. Managed care organizations participating in the Texas Medicaid program may also perform reviews of these claims and initiate recoupment of funds, but the number and frequency of their reviews varies.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Include a rider in the introduced 2016–17 General Appropriations Bill to require the Texas Department of State Health Services to modify the methodology it uses to estimate the rate of early elective deliveries in Texas to include the use of administrative claims data for all payer types contained in the Texas Health Care Information Collection data combined with birth certificate data.
- ◆ **Recommendation 2:** Include a rider in the introduced 2016–17 General Appropriations Bill to require the Texas Department of State Health Services to annually report on its website state-estimated summary data regarding the rate of elective early deliveries. The rate should be reported by payer type and health service

region, and by facility if allowed by state and federal law.

- ◆ **Recommendation 3:** Include a rider in the introduced 2016–17 General Appropriations Bill to require the Texas Health and Human Services Commission to regularly audit claims submitted in the Texas Medicaid fee-for-service and managed care programs for obstetric delivery procedures that include a modifier indicating that the delivery was medically necessary and before 39 weeks of gestation.
- ◆ **Recommendation 4:** Include a rider in the introduced 2016–17 General Appropriations Bill to require the Texas Health and Human Services Commission, in collaboration with the Texas Department of State Health Services, to evaluate the effectiveness of strategies to reduce early elective deliveries using improved data and audit results and submit a report to the Legislative Budget Board and the Office of the Governor by December 1, 2016.

DISCUSSION

Early elective deliveries (EEDs) of infants occur after 37 but before 39 completed weeks of gestation (i.e., from 37 weeks and 0 days to 38 weeks and 6 days), and are not medically necessary. In this report, the terms elective and nonmedically indicated are used interchangeably. Nonmedical reasons for an EED may include wanting to schedule the birth of the infant on a specific date, living far away from a hospital, or relief of discomfort in the last weeks of pregnancy. EEDs may occur either by induction of labor that results in a vaginal or cesarean delivery, or by a scheduled cesarean delivery. Induction is starting labor with the use of certain drugs or other means. In cesarean deliveries, infants are delivered through incisions made in the mother’s abdomen and uterus.

Research has shown that EEDs without medical or obstetrical indication are linked to maternal and infant complications. Since 1979, the American College of Obstetricians and Gynecologists (ACOG) has promoted a clinical guideline discouraging deliveries before 39 weeks of gestation without medical or obstetrical need. According to ACOG, there are greater reported rates of morbidity and mortality among newborns and infants delivered during the early-term period compared with those delivered at 39 weeks and 40 weeks of gestation. For example, ACOG reports that, among infants delivered at 37 weeks of gestation, regardless of indication, there were higher rates of respiratory failure and ventilator use as compared with infants delivered at 39 weeks of

gestation. **Figure 1** shows the complications that may result from EEDs.

**FIGURE 1
MATERNAL AND INFANT COMPLICATIONS FROM EARLY ELECTIVE DELIVERIES, AS OF FISCAL YEAR 2014**

MATERNAL	INFANT
Labor induction increases the chance of infection, uterine rupture, and hemorrhage	Neonatal mortality
Labor induction may increase the chance of having a cesarean delivery	Breathing problems, including respiratory distress syndrome, transient tachypnea, ventilator use, pneumonia, respiratory failure
Cesarean delivery is associated with increased risk of infection, hemorrhage, and problems related to use of anesthesia	Temperature problems
Repeat cesarean deliveries increase the chance of uterine rupture and medical need for a hysterectomy at the time of delivery	Feeding difficulties
	High levels of bilirubin, which can cause jaundice
	Hypoglycemia
	Hearing and vision problems
	Learning and behavior problems

SOURCE: American College of Obstetricians and Gynecologists.

TEXAS HEALTH AND HUMAN SERVICES AGENCIES’ STRATEGIES TO DECREASE EARLY ELECTIVE DELIVERIES

Improving maternity care practices, such as reducing EEDs, can help address some of the contributing factors to poor maternal and infant health outcomes. Poor outcomes can increase healthcare spending, including spending in the Texas Medicaid program. For example, infant stays in hospital neonatal intensive care units (NICUs) due to complications that may result from EEDs are costly. During each month of fiscal year 2012, approximately one-fourth of newborns enrolled in the Texas Medicaid program required a NICU stay. In fiscal year 2013, the average amount spent per NICU stay by the Texas Medicaid program was \$19,063 in All Funds. In fiscal year 2013, the total amount spent on NICU stays by the Texas Medicaid program was \$419 million in All Funds.

Legislation passed by the Eighty-second Legislature, 2011, required the Texas Health and Human Services Commission (HHSC) to implement quality initiatives to reduce the

number of EEDs performed at hospitals for Medicaid clients before 39 completed weeks of gestation. The legislation also required hospitals that provide obstetrical services to develop quality initiatives, in collaboration with physicians, to reduce the number of EEDs performed at hospitals before 39 completed weeks of gestation.

In response to this legislation, beginning in October 2011, the Texas Medicaid program denies payment of physician claims for labor inductions, cesarean deliveries, or any deliveries following labor induction before 39 completed weeks of gestation if not medically necessary or properly documented. This policy applies to obstetric delivery procedures provided by physicians to Medicaid clients in fee-for-service and managed care. Physicians who bill Medicaid for obstetric delivery procedures are required to include a modifier on claims to indicate whether deliveries are:

- medically necessary and before 39 weeks of gestation (U1);
- at 39 weeks of gestation or later (U2); or
- nonmedically necessary and before 39 weeks of gestation (U3).

Medicaid physician claims without a modifier and those that indicate the delivery was not medically necessary and occurred before 39 weeks of gestation are denied payment. Records are subject to retrospective review by the HHSC Office of Inspector General (OIG). Payments made for deliveries that fail to meet medical necessity criteria, as determined by review of medical documentation, are recouped. Recoupment applies to obstetric delivery procedures provided by physicians and to associated hospital claims. Managed care organizations (MCOs) participating in the Texas Medicaid program may also perform reviews of these claims and initiate recoupment of funds. The Texas Medicaid program has a training module to educate providers about the Texas Medicaid reimbursement criteria for delivery of infants at less than 39 weeks of gestation.

In May 2014, the Texas Department of State Health Services (DSHS) began reporting birth outcomes to hospital administrators through a Web portal on a quarterly basis. The reports contain hospital-specific performance data. Hospitals are able to use these reports to compare their rates to those of Texas overall, public health regions, summary rates of hospitals that show a similar number of births, and other individual de-identified hospitals. The rates are derived from birth certificate data. The goal of the reports is to educate hospitals about their birth outcomes and to help

them identify opportunities to improve those outcomes. The performance measures include: (1) percentage of very low-birth-weight infants; (2) percentage of nonmedically indicated early term deliveries; and (3) primary cesarean delivery rate.

Hospitals with data significantly higher than average may receive additional targeted outreach from the state. DSHS and HHSC have also implemented various strategies to increase awareness among providers and patients about the consequences of EEDs. As part of the Texas Collaborative for Healthy Mothers and Babies, DSHS is also organizing a series of perinatal learning collaboratives with hospitals that will include efforts to reduce EEDs.

STRENGTHEN EFFORTS TO REDUCE EARLY ELECTIVE DELIVERIES

The Texas Health and Human Services Enterprise should strengthen efforts to reduce EEDs by improving data quality and reporting on the prevalence of EEDs and increasing audits of Medicaid claims for early deliveries.

IMPROVE DATA QUALITY AND REPORTING ON THE PREVALENCE OF EARLY ELECTIVE DELIVERIES

The state uses two types of data to estimate the rate of EEDs in Texas: birth certificate data and Medicaid administrative claims data. These data sources have methodological limitations and yield different results. As a result, it is difficult for the state to evaluate the effects of efforts to reduce EEDs. Improving the quality of the data used by the state to estimate the EED rate can help the state target resources toward effective efforts that are intended to reduce these deliveries and ultimately improve maternal and infant health outcomes.

DSHS uses birth certificate data to estimate the rate of EEDs in Texas. The rate includes only deliveries after 37 weeks, but before 39 completed weeks of gestation. As shown in **Figure 2**, according to DSHS's analysis of birth certificate data, there were 82,473 early deliveries in Texas in calendar year 2013. Of these, 29,085, or 35 percent, show no medical indication for early delivery. There were 40,005 early deliveries in the Texas Medicaid program in calendar year 2013. Of these, 13,526, or 34 percent, show no medical indication for early delivery. This data source may overestimate the EED rate because the diagnoses listed on birth certificates are not comprehensive. Maternal diagnoses are variably recorded on birth certificates. As a result, using birth certificate data by itself may not include some reasons

FIGURE 2
STATE-ESTIMATED EARLY ELECTIVE DELIVERIES AMONG TEXAS RESIDENT WOMEN, 2013

DATA SOURCE	ALL PAYERS			MEDICAID		
	TOTAL EARLY DELIVERIES	EARLY ELECTIVE DELIVERIES	PERCENTAGE OF EARLY ELECTIVE DELIVERIES	TOTAL EARLY DELIVERIES	EARLY ELECTIVE DELIVERIES	PERCENTAGE OF EARLY ELECTIVE DELIVERIES
Analysis of birth certificate data	82,473	29,085	35.3%	40,005	13,526	33.8%
Analysis of Medicaid administrative claims data	N/A	N/A	N/A	54,962	50	0.09%

NOTE: Birth certificate data is for calendar year 2013 and Medicaid administrative claims data is for fiscal year 2013. Birth certificate data includes births in Texas hospitals among Texas resident women, while the Medicaid administrative claims data includes births among Texas Medicaid recipients, including some that occurred at non-Texas hospitals. The difference between the total number of early deliveries in Medicaid reported by each data source is partially due to undercounting of Medicaid births in birth certificate data for clients who obtain retroactive Medicaid coverage after hospital discharge. Also, birth certificate data includes only deliveries after 37 but before 39 completed weeks of gestation while the Medicaid claims data includes all deliveries before 39 completed weeks of gestation.

SOURCE: Legislative Budget Board.

that would help explain why an early delivery was actually medically indicated.

HHSC has analyzed Medicaid administrative claims data in fee-for-service and managed care to calculate the number of claims submitted by delivering physicians with the U3 modifier (i.e., nonmedically necessary and less than 39 weeks). Only 50 claims, or .09 percent of total early delivery claims, used the U3 modifier in fiscal year 2013. This data source may underestimate the EED rate because there is financial incentive for billing providers to miscode their claims and incorrectly report that an early elective delivery was medically indicated. This practice also results in providers receiving payment for an EED that is prohibited by Medicaid policy. Although the rate calculated with Medicaid administrative claims data uses a larger total number of early deliveries, the number of these deliveries reported as elective (i.e., 50) is still much smaller than the number reported using birth certificate data.

Data in the Texas Health Care Information Collection (THCIC) could potentially be used by the state in combination with birth certificate data to better estimate the EED rate in Texas. THCIC, which is maintained by DSHS, is a statewide healthcare data collection system that includes healthcare charges, utilization data, provider quality data, and outcome data. All Texas hospitals are required to submit discharge claim data on all discharged inpatients to DSHS. Hospitals are required to submit a minimum data set for all patients for which a discharge claim is submitted, regardless of payer type. The minimum data set includes data elements that could help the state estimate the EED rate, including diagnosis codes and procedure codes. DSHS creates public-use data files that contain certain data elements for each inpatient discharge, including facility name. As a result, it is

possible for EED rates derived from THCIC data to be reported publicly at the facility level.

Recommendation 1 would include a rider in the introduced 2016–17 General Appropriations Bill to require DSHS to modify the methodology it uses to estimate the EED rate in Texas to include the use of administrative claims data for all payer types contained in THCIC data combined with birth certificate data. THCIC has certain limitations, such as the lack of codes for gestational age, which is why birth certificate data would be needed. Although these administrative data sets may omit certain medical indications identifiable only through a medical record review that would explain why an early delivery was medically indicated, this approach would provide a more accurate estimate of the EED rate compared with the state’s current data sources.

DSHS could continue to use its current guidelines for calculating the EED rate, or the agency could use the guidelines for the performance measure required by The Joint Commission (TJC) as part of its reporting requirements for certain accredited hospitals. TJC is an independent, not-for-profit organization that accredits and certifies more than 20,500 healthcare organizations and programs in the United States. The calculation guidelines for the EED measure DSHS uses are from the Collaborative Improvement and Innovation Network (COIIN) project operated by the federal Health Resources and Services Administration. The COIIN project is a collaborative effort involving 19 states, including Texas, to reduce infant mortality and improve birth outcomes, including reducing the EED rate. The EED rate is shared among participating states and national experts, and the rate is used to benchmark progress.

Figure 3 shows a comparison of the performance measure DSHS uses to estimate the EED rate and the measure TJC uses. There are differences in what is included in the numerator and denominator for the two measures and in the data source used. For example, there is some variation between the measures in the specific medical conditions for which a delivery might be excluded from the measure calculation. If DSHS chose to use the measure TJC uses, the agency could adopt the numerator and denominator definitions, but the data source most likely would be limited to administrative claim data in THCIC and birth certificate data. Also, certain medical indications specified by TJC for exclusion from the numerator or denominator calculations might not be included in DSHS's EED rate calculation because the identification of these conditions would require medical record review.

DSHS does not publicly report its summary data on the EED rate. Furthermore, the state cannot publicly report the EED rate by facility because the primary data source used by the state to estimate this rate (i.e., birth certificate data) is restricted. Specifically, the Texas Health and Safety Code prohibits the state from publicly reporting facility-level data sourced from certain sections of a birth certificate. The sections of the birth certificate that are restricted include the items used by the state to evaluate whether an early delivery was medically indicated or elective.

TJC publicly reports performance measurement data for EEDs that it collects from certain accredited hospitals. TJC reports this data at the facility level on its website. TJC's performance system includes measures for elective delivery (PC-01) and cesarean section (PC-02), among others. The Hospital Inpatient Quality Reporting program operated by the federal Centers for Medicare and Medicaid Services (CMS) includes TJC's EED measure PC-01, which is publicly reported for each Medicare-certified hospital on CMS's Hospital Compare website. Hospitals who report designated quality measures to CMS, including their calculated EED rates, receive higher Medicare payment rates. The percentage of pregnant women who had an EED reported by Texas hospitals to CMS's Hospital Inpatient Quality Reporting program is 7 percent. These data sources potentially underestimate the EED rate. The lack of public reporting on the EED rate by the state limits access to objective information that is needed to promote transparency, accountability, and continuous improvement.

To address this concern, Recommendation 2 would include a rider in the introduced 2016–17 General Appropriations Bill to require DSHS to annually report on its website state-estimated summary data on the rate of EEDs by payer type and health service region, and by facility, if allowed by state and federal law. DSHS should take steps to determine whether its calculated EED rate, which should be derived from a combination of THCIC data and birth certificate data, could be publicly reported at the facility level.

**FIGURE 3
COMPARISON OF EARLY ELECTIVE DELIVERY PERFORMANCE MEASURES, FISCAL YEAR 2014**

ENTITY	MEASURE TITLE	NUMERATOR	DENOMINATOR	DATA SOURCE
Texas Department of State Health Services	Nonmedically indicated early term deliveries	Number of nonmedically indicated inductions of labor and cesarean deliveries (without a trial of labor) from gestational ages 37 weeks, 0 days, to 38 weeks, 6 days. Excludes women with certain medical conditions that occur during labor.	Total number of single births from gestational ages 37 weeks, 0 days, to 38 weeks, 6 days. Excludes women with certain medical conditions present before or during pregnancy.	Birth certificate data
The Joint Commission	Elective Delivery: Perinatal Care (PC-01)	Number of elective deliveries as defined by select procedure codes for induction of labor or cesarean delivery while not in active labor. Excludes women with certain medical conditions that occur during labor and with certain medical conditions present before pregnancy.	Number of patients delivering newborns from gestational ages 37 weeks, 0 days, to 38 weeks, 6 days, as defined by select diagnosis codes. Excludes patients with conditions possibly justifying elective delivery before 39 weeks' gestation.	Administrative claims data and medical records

NOTE: The Joint Commission is an independent, not-for-profit organization that accredits and certifies more than 20,500 healthcare organizations and programs in the United States. The DSHS measure includes births in Texas hospitals among Texas resident women.
SOURCE: Legislative Budget Board.

INCREASE AUDITS OF MEDICAID CLAIMS FOR EARLY DELIVERIES

As noted previously, the Texas Medicaid program denies physician claims for obstetric delivery procedures before 39 completed weeks of gestation if the procedures are not medically necessary or properly documented. As a result, physicians who submit Medicaid claims for these early deliveries could potentially report incorrectly that the procedures were medically indicated. In these cases, the state pays for the cost of EEDs through the state share of Medicaid funding, and the EEDs may also contribute to healthcare spending associated with maternal and infant complications that potentially could have been avoided. However, HHSC does not regularly audit these claims and, therefore, may fail to identify payments that should be recouped. OIG audits of Medicaid claims submitted with the U1 modifier (i.e., medically necessary delivery before 39 weeks of gestation) have been limited to a sample of claims submitted in the fee-for-service program during select months in fiscal year 2012. These audits found that the majority of Medicaid fee-for-service claims that were paid for delivery before 39 weeks of gestation had appropriate corresponding medical records to indicate that early delivery was medically necessary. However, it is unclear whether these findings can be generalized to Medicaid managed care and to other years. Of the 207,058 births paid by the Texas Medicaid program in fiscal year 2013, 30 percent (i.e., 61,489) were paid through the fee-for-service system, and 70 percent (i.e., 145,569), were paid by Medicaid MCOs. Furthermore, the number and frequency of reviews of Medicaid physician claims submitted with the U1 modifier by Medicaid MCOs varies. Only 11 of the 19 MCOs report having conducted a retrospective review of these claims.

Recommendation 3 would include a rider in the introduced 2016–17 General Appropriations Bill to require HHSC to regularly audit claims submitted in the Texas Medicaid fee-for-service and managed care programs for certain obstetric delivery procedures. HHSC would be required to audit claims that include a modifier indicating that the delivery was medically necessary and before 39 weeks of gestation. This audit process would ensure that the state recoups any funds paid for EEDs that are not authorized by the Texas Medicaid program.

Recommendation 4 would include a rider in the introduced 2016–17 General Appropriations Bill that would require HHSC, in collaboration with DSHS, to evaluate the effectiveness of strategies to reduce early elective deliveries

using improved data and audit results, and to submit a report to the Legislative Budget Board and the Office of the Governor by December 1, 2016.

FISCAL IMPACT OF THE RECOMMENDATIONS

The recommendations in this report would allow the state to strengthen efforts to reduce EEDs and improve maternal and infant health outcomes. These goals would be accomplished by improving data analysis and reporting on EEDs, and by increasing audits of Medicaid claims for early deliveries. Specifically, Recommendations 1 and 2 would direct DSHS to modify the source of data used to estimate the EED rate in Texas and to annually report this rate publicly. Recommendation 3 would require the HHSC to regularly audit Medicaid claims for certain obstetric delivery procedures. It is estimated that the recommendations would have no significant fiscal impact and could be implemented using existing resources. Funds recouped by HHSC would help offset the cost to conduct additional audits. Recommendation 4 would direct HHSC, in collaboration with DSHS, to evaluate and report on efforts to reduce EEDs. To the extent that the recommendations reduce EEDs in the Texas Medicaid program, and thereby reduce spending related to negative maternal and infant health outcomes that result from these deliveries, there would be savings to the state. For example, Medicaid spending on costly NICU stays could be reduced.

The introduced 2016–17 General Appropriations Bill includes a rider that implements Recommendations 1, 2, 3 and 4.

OVERVIEW OF FAMILY PLANNING SERVICES IN TEXAS

Family planning programs provide low-income women with preventive health screenings and contraceptive services. The federal and state governments have funded family planning services since the 1960s, both for their public health benefits and to help contain pregnancy-related Medicaid costs. Texas provides family planning services through two programs at the Texas Department of State Health Services and the Women's Health Program at the Texas Health and Human Services Commission.

The Women's Health program began operating in 2007. From fiscal years 2010 to 2014, General Revenue Funds expended for the program increased from \$3.4 million to \$30.7 million. The number of clients served by the program decreased from 115,226 in fiscal year 2011 to 85,562 in fiscal year 2013. From fiscal year 2010 to 2014, the amount of General Revenue Funds appropriated for the Texas Department of State Health Service's family planning strategy increased, and Federal Funds decreased. During that period, the number of clients served by the strategy decreased approximately 72.2 percent. This report provides information on the family planning services provided through the Women's Health Program at the Texas Health and Human Services Commission and the Family Planning Services and Community Primary Care Services strategies at the Texas Department of State Health Services.

FACTS AND FINDINGS

- ◆ The family planning programs at the Texas Department of State Health Services and the Texas Health and Human Services Commission help contain Medicaid costs. In fiscal year 2013, pregnancy-related Medicaid services cost the state approximately \$2.4 billion in All Funds, including \$971.0 million in General Revenue Funds.
- ◆ From fiscal years 2010 to 2014, expenditures of General Revenue Funds for family planning services provided through the Texas Health and Human Services Commission's Women's Health Program and the Texas Department of State Health Services's Family Planning and Community Primary Care Services programs have increased approximately \$84.4 million. Federal Funds in the programs have decreased \$71.9 million.

- ◆ The Texas Women's Health Program is estimated to have averted 6,160 pregnancies in fiscal year 2013, resulting in a savings to the state of \$72.0 million in All Funds, including \$29.3 million in General Revenue Funds.
- ◆ Although the Texas Women's Health Program eligibility guidelines exclude some women who would be eligible for Medicaid coverage for a pregnancy, the Texas Department of State Health Services family planning program eligibility level ensures that all women in Texas who would qualify for Medicaid, including Emergency Medicaid, if pregnant can receive pregnancy prevention services.

DISCUSSION

Family planning programs provide low-income women in the U.S. with preventive health screenings and contraceptive services. The federal and state governments have funded family planning services since the 1960s, both for their public health benefits and to help contain Medicaid costs.

The U.S. Food and Drug Administration approved the birth control pill and intrauterine device (IUD) in 1960. Within five years, the pill was the most popular contraceptive device in the country. Research in the 1960s indicated that higher rates of unintended childbearing led to increased poverty, more reliance on public assistance programs, and reduced rates of workforce participation. Data also showed that closely spaced pregnancies could affect a woman's health adversely. In response to these concerns, the U.S. Congress added Title X to the federal Public Health Service Act in 1970. Title X remains the only federal program dedicated solely to the provision of family planning services on a nationwide basis. The federal and state governments also use Medicaid, Medicaid waivers, federal block grants, and state contributions to provide family planning services.

In addition to the family planning services provided to individuals who qualify for Medicaid, the state provides family planning services to other populations through the Family Planning and Community Primary Care Services programs at the Texas Department of State Health Services (DSHS) and through the Women's Health Program at the Texas Health and Human Services Commission (HHSC).

DSHS family planning services have been funded with General Revenue Funds and a variety of Federal Funds, including Title X. The Women’s Health Program was established as a Medicaid waiver funded mostly by the federal government and was later transformed into a state program and renamed the Texas Women’s Health Program.

DSHS and HHSC family planning services include cervical and breast cancer screenings, as well as screenings for diabetes, hypertension, high cholesterol, and sexually transmitted infections. Clients are also offered counseling for a method of contraception, which may include abstinence; natural family planning; short-term prescriptions, such as contraceptive pills or injections; longer-term methods, such as intrauterine devices and subdermal implants; and options for permanent contraception.

Before 2007, when the Women’s Health Program began operating, the DSHS family planning program was the main way low-income women in Texas accessed publicly funded preventive and family planning services. Women who had enrolled in Medicaid following a confirmed pregnancy could also access family planning services during the 60 days of postpartum Medicaid coverage; but at the end of those 60 days, most women lost eligibility for all Medicaid benefits, including family planning. In its 2006 waiver proposal to the federal Centers for Medicare and Medicaid Services (CMS), HHSC noted that DSHS family planning services could support only about 25 percent of women in need of publicly funded family planning and related preventive services. The unmet need, according to the agency, resulted in higher birth rates among low-income women.

PREGNANCY-RELATED MEDICAID COSTS

In addition to their public health benefits, the DSHS and HHSC programs help contain pregnancy-related Medicaid costs, which were \$2.4 billion in All Funds in fiscal year 2013. Costs in the Medicaid program for pregnant women include the costs of prenatal care, labor and delivery,

postpartum care, and acute care services not related to the pregnancy. Emergency Medicaid, pursuant to federal law, pays labor and delivery costs for non-U. S. citizens who are pregnant and uninsured. Coverage by both types of Medicaid include the cost of one year of Medicaid coverage for infants.

Figure 1 shows the pregnancy-related Medicaid costs in Texas for fiscal year 2013.

HHSC’s 2006 proposal to CMS to establish the Women’s Health Program credited improved access to contraception with potentially reducing the number of and costs associated with low birth weight and premature deliveries and reducing the number of infant deaths attributable to closely spaced pregnancies. It also noted positive health and budget outcomes from the “simple screenings routinely performed during family planning visits.” For instance, HHSC noted that breast cancer, the second-most common cancer in women, is more successfully treated the earlier it is detected. Likewise, cervical cancer, which typically has no recognizable symptoms until it reaches an advanced stage, typically can be successfully treated when detected early.

WOMEN’S HEALTH PROGRAM

The Medicaid Women’s Health Program (MWHP) was a Medicaid demonstration waiver, meaning it waived some Medicaid eligibility requirements so that women meeting certain criteria could access basic, preventive health screenings and family planning services covered by the Texas Medicaid program. It was established by the Texas Legislature in 2005 and approved by the U.S. Department of Health and Human Services and CMS in December 2006. The waiver was operated by HHSC and applied to uninsured U.S. citizens or documented immigrants who lived in Texas, did not have private health insurance, were between the ages of 18 and 44, and whose income and family size put them below 185 percent of the federal poverty level (FPL). In its waiver request to CMS, HHSC stated that expanding family planning services would help to “reduce the number of

**FIGURE 1
PREGNANCY-RELATED MEDICAID COSTS IN TEXAS, FISCAL YEAR 2013**

COVERAGE	CLIENTS	ALL FUNDS COST	GENERAL REVENUE FUNDS COST	AVERAGE COST PER CLIENT (ALL FUNDS/GENERAL REVENUE FUNDS)
Medicaid (excluding Emergency Medicaid)	154,933	\$1,809,498,673	\$738,094,509	\$11,679 / \$4,764
Emergency Medicaid	52,125	571,644,119	233,173,636	10,967 / 4,473
TOTAL	207,058	\$2,381,142,792	\$971,268,145	\$11,500 / \$4,690

SOURCE: Legislative Budget Board.

unintended pregnancies among low-income women unable to afford counseling, contraception, and services.”

The program’s income eligibility threshold of 185 percent of FPL was meant to include all women who would be eligible for Medicaid coverage of a pregnancy. Because a confirmed pregnancy test increases a potential client’s family size by one, the 185 percent eligibility threshold for MWHP excluded women whose income and family size were above 185 percent but who would be below it with a pregnancy. In 2011, Legislative Budget Board (LBB) staff estimated that approximately 108,000 women in Texas were ineligible for MWHP but eligible to have a pregnancy covered by Medicaid.

Family planning services are less expensive than other Medicaid services, and the state pays a smaller share of the costs. The federal government pays for more than half of Texas’ pregnancy-related Medicaid costs and for 90 percent of the cost of the state’s Medicaid family planning services and supplies. **Figure 2** shows Medicaid Women’s Health Program costs by fund type for fiscal year 2010 through fiscal year 2012, the last full year of the program.

**FIGURE 2
MEDICAID WOMEN’S HEALTH PROGRAM COSTS
FISCAL YEARS 2010 TO 2012**

YEAR	GENERAL REVENUE FUNDS		ALL FUNDS
	FEDERAL FUNDS	FEDERAL FUNDS	
2010	\$3,397,326	\$30,575,931	\$33,973,257
2011	\$3,387,613	\$34,538,519	\$38,376,132
2012	\$3,534,506	\$31,810,555	\$35,345,061

SOURCE: Texas Health and Human Services Commission.

The method which CMS has prescribed for evaluating family planning waivers is to subtract the fertility rate of the women enrolled in the program from a baseline fertility rate. That number multiplied by the number of women enrolled in the waiver program is an estimate of the number of pregnancies averted or delayed as a result of the family planning program. In October 2010, HHSC estimated that MWHP had delayed or averted 5,726 births during 2008, the program’s second year, an estimated savings of \$63.0 million in All Funds, including \$25.0 million in General Revenue Funds. The agency estimated the savings from this reduction, after accounting for program expenditures, to be approximately \$42.4 million in All Funds, including approximately \$16.8 million in General Revenue Funds.

During the 2012–13 biennium, HHSC applied for but did not receive federal approval to continue the MWHP waiver. The waiver was not approved because, pursuant to state law, certain providers were prohibited from participating in the program. As a result, Texas stopped receiving the 90 percent Federal Funds match for the program on January 1, 2013.

For the first four months of fiscal year 2013, the Women’s Health Program was eligible for Federal matching funds. All Funds costs during this time were approximately \$11.5 million, including approximately \$1.1 in General Revenue Funds and \$10.3 in Federal Funds. Following the end of the 90 percent federal match, MWHP was re-configured as the Texas Women’s Health Program (TXWHP) in January 2013. The program’s All Funds budget for the remainder of fiscal year 2013 was approximately \$19.8 million, including \$10.2 million in General Revenue Funds and \$9.6 million in Other Funds. Costs per member, per month were \$23.29 in fiscal year 2012 and \$22.86 in fiscal year 2013. **Figure 3** shows the number of clients served by MWHP and TXWHP from fiscal years 2011 to 2013.

**FIGURE 3
FAMILY PLANNING CLIENTS IN TEXAS SERVED BY THE
WOMEN’S HEALTH PROGRAM
FISCAL YEARS 2011 TO 2013**

YEAR	CLIENTS
2011	115,226
2012	103,671
2013	85,562

NOTE: The Women’s Health Program includes the Medicaid Women’s Health Program (2011 to December 2012) and the Texas Women’s Health Program (January 2013 to the end of fiscal year 2013).

SOURCE: Texas Health and Human Services Commission.

The General Appropriations Act (GAA), 2014–15 Biennium, includes \$71.3 million in General Revenue Funds for TXWHP. The Texas Sunset Advisory Commission (SAC) found that, as of June 2014, the Texas Women’s Health Program had 1,828 physicians or advanced practice nurses delivering services at 1,404 sites.

According to the CMS equation and data provided by HHSC, the TXWHP delayed or averted 6,160 births in fiscal year 2013. These averted births saved the state approximately \$72.0 million in All Funds, including approximately \$29.3 million in General Revenue Funds.

**TEXAS DEPARTMENT OF STATE
HEALTH SERVICES FAMILY PLANNING**

DSHS family planning programs provide the same basic health screenings and contraceptive services as TXWHP. One difference between the HHSC and DSHS family planning programs is that male clients are eligible for services through DSHS. Another is that HHSC's TXWHP has a citizenship requirement that the DSHS program does not. Non-U.S. citizens who are pregnant and remain uninsured would have their pregnancy delivery paid for by Emergency Medicaid, pursuant to federal law. While TXWHP eligibility excludes some women who would be eligible to have pregnancy costs covered by Medicaid, the DSHS eligibility level, 250 percent of FPL, ensures that all women in Texas who would qualify for pregnancy or delivery coverage through Medicaid or Emergency Medicaid can receive preventive services.

Before fiscal year 2011, the DSHS family planning program budget was more than \$100.0 million in All Funds, most of which was Federal Funds. In 2011, funding for the DSHS family planning strategy program was reduced by approximately \$61.7 million in All Funds, including decreases of \$14.9 million in General Revenue Funds and \$46.8 million in Federal Funds. These reductions resulted from a reallocation of funding among health-related programs. **Figure 4** shows the total funding for the DSHS family planning strategy between fiscal years 2008 and 2015.

**FIGURE 4
TEXAS DEPARTMENT OF STATE HEALTH SERVICES FAMILY
PLANNING STRATEGY FUNDING
2008–09 TO 2014–15 BIENNIA**

BIENNIUM	GENERAL REVENUE FUNDS	FEDERAL FUNDS	ALL FUNDS
2008–09	\$16,502,755	\$88,221,657	\$104,868,909
2010–11	\$23,359,775	\$84,269,312	\$111,983,114
2012–13	\$752,052	\$37,126,148	\$37,989,175
2014–15	\$37,798,357	\$5,226,544	\$43,150,668

NOTE: All Funds amounts include Other Funds that are not shown in the figure.

SOURCE: Legislative Budget Board.

The DSHS family planning program has also been affected by riders in the GAA. During the 2006–07 biennium, budget riders: required parental consent for minors who sought contraception; allocated up to \$20.0 million for family planning services provided by Federally Qualified

Health Centers (FQHC); and allocated \$2.0 million for services provided by the Baylor College of Medicine. The GAA, 2008–09 Biennium, included riders that directed the agency to use funds to reimburse providers for services not covered by MWHP, including some testing and treatment for sexually transmitted infections. The riders also required providers that might be affiliated with abortion service providers to maintain legal separation and separate sets of accounting records and to submit to biannual audits by HHSC.

Figure 5 shows All Funds expenditures for DSHS family planning services by provider type for the 2010–11 biennium. These totals include contracted funds only and exclude funds used for program administration.

The GAA, 2012–13 Biennium, included riders that established an appropriation matrix to govern the distribution of family planning funds. The priority order, which expands on a provision in the Government Code, according to the rider, is:

1. public entities that provide family planning services, including state, county, local community health clinics, FQHCs, and clinics operated by the Baylor College of Medicine;
2. non-public entities that provide comprehensive primary and preventive care as part of their family planning services; and
3. non-public entities that provide family planning services but do not provide comprehensive primary and preventive care.

DSHS is directed to use this methodology to the extent that it does not severely limit or eliminate access to services in any region.

Figure 6 shows All Funds expenditures for family planning services by provider type, according to the GAA, 2012–13 Biennium, Rider 77, page II-76, appropriation matrix. The average cost of services was approximately 13.3 percent higher in the 2012–13 biennium than in the 2010–11 biennium. These totals include contracted funds only and exclude funds used for program administration.

Figure 7 shows All Funds expenditures for family planning services according to the appropriation matrix included in the GAA, 2014–15 Biennium, Rider 65, page II-74. These totals include contracted funds only and exclude funds used for program administration. Fiscal year 2014 client counts

FIGURE 5
TEXAS DEPARTMENT OF STATE HEALTH SERVICES FAMILY PLANNING PROGRAM EXPENDITURES IN ALL FUNDS BY PROVIDER TYPE, FISCAL YEARS 2010 TO 2011

APPROPRIATIONS	2010	2011	BIENNIAL TOTAL OR AVERAGE
Allocations for family planning services (excluding FQHC and Baylor College of Medicine funding)	\$40,849,865	\$39,865,947	\$80,715,812
• Unduplicated clients served	177,004	170,046	347,050
• Average cost	\$230.78	\$234.44	\$232.58
FQHC allocations for family planning	\$7,861,897	\$7,793,588	\$15,655,485
• Unduplicated clients served	27,663	26,366	54,029
• Average cost	\$284.20	\$295.59	\$289.76
Baylor College of Medicine allocations for family planning	\$1,689,473	\$1,601,526	\$3,290,999
• Unduplicated clients served	7,313	6,556	13,869
• Average cost	\$231.02	\$244.28	\$237.29
Total family planning allocations	\$50,401,235	\$49,261,061	\$99,662,296
• Unduplicated clients served	211,980	202,968	414,948
• Average cost	\$237.76	\$242.70	\$240.18

NOTES:

- (1) FQHC = Federally Qualified Health Centers.
- (2) Client counts are unduplicated in fiscal years; biennial totals may include clients served in more than one fiscal year.
- (3) Totals exclude funds for program administration.
- (4) Average costs are expenditures divided by unduplicated clients served.

SOURCE: Legislative Budget Board.

FIGURE 6
TEXAS DEPARTMENT OF STATE HEALTH SERVICES FAMILY PLANNING PROGRAM EXPENDITURES IN ALL FUNDS BY PROVIDER TYPE AND RIDER 77 PRIORITY ORDER, FISCAL YEARS 2012 TO 2013

APPROPRIATIONS	2012	2013	BIENNIAL TOTAL OR AVERAGE
Allocations to public entities providing family planning services, including state, county, and local community health clinics (Priority 1)	\$9,319,226	\$6,330,740	\$15,649,966
• Unduplicated clients served	37,490	21,099	58,589
• Average cost	\$248.58	\$300.05	\$267.11
FQHC allocations for family planning (Priority 1)	\$5,659,100	\$3,457,014	\$9,116,114
• Unduplicated clients served	15,889	13,921	29,810
• Average cost	\$356.16	\$248.33	\$305.81
Baylor College of Medicine allocations for family planning (Priority 1)	\$1,199,365	\$1,065,337	\$2,264,702
• Unduplicated clients served	5,381	4,401	9,782
• Average cost	\$222.89	\$242.07	\$231.52
Non-public entities providing comprehensive primary and preventive care (Priority 2)	\$1,618,860	\$1,768,340	\$3,387,200
• Unduplicated clients served	3,330	9,375	12,705
• Average cost	\$486.14	\$188.62	\$266.60

FIGURE 6 (CONTINUED)
TEXAS DEPARTMENT OF STATE HEALTH SERVICES FAMILY PLANNING PROGRAM EXPENDITURES IN ALL FUNDS BY PROVIDER TYPE AND RIDER 77 PRIORITY ORDER, FISCAL YEARS 2012 TO 2013

APPROPRIATIONS	2012	2013	BIENNIAL TOTAL OR AVERAGE
Non-public entities providing family planning services but not comprehensive primary care services (Priority 3)	\$3,327,357	\$0	\$3,327,357
• Unduplicated clients served	13,070	0	13,070
• Average cost	\$254.58	\$0	\$254.58
Total biennial expenditures on family planning services	\$21,123,908	\$12,621,431	\$33,745,339
• Unduplicated clients served	75,160	48,796	123,956
• Average cost	\$281.05	\$258.66	\$272.24

NOTES:

- (1) FQHC = Federally Qualified Health Centers.
- (2) Priority established pursuant to the General Appropriations Act (2012–13 Biennium), Rider 77.
- (3) Client counts are unduplicated in fiscal years; biennial totals may include clients served in more than one fiscal year.
- (4) Totals exclude funds for program administration.
- (5) Average costs are expenditures divided by unduplicated clients served.

SOURCE: Legislative Budget Board.

FIGURE 7
TEXAS DEPARTMENT OF STATE HEALTH SERVICES FAMILY PLANNING PROGRAM EXPENDITURES IN ALL FUNDS BY PROVIDER TYPE AND RIDER 65 PRIORITY ORDER, FISCAL YEARS 2014 TO 2015

APPROPRIATIONS	2014	2015	BIENNIAL TOTAL OR AVERAGE
Allocations to public entities providing family planning services, including state, county, and local community health clinics (Priority 1)	\$10,619,543	\$10,307,698	\$20,927,241
• Unduplicated clients served	20,544	N/A	N/A
• Average cost	\$516.92	N/A	N/A
FQHC appropriations for family planning (Priority 1)	\$5,849,892	\$5,635,516	\$11,484,408
• Unduplicated clients served	22,905	N/A	N/A
• Average cost	\$255.40	N/A	N/A
Baylor College of Medicine allocations for family planning (Priority 1)	\$2,313,230	\$2,171,453	\$4,484,683
• Unduplicated clients served	7,691	N/A	N/A
• Average cost	\$300.77	N/A	N/A
Non-public entities providing comprehensive primary and preventive care (Priority 2)	\$1,446,188	\$1,357,552	\$2,803,740
• Unduplicated clients served	5,739	N/A	N/A
• Average cost	\$251.99	N/A	N/A
Non-public entities providing family planning services but not comprehensive primary care services (Priority 3)	0	0	0
• Unduplicated clients served	0	0	0
• Average cost	0	0	0

FIGURE 7 (CONTINUED)
TEXAS DEPARTMENT OF STATE HEALTH SERVICES FAMILY PLANNING PROGRAM EXPENDITURES IN ALL FUNDS BY PROVIDER TYPE AND RIDER 65 PRIORITY ORDER, FISCAL YEARS 2014 TO 2015

APPROPRIATIONS	2014	2015	BIENNIAL TOTAL OR AVERAGE
Total biennial expenditures on family planning services	\$20,228,853	\$19,472,219	\$39,701,072
• Unduplicated clients served	56,879	65,000	121,879
• Average cost	\$355.65	\$299.57	\$325.74

NOTES:

- (1) FQHC = Federally Qualified Health Centers.
- (2) Priority established pursuant to the General Appropriations Act (2014–15 Biennium), Rider 65, page II-74.
- (3) Fiscal year 2014 client counts are projected. Fiscal year 2015 counts are the strategy's output measures. Client counts are unduplicated in fiscal years; biennial totals may include clients served in more than one fiscal year.
- (4) Totals exclude funds for program administration. Family planning expenditures in the Community Primary Care Services program are excluded.
- (5) Average costs are expenditures divided by unduplicated clients served.

SOURCE: Legislative Budget Board.

are projected, fiscal year 2015 counts are the strategy's output measures.

The GAA, 2014–15 Biennium, Rider 91, page II-79, appropriated \$32.1 million in General Revenue Funds to replace Federal Funds lost when DSHS did not receive Title X funds from the federal government. In addition, biennial appropriations for DSHS's Community Primary Care Services strategy was increased to \$126.4 million from \$21.0 million in the previous biennium. The GAA, 2014–15 Biennium, Rider 89, page II-79, directs the agency to allocate \$50.0 million in each year of the biennium to provide primary healthcare services to women that may include: preventive health screenings, such as for breast and cervical cancers, diabetes, cholesterol, hypertension, and sexually transmitted infections including HIV; family planning services, including contraception; perinatal services; and dental services. DSHS could not provide expenditure data

for family planning services in this strategy because fiscal year 2014 expenditures were not tracked by service type. In fiscal year 2015, according to DSHS, contractors will bill for services on a fee-for-service basis, which will allow tracking of expenditures by service type.

SAC found that, as of June 2014, the DSHS Family Planning program had an unknown number of physicians and advanced practice nurses delivering services at 89 sites. The Community Primary Care Services program had an unknown number of physicians and advanced practice nurses delivering services at a total of 220 sites.

Figure 8 shows funding for the DSHS family planning program. These totals include contracted funds only and exclude funds used for program administration. For the 2012–13 biennium, DSHS combined Federal Funds and non-Federal Funds and awarded contracts to providers that

FIGURE 8
TEXAS DEPARTMENT OF STATE HEALTH SERVICES FAMILY PLANNING PROGRAM FUNDING AND CLIENTS SERVED, FISCAL YEARS 2010 TO 2014

YEAR	GENERAL REVENUE FUNDS	FEDERAL FUNDS	ALL FUNDS	CLIENTS	AVERAGE COST
2010	\$7,648,118	\$42,753,117	\$50,401,235	211,980	\$237.76
2011	\$7,644,713	\$41,616,348	\$49,261,061	202,698	\$242.70
2012	N/A	N/A	\$21,123,908	75,160	\$281.05
2013	N/A	N/A	\$12,621,431	48,796	\$258.66
2014	\$18,285,163	\$1,943,690	\$20,228,853	56,879	\$355.65
PERCENT CHANGE, 2010 TO 2014	139.08%	(95.45%)	(59.86%)	(72.22%)	49.458%

NOTES:

- (1) Totals exclude funds used for program administration.
- (2) Fiscal year 2014 client counts are projected.
- (3) Average costs are expenditures divided by unduplicated clients served.

SOURCE: Legislative Budget Board.

may have included both. Amounts for the 2012–13 biennium are only shown in All Funds. The overall change since fiscal year 2010 is also shown. Family planning expenditures in the Community Primary Care Services strategy are not shown.

Data is not readily available to estimate the effects of the DSHS family planning program in terms of Medicaid cost containment, including savings from averted births.

SUMMARY OF CHANGES

From fiscal years 2010 to 2014, All Funds expenditures for MWHP/TXWHP decreased from \$34.0 million to \$30.7 million. General Revenue expenditures increased from \$3.4 million in fiscal year 2010 to \$30.7 million in fiscal year 2014. According to CMS’s formula and HHSC’s data, the program averted 5,726 births during calendar year 2008, saving the state approximately \$63.0 million in All Funds, including approximately \$25.0 million in General Revenue Funds. During 2013, the program averted 6,160 births, a net savings of \$72.0 million in All Funds, including \$29.3 million in General Revenue Funds. The number of clients served by the program decreased from 115,226 in fiscal year 2011 to 85,562 in fiscal year 2013.

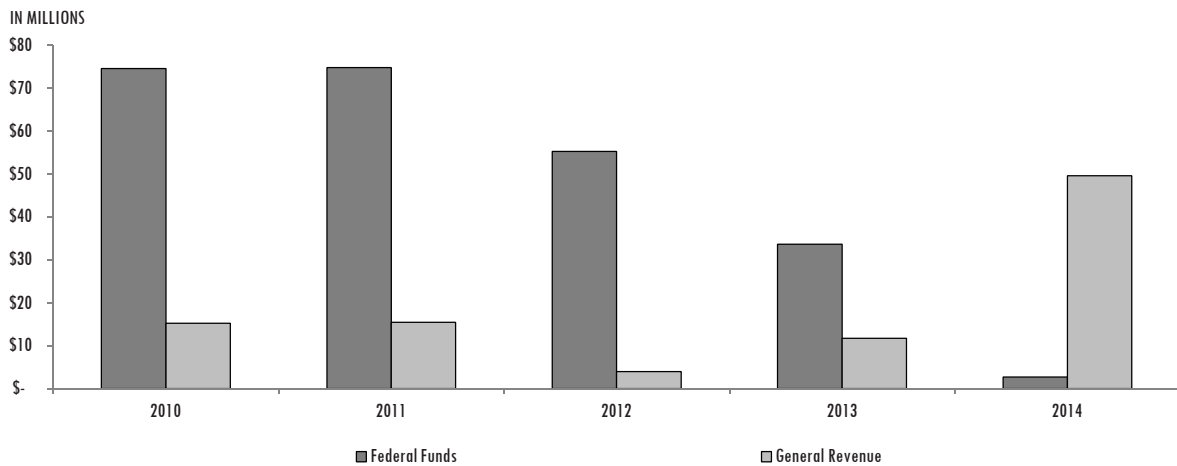
From fiscal years 2010 to 2014, the funding for DSHS family planning program, including program administrative costs, decreased from \$55.9 million in All Funds to \$21.6 million in All Funds. The amount of General Revenue expended increased from \$11.8 million to \$18.8 million. During that period, Federal Funds in the strategy decreased

from \$44.0 million to \$2.7 million. The number of clients served by the family planning strategy decreased from 211,980 to 58,879. The GAA, 2014–15 Biennium, Rider 89, page II-79, allocates \$100.0 million in General Revenue Funds in the Community Primary Health Care Services strategy for women’s health services that include but are not limited to the family planning services provided by TXWHP and DSHS Family Planning Services strategy.

For all family planning spending in the HHSC Women’s Health Program and DSHS family planning program, the net change in General Revenue costs between fiscal years 2010 and 2014 was an increase of approximately \$34.4 million in General Revenue. An additional \$50.0 million for each year of the 2014–15 biennium was allocated to women’s health services, which include but are not limited to family planning, in the Community Primary Care Services program. The net change in Federal Funds for family planning services at both HHSC and DSHS is a decrease of approximately \$71.9 million. Fiscal year 2014 estimates of women served by the Texas Women’s Health Program are not currently available, but the DSHS family planning program projections for fiscal year 2014 are 56,879, a decrease from 211,980 in fiscal year 2010.

Figure 9 shows General Revenue Funds and Federal Funds expenditures for family planning services provided by DSHS and HHSC from fiscal year 2010 to fiscal year 2014.

**FIGURE 9
GENERAL REVENUE FUND AND FEDERAL FUND EXPENDITURES FOR FAMILY PLANNING SERVICES THROUGH THE DEPARTMENT OF STATE HEALTH SERVICES FAMILY PLANNING PROGRAM AND THE MEDICAID- AND TEXAS WOMEN’S HEALTH PROGRAM, FISCAL YEARS 2010 TO 2014**



NOTE: Totals do not include expenditures in the Community Primary Care Services program.
SOURCE: Legislative Budget Board.

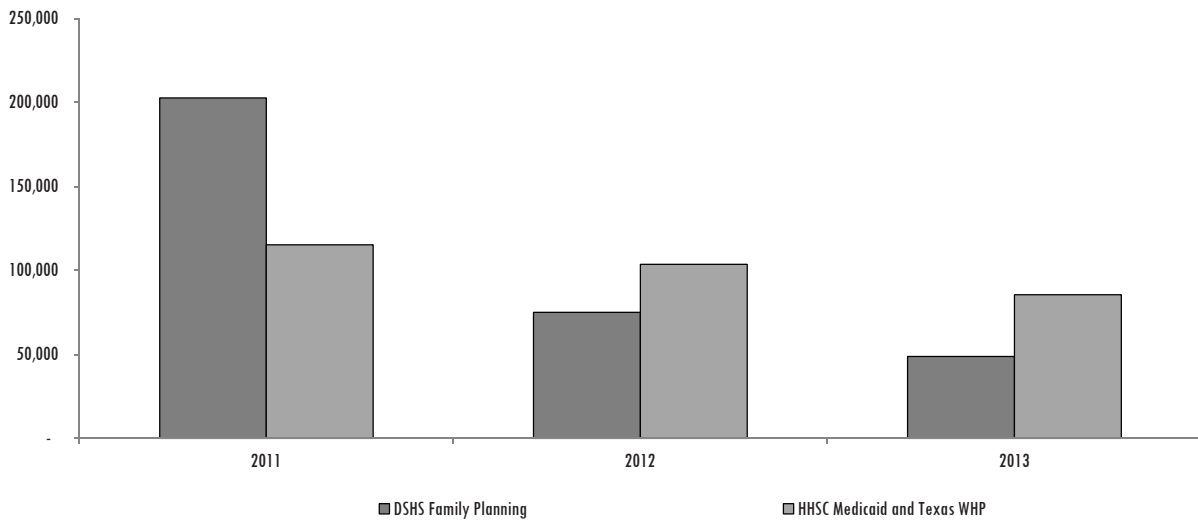
Figure 10 shows the combined unduplicated family planning clients served per fiscal year by the DSHS family planning program, the Medicaid Women’s Health Program, and the Texas Women’s Health Program from fiscal year 2011 to fiscal year 2013.

Funds for its Family Planning Services strategy. This amount includes \$37.8 million in General Revenue Funds and \$5.0 million in Federal Funds. DSHS also requested \$126.8 for its Community Primary Care Services strategy, which includes funding focused on women’s health services, including family planning, breast and cervical cancer services, prenatal services, and other preventive services for women age 18 and older.

LEGISLATIVE APPROPRIATIONS REQUESTS FOR FAMILY PLANNING, 2016–17 BIENNIUM

HHSC’s 2016–17 Legislative Appropriations Request (LAR) includes \$69.3 million in General Revenue Funds for TXWHP. The DSHS LAR includes \$42.9 million in All

**FIGURE 10
FAMILY PLANNING CLIENTS SERVED BY THE DEPARTMENT OF STATE HEALTH SERVICES FAMILY PLANNING PROGRAM AND THE MEDICAID- AND TEXAS WOMEN’S HEALTH PROGRAM, FISCAL YEARS 2011 TO 2013**



NOTE: Totals do not include clients of the Community Primary Care Services program.
SOURCE: Legislative Budget Board.

OVERVIEW OF THE TEXAS JUVENILE JUSTICE DEPARTMENT'S SECURE INSTITUTIONS AND PLACEMENT PROCESS

In 2007, the Texas Legislature began the process of reforming the state's juvenile justice system. The Eightieth Legislature, Regular Session, 2007, mandated a 12:1 youth to staff ratio, prevented misdemeanants from being committed to the state's care, amended the age limit of commitment eligible youth to age 19, established consistent assessment of youth risk and needs at orientation, and made placing juvenile offenders close to home a priority. These policy changes significantly reduced the state's juvenile correctional population and, as a result, the state has closed multiple facilities and redirected resources to county-based juvenile probation departments.

Legislative requirements; the quality, condition, number, and geographic distribution of facilities; and institutional capacity all influence how the Texas Juvenile Justice Department uses its secure institutional space to achieve its mission to create a safer Texas through the establishment of a continuum of services that promotes positive youth outcomes. The following is a summary of the Texas Juvenile Justice Department's secure institutions and placement process.

FACTS AND FINDINGS

- ◆ Responsibility for the Texas juvenile justice system is shared by the state and local governments. Counties provide probation services and the state operates a system of five secure institutions, and owns another that is not operational.
- ◆ New commitments to the Texas Juvenile Justice Department decreased 70 percent from fiscal years 2006 to 2013.
- ◆ As of September 2014, the Texas Juvenile Justice Department had 1,174 permanent assignment beds on-line. These are beds that are currently available to assign to youth.
- ◆ The Texas Juvenile Justice Department considers offense severity, youth risk level, proximity to home, and treatment needs when determining which institution is appropriate for a juvenile.
- ◆ As of September 2014, the Texas Juvenile Justice Department had secure institutions that were

operational in four of the state's seven juvenile probation department regions.

DISCUSSION

In Texas, the state and county governments share responsibility for the juvenile justice system. Counties provide juvenile probation services, and the state operates the juvenile corrections system. Prior to December 2011, the state portion of the juvenile justice system was operated by two separate state agencies. The Texas Juvenile Probation Commission (TJPC) administered grants to county probation departments, managed state data systems, and provided oversight and technical support. The Texas Youth Commission (TYC) operated a system of secure correctional facilities. The Eighty-second Legislature abolished TYC and TJPC, and replaced them with the Texas Juvenile Justice Department (TJJD). TJJD is now responsible for all of the functions for which TJPC and TYC were previously responsible.

The juvenile justice system in Texas has been in transition since 2007, primarily due to agency mismanagement and allegations of abuse at TYC. Following a sexual abuse scandal and a Legislative Audit Committee's finding of gross fiscal mismanagement at TYC, the Governor appointed a TYC Conservator in March 2007. TYC remained under conservatorship until October 2008.

The Eightieth Legislature, 2007, reformed TYC and mandated a 12:1 youth to direct supervisory staff ratio, prevented misdemeanants from being committed to TYC, changed the age limit of commitment eligible youth to age 19, instituted a consistent assessment of youth risk and needs at orientation, made placing juvenile offenders close to their home a consideration, and established an Office of Inspector General and Office of Independent Ombudsman for TYC. TJPC received \$57.9 million in new appropriations for the 2008–09 biennium to distribute grants to fund secure placements, enhanced community corrections programs, and programs for misdemeanants who were no longer TYC eligible.

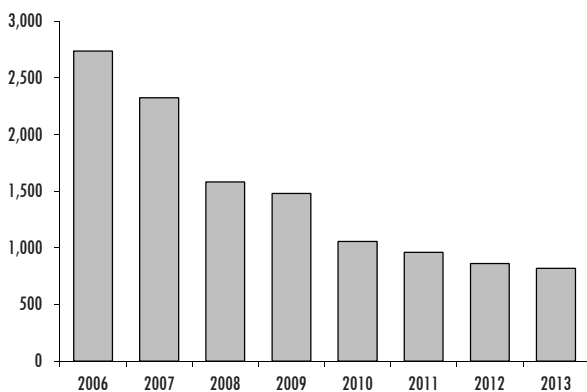
TJPC and TYC were each subject to sunset review in consecutive biennia. The Sunset Advisory Commission (SAC) issued joint reports for TJPC and TYC. In 2009, SAC

recommended that the Eighty-first Legislature consolidate TJPC and TYC. The Legislature instead continued the two agencies and appropriated \$45.7 million to TJPC for a new grant program for the 2010–11 biennium to reduce commitments to TYC through the Community Corrections Diversion Program. The rider authorizing the program required TJPC to return grant funds to TYC if total commitments to TYC surpassed a target. TJPC assigned each juvenile probation department a commitment target. Each juvenile probation department's Community Corrections Diversion Program grant amount was based on the department committing fewer juveniles than the target. As a result, juvenile probation departments have worked under the assumption that there is a state mandated cap on their commitments to TYC and now TJJD. Appropriations to TYC decreased by \$106 million for the 2010–11 biennium compared to the previous biennium.

In the Regular Session of the Eighty-second Legislature, 2011, SAC recommended continuing TYC and TJPC for six more years. Instead, the Eighty-second Legislature enacted Senate Bill 653, which abolished TJPC and TYC and established TJJD.

Programs designed to reduce commitments, combined with other factors, resulted in significantly fewer commitments to TJJD. **Figure 1** shows that from fiscal years 2006 to 2013, new commitments to TJJD decreased from 2,738 to 818, a 70 percent reduction.

FIGURE 1
NEW COMMITMENTS TO THE TEXAS YOUTH COMMISSION
AND TEXAS JUVENILE JUSTICE DEPARTMENT
FISCAL YEARS 2006 TO 2013



SOURCE: Legislative Budget Board.

The relatively quick reduction in commitments resulted in excess capacity at the state's secure institutions. As **Figure 2** shows, from fiscal years 2007 to 2013, TYC/TJJD closed eight state-run secure institutions. Most of these facilities were transferred or returned to the control of other state agencies. These closed institutions are located across the state. Three of the eight closed institutions are located in regions of the state that do not now have any state-run secure institutions. Two of the institutions, the West Texas State School and Victory Field Correctional Academy, are owned by other state entities and had been leased by TYC. Unit II of the Ron Jackson State Juvenile Correctional Facility was transferred to Brown County for \$10. This facility is now operated by G4S, a private prison and juvenile detention facility operator, as a contract-secure institution called the Oaks. As of December 4, 2014, TJJD had 35 committed youth placed at the Oaks.

The General Land Office (GLO) reports and makes recommendations on state-owned real estate. GLO is required to appraise each property every four years. The Real Property Evaluation Report includes an appraisal of state-owned land and recommendations to retain or sell each property. GLO considers market conditions, the highest and best use of each facility, and the recommendations from the agency or entity operating the facility. In the September 2012 report, GLO recommended selling or leasing the Al Price Correctional Facility and the Sheffield Boot Camp. GLO recommended retaining all of the other secure institutions. **Figure 3** shows GLO recommendations for TJJD institutions.

After closing three secure institutions in 2011, six secure institutions remained to be operated by TJJD. The 2014–15 General Appropriations Act authorizes TJJD to operate no more than five secure institutions as of January 1, 2014, and restricts statewide capacity in state-run secure institutions to 1,356 beds.

TJJD released a report in August 2013 comparing the quality and condition of the physical plant and the agency's ability to safely manage youth at each of the state-run secure institutions and recommended closing the Corsicana Residential Treatment Center (CRTC). TJJD's board approved this recommendation and submitted it to the Legislative Budget Board (LBB) on September 1, 2013. In December 2013, TJJD transferred all youth out of CRTC after determining that facility was unsafe for the juvenile population it served. The final disposition of CRTC has not been settled as of the date of this publication. CRTC is now minimally staffed and

**FIGURE 2
STATE-RUN SECURE JUVENILE CORRECTIONS INSTITUTIONS TRANSFERRED, FISCAL YEARS 2007 TO 2013**

INSTITUTION	LOCATION	DISCONTINUED OPERATIONS	TRANSFERRED TO	TRANSFER DATE	COMPENSATION
Marlin Unit	Marlin	August 2007	Texas Department of Criminal Justice	September 2007	None
San Saba State School	San Saba	August 2007	Texas Department of Criminal Justice	September 2007	None
Sheffield Boot Camp	Sheffield	March 2008	Adjutant General	Unknown	None
West Texas State School	Pyote	August 2010	University of Texas' University Lands	August 2010	None (Lease)
Victory Field Correctional Academy	Vernon	August 2010	Department of State Health Services	August 2010	None (Lease)
Ron Jackson State Juvenile Correctional Complex Unit II	Brownwood	August 2011	Brown County	April 2012	\$10
Al Price Juvenile Correctional Facility	Beaumont	August 2011	Jefferson County	January 2014	None
Crockett State School	Crockett	August 2011	City of Crockett	January 2014	None

NOTE: The Texas Juvenile Justice Department was unable to verify the date of transfer of the Sheffield Boot Camp.
SOURCE: Texas Juvenile Justice Department.

**FIGURE 3
GENERAL LAND OFFICE RECOMMENDATIONS FOR TEXAS JUVENILE JUSTICE DEPARTMENT SECURE INSTITUTIONS
SEPTEMBER 2012**

INSTITUTION	COUNTY	CURRENT USE	HIGHEST AND BEST USE	TOTAL ACRES	TOTAL MARKET VALUE (IN MILLIONS)	2012 RECOMMENDATION
Corsicana Residential Treatment Center	Navarro	Juvenile Detention Center	Juvenile Detention Center	106.36	\$7.7	Retain
Crockett State School	Houston	TYC Juvenile Correctional Facility	TYC Juvenile Correctional Facility	70.54	\$3.2	Retain
Evins Regional Juvenile Center	Hidalgo	Juvenile Detention Center	Juvenile Detention Center	99.9	\$12.1	Retain
Gainesville State School	Cooke	Juvenile Detention Center	Juvenile Detention Center	189.78	\$12.5	Retain
Giddings State School	Lee	State Home, School, and Metrology Laboratory	State Home, School, and Metrology Laboratory	194.95	\$11.9	Retain
McLennan County State Juvenile Correctional Facility	McLennan	Juvenile Correctional Facility	Juvenile Correctional Facility	138.06	\$34.7	Retain
Ron Jackson State Juvenile Correctional Facility	Brown	Juvenile Correctional Facility	Juvenile Correctional Facility	164.89	\$8.7	Retain
Al Price State Juvenile Correctional Facility	Jefferson	Juvenile Correctional Facility	Juvenile Correctional Facility	50.23	\$2.6	Sale/Lease
Sheffield Boot Camp	Pecos	Youth Correctional Facility	Youth Correctional Facility	23.8	\$4.3	Sale/Lease

SOURCE: General Land Office.

no juveniles are housed there. **Figure 4** shows the results of TJJD's closure study.

CAPACITY LIMITATION

A rider in TJJD's bill pattern in the 2012–13 General Appropriations Act established a cap on statewide capacity at state-run secure institutions of 1,600 beds. TJJD was given the authority to close up to three institutions to reduce capacity to the cap or below. Subsequently, a rider in TJJD's bill pattern in the 2014–15 General Appropriations Act set a cap on statewide capacity at state-run secure institutions of 1,356 beds. The LBB and TJJD previously did not have a shared definition of capacity, which has made the rider restrictions on capacity unclear in practice. The two agencies developed a common understanding of what constitutes capacity during the Eighty-third Legislative interim. TJJD has beds that are designed for permanent assignment, such as those in most dorms, and beds that are designed for a temporary assignment, such as those in the clinic or security wings. Among both permanent and temporary assignment beds, some are located in dorms or wings that are currently staffed and operational. These beds are considered on-line. The remaining beds are considered off-line. Of the off-line beds, some would require minimal work to be brought on-line, and some would require significant time or cost to be brought on-line. Off-line beds that would require simple changes or staffing up a wing are considered short-term off-line. Off-line beds that would require construction or remediation, such as beds in areas that have been converted

to offices or beds in areas that are in violation of the Prison Rape Elimination Act (PREA), would be considered long-term off-line. **Figure 5** shows the capacity in TJJD secure institutions by bed type. All permanent and temporary assignment beds are included in total physical bed capacity.

In addition to the five state-run secure institutions, and despite the unused operating capacity in those facilities, TJJD also sends some juveniles committed to the state to contract facilities. TJJD has contracts with two privately run, contract-secure institutions. One of these private providers, Cornerstone, operates a facility that was previously owned and operated by TYC. At the end of August 2014, the state held 1,033 youth in state-run institutions and 56 youth in contract-secure facilities.

PRISON RAPE ELIMINATION ACT

In 2003, the federal government enacted PREA, which establishes a zero tolerance policy of sexual abuse of incarcerated people and applies to "any federal, state, or local confinement facility, including local jails, police lockups, juvenile facilities, and state and federal prisons." TJJD requires facility superintendents to develop plans for their facilities to improve detection, prevention, and response to incidents of sexual violence in their facilities. **Figure 6** shows the steps that TJJD reports it is taking to achieve PREA compliance. These steps require additional staffing to implement and reduce TJJD's flexibility in how it uses dorm space.

**FIGURE 4
RESULTS FROM THE TEXAS JUVENILE JUSTICE DEPARTMENT FACILITY CLOSURE STUDY
SEPTEMBER 2013**

INSTITUTION	CITY	COUNTY	COST OF IMMEDIATE REPAIRS NEEDED IN		
			THE 2014–15 BIENNIUM	ORIGINALLY CONSTRUCTED	AGENCY RECOMMENDATION
Evins Regional Juvenile Center	Edinburg	Hidalgo	\$773,533	1990	Retain
Gainesville State School	Gainesville	Cooke	\$125,000	1913	Retain
Giddings State School	Giddings	Lee	\$128,000	1971	Retain
McLennan County State Juvenile Correctional Facility	Mart	McLennan	\$320,000	2000	Retain
Ron Jackson State Juvenile Correctional Facility	Brownwood	Brown	\$645,000	1970	Retain
Corsicana Residential Treatment Center	Corsicana	Navarro	\$4,416,313	1889	Closure
TOTAL			\$6,407,846		

NOTE: The dollar amounts in this figure were published in the Texas Juvenile Justice Department's Facility Closure Report. In January 2014 the Texas Juvenile Justice Department reported immediate repair needs of \$786,956 and total capital needs of approximately \$4.7 million at the Corsicana Residential Treatment Center.

SOURCE: Texas Juvenile Justice Department.

**FIGURE 5
TEXAS JUVENILE JUSTICE DEPARTMENT SECURE INSTITUTION CAPACITY, AUGUST 2014**

INSTITUTION	POPULATION	PERMANENT ASSIGNMENT ON-LINE	PERMANENT ASSIGNMENT SHORT-TERM OFF-LINE	PERMANENT ASSIGNMENT LONG-TERM OFF-LINE	PHYSICAL CAPACITY
Corsicana Residential Treatment Center	0	0	149	0	170
Evins Regional Juvenile Center	129	136	28	12	209
Gainesville State School	244	288	0	56	396
Giddings State School	215	226	64	8	345
McLennan County State Juvenile Correctional Facility	253	312	48	112	555
Ron Jackson State Juvenile Facility	190	212	56	0	315
TOTAL	1,031	1,174	345	188	1,970

NOTE: Physical capacity includes all on-line and off-line temporary and permanent assignment beds. Population reflects number of juveniles as of December 4, 2014.

SOURCE: Legislative Budget Board.

**FIGURE 6
TEXAS JUVENILE JUSTICE DEPARTMENT PRISON RAPE ELIMINATION ACT COMPLIANCE ACTION PLAN, JUNE 2014**

- Installed additional cameras in blind spot areas
- Limit shower access for facility and halfway house youth to one at a time or two at a time depending on physical plant and layout
- Ensure that the PREA informational posters are consistently visible throughout the facility
- Ensure that the Safe Housing Re-assessments are updated per policy within 90 days thereafter or sooner if policy criteria or physical misbehavior requires it
- Ensure that the 1:12 staff to youth ratio is maintained at all times
- Maintain the line of sight supervision of the youth at all times
- Ensure that facility staff are trained in PREA annually
- Ensure that there is no cross gender supervision when a youth showers, changes clothing or during restroom routines.
- Installed additional lighting outside the facilities and halfway houses
- Installed windows into the office doors in all of the halfway houses
- Continue to discuss PREA-related topics during Town Hall and staff meetings as a standing agenda item
- Victims of sexual abuse are offered and or provided trauma counseling service by the facility mental health professional
- Assign seating in the van during program outing transport
- Conduct unannounced facility visits by the facility administrators on all shifts monthly
- Conduct a Safe Housing Assessment on each youth upon Intake and Orientation to ensure appropriate facility placement
- Monitor the surveillance video (live and archival)
- Ensure that the Face to Name headcounts are conducted consistently during every major movement
- Ensure that each youth is in their appropriate assigned room
- Implemented the "knock and announce" protocol when an opposite gender staff enters a dorm, cottage, or sleeping area of a youth
- Ensure that every youth in TJJD views the "Safeguarding your Sexual Safety" DVD, have the PREA script read to them and is informed of how to report any sexual misconduct incident via the hotline, staff, volunteers, grievance, parent, third party, etc.
- Conduct Criminal Records Check and Child Abuse Registry checks on new employees, volunteers and contractors.
- Place vulnerable and or predatory youth on safety plan
- Victims who allege any sexual misconduct allegation are monitored for 90 days to ensure that retaliation does not occur
- Conduct quarterly and annual facility Vulnerability Assessments

SOURCE: Texas Juvenile Justice Department.

PHYSICAL PLANT COSTS

TJJD operates five secure institutions of various ages and condition. The quality and condition of the physical structures at a secure institution have an impact on the costs to operate the facilities. Utility and maintenance costs are the primary non-direct supervisory staff costs associated with operating a secure institution. The following is a comparison of the total and per-bed physical plant related costs of operating the state's five secure institutions.

UTILITY COSTS

Maintenance and utility costs at state-run secure institutions are supported by General Revenue Funds. In fiscal year 2013, TJJD expended \$3.3 million for utilities at operational secure institutions. Nearly two-thirds of the costs were for electricity. TJJD also expended more than \$250,000 for utilities at two facilities that were not operational and have since been transferred to Jefferson County and the city of Crockett, respectively. **Figure 7** shows fiscal year 2013 utility costs for each of the state's secure institutions.

The costs associated with operating secure institutions vary based on size, age, and location. Newer buildings are likely to be more energy efficient than older ones. On average, the state spent \$2,103 per bed of on-line permanent assignment capacity on utilities in fiscal year 2013. The Ron Jackson State Juvenile Correctional Facility had the highest utility costs on a per-bed basis. In fiscal year 2013, 59.2 percent of the permanent assignment capacity at the Ron Jackson State Juvenile Correctional Facility was off-line. This was the highest percentage of any of the state-run secure institutions. Total utility costs per-bed at the state's oldest institution, the 127-year old CRTC were 97.1 percent higher than at the

state's most recently constructed facility, the McLennan County State Juvenile Correctional Facility (MCSJCF). MCSJCF had the lowest per bed utility costs. **Figure 8** shows fiscal year 2013 utility costs per bed for each of the state's secure institutions.

MAINTENANCE COSTS

Maintenance costs depend on factors such as facility age, intensity of use, and quality of construction. In fiscal year 2013, TJJD expended \$4.2 million on routine facility maintenance at secure institutions. The largest expenditure category was for maintenance staff costs. TJJD expended an additional \$141,673 maintaining two facilities that were not operational and have since been transferred to Jefferson County and the City of Crockett, respectively. **Figure 9** shows the fiscal year 2013 maintenance costs from General Revenue Funds at each of the state's secure institutions.

Newer facilities tend to be less expensive to maintain. On average, the state spent \$2,679 per bed of on-line permanent assignment capacity on maintenance in fiscal year 2013. Total maintenance costs per-bed at CRTC were 156.6 percent higher than at MCSJCF. The Ron Jackson State Juvenile Correctional Facility had the highest maintenance costs on a per-bed basis. MCSJCF had the lowest per bed maintenance costs. **Figure 10** shows fiscal year 2013 maintenance costs per bed for each of the state's secure institutions.

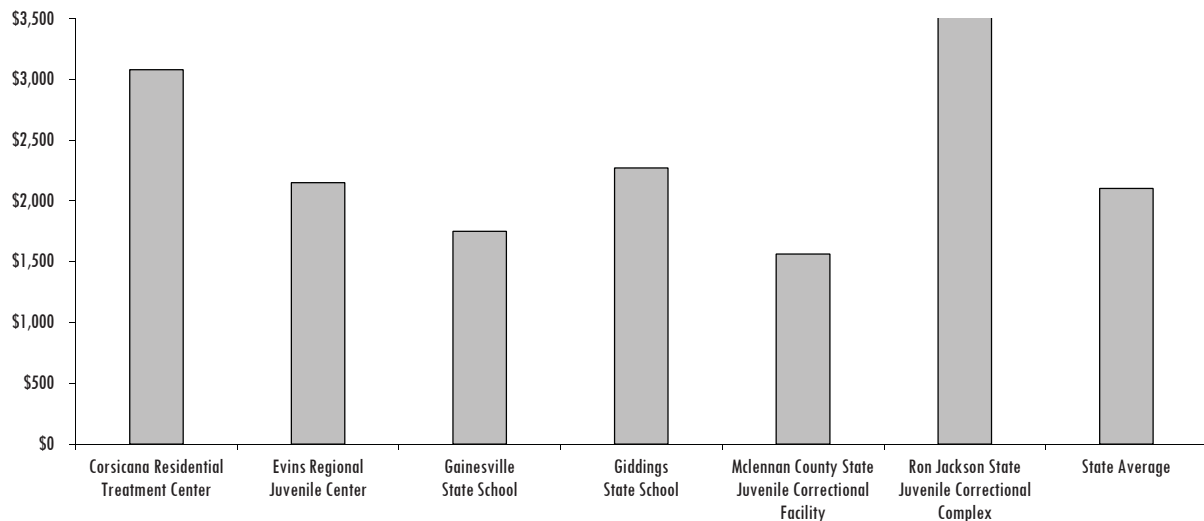
The annual non-direct supervisory staff costs to operate a given facility combine maintenance and utility costs. On a per-bed basis, the Ron Jackson State Juvenile Correctional Facility was the most expensive state-run secure institution to operate in fiscal year 2013. It cost 17 percent more to operate

**FIGURE 7
GENERAL REVENUE FUNDS EXPENDITURES FOR UTILITIES AT STATE-RUN SECURE INSTITUTIONS, FISCAL YEAR 2013**

INSTITUTION	ELECTRICITY	NATURAL GAS	TELECOMMUNICATIONS	WASTE DISPOSAL	WATER	TOTAL
Ron Jackson State Juvenile Correctional Facility	\$260,759	\$19,896	\$107,522	\$25,892	\$29,742	\$443,811
Gainesville State School	\$287,224	\$52,360	\$41,304	\$101,293	\$77,711	\$559,891
Evins Regional Juvenile Center	\$252,155	\$0	\$37,640	\$24,343	\$12,763	\$326,901
Corsicana Residential Treatment Center	\$276,135	\$30,777	\$51,532	\$59,696	\$40,829	\$458,969
McLennan County State Juvenile Correctional Facility	\$627,596	\$56,693	\$63,589	\$74,652	\$16,846	\$839,375
Giddings State School	\$432,367	\$55,755	\$73,398	\$90,094	\$30,157	\$681,772
TOTAL UTILITIES	\$2,136,236	\$215,480	\$374,985	\$375,970	\$208,048	\$3,310,720

SOURCE: Texas Juvenile Justice Department.

FIGURE 8
TEXAS JUVENILE JUSTICE DEPARTMENT SECURE INSTITUTION UTILITY COSTS PER BED OF OPERATING CAPACITY
FISCAL YEAR 2013



SOURCE: Legislative Budget Board.

FIGURE 9
GENERAL REVENUE FUNDS EXPENDITURES FOR MAINTENANCE AT STATE-RUN SECURE INSTITUTIONS, FISCAL YEAR 2013

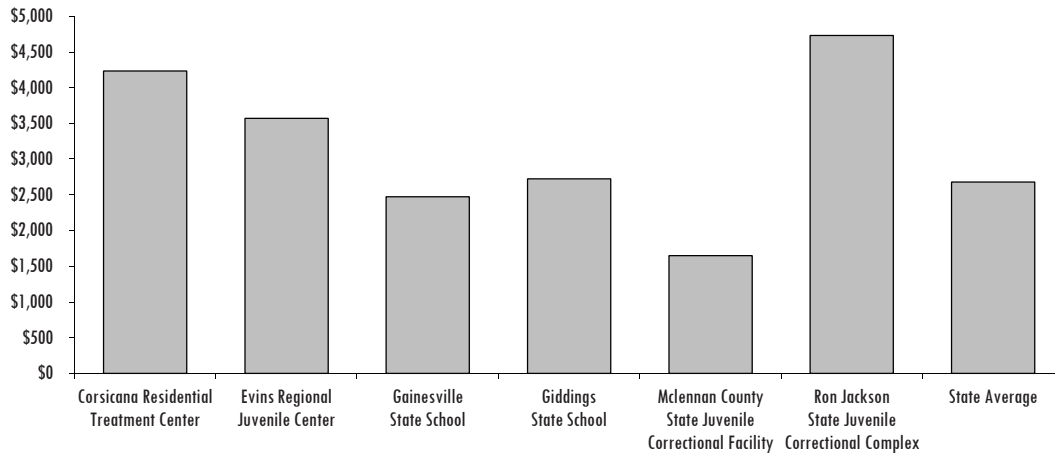
INSTITUTION	EMPLOYEE PAY & TRAINING	EQUIPMENT, MATERIALS, & SUPPLIES	BUILDINGS & GROUNDS	TELECOMMUNICATIONS	VEHICLES	INFORMATION TECHNOLOGY	FEES & SERVICES	OTHER	TOTAL
Ron Jackson State Juvenile Correctional Facility	\$370,607	\$136,452	\$1,565	\$13,038	\$7,202	\$0	\$14,217	\$5,580	\$548,661
Gainesville State School	\$379,739	\$187,678	\$119,282	\$30,849	\$51,315	\$704	\$15,669	\$5,741	\$790,977
Evins Regional Juvenile Center	\$301,041	\$141,562	\$50,704	\$16,866	\$16,848	\$0	\$13,158	\$2,575	\$542,755
Corsicana Residential Treatment Center	\$268,696	\$210,554	\$66,506	\$42,236	\$9,201	\$4,915	\$17,347	\$11,335	\$630,790
McLennan County State Juvenile Correctional Facility	\$328,422	\$406,579	\$56,111	\$47,160	\$16,650	\$4,254	\$21,342	\$5,349	\$885,866
Giddings State School	\$395,411	\$241,313	\$54,972	\$88,613	\$8,356	\$0	\$22,913	\$6,309	\$817,888
TOTAL	\$2,043,917	\$1,324,138	\$349,140	\$238,761	\$109,572	\$9,873	\$104,648	\$36,888	\$4,216,937

SOURCE: Texas Juvenile Justice Department.

the Ron Jackson State Juvenile Correctional Facility than the next most expensive facility, CRTC. MCSJCF was the least expensive facility to operate in fiscal year 2013. **Figure 11**

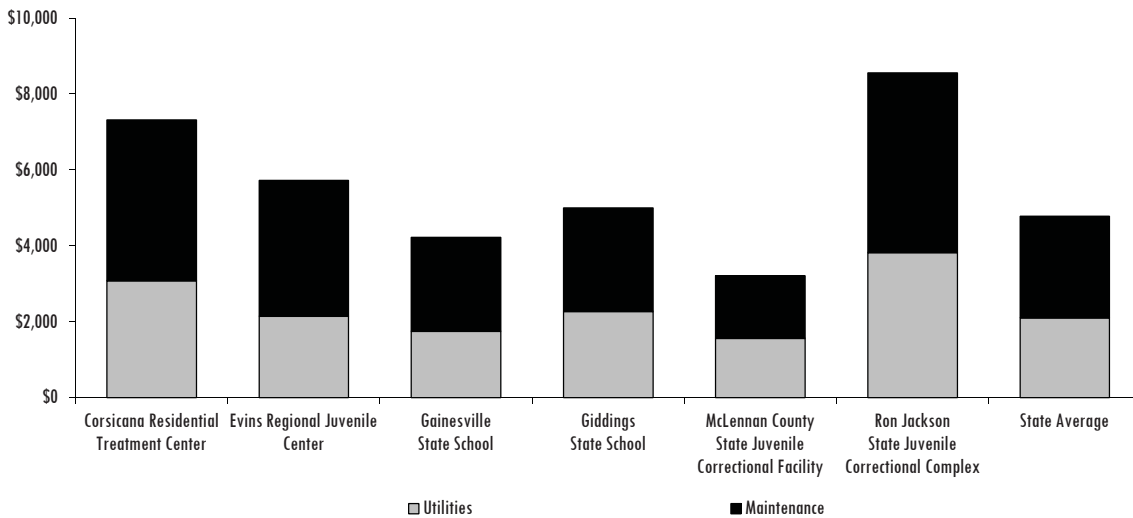
shows the combined per-bed utility and maintenance costs at each of the state's secure institutions.

FIGURE 10
TEXAS JUVENILE JUSTICE DEPARTMENT SECURE INSTITUTION MAINTENANCE COSTS PER BED OF OPERATING CAPACITY
FISCAL YEAR 2013



SOURCE: Legislative Budget Board.

FIGURE 11
TEXAS JUVENILE JUSTICE DEPARTMENT SECURE INSTITUTION UTILITY AND MAINTENANCE COSTS PER BED OF OPERATING CAPACITY, FISCAL YEAR 2013



SOURCE: Legislative Budget Board.

CAPITAL REPAIR NEEDS

For the 2014–15 biennium, TJJD identified \$8.3 million in capital repair needs, as shown in **Figure 12**. The largest category of identified repair needs was for safety and security improvements. The \$3.3 million safety and security line item includes \$361,806 for topsoil at CRTC. TJJD has indicated that broken glass on the ground at CRTC is a significant

safety risk, some juveniles have used the glass to commit self-harm. TJJD was appropriated \$5.5 million for the 2014–15 biennium to cover many of these needs.

FACILITY-RELATED DEBT

According to the Texas Public Finance Authority, as of July 2014 the state has \$99.7 million in outstanding General

FIGURE 12
TEXAS JUVENILE JUSTICE DEPARTMENT IDENTIFIED CAPITAL NEEDS, 2014–15 BIENNIUM

NEED	CORSICANA RESIDENTIAL TREATMENT CENTER	EVINS REGIONAL JUVENILE CENTER	GAINESVILLE STATE SCHOOL	GIDDINGS STATE SCHOOL	RON JACKSON STATE JUVENILE CORRECTIONAL FACILITY	MCLENNAN COUNTY STATE JUVENILE CORRECTIONAL FACILITY	TOTAL
Utility, Road & Site Work	\$0	\$0	\$0	\$256,000	\$0	\$633,000	\$889,000
Roof Repairs & Replacements	\$256,000	\$0	\$0	\$0	\$0	\$0	\$256,000
Safety & Security	\$901,006	\$456,000	\$200,000	\$200,000	\$1,020,000	\$520,000	\$3,297,006
General Repairs	\$0	\$1,413,400	\$0	\$256,000	\$256,000	\$224,000	\$2,149,400
HVAC/Lighting	\$280,192	\$619,400	\$0	\$249,600	\$25,000	\$0	\$1,174,192
HIPAA Required Reconfiguration	\$0	\$0	\$125,000	\$0	\$0	\$0	\$125,000
Vocational Program Expansion	\$425,150	\$0	\$0	\$0	\$0	\$0	\$425,150
TOTAL CAPITAL NEEDS	\$1,862,348	\$2,488,800	\$325,000	\$961,600	\$1,301,000	\$1,377,000	\$8,315,748

NOTE: Data based on information submitted in April 2014.
SOURCE: Texas Juvenile Justice Department.

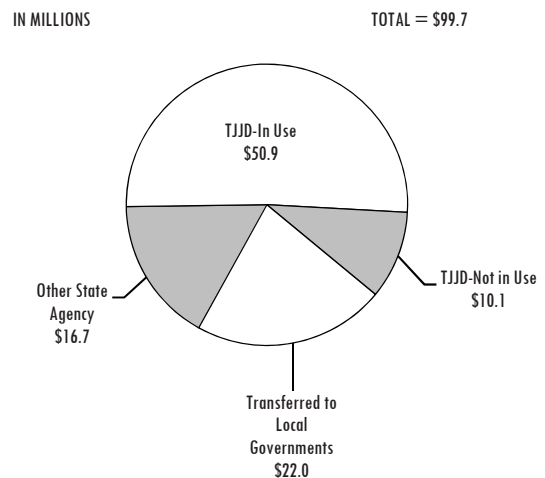
Obligation bond debt related to secure institutions either currently or previously operated by TJJD. This debt is typically used to finance construction, facility repairs, and safety and security upgrades. Of that debt, 51 percent is related to institutions still in operation by TJJD. **Figure 13** shows that of the remaining debt, \$16.7 million is related to facilities that are currently used by other state agencies, \$22 million is related to facilities that have been transferred to local governments, and \$10.1 million is related to CRTC. Nearly one-third of the debt outstanding is related to CRTC or facilities that have been transferred to local governments. The state is not currently using these facilities.

According to TJJD data, the agency expended \$13.7 million in General Obligation Bond Proceeds from fiscal years 2008 to 2013 and expects to spend \$1.6 million in fiscal year 2014. Construction or repairs were funded at each of the state's secure institutions. More than one-quarter of these funds were spent at the Gainesville State School. Statewide, close to \$1.5 million was used to fund improvements to security camera systems.

STAFFING

TJJD currently has almost 2,000 staff working at secure institutions. The majority of these staff are Juvenile Correction Officers (JCOs). JCOs are responsible for the direct care of juveniles in the correctional setting. The posted starting salary for a JCO is approximately \$30,000 annually. TJJD has case managers and teachers who also provide direct

FIGURE 13
TEXAS JUVENILE JUSTICE DEPARTMENT SECURE INSTITUTION-RELATED GENERAL OBLIGATION BOND DEBT SERVICE OUTSTANDING, JUNE 30, 2014



NOTE: TJJD = Texas Juvenile Justice Department.
SOURCE: Legislative Budget Board.

services to the juveniles. JCOs, case managers, and teachers comprise approximately three-quarters of all staff at the state-run secure institutions. **Figure 14** shows the number of staff by position at each state-run secure institution as of February 28, 2014. TJJD has reduced staffing levels at CRTC since February 2014.

FIGURE 14
TEXAS JUVENILE JUSTICE DEPARTMENT CORRECTIONAL INSTITUTION STAFF BY POSITION, FEBRUARY 28, 2014

INSTITUTION	JUVENILE CORRECTION OFFICERS	CASE MANAGERS	EDUCATORS	ALL OTHER STAFF
Corsicana Residential Treatment Center	5	0	0	20
Evins Regional Juvenile Center	162	14	26	64
Gainesville State School	224	26	35	70
Giddings State School	234	19	41	85
McLennan County State Juvenile Correctional Facility	389	47	57	121
Ron Jackson State Juvenile Correctional Facility	208	25	27	95
All State-Run Secure	1,222	131	186	455

NOTE: All Other Staff includes maintenance, security, and other administrative staff positions.
SOURCE: Texas Juvenile Justice Department.

TJJD is required by statute to maintain a 12:1 ratio of youth to direct supervisory staff. According to TJJD, there are several reasons why the agency typically operates with fewer youth per staff. Frequently, building layout requires a smaller staffing ratio for safety and security reasons. For example, local fire codes may require the space between dorms to be staffed so that the dorm doors can be opened in case of fire. Compliance would require dedicated staff in an unoccupied area, in addition to the staff in the dorms occupied by juveniles. In the few open bay dorms that TJJD operates, there could be 24 juveniles and two JCOs in one room. If an altercation occurs between two juveniles, one JCO could intervene, leaving the second JCO responsible for the other 22 juveniles in the room. TJJD considers this situation unsafe and therefore schedules additional JCOs as a precaution. TJJD schedules more JCOs for morning and afternoon shifts when there are more activities, with a slightly reduced overnight shift. **Figure 15** shows the number of JCOs scheduled for each shift at state-run secure institutions.

According to TJJD, the agency faces challenges in maintaining desired staffing levels. The most significant challenge is staff turnover for JCOs. In fiscal year 2013, the JCO turnover rate

was 40.4 percent across all facilities. The percentage was highest at the Gainesville State School and lowest at the Ron Jackson State Juvenile Correctional Facility. **Figure 16** shows the JCO turnover rate for each of the state-run secure institutions in fiscal year 2013.

In light of the high percentage of staff turnover, TJJD requires JCOs to work overtime to maintain staffing levels. Overtime results in an additional cost to the state because JCOs are entitled to receive overtime pay of time-and-a-half. As of April 2014, overtime accounts for 6.0 percent of total hours worked by JCOs in fiscal year 2014. This percentage fluctuates from year to year. From fiscal years 2006 to 2014, overtime accounts for 5.2 percent of total hours worked by JCOs. During this period, the Ron Jackson State Juvenile Correctional Facility has consistently had the lowest percentage of overtime hours. Prior to its closure, CRTC had the highest percentage of overtime hours during this period. The use of overtime at CRTC spiked in 2012 when 15.9 percent of all hours worked by JCO's were overtime. **Figure 17** shows overtime as a percentage of total JCO hours worked at state-run secure institutions.

FIGURE 15
JUVENILE CORRECTION OFFICERS SCHEDULED PER SHIFT, APRIL 2014

INSTITUTION	SHIFT HOURS 6 AM TO 2 PM	SHIFT HOURS 2 PM TO 10 PM	SHIFT HOURS 10 PM TO 6 AM
Evins Regional Juvenile Center	63	63	54
Gainesville State School	90	90	77
Giddings State School	97	97	83
McLennan County State Juvenile Correctional Facility	141	141	121
Ron Jackson State Juvenile Correctional Facility	82	82	70

NOTE: The Corsicana Residential Treatment Center is not included because it is not currently used to house juveniles and there are no Juvenile Correction Officers currently on staff there.
SOURCE: Texas Juvenile Justice Department.

**FIGURE 16
JUVENILE CORRECTION OFFICER TURNOVER RATE
FISCAL YEAR 2013**

INSTITUTION	PERCENTAGE
Corsicana Residential Treatment Center	40.8%
Evins Regional Juvenile Center	39.7%
Gainesville State School	64.7%
Giddings State School	50.4%
McLennan County State Juvenile Correctional Facility	27.2%
Ron Jackson State Juvenile Correctional Facility	18.2%
System Total	40.4%

SOURCE: Texas Juvenile Justice Department.

JUVENILES SERVED

Only a small percentage of juvenile offenders in Texas are committed to state-operated secure institutions. Less than 3 percent of the juveniles who receive services are committed to TJJD. Other than a small number who are certified to stand trial in the adult system, the remaining juveniles who receive a disposition are served by county probation departments.

The state places restrictions on the offenses for which, and the age at which a county may commit a juvenile to TJJD. Within those restrictions, the decision of whether or not to commit a juvenile to the state is made at the discretion of the local courts, with the advice of the local juvenile probation department. A juvenile may only be committed to the state for a felony offense or for violating probation that was received for a felony offense. Most juveniles receive probation or deferred adjudication for felony offenses.

Juveniles committed to TJJD are either sentenced offenders or non-sentenced offenders. Sentenced offenders are those who committed capital or first degree felony offenses. Juvenile courts send these juveniles to TJJD with a pre-determined sentence, referred to as a determinate sentence. Juveniles with a determinate sentence typically serve a portion of the sentence in a TJJD secure institution and then serve the remainder of their sentence either in a Texas Department of Criminal Justice facility or under adult parole supervision. **Figure 18** lists the determinate sentence offenses. In fiscal year 2014, approximately 9 percent of all youth committed to TJJD received a determinate sentence. All other offenders who are committed to TJJD are non-sentenced offenders. These juveniles are given a minimum

**FIGURE 17
OVERTIME WORKED BY JUVENILE CORRECTION OFFICERS AT STATE-RUN SECURE INSTITUTIONS
FISCAL YEARS 2006 TO 2014**

INSTITUTIONS	2006	2007	2008	2009	2010	2011	2012	2013	2014	2006 TO 2014
Corsicana Residential Treatment Center	4.4%	5.0%	5.3%	5.5%	11.1%	6.6%	15.9%	6.4%	3.5%	7.0%
Evins Regional Juvenile Center	5.8%	4.4%	5.7%	3.0%	3.4%	3.8%	7.1%	5.7%	12.8%	5.4%
Gainesville State School	3.4%	3.7%	7.7%	3.3%	2.6%	1.7%	3.6%	4.4%	2.9%	3.7%
Giddings State School	3.7%	4.0%	6.1%	5.3%	5.0%	2.3%	6.5%	9.3%	6.7%	5.4%
McLennan County State Juvenile Correctional Facility	6.0%	7.3%	8.9%	7.6%	8.1%	3.1%	7.7%	5.4%	5.6%	6.8%
Ron Jackson State Juvenile Correctional Facility	4.8%	4.5%	2.5%	1.2%	0.9%	1.6%	1.2%	1.2%	4.3%	2.6%
TJJD TOTAL	4.9%	5.3%	6.4%	4.8%	5.2%	2.8%	6.5%	5.5%	6.0%	5.2%

NOTE: Calculated as a percentage of total hours worked.
SOURCE: Legislative Budget Board.

**FIGURE 18
DETERMINATE SENTENCE OFFENSES, FISCAL YEAR 2014**

Murder	Aggravated Assault
Attempted Murder	Aggravated Robbery
Capital Murder	Attempted Aggravated Robbery
Attempted Capital Murder	Felony Injury to a Child, Elderly, or Disabled Person
Manslaughter	Felony Deadly Conduct
Intoxication Manslaughter	Aggravated or First-Degree Controlled Substance Felony
Aggravated Kidnapping	Criminal Solicitation of a Capital or First-Degree Felony
Attempted Aggravated Kidnapping	Second-Degree Felony Indecency With a Child
Aggravated Sexual Assault	Criminal Solicitation of a Minor
Sexual Assault	First Degree Felony Arson
Attempted Sexual Assault	Habitual Felony Conduct (Three Consecutive Felony Adjudications)

SOURCE: Texas Juvenile Justice Department.

length of stay by TJJD during the assessment and orientation process. Non-sentenced offenders must be released from TJJD by their nineteenth birthday.

PLACEMENT OF COMMITTED YOUTH

TJJD considers various factors when determining which facility is appropriate for a given juvenile. According to TJJD, offense severity, youth risk level, proximity to home, and treatment needs are all important considerations. Each juvenile who is committed to the state initially goes to an orientation and assessment unit. Males are sent to MCSJCF and females are sent to the Ron Jackson State Juvenile Correctional Facility. The purpose of orientation and assessment is to determine the treatment needs and identify a treatment plan for each youth. At this stage, TJJD determines each juvenile's risk level. TJJD places juveniles into a high-, medium-, or low-security facility. Juveniles can move to different facilities as treatment needs change or as the youth prepare to return to their home communities. The five currently operational state-run secure institutions and two contract-secure institutions are designated as high-security facilities. **Figure 19** shows the specialized treatment services available at each secure institution. As of May 2014, 68.9 percent of juveniles in high-security facilities were classified as low- or medium-risk youth.

It is uncommon for TJJD to house a sentenced offender at a contract-secure facility. According to data provided by TJJD, only five revoked or sentenced offenders are in contract-secure facilities as of May 2014. These offenders represent 1.8 percent of all revoked or sentenced offenders. According

**FIGURE 19
TEXAS JUVENILE JUSTICE DEPARTMENT SECURE INSTITUTIONS LEVEL AND TYPE OF SPECIALIZED TREATMENT SERVICES AVAILABLE, FISCAL YEAR 2014**

INSTITUTION	CAPITAL OFFENDER/ AGGRESSION REPLACEMENT THERAPY		SEX OFFENDER		MENTAL HEALTH		ALCOHOL AND OTHER DRUG	
	HIGH	MED	HIGH	MED	HIGH	MED	HIGH	MED
Evins Regional Center		•				•	•	•
Gainesville State School		•		•		•	•	•
Giddings State School	•	•	•	•		•	•	•
McLennan County Residential Treatment Facility		•		•	•	•		•
McLennan County State Juvenile Correctional Facility		•	•	•		•	•	•
Ron Jackson State Juvenile Correctional Facility	•	•	•	•	•	•	•	•

NOTES:

- (1) The Corsicana Residential Treatment Center was open for two months of fiscal year 2014 and provided services for juveniles with severe mental health needs.
- (2) The McLennan County Residential Treatment Facility is a specialized treatment facility within the McLennan County Juvenile Correctional Facility and provides services for juveniles with severe mental health needs.

SOURCE: Texas Juvenile Justice Department.

to TJJD, the agency does not place youth with high needs for treatments such as those listed in **Figure 19** at contract-secure facilities because these facilities do not offer all the needed services. At state-run secure institutions, 44.3 percent of youth are sentenced offenders, committed an offense classified as high severity, or have had their parole revoked. This is compared to only 11.5 percent of offenders at the contract-secure institutions.

TJJD also operates eight state-run halfway houses and contracts with several treatment facilities, which are designated as medium- and low-security facilities. These facilities are most typically used for youth preparing to make the transition from a secure institutional setting to returning to their home communities.

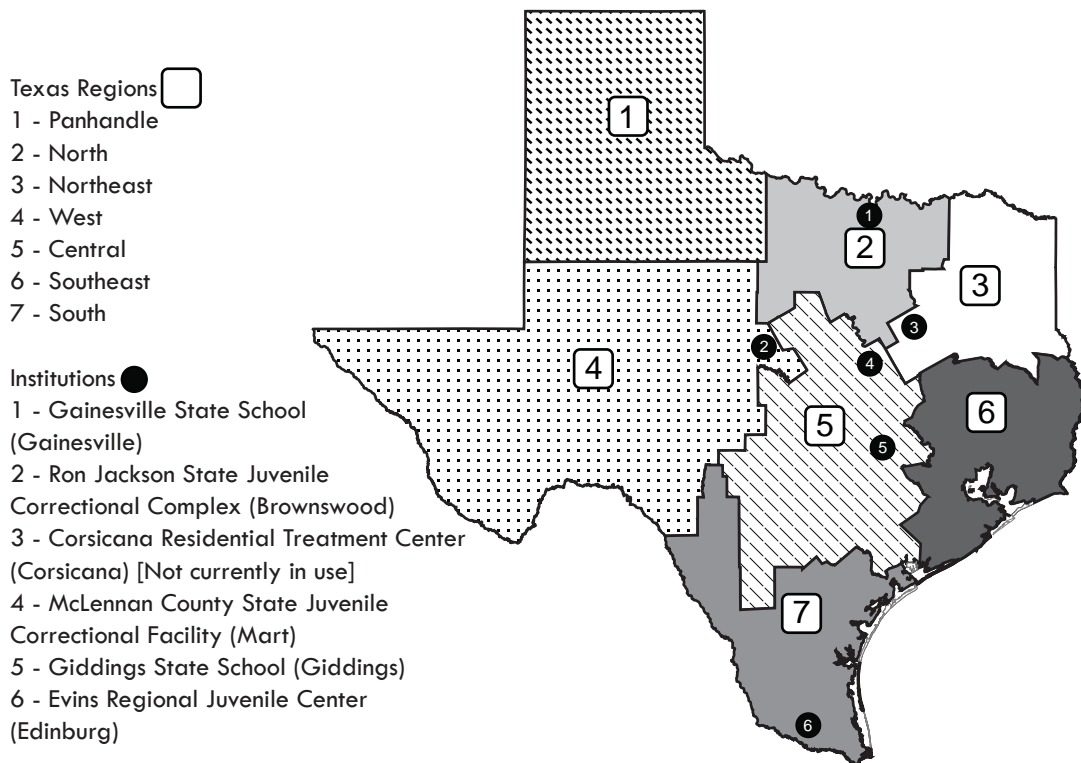
REGIONAL DISTRIBUTION

The reforms passed by the Eightieth Legislature, 2007, require TJJD to consider where youth are from when making placement decisions. According to TJJD, the agency places youth at the facility closest to their home that can meet their service needs. The state is divided into seven regions, which allows the juvenile probation departments to organize into

regional planning groups. These regions are Central, North, Northeast, Panhandle, South, Southeast, and West. These regions provide some basis for evaluating the extent to which TJJD places committed youth into facilities that are closest to the juvenile's home. **Figure 20** shows the geographic boundaries of the state's regions and the location of TJJD's secure institutions.

The juvenile's home region is the region in which the county from which the juvenile was committed is located. In fiscal year 2014, TJJD operated secure institutions that are located in four of the seven regions. TJJD does not operate a secure institution in the Panhandle or Southeast region. In 2014, TJJD transferred the Al Price facility to Jefferson County, which is located in the Southeast Region. TJJD contracts with the Garza County Regional Juvenile Center to serve some committed youth. Garza County is in the Panhandle region. In fiscal year 2013, approximately one-third of juveniles initially placed in a state-run secure institution were placed in an institution located in their home region. One-third of committed juveniles were from a region in which a secure institution was not located. According to TJJD, the remaining one-third of committed youth may be placed in

**FIGURE 20
MAP OF TEXAS JUVENILE JUSTICE DEPARTMENT REGIONS AND SECURE INSTITUTIONS, FISCAL YEAR 2015**



SOURCE: Legislative Budget Board.

an institution outside of their home region for a variety of reasons, including:

- an institution in another region may actually be closer to their home county;
- the youth may need treatment services that are only offered in one institution;
- there may not be available capacity at the closest institution; or
- the youth may be female.

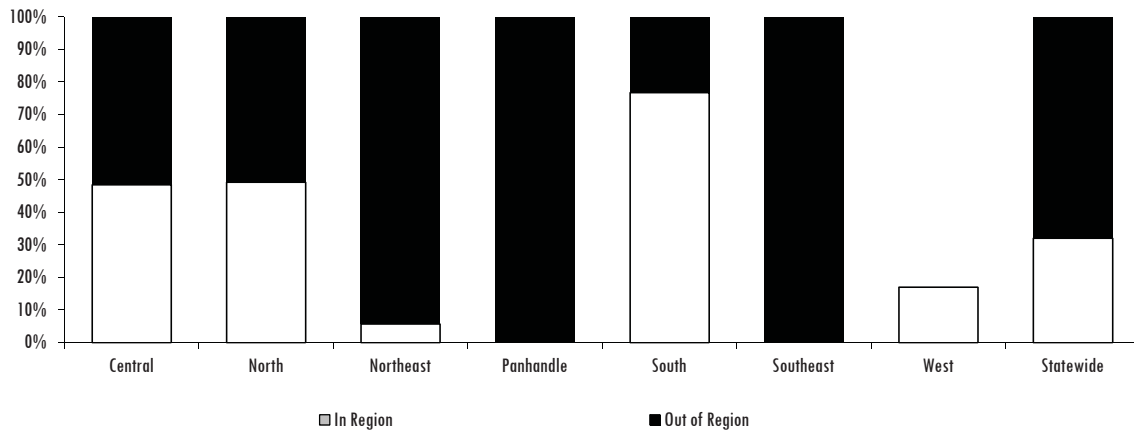
The percentage of youth placed in their home region varies across the regions of the state. Youth from the Panhandle and Southeast regions cannot be placed in their home region unless they are placed in contract care because there are no state-run secure institutions located within those regions. Because CRTC is not operational, the state is unable to place youth from the Northeast region in their home region. However, CRTC was operated as a low-occupancy, specialized treatment facility, so very few youth from the Northeast region were placed there for their initial placement when it was operational and housing juveniles. Less than 6 percent of the committed youth from the Northeast region were initially placed at CRTC. Most of the youth from the Northeast region were initially placed in the nearby Gainesville State School and MCSJCF. More than three-quarters of the committed youth from the South region are initially placed at the Evins Regional Juvenile Center. **Figure 21** shows the percentage of committed youth from each region who were initially placed in a secure institution in their home region during fiscal year 2013.

PER DAY COSTS

There are several ways to estimate the cost-per-day of serving juveniles committed to the state. State-operated secure operations at TJJD are funded on a per-juvenile, per-day basis. In the 2014–15 biennium, state-operated secure operations at TJJD were funded at a rate of \$190.99 per-juvenile per-day. The LBB’s *Criminal Justice Uniform Cost Report Fiscal Years 2010 to 2012* (cost report) divides all costs associated with housing juveniles in secure institutions by the total number of juveniles in those institutions to calculate an average cost. In fiscal year 2012, on average it cost \$380.32 to place a juvenile in a state-run secure institution for one day. The cost report estimated that contract facilities cost \$166.25 per day. The cost report includes administrative overhead at TJJD and benefits paid by the Employee Retirement System of Texas in the average cost calculations. Most of the costs associated with housing juveniles in secure facilities are fixed and the statewide institutional population is expected to stay relatively constant, therefore it is reasonable to assume that the average cost will remain relatively constant.

While average cost-per-day is a useful figure for comparison purposes, marginal cost, the cost required for each additional juvenile at a certain facility, is more descriptive of the cost pressures faced by TJJD. TJJD provided LBB staff with an estimate of the marginal cost to serve a juvenile at each facility. TJJD estimated that it costs \$38.13 per day for each additional juvenile at each state-run secure institution if there is available on-line capacity. These costs include medical care, food, clothing, and dorm supplies. The marginal cost increases when there is no on-line capacity available because

FIGURE 21
COMMITTED YOUTH INITIALLY PLACED IN A SECURE INSTITUTION IN THEIR HOME REGION, FISCAL YEAR 2013



SOURCE: Texas Juvenile Justice Department.

TJJD would need to staff an additional wing to house the juvenile. In such a case, this juvenile becomes more expensive to serve. TJJD estimates that if a wing were needed to be opened at the Evins Regional Center, it would cost at least \$1,097.40 per day in staff costs for the additional wing. If the wing houses 16 juveniles, then the average additional total cost to serve those 16 additional offenders is \$106.72 per day. TJJD estimates that it would cost \$6.4 million annually to re-populate CRTC. **Figure 22** shows the marginal cost to serve a juvenile at each of the state-run secure institutions. For example, each additional juvenile that TJJD is required to house will cost the agency \$38.13 more per day in medical care, food, clothing, and dorm supplies. Whether or not there are additional staffing costs that result from serving an additional juvenile depends on the available on-line capacity at the facility. If the facility has available on-line capacity there are no additional staffing costs as a result of housing the juvenile. If the facility does not have any available on-line capacity and must open an additional wing to serve the juvenile then the marginal staffing costs of serving that juvenile are whatever it costs to fully staff the additional capacity at that facility. In the example of the Evins Regional Center above, the marginal staffing costs to serve an additional juvenile if there is no available on-line capacity is \$1,097.40 per day. Once additional capacity is brought on-line, there are no marginal staffing costs for adding additional youth at that facility until the newly opened wing is full.

EXAMPLES OF PLACEMENT DECISION MAKING PROCESS

To illustrate how TJJD decides where to place a juvenile, TJJD provided several hypothetical scenarios. These scenarios describe the factors that TJJD considers when making placement decisions, which include severity of offense,

treatment needs, location and environment of home, and cost of placement. **Figure 23** shows the hypothetical placement decisions TJJD would likely make in four different scenarios.

Youth 1 commits a moderate severity offense, has moderate treatment needs, and has a supportive home in Dallas. TJJD would prefer to place an offender with this profile at a contract facility. If the contract facilities do not accept this juvenile, then TJJD would place him at the Gainesville State School because it is the closest facility to his home county.

Youth 2 commits a high severity offense and has high sexual behavior treatment needs. TJJD places high severity offenders in state-run secure institutions. The Giddings State School, the MCSJCF, or the Gainesville State School would be appropriate for his offense severity and treatment needs. TJJD would place him at Giddings because it is the closest facility to his home in Houston. At the time that this scenario was provided, Giddings was over its budgeted capacity, but additional on-line capacity had already been made available, and a new wing would need to be opened to serve him at MCSJCF.

Youth 3 is a sentenced offender with high treatment needs and a supportive home. TJJD places sentenced offenders at state-run secure institutions. The Giddings State School, the MCSJCF, or the Gainesville State School would be appropriate for his offense severity and treatment needs. TJJD would place him at Giddings, despite MCSJCF being the closest facility to his home in Temple. At the time that this scenario was provided, Giddings was over its budgeted capacity, but additional on-line capacity had already been made available and a new wing would need to be opened to serve him at MCSJCF.

**FIGURE 22
MARGINAL COST-PER-DAY AT EACH STATE-RUN SECURE INSTITUTION**

INSTITUTION	MEDICAL	FOOD	CLOTHING	DORM SUPPLIES	STAFFING - AVAILABLE ON-LINE CAPACITY	STAFFING - NO ON-LINE CAPACITY
Evins Regional Center	\$23.59	\$8.44	\$1.38	\$4.72	\$0.00	\$1,097.40
Gainesville State School	\$23.59	\$8.44	\$1.38	\$4.72	\$0.00	\$1,320.54
Giddings State School	\$23.59	\$8.44	\$1.38	\$4.72	\$0.00	\$1,320.54
McLennan County Residential Treatment Facility	\$23.59	\$8.44	\$1.38	\$4.72	\$0.00	\$1,723.01
McLennan County State Juvenile Correctional Facility	\$23.59	\$8.44	\$1.38	\$4.72	\$0.00	\$1,924.25
Ron Jackson State Juvenile Correctional Facility	\$23.59	\$8.44	\$1.38	\$4.72	\$0.00	\$716.34

SOURCE: Texas Juvenile Justice Department.

FIGURE 23
TEXAS JUVENILE JUSTICE DEPARTMENT HYPOTHETICAL YOUTH PLACEMENT SCENARIOS, FISCAL YEAR 2014

FACTOR	YOUTH 1	YOUTH 2	YOUTH 3	YOUTH 4
Gender	Male	Male	Male	Male
Age	16.5	15.3	16.3	14.1
Sentenced Offender	No	No	Yes	No
Minimum Length of Stay	12 Months	18 Months	36 Months	12 Months
Offense Severity	Moderate	High	High	Moderate
Offense	Assault	Aggravated sexual assault	Aggravated sexual assault	Arson
Treatment Needs	Moderate violent behavior, moderate alcohol or other drug use	Moderate violent behavior, high sexual behavior	High sexual behavior, high alcohol or other drug use, moderate violent behavior	High mental health, moderate violent behavior need
Home County	Dallas	Harris	Bell	Bexar
Family Status	Supportive	Family refusing to take home, victim still lives in the home	Supportive	Supportive, but live in Oklahoma
Home Status	Approved	Conditionally approved pending family unification requirements	Approved	Post TJJD plan is to pursue interstate compact with Oklahoma
Placement Decision	Contract Care at the Oaks	Giddings State School	Giddings State School	McLennan County Residential Treatment Center
Marginal Cost-per-Day	\$138.25	\$38.13	\$38.13	\$38.13
Average Additional Cost-per-Day	\$138.25	\$258.22	\$258.22	\$38.13

NOTE: Average Additional Cost-per-Day includes any additional costs that resulted because a facility had to open an additional wing beyond what is budgeted for that facility.

SOURCE: Texas Juvenile Justice Department.

Youth 4 commits a moderate severity offense and has high treatment needs, including high mental health treatment needs. McLennan County Residential Treatment Facility is the only facility that could meet his treatment needs because TJJD does not have contracts with any programs that offer high intensity mental health treatment.

Placement decisions are complex and require balancing factors to serve the youth in the most appropriate setting. According to TJJD, the agency only considers cost in placement decisions to the extent that if two facilities can meet a juveniles treatment needs TJJD will place that juvenile in the facility with available on-line capacity. Because not all youth can be served at any facility, space and staffing are frequently increased and decreased to levels that may otherwise be inefficient given the number of youth. The agency’s mission and legislative reforms govern how the agency serves the youth committed to state care.

OVERVIEW OF TEXAS BORDER SECURITY FUNDING AND ACTIVITIES

The Texas-Mexico border spans 1,241 miles. More traffic that facilitates trade crosses this border than at any other point along the southern U.S. border. In addition to crossings that occur at designated ports of entry, illegal activity occurs between ports of entry. In response to this criminal activity, the Trusteed Programs Within the Office of the Governor began providing grants, from discretionary funds, to increase law enforcement presence along the border during fiscal year 2006. The Legislature first appropriated state funds specifically for border security during fiscal year 2008. State funds are used to enhance ongoing operations and are in addition to funding provided for other activities related to regular law enforcement or homeland security. In addition to amounts included in the General Appropriations Act, state agencies may use Federal Funds that are paid directly to them by the federal government for border security activities.

Border security funding primarily has been appropriated by the Legislature to the Texas Department of Public Safety. Funding also is appropriated to other agencies, including Trusteed Programs Within the Office of the Governor, the Texas Parks and Wildlife Department, and the Texas Department of Criminal Justice. The Texas Military Department recently has begun involvement in state-funded border security activities. The following is an overview of funding appropriated by the Legislature and a description of activities for which this funding is used.

FACTS AND FINDINGS

- ◆ Ports of entry along the Texas–Mexico border facilitate more than one-third of all trade that occurs between the U.S. and Mexico. Texas is the only state to have experienced an increase in apprehensions of persons crossing between ports of entry from federal fiscal years 2003 to 2013.
- ◆ Since fiscal year 2008, approximately \$920.6 million in All Funds has been appropriated to state agencies for border security activities through the General Appropriations Act. For the 2014–15 biennium, about \$467.9 million is appropriated for border security activities. The majority of these appropriations consisted of state funds; additional federal funds have been provided outside of sum-certain amounts appropriated by the Legislature.

- ◆ Border security funding primarily has been appropriated to the Texas Department of Public Safety in the General Appropriations Act over several biennia. Additional appropriations for border security have also been appropriated to other agencies which do not have strategies specifically related to border security in the General Appropriations Act.
- ◆ The first state agency to direct funds to enhanced border security activities was Trusteed Programs Within the Office of the Governor. Border security-related expenditures primarily have been in the form of grants to local law enforcement agencies to fund staff, purchase equipment, and prosecute criminals.
- ◆ The Texas Department of Public Safety’s border security expenditures have included the purchase of equipment, pay for state trooper salaries and overtime, and capital projects such as the construction of command centers and crime labs. Some appropriations to the agency have been directed for grant funding provided to local entities and other state agencies.
- ◆ The Texas Parks and Wildlife Department has received appropriations for game warden salaries and overtime pay and equipment used during enhanced border security activities.
- ◆ Texas Department of Criminal Justice appropriations related to border security have been for staff salaries to assist in investigations and apprehensions related to transnational gang activity.
- ◆ The Texas Military Department historically has not received direct appropriations for border security activities but rather has been funded by the federal government or through reimbursements provided by the Texas Department of Public Safety. During fiscal year 2014, the Texas Military Department began receiving funds to provide staff and equipment along the border to supplement other state agencies’ activities.

DISCUSSION

Texas shares an international border of 1,241 miles with Mexico. As of 2014, Texas had 29 official ports of entry at U.S. land borders, seaports, and airports. These are officially designated locations at which a customs and border patrol officer can accept entries of merchandise, collect duties, and enforce customs and navigation laws. Ports of entry facilitate legitimate travel and trade and include vehicular border crossings and rail crossings open for travel between Texas and Mexico, with additional crossings proposed or undergoing construction. Millions of vehicle, pedestrian, truck, and rail crossings occur across the Texas-Mexico border each year. **Figures 1 and 2** show northbound and southbound border crossings during calendar year 2013.

Northbound and southbound traffic across the Texas-Mexico border contributes to trade. More crossings occur between Texas and Mexico than anywhere else on the U.S. southern border, as shown in **Figure 3**.

According to the U.S. Census Bureau, during calendar year 2013 the value of exports to Mexico that originated in Texas was approximately \$101.0 billion. U.S. imports through Texas from Mexico totaled about \$94.6 billion. For both imports and exports, approximately one-third of trade between the U.S. and Mexico was transported through Texas during calendar year 2013.

Each land port of entry has a border station operated by the U.S. Customs and Border Protection (CBP) Office of Field Operations. CBP is responsible for facilitating legitimate travel and trade while securing the flow of people and goods by screening all foreign visitors, returning American citizens, and imported cargo at these ports of entry. The state stations Texas Alcoholic Beverage Commission staff at some ports of entry. These staff monitor compliance with Texas importation laws for alcohol and cigarettes and collect appropriate fees and taxes. Texas Department of Public Safety (DPS) Troopers

**FIGURE 1
NORTHBOUND CROSSINGS AT TEXAS-MEXICO BORDER
CALENDAR YEAR 2013**

TRANSPORTATION	CROSSINGS
Vehicle	31,584,131
Pedestrian	15,870,112
Truck	3,577,037
Rail	7,971
Total	51,039,251

NOTE: Does not include bus crossings.
SOURCE: U.S. Department of Transportation Bureau of Transportation Statistics.

**FIGURE 2
SOUTHBOUND CROSSINGS AT TEXAS-MEXICO BORDER,
CALENDAR YEAR 2013**

TRANSPORTATION	CROSSINGS
Vehicle	15,076,290
Pedestrian	6,579,816
Truck	3,122,769
Rail	475,524
Total	25,254,399

SOURCE: Texas Center for Economic and Enterprise Development at Texas A&M International University.

may stop commercial vehicles once they are released from a border station to conduct motor vehicle safety inspections.

In addition to legitimate trade, there is cross-border illegal activity, including narcotics smuggling. Preventing illegal activity between ports of entry is the focus of the state's border security operations. **Figure 4** shows an overview of seizures associated with illegal activities during calendar year 2013. This overview represents all seizure data reported to DPS by local, state, and federal entities within certain counties located in the southern portion of the state.

Operations to prevent illegal activity led to 1,358 vehicle pursuits during fiscal year 2013, or a monthly average of

**FIGURE 3
U.S.-MEXICO BORDER CROSSING ENTRIES BY STATE, CALENDAR YEAR 2013**

STATE	TOTAL BORDER MILES	TRUCKS	TRAINS	PERSONAL VEHICLES	PEDESTRIANS	TOTAL	PERSONAL VEHICLE PASSENGERS
Texas	1,241	3,577,037	7,971	31,584,131	15,870,112	51,039,251	59,019,742
California	140	1,143,338	504	26,033,552	17,729,194	44,906,588	46,084,882
Arizona	373	381,568	866	8,172,192	7,154,131	15,708,757	15,462,699
New Mexico	180	92,924	0	757,794	445,498	1,296,216	1,557,628

NOTE: Does not include bus crossings and shows only crossings into the United States. Total border miles based on data from the U.S. Census Bureau.

SOURCE: U.S. Department of Transportation Bureau of Transportation Statistics.

FIGURE 4
TEXAS DEPARTMENT OF PUBLIC SAFETY SEIZURE OF ASSETS IN SOUTHERN TEXAS COUNTIES, CALENDAR YEAR 2013

FREQUENCY	CURRENCY	MARIJUANA	COCAINE	HEROIN	METHAMPHETAMINES	STOLEN VEHICLES RECOVERED
Weekly Average	\$425,698	29,779	227	26	65	26
Annual Total	\$22,136,304	1,548,490	11,803	1,367	3,429	1,331

NOTE: Drug seizures measured in pounds.
SOURCE: Department of Public Safety.

113. According to DPS, state law enforcement officers have concurrent jurisdiction with local and federal entities to enforce laws along the border, with the exception of immigration law. The supremacy clause outlined in the U.S. Constitution, Article VI, Paragraph 2, establishes that federal law and the federal Constitution take precedence over state law. Because federal law controls immigration issues, the federal government is responsible for enforcement. If state law enforcement officials observe a violation of federal law during the regular course of duties or overt operations, they notify federal authorities.

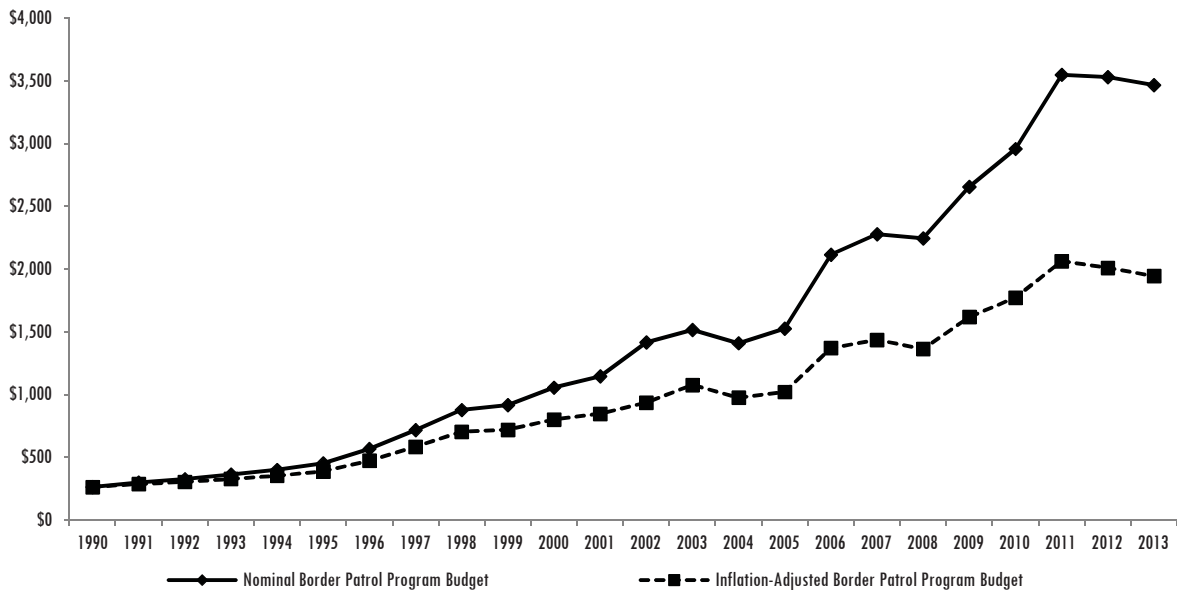
FEDERAL BORDER SECURITY ACTIVITIES

In matters of border security, the U.S. Constitution requires the federal government to repel invasions across state borders. Immigration law is established by the U.S. Congress, and due to federal preemption provided through the U.S. Constitution, Article VI, federal agencies are responsible for

enforcing these laws. The U.S. Border Patrol (USBP) is the federal entity responsible for securing the border between ports of entry. USBP’s mission is to prevent dangerous people and capabilities from entering the U.S. by averting the illegal trafficking of people and contraband. USBP conducts border enforcement activities within 20 regional sectors. Of these sectors, nine are located along the southwest border with Mexico; four sectors are wholly in Texas (i.e., Big Bend, Del Rio, Laredo and Rio Grande Valley sectors) and one is shared by a part of Texas and all of New Mexico (El Paso Sector).

Figure 5 shows actual dollars and inflation-adjusted constant dollars appropriated to USBP from federal fiscal years 1990 to 2013. During federal fiscal year 1990, USBP was appropriated \$262.6 million. By federal fiscal year 2013, funding had increased to \$3.5 billion, which represents more than a 1,200 percent funding increase. When adjusted for inflation, the federal fiscal year 2013 appropriation level

FIGURE 5
FEDERAL BORDER PATROL APPROPRIATIONS, FEDERAL FISCAL YEARS 1990 TO 2013



SOURCE: Legislative Budget Board.

showed more than a 600 percent increase in funding since federal fiscal year 1990.

In tandem with these increased appropriation levels, the federal government has increased the number of border patrol agents. During federal fiscal year 1993, for example, there were 4,028 border patrol agents; by federal fiscal year 2013, the number had grown to 21,391; an increase of more than 430 percent within 20 years. The number of USBP agents staffed in the five sectors partially or fully located in Texas increased almost doubled between federal fiscal years 2003 and 2013, as shown in **Figure 6**.

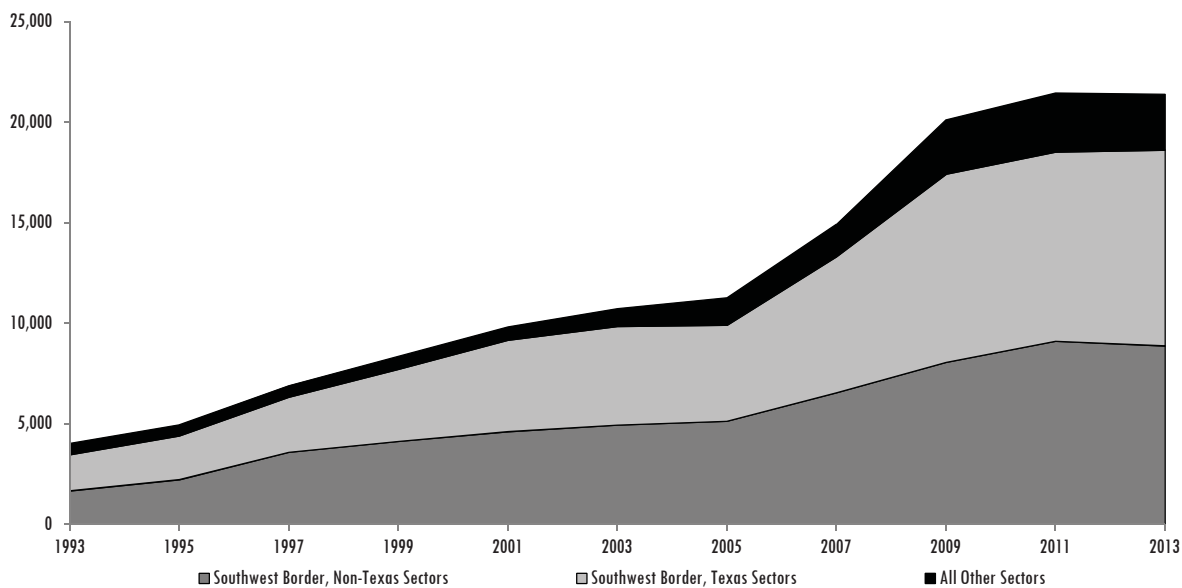
Establishing objective metrics to gauge progress toward border security has been hampered by the subjective nature of what constitutes a secure border. The federal government, for example, no longer uses an operational outcome measure for border security. However, from calendar year 2004 to 2011, operational control was the federal government’s primary outcome measure pertaining to border security. Operational control included the first two elements of a five-tier categorization of relative border security, in which security was defined as the ability to detect, respond to, and interdict cross-border illegal activity. According to the U.S. Government Accountability Office (GAO), at the end of federal fiscal year 2010, the U.S. Department of Homeland Security (DHS) reported that 44 percent of the 1,950-mile southwest border was within operational control (i.e., falling

under the Controlled or Managed tiers). **Figure 7** shows these federal border security control categories.

According to the GAO, during federal fiscal year 2011 the federal government stopped using operational control altogether as a gauge of border security attainment. DHS planned to improve the quality of measures by using a more quantitative-based index outcome measure which would be in place by fiscal year 2012. As of September 2014, DHS has not provided this new metric to measure border security. As an interim measure, DHS is using output measures such as the number of apprehensions on the southwest border between the ports of entry. However, the agency states that this measure does not relate to effectiveness because it cannot be compared to the amount of illegal activity that crosses the border undetected. **Figure 8** shows the number of USBP apprehensions along the southwest border from 1960 through 2013.

This data provides limited information because the number of apprehensions cannot be attributed to an isolated factor. For example, the increased number of apprehensions in 1986 and 2000 could be attributed to USBP enforcement efforts or to other factors, such as economic conditions that motivated greater numbers of border crossings. As another example, the reductions in apprehension in 1979 and 2010 could be attributable to the deterrent effect of increased border enforcement efforts or the result of a weakened U.S.

FIGURE 6
U.S. BORDER PATROL AGENTS, FEDERAL FISCAL YEARS 1993 TO 2013



SOURCE: Legislative Budget Board.

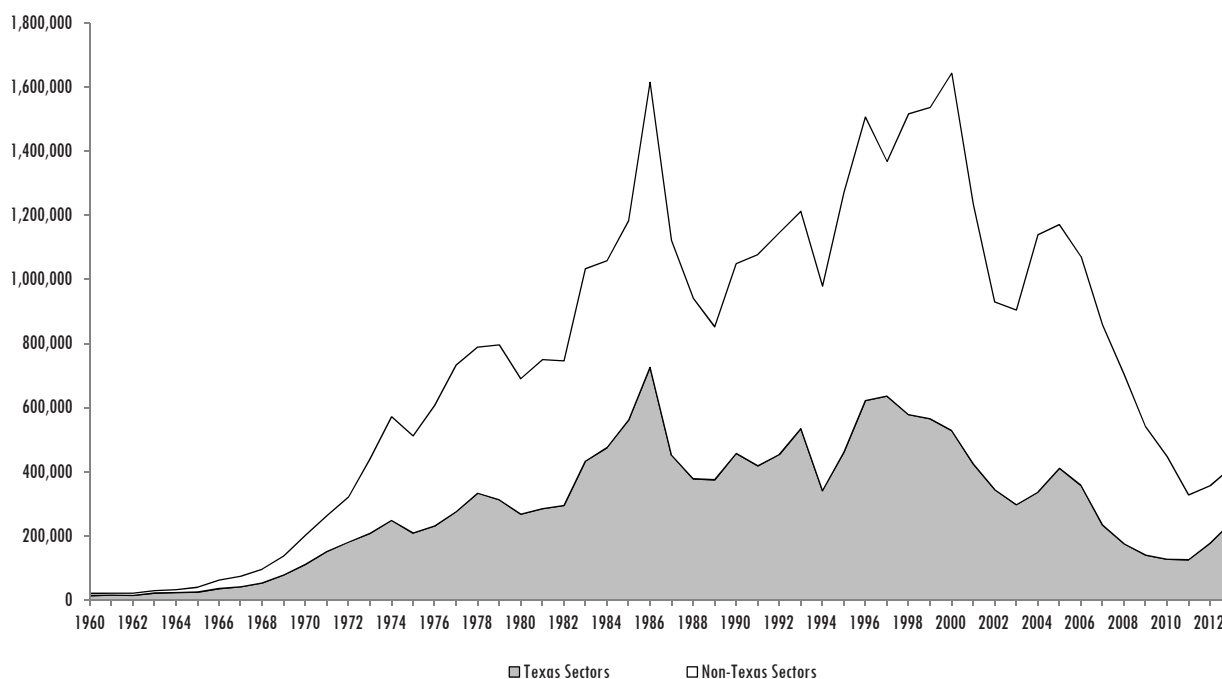
**FIGURE 7
FEDERAL BORDER SECURITY CATEGORIES, FEDERAL FISCAL YEARS 2004 TO 2011**

TIER	OPERATIONAL CONTROL ATTAINED	DEFINITION	PERCENT ACHIEVED (SOUTHWEST BORDER)
Controlled	Yes	Continuous detection and interdiction resources at the immediate border with a high probability of apprehension upon illegal entry.	6.6
Managed	Yes	Multi-tiered detection and interdiction resources in place to implement the border control strategy with a high probability of apprehension after entry.	37.4
Monitored	No	Substantial detection resources in place, but accessibility and resources affect ability to respond.	37.2
Low-level Monitored	No	Some knowledge is available to develop a rudimentary border control strategy, but the area remains vulnerable because of inaccessibility or limited resource availability.	18.8
Remote	No	Information is lacking to develop a meaningful border control strategy because of inaccessibility or lack of resources.	0.0

NOTE: Operational control attained refers to the U.S. Border Patrol's determination that an adequate control level for a particular tier has been met. Percent achieved is based on results at the end of federal fiscal year 2010.

SOURCE: U.S. Government Accountability Office.

**FIGURE 8
U.S. BORDER PATROL APPREHENSIONS ALONG THE SOUTHWEST BORDER, FEDERAL FISCAL YEARS 1960 TO 2013**



SOURCE: Legislative Budget Board.

economy that discouraged border crossings. Additionally, factors in the countries from which migrants come can affect the number of migrants who try to cross the border and, therefore, the number that could be detained. For instance, increases in violence or poor economic conditions could motivate more border crossings.

From federal fiscal years 2003 to 2013, total USBP apprehensions decreased in the southwestern sectors. During federal fiscal year 2003, approximately 905,000 apprehensions were made. During federal fiscal year 2013, fewer than 414,400 apprehensions were made. However, this decrease did not occur evenly across sectors. The number of USBP

apprehensions decreased or remained relatively steady in most southwestern sectors, however, apprehensions in the Rio Grande sector increased from approximately 78,000 for federal fiscal year 2003 to almost 155,000 for federal fiscal year 2013. This sector experienced the largest increase in apprehensions among all southern border sectors during this period.

STATE BORDER SECURITY ACTIVITIES

DPS’s 2013 *Public Safety Threat Overview* report states Mexican cartels are the largest organized crime threat in Texas. These cartels have networks operating in Texas to move drugs, people, cash, weapons, and stolen vehicles between Texas and Mexico. DPS states the cartels engage in kidnapping and assault within Texas. **Figure 9** shows the amount of drug and currency seizures in Texas between fiscal years 2010 and 2014. These seizures include all data reported to DPS by local, state, and federal entities within certain counties located in the southern portion of the state.

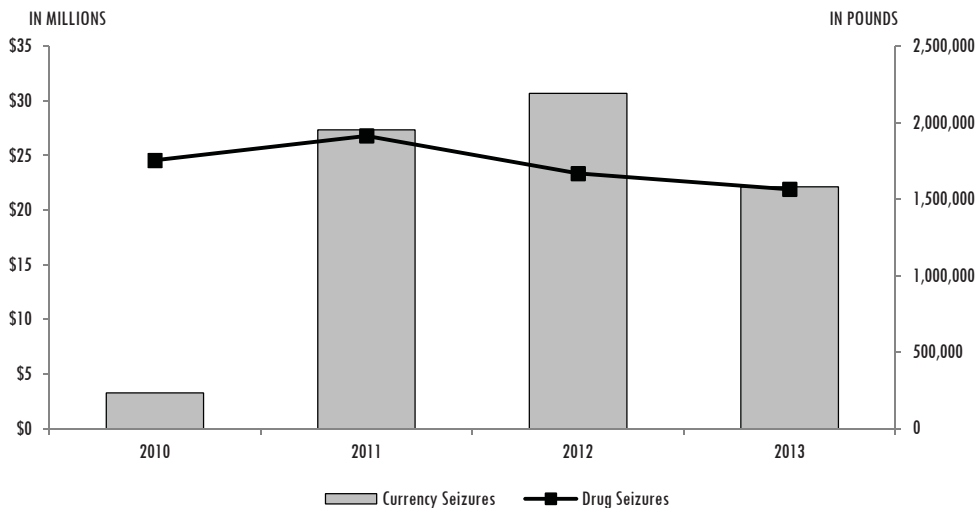
According to DPS, the Texas Rangers have provided border security since the entity was founded in 1823. In response to criminal activity in the Texas-Mexico border region, the state intensified supplemental law enforcement activities during fiscal year 2006, alongside federal border security efforts. The state’s support began by providing funding primarily for local law enforcement staff, and DPS law enforcement staff began to focus assets along sections of the international border.

Figure 10 shows the number of operations coordinated by Texas law enforcement entities.

The state’s All Funds appropriations for border security operations have more than tripled during the past four biennia. Funding sources have included Federal Funds, General Revenue Funds, General Revenue–Dedicated Funds, and Other Funds (the State Highway Fund and bond proceeds). Appropriations for border security activities during this period have been made to DPS, Texas Parks and Wildlife Department (TPWD), Trusteed Programs Within the Office of the Governor (Governor’s Office), the Texas Department of Criminal Justice (TDCJ), and most recently the Texas Military Department (TMD).

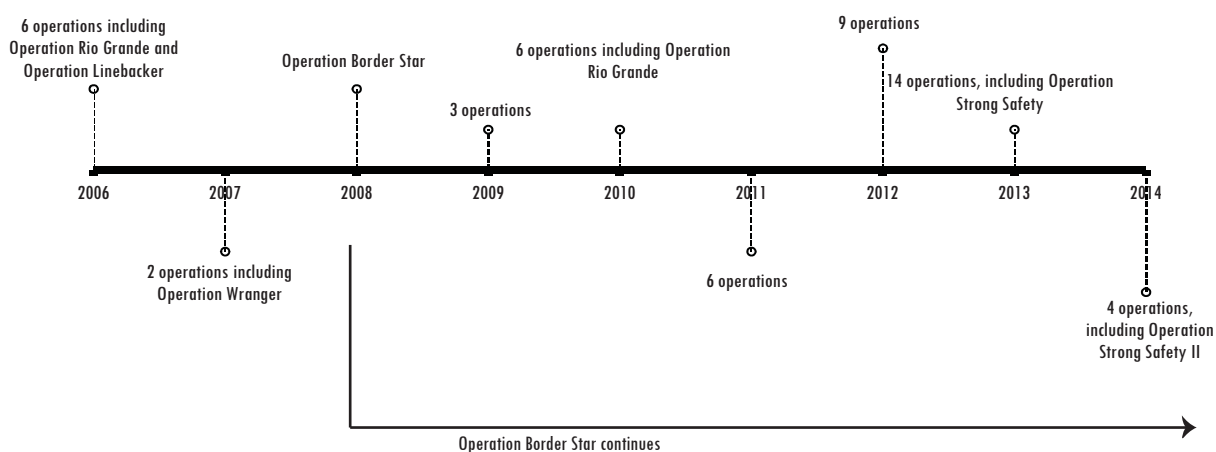
Following is a description of appropriations to each of these agencies for border security and an overview of the border security activities undertaken with this funding. Determining legislative appropriations for border security is complicated by the open-ended definition of border security and because funding has been provided across multiple strategies in multiple agency’s bill patterns in the General Appropriations Act. The Legislative Budget Board’s (LBB) *Texas State Government Effectiveness and Efficiency Report*, January 2015, includes recommendations to address these issues in the review entitled “Improve Transparency and Oversight of State Border Security Activities.” Appropriation amounts included below represent border security funding based on legislative intent and agencies input regarding their definitions of border security activities. For instance, DPS

FIGURE 9
CURRENCY AND DRUG SEIZURES IN TEXAS, FISCAL YEARS 2010 TO 2014



SOURCE: Department of Public Safety.

FIGURE 10
BORDER SECURITY OPERATIONS COORDINATED BY TEXAS LAW ENFORCEMENT ENTITIES, FISCAL YEARS 2006 TO 2014



NOTE: All border security operations conducted since fiscal year 2008 are considered to be part of Operation Border Star.
SOURCE: Legislative Budget Board.

considers funding for overtime pay for all Troopers to be a border security-related appropriation because it increases the agency’s capacity overall, which indirectly increases specific border security efforts.

OFFICE OF THE GOVERNOR

Since 2003, statute has required the Governor to direct homeland security in Texas and develop a statewide strategy that includes specific plans to protect the state’s international border, ports, and airports. The Governor’s first Homeland Security Strategic Plan covered fiscal years 2005 to 2010. It included one objective related to border security, which was to prevent terrorists from exploiting the Texas-Mexico border. The strategic plan stated that providing federal funding for state and local law enforcement officers to patrol the border was a cost-effective way to augment federal border security and reduce border-related crime. The plan posited that state support would be provided for a similar program focused on local law enforcement. The strategic plan called for the enlistment of the National Guard to provide support and training without militarizing the border. The current Homeland Security Strategic Plan, which covers fiscal years 2010 to 2015, identifies homeland security threats that could occur along the border. These challenges include weapons of mass effect that could enter through the border, Mexican cartels that control territory near the Texas-Mexico border, gangs operating in Texas in concert with Mexican cartels, the illegal crossing of persons across the border, and potential disease outbreaks. The plan includes one objective specific to the border, which is to “prevent terrorists and criminal

enterprises from exploiting Texas’ international border; including land, air, and sea”; however, other objectives include discussion of actions that could be taken in border areas.

The Office of the Governor’s Criminal Justice Division (CJD) first provided funds for border security law enforcement activities in fiscal year 2006 when it funded Operation Linebacker from a federal grant. Operation Linebacker was intended to provide staff, specialized equipment, and resources to local sheriff’s departments for increased law enforcement presence along the Texas-Mexico border to deter crime. According to the Governor’s Office, approximately \$5.7 million was provided to counties during Operation Linebacker. Of the funds awarded:

- 63 percent was used for staff costs, including overtime expenses and salaries;
- 29 percent was used to purchase equipment, including law enforcement vehicles, off-road vehicles, radios, night vision equipment, cameras, and computers; and
- 8 percent was used for travel expenses, equipment installation costs, and general supplies.

Figure 11 shows outcomes reported by counties that received Operation Linebacker funding.

During fiscal year 2006, CJD provided discretionary federal funds to temporarily concentrate existing state and local law enforcement officers and equipment along strategic sections of the border. This activity was known as Operation Rio

**FIGURE 11
RESULTS OF SELECTED MEASURES FOR OPERATION
LINEBACKER, FISCAL YEAR 2006**

MEASURE	RESULT
Average Number of Part-Time Sworn Staff	82
Average Number of Full-Time Sworn Staff	140
Regular Hours Worked by Sworn Staff	630,369
Overtime Hours Worked by Sworn Staff	118,701
Number of Intelligence Referrals	763
Number of Multi-jurisdictional Operations	441
Value of Cash Seizures	\$3,261,226
Value of Drug Seizures	\$77,269,785
Value of Weapons Seizures	\$36,221
Value of Vehicle Seizures	\$386,550
Arrests for Trafficking of Person	1
Arrests for Drug Violation	742

NOTES:

- (1) Self-reported data from counties. Not all staff was funded through Operation Linebacker grants. El Paso, Jeff Davis, and Pecos counties did not report regular or overtime hours worked by sworn staff.
- (2) Some entities that received Operation Linebacker grants expended the funds over multiple fiscal years. These measures represent results from the grant's expenditure across all fiscal years in which they were made.
- (3) Arrests for trafficking of person and drug violations were tracked for the period May 1, 2006, to December 31, 2007.

SOURCE: Office of the Governor.

Grande. A third operation using federal grants awarded to CJD, known as Operation Wrangler, occurred during fiscal year 2007. Operation Wrangler placed state, local, and private agency staff along known drug and crime corridors in the border area for a 12-day period.

For fiscal year 2006, CJD awarded \$3.4 million in grant funds to the Texas Border Sheriff's Coalition, which distributed funds to local entities that previously received Operation Linebacker funding for the same services. The coalition is made up of the chief law enforcement officers in the following participating border counties: Brewster, Cameron, Culberson, Dimmit, El Paso, Hidalgo, Hudspeth, Jeff Davis, Kinney, Maverick, Pecos, Presidio, Starr, Terrell, Val Verde, Webb, Zapata, and Zavala counties. The coalition coordinated activities among its member counties and subcontracted with sheriff's departments using these grant funds. Some of the funding was used for the coalition's operating costs.

The Governor's Office continued to provide funds to local law enforcement for staff, equipment, and planning resources

out of discretionary funds for criminal justice until fiscal year 2008, when the Legislature began appropriating funds to DPS for this purpose.

The Texas Border Sheriff's Coalition has continued to receive funding from the Governor's Office for other purposes since fiscal year 2007. From fiscal years 2008 to 2014, the group received almost \$2.6 million in All Funds, an annual average of \$368,153, to coordinate activities among counties along the Texas-Mexico border, DPS, and regional intelligence centers. The coalition also received approximately \$6.3 million for fiscal years 2009 and 2010 for the Border Watch program. This program originally was developed between the Governor's Office of Homeland Security and an outside provider in consultation with DPS in fiscal year 2007. The Governor's Office of Homeland Security was allocated \$208,000 for fiscal year 2007, when the program began. The Border Watch program provided cameras and information technology that allowed law enforcement and the public to conduct surveillance along the border. This surveillance identified active smuggling routes and high-crime areas so that law enforcement could intervene and stop criminal activity. This program later was adapted by DPS and became Operation Drawbridge. Since fiscal year 2012, CJD has provided \$2.7 million in total to DPS for Operation Drawbridge and updated technology.

Appropriations to Trusteed Programs Within the Office of the Governor for border security since fiscal year 2008 are shown in **Figure 12**.

Appropriations to the Governor's Office for the 2010–11 biennium included \$4.0 million to provide prosecution resources for districts statewide in response to the costs faced by border communities to prosecute drug and human trafficking cases. This led to the establishment of the Border Prosecution Unit, which covers 16 prosecution offices across 39 counties from El Paso to Brownsville. During the first year of appropriations for this purpose, the entire grant was provided to the office of the 34th Judicial District Attorney, which administered it by contract with the other 15 participating jurisdictions' district attorneys. At the time, there was no definition of crimes characterized as border crimes. Funding from this grant was used to hire assistant prosecutors and investigators whose primary responsibility is to handle and coordinate the prosecution of border crimes. These cases are focused on violent crimes (murder, kidnapping, and extortion), crimes associated with cartels and the drug trade, financial crimes, and human trafficking.

**FIGURE 12
TRUSTEED PROGRAMS WITHIN THE OFFICE OF THE GOVERNOR APPROPRIATIONS FOR BORDER SECURITY ACTIVITIES
2008–09 TO 2014–15 BIENNIA**

METHOD OF FINANCE	2008–09 BIENNium	2010–11 BIENNium	2012–13 BIENNium	2014–15 BIENNium
Operators and Chauffeurs License Account 99	\$0	\$13,250,000	\$4,000,000	\$6,751,730
Purpose	N/A	Funds provided for prosecution resources for districts statewide, to provide equipment and training to support patrol operations, for overtime to expand gang enforcement patrols and multi-jurisdictional gang investigations, and to expand gang prevention efforts	Funds provided for prosecution resources	Funds provided for prosecution resources

NOTES: Due to an unexpected shortfall in the Operators and Chauffeurs License Account 99, the Office of the Governor reallocated \$2.44 million from the Criminal Justice Planning Account 421 to cover border prosecution grants for fiscal year 2014. The Governor’s Criminal Justice Division has discretionary funding in the Criminal Justice Planning Account that can be used to support local law enforcement, which may have been provided for efforts that could be considered border security. These amounts are not appropriated for this purpose and are not shown. SOURCE: Legislative Budget Board.

The Eighty-second Legislature, Regular Session, 2011, established the Prosecution of Border Crime Grant Program at CJD and defined border crime in statute. The statute specifies that for purposes of this program, border crime offenses are committed by a person who is not a U.S. citizen or national and is not lawfully present in the country; coordinated with or related to activities or crimes that are committed in the United Mexican States; or offenses defined in the following statutory provisions:

- the Texas Code of Criminal Procedure, Section 3g(a) (2), Article 42.12;
- the Texas Penal Code, Chapters 19, 20, 20A, 46, or 71;
- the Texas Penal Code, Title 7 or 8; and
- the Texas Health and Safety Code, Chapter 481.

These crimes generally encompass kidnapping/person smuggling, trafficking of persons, unlawfully carrying weapons, organized crime, arson, criminal mischief, other property damage, bribery and corruption, and drug crimes. Statute defines border region for the purposes of this program as the portion of this state that is located in a county that is adjacent to an international border or adjoining one of these counties. Applications for funding are submitted to CJD, which awards and monitors the grants. Total amounts provided from this grant program are shown in **Figure 13**.

Performance measures are required to be reported by district attorney offices’ that receive funds through the program. According to the Governor’s Office, data collection methods vary depending on each jurisdiction’s records management

**FIGURE 13
PROSECUTION OF BORDER CRIME GRANT PROGRAM
AWARDS, FISCAL YEARS 2012 TO 2014**

YEAR	TOTAL AWARDED
2012	\$2,318,555
2013	\$913,685
2014	\$2,327,406

SOURCE: Office of the Governor.

system. An aggregate of the self-reported measure results for fiscal years 2012 and 2013 are shown in **Figure 14**.

DEPARTMENT OF PUBLIC SAFETY

DPS is the primary agency responsible for coordinating and leading the state’s border security efforts, which are developed based on direction in the Governor’s Homeland Security Strategic Plan and from the Legislature. Instructions for preparing and submitting agency strategic plans, which are provided by the Governor’s Office of Budget, Planning and Policy and the LBB, include securing the Texas-Mexico border from all threats as a priority goal. DPS’s strategic plan for fiscal years 2011 to 2015 includes two strategies specifically related to border security. DPS describes its border security strategy as planning, coordinating, and executing interagency operations to detect, deter, and interdict the northbound and southbound smuggling of drugs, humans, weapons, currency, and stolen vehicles through the Texas border region. The second strategy relates to local border security and funds provided to local law enforcement agencies.

According to DPS, its border security operations, like regular law enforcement operations, have the goal of deterring and

FIGURE 14
MEASURES RELATED TO THE BORDER CRIME PROSECUTION GRANT PROGRAM, FISCAL YEARS 2012 AND 2013

MEASURE	2012	2013
Border crime cases filed	2,486	2,515
Border crime cases prosecuted	2,796	2,438
Border crime cases dismissed	189	306
Border crime cases referred by federal agencies for state prosecution	354	130
Border crime cases referred for federal prosecution	62	36
Border crime cases resulting in convictions or community supervision	1,765	1,690
Cases outside the jurisdiction in which prosecution assistance was provided	315	431
Contact hours of training conducted	1,793	3,774
Direct technical assistance consultations provided	2,185	2,667
Hours of training attended	1,663	1,176
Individuals attending training sessions	1,304	1,228
Investigators hired	3	1
Legal assistants hired	4	1
Prosecutors hired	17	9
Training sessions conducted	173	117
Training sessions attended	138	145

NOTE: Border crime cases resulting in convictions or community supervision include probation and deferred adjudication.

SOURCE: Office of the Governor.

preventing criminal activity. However, operations specifically related to border security:

- occur primarily in high-threat areas in the Texas-Mexico border regions;
- focus primarily on border-related crime such as drug and human trafficking, extortion, and home invasions; and
- typically involve a large number of law enforcement staff during surges.

DPS’s jurisdiction in border areas is concurrent with federal and local jurisdiction with the exception of enforcing immigration laws which federal agencies are solely responsible for in accordance with the U.S. Constitution. DPS states that if, in the regular course of their duties or overt operations officers observe violations of federal laws that are not within their purview, federal authorities are notified.

DPS involvement in supplemental border security activities since fiscal year 2006 primarily has included focused surge operations. These operations have typically concentrated existing assets temporarily with the intention of achieving a specific objective. The first border security surge operations from fiscal years 2006 to 2007 were funded individually with grants from CJD. During fiscal year 2008, the Legislature

appropriated funds specifically for border security purposes and included authority for DPS to expend funds for surge operations. Since this time DPS has funded surge operations out of its direct appropriations, which are shown in **Figure 15**.

During fiscal year 2007, DPS, with other agencies’ assistance, began establishing regional Joint Operations Intelligence Centers (JOIC) and the Border Security Operations Center (BSOC) in Austin. Six JOICs are operational along the border and coastal bend areas of the state. JOICs are used to coordinate border security operations and serve as unified command centers that include officials from federal, state, local, and military agencies. The Texas Rangers coordinate the centers and state border security activities in cooperation with all participants. Additionally, the JOICs serve as centralized locations where participating law enforcement and other governmental entities send information about border-related crimes. JOICs consolidate this information and send it to the BSOC, which tracks trends and monitors border crime. This analysis of intelligence and threat trends is used to assess operational requirements and make recommendations regarding operations and resources. Specific operations are conducted within command and control structures that involve other state agencies, county

**FIGURE 15
TEXAS DEPARTMENT OF PUBLIC SAFETY APPROPRIATIONS FOR BORDER SECURITY ACTIVITIES
2008–09 TO 2014–15 BIENNIA**

METHOD OF FINANCE	2008–09	2010–11	2012–13	2014–15
General Revenue Fund	\$63,704,714	\$0	\$53,372,958	\$166,549,889
State Highway Fund	\$44,444,865	\$24,162,673	\$119,476,207	\$222,563,230
Operators and Chauffeurs License Account 99	\$0	\$42,804,714	\$40,084,202	\$0
Federal Funds (American Recovery and Reinvestment Act)	\$0	\$29,050,000	\$0	\$0
General Obligation Bond Proceeds	\$0	\$6,100,000	\$0	\$0
Emergency Radio Infrastructure Account 5153	\$0	\$0	\$0	\$5,500,000
Emerging Technology 5124	\$0	\$0	\$0	\$7,000,000
TOTAL	\$108,149,573	\$102,117,387	\$212,933,367	\$401,613,119
Purpose	Funds provided for grants to local law enforcement for surge operations; to establish 12 JOICs and the BSOC; to fund expenses associated with surge operations; to fund salaries; 4 helicopters; 1 recruit training school; and other equipment	Funds provided to pay salaries; purchase helicopters and acquire other equipment; fund 1 additional recruit training school; fund a crime laboratory; continued development of JOICs and the BSOC; provide grants for local law enforcement entities; and to fund expenses associated with surge operations	Funds for 646 full-time equivalent positions; overtime sufficient to extend trooper work days to 9 hours; replacement vehicles; to increase the number of JOICs; additional aircraft, replacement parts, and video links for helicopters; the Tactical Marine Unit; to conduct southbound checkpoints; information technology and software upgrades; fiber optic technology for vehicle searches; grants to local law enforcement; and funding TPWD and TMD	Funds provided for crime laboratory capacity building; DNA testing; the Tactical Marine Unit; interoperability; patrol vehicles and fuel; additional recruit training schools; information technology upgrades; trooper salary increases; grants to local law enforcement; and funding TPWD and TMD

NOTES:

- (1) These appropriation amounts are based on the Texas Department of Public Safety’s definition of border security, which has at times included activities occurring across the state and assumed that funding any items that indirectly increase the agency’s general capacity also increase border security efforts.
- (2) JOIC = Joint Operations Intelligence Center; BSOC = Border Security Operations Center; TMD = Texas Military Department; TPWD = Texas Parks and Wildlife Department.
- (3) Amounts for the 2014–15 biennium include \$5.5 million in funds directed to the agency by the Governor using authority provided in the Texas Government Code and General Appropriations Act to access General Revenue–Dedicated account balances. Amounts for the 2014–15 biennium also include \$64.9 million transferred to the agency as a result of the Legislative Budget Board’s approval of a proposal by the Office of the Governor for budget execution to provide additional funds for border security.

SOURCE: Legislative Budget Board.

and municipal law enforcement agencies, and coordination with federal agencies.

DPS’s border security operations are intended specifically to deny Mexican drug cartels and their associates the ability to move drugs and people into Texas between ports of entry and

to reduce the power of these organizations. The long-term, DPS-led border security effort that began in fiscal year 2008 is called Operation Border Star. The activity is the combined effort of local, state, and federal agencies to combat smuggling into Texas. This operation has included smaller, more focused efforts, including Operation Strong Safety, which began in

fall 2013. During fiscal year 2009, the Texas Rangers organized Ranger Reconnaissance Teams, which are tactical contact teams deployed in concealed positions that can respond quickly to reported incidents. Since 2010, these teams have been focused on the lower Rio Grande Valley, which DPS considers to be the area with the most serious tactical threat. These teams work in concentration with other DPS assets that help to identify transit routes and to funnel traffic toward Ranger positions. The teams intercept persons, narcotics, currency, contraband, and vehicles. From fiscal years 2009 to 2011, border security operations were expanded to support interdictions along major transit corridors such as those connecting Houston, Dallas–Fort Worth, Austin, San Antonio, and Amarillo. During focused operations, tactical activities are managed from a mobile command center located near the operation site. This center is a portable semi-trailer that allows staff to connect to the DPS computer network, telephone, fax, television, Internet, aircraft video feeds, and law enforcement radios.

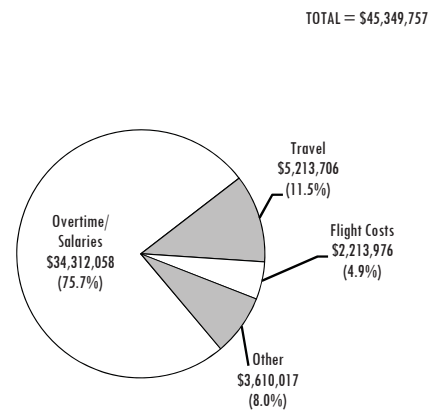
DPS initiated Operation Strong Safety during fall 2013, in which continuous patrols along the Rio Grande River occurred in conjunction with local, state, and federal partners. DPS reports that for the period of 2013 when Operation Strong Safety was in effect, the following occurred:

- 49 percent decrease in marijuana seizures;
- 42 percent decrease in cocaine seizures;
- 95 percent decrease in methamphetamine seizures;
- 185 percent increase in U.S. currency seizures;
- 67 percent increase in recovery of stolen vehicles;
- 74 percent decrease in felony pursuits; and
- 31 percent decrease in Operation Drawbridge camera detections.

In May 2014, DPS was directed to plan and execute a 90-day surge operation in border counties to begin no earlier than September 1, 2014. DPS was authorized to use any appropriated funds to support this operation. The agency was required to provide a detailed cost estimate before the launch of the operation and to establish metrics to measure the impact and effectiveness of the operation. In June 2014, the Governor, Lieutenant Governor, and Speaker of the House directed DPS to plan and execute a surge operation in Texas border counties based in part on the results of Operation Strong Safety. DPS was directed to complete this operation using existing resources, and the direction specified

that the cost would need to be addressed during the Eighty-fourth Legislature, Regular Session, 2015. DPS began this surge, known as Operation Strong Safety II, in June 2014 and estimated the weekly cost would be \$1.3 million. Through December 10, 2014, DPS costs for this surge have been consistent with this estimate. **Figure 16** shows DPS’s expenditures for Operation Strong Safety II from June 2014 through December 10, 2014.

FIGURE 16
TEXAS DEPARTMENT OF PUBLIC SAFETY OPERATION
STRONG SAFETY II EXPENDITURES
JUNE 2014 TO DECEMBER 10, 2014



NOTE: The Other category includes items such as materials and consumables, food, rental expenses, repair costs, and fuels.
 SOURCE: Legislative Budget Board.

Several DPS assets are employed primarily during border security operations. Details of the use of DPS air assets in border security operations are shown in **Figure 17**. In addition to these air assets, both the Tactical Marine Unit (TMU) and Texas Rangers operate water vessels.

TMU was established to respond to confrontations between Mexican cartels and law enforcement along the Rio Grande River. According to DPS, cartel members confronted officers on the U.S. side of the border to recover drugs driven into the river, and on multiple occasions the cartel members shot at the officers. TMU crews operating the boats have received advanced tactical and boat operations training. Rangers in the boats have returned fire if fired upon; to date no injuries have been reported. As of September 2014, TMU had six large vessels, two shallow water vessels, and one undercover vessel. The large vessels operate 24 hours a day, every day of the week. Decisions regarding the location of TMU deployments are based on multiple variables such as the

FIGURE 17
NUMBER OF AIRCRAFT HOURS FLOWN IN SUPPORT OF
BORDER SECURITY, CALENDAR YEARS 2006 TO 2014

YEAR	HOURS FLOWN
2006	157
2007	877
2008	2,095
2009	4,462
2010	4,601
2011	4,453
2012	4,352
2013	4,959
2014	5,335

NOTES:

(1) Calendar year 2014 data reported as of December 15, 2014.

(2) Includes hours flown by aircraft and helicopters.

SOURCE: Department of Public Safety.

threat environment, operational goals and objectives, coordination with other agencies, availability of TMU resources, and suitability of TMU resources to the environment. TMU vessels operate along both the Gulf Intracoastal Waterway and the Rio Grande River.

DPS aircraft are used for activities across the state, including border security support. According to DPS, during calendar year 2013, its aircraft were involved in more than 4,700 arrests by local, state, and federal law enforcement and the seizure of narcotics with a value of almost \$30.2 million in border areas. DPS has purchased a single-engine turbine aircraft, known as Spectre, that can operate at a high altitude. At this altitude aircraft can be used for patrol and surveillance operations without alerting Mexican cartels. DPS reports that Spectre has lower operating costs than some helicopters and less maintenance requirements, which increase its operations capacity.

In total, DPS has eight airplanes, including two based in border cities. All aircraft receive inspections for every 100 hours of operations in accordance with Federal Aviation Administration regulations. According to DPS, fuel and maintenance costs for these aircraft are \$664 per hour of flight time. Additionally DPS has 15 helicopters, including five based in areas under the jurisdiction of the JOICs. Helicopters are inspected at 100, 200, 400, and 800 hours of operation and at 12 years. Maintenance costs for these inspections vary depending upon the level of inspection occurring. A 100 hour inspection generally takes 4 days while a 12 year inspection can take 12 weeks. During surge

operations these aircraft may be flown for more than 100 hours; requiring inspections at various points during a surge. When this occurs, DPS must either use aircraft from another part of the state or reduce air support.

The length of the Texas-Mexico border (1,241 miles) would necessitate a large number of staff to have law enforcement coverage along the entire border. To address this concern, DPS has developed detection technology using video cameras that provide surveillance capabilities to support operations. These cameras, part of Operation Drawbridge, provide heat and motion detection and low-light capability. When heat or movement is detected by a camera, an image is captured and sent to the Texas Fusion Center, BSOC, DPS communications facilities, and USBP facilities. Staff monitor the cameras continuously and use monitoring software to validate whether an image shows potentially criminal activity. If the activity is considered criminal, an alert is sent to USBP, the local sheriff's office, the Fusion Center, and other border law enforcement partners. Agents are dispatched to the scene to make an apprehension or push the activity back across the border. Operation Drawbridge cameras are portable and can be moved along the border to support interdiction operations or be located in hard-to-monitor areas where there is likely to be smuggling traffic. For instance, cameras may be placed in areas where exposure deaths regularly occur. DPS reports the cameras cost approximately \$300 each. By the end of July 2014, the cameras had detected more than 95,000 criminal exploitations of the border; more than 46,000 individuals and 72 tons of narcotics had been apprehended based on information provided through Drawbridge cameras. According to DPS, the most cost-effective and reliable technological assets are staffed aircraft combined with the use of Drawbridge cameras.

DPS troopers and staff from multiple areas are involved in the agency's border security efforts. This includes Texas Highway Patrol officers, Texas Rangers, staff from the Law Enforcement Support Division, and staff from the Aircraft and TMU divisions. The number of hours these staff have spent in support of border security operations during the past six fiscal years has fluctuated, as shown in **Figure 18**.

The Legislature first appropriated funds directly to DPS for local border security efforts via a rider in the General Appropriations Act for the 2008–09 biennium. At that time, the Governor's Office ceased regularly providing grants to local law enforcement for this purpose. The purpose of these grants to local law enforcement is to provide increased patrol and investigative capacity along the border. DPS states these

**FIGURE 18
STAFFING HOURS SUPPORTING BORDER SECURITY OPERATIONS, FISCAL YEARS 2009 TO 2014**

YEAR	TEXAS HIGHWAY PATROL	TEXAS RANGERS	LAW ENFORCEMENT SUPPORT DIVISION
2009	52,742 Regular; 26,610 Overtime	Unavailable	Unavailable
2010	28,503 Regular; 48,209 Overtime	Unavailable	1,192 Regular; 369 Overtime
2011	36,852 Regular; 78,494 Overtime	Unavailable	4,170 Regular; 1,249 Overtime
2012	34,163 Regular; 25,107 Overtime	16,442 Regular; 8,856 Overtime	4,226 Regular; 1,602 Overtime
2013	37,538 Regular; 44,045 Overtime	17,373 Regular; 9,918 Overtime	2,917 Regular; 2,127 Overtime
2014	42,000 Regular; 45,387 Overtime	32,922 Regular; 2,218 Overtime	270 Regular; 244 Overtime

NOTE: Fiscal year 2014 data for the Texas Highway Patrol reflects September 2013 through July 2014 only. Staffing hours data supporting border security operations by the Texas Rangers was not collected before fiscal year 2012.

SOURCE: Department of Public Safety.

grants have achieved this purpose based on grantee expenditures and activities, feedback from the JOICs and DPS regional commanders, and analysis of results and metrics shown in the compilation of operational reports. The grants provided by DPS can be used for overtime and operational costs for increased patrol and investigative capacity for certified peace officers and law enforcement support staff following the DPS overtime policy. Funds subject to this rider also may be provided for overtime, operational costs, increased patrol and investigative capacity for TPWD, and travel expenses for TMD. Amounts distributed by DPS to local governments since fiscal year 2008 have ranged from \$5.0 million to \$21.0 million per fiscal year, as shown in **Figure 19**. **Figure 20** shows the counties in which local entities have received border security grant funds from DPS from fiscal years 2008 to 2014.

According to DPS, selection of local border security grant recipients is based on previous participation in the program, input from JOICs, previous requests for reimbursement, and

Texas Ranger management input. Criteria used to review grant applications includes the quality of the application, the applicant’s history of available alternative funding, past grant effectiveness, risk (indicated by population and proximity to the border), and operational performance.

DPS reports it assesses quantitative and qualitative factors to evaluate progress toward securing the border and determine the output of these operations. These indicators are shown in **Figure 21**.

TEXAS PARKS AND WILDLIFE DEPARTMENT

According to TPWD, the agency has been involved unofficially in border security for more than 40 years; however, its official participation began in fiscal year 2006 during Operation Stonegarden. This ongoing program is the nation’s largest federal border security grant program for states and provides funding to improve law enforcement preparedness along U.S. land borders. TPWD’s law enforcement border operation mission statement is to

**FIGURE 19
TEXAS DEPARTMENT OF PUBLIC SAFETY AGGREGATE FUNDING DISTRIBUTED FOR LOCAL BORDER SECURITY GRANTS
FISCAL YEARS 2008 TO 2014**

YEAR	LOCAL ENTITIES	TEXAS PARKS AND WILDLIFE DEPARTMENT	TEXAS MILITARY DEPARTMENT
2008	\$6,901,598	\$171,698	\$1,494,333
2009	\$25,066,554	\$1,021,802	\$4,575,673
2010	\$11,155,151	\$0	\$0
2011	\$21,657,509	\$0	\$0
2012	Unknown	\$1,200,000	\$2,017,170
2013	\$4,607,000	\$900,000	\$2,256,957
2014	\$4,585,482	\$900,000	\$2,270,808

NOTES:

(1) The Department of Public Safety did not provide amounts distributed to local entities in fiscal year 2012.

(2) Amounts distributed to the Texas Parks and Wildlife Department were in addition to legislative appropriations to that agency.

SOURCE: Department of Public Safety.

FIGURE 20
COUNTIES IN WHICH LOCAL BORDER SECURITY GRANTS HAVE BEEN DISTRIBUTED, GRANT YEARS 2010 TO 2014



NOTE: Entities that received grants included cities, counties, councils of governments, tribes, and regional planning commissions. The counties depicted represent the location of all cities, counties, and tribes or the membership of all councils of governments and regional planning commissions that received grants.
 SOURCE: Legislative Budget Board.

FIGURE 21
TEXAS DEPARTMENT OF PUBLIC SAFETY BORDER SECURITY INDICATORS, AS OF SEPTEMBER 2014

PRIMARY INDICATORS

Drug prices	Seizures of drugs, weapons, and currency
Drug availability	Apprehensions

SECONDARY INDICATORS

Decrease in drug seizures in operation areas	Decrease in the number of Drawbridge hits in operation areas
Decrease in apprehension of undocumented persons in certain operation areas	Decrease in state house related extortions and kidnappings
Decrease in pursuits in operation areas and adjacent communities	Decrease in bailouts north of the operation areas
Decrease in home invasions in operation areas and adjacent communities	Decrease in unidentified remains in Brooks County

SOURCE: Department of Public Safety.

“deploy forces to deny and disrupt illegal operations along the Texas-Mexico border region.” Game wardens conduct operations to prevent, disrupt, and capture persons involved in poaching (which includes illegal commercial fishing, illegal hunting, criminal trespass, environmental crime, or other crimes related to the natural resources of Texas). These

operations include maritime security activities that take place along the Rio Grande River, inland bays, and nine nautical miles into the Gulf of Mexico. Game wardens also prevent, disrupt, and capture persons involved in illegal activity associated with theft, burglary, human trafficking, narcotics, stolen vehicles, firearms, or transporting currency across the

border. TPWD game wardens enforce laws in the Texas Penal Code, the Texas Code of Criminal Procedure, the Texas Parks and Wildlife Code. The Water Safety Act, a federal law that has been adopted in Texas statute, provides game wardens the authority to stop any boat at any time. According to TPWD, when game wardens attempt to stop persons from committing crimes, they typically contact another entity to make the arrest. Game wardens also detain persons for trespassing. Appropriations to TPWD for border security since fiscal year 2008 are shown in **Figure 22**.

Game wardens who work in border areas are involved daily in border security activities. TPWD conducts border surges based on intelligence and trends, and assists in coordinated activities with federal, state, and local agencies. These surges are what TPWD considers to be in addition to daily operations. TPWD border operations are administered by TPWD’s Chief of Homeland Security in conjunction with the majors of three TPWD regions along the border, and in consultation with the Texas Rangers Reconnaissance Team and USBP. When TPWD conducts enhanced border operations, it notifies local police departments, sheriff’s

offices, and port authorities. Game wardens assist these entities in responding to border-related incidents when requested. TPWD seizure data in certain counties is reported to JOICs, and TPWD shares intelligence with other law enforcement entities. The results of TPWD activities along the border are shown in **Figures 23** and **24**.

TPWD has 336 boats in its fleet, approximately 60 percent of these vessels are based in game warden regions that include the border area. These can be used for border security along both the Rio Grande River and maritime areas and for daily patrols and search and rescue missions. During surge operations, costs associated with the use of these boats is funded through an interagency contract with DPS in which TPWD is reimbursed for border security-related costs that are in addition to normal operations. **Figure 25** shows the number of hours the boats have been operated as part of border security surge operations since fiscal year 2008.

In addition to boat assets, TPWD has 10 dogs that are used in daily operations, 2 of which have been used in border security surge operations. In the same manner that TPWD is

**FIGURE 22
TEXAS PARKS AND WILDLIFE DEPARTMENT APPROPRIATIONS FOR BORDER SECURITY ACTIVITIES
2008–09 TO 2014–15 BIENNIA**

METHOD OF FINANCE	2008–09 BIENNIA	2010–11 BIENNIA	2012–13 BIENNIA	2014–15 BIENNIA
General Revenue Fund	\$2,125,193	\$2,125,192	\$2,125,192	\$7,418,633
Operators and Chauffeurs License Account 99	\$0	\$1,650,000	\$1,650,000	\$1,650,000
Federal Funds (American Recovery Reinvestment Act)	\$0	\$500,000	\$909,759	\$0
TOTAL	\$2,125,193	\$4,275,192	\$4,684,951	\$9,057,633
Purpose	Funding provided for additional game warden full-time equivalent positions; overtime; operational cost for increased patrol and investigative capacity; vehicles; and computers	Funds provided for enhanced border security operations; new game warden full-time equivalent positions and overtime pay; patrol boats; off-road vehicles; and night vision goggles	Funds provided for enhanced border security operations; new game warden full-time equivalent positions and overtime pay; and tactical vessels, equipment, and operations	Funds provided for enhanced border security operations; new game warden full-time equivalent positions and overtime pay; game warden salary increases; and tactical vessels, equipment, and operations

NOTES:

- (1) Funds from the Operators and Chauffeurs License Account are provided for additional game wardens and overtime. During the 2010–11 biennium, American Recovery and Reinvestment Act funds were provided for patrol boats from Trusteed Programs Within the Office of the Governor. For the 2012–13 and 2014–15 biennia, tactical vessels, equipment, and operations were paid for using General Revenue Fund appropriations. The 2014–15 biennium’s appropriations also included salary increases for game wardens.
- (2) Due to an unexpected shortfall in the Operators and Chauffeurs License Account in the 2014–15 biennium, expenditures from this account did not occur. The agency used funds provided through an existing interagency contract with the Texas Department of Public Safety to offset a portion of this.
- (3) Amounts for the 2014–15 biennium include \$5.3 million transferred to the agency as a result of the Legislative Budget Board’s approval of a proposal by the Office of the Governor for budget execution to provide additional funds for border security.

SOURCE: Legislative Budget Board.

**FIGURE 23
TEXAS PARKS AND WILDLIFE DEPARTMENT STATEWIDE
SEIZURES AND ARRESTS
SEPTEMBER 2006 TO DECEMBER 15, 2014**

METRIC	AMOUNT	ESTIMATED VALUE
Marijuana	50,097 pounds	\$40,077,600
Cocaine	78 kilograms	\$1,170,000
Boats	273	\$819,000
Motors	272	Unknown
Arrests	204	N/A
Hoop Net	122	\$15,250
Gill Net	1,058,659 feet	\$1,058,659

NOTE: This does not include seizures and arrests made by Texas Parks and Wildlife Department personnel while working with other entities during joint operations. When working with other agencies as a taskforce, only the lead agency reports data.

SOURCE: Texas Parks and Wildlife Department.

**FIGURE 24
TEXAS PARKS AND WILDLIFE DEPARTMENT MARIJUANA
SEIZURES, FISCAL YEARS 2006 TO 2013**

YEAR	BORDER COUNTIES	NON-BORDER COUNTIES
2006	800	0
2007	3,941	0
2008	1,500	860
2009	7,436	300
2010	1,138	631
2011	3,521	2,707
2012	2,779	314
2013	17,557	0
TOTAL	38,671	4,812

NOTES:

(1) The Texas Parks and Wildlife Department attributes the large increase in seizures in fiscal year 2013 to more involvement with federal High Intensity Drug Trafficking Area task forces, which resulted in game wardens having more related intelligence.

(2) Seizure amounts shown in pounds.

SOURCE: Texas Parks and Wildlife Department.

reimbursed for the use of boats during surge operations, TPWD receives reimbursement from DPS for game wardens involved in surge operations, according to an interagency contract. **Figure 26** shows the total number of staffing hours for which game wardens have been involved in border security surge operations since fiscal year 2008.

TPWD also monitors Operation Drawbridge cameras with DPS. TPWD monitoring primarily occurs at night, and game wardens respond to camera detections if they have been

**FIGURE 25
USE OF TEXAS PARKS AND WILDLIFE DEPARTMENT
ASSETS IN BORDER SECURITY OPERATIONS
FISCAL YEARS 2008 TO 2013**

YEAR	BOAT HOURS
2008	5,483
2009	6,765
2010	0
2011	0
2012	5,840
2013	3,931

NOTE: The Texas Parks and Wildlife Department and Department of Public Safety did not have an interagency contract during fiscal years 2010 and 2011; therefore, these boats were not used as part of surge operations.

SOURCE: Texas Parks and Wildlife Department.

**FIGURE 26
TEXAS PARKS AND WILDLIFE STAFFING HOURS
SUPPORTING BORDER SECURITY OPERATIONS
FISCAL YEARS 2008 TO 2014**

YEAR	STAFFING HOURS
2008	23,936
2009	41,953
2010	0
2011	0
2012	41,808
2013	31,403
2014	53,791

NOTE: The Texas Parks and Wildlife Department and Department of Public Safety did not have an interagency contract during fiscal years 2010 and 2011; therefore, game wardens were not used as part of surge operations.

SOURCE: Texas Parks and Wildlife Department.

placed in a location at TPWD's request. TPWD also participates in operational briefings, meetings, and reviews with DPS.

TEXAS DEPARTMENT OF CRIMINAL JUSTICE

TDCJ receives border security appropriations for staff to help prevent transnational gang activity by assisting in criminal investigations and fugitive apprehension. These staff are within the purview of TDCJ's Office of the Inspector General and also provide information to TDCJ's Fusion Center. The Fusion Center serves as the hub for the collection, assessment, analysis, and dissemination of gang-related and intelligence information to all appropriate stakeholders. Operational duties of the Fusion Center include managing the Texas Anti-Gang Information Tracking (TAGIT) system;

maintaining an information clearinghouse to collect and appropriately process relevant TDCJ gang information and intelligence provided by prison gangs and law enforcement agencies; providing informative, timely reports and assessments through comprehensive gang information and intelligence analysis; and increasing networking interactions and improving relationships between prison gangs, TDCJ staff, and law enforcement agencies to encourage collaboration and sharing of gang information and intelligence. Appropriations to TDCJ for border security-related activities are shown in **Figure 27**.

TEXAS MILITARY DEPARTMENT

The Texas National Guard, which is a part of TMD, has assisted in Texas border security activities since fiscal year 2006. This participation primarily has been directed federally or within the scope of DPS operations. As a result, federal funds or reimbursements from DPS have been the primary source of funding for guard activities related to border security. During fiscal year 2014, TMD received state funds specifically for border security. Before that year, TMD did not receive appropriations of state funds specifically for activities which it may have conducted in the border region or in conjunction with border security efforts. Any state funds TMD spent in relation to border security before fiscal year 2014 were at its discretion and not directed through appropriation decisions made by the Legislature.

The guard can be activated three different ways, but for the purposes of border security it has participated in mostly federally funded border operations. One historical approach to activating the guard has been through the U.S. Code, Title 32 status, a federally funded activity within the Governor’s control. Title 32 provides authority for the guard to engage

in law enforcement activities. Examples of Title 32 missions are Operation Jump Start and Operation Phalanx. Operation Jump Start occurred from calendar years 2006 to 2008 across the U.S. southwestern border and cost \$1.2 billion total; approximately \$190.3 million was from Texas Army and Air National Guard expenditures, which were federally funded. A total of 1,676 Texas military forces personnel were deployed in support of Operation Jump Start and were tasked with observation and intelligence gathering.

Operation Phalanx initially occurred during calendar years 2010 and 2011 and cost \$110.0 million. The operation was extended three times past the originally scheduled end date of June 30, 2011. The Texas National Guard’s specific mission within Operation Phalanx was Operation River Watch. A total of 286 Texas Army National Guard members were deployed in support of the initial phase of Operation River Watch, which cost approximately \$31.1 million. Eighty-five Texas Army National Guard members deployed in support of Operation River Watch II, bringing the total cost for the Texas’ guard participation in both phases to \$56.7 million, all of which was federally funded. The role of the Texas guard during Operation River Watch was to support USBP by identifying entries across the border. Observation by the Texas guard was credited with leading to the seizure of 17,665 pounds of marijuana, 4,030 apprehensions, and 3,417 persons who turned back to Mexico before being apprehended. The guard also provided criminal analysts, who assisted with investigations related to activities such as human smuggling, narcotics smuggling, and export enforcement issues.

Another federally funded activation method is known as the U.S. Code, Title 10 status, through which the guard is under the command of the Secretary of Defense. Pursuant to Title

**FIGURE 27
TEXAS DEPARTMENT OF CRIMINAL JUSTICE APPROPRIATIONS FOR BORDER SECURITY ACTIVITIES
2008–09 TO 2014–15 BIENNIA**

METHOD OF FINANCE	2008–09 BIENNIA	2010–11 BIENNIA	2012–13 BIENNIA	2014–15 BIENNIA
Operators and Chauffeurs License Account 99	\$500,000	\$450,000	\$450,000	\$450,000
Purpose	Funds to provide the Office of Inspector General with additional officers to staff the Fusion Center and coordinate other gang intelligence activities	Funds to provide the Office of Inspector General with additional officers to staff the Fusion Center and coordinate other gang intelligence	Funds to provide the Office of Inspector General with additional officers to staff the Fusion Center and coordinate other gang intelligence	Funds to provide the Office of Inspector General with additional officers to staff the Fusion Center and coordinate other gang intelligence

NOTE: Due to an unexpected shortfall in the Operators and Chauffeurs License Account, the Texas Department of Criminal Justice reallocated \$450,000 from General Revenue Funds appropriations to cover these staff costs during the 2014–15 biennium.
SOURCE: Legislative Budget Board.

10, guard members may not directly participate in civilian law enforcement activities according to the Posse Comitatus Act of 1878, with the exception of counterdrug activities as authorized by the National Defense Authorization Act of 1991. The Texas National Guard has never been activated for border security purposes pursuant to this method.

The third activation method is state-funded and within the Governor’s control. The Texas Constitution, Article IV, Section 7, and the Texas Government Code, Chapter 431, Subchapter H, authorize the Governor to deploy state military forces to enforce state law, suppress insurrections, and repel invasions. Operation Wrangler, a short-term, second-phase surge of law enforcement, was a state-funded Texas National Guard border mission that occurred during January 2007 and cost \$1.1 million in All Funds. A total of 550 Texas National Guard members deployed with the purpose of augmenting local, state, and federal law enforcement efforts. This mission has transitioned into Operation Border Star, with Texas National Guard participation of a few dozen personnel coordinating with multiple law enforcement agencies at JOICs. TMD has an interagency contract with DPS in which DPS reimburses TMD for Operation Border Star costs incurred. The amount of reimbursement since fiscal year 2011 is shown in **Figure 28**.

**FIGURE 28
TEXAS MILITARY DEPARTMENT REIMBURSEMENT FOR
OPERATION BORDER STAR PARTICIPATION
FISCAL YEARS 2011 TO 2014**

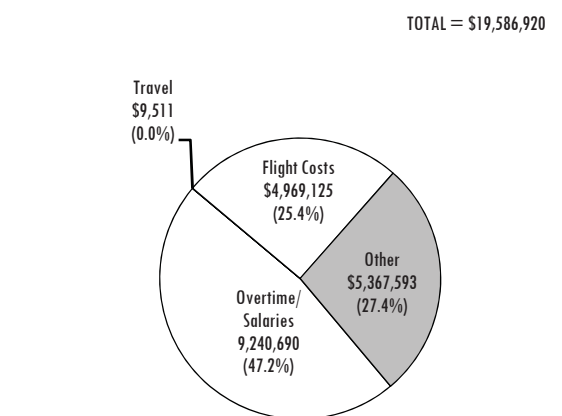
YEAR	AMOUNT
2011	\$1,859,314
2012	\$1,899,570
2013	\$2,107,568
2014	\$1,667,122

NOTE: Reimbursement provided from the Department of Public Safety through an interagency contract.
SOURCE: Legislative Budget Board.

On July 21, 2014, the Governor again used this statutory authority to direct the deployment of up to 1,000 Texas National Guard members in support of Operation Strong Safety II. The purpose of the guard’s participation in Operation Strong Safety II is to assist law enforcement with detecting illegal activity at the border, including using air assets to patrol. TMD was fully operational as part of this operation on August 24, 2014. The cost of the guard’s participation in Operation Strong Safety II was originally estimated to be \$12.0 million per month. In the first two months expenditures were less than estimated. These costs

are related to pay and allowances for personnel, meals and lodging, operations, maintenance, and flight hours. To fund this cost, the Governor used authority pursuant to Rider 2 in the Trusteed Programs Within the Office of the Governor’s bill pattern in the 2014–15 General Appropriations Act and the Texas Government Code, Chapter 401, to access balances in the Emergency Radio Infrastructure Account. The Texas Government Code, Chapter 411, states these funds may be appropriated for public safety purposes. TMD received \$32.5 million from DPS from the Emergency Radio Infrastructure Account (General Revenue–Dedicated Funds). **Figure 29** shows TMD’s expenditures for Operation Strong Safety II since the agency’s state-funded involvement began in September 2014 through November 2014.

**FIGURE 29
TEXAS MILITARY DEPARTMENT’S OPERATION STRONG
SAFETY II EXPENDITURES
AUGUST 2014 TO NOVEMBER 25, 2014**



NOTE: Other includes items such as materials and consumables, food, rental expenses, repair costs, and fuels.
SOURCE: Legislative Budget Board.

TOTAL STATE APPROPRIATIONS FOR BORDER SECURITY

State agencies have used funds designated for border security for a variety of purposes, such as to purchase equipment, pay salaries associated with hiring additional law enforcement staff and overtime, cover costs associated with prosecuting criminals, and for capital projects such as the construction of command centers and crime labs. The total amount of appropriations for these border security-related activities since the 2008–09 biennium is shown in **Figure 30**.

In November 2014, the Governor submitted a budget execution proposal related to border security to the Legislative Budget Board. In accordance with the Texas Government Code, Section 317.002, the Governor stated insufficient

FIGURE 30
TOTAL STATE APPROPRIATIONS FOR BORDER SECURITY, 2008–09 TO 2014–15 BIENNIA

BIENNIUM	TEXAS DEPARTMENT OF PUBLIC SAFETY	TEXAS PARKS AND WILDLIFE DEPARTMENT	TRUSTEED PROGRAMS WITHIN THE OFFICE OF THE GOVERNOR	TEXAS DEPARTMENT OF CRIMINAL JUSTICE	TEXAS MILITARY DEPARTMENT	TOTAL
2008–09	\$108.2	\$2.1	\$0.0	\$0.0	\$0.0	\$110.3
2010–11	\$102.1	\$4.3	\$13.3	\$0.5	\$0.0	\$120.2
2012–13	\$212.9	\$4.7	\$4.0	\$0.5	\$0.0	\$222.2
2014–15	\$401.6	\$9.0	\$6.8	\$0.5	\$50.0	\$467.9
TOTAL	\$824.8	\$20.1	\$24.1	\$1.5	\$50.0	\$920.6

NOTES:

- (1) Amounts shown in millions. Amounts show border security funding based on legislative intent and with input from agencies regarding their definitions of border security activities.
- (2) The Texas Military Department (TMD) has not received direct appropriations for border security through the General Appropriations Act. In fiscal year 2014, the Governor used authority provided in the Texas Government Code and General Appropriations Act to access General Revenue-Dedicated account balances which were provided to the Texas Department of Public Safety (DPS) for transfer to TMD. In addition, since fiscal year 2008, DPS has provided funds to TMD at their discretion which are included in totals for DPS.
- (3) In December 2014 the Legislative Budget Board approved a proposal by the Office of the Governor for budget execution to provide additional funds for border security. As a result, the following amounts, which are included in this figure, were transferred from appropriations made to other agencies for fiscal year 2015 to these agencies: DPS—\$64.9 million, the Texas Parks and Wildlife Department—\$3.7 million, and TMD—\$17.5 million. Amounts transferred from Trusteed Programs Within the Office of the Governor are only included in amounts shown for the agency that received the funds.

SOURCE: Legislative Budget Board.

budget authority at TMD, DPS, and TPWD to secure the Texas-Mexico border constituted an emergency. The proposal was approved by LBB on December 1, 2014. As a result, \$86.1 million in total was transferred to TMD (\$17.5 million), DPS (\$64.9 million), and TPWD (\$3.7 million). These transfers were made from appropriations of General Revenue Funds and General Revenue–Dedicated Funds provided to other agencies in the 2014–15 General Appropriations Act.

IMPROVE TRANSPARENCY, COORDINATION, AND OVERSIGHT OF STATE BORDER SECURITY ACTIVITIES

Texas began appropriating funds to supplement federal border security efforts during fiscal year 2006. Since that time, All Funds appropriations for border security operations have more than tripled. In addition to amounts included in the General Appropriations Act, state agencies may use Federal Funds that are paid directly to them by the federal government for border security activities. Border security appropriations have been challenging to track because they are spread across agencies and strategies. Additionally, no common definition of border security has been used to identify these funds throughout the budget. The Texas Department of Public Safety previously has designated all of Texas as a border zone and considered funding of any items that increased the agency's general capacity to also indirectly increase border security efforts. Other agencies have limited designation of the border region to smaller geographic areas, and recently the Texas Department of Public Safety has done so as well.

The Border Security Council was established to make recommendations regarding performance measures, reporting requirements, and the allocation of funds for border security at the Office of the Governor. This council's recommendations do not apply to other agencies. Despite the participation of multiple state agencies in border security operations, no formal requirement is in place to ensure cross-agency collaboration or to track the state's progress across agencies toward achieving a more secure border. Additionally, performance measures linked directly to state border security activities previously have not been developed or used in a way that sufficiently allows the monitoring of state spending. Consistent reporting on border security and modifying requirements of the Texas Border Security Council would ensure coordination among agencies, improve transparency, and enhance oversight of the state's efforts and progress toward securing the border with Mexico.

FACTS AND FINDINGS

- ◆ Texas has no legally established definition of border security. However, at least three definitions delineate the border region in statute. Additional geographic boundaries are set in statute that apply to specific border-related programs; however, none of these programs are associated with border security activities.

- ◆ The Border Security Council is statutorily required to recommend performance measures, reporting requirements, and the allocation of funds for border security by the Office of the Governor. The Homeland Security Council is required to annually report to the Governor regarding the status of funding state programs for homeland security, recommendations to reduce homeland security threats, and the improvement of agency activities.

CONCERNS

- ◆ The lack of consistent reporting on border security inhibits tracking of border security-related expenditures and activities across agencies and biennia, and the ability to distinguish border security activities from other functions of homeland security, which may be funded separately. Without such reporting, including outcomes, the state may not be able to evaluate the strategic value of the allocation of border security resources.
- ◆ Neither the Border Security Council nor the Homeland Security Council are required to make recommendations regarding performance standards, reporting requirements, or the allocation of funds for border security that are appropriated to the agencies that receive most state appropriations for this function. As a result, the state's cross-agency collaboration in oversight and measuring the results of border security operations is limited.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Include a rider in the introduced 2016–17 General Appropriations Bill to require certain information, including outcomes, on border security to be reported to the Legislative Budget Board using specified criteria.
- ◆ **Recommendation 2:** Amend statute to reconstitute the Border Security Council as a special advisory council of the Homeland Security Council and require the Homeland Security Council's annual report to include an assessment of the performance, reporting, and funding amounts for the state's border

security activities that is made available on the Office of the Governor's website.

DISCUSSION

During fiscal year 2006, the Office of the Governor (Governor's Office) began providing aid to law enforcement entities in 16 Texas counties located along the international border with Mexico to supplement federal border security efforts. That same year, the Texas Department of Public Safety (DPS) began enhancing operations along the border. At the time, no specific appropriations for border security were made by the Legislature. For the 2008–09 biennium, the Legislature appropriated \$110.3 million in All Funds for border security. Since then, the state's All Funds appropriations for activities agencies describe as related to border security have more than tripled. DPS, the Texas Parks and Wildlife Department (TPWD), the Trusteed Programs Within the Office of the Governor (Governor's Office), the Texas Department of Criminal Justice (TDCJ), and the Texas Military Department (TMD) have received border security funding. In addition to amounts included in the General Appropriations Act, state agencies may manage Federal Funds that are paid directly to an agency by the federal government.

DEFINING BORDER SECURITY

The state has neither established a legal definition of border security nor clearly defined a border region for purposes of border security funding. At least three separate definitions of the border region exist in statute, and additional geographic boundaries designating the border area have been established for specific programs. However, none of these statutory boundaries apply to programs related to DPS or TPWD border security activities. These two agencies received approximately 98 percent of state appropriations for border security for the 2014–15 biennium. Agencies that have received state appropriations for border security use different definitions for the border region and what constitutes a border security activity, as shown in **Figures 1** and **2**.

The federal government also does not have a definition of border security. Previously, the measure operational control was used to determine how much of the border was secure. This measured the government's ability to detect, respond to, and interdict cross-border illegal activity. However, the use of this measure was discontinued in federal fiscal year 2011 because federal agencies believed a more quantitative outcome measure could be developed. Since that time the federal government has been working to define border

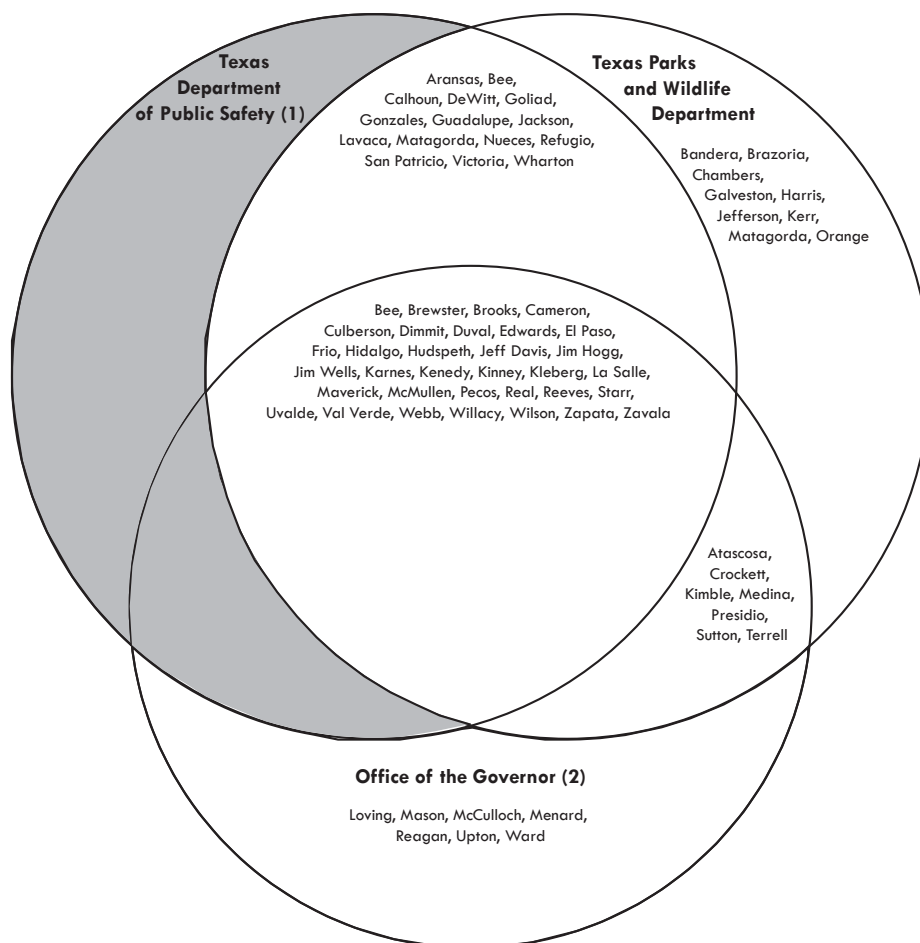
security and develop measures to track progress toward securing the border. The U.S. Customs and Border Protection's border patrol sectors extend beyond Texas, while other federal conventions are more limited. No other states are known to have a definition of border security; however, several states that share an international border define the border region. The state of Washington specifically defines border-related crime statistic as the sum of infractions and citations issued, and arrests of persons who permanently reside outside the state in a border area during a calendar year. Other state and federal definitions of the border region are shown in **Figure 3**.

The lack of consistent reporting on border security inhibits tracking of border security expenditures and related performance results across agencies and biennia. Texas statutes define homeland security activities as any activity related to the prevention or discovery of, response to, or recovery from a terrorist attack, natural or man-made disaster, hostile military or paramilitary action, or extraordinary law enforcement emergency. This definition can include border security activities, but in some instances the Legislature has provided funding for these activities separately from other homeland security functions. In other instances, funding for the two has been combined, and it is not possible to discern clearly between border security activities and other functions of homeland security without a common definition of border security.

Without a consistent border security definition, it has been challenging to determine total expenditures for border security. Some have referenced border security funds as only the appropriations made in two DPS budget strategies that specifically reference border security. However, TPWD, TDCJ, and the Governor's Office have received state funds for border security activities that are included in riders or broader strategies of agencies' budgets. As a result, funds expended by these agencies are not included in a definition of border security based solely on the DPS budget strategies that specifically mention the border. Other stakeholders have included funding allocated across agencies and strategies in the General Appropriations Act to determine border security funding amounts.

As **Figure 1** shows, agencies receiving border security-related funding define the border region in different ways. Each agency uses its own definition of border region when compiling data for metrics associated with their border security activities. As a result, these results are not comparable

**FIGURE 1
BORDER REGION COUNTIES BY TEXAS AGENCY, AS OF SEPTEMBER 2014**



NOTES:

- (1) In addition to counties, the Texas Department of Public Safety defines the border region as the 1,241-mile international border with Mexico.
- (2) The Office of the Governor did not report specific counties in its definition. However, the Texas Government Code, Section 772.0071, which applies to the Criminal Justice Division at the Office of the Governor, defines the border region. Counties shown are based on the Office of the Governor’s interpretation of this statute.

SOURCE: Legislative Budget Board.

and cannot be aggregated to reflect the state’s overall efforts to secure the border.

DPS previously considered the entire state to represent the border, which expanded the scope of what is categorized as border security. Alternatively, TPWD distinguished between daily operations that include border security and enhanced operations for border security in tracking border security expenditures and activities. This lack of consistency in reporting on border security and the border region has hindered oversight of performance and funding designated for border security. For instance, riders in the General Appropriations Act since the 2008–09 biennium directing

DPS appropriations refer to the border region. In 2009, the State Auditor’s Office (SAO) found that, without specific direction as to where these resources should be placed, DPS has allocated resources and appropriations to areas typically considered to be outside operational sectors along the border. As a result, SAO was not able to evaluate the strategic value of the allocation of these resources.

Recommendation 1 would include a rider in Article IX of the introduced 2016–17 General Appropriations Bill to require agencies participating in border security to report all budgeted and expended amounts as well as performance results for border security to the Legislative Budget Board

**FIGURE 2
ELEMENTS OF TEXAS AGENCY BORDER SECURITY OPERATIONS, AS OF SEPTEMBER 2014**

ELEMENT	TEXAS DEPARTMENT OF PUBLIC SAFETY	TEXAS PARKS AND WILDLIFE DEPARTMENT	OFFICE OF THE GOVERNOR
Definition of border security	<ul style="list-style-type: none"> The detection and interdiction of all people, drugs, and other contraband illegally entering Texas from Mexico between the ports of entry at the Texas-Mexico border. 	<ul style="list-style-type: none"> Operations to deny, disrupt, and/or capture persons involved in poaching or illegal activity. 	<ul style="list-style-type: none"> A multifaceted approach to prevent crime that results from the state's location adjacent to the border with Mexico and the Gulf of Mexico.
Key characteristics of border security activities	<ul style="list-style-type: none"> Occur in high-threat areas in the Texas-Mexico border region. Focus primarily on border-related crime. A greater density of law enforcement personnel and equipment. 	<ul style="list-style-type: none"> Game warden staffing hours and boats used in operations funded through an interagency contract with the Department of Public Safety. 	<ul style="list-style-type: none"> Determined by parameters of grants awarded from discretionary funds.
Crimes specifically noted as related to border security	<ul style="list-style-type: none"> Drug and human trafficking, extortion, and home invasions. 	<ul style="list-style-type: none"> Illegal commercial fishing, illegal hunting, criminal trespass, environmental crime, or other crime related to the natural resources of Texas. Illegal activity such as theft, burglary, trafficking in humans or narcotics, stolen vehicles, firearms, or currency across the Texas-Mexico border. 	<ul style="list-style-type: none"> Crimes defined in the Texas Government Code, Section 772.0071, which generally encompass: kidnapping/person smuggling; trafficking of persons; unlawfully carrying weapons; organized crime; arson; criminal mischief; other property damage; bribery and corruption; and drug crimes.

SOURCE: Legislative Budget Board.

**FIGURE 3
FEDERAL AND STATE DEFINITIONS OF BORDER REGION, AS OF SEPTEMBER 2014**

ENTITY	DEFINITION
U.S. Customs and Border Protection	The Big Bend, Del Rio, El Paso, Laredo, and Rio Grande Valley sectors include all counties in Texas, the state of New Mexico, and the state of Oklahoma
U.S. Environmental Protection Agency (La Paz Agreement)	62.15 miles (100 kilometers) on each side of the international border
U.S. Federal Reserve Bank of Dallas	Counties or cities (Brownsville, Del Rio, McAllen, Eagle Pass, El Paso, Laredo) adjacent to the international boundary
State of Arizona (Department of Transportation)	The geographic area within 62 miles of the Arizona-Mexico border line and in Mexico within 6 miles of the Arizona-Mexico border line
State of California (California-Mexico Border Relations Council)	The line of demarcation between California and Mexico
State of Washington (Revised Code, Title 66, Liquor Revolving Fund)	Any incorporated city or town, or unincorporated area, located within seven miles of the Washington-Canadian border or any unincorporated area that is a point of land surrounded on three sides by saltwater and adjacent to the Canadian border

NOTE: California statutes also include a separate definition for the California-Baja border region.

SOURCE: Legislative Budget Board.

under specified criteria. This would allow expenditures and related activities to be tracked across agencies and biennia. The rider would specify that border security includes activities related to deterring crimes and enforcing state laws related to offenses listed in the Texas Government Code, Section 772.0071 and hunting and fishing laws relating to poaching, or for which Texas receives federal grants intended to enhance law enforcement, between designated entry and exit points in counties:

- adjacent to or a portion of which is located within 20 miles of an international border;
- adjacent to two counties located on an international border with a population of more than 5,000 and less than 7,500 according to the most recent decennial census; or
- adjacent to the Gulf Intracoastal Waterway, as defined by the Texas Transportation Code, Section 51.002(4).

The geographic area that makes up the border region proposed in Recommendation 1 is based on a number of considerations. At the request of the commissioner of the Texas Department of Agriculture (TDA), Retired U.S. Army General Barry McCaffrey and Retired U.S. Army General Robert Scales developed and recommended a military-style strategy and operational and tactical requirements for securing the Texas-Mexico border. These recommendations were presented in a report published in September 2011. The report states that certain drug cartels are seeking to establish an area one county deep into Texas in which they would not be subject to Mexican law enforcement and would have access to trans-shipment points to distribute narcotics throughout the U.S.

Several international organizations have developed definitions or descriptions of border security. The United Nations, which uses the term border control rather than border security, states that border control is the first line of defense against illegal cross-border movement of goods and cargo. Neither the Organization for Economic Cooperation and Development nor the World Bank defines border security; however, both entities refer to border guards and customs officials located along borders when describing border-related activities. Additionally, the RAND Corporation, a nonprofit research organization, proposed a model of border security focused on denying the cross-border flow of people and materials. The Stimson Center, a nonprofit research center, defines border security as basic monitoring and control and the ability to conduct customs operations through trade and

export controls. Additionally, the Stimson Center describes physical border security as the monitoring of the interstate border area and channeling the flow of people and materials to designated entry and exit points.

Consistent with the strategy developed at the request of the TDA commissioner and definitions used by international organizations and policy research centers, the reporting requirement proposed in Recommendation 1 would include certain counties along the Texas-Mexico border and counties along the Gulf of Mexico, as shown in **Figure 4**. This reporting requirement would encompass activities undertaken by DPS and TPWD to prevent the crossing of goods into Texas between ports of entry and includes counties that receive grants through the Governor's Office. Any activity that supports the enforcement of these laws, such as work undertaken to coordinate and monitor operations at DPS's Joint Operations Intelligence Centers (JOIC) and Border Security Operations Center (BSOC), would also be included.

The Texas Government Code, Section 772.0071, refers to the Prosecution of Border Crime Grant Program that was codified by the Eighty-second Legislature, Regular Session, 2011. This program provides funding through the Criminal Justice Division at the Office of the Governor for district attorneys in the border area to prosecute individuals charged with any crime that occurs in the border region and undermines public safety or security. Statute authorizes these funds to be spent only in counties adjacent to an international border or adjoining one of these counties. The statute specifies that for purposes of this program, border crime offenses are committed by a person who is not a U.S. citizen or national and is not lawfully present in the country; coordinated with or related to activities or crimes that are committed in the United Mexican States; or offenses defined in the following statutory provisions:

- the Texas Code of Criminal Procedure, Section 3g(a)(2), Article 42.12;
- the Texas Penal Code, Chapters 19, 20, 20A, 46, or 71;
- the Texas Penal Code, Titles 7 or 8; or
- the Texas Health and Safety Code, Chapter 481.

These offenses generally encompass kidnapping or person smuggling, trafficking of persons, unlawfully carrying weapons, organized crime, arson, criminal mischief, other property damage, bribery and corruption, and drug crimes.

FIGURE 4
TEXAS COUNTIES INCLUDED IN RECOMMENDATION 1



SOURCE: Legislative Budget Board.

According to the Governor’s Office, these crimes were identified as the program’s focus through a collaborative effort between the Border Prosecution Unit and DPS in 2010 and represent criminal activities that can be attributed to border area criminal enterprises and organized crime.

BORDER SECURITY COUNCIL

Two state councils with missions related to border security have been established in statute: the Border Security Council and the Homeland Security Council.

The Border Security Council makes recommendations regarding performance measures, reporting requirements, and the allocation of funds for border security by the Office of the Governor. One-third of the council’s membership is statutorily required to consist of persons from the border area. In 2008, the council had 11 members, including a judge from Hudspeth County and sheriffs from Maverick County and Victoria County. Statute establishing the council does not define the border area, nor does it require the

council to make recommendations on a regular basis. At the time the council was established, no state agency other than the Governor’s Office received state appropriations for border security. Since fiscal year 2008, appropriations have been provided to other agencies, and as of the 2014–15 biennium, the Governor’s Office received approximately 2 percent of total appropriations for border security. The Border Security Council has not released any recommendations since 2008.

The Homeland Security Council also is established in statute and is required to annually report to the Governor regarding the status of funding state programs for homeland security, recommendations to reduce homeland security threats, and recommendations to improve agencies capabilities. Statute specifies 31 legislative and state agency representatives that must serve on this council. The Governor is also responsible for developing the state’s homeland security strategy, which is required to plan for protecting the state’s international border, ports, and airports; no other specific direction related to border issues is statutorily provided to the council.

No statutory requirement is in place for either council to make recommendations regarding coordination, performance standards, reporting requirements, or the allocation of most funds for border security. As a result, different levels of oversight are applied to border security-related funds, depending upon the receiving agency, coordination of funding could be enhanced, and it is not possible to accurately measure results of border security activities across agencies.

The level of oversight and consideration required of funds allocated by the Governor's Office is not applied to approximately 98 percent of funds designated for border security and appropriated to other agencies through the General Appropriations Act, 2014–15 Biennium. Additionally, the Border Security Council has not provided oversight of funds administered by the Governor's Office since its last report was released in 2008.

Coordination of funding for border security among some agencies may not be occurring. For instance, the Governor's Office has provided funding to the Texas Border Sheriff's Coalition for operating costs since fiscal year 2008. These grants totaled almost \$2.6 million in All Funds from fiscal years 2008 to 2014, or an annual average of \$368,153. According to the Governor's Office, the coalition supports the state's border security operations by coordinating activities among its 20 member counties along the Texas-Mexico border, DPS, and regional intelligence centers. However, DPS activities (including operation of the BSOC, six regional JOICs, and DPS-led ongoing operations in the border region) also coordinate activities among local, state, and federal entities. If the Border Security Council were active and membership included representatives familiar with the activities of both entities, the council could determine whether these activities are duplicative and whether both entities should continue to receive state funding for coordination.

Multiple state agencies receive funding for border security operations and there is limited cross-agency collaboration in measuring and monitoring border security operation's results. Metric results developed by individual agencies can be tracked, but these metric results cannot be aggregated effectively because not all agencies track the same information, nor do they use a consistent methodology to measure performance. The results of some measures, as currently reported, cannot be isolated in a way that reflects the impact of state funding. DPS reports weekly and annual summaries of measures it considers to be related to border security in the area it considers to be the border sector. Beginning in fiscal

year 2015 these reports were published on DPS's website, although previously they were not widely available. These measures are output- rather than outcome-based, and summaries include reports from more than 100 entities, including TPWD, local, and federal entities. The Governor's Office also has measures used to track the Border Crime Prosecution Grant Program, which it publishes through Criminal Justice Division biennial reports. The introduced 2016–17 General Appropriations Bill includes performance metrics for DPS border security operations. These metrics are limited to the results of DPS activities, and metrics are not included for other agencies.

The Texas Government Code, Section 421.025, authorizes the Governor to appoint special advisory committees that include representatives of state or local agencies or nongovernmental entities to assist the Homeland Security Council in performing its duties. Statute establishes the First Responder Advisory Council and the Private Sector Advisory Council as permanent special advisory committees to advise the Governor regarding homeland security issues. Statute also establishes the composition of these committees.

Recommendation 2 would amend statute to eliminate the Border Security Council as an independent council and re-establish it as a special advisory committee to the Homeland Security Council. Recommendations submitted by this new special advisory committee would be made available on the Office of the Governor's website. The new special advisory committee's membership would include, at a minimum, representatives from the following:

- each state agency that receives state appropriations for border security (based on 2014–15 biennial appropriations, these agencies would include DPS, TPWD, the Governor's Office, and TDCJ);
- a minimum of three local entities that receive local border security grant funding from DPS, or a minimum of one-third of the entities that receive such funding in the event that fewer than three entities receive it; and
- a minimum of three mayors, or their representatives, from municipalities located in areas in which appropriations for border security are spent, pursuant to the General Appropriations Act.

These membership requirements would ensure the committee includes representation from entities that receive state funding for border security operations and retains locally elected members from the border area who were part of the

previous Border Security Council. This special advisory committee would be required to develop performance measures and related standards, reporting requirements, audit methods, and other procedures to ensure funds that are allocated by the state for border security are used properly and recipients of the funds are accountable. The committee then would recommend these procedures to the Homeland Security Council. This oversight would ensure a regular assessment of the state's border security funding needs. Additionally, this requirement would allow for alignment of measures used to report progress in meeting border security objectives and ensure they are considered across state government, rather than progress and goals of agencies being reported individually or alongside results from non-state entities. The special advisory committee should ensure a common methodology is used to report information regarding costs, performance measures, and explanations of results because the measurements would be used across entities.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations are not expected to have a significant fiscal impact to the state. Recommendation 1 would include a rider in the introduced 2016–17 General Appropriations Bill to require certain information relating to border security to be reported to the Legislative Budget Board using specified border security criteria. This rider would not result in a change in appropriation levels for any agencies, although appropriations among individual strategies in agency's bill patterns could change to allow funds to be tracked in accordance with this reporting requirement. Recommendation 2 would amend statute to reestablish the current Border Security Council as a special advisory committee to the Homeland Security Council. No additional costs are anticipated, as the work of the Border Security Council could be absorbed within the Homeland Security Council's existing requirements.

The introduced 2016–17 General Appropriations Bill includes a rider to implement Recommendation 1.

DEVELOP PLANS TO ADOPT INCIDENT-BASED CRIME REPORTING IN TEXAS

In Texas, many local law enforcement agencies voluntarily report crime data to the Texas Department of Public Safety, which reports the data to the Federal Bureau of Investigation. The Federal Bureau of Investigation administers the Uniform Crime Reporting Program using data reported from every state and publishes an annual report called *Crime in the United States*. The program allows law enforcement agencies and the public to accurately assess the prevalence of or trends in crime.

The Uniform Crime Reporting Program has used summary reporting system data since its inception in the 1930s. In a summary reporting system, law enforcement agencies count and aggregate the number of known offenses of certain crimes as well as arrest information. Specific information regarding individual crimes is not included in a summary reporting system. During the 1980s, national law enforcement community members interested in more detailed data developed the National Incident-Based Reporting System. This system is incident-based rather than summary-based and includes data such as time, date, type of location, modus operandi, and demographics of victims and suspects. The enhanced data in incident-based reports may have operational value for law enforcement agencies and affected communities. Benefits include more information about more kinds of crimes, the ability to associate useful information with certain individuals or locations, and the capability to identify criminal trends and study the effectiveness of programs that aim to address those trends.

Despite the benefits of incident-based reporting, in Texas Uniform Crime Report participation is voluntary and most law enforcement agencies do not report incident-based data. Agencies may not report incident-based data because of cost, required changes in practice, or misunderstandings about the differences between summary and incident data. Providing resources to address these concerns would help more Texas law enforcement agencies adopt and realize the benefits of incident-based crime reporting.

FACTS AND FINDINGS

- ◆ Texas adopted the Uniform Crime Report as its official crime report in 1976. More than 99.8 percent of the Texas population is included in jurisdictions that report this data.

- ◆ Statistics for the Uniform Crime Report can be submitted in two ways. Data submitted via the summary reporting system includes condensed information on 10 major crimes. Data submitted via the National Incident-Based Reporting System includes comprehensive information on 23 categories of crimes, including more than 45 separate crimes. It also includes additional arrest data on several additional crimes.
- ◆ Law enforcement officials contend that incident-based crime data allow law enforcement agencies and other interested parties to identify crime trends, at-risk populations, and potentially dangerous locations for law enforcement. To address a jurisdiction's crime, prevention strategies can be developed, evaluated, and modified with empirical, incident-based evidence that is not included in summary reports.
- ◆ Depending on a law enforcement agency's technology infrastructure and administrative practices, costs of transitioning from summary- to incident-based crime reporting could range from a minimal, one-time upgrade cost to more expensive costs associated with new systems and training. An agency also may need internal and external training on the uses and meaning of incident-based data.

CONCERNS

- ◆ Offenses covered by the Uniform Crime Report's summary reporting system are limited and do not include many modern crimes of interest to law enforcement and the public, such as drug offenses and kidnapping. As a result, not all law enforcement agencies, including the Department of Public Safety, and other entities have the most comprehensive information available to analyze and develop informed responses to crime.
- ◆ Despite Federal Bureau of Investigation and other jurisdictions' findings that incident-based crime reporting is beneficial, only 59 of the more than 1,000 Texas law enforcement agencies that submit data to the Uniform Crime Report use incident-based reporting.

- ◆ No independent readiness assessment has been conducted among Texas agencies to determine the feasibility of expanding incident-based crime reporting across the state to provide more comprehensive data. State resources provided to entities for submitting crime reports do not incentivize or address barriers to incident-based reporting.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require the Texas Department of Public Safety to develop a plan meeting certain requirements for implementing or expanding statewide incident-based crime reporting. The plan should include input from stakeholders and be provided to the Governor, the Legislative Budget Board, and the appropriate standing committees of the Legislature by September 1, 2016.
- ◆ **Recommendation 2:** Appropriate \$5.0 million in General Revenue–Dedicated Funds to the Texas Department of Public Safety in the introduced 2016–17 General Appropriations Bill and include a rider directing the agency to provide grants to law enforcement agencies for upgrading technology infrastructure to implement incident-based crime reporting.
- ◆ **Recommendation 3:** Amend statute to expand the allowable uses of the Texas Commission on Law Enforcement Account to include grants administered by the Texas Department of Public Safety for training on incident-based crime reporting.
- ◆ **Recommendation 4:** Include a contingency rider in the introduced 2016–17 General Appropriations Bill to appropriate \$300,000 in General Revenue–Dedicated Funds to the Texas Department of Public Safety and direct the funds to be used to provide grants for training law enforcement on incident-based crime reporting.
- ◆ **Recommendation 5:** Amend statute to require the Texas Department of Public Safety to publish a summary of incident-based crime reporting data regularly on its website.

DISCUSSION

As early as 1870, the U.S. Congress showed an interest in collecting national crime statistics. Although Congress authorized crime statistic collection, no immediate action

was taken. By the 1920s, however, public concerns regarding criminals such as Al Capone and Henry Dillinger prompted action regarding the rise of crime in the U.S. However, since no national crime tracking system was in place, there was no reliable way to monitor the prevalence and fluctuations of crime.

UNIFORM CRIME REPORT

In 1927, the International Association of Chiefs of Police (IACP) received a federal grant to address national crime statistics. The IACP formed a committee to examine crime records, hired technical staff, and consulted advisors such as Federal Bureau of Investigation (FBI) Director J. Edgar Hoover. The IACP adopted a system to classify and report crimes in 1929. Crimes were included based on their seriousness, frequency, national pervasiveness, and likelihood of being reported. To ensure that jurisdictions nationwide were reporting the same data, standardized offense definitions were developed that would supersede local crime definitions for summary reporting purposes. Crimes reported through this system include murder, non-negligent manslaughter, forcible rape, robbery, aggravated assault, burglary, larceny-theft, and motor vehicle theft.

Within months of dissemination of the Uniform Crime Report (UCR), more than 400 agencies were participating voluntarily in the UCR program. Data represented more than 20 million U.S. citizens in 43 states. In 1930, Congress authorized the U.S. Attorney General to gather crime information; the Attorney General designated the FBI to serve as the national statistical collector for crime data. By 1956, more than 5,700 law enforcement agencies (LEA) reported UCR data to the FBI. Since 1958, the FBI has published UCR data in *Crime in the United States* annually to provide the public and interested entities with summarized crime data.

The data reported in the UCR has expanded to include data regarding law enforcement officers who were assaulted or killed, murder victim information, arson, hate crimes, and human trafficking.

According to the FBI, the data is useful to other parties, including sociologists, legislators, municipal planners, the media, and academia. UCR data can help in research, planning, and monitoring crime and crime prevention programs.

SUMMARY-BASED REPORTING

The UCR was established to use summary-based reporting system (SRS) data. LEAs record the number of known offenses that are included in the UCR, assaults or deaths of LEA officers, and other select data. The age, sex, and race of arrestees are recorded. For certain crimes, basic information is recorded about the victims. Additional data are collected for property offenses, including the type and amount of property stolen and recovered. A SRS uses a hierarchy rule, meaning that generally only the highest-ranking crime on an FBI hierarchy list is considered for crime reporting purposes. For example, an incident involving burglary and larceny would only appear as a burglary in a SRS.

The data typically are aggregated and submitted to the LEA's state UCR program monthly. Generally, a state's UCR program collects data from local LEAs and then submits data to the FBI for inclusion in its annual *Crime in the United States* report. If there is not a statewide UCR program in a jurisdiction, local LEAs submit data directly to the FBI. The FBI designates the types of crime by two categories, Part I or Part II. The UCR's summary data includes information regarding Part I offenses, or index crime offenses, and arrest data only for Part II offenses. **Figure 1** shows Part I offenses, and **Figure 2** shows Part II offenses.

**FIGURE 1
UNIFORM CRIME REPORT PART I OFFENSES
CALENDAR YEAR 2013**

VIOLENT CRIMES	PROPERTY CRIMES
Murder and non-negligent manslaughter	Burglary
Rape	Larceny-theft
Robbery	Motor vehicle theft
Aggravated assault	Arson
Human trafficking/commercial sex acts	
Human trafficking/involuntary servitude	

SOURCE: Federal Bureau of Investigation.

As of calendar year 2013, UCR data from more than 18,000 LEAs is reported to the FBI. Data includes 309 million U.S. residents, or 98.0 percent of the U.S. population. Data contributors include LEAs in municipalities, universities and colleges, counties, states, tribal jurisdictions, and federal entities.

In 1976, Texas adopted the UCR as its official crime report. The Department of Public Safety's (DPS) Crime Records Service administers the UCR program in Texas. Although

UCR participation is voluntary for Texas LEAs, nearly 1,000 agencies provide summary data to DPS each month. LEAs may transmit data to DPS by mail or electronically. DPS verifies the data and can make minor corrections; the agency must consult the LEAs to address larger errors or inconsistencies. Once data is verified, DPS transmits it to the FBI. Of the more than 1,000 law enforcement LEAs that submit crime data covering 99 percent of the state's population, 988 agencies including 86.9 percent of the state's population report summary data to DPS.

Although UCR participation is voluntary, certain crime data are required to be reported because of state or federal law. For example, universities with students that can receive federal financial aid must report certain data. Many agencies that provide grants to LEAs require UCR participation as a prerequisite to grant awards.

DPS uses LEA-submitted data to compile its annual *Crime in Texas* report. The report summarizes data regarding UCR Part I offenses, or index crime offenses. The report also provides analysis such as comparisons of index crimes across time and in-depth information regarding specific crimes. For example, the 2013 *Crime in Texas* report includes demographic information of murder victims. This data was collected from LEAs using the FBI's Supplemental Homicide Reporting system. The DPS report also shows crimes by jurisdiction.

In addition to UCR data shown in **Figures 1** and **2**, DPS also collects data on the following, which is included in the *Crime in Texas* report:

- family violence and dating violence;
- hate crimes;
- campus crime;
- sexual assault; and
- law enforcement personnel data.

INCIDENT-BASED REPORTING

Although the UCR became widely used initially, after several decades many entities determined the summary-based system required updating to maximize its usefulness. During the 1980s, the FBI, the federal Bureau of Justice Statistics, the IACP, and the National Sheriffs' Association worked together to update the system. *Blueprint for the Future of the Uniform Crime Reporting Program* was published in 1985. It included three specific areas for change:

**FIGURE 2
UNIFORM CRIME REPORT PART II OFFENSES, CALENDAR YEAR 2013**

Simple assault	Fraud	Stolen property	Weapons
Forgery and counterfeiting	Embezzlement	Vandalism	Prostitution and commercial vice
Sex offenses	Drug abuse	Gambling	Assisting or promoting prostitution
Driving under the influence	Liquor laws	Drunkness	Purchasing prostitution
Vagrancy	Suspicion	Curfew and loitering (age 18 and younger)	Offenses against the family and children
All other offenses	Runaways		Disorderly conduct

SOURCE: Federal Bureau of Investigation.

- LEAs would use incident-based reporting;
- the UCR would collect limited- and full-participation levels of data; and
- the UCR program would include a quality assurance program.

In 1988, after a pilot program in South Carolina, national law enforcement community leaders endorsed a new crime reporting program that would be incident-based and managed by the FBI. Groups in support of the incident-based system included the IACP, the National Sheriffs' Association, Major Cities Chiefs Police Association, and the Association of State Uniform Crime Reporting Programs.

The FBI's incident-based crime reporting system is called the National Incident-Based Reporting System (NIBRS). It includes more offenses than summary-based reports and more data on each offense. **Figure 3** shows the 23 major offense categories, representing 49 specific crimes included in Group A offenses. NIBRS includes at least 57 data elements in its category of Group A offenses, including data regarding administrative matters, offenses, victims, property, and arrestees. Unlike summary-based data, IBR data collects detailed information regarding the attributes of each crime. Instead of using a hierarchical system, NIBRS can report on up to 10 offenses that occur within a given incident. Data are collected regarding:

- the date, time, and location type of the incident;
- a list of all offenses that occurred;
- demographic information of each victim and offender;
- details such as type of injury, type of weapon, and drug involvement; and
- clearance information (a crime is considered cleared when an offender has been identified, charges have been pressed, and a subject is taken into custody).

In addition to Group A offenses, NIBRS also collects arrest-only data regarding its category of Group B offenses. This collection is similar in nature to the summary-based system's Part II offenses, although the offenses are different. **Figure 4** shows Group B offenses.

Although UCR data can be submitted electronically to state programs or in paper form via mail, NIBRS data is only collected electronically when the LEA staff enters incident information. Generally, the person entering the report is a police officer or a detective. In many records management system applications, the record cannot be finalized unless all relevant NIBRS data is included. LEA staff then verify and transmit data to the state UCR program, which submits the data to the FBI. Not all LEAs that collect incident-based data

**FIGURE 3
NATIONAL INCIDENT-BASED REPORTING SYSTEM'S GROUP A OFFENSE CATEGORIES, CALENDAR YEAR 2012**

CRIMES AGAINST PERSONS		CRIMES AGAINST PROPERTY		CRIMES AGAINST SOCIETY	
Assault offenses	Arson	Fraud offenses	Drug/narcotic offenses		
Homicide offenses	Bribery	Larceny/theft offenses	Gambling offenses		
Human Trafficking	Burglary/breaking and entering	Motor vehicle theft	Pornography/obscene material		
Kidnapping/abduction	Counterfeiting/forgery	Robbery	Prostitution offenses		
Sex offenses, forcible	Destruction/damage/vandalism	Stolen property offenses	Weapon law violations		
Sex offenses, non forcible	Embezzlement	Extortion/blackmail			

SOURCE: Federal Bureau of Investigation.

**FIGURE 4
NATIONAL INCIDENT-BASED REPORTING SYSTEM'S GROUP B OFFENSE CATEGORIES, CALENDAR YEAR 2012**

CRIMES		
Bad checks	Curfew/loitering/vagrancy violations	Disorderly conduct
Driving under the influence	Drunkenness	Family Offenses (Nonviolent)
Liquor law violations	Peeping Tom	
Trespass of real property	All other offenses	

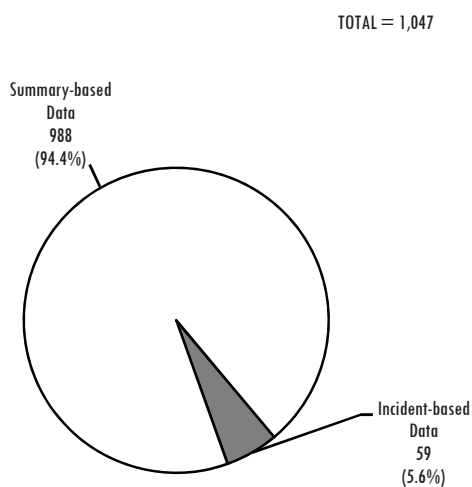
SOURCE: Federal Bureau of Investigation.

submit it to DPS or the FBI; some may use it internally. LEAs may also use other sources for IBR reporting, such as dispatch calls.

Fifteen states reported all of their 2012 UCR data via NIBRS, and most states (including Texas) are certified for NIBRS participation. As of calendar year 2012, NIBRS data was submitted to state or federal authorities by 6,115 LEAs, or one-third of agencies that submit UCR data. NIBRS data is included in an annual FBI publication and several specialized reports.

Figure 5 shows the type of data that Texas' UCR program participants submit to DPS. Approximately 1,050 LEAs submit crime data that includes more than 99 percent of the state's population; only 59 Texas agencies, accounting for 13 percent of the state's population, voluntarily collect and submit NIBRS data to DPS.

**FIGURE 5
TEXAS UNIFORM CRIME REPORT PARTICIPANTS REPORTING METHODS, CALENDAR YEAR 2014**



NOTE: Texas' Uniform Crime Report data covers 99.8 percent of the state's population. Of this, summary-based data covers 86.9 percent of the population and incident-based data covers 12.9 percent of the population.
SOURCE: Texas Department of Public Safety.

DPS also administers the Texas Incident-Based Reporting System (TIBRS). The program includes NIBRS data and information on family violence, sexual assault, and drug seizures, as required by the Legislature. DPS estimates statewide implementation of TIBRS will take a number of years, and no NIBRS- or TIBRS-specific report is published. NIBRS data is converted to summary-based data for the *Texas Crime Report*. Data is converted according to FBI's technical specifications.

BENEFITS OF INCIDENT-BASED REPORTING

Stakeholders have identified several beneficial uses of incident-based crime data. Law enforcement entities that use incident-based reporting have demonstrated that it provides more utility, allows for increased collaboration and enhanced data analysis, and is more efficient and accurate than summary-based data.

EXPANDED DATA UTILITY

Incident-based crime data is more useful to LEAs than summary data because it tracks more crimes with more detail. According to DPS, the characteristics of crime change. To accurately convey crime data, the reporting system must track emerging crimes of interest to LEAs and the public. Crimes and other data have been added to the UCR's summary reports; however, the scope of NIBRS is much larger and includes more crimes. Incident-based data relating to drug offenses, sex offenses, and kidnapping offenses may be particularly relevant to Texas because of the state's location along an international border and the resulting interest in border security and human trafficking issues.

Another immediate benefit of incident-based data for LEA officers is the availability of more information concerning a person or location before responding to a situation. For example, an officer called to a certain address could use IBR data to learn of other events that may have occurred at the address, or whether incidents with guns or violence were

associated with the address. Such information could help an officer be better prepared to respond to the situation.

INCREASED COLLABORATION

Incident-based crime reporting is one way to allow for connectivity between data. Increased connectivity can allow local agencies to better understand what is happening within the jurisdiction and coordinate efforts to address crime. For example, LEAs can track where and when pick-pocketing occurred through IBR data. Summary data would list only the number of thefts and the property amount stolen, but it would not provide the time and locations of the thefts. Physical location data is not yet a part of NIBRS, but many LEAs record location data in their records management systems, which means that data would be available to add into NIBRS.

Jurisdictions that collect NIBRS data can share observations and strategies with other jurisdictions that may experience similar trends. In Connecticut, the Brandford Police Department used search functions in its database to successfully locate active criminals in the region. A search for a suspect's description and modus operandi linked that suspect to more than a dozen similar crimes in nearby cities. The department reported that without the NIBRS database this search would not have been possible. Some LEAs have considered linking NIBRS systems on a regional level to jointly track and address crime.

On a statewide or national level, state and federal LEAs can view trends across jurisdictions to better understand criminal behavior. For example, DPS could study statewide NIBRS data and observe trends such as increases of drug trafficking along certain corridors or a rise in violent crimes against females of a certain age group. Such trends may not be readily obvious to DPS if the same known crimes were reported with summary-based reports.

LEAs also have the ability to add additional elements to IBR data to better understand the nature of the crime in question. For example, Tennessee added identity theft to its IBR program to help address that crime trend.

ENHANCED DATA ANALYSIS

In Tennessee, state law requires LEAs to contribute NIBRS data to the Tennessee Bureau of Investigation (TBI). Before this requirement, Tennessee agencies were not required to submit any UCR data to TBI. Since agencies have been reporting data, TBI has undertaken several analyses and issued reports. Analyses of crimes against the elderly revealed

that fraud was a common crime committed against this group, and that the victims often knew those who committed the fraud. Discovering the commonality of fraud and the identity of likely perpetrators allows the agencies and policymakers to make informed decisions and to monitor progress in addressing these crimes. TBI has studied and issued similar reports regarding domestic violence and family violence.

TBI also makes NIBRS and additional Tennessee IBR data available through customizable online searches. Advocacy groups, media, and other entities can access the information without requesting it from TBI or other LEAs.

IMPROVED EFFICIENCY AND ACCURACY

Systems via which NIBRS data is reported increase the efficiency of crime reporting compared to UCR data reporting systems. Data can be entered into an LEA's records management system by the responding officer or investigator at the time of the crime. LEAs that use IBR reporting may have management systems pre-programmed with NIBRS guidelines so that the data are ready to be reported to the state UCR program and the FBI. LEAs report they can minimize turnaround time of incident reports to prosecutors because IBR data are already entered into the system.

NIBRS can report up to 10 crimes within one incident. This level of detail helps to eliminate subjective differences in reporting among LEAs that may contribute to inaccurate reports. NIBRS submission may reduce crime reporting data errors by reducing the likelihood of human error in steps such as tallying, classification of incidents, and form completion. Data does not need to be summarized or transcribed by LEA staff, which helps to minimize errors.

In Texas, many local entities submitting UCR data mail paper reports rather than submitting reports electronically. DPS employs eight full-time equivalent (FTE) positions to convert hard-copy data into a digital format to compile statewide crime reports. Some or all of these FTEs would no longer be needed or could be reassigned if more LEAs reported IBR data, which is only transmitted electronically rather than via paper reports.

In Connecticut, the Groton City Police Department reported an initial decrease in patrol efficiency when its IBR system was implemented. Within a month, however, data entry times for officers matched times needed to enter the less extensive summary data.

EXPANDING INCIDENT-BASED CRIME REPORTING IN TEXAS

Although SRS data can provide general information about crime in Texas, offenses covered by the summary reporting system are limited and do not include many modern crimes of interest to law enforcement and the public, such as drug offenses and kidnapping. LEAs, DPS, and other entities without access to a jurisdiction's IBR data do not have the most complete information available to analyze, develop informed responses to, and evaluate and modify programs that address crime. Although some operational value may be gained internally from LEAs utilizing incident-based data, the state as a whole could better track crime in Texas if more LEAs report IBR data. This statewide tracking would assist DPS and other entities to assess trends across jurisdictions.

To encourage LEAs to use IBR crime reporting, DPS should examine crime reporting concerns and obstacles and plan for its continued expansion. Recommendation 1 would amend the Texas Government Code to require DPS to develop a plan for implementing or expanding NIBRS reporting statewide. The plan would:

- build on available experience and infrastructure;
- identify additional resource needs;
- include input from stakeholders, including law enforcement agencies, law enforcement associations, advocacy groups, and academic institutions;
- include outreach strategies to educate the public on the differences between SRS and IBR data;
- contain measures to track progress and success of NIBRS reporting in Texas;
- examine options to leverage state purchasing power of FBI-approved NIBRS records management systems; and
- determine the feasibility of developing a FBI-approved NIBRS records management system that Texas LEAs could use.

The plan and measures would be provided to the Governor, the Legislative Budget Board, and the appropriate standing committees of the Legislature by September 1, 2016, and would be updated each subsequent biennium.

Stakeholders including LEAs, office representatives, policymakers, DPS, the Texas Commission on Law Enforcement, academics, and advocacy groups could work together to develop the plan. Agencies that have implemented

IBR crime reporting successfully could provide guidance to agencies considering the transition. Agencies that have transitioned successfully could help draft an assessment that would assist LEAs that are considering the transition to better understand costs and efforts associated with implementing IBR reporting.

Some reasons that LEAs may choose not to report NIBRS data to DPS may include cost, required changes in practice, and misunderstandings regarding the meaning of data.

Costs of converting from SRS reporting to IBR reporting vary depending on the size of the LEA, the LEA's reporting practices and technological infrastructure, negotiations with technology vendors, and training needs. Additionally, NIBRS-compliant records management system software may have a higher cost than noncompliant software.

Costs for individual LEAs may be difficult to estimate. When the Delaware Department of Public Safety decided to transition from SRS crime reporting to NIBRS reporting, the agency's original estimate of \$18,000 in transition costs increased to nearly \$100,000. Unexpected issues that arose during implementation included software programming errors and required changes to a statewide information system, as directed by state policymakers. However, a Texas LEA switched from SRS to NIBRS reporting when it made a planned upgrade of its records management systems in 2002. Costs were minimal beyond the planned technology upgrade.

The Office of the Governor's Criminal Justice Division has awarded LEAs several grants to help convert records management systems for NIBRS crime data extraction. The average award amount for the grants was approximately \$51,000.

To help LEAs overcome cost barriers to implementing IBR reporting, Recommendation 2 would appropriate \$5.0 million in General Revenue–Dedicated Funds to DPS and include a rider in the introduced 2016–17 General Appropriations Bill directing DPS to use the funds to provide grants for upgrading law enforcement agencies' technology infrastructure so they may implement IBR. This amount is estimated to allow DPS to provide grants of approximately \$51,000 to 10 percent of LEAs that report SRS data. Funds would be appropriated from the Emergency Radio Infrastructure Account No. 5153 (General Revenue–Dedicated Funds), which receives revenues from court costs paid by persons convicted of certain offenses. Statute authorizes the use of this account for public safety purposes. Historically revenues deposited to the account have been

approximately \$9 million to \$10 million per fiscal year. No appropriations were made from the account prior to calendar year 2014, when the Governor provided funds from this account to pay for border security operations. Prior to this, the account had accumulated a fund balance of \$26.2 million at the end of fiscal year 2013. Based on the amount of revenue deposited in previous fiscal years, it is assumed revenues to the account in future fiscal years would provide sufficient funding to implement this recommendation.

Some LEAs have expressed concern regarding the process changes that are necessary to transition to NIBRS reporting. They consider the changes to be an unnecessary use of agency resources because participation in the UCR program is voluntary. New records management systems may require training administrative and other staff. Some users, such as police officers and investigators, must understand how to input information in the field and also may desire to learn more about the benefits of new reporting steps.

Recommendations 3 and 4 together would provide LEAs with training necessary to understand the reasons for enhanced reporting and how to utilize it. Recommendation 3 would amend the Texas Occupations Code to expand the allowable uses of the Texas Commission on Law Enforcement Account No. 116 (General Revenue–Dedicated Funds) to include grants administered by DPS for training on IBR crime reporting. Recommendation 4 would add a contingency rider in the introduced 2016–17 General Appropriations Bill to appropriate \$300,000 to DPS for the 2016–17 biennium and direct this funding to be distributed as grants for training law enforcement on IBR reporting, contingent on enactment of legislation implementing Recommendation 3. Funds would be appropriated from the Texas Commission on Law Enforcement Account No. 116 (General Revenue–Dedicated Funds), which receives funds from court costs paid by persons convicted of certain offenses. Funds from this account are appropriated to the Texas Commission on Law Enforcement to exercise its powers and perform its duties, which include law enforcement training. Appropriations consistently have been less than revenue collected, and as a result a balance has accumulated in the account that is several times the amount necessary to biennially fund TCLE and other training initiatives. The balance at the end of fiscal year 2014 was \$24.4 million. This recommendation assumes that approximately 10 percent of LEAs that report SRS data would transition to NIBRS data and seek training grants of \$3,000 each.

Local jurisdictions have expressed concerns regarding perceptions of enhanced crime data in IBR reports. Transitioning from SRS to IBR data can lead to what may appear as an increase in crime, because IBR data includes more criminal offenses and does not have a hierarchical element. For example, an incident involving robbery, rape, and burglary would appear as one crime in a SRS report but would appear as three crimes in an IBR report. The differences in SRS and IBR reporting could be misleading when comparing the two reports of the same events. Likewise, SRS data may indicate a jurisdiction has less crime than it does, or may lead to an incorrect comparison of one jurisdiction's crime rate with another's rate. The FBI discourages comparison of jurisdictions using UCR data because the comparison does not consider factors such as geography, demography, population transience, relationship with other jurisdictions, and economy.

Recommendation 5 would amend the Texas Government Code to require DPS to regularly publish on its website a summary of existing IBR data. In other jurisdictions that have transitioned to IBR data, such as in Tennessee, state law enforcement ran SRS and IBR data together for several months to show LEAs what numbers may look like before publishing this data publicly. DPS could provide a similar presentation for LEAs in Texas to help them understand the reasons for differences in the two reports. DPS could then publish data in a report similar to the FBI's NIBRS 2012 website, which utilizes NIBRS data to show information such as age, groups most victimized by crime, and gang violence information. The NIBRS 2012 website includes more than 90 tables of information. This recommendation would provide LEAs and other interested parties with more comprehensive data when it is available so that it can be used to better analyze and develop responses to crime.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would result in a cost of \$5.3 million in General Revenue–Dedicated Funds for the 2016–17 biennium. Recommendation 2 would appropriate \$5.0 million to DPS for the 2016–17 biennium from the Emergency Radio Infrastructure Account No. 5153 (General Revenue–Dedicated Funds). This recommendation assumes that 10 percent of LEAs that currently report SRS data would transition to NIBRS, and that the average grant award would be \$51,000. This amount is the average grant awarded by the Office of the Governor's Criminal Justice Division for NIBRS implementation. Statute already authorizes the use of this account for public safety purposes, and a rider will

direct DPS to provide grants with these funds for upgrading law enforcement agencies' technology infrastructure to implement incident-based crime reporting.

Recommendation 3 would amend statute to authorize DPS to utilize the Texas Commission on Law Enforcement Account No. 116 (General Revenue–Dedicated Funds) for the purpose of educating LEAs on crime reporting. Recommendation 4 would include a contingency rider appropriating \$300,000 to DPS for the 2016–17 biennium from the Texas Commission on Law Enforcement Account No. 116 (General Revenue–Dedicated Funds) contingent on enactment of legislation implementing Recommendation 3. This recommendation assumes training costs will be similar to costs that an LEA that reports NIBRS previously paid for training, and adjusts those costs for inflation.

Any costs associated with Recommendations 1 and 5 would not be significant and could be absorbed by DPS using existing resources. **Figure 6** shows the five-year fiscal impact of Recommendations 2 and 4.

FIGURE 6
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATIONS
FISCAL YEARS 2016 TO 2020

YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE–DEDICATED FUNDS
2016	(\$2,669,174)
2017	(\$2,669,174)
2018	(\$2,669,174)
2019	(\$2,669,174)
2020	(\$2,669,174)

SOURCE: Legislative Budget Board.

The introduced 2016–17 General Appropriations Bill includes appropriations and riders to implement both recommendations.

IMPROVE DRIVER RESPONSIBILITY PROGRAM COMPLIANCE AND PROMOTE GOOD DRIVING BEHAVIOR

The Driver Responsibility Program, which began on September 1, 2003, is administered by the Texas Department of Public Safety. In accordance with the program, surcharges are levied on persons convicted of certain driving offenses. The purposes of the program are to enhance public safety and to shift some accident-related costs in the form of uncompensated trauma care from the general population. As of the end of fiscal year 2014, more than \$3.6 billion in Driver Responsibility Program surcharges had been billed since the program's inception, but only 51 percent of these surcharges have been collected (\$1.4 billion). The majority of the 49 percent of uncollected surcharges represent amounts owed by people who are not in compliance with the program.

The Legislature has modified provisions of the Driver Responsibility Program to improve compliance; however, there continues to be a high rate of noncompliance. Additional options to increase Driver Responsibility Program compliance and improve driving behavior include expanding program outreach efforts, increasing consequences for non-payment of surcharges, and incentivizing good driving behavior.

FACTS AND FINDINGS

- ◆ One of the original objectives of the Driver Responsibility Program was to enhance public safety; however, to date there has not been an analysis of the program's impact on traffic safety.
- ◆ One percent of Driver Responsibility Program revenue collected is allocated to the General Revenue Fund for program administration. The remaining 99 percent is divided equally between the Designated Trauma Facility and Emergency Medical Services Account 5111 (General Revenue–Dedicated Funds) and the General Revenue Fund. These funds help reimburse hospitals for uncompensated trauma care and provide financial incentives for earning or maintaining trauma center designations.
- ◆ The only sanction for non-payment of Driver Responsibility Program surcharges is license suspension.

CONCERN

- ◆ Activities such as informing potential violators about the Driver Responsibility Program, imposing additional consequences for nonpayment of surcharges, and incentivizing good driving behavior have been limited.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Include a rider in the introduced 2016–17 General Appropriations Bill to direct the Texas Department of Public Safety to improve Driver Responsibility Program outreach by: (1) including a Driver Responsibility Program statement in TexasSure letters, driver license renewal notices, and on websites that allow for electronic payment of Driver Responsibility Program surcharges; and (2) developing information regarding the Driver Responsibility Program that can be incorporated into peace officer training curricula.
- ◆ **Recommendation 2:** Amend statute to intercept state lottery winnings and unclaimed property proceeds of individuals with outstanding Driver Responsibility Program surcharges.
- ◆ **Recommendation 3:** Amend statute to reduce the amount of Driver Responsibility Program surcharges for offenses of no insurance or no license by 50 percent if drivers comply with applicable insurance and driver license laws.

DISCUSSION

The Seventy-eighth Legislature, Regular Session, 2003, established the Driver Responsibility Program (DRP). The purpose of the program is to levy surcharges on irresponsible drivers to enhance public safety and shift some of the burden of accident-related costs from the general population to persons who accumulate moving violations or are convicted of certain driving-related offenses. The program, which began on September 1, 2003, assesses surcharges annually for up to three years on drivers convicted of certain driving offenses in Texas. DRP is administered by the Texas Department of Public Safety (DPS). DRP surcharges may be assessed for two reasons: (1) based on points assigned to individuals' driver's licenses for moving violations; and (2) as

the result of a conviction for driving while intoxicated (DWI), driving with an invalid license, driving without a license, or driving without insurance. **Figure 1** shows each type of violation and the applicable surcharges. According to the Texas Transportation Code, Chapter 708, if an individual has not entered into an agreement to pay a surcharge by the 105th day after the date the surcharge was assessed, the individual's license is automatically suspended. According to DPS, approximately 1.4 million driver licenses are suspended for non-payment of surcharges as of April 2014.

REVENUE SOURCES AND USES

During the first biennium DRP revenue was collected (2004–05), 1 percent of the revenue was directed to the General Revenue Fund for program administration. The remaining 99 percent was divided equally (49.5 percent) between the Designated Trauma Facility and Emergency Medical Services Account 5111 (General Revenue–Dedicated Funds) and the Texas Mobility Fund (Other Funds). Beginning in fiscal year 2006, the 49.5 percent of funds previously allocated to the Texas Mobility Fund were allocated instead to the General Revenue Fund. If combined deposits to the General Revenue Fund from DRP and the \$30 state traffic fine assessed for traffic offense convictions reach an annual \$250.0 million limit, additional revenue would be directed to the Texas Mobility Fund (Other Funds). As of the end of fiscal year 2014, this limit has never been

reached. **Figure 2** shows the allocation of DRP collections between these funds.

The Designated Trauma Facility and Emergency Medical Services Account 5111 (General Revenue–Dedicated Funds) was established to provide funding for designated trauma facilities, county and regional emergency medical services, and trauma-care systems. The account receives revenue from DRP surcharges and the state traffic fine. The majority of expenditures from this account are used to offset the annual cost to eligible hospitals for uncompensated trauma care and provide a financial incentive for more hospitals to earn or maintain a trauma center designation. According to the Texas Department of State Health Services Emergency Medical Services and Trauma Registry hospital data, motor vehicle traffic accidents are the second-largest cause of traumatic injury in Texas. The 49.5 percent of DRP surcharge revenue that is deposited to the General Revenue Fund is available to the Legislature for general purpose spending.

DRIVER RESPONSIBILITY PROGRAM COLLECTIONS AND COMPLIANCE

DRP has generated less revenue than originally was anticipated. When the program was introduced in 2003, DPS projected a 66 percent collection rate for DRP. Based on this rate, it was projected DRP would assess \$181.5 million and collect \$119.8 million in surcharges for fiscal

**FIGURE 1
TEXAS DRIVER RESPONSIBILITY PROGRAM VIOLATIONS AND SURCHARGES, FISCAL YEAR 2014**

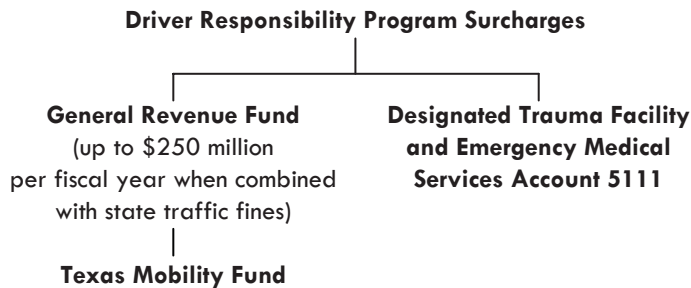
VIOLATION CATEGORY	VIOLATION	ANNUAL SURCHARGE AMOUNT
Points	2 points per moving violation; 3 points per moving violation resulting in an accident	\$100 for 6 points accrued in a 36-month period, \$25 for each additional point
Conviction	First Driving While Intoxicated (DWI): DWI, Intoxication Assault, or Manslaughter	\$1,000
	Subsequent DWI: DWI, Intoxication Assault, or Manslaughter	\$1,500
	DWI with Blood Alcohol Concentration of 0.16 or More	\$2,000
	No Insurance	\$250
	Driving While License Invalid: Driver license is canceled, suspended, denied, or revoked	\$250
	No Driver License: No driver license or commercial driver license, an expired license or endorsement violation(s)	\$100

NOTES:

- (1) Exceeding posted speed limit by less than 10 percent, unless in a school zone, is exempt.
- (2) Points are not assessed for individuals who complete defensive driving courses.
- (3) Individuals who have six or more points on their driver record are assessed a surcharge each year they maintain six or more points.
- (4) Surcharges for categories other than points are assessed each year for three years.

SOURCE: Texas Department of Public Safety.

**FIGURE 2
ALLOCATION OF TEXAS DRIVER RESPONSIBILITY PROGRAM COLLECTIONS, FISCAL YEAR 2014**



SOURCE: Legislative Budget Board.

year 2004. **Figure 3** shows projected and actual assessments and collections for fiscal years 2004 to 2008.

DRP has had lower-than-anticipated collection rates across surcharge categories each year since its inception. As of the end of fiscal year 2014, more than \$3.6 billion in DRP surcharges had been billed since the program began, but only 51 percent of these surcharges had been collected (\$1.4 billion). **Figure 4** shows the amount of DRP collections, by fund allocation, since fiscal year 2007. Historically, compliance rates have varied by offense category. According to DPS, the largest number of new DRP convictions for fiscal year 2014 (500,588) was for driving without insurance. The overall compliance rate for this category in the same year was 22.9 percent. The points surcharge category historically has had higher compliance than other categories; for fiscal year 2014, this category had a compliance rate of 60.6 percent. **Figure 5** shows compliance rates for all DRP surcharge categories for fiscal year 2014.

The Texas Legislature has initiated modifications to DRP in an effort to improve compliance and minimize negative financial effects of the program, particularly license suspensions. Legislation passed in 2007 authorized more extensive collection techniques, the reinstatement of installment plans, amnesty programs, and a reduction in total surcharges paid for offenders demonstrating improved behavior. Legislation passed in 2009 required DPS to establish an indigency program and amended notification requirements used when collecting surcharges. Although compliance and surcharge collections have improved since these modifications were implemented, the program’s rate of noncompliance is approximately 54 percent as of November 2014.

**ENHANCE COMPLIANCE AND
PROMOTE GOOD DRIVING BEHAVIOR**

In addition to reimbursing medical facilities for a portion of uncompensated trauma care, the establishment of DRP was intended to improve traffic safety. However, DPS staff have stated that the agency has no data relating to the program’s

**FIGURE 3
TEXAS DRIVER RESPONSIBILITY PROGRAM ASSESSMENTS AND COLLECTIONS, FISCAL YEARS 2004 TO 2008**

YEAR	PROJECTED		ACTUAL	
	ASSESSMENTS	COLLECTIONS	ASSESSMENTS	COLLECTIONS
2004	\$181.5	\$119.8	\$0.0	\$0.0
2005	\$344.5	\$227.4	\$167.6	\$42.4
2006	\$507.7	\$335.1	\$327.2	\$102.9
2007	\$507.7	\$335.1	\$421.5	\$162.5
2008	\$507.7	\$335.1	\$375.8	\$167.2

NOTES:

- (1) Amounts shown in millions.
- (2) No Driver Responsibility Program (DRP) surcharges were assessed or collected for fiscal year 2004. According to Department of Public Safety staff, the DRP vendor, Municipal Services Bureau, signed the DRP contract on August 26, 2004, and the first surcharge payment was received September 27, 2004. Surcharges for any convictions committed before the contract was implemented were not assessed until fiscal year 2005.

SOURCE: Legislative Budget Board.

**FIGURE 4
DRIVER RESPONSIBILITY PROGRAM COLLECTIONS, FISCAL YEARS 2007 TO 2014**

FUND	2007	2008	2009	2010	2011	2012	2013	2014
General Revenue Fund	\$80.0	\$84.6	\$85.7	\$81.9	\$86.1	\$88.4	\$68.7	\$73.0
Designated Trauma Facility and EMS Account 5111	\$78.5	\$81.1	\$84.0	\$80.4	\$84.4	\$85.0	\$69.1	\$71.6

NOTE: Amounts shown in millions.
SOURCE: Legislative Budget Board.

**FIGURE 5
TEXAS DRIVER RESPONSIBILITY PROGRAM COMPLIANCE RATES, FISCAL YEAR 2014**

OFFENSE	COMPLIANCE
Driving While License Invalid	18.4%
Driving Without a License	19.0%
No Insurance	22.9%
Driving While Intoxicated	37.3%
Points	60.6%

SOURCE: Legislative Budget Board.

effects on traffic safety or the number of insured drivers, and no independent analysis of this outcome has occurred. Additionally, the structure of the DRP does not provide specific incentives to improve traffic safety by means such as encouraging good driving behavior.

Additional options to increase DRP compliance and improve driving behavior include enhancing program outreach efforts, increasing consequences for nonpayment of surcharges, and incentivizing good driving behavior.

INFORM POTENTIAL VIOLATORS ABOUT THE DRIVER RESPONSIBILITY PROGRAM

Some DRP offenders have stated they were unaware of the potential for surcharges when they pled to an offense or were found guilty by the court. These offenders claim they believed their entire penalty had been discharged when they paid their court fines and fees. Statute requires a statement on citations to inform drivers about the possibility of DRP surcharges. This statement, however, is not detailed and may not be obvious to citation recipients. **Figure 6** shows this statement. Methods of informing the public about DRP and the potential for surcharges include these citation statements, mailed notices to DRP offenders when surcharges have been assessed, and information on DPS’s website.

Some municipalities allow individuals to pay tickets for certain offenses online; online-payable tickets include misdemeanor traffic violations that result in points being assessed against a driver license. These online payment systems are not required to include a statement warning the

**FIGURE 6
TEXAS DRIVER RESPONSIBILITY PROGRAM STATEMENT ON TRAFFIC CITATION AS OF FISCAL YEAR 2011**

GENERAL INFORMATION

This matter is now before the Court. Call (512) 974-4800 for information or visit our website at: www.cityofaustln.org/court.

2nd Conviction of No Vehicle Liability Insurance

A second or subsequent conviction of an offense under the Texas Motor Vehicle Safety Responsibility Act will result in the suspension of your driver’s license and motor vehicle registration unless you file and maintain evidence of financial responsibility with the Department of Public Safety for two years from the date of conviction. The department may waive the requirement to file evidence of financial responsibility if you file satisfactory evidence with the department showing that at the time this citation was issued, the vehicle was covered by a motor vehicle liability insurance policy or that you were otherwise exempt from the requirements to provide evidence of financial responsibility.

NOTICE OF POTENTIAL SURCHARGE

A conviction of an offense under a traffic law of this state or a political subdivision of this state may result in the assessment on your driver’s license of a surcharge under the Driver Responsibility Program.

Failure to Respond

Failure to respond on or before the appearance date on the front of your ticket may result in:

1. A higher fine amount. You will be subject to paying the Standard Fine if you do not respond on or before your appearance date.
2. An ARREST WARRANT (additional \$50 fee) issued against you.
3. A request to the Texas DPS for denial of driver’s license renewal and a \$30.00 fee may be added.
4. A request to the Texas Department of Transportation to withhold your vehicle registration renewal.
5. Referral to a collection agency with a possible 30% fee added to the amount owed.

ADMONISHMENT

If you are convicted of a misdemeanor offense involving violence where you are or were a spouse, intimate partner, parent, or guardian of the victim or are or were involved in another, similar relationship with the victim, it may be unlawful for you to possess or purchase a firearm, including a handgun or long gun, or ammunition, pursuant to federal law under 18 U.S.C. Section 922(g)(9) or Section 46.04(b), Texas Penal Code. If you have any questions whether these laws make it illegal for you to possess or purchase a firearm, you should consult an attorney.

SOURCE: Legislative Budget Board.

offender of possible DRP surcharges. Paying a ticket online for a driving offense is equivalent to pleading guilty in a court of law, and depending on other offenses charged to an individual’s driving record, this action could make the ticket recipient subject to DRP. For example, an individual paying a ticket online for a moving violation of a state traffic law in some cities may not realize that receiving two more moving violations within 36 months could subject that driver to DRP surcharges. Additionally, individuals who pay tickets

online for a conviction-based DRP offense, such as driving without insurance, may not understand that they are subject to paying DRP surcharges in addition to the fines and fees they pay for their convictions. Municipalities and peace officers may employ additional, alternative methods to make people aware of the program and these surcharges to address these circumstances.

The state already contacts certain individuals regarding potential violations of law that would be subject to DRP. The TexasSure Program at the Texas Department of Insurance (TDI) matches registered vehicles with insurance policies using information provided from the Texas Department of Motor Vehicles and insurers. TDI mails letters to the owners of unmatched registered vehicles to inform them of their status and provide specific guidance to correct the situation. Additionally, DPS mails driver license renewal notices to Texans about six weeks before a license expires. Letters mailed for both of these purposes do not inform recipients that driving without insurance and driving with an invalid license are offenses subject to DRP surcharges. As a result, the state is not using these opportunities to better inform certain populations of the potential to incur DRP surcharges if they violate these laws.

To better inform persons with potential to be subject to DRP of the program and its requirements, Recommendation 1 would include a rider in the introduced 2016–17 General Appropriations Bill to direct DPS to improve DRP outreach and education. The rider would require DPS to develop language regarding the DRP program and would require DPS to work with applicable agencies to include the language: (1) in TexasSure verification letters; (2) in driver license renewal notices; and (3) on the websites of municipalities that allow individuals to pay fines online for surchargeable offenses related to DRP.

Additionally, training and continuing education for Texas law enforcement officers, including those who issue traffic citations, does not include information about DRP. The rider also would direct DPS to develop information that provides an overview of DRP and would require DPS to work in cooperation with the Texas Commission on Law Enforcement (TCOLE) to incorporate this information into TCOLE's peace officer training academy and continuing education curricula. This training would educate peace officers about DRP so they would have the information needed to notify individuals charged with moving violations or other DRP offenses about potential surcharges.

ADDITIONAL CONSEQUENCES FOR NON-PAYMENT OF SURCHARGES

The only sanction for nonpayment of DRP surcharges is license suspension. Other state agencies have the authority to put a hold on state payments and garnish wages of individuals with outstanding debts. Specifically, the Office of the Attorney General files liens against property and other assets, garnishes wages, and intercepts lottery winnings to improve child support payment collections. The amount of a delinquent tax or other money owed by individuals to the Texas Comptroller of Public Accounts (CPA), the Texas Workforce Commission, or the Texas Alcoholic Beverage Commission may be deducted from lottery winnings.

To maximize DPS's authority to collect outstanding DRP surcharges, lottery winnings and unclaimed property proceeds of persons who are not compliant with DRP should be intercepted. Recommendation 2 would amend the Texas Government Code, Chapter 466, to require the Texas Lottery Commission (TLC) to intercept state lottery winnings, and the Texas Property Code, Title 6, to require CPA to intercept unclaimed property proceeds for individuals with outstanding DRP surcharges. This interception would require the executive director of TLC to deduct the amount of surcharges owed from prize winnings and transfer this amount to DPS once a delinquency has been reported. TLC would then pay the balance to the prize winner. Lottery winnings would be intercepted only if the value is more than \$500, because any amount less than that is paid out in cash to the winner. The prioritization of lottery proceed deductions is based on CPA's warrant hold process, which allows CPA to hold disbursement of certain state payments for individuals with delinquent taxes or other compensation. The warrant hold process specifies that the highest priority hold among multiple state debts is for child support payments, and the second-highest priority is for CPA tax office delinquencies. Other state debts are prioritized in order of their hold dates. It is assumed that deductions related to DRP surcharges would fall into this third category and would be based on the date they are reported to the TLC executive director. The CPA's interception of unclaimed property proceeds also would be limited to the amounts owed and would be managed and prioritized in the same manner as the lottery proceeds.

INCENTIVIZE GOOD DRIVING BEHAVIOR

The structure of the DRP program does not provide specific incentives for drivers to improve their behavior. As a result, the state is missing an opportunity to reduce undesirable driving behavior such as driving without a license or

insurance. In January 2007, the Legislative Budget Board (LBB) published a review in the *Texas State Government Effectiveness and Efficiency Report* that recommended amending statute to provide incentives for bad drivers to change their behavior through reductions in surcharges or the number of years surcharges are assessed. This recommendation was adopted, and the Texas Transportation Code, Chapter 708, allows DPS by rule to offer DRP offenders an incentive for compliance with the law, including a reduction in surcharges or the number of years surcharges are collected. This provision, however, has not been implemented fully.

DPS established an incentive program based on financial need in fiscal year 2013. Through this program, DRP offenders with a household income of between 125 percent and 300 percent of the federal poverty level (FPL) are eligible for a 50 percent reduction of DRP surcharges. The objective of the incentive program established in statute was to encourage good driving behavior; however, the structure of the current program does not achieve this. Rather than reducing surcharges for people who have come into compliance with statutory requirements, the program reduces surcharges for individuals solely based on their income.

Recommendation 3 would amend the Texas Transportation Code, Chapter 708, to expand the existing incentive program to include driving behavior-based benefits to encourage compliance. DPS should offer a 50 percent reduction to DRP surcharges for the offenses of no insurance and no driver license if drivers come into compliance with applicable insurance and driver license laws. Specifically, an offender charged with no driver license would be required to obtain a driver license not later than the 60th working day after the date of the offense; compliance could include the temporary driver license receipt provided by DPS until a new card arrives. This incentive would be available only to individuals without a driver license or commercial driver license, or with an expired license or endorsement violation. It would not apply to individuals with a canceled, suspended, denied, or revoked license. Driver licenses have a range of fees, but the fee for the most common license is \$24. An offender charged with no insurance would be required to establish financial responsibility with an automobile insurance policy that is valid for at least a six-month period not later than the 60th working day after the date of the offense.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 would result in additional people paying DRP surcharges; resulting in increased compliance and collections, although the amount of revenue gain cannot be determined at this time. This recommendation could also lead to additional persons complying with state laws and therefore avoiding DRP surcharges. Recommendation 2 would have no net fiscal impact but could impact the allocation of revenue. Revenue gains to the DRP from intercepted lottery proceeds and unclaimed property potentially could result in a loss of revenue in an equal amount to the State Owned Multicategorical Teaching Hospital Account 5049 (General Revenue–Dedicated Funds) and the General Revenue Fund. Any additional administrative costs associated with Recommendations 1 and 2 could be absorbed within existing agency resources, because these proposals include modifications of existing processes.

Recommendation 3 would result in a revenue loss; however, the amount of revenue loss cannot be estimated because it is unknown how many individuals would take part in the behavior-based incentive program.

The introduced 2016–17 General Appropriations Bill includes a rider to implement Recommendation 1.

IMPROVE PUBLIC SAFETY BY AUTHORIZING ALL COUNTIES TO ADOPT FIRE CODES

U.S. fire statistics during the last 30 years show a decrease in fire-related injuries, deaths, and property damage. From 1985 to 1994, fires caused an annual average of 29,000 injuries, 5,300 deaths, and more than \$15 billion in property damage. By 2011, average annual casualties dropped by half, and property damage decreased by \$4 billion. Authorities attribute the decrease in part to advances in fire codes, fire education, and construction. In 2013, local jurisdictions in Texas reported to the State Fire Marshal’s Office more than 71,000 fires that caused 866 civilian injuries, 167 deaths, and approximately \$622 million in property damage.

To improve public safety, all states except Texas and Missouri have adopted statewide fire codes. A fire code prescribes requirements intended to provide a reasonable level of safety and property protection from risks associated with fire, explosions, and other hazards. Codes include standards for building design, construction, maintenance, and occupation. Emergency service districts and all municipalities in Texas are authorized to adopt fire codes. However, two-thirds of Texas counties are not authorized to adopt a fire code because state law limits authority only to counties of a certain size or location. Despite the documented benefits of codes, most counties in Texas are unable to adopt and enforce fire codes to protect public safety. With authorization to adopt fire codes, counties could provide oversight, collaborate with stakeholders, and impose penalties related to fire code violations. Additionally, property owners in counties could realize savings from lower insurance rates through codes and their enforcement.

FACTS AND FINDINGS

- ◆ Since the 1970s, the U.S. has had an overall decrease in the number of fires as well as fire-related injuries and deaths. The U.S. Fire Administration attributes this decrease to the use of fire codes, sprinklers, smoke alarms, new construction techniques, education, and improved firefighting.
- ◆ Adoption and enforcement of fire codes has been shown to result in lower insurance rates and fewer fires, and reduce the loss of life and property when fires occur.

CONCERN

- ◆ Despite the documented benefits of fire codes to public safety, more than 65 percent of the counties in Texas lack the statutory authority to adopt and enforce fire codes. Without this authority, those counties lack a public safety tool that municipalities, emergency service districts, and other counties have to reduce the risk of fires and their consequences.

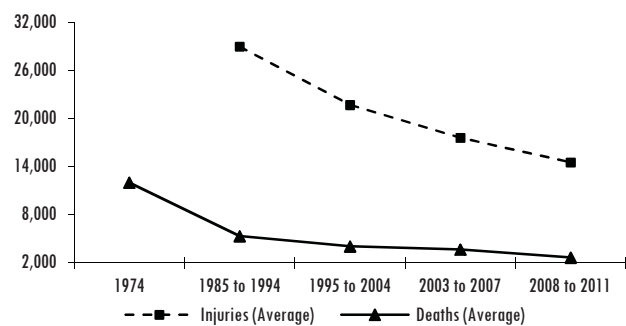
RECOMMENDATION

- ◆ **Recommendation 1:** Amend statute to authorize, but not require, the commissioners courts of all counties to adopt fire codes.

DISCUSSION

When the U.S. Fire Administration (USFA) was established in 1974, an estimated 12,000 people died from fires annually. One of USFA’s goals was for the U.S. to reduce annual fire deaths by half within 25 years. From 1985 to 1994, fires caused an annual average of 29,000 injuries and 5,300 deaths. The USFA met its goal of reducing U.S. fire death by half, and as shown in **Figure 1**, civilian deaths from fires have continued to trend downward. The figure also shows national fire statistics related to civilian injuries. When property damage figures are adjusted for inflation to 2014 amounts, annual damages averaged \$15.1 billion during the years from 1985 to 1994 and \$11.1 billion during 2008 to 2011.

FIGURE 1
FIRE-RELATED INJURIES AND DEATHS IN THE U.S.
CALENDAR YEARS 1974 TO 2011



SOURCE: U.S. Fire Administration.

The USFA attributes the steady decrease in fires and casualties to the increased use of fire codes, sprinklers, and smoke alarms; new construction techniques; education; and improved firefighting.

TEXAS FIRE STATISTICS

The Texas State Fire Marshal’s Office, a part of the Texas Department of Insurance, publishes *Fires in Texas*, an annual report to help Texans understand the effects of fires on the state and its residents. The most recent edition reports the occurrence of more than 71,100 fires in 2013. These fires resulted in 866 civilian injuries and 167 civilian deaths. **Figure 2** shows Texas fire statistics for the last seven available calendar years.

MINIMIZE THE RISK OF FIRES AND RELATED DAMAGE

Many jurisdictions use fire codes to help prevent or minimize the effects of fires. According to the National Fire Protection Association (NFPA), the goal of a fire code is to prescribe minimum requirements necessary to provide a reasonable level of safety and property protection from risks associated with fire, explosions, and other hazards. Codes include standards for building design, construction, maintenance, and occupation.

In Texas, statute requires that fire codes adopted by counties conform to or exceed the 2005 versions of the *International Fire Code* (IFC) or the *Uniform Fire Code*, which is now known as *NFPA 1: Fire Code*. As an example of what can be included in codes, the NFPA code specifies signage and lighting requirements to help minimize risk of injury or death from a fire, and information regarding whether doors can be fastened to prevent egress. Codes can be as specific as stating what kinds of voice amplification are appropriate for entertainment events such as crop mazes. Codes may also be

customized to meet an individual community’s needs. Counties that adopt a fire code can specify which sections of model codes are adopted, make amendments to model codes, and make additions as long as they conform to standards required by statute.

Data from the U.S. Fire Administration shows that the enforcement of fire codes helps to prevent and minimize fire-related losses. Fire code inspection and enforcement help building owners and managers discover and correct conditions that threaten life and property. Inspection and enforcement also provide fire safety officials and community leaders with opportunities to educate building owners and managers about how to reduce the risk of future hazards. In counties currently authorized to adopt a fire code, county employees or employees of other state entities under contract with the county perform the inspection. Counties may charge inspection fees and compliance certificate fees to cover the cost of the inspections and related expenses. Fees must be set in amounts necessary to cover costs associated with inspections and permitting and can only be used for that purpose. In counties in which a building may need inspection but no authority is available to perform the inspection, the State Fire Marshal’s Office may be contacted to perform the inspection.

According to a study conducted by the National Fire Protection Association and Fire Protection Research Foundation, inspections lower the general risk level of a fire when building owners or occupants collaborate with inspectors to improve conditions. Research has shown that, in municipal areas, buildings subject to fire code inspection generally account for less than one-fourth of structure fires, less than 10 percent of injuries, less than 5 percent of deaths, and less than one-third of property damage.

**FIGURE 2
FIRE STATISTICS IN TEXAS, CALENDAR YEARS 2007 TO 2013**

YEAR	REPORTED FIRES	CIVILIAN INJURIES	CIVILIAN DEATHS	DAMAGES (IN MILLIONS)	DAMAGES ADJUSTED FOR INFLATION (IN MILLIONS)
2007	73,704	683	138	\$455.6	\$523.5
2008	93,643	709	181	\$561.1	\$620.9
2009	80,961	746	133	\$548.3	\$608.9
2010	76,781	791	175	\$510.1	\$557.4
2011	102,799	825	169	\$1,035.7	\$1,097.0
2012	71,303	744	174	\$480.9	\$499.0
2013	71,119	866	167	\$621.6	\$621.6

NOTE: Damage figures are adjusted for inflation to 2014 dollars using the Consumer Price Index inflation calculator. Several wildfires occurred in 2011, resulting in over 100,000 reported fires.
SOURCE: State Fire Marshal’s Office.

As fire codes and enforcement have become more prevalent, the U.S. has experienced a long-term downward trend in fatalities and fires in commercial and public structures. For example, from 1980 to 2002, there was a 60 percent decrease in office building fires; and from 1980 to 1999, fires in all building types decreased by 51 percent. This trend is attributed to improved application of safety codes and standards.

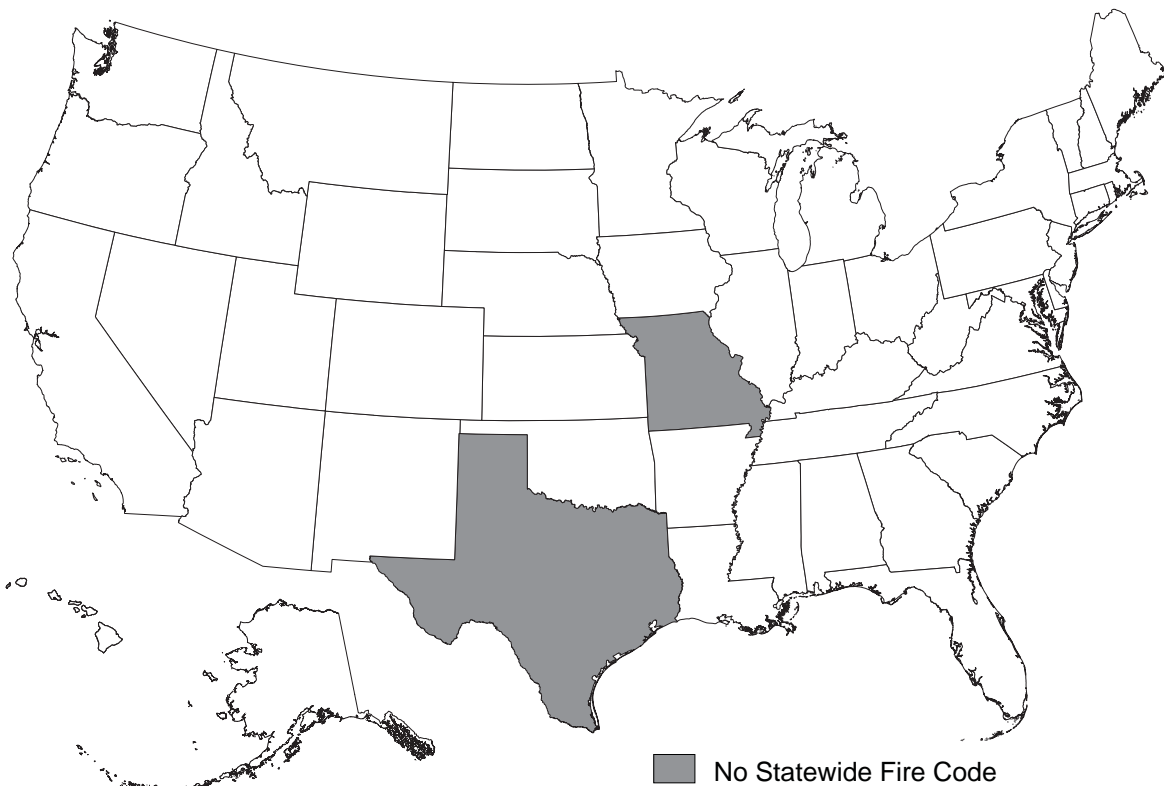
Adoption and enforcement of fire codes can factor into decreased insurance costs. The Insurance Services Office (ISO) is an organization that provides insurance companies and insurance regulators with information about risk. ISO's staff assesses communities throughout the U.S. to consider fire protection factors, including fire codes. ISO then rates communities based on its findings. Insurance companies use ISO's findings when underwriting and pricing homeowner and commercial insurance. ISO's actuarial data indicates communities that enforce fire codes experience fewer fire-related losses than areas without enforced codes. Codes, along with other factors, can positively affect ISO's ratings of a community and therefore decrease insurance costs for structures in the community.

In addition to benefits for commercial, public, and multifamily residential buildings, fire codes also benefit industrial facilities and the communities in which they sit. For example, fire codes provide guidance on hazardous materials and flammable and combustible liquids to building inspectors, fire authorities, and facility owners. State and federal laws require facilities that store hazardous chemicals to provide Tier II Chemical Reports to the Texas Department of State Health Services, the local fire department, and the local emergency planning committee. These reports provide information on the types and amounts of hazardous materials stored so that authorities can better prepare for potential risks. Every Texas county has at least one facility that is required to file a Tier II Chemical Report, and more than 110 counties have facilities that report storing ammonium nitrate, the substance that caused the 2013 explosion in West, Texas.

AUTHORIZE ALL COUNTIES TO ADOPT FIRE CODES

Figure 3 shows the prevalence of fire codes in the U.S. All states but Texas and Missouri have enacted statewide fire codes.

**FIGURE 3
FIRE CODE STATUS BY STATE, CALENDAR YEAR 2014**



SOURCE: National Conference of State Legislatures.

While enforcement of fire codes has been shown to improve public safety and decrease insurance costs, not all jurisdictions in Texas are allowed to adopt and enforce fire codes.

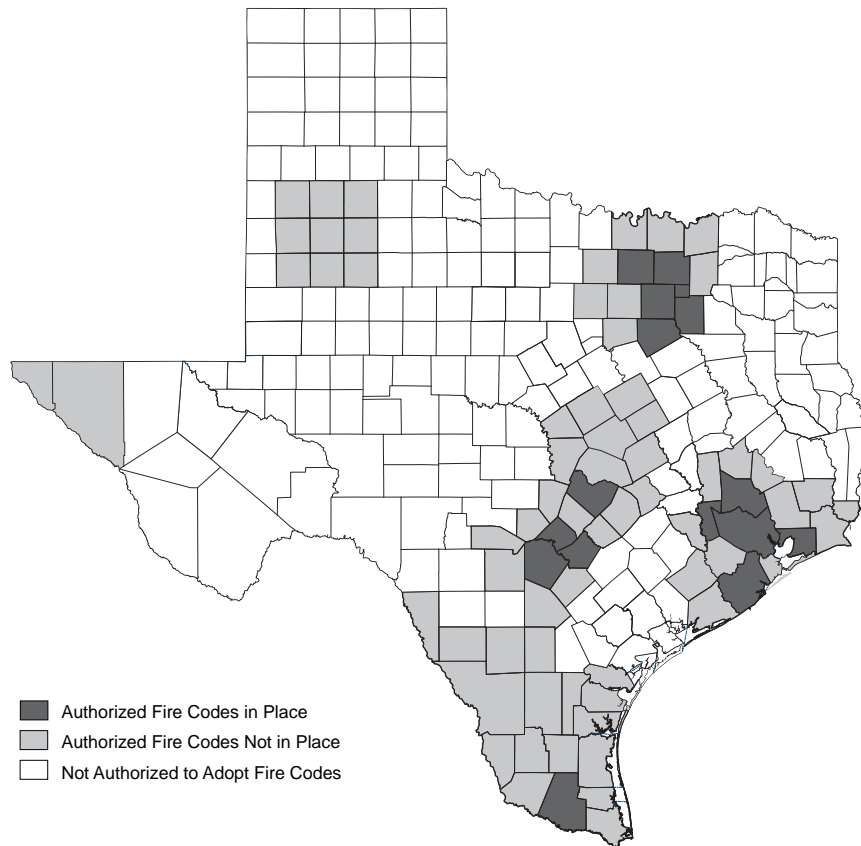
The Texas Local Government Code authorizes all municipalities in the state to adopt ordinances, including ordinances for fire safety. While no state entity tracks which municipalities have adopted fire codes, the State Fire Marshal’s Office estimates that a majority of large and mid-sized cities have adopted a code. According to the State Fire Marshal’s Office, the *International Fire Code* is the most common fire code adopted by municipalities in the state.

Emergency Service Districts (ESDs) also may adopt fire codes. ESDs may provide emergency services, fire fighting services, or both. As of August 2014, there are approximately 300 ESDs in the state. Approximately 75 percent of ESDs provide fire fighting services, although they do not necessarily adopt fire codes.

The Texas Local Government Code also authorizes certain counties to adopt fire codes. The Seventy-first Legislature, 1989, authorized commissioners courts of counties with populations of more than 250,000 to adopt fire codes for unincorporated areas. The Seventy-fifth Legislature, 1997, authorized counties adjacent to those with populations of more than 250,000 to adopt fire codes for unincorporated areas. Fire codes in unincorporated areas of counties apply to commercial buildings, public buildings, and multifamily residential buildings containing four or more units. According to 2010 federal census data, only 20 of Texas’ 254 counties have populations of more than 250,000. An additional 62 counties are adjacent to those counties, meaning 82 of the state’s 254 counties may adopt fire codes in unincorporated areas. In sum, more than two-thirds of Texas counties (172) do not have the authority to adopt fire codes in unincorporated areas.

Many counties authorized to adopt fire codes choose not to do so. **Figure 4** shows which counties are eligible to adopt a

FIGURE 4
TEXAS COUNTY FIRE CODE AUTHORIZATION AND STATUS, CALENDAR YEAR 2014



SOURCE: Texas Legislative Council.

fire code and which counties have adopted a fire code. A county may choose not to adopt a code because it lacks resources to fund enforcement; a majority of the county population or land already has coverage pursuant to municipal fire codes or emergency service districts; or the community lacks interest in more stringent building and safety standards due to the extra costs involved. However, these counties have the statutory authority to adopt a fire code at any time if circumstances change or if they determine it is in their interest to do so.

While many counties are not authorized to adopt fire codes, the Texas Local Government Code authorizes county commissioners in all counties to establish fire marshals offices. This office can investigate and report on fires that cause property damage or injury, investigate arson, and inspect certain structures for fire or life safety hazards. However, fire marshals do not have permitting authority, and their inspection authority is more limited than what is allowed pursuant to a fire code. To promote fire code compliance, the statute authorizing counties to adopt fire codes also allows them to pursue injunctive relief. As of August 2014, 51 counties have appointed fire marshals. Some counties with fire marshals also have fire codes.

Despite the documented public health and safety benefits of fire codes, the majority of counties in Texas are not authorized to adopt and enforce these codes. Such counties lack a tool that municipalities, ESDs, and other counties have to provide oversight, collaborate with stakeholders, and impose penalties related to fire codes. Additionally, counties that cannot adopt and enforce fire codes cannot realize savings from lower insurance rates through codes and their enforcement.

Recommendation 1 would amend statute to authorize all counties, rather than only those adjacent to or with a population of 250,000 or more, to adopt fire codes. Under this recommendation, any county commissioners court could approve adoption of the fire code, just as occurs in counties that are currently provided this authority. This would ensure that all municipalities, emergency service districts and counties have the same option to use fire codes to prevent and minimize fires and to positively impact insurance rates.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 would not result in a direct fiscal impact to the state. Approximately 25 percent of the State Fire Marshal’s current inspections are of buildings in jurisdictions without fire codes. The State Fire Marshal provides necessary

inspections when a local entity is not authorized to do so. It is estimated that these inspections cost \$241,000 annually. Funds for inspections come from the Department of Insurance Operating Fund (General Revenue–Dedicated Account 0036) and Insurance Maintenance Tax Fees (General Revenue Account 8042). It is assumed that allowing more local authorities to adopt fire codes and therefore perform inspections in lieu of the State Fire Marshal’s inspections would result in cost-avoidance for the Texas Department of Insurance (TDI). At this time, the impact of reducing the amount of code inspections that the State Fire Marshal performs cannot be estimated. Funds appropriated to TDI for this purpose would presumably be used for other inspections. TDI has the authority to adjust the insurance maintenance tax to generate sufficient revenue to cover its operating expenses. Therefore, TDI could reduce this tax as appropriate to account for any cost savings that would result from this recommendation.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of this recommendation.

EXPAND THE MARKET TO WHICH TEXAS CORRECTIONAL INDUSTRIES CAN SELL GOODS AND SERVICES

The Texas Government Code charges Texas Correctional Industries, a department within the Department of Criminal Justice, with two objectives: provide offenders with marketable job skills to help reduce recidivism, and reduce the agency's costs. To achieve these objectives, programs within Texas Correctional Industries train and employ approximately 5,000 incarcerated offenders to manufacture goods and perform services to sell to governmental entities. According to the Texas Department of Criminal Justice, the longer that these offenders work in these work programs prior to release, the less likely they are to recidivate.

Under current law, Texas Correctional Industries generally may sell goods and services only to certain governmental entities. It may not sell goods or services on the open market to most private businesses, including private prison vendors that are under contract with the Texas Department of Criminal Justice. Additionally, Texas Correctional Industries may not sell goods to current or retired state employees. These statutory restrictions impede the programs from achieving their potential.

Lifting these restrictions would provide Texas Correctional Industries additional opportunities to meet its objectives. Amending state law to authorize Texas Correctional Industries to sell goods to private prison vendors and to state employees would result in additional annual sales revenue of more than \$2.9 million in General Revenue Funds. These funds would be appropriated to the Texas Department of Criminal Justice to cover the cost of goods and services sold. In the long-term, selling to new markets would allow Texas Correctional Industries to generate more revenue, thereby freeing up funding for other uses.

CONCERN

- ◆ Statute authorizes Texas Correctional Industries to sell goods to the public but criminalizes the sale of prison-made goods on the open market. As a result, Texas Correctional Industries' market is limited to entities explicitly listed in statute. Its market does not include common correctional industry purchasers such as private prison vendors and state employees, thereby limiting the potential to fully meet the program's objectives.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to authorize Texas Correctional Industries to sell goods and services to and contract with private prison vendors with whom the Texas Department of Criminal Justice contracts, except in instances in which Texas-based businesses are already selling similar goods or services to a private prison vendor.
- ◆ **Recommendation 2:** Amend statute to authorize Texas Correctional Industries to sell goods and services to current and retired state employees.

DISCUSSION

Texas has several programs to reduce recidivism rates of incarcerated offenders. Texas Correctional Industries (TCI), a department within the Texas Department of Criminal Justice (TDCJ) is one such program that focuses on reducing recidivism by providing offenders with marketable job skills. TCI was established in 1963 by the Prison Made Goods Act. It includes six divisions: Garment, Graphics, Furniture, Metal, Marketing and Distribution, and Offender Work and Training Programs. Offenders who participate in the program receive on-the-job training related to manufacturing goods and providing services. Broad categories of goods produced include graphics, janitorial supplies, garments and textiles, furniture, and metal. Services include seating refurbishing and installation, braille transcription, bus renovation, tire retreading, computer recovery, and geographic information system conversion. The most common goods TCI sells to TDCJ include offender and employee uniforms and soap products. License plates, road signs, and modular furniture account for the most common items sold to other agencies.

TCI is appropriated approximately \$65 million in General Revenue Funds and Other Funds per fiscal year. This amount includes more than \$49 million from receipts and sales its programs generate annually. This revenue is deposited to the General Revenue Fund and appropriated back to the agency. TCI's remaining operating budget is funded with approximately \$15 million in General Revenue Funds.

REDUCING RECIDIVISM BY PROVIDING MARKETABLE JOB SKILLS

According to TDCJ, TCI provides offenders with marketable job skills that help reduce recidivism. At the end of January 2014, approximately 5,000 of TDCJ’s 150,935 offenders worked in one of TCI’s 37 facilities. Offenders wishing to participate in TCI undergo an application and acceptance process coordinated through TDCJ’s Offender Work & Training Programs division. Offenders may receive certain job skill certifications that are coordinated through the Offender Work & Training Programs division or Windham School District. Certifications include those issued by American Welding Society, Automotive Service Excellence, and the Library of Congress.

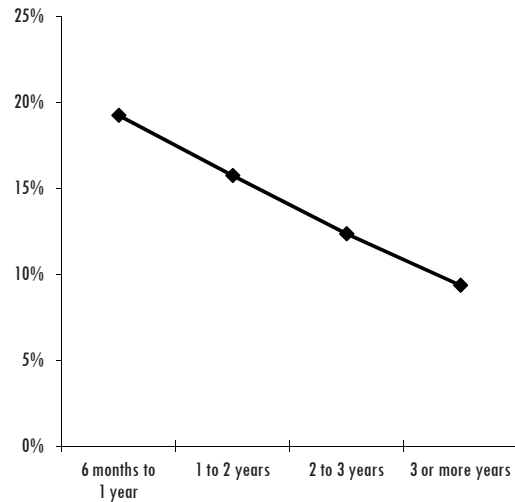
Offenders working as welders, mechanics, truck drivers, and recently as braille transcribers are most successful in obtaining jobs in those industries upon release. In addition to learning trade skills, TCI and other states’ correctional industries programs report that offenders also learn soft skills such as a work ethic, a positive attitude, interpersonal skills and a sense of personal accomplishment. Officials state that these skills help offenders gain and maintain employment once they are released from prison.

Research by TDCJ found that offenders who work in the TCI program for at least six months before their release recidivate at a lower rate than the general prison population. Of offenders released in fiscal year 2009, the general population recidivated at an average rate of 22.6 percent, meaning that 22.6 percent of the general population of offenders was reincarcerated within three years of release from TDCJ. Offenders who work in the TCI program for at least six months before their release recidivate at an average rate of 15.7 percent over three years. The longer an offender works in the TCI program prior to release, the less likely the offender is to recidivate. **Figure 1** shows the recidivism rates of offenders by amount of time spent in TCI on-the-job training prior to release.

According to TDCJ, offenders who participate in TCI typically commit fewer major disciplinary offenses than non-participants. Disciplinary offenses can lead to expulsion from the program so offenders have extra incentive to adhere to behavioral guidelines.

TCI does not pay wages to offenders in its programs. Participants receive good conduct time credit if they satisfactorily participate in assigned work. For many offenders, good conduct time credit may be added to calendar

**FIGURE 1
THREE-YEAR RECIDIVISM RATE OF OFFENDERS RELEASED FROM THE TEXAS DEPARTMENT OF CRIMINAL JUSTICE BY AMOUNT OF TIME IN TEXAS CORRECTIONAL INDUSTRIES FISCAL YEAR 2009**



SOURCE: Texas Department of Criminal Justice.

time served when calculating eligibility for the offender’s release on parole or mandatory supervision. Good conduct time may lead to the offender spending less time in prison.

REDUCING THE TEXAS DEPARTMENT OF CRIMINAL JUSTICE’S COSTS

TCI’s annual operating budget is approximately \$65 million in General Revenue Funds and Other Funds. The majority of TCIs appropriations are Other Funds, including more than \$45 million in Appropriated Receipts and more than \$5 million in Interagency Contracts. Generally, sales to customers such as a city or county are not funded by state funds, and are considered TCI Receipts. Sales to state-funded customers are considered Interagency Contracts. TCI is appropriated less than \$300,000 in General Revenue–Dedicated Funds annually (Account 5060, Private Sector Prison Industries). The remaining balance of TCI’s budget includes \$15 million in General Revenue Funds.

TCI products are generally comparable to or less expensive than products available to TDCJ from outside vendors, which allows for cost avoidance on the purchase of those products. In the long term, reduced costs plus profit gained from selling to new markets could make General Revenue Funds currently appropriated to TCI available to the Legislature to appropriate for other purposes.

AUTHORIZED AND PROHIBITED SALES

The Texas Government Code generally criminalizes the sale of prison-produced items on the Texas open market. Open market is interpreted as meaning the public or anyone other than those entities explicitly allowed by law. A person commits a Class B misdemeanor by intentionally selling or offering to sell an article or product that the person knows was manufactured by an offender. In Texas, Class B misdemeanors are punishable by a fine of up to \$2,000 as well as up to six months of confinement in jail. While the statute that enumerates TCI’s objectives explicitly provides for sales to the public, the Class B misdemeanor effectively prohibits many such sales by criminalizing them. As a result, private businesses, nonprofit organizations, state employees, and the public at large cannot purchase from TCI since it would be a crime for TCI to sell to them. The Legislature has previously established some exceptions to this misdemeanor. **Figure 2** shows exceptions to the general criminal offense of selling prison-made goods on the open market.

**FIGURE 2
EXCEPTIONS TO THE OFFENSE OF SELLING PRISON-MADE
GOODS ON THE OPEN MARKET, FISCAL YEAR 2015**

EXCEPTION	STATUTORY AUTHORITY
State flag or similar item produced for sale or distribution by the Legislature.	Texas Government Code, §497.010(c)
Service provided under a contract for which the Private Sector/Prison Industry Enhancement Certification Program does not require certification.	Texas Government Code, §497.010(c)
Arts and crafts made and sold by offenders to the public.	Texas Government Code, §497.010(c)

SOURCE: Texas Government Code.

Statute also authorizes certain sales of prison-made items through contract to certain entities. The Texas Government Code authorizes TCI to contract with and sell to certain governmental entities and educational institutions. **Figure 3** shows the entities statutorily authorized to purchase prison-made items. In addition to being authorized to purchase goods from TCI, state agencies and political subdivisions are required to purchase TCI-made articles and products unless they qualify for certain exceptions. Agencies and political subdivisions may request a waiver exempting them from this duty if they can purchase articles and products elsewhere at a lower price or if TCI goods do not meet necessary specifications. Goods and services are purchased through the

**FIGURE 3
ENTITIES AUTHORIZED TO PURCHASE PRISON-MADE
GOODS, FISCAL YEAR 2015**

ENTITY	STATUTORY AUTHORITY
Texas Department of Criminal Justice	Texas Government Code, §497.002(a)(2)
The public	Texas Government Code, §497.002(a)(2)
Agencies of the state	Texas Government Code, §497.002(a)(2)
Political subdivisions of the state	Texas Government Code, §497.002(a)(2)
Other states	Texas Government Code, §497.022(1)
Federal government	Texas Government Code, §497.022(1)
Foreign government	Texas Government Code, §497.022(1)
Any agency of other states, the federal government, or foreign governments	Texas Government Code, §497.022(1)
Private or independent institution of higher education	Texas Government Code, §497.022(2)
Private school or person with a visual disability	Texas Government Code, §497.022(3)

SOURCE: Texas Government Code.

Comptroller of Public Accounts’ Texas Procurement and Support Services division (TPASS) or from TCI directly.

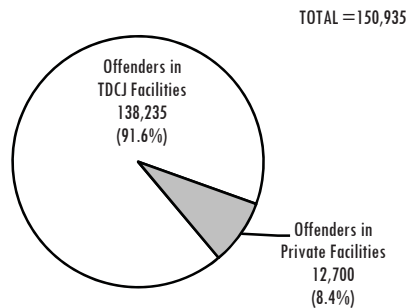
CORRECTIONAL INDUSTRIES IN OTHER STATES

Forty-nine of the 50 states in the U.S. operate correctional industries programs. The federal government also operates a correctional industries program. More than 30 states authorize their correctional industries programs to sell to private contractors on government contracts. For example, some states require private prison vendors to purchase from, or consider purchasing from, the state’s correctional industries program. The correctional industries programs in more than 20 states may sell to state or local government employees. Some states market prison-made goods to the public or nonprofit organizations in physical stores or online.

**EXPANDING THE MARKET TO WHICH TCI CAN SELL
GOODS AND SERVICES**

As of January 2014, private prison vendors operate 14 prisons in Texas and oversee approximately 12,700 offenders, or 8.4 percent of Texas’ offenders. **Figure 4** shows the offender populations in facilities run by TDCJ and private prisons under contract with TDCJ. While private vendors can and

**FIGURE 4
OFFENDER POPULATION IN STATE AND PRIVATELY
OPERATED FACILITIES, JANUARY 2014**



SOURCE: Texas Department of Criminal Justice.

do purchase prison-made goods in other states, they cannot do so in Texas because of current statutory prohibitions. Depending on whether offenders are in a private or public prison, they could have TCI-made uniforms or uniforms made by a third party. The vendors under contract with TDCJ cannot lower or avoid costs through purchasing from TCI as TDCJ can for its own facilities.

Recommendation 1 would amend the Texas Government Code, Chapter 497, to authorize, but not require, private prison vendors that operate in Texas to purchase goods and services from TCI. Under this recommendation the Texas Board of Criminal Justice would be granted rulemaking authority to develop rules and best practices for sales to private prison vendors. TCI would be prohibited from selling goods or services to private prison vendors if Texas-based private businesses are already selling those goods or services to private prison vendors. Items and services would only be authorized for shipping and use within Texas in order to maintain compliance with existing federal law regarding prison-made goods and interstate commerce (United States Code, Title 18, Section 1761).

Upon implementation of this recommendation, TDCJ could provide incentives to increase TCI sales by allowing private prison vendors to retain a percentage of the cost savings realized from purchasing TCI goods instead of private goods. For example, if a private prison vendor is paying \$5 million to a third party for a good, and TCI could provide the good for \$3 million, the private vendor could purchase the good from TCI. The private prison vendor could be allowed to keep a percentage of the savings. This incentive would result in savings to the private prison vendor and TDCJ, as well as additional business for TCI.

Recommendation 2 would amend the Texas Government Code, Chapter 497, to authorize the sale of TCI goods and services to current and retired state employees. The State of Texas employs more than 300,000 full time equivalent employees, and the Employee Retirement System has more than 90,000 retirees. This recommendation would add nearly 400,000 additional individuals to TCI’s potential market. More than 20 states include state employees in their markets to gain additional revenue and training for offenders. TCI already manufactures several of the most common goods and services that correctional industry programs provide to state employees in other states. These include garments, metal products such as grills and fire pits, and furniture refurbishing services.

If implemented, this recommendation would provide the Texas Board of Criminal Justice rulemaking authority to establish controls on purchasing procedures for current and retired state employees. For example, TDCJ could have state employees use their agency’s administrative department or the Employee Retirement System to place orders with TCI. Alternatively, all orders could be placed online following an eligibility verification process. TDCJ could require purchasers to sign affidavits stating that they are current or retired state employees and that they would not resell or transport goods across state lines. TCI or an appropriate TDCJ division would determine which goods and services would be available to the public, the minimum quantity or price of sales orders, delivery and production schedules, and other details relevant to ensuring that TCI is not impeded in effectively meeting its objectives.

FISCAL IMPACT OF THE RECOMMENDATIONS

Beginning in fiscal year 2017, these recommendations would result in an annual revenue gain of \$2.9 million in General Revenue Funds and an offsetting cost of \$2.9 million in General Revenue Funds.

Recommendation 1 would result in an estimated annual net revenue gain of \$369,794. TCI estimates that if private prison vendors operating in Texas purchased items from TCI, it would realize an estimated increase in sales revenue of \$2.5 million which would be deposited to General Revenue (Account 8030, Texas Correctional Industries Receipts). It is assumed that 15 percent of the gain would be profit and the remainder would cover costs associated with administering the program. As discussed previously, TDCJ could also benefit from cost savings as a result of private prison vendors’ lower costs.

Recommendation 2 would result in an estimated annual net revenue gain of \$73,950. Data relating to TCI purchasing projections of current and retired state employees are not available. Some states whose correctional industry programs sell to state employees report that these sales make up 1 percent of total correctional industries sales. Assuming that allowing the sale of goods to current and retired state employees results in a 1 percent gain in sales, TCI would realize additional annual sales revenue of \$493,004 which would be deposited to General Revenue (Account 8030, Texas Correctional Industries Receipts). It is assumed that 15 percent of the gain would be profit and the remainder would cover costs associated with the TCI program.

The combined recommendations would result in gross annual sales revenue of \$2.9 million, which would be deposited to General Revenue (Account 8030 – TCI Receipts). This analysis assumes it would take one year to develop rules for and fully prepare for TCI to sale goods to private prison vendors and current and retired state employees. An existing rider in TDCJ’s bill pattern appropriates all receipts collected from the sale of products produced by TCI to TDCJ for use in TCI. As a result, any additional revenue resulting from these recommendations would be appropriated and available for TCI activities. As a result, no additional revenue is anticipated until fiscal year 2017, and no adjustments are recommended to TDCJ’s appropriations for the 2016–17 biennium. In the long-term, selling to new markets would allow Texas Correctional Industries to generate more revenue, thereby freeing up funding for other uses.

**FIGURE 5
FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2016 TO 2020**

YEAR	PROBABLE GAIN/ (LOSS) TO GENERAL REVENUE FUNDS	PROBABLE SAVINGS/ (COST) TO GENERAL REVENUE FUNDS
2016	\$0	\$0
2017	\$2,958,298	(\$2,958,298)
2018	\$2,958,298	(\$2,958,298)
2019	\$2,958,298	(\$2,958,298)
2020	\$2,958,298	(\$2,958,298)

SOURCE: Legislative Budget Board.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

OVERVIEW OF ESTIMATED NET COSTS OF TECHNICAL REVOCATIONS FROM PAROLE

Texas has the largest population of state-incarcerated offenders in the country and houses more than 150,000 felons. Some individuals convicted of felonies may not serve all of their sentence incarcerated in a prison or state jail and may instead be supervised in the community. This supervision occurs either through probation, which occurs instead of incarceration or parole, which occurs after incarceration. This period of supervision in the community may be revoked if the felon commits a new offense or fails to comply with the technical terms of the supervision, such as failing to meet with a parole or probation officer. This second type of revocation is called a technical revocation, and these offenders are often targeted for diversion from incarceration through more intensive supervision or intermediate sanctions strategies due to the lack of severity of their offense and low risk of recidivism.

Incarceration can cost over 9 times as much as parole supervision. Therefore, revoking a parole violator to prison increases state costs. Balanced against this cost, however, are the costs to the state, local governments, and victims for crimes these individuals may commit if they were not incarcerated. Legislative Budget Board staff developed an estimate of the net fiscal impact that would have occurred for a single-year cohort of technical revocations from parole had these parole violators been allowed to remain in the community. To determine these costs, Legislative Budget Board staff used an econometric simulation model and technical assistance from the Pew-MacArthur Results First Initiative. This report compares the total cost, both direct and indirect, of revoking a technical violator of parole conditions to prison to the cost of the offender remaining in the community.

FACTS AND FINDINGS

- ◆ In 2013, there were 24,186 revocations from probation and 5,850 revocations from parole. Approximately 10.7 percent of probation revocations and 6.7 percent of parole revocations statewide were the result of technical revocations.
- ◆ Gross state costs that could have been avoided had all 2007 parole technical revocations remained in the community, rather than be returned to prison, were \$27.4 million during a five-year period. Actual

budget savings would depend on changes in prison utilization during this time.

- ◆ The LBB modeled costs that would have been incurred due to new offenses had these individuals not been technically revoked. The estimated direct costs are \$2.9 million in state costs and \$2.1 million in local costs that would have been generated over a 31 year period. In addition to these direct costs, \$12.6 million in victimization costs would have been generated over a five-year period.
- ◆ For every \$1.00 spent by the state to incarcerate the 2007 cohort of technical revocations, an estimated \$0.56 of victimization costs were avoided.
- ◆ The necessary data to conduct a similar estimation for probation revocations is not yet available.

DISCUSSION

Texas has the largest population of state-incarcerated offenders in the country, housing more than 150,000 felons in its 109 prisons and state jails. In 2013, 50.0 percent of offenders entering Texas prisons entered as a result of a revoked term of community supervision (probation) or parole supervision. The estimated marginal daily cost of incarceration is \$33.25 per day, determined by adding the contract rate for private state jails to the Texas Department of Criminal Justice's (TDCJ) estimate of fixed allocated costs. This cost estimate is 11.1 times the average cost of community supervision (\$2.99 per day) and 9.2 times higher than the cost of parole supervision (\$3.63 per day). As a result, the decision to revoke parole or probation results in significant costs to the state. However, there may also be costs when a person who violates conditions of supervision is not incarcerated. Offenders on community supervision and parole supervision who engage in new criminal activity that would be prevented if they were incarcerated generate new costs to law enforcement, jails, and courts. In addition, this new criminal activity results in tangible victim costs such as health care expenses, property damage and losses in future earnings as well as intangible victim costs such as jury awards for pain, suffering and lost quality of life.

COMMUNITY SUPERVISION (PROBATION)

Community Supervision and Corrections Departments (CSCDs) in Texas are operated at the county level and are administered by staff hired by the judiciary to supervise and rehabilitate offenders sentenced to community supervision in Texas by local courts. For Texas 254 counties there are 122 CSCDs; several highly populated counties have their own CSCDs while some departments serve two or more less populated counties. TDCJ's Community Justice Assistance Division (CJAD) enforces standards, provides training and monitors the performance of departments.

In addition to oversight of the local probation function, CJAD also provides state formula and diversion funding that finance 63.2 percent of the cost of supervision and supplement fees paid by offenders. For the 2006–07 biennium, when the TDCJ incarcerated population reached its highest counts, the Legislature appropriated \$480 million to support the community supervision system, increasing funding for community supervision diversion programs, in part to try to control the growth in the population of incarcerated felons. By the 2014–15 biennium, TDCJ was appropriated \$598.8 million for community supervision programs, an increase of almost \$119.0 million. Partly as a result of these efforts, the incarcerated population of TDCJ has decreased from a high of 156,652 on May 29, 2008 to an average of approximately 150,300 for the first several months of fiscal year 2015.

A revocation can occur when a individual under parole or deferred adjudication commits a new crime or fails to fulfill the terms of their probation. In these cases, the CSCD officer refers the case to court which considers either a Motion to Revoke (MTR) Probation or a Motion to Adjudicate (for defendants on deferred adjudication). The felony revocation hearing is held before a district court judge. The most common reasons for having a revocation hearing are for the commission of a new offense, or for a technical violation of

conditions of community supervision (such as not reporting to a probation officer, being arrested and not reporting the arrest to the probation officer, or failing a drug test). The judge can rule to modify a probationer's terms of community supervision (such as requiring the probationer to complete treatment, pay additional fees, or spend a short period of time incarcerated in the local county jail) and continue their case. Or the judge may rule to revoke community supervision and send the individual to incarceration. Multiple MTRs may be filed before an offender successfully completes community supervision or is revoked.

Figure 1 shows the number of community supervision revocations to prison or state jails, the total felony community supervision population, and the revocation rate in each year from fiscal year 2009 to fiscal year 2013. Since fiscal year 2009, felony revocations to TDCJ have decreased from 24,692 to 24,186 for fiscal year 2013. The revocation rate, community supervision revocations divided by population under supervision, has been largely stable since 2009.

While the number of probationers revoked to prison is known, the length of time they spend in prison cannot currently easily be determined from existing state data sources and as a result the cost to the state of these revocations cannot be determined. Accordingly, in September 2007, Legislative Budget Board (LBB) staff, in coordination with CJAD, selected a sample of CSCDs from which to capture individual information on offenders revoked from community supervision. Five CSCDs were selected as data collection sites: Harris, Dallas, Tarrant, Travis, and Bexar counties. During 2013, these five CSCDs accounted for 39.5 percent of the state's felony offenders under community supervision and 41.8 percent of the state total felony revocations. A total of 795 felons supervision was revoked in the selected departments in this month. This study of community supervision revocations showed that 94.3 percent of revocations led to incarceration in a state jail (52.4

FIGURE 1
TEXAS DEPARTMENT OF CRIMINAL JUSTICE FELONY PROBATION POPULATION, FISCAL YEARS 2009 TO 2013

FISCAL YEAR	ALL PROBATION REVOCATIONS	TECHNICAL PROBATION REVOCATIONS	TOTAL PROBATION POPULATION	TOTAL REVOCATION RATE	TECHNICAL REVOCATION RATE
2009	24,692	12,845	241,414	10.2%	5.3%
2010	24,239	12,627	238,951	10.1%	5.3%
2011	23,881	12,094	236,478	10.1%	5.1%
2012	23,449	12,034	231,376	10.1%	5.2%
2013	24,186	12,287	225,843	10.7%	5.4%

NOTE: Total population in a fiscal year shows the count of persons on probation as of the last day of August.

SOURCE: Texas Board of Pardons and Paroles.

percent) or prison (41.9 percent). The average sentence length revoked to state jails was 9.2 months and 53.0 months for prison. Of all revocations in the sample, 57.8 percent were technical revocations.

PAROLE REVOCATIONS AND TECHNICAL REVOCATIONS

Although the Parole Division of TDCJ administers the parole supervision system in Texas, the Texas Board of Pardons and Paroles (TBPP) reviews allegations of parole violations and makes decisions on whether to revoke supervision and return parolees to prison. **Figure 2** shows how, since 2009, parole revocations in Texas have decreased in number and as a rate of the parole supervision population.

The reduction in parole revocations has helped stabilize the growth of the Texas correctional population since fiscal year 2009. In addition to the parole or revocation decision, TBPP has other options to manage offenders who do not comply with conditions of parole such as Intermediate Sanction Facilities (ISFs). These are secure facilities in which parolees serve between three and four months in lieu of a revocation with programs to address behavioral problems and substance abuse issues.

Parole revocation includes three categories. A technical revocation occurs when one or more conditions of release is violated but no new offense has been committed. Technical violations, such as failure to meet with a parole officer, also are known as administrative violations. Revocations for new offenses include offenders who have pending felony or misdemeanor charges in addition to possible technical violations at the time of revocation. These lead either to new convictions or to law violation revocations, where the new offense is not adjudicated. In fiscal year 2013, 12.0 percent of all revocations were classified as technical, down from 13.0 percent in fiscal year 2009.

Although technical revocations from probation represent a much larger share of the total revocation-to-prison population (12,287 compared to 702 for fiscal year 2013), the data needed to conduct an analysis of the total net cost of probation revocations is not yet available.

FINANCIAL PROJECTIONS OF PAROLE REVOCATIONS

The Washington State Institute for Public Policy (WSIPP), at the direction of the Washington State Legislature, developed a rigorous econometric approach to model costs and benefits of public policies to identify evidence-based programs. The Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation initiated an effort to make this model and other evidence-based policymaking tools available to states through the Pew-MacArthur Results First Initiative. A key part of this initiative involves providing technical assistance to allow other states to use their state-specific data to customize the Results First model. In this analysis, LBB staff applied Texas specific recidivism patterns and criminal justice system costs in the Results First model to determine the net costs of technical parole revocation for state and local government and for crime victims.

The costs of parole revocations are substantial and result in direct expenses to taxpayers for funding additional incarceration. Results First research using the WSIPP model has focused on reducing parole recidivism by developing more effective support in the community. In New Mexico, for example, this research suggests that reducing recidivism by 10 percent would save \$8.3 million in prison costs and would reduce victimization costs by an estimated \$40 million.

**FIGURE 2
PAROLE POPULATION AND REVOCATIONS, FISCAL YEARS 2009 TO 2013**

FISCAL YEAR	TOTAL PAROLE REVOCATIONS	NEW CONVICTION PAROLE REVOCATIONS	TECHNICAL PAROLE REVOCATIONS	LAW VIOLATION PAROLE REVOCATIONS	TOTAL PAROLE SUPERVISION POPULATION	TOTAL REVOCATION RATE	TECHNICAL REVOCATION RATE
2009	7,471	6,005	1,045	421	80,286	9.3%	1.3%
2010	6,929	5,641	818	470	81,095	8.5%	1.0%
2011	6,381	5,320	720	341	81,175	7.9%	0.9%
2012	5,935	4,708	709	518	86,786	6.8%	0.8%
2013	5,850	4,669	702	479	87,662	6.7%	0.8%

NOTE: Total population in a fiscal year shows the count of persons on parole as of the last day of August.
SOURCE: Texas Board of Pardons and Paroles.

ESTIMATING THE NET COSTS OF TECHNICAL REVOCATION OF PAROLEES

In considering Texas' existing parole and prison programs, the Results First model can be used to estimate total net costs if felons who were technically revoked instead remained in the community. This research question addresses legislation filed in previous sessions that would restrict the number of individuals who would be subject to technical revocation. Technical revocations are for less intensive administrative violations and could potentially be addressed with more effective supervision or intermediate sanctions strategies rather than incarceration. Addressing the question of technical revocations among parolees while implementing the Results First model also provides insight about technical revocations in the larger probation population.

If technical revocations are restricted from current levels, some proportion of the individuals who would otherwise have been incarcerated will commit new offenses. These offenses will result in direct costs to the state and local governments, as well as costs to victims. Once these costs are calculated, they can be compared to the direct state costs of incarceration and inform an analysis of the costs of technical revocation generally. While this analysis presents a net cost to the state for technical revocations, budget savings from any policy change would be largely dependent on changes in the mix of types of prisons funded by the state. In addition, the analysis presented here does not differentiate among the population of technical revocations by the initial crime for which the individuals were incarcerated. Changes that focus on categories of convicted felons less likely to recidivate for less serious offenses could result in greater net savings.

To estimate the net costs of parole technical revocations, LBB staff used data from TDCJ that contained the 1,413 technical parole revocations who entered a TDCJ facility during fiscal year 2007. For these individuals, the average period of incarceration due to a parole revocation—either until sentence discharge, another parole event, or a maximum incarceration of five years—was 654 days.

To determine the total net costs of returning these felons to incarceration, LBB staff developed an estimate of the cost incurred by the state for incarceration compared to the cost the state would have incurred had the offenders remained on community supervision. The estimated cost of incarcerating these felons was \$27.4 million during a five year period—1,413 felons multiplied by their average length of incarceration. The estimated costs of parole supervision for the population was then subtracted from this amount. The

estimate represents the maximum possible savings to the state from eliminating technical revocations for these felons. The majority of savings would occur within the first two years. Note, however, that realizing most of these savings would require changes in prison utilization such as closing facilities or prison wings.

However, the state cannot avoid all direct costs simply by not incarcerating these individuals. The activities these individuals would have engaged in had they not been within the control of a prison also have to be taken into account. While not incarcerated, some of these individuals will commit criminal acts that would impose new direct costs on the state and indirect local costs and victimization costs. To compare the potential state costs of \$27.4 million with these factors, LBB staff analyzed the predicted level of future criminal activity had the offenders not been revoked and returned to incarceration using the Results First model.

The simulation model includes four main elements. First, an estimate of the length of incarceration and parole supervision for seven broad crime categories was developed. Data used to estimate length of incarceration for Texas considered the total length of incarceration for all fiscal year 2013 releases. Parole supervision length was estimated by determining the amount of sentence that remained upon release. Next, estimates of overall criminal victimization of the state population were developed using FBI data.

Third, an estimate of both the likelihood and severity of recidivism was developed. All prisoners released to parole supervision for fiscal year 2008 were matched to Texas Department of Public Safety data on convictions in Texas during a five-year period. Using this match, measurements were developed of the likelihood and frequency of recidivism, length of time until first recidivism, the number of criminal events for each recidivating conviction, and the most severe crime committed on each date of conviction. These measures were used to estimate cumulative recidivism, hazard recidivism, and the relative likelihood any recidivism event would be within one of seven broad categories of crime.

Finally, costs were estimated for law enforcement, courts, jail, prison, supervision, and victimization were developed. **Figure 3** shows the costs used in the model. A per day cost for prison of \$33.25 was used as an estimate of the marginal cost of incarceration and a cost of \$3.63 for parole supervision as the marginal cost of parole. This approximated prison cost also was used to generate the \$27.4 million net cost of revocation described previously.

FIGURE 3
ESTIMATED COSTS FOR TEXAS REVOCATIONS IN PEW-MACARTHUR RESULTS FIRST INITIATIVE MODEL, 2014

COST ELEMENT	ESTIMATE	SOURCE
Law Enforcement	\$557/arrest	Pew-MacArthur Results First Initiative, from Bureau of Justice Statistics expenditure data and WSIPP estimates.
Courts and Prosecutors	Varies by crime type (from \$167 for a misdemeanor to \$126,626 for a murder)	Washington State costs deflated for Texas' lower cost of living.
Jail	\$22,463/year	Texas Commission on Jail Standards
Local Supervision	\$504/year	Legislative Budget Board Criminal Justice Uniform Cost Report
Prison	\$12,145/year	Legislative Budget Board Criminal Justice Uniform Cost Report: Private state jail contract rate and fixed allocated costs
Parole Supervision	\$1,326/year	Legislative Budget Board Criminal Justice Uniform Cost Report

SOURCES: Legislative Budget Board; Texas Commission on Jail Standards; Bureau of Justice Statistics; Pew-MacArthur Results First Initiative.

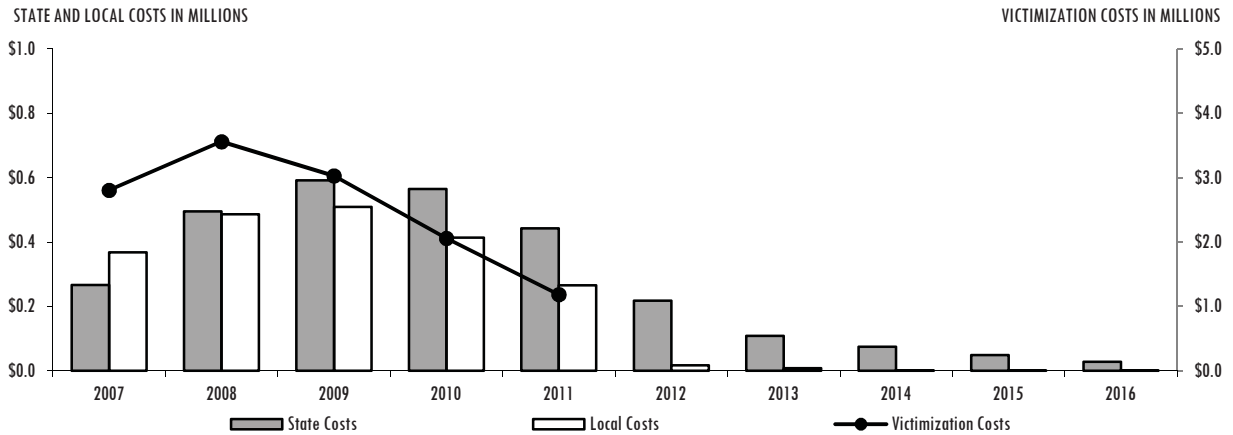
Using the Results First model, 1,000 simulations were run and the average result were used to estimate the cost per crime these individuals would have committed had they remained in the community rather than been revoked to prison. The model calculated that the total direct cost to state taxpayers for each crime would be \$12,443: \$7,285 in state costs and \$5,158 in local costs. State costs include prison and some law enforcement expenses. Local costs include courts, jails, prosecutors, and local law enforcement. In addition to these costs, the model also calculated that each crime generates \$31,478 in victimization costs. Victimization costs include tangible victim costs, which include medical and mental health care expenses, property damage and losses, and the reduction in future earnings incurred by crime victims; and intangible victim costs, which place a dollar value on the pain and suffering of crime victims. It is also important to note that not all victimization cost can be quantified. Crime avoidance has its own virtue.

As stated previously, 1,413 offenders were revoked for technical violations of parole conditions for fiscal year 2007, and the average length incarceration for their technical revocation was 654 days. To predict how many crimes these individuals would have committed had they remained in the community on parole supervision rather than in prison, the actual recidivism patterns of another group of offenders—those released in fiscal year 2010. For this cohort the number of new convictions that occurred during a 654-day period following their release on parole was counted. This sum was then divided by the number of offenders. The 19,237 offenders from the 2010 cohort were convicted of 5,454 new crimes—a rate of 28.4 percent per 100 offender over this 654 day period.

Using the estimates for cost of crime and rate of criminal activity, the total costs that if technically revoked felons had remained in the community can be estimated at \$2.9 million in direct state costs over 31 years, resulting in a net savings of \$24.5 million. In contrast to direct state savings, however, the release of these felons would have imposed an estimated \$2.1 million in local costs in the form of courts, prosecutors, law enforcement, and jail expenses. Although the estimated reduction in state budget demands would largely occur in the first two years, local costs would be distributed more broadly during the entire period. **Figure 4** shows estimated state, local, and victimization costs for the first 10 years.

The total cost of victimizations had these individuals been in the community would have been \$12.6 million over five years—approximately \$8,900 per individual felon. This means that, for every \$1.00 spent to incarcerate these individuals, \$0.56 in victimization costs were avoided. **Figure 5** shows the victimization cost per crime category used in the Results First model.

FIGURE 4
ESTIMATED COSTS IN TEXAS GENERATED BY TECHNICALLY REVOKED OFFENDERS' POTENTIAL NEW OFFENSES
FISCAL YEARS 2007 TO 2016



NOTE: Victimization costs calculated for a maximum parole period of five years.
 SOURCES: Legislative Budget Board; Pew-MacArthur Results First Initiative.

FIGURE 5
ESTIMATED VICTIMIZATION COST BY PEW/RESULTS FIRST
CRIME CATEGORY

CATEGORY	COST
Murder	\$9,159,517
Sex offense	\$203,768
Robbery	\$8,275
Burglary	\$1,922

NOTE: Other felonies and misdemeanors are assessed a victimization cost of zero.
 SOURCE: Pew-MacArthur Results First Initiative.

IMPROVE AVAILABLE INFORMATION ON BRACKISH GROUNDWATER FOR WATER PLANNING

The availability of fresh water in Texas is projected to diminish in the coming decades. Water providers are looking for alternative supplies to meet demand. One potential alternative is brackish groundwater, water that has a higher content of salinity and other substances than fresh water. Texas' water resources are estimated to include approximately 5.4 billion acre feet of fresh groundwater and 2.7 billion acre feet of brackish groundwater. Through desalination, brackish supplies can be converted to a potable drinking source. The 2012 State Water Plan projects that use of this method will increase more than 200 percent by 2060; however, the term brackish groundwater is not defined in state law. Variations in what constitute brackish or treatable water may impact the uniformity of how this resource is referenced, regulated, or permitted by state agencies, groundwater conservation districts, and other involved parties.

In some cases, fresh groundwater sources may be hydrologically connected to brackish groundwater sources. By withdrawing significant volumes of brackish groundwater from an aquifer, the quality and quantity of fresh water in that formation may also be affected. Because this connection is not well-defined in the groundwater sources throughout the state, additional data is necessary to ascertain opportunities for and the effects of increased brackish groundwater withdrawals. More definitive information on the nature of these relationships would improve groundwater conservation districts' ability to adopt unique desired future conditions for portions of an aquifer within their jurisdiction. The districts would also have more accurate information to establish unique permitting or other regulatory standards and incentivize the use of brackish groundwater resources.

CONCERNS

- ◆ The term brackish groundwater is not defined in statute or in the Texas Administrative Code. State entities such as the Texas Groundwater Protection Committee, Texas Water Development Board, and other entities involved in the permitting and analysis of water use different thresholds to define a brackish water source. These varied definitions could result in entities regulating or permitting water of a certain quality in inconsistent or conflicting ways.

- ◆ Less than 5 percent of identified brackish sources in the state have been analyzed in detail by the Texas Water Development Board. Well operators are required to submit well log information they collect to the Railroad Commission of Texas, but no standardized process exists to share this information with the Texas Water Development Board. As a result, there is a significant lack of analysis on the characteristics of both fresh and brackish waters in aquifers, including the salinity, depth, and feasibility of extracting that water for beneficial use.
- ◆ Groundwater conservation districts' use of outside contractors for modeling purposes may result in analysis with non-uniform data collection practices and methodologies. These data impact projections of how much water (brackish or fresh) is available for permitting as part of the state's desired future conditions process, as well as other projections related to statewide water planning.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require the Texas Groundwater Protection Committee to adopt a standardized groundwater classification system through rulemaking and require state agencies and groundwater conservation districts to reference this system when devising modifications of their own regulatory and permitting processes.
- ◆ **Recommendation 2:** Amend statute to require the Railroad Commission of Texas to annually provide electronic well log data to the Texas Water Development Board for statewide planning and groundwater management purposes.
- ◆ **Recommendation 3:** Amend statute to require the Texas Water Development Board to adopt standards and methodologies to ensure that groundwater conservation districts are using a standardized approach when the districts use brackish and fresh groundwater data to formulate their individual or shared desired future conditions.

DISCUSSION

According to the 2012 State Water Plan, the supply of fresh water in Texas is diminishing. A projected deficit of 8.3 million acre feet of water (38 percent of projected demand) will exist by 2060, if additional supply strategies are not implemented. An acre foot is the volume of water needed to cover one acre to a depth of one foot. It equals 325,851 gallons. The State Water Plan provides strategies that could be implemented to meet projected water supply needs. According to the plan, only 3.6 percent of the future water deficit would be addressed using brackish groundwater for desalination and conjunctive use. Conjunctive use is a combination of management practices intended to blend waters of varying quality (such as fresh and brackish water) to make the best use of surface water during wet periods and groundwater during dry periods.

Brackish water is commonly thought of as salty water with a lesser degree of saline or total dissolved solids (TDS) than seawater. According to the Texas Water Development Board (TWDB), a benefit of using desalinated brackish groundwater is the preservation of dwindling freshwater aquifers. According to TWDB, the population of Texas is expected to double within the next 50 years, and water demand could increase by 27 percent in that period. During this period, groundwater supplies (the volume of predominantly fresh groundwater that can be produced with current permits and existing infrastructure) are expected to decrease by 32 percent. Proposed water strategies in the State Water Plan are the result of survey responses from water providers. Additionally, compared to other water supply strategies, such as construction of a new major reservoir or desalinating surface water or seawater, desalination of brackish groundwater can be a more cost effective option when available.

Texas is estimated to have an abundance of both fresh and brackish groundwater in its aquifers. The most recent data available was compiled in 2003 by a consultant for TWDB for regional planning purposes. By defining brackish water as having TDS greater than 1,000 mg/L, the consultant estimated that the state had approximately 2.7 billion acre feet of brackish groundwater and 5.4 billion acre feet of fresh groundwater. **Figure 1** shows that brackish groundwater was estimated to be available in every regional planning area of the State Water Plan, as well as in almost every aquifer. In general, brackish groundwater was also more prevalent than fresh groundwater in parts of the southern gulf coast area and in areas of West Texas. Regions F, L, M, and N, representing

the metropolitan areas of Midland, San Antonio, Brownsville, and Corpus Christi, respectively, also contained significant brackish groundwater resources. Estimates for fresh water shown in **Figure 2** likely include some brackish water because, according to TWDB staff, the boundaries of the designated aquifers extended to 3,000 TDS and occasionally up to 5,000 and 10,000 TDS. Because these data were compiled more than 10 years ago, the specific portion of estimated groundwater reserves designated as fresh or brackish is unknown today.

DEFINING GROUNDWATER QUALITY

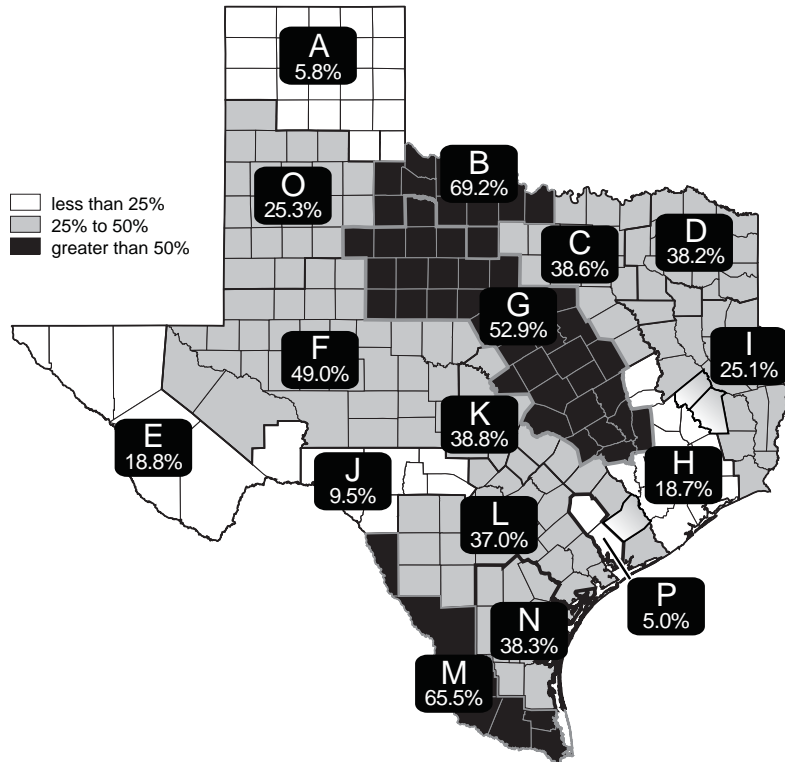
There is no statutory definition of brackish groundwater. As a result, state agencies and studies define a brackish source differently. For example, the Texas Water Development board references brackish groundwater as having a TDS greater than 1,000 mg/L; meanwhile, the Texas Groundwater Protection Committee refers to brackish sources as having a TDS of between 3,000 to 10,000 mg/L. This inconsistency could result in entities referencing, regulating, or permitting water of a certain quality in inconsistent or conflicting ways. This may be exacerbated because the number of brackish groundwater development projects are expected to increase significantly.

Increased use of brackish groundwater may be challenging because of potential differences between permitting and regulatory responsibilities of state agencies, groundwater conservation districts (GCDs), and use by private industry or landowners. According to the 2012 State Water Plan, the amount of brackish groundwater desalination in Texas will increase by more than 200 percent by 2060. Conjunctive use that may involve the blending of brackish groundwater with freshwater sources is also projected to increase by more than 400 percent during the same period.

Current ranges for what could constitute brackish water are established by different government agencies, research groups, and other states. Other sources, such as the State of Texas Emergency Management Plan, define brackish as a type of water with a somewhat salty taste that does not meet drinkability standards.

Figure 3 shows a range of 1,000 to 35,000 TDS for what could constitute a brackish source. According to RRC, a TDS concentration of 1,000 is a somewhat arbitrary upper limit of fresh water based on the suitability of water for human consumption. Water with a TDS greater than 1,000 can also be used for certain farming and irrigation purposes. Although water with TDS greater than 1,000 mg/L is used

**FIGURE 1
GROUNDWATER CONTAINING TOTAL DISSOLVED SOLIDS FROM 1,000 TO 10,000 MG/L AS A PERCENTAGE OF ALL IDENTIFIED GROUNDWATER IN REGIONAL PLANNING AREAS, AS OF FISCAL YEAR 2003**



NOTES: Fresh water estimated available volume (in acre feet) includes groundwater with total dissolved solids (TDS) > 1,000 milligrams per liter (mg/L).

SOURCE: Texas Water Development Board.

for domestic supply in areas where water of lower TDS content is not available, water containing greater than 3,000 mg/L is often too objectionable to drink.

TDS is a standard parameter for water composition, but it is not the only variable that should be considered when determining the utility or classification of groundwater resources. Depending on the geological structure of an area, the pumping of brackish groundwater may directly impact fresh groundwater by drawing down water levels and compromising the quality of both fresh and brackish groundwater. For example, the New Mexico Water Resources Research Institute reported in 2004 that increased pumping of brackish groundwater near the Pecos River could deplete the freshwater-river-flow equivalent by 29 percent of the volume of groundwater pumped over a 40-year time span. The brackish water could be pumped, but only if an equivalent volume of surface water rights were retired to offset that impact. Conversely, it has been shown that increased pumping from freshwater aquifers near the Atlantic

coast, particularly in southeastern Florida, has led to increased saltwater intrusion into those coastal aquifers. The salinity of a source initially identified as fresh or brackish can change and be further impacted by significant levels of pumping. Factors such as these should be considered when defining water quality within aquifer formations that have varying degrees of saline water sources.

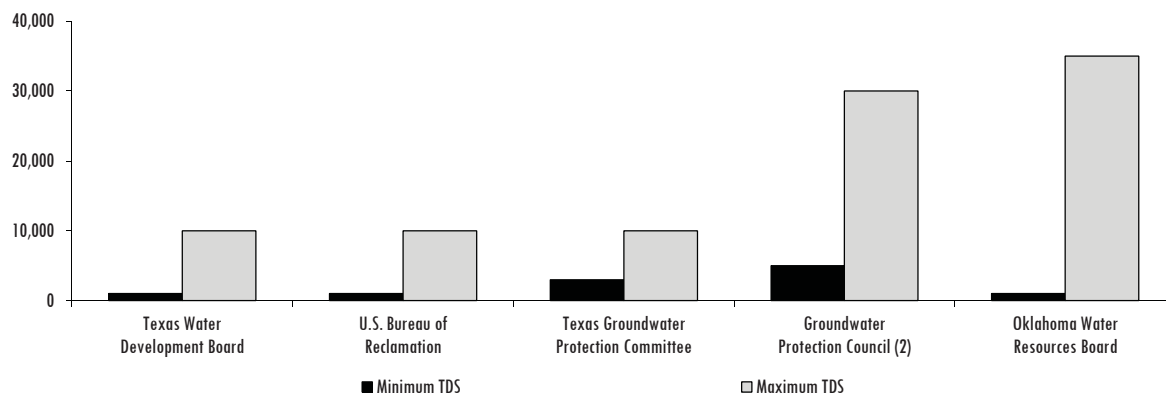
The Texas Groundwater Protection Committee (TGPC) is a statutorily established interagency committee that coordinates state agency actions for the protection of groundwater quality in Texas. Membership includes state agencies such as the Texas Commission on Environmental Quality (TCEQ), TWDB, the Railroad Commission of Texas (RRC), and the Texas Department of Licensing and Regulation (TDLR). Although TGPC has developed a groundwater classification system, shown in **Figure 4**, the committee is not statutorily required to do so, and there is no statutory requirement that state agencies consider or refer to this classification. If used, this classification system would

**FIGURE 2
ESTIMATES OF GROUNDWATER ANNUAL NEEDS AND AVAILABLE VOLUMES IN REGIONAL PLANNING AREAS, AS OF FISCAL YEAR 2003**

REGIONAL WATER PLANNING AREA	ESTIMATED POPULATION BY 2060	ESTIMATED ANNUAL WATER NEEDS BY 2060 (ACRE FEET)	ESTIMATED AVAILABLE VOLUME (ACRE FEET)			
			FRESH WATER, OR LESS THAN 1,000 MG/L TDS (1)	1,000 TO 3,000 MG/L TDS	3,000 TO 10,000 MG/L TDS	1,000 TO 10,000 MG/L TDS (TOTAL)
A	541,035	418,414	308,071,890	7,883,200	11,216,400	19,099,600
B	221,734	40,397	6,462,390	5,952,000	8,583,000	14,535,000
C	13,045,592	1,588,236	135,242,637	43,371,200	41,577,700	84,948,900
D	1,213,095	96,142	90,352,712	28,866,800	26,916,500	55,783,300
E	1,542,824	226,569	541,524,251	121,871,400	3,511,000	125,382,400
F	724,094	219,995	388,369,121	267,167,600	105,680,700	372,848,300
G	3,448,879	390,732	174,421,819	121,988,600	73,551,800	195,540,400
H	11,346,062	1,236,335	852,753,911	122,571,300	73,298,100	195,869,400
I	1,482,448	182,145	577,944,008	114,227,300	79,155,200	193,382,500
J	205,910	2,389	81,930,857	3,201,400	5,436,400	8,637,800
K	2,831,937	367,671	318,912,813	101,824,800	100,127,400	201,952,200
L	4,297,786	436,751	712,174,901	300,957,900	116,809,300	417,767,200
M	3,935,223	609,906	208,506,490	270,765,700	125,303,200	396,068,900
N	885,665	75,744	534,614,033	200,286,200	132,122,600	332,408,800
O	551,758	2,366,036	270,665,192	46,655,400	45,107,400	91,762,800
P	49,663	67,739	148,793,472	1,364,500	6,461,400	7,825,900
STATE TOTAL	46,323,725	8,325,201	5,350,740,497	1,758,955,300	954,858,100	2,713,813,400

NOTES:
 (1) Fresh water may include groundwater with TDS > 1,000.
 (2) TDS = total dissolved solids; volumes have been rounded off to the nearest hundred.
 (3) Mg/L = milligrams per liter.
 SOURCE: Texas Water Development Board.

**FIGURE 3
RANGES OF DEFINED BRACKISH WATER QUALITY, FISCAL YEAR 2013**



NOTES:
 (1) Quality is based on the concentration range of total dissolved solids in milligrams per liter (mg/L).
 (2) Groundwater Protection Council is a nonprofit 501(c)6 organization.
 SOURCE: Legislative Budget Board.

**FIGURE 4
GROUNDWATER CLASSIFICATION SYSTEM OF THE TEXAS GROUNDWATER PROTECTION COMMITTEE, JANUARY, 2013**

CLASS	QUALITY	EXAMPLES OF USE
Fresh	Zero to 1,000	Drinking and all other uses.
Slightly Saline	More than 1,000 to 3,000	Drinking if fresh water is unavailable, livestock watering, irrigation, industrial, mineral extraction, oil and gas production.
Moderately Saline	More than 3,000 to 10,000	Potential/future drinking and limited livestock watering and irrigation if fresh or slightly saline water is unavailable; industrial, mineral extraction, oil and gas production.
Very Saline to Brine	More than 10,000	Mineral extraction, oil and gas production.

NOTE: Quality is based on the concentration range of Total Dissolved Solids in milligrams per liter (mg/L).
SOURCE: Texas Groundwater Protection Committee.

allow member agencies to more consistently categorize and engage in specific protection or restorative measures, depending on the quality or use of water identified. Requiring ongoing development of a classification system for groundwater quality and present or potential use through TGPC would allow for a collaborative interagency approach and ensure the continual evaluation and development of this classification system. Local input could also be obtained through participation by the Texas Alliance for Groundwater Districts, which is a TGPC member.

Defining brackish groundwater would provide guidance to state agencies, GCDs, and other involved parties with related responsibilities. GCDs would also reference these definitions, if they plan to adopt specific management criteria for this type of water. Recommendation 1 would amend the Texas Water Code, Section 26.405, to require TGPC to adopt a standardized groundwater classification system through rulemaking and require state agencies and groundwater conservation districts to reference this system when devising modifications to their own regulatory and permitting processes. TGPC would define and periodically review the specific characteristics of what constitutes treatable or brackish groundwater in relation to fresh, sea, and other water classifications, as may be applicable to the proper management of groundwater. TGPC would also take into consideration the relative location of brackish or treatable water and whether it can be produced for use without negatively impacting freshwater sources. TGPC would also solicit public input during its review process to accurately capture the priorities and concerns of the public for how groundwater of various characteristics should be defined.

Recommendation 1 would provide state and local entities with a common point of reference, if they wish to develop a specific permitting or regulatory framework for a brackish or treatable water source in the future. In defining treatable or brackish groundwater, consideration should be given to: the

TDS content; the geographic location of the waters in relation to the Gulf of Mexico (due to potential caving in or sinking of land from significant water withdrawal, also known as subsidence); existing laws and administrative rules; and existing permit requirements that involve the use of or make reference to such waters. Complexities such as salinity in water and variations in water quality, both spatially and temporally, should also be taken into account. These definitions and the determined quality and characteristics of groundwater, however, would not impact ownership of that resource as currently defined in the Texas Water Code, Chapter 36.

DATA UTILIZATION IN GROUNDWATER CHARACTERIZATION

TWDB staff conducts two types of studies that analyze the groundwater resources of the state: groundwater availability models (GAMs) and Brackish Resources Aquifer Characterization System (BRACS) studies. GAMs simulate the regional flow of water through the 30 major and minor aquifers to address specific questions such as modeled available groundwater. According to the 2012 State Water Plan, modeled available groundwater is the total amount of groundwater, including both permitted and exempt uses that can be produced from an aquifer in an average year that achieves the desired future condition for the aquifer, a quantified representation of desired future groundwater resources. GAM estimates may include some brackish water as the majority of aquifers are mapped up to 3,000 TDS. BRACS studies are designed to determine the volumes of fresh and brackish groundwater through detailed three-dimensional mapping of the aquifers. These studies can be used to define potential areas or zones for groundwater resource development. According to TWDB, as of 2013, only 5 percent of the brackish aquifers in the state have been analyzed and mapped in sufficient detail as part of the BRACS studies.

According to TWDB, data limitations regarding withdrawals of brackish waters from aquifers are significant. In general, reported groundwater use or estimates of groundwater use do not separate fresh and brackish water withdrawals. Increased use of brackish groundwater could affect planning activities. Generalizing the effects, however, is difficult because groundwater quality in aquifers may respond differently to changes in use patterns, location of uses, and timing of groundwater withdrawals. According to TWDB, location-specific studies would be necessary to quantify how planning activities would be affected.

Impacts of water withdrawals to associated aquifer levels are also a challenge to determine. Without data identifying specific amounts of brackish water withdrawals, TWDB staff is unable to determine impacts to associated aquifer levels from brackish water production, including whether or not brackish withdrawals are impacting the volume or quality of freshwater sources. This lack of data could affect the willingness of local GCDs to grant permits with specific incentives for brackish groundwater development. To determine the withdrawn water's quality and characteristics, samples would need to be tested at each site that produces brackish water. The TWDB is able to test approximately 300 wells for water quality each year, returning to the same areas every four years.

WELL DATA REPORTING

Oil and gas entities who wish to drill an injection water supply well that penetrates the base of usable quality water must apply for a permit for this action through RRC. RRC defines base of usable quality water as groundwater with a TDS of 3,000 or less. The definition may also include higher concentrations of TDS if the water source is identified by TWDB as currently being used as a source of water for desalination; or if there is potential hydrological connectivity to usable quality water. Permits consist of requirements related to the casing, cementing, and completion of the well.

Water use for shale-gas production can be estimated because operators report the water used for well completion to RRC. For example, it is estimated that 117,000 acre feet of water were used in shale gas production-related processes during 2010 to stimulate approximately 15,000 wells in the Barnett Shale area of Texas. Oil and gas well operators are not required to submit information on the source or quality of water used, so water use estimates may include volumes of either fresh and/or brackish water. In fiscal year 2012, there were 246,468 producing oil and gas wells in Texas.

House Bill 878, Eighty-third Legislature, Regular Session, 2013, amended the Texas Natural Resources Code, Chapter 91, to require operators of oil-related or gas-related wells to file well log data with RRC not later than 90 days after completion of drilling of the well. The bill also authorized RRC to assess administrative penalties for failure to submit data and authorizes electronic submittal of the data. Well log data contains information that indicates a well's rock formation characteristics by illustrating its response to electric current. Well log data provides important hydrogeological information, increases the efficient production of the state's oil and gas resources, and is important for the protection of the state's natural resources, such as groundwater. Information relating to water salinity, porosity, and permeability is also available through the well log data.

RRC is not required to provide data to TWDB for groundwater modeling and planning activities. Obtaining additional information on the specific location, salinity, pumping, and depth grade needed to extract groundwater would improve TWDB's understanding of the qualities and behaviors of aquifers in the state. Improved data analysis may also enhance the agency's ability to recommend optimal sites for locating regional treatment facilities based on groundwater availability. As stated in TWDB's *Brackish Groundwater Exploration Guidance Manual*, prepared by an outside consultant in 2008, "a thorough hydrogeologic assessment should be performed to develop the confidence required to invest in a desalination facility."

Recommendation 2 would amend the Texas Natural Resources Code, Section 91.552, to require RRC to transmit electronic well log data to TWDB annually. With this data, TWDB would have an enhanced ability to identify where brackish and fresh water are. The agency could use this information to better assess water quality and determine an aquifer's ability to produce water. Information provided would also be made available to GCDs for their planning purposes. TWDB would use the well data for statewide water resource planning, improving the accuracy of modeled available groundwater, and providing accurate information to GCDs in the desired future conditions process.

GROUNDWATER CONSERVATION DISTRICTS

GCDs are the state's preferred method of groundwater management. These entities provide for the conservation, preservation, protection, recharging, and prevention of waste of the groundwater resources within their jurisdictions.

GCDs register and permit water wells (through the formulation of production limitations and well spacing requirements), develop a comprehensive management plan, and adopt necessary rules to implement the management plan. GCDs may be established through the action of the Texas Legislature; through a landowner petition procedure based on the Texas Water Code, Chapter 36; or by TCEQ on its own motion in a designated priority groundwater management area. Not all areas of the state have a GCD. In areas without a GCD, groundwater is subject to the Rule of Capture. Rule of Capture allows landowners to pump as much water as they wish from beneath their land, as long as the water is put to beneficial use.

As of September 2013, 102 GCDs have been formed in the state, including 99 established (confirmed) districts and three unconfirmed districts. The established districts cover all or part of 180 of the state's 254 counties, or 70.9 percent. GCDs have many unique attributes. Confirmed GCDs range from encompassing one to five counties, and they represent rural areas with populations of 10,000 through suburban populations exceeding 500,000. The predominant customer needs in a particular GCD can also range from agricultural, oil and gas, to a municipal public water supply.

DESIRED FUTURE CONDITIONS

Desired future conditions (DFCs) represent the desired, quantified condition of groundwater resources (such as water levels, spring flows, or volumes) within a management area at one or more specified future times. The statutorily required DFC process is defined by GCDs (within a groundwater management area) as part of the regional GCD joint planning process. DFCs have to be physically possible, individually and collectively, if different DFCs are set for different geographic areas overlying an aquifer or subdivision of an aquifer.

If requested, TWDB will assist GCDs in identifying and accessing technical information and data necessary to develop and evaluate DFC statements. Historically, the agency provided groundwater modeling services to the districts for development of initial DFC statements. However, appropriations for this activity were reduced by the Eighty-second Legislature, Regular Session, 2011, and TWDB no longer provides this service. TWDB now helps the districts identify qualified contractors to conduct modeling runs. Contracting with separate entities for these technical services by individual GCDs may lead to studies with non-uniform methodologies in the development of DFCs, thereby

compromising the accuracy of this process and the ability to combine the statements for a statewide assessment.

GCDs engaged in joint planning must consider "aquifer uses and conditions" among other factors in proposing DFCs. Any increased use of brackish groundwater, as well as increasing or decreasing use of fresh groundwater, would need to be considered. The Texas Water Code, Chapter 36, authorizes GCDs to adopt different DFCs related to brackish groundwater production and to establish management zones from which brackish groundwater can be produced.

Recommendation 3 would amend the Texas Water Code, Chapter 36, to require TWDB to adopt standards and methodologies and produce a guidance document to ensure that GCDs use a standardized approach when formulating individual or shared DFCs. These standards would also provide information on how to effectively differentiate and establish separate DFCs for fresh and brackish groundwater resources, without significantly affecting the existing uses of groundwater. The improved consistency in modeling groundwater availability for individual or joint DFCs between districts would assist in determining separate DFCs for brackish and fresh groundwater sources applicable to each region. By differentiating brackish from fresh sources and delineating which portions are within an area of feasible extraction, GCDs would obtain better information regarding what their managed available groundwater should be.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would have no significant fiscal impact. Recommendation 1 would require TGPC to define terms related to groundwater classification, which may include brackish, treatable, and other terms related to groundwater management. Recommendation 2 would require the RRC to share electric well log data with TWDB to gain additional information on aquifer characteristics. TWDB would receive and manage this data using existing resources. Recommendation 3 would require TWDB to adopt standards and methodologies to ensure that GCDs are using a standardized approach when formulating their individual or shared DFCs. TWDB would establish these standards using existing resources.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

IMPROVE STATE AND LOCAL DROUGHT PLANNING TO MORE EFFECTIVELY MANAGE WATER RESOURCES

In 2011, Texas experienced the worst documented single-year drought on record. According to the Texas A&M AgriLife Extension Service, the estimated economic loss to agriculture attributed to the drought in calendar year 2011 was approximately \$7.6 billion. Rainfall since that year has helped improve conditions, but as of August 2014, approximately 40 percent of Texas still was considered in severe drought by the U.S. Drought Monitor.

State involvement in drought planning and response, outside of ensuring that senior water-right priority calls are honored, consists primarily of requiring that water suppliers complete and submit drought contingency plans every five years. The Texas Commission on Environmental Quality sets requirements for what these plans should include, such as: provisions for public education; criteria for initiation and termination of drought stages; and specific, quantified targets for water use reductions. Water suppliers are statutorily required to implement drought contingency plans upon issuance of a Texas Governor's Emergency Disaster Proclamation for Drought. Local governments' lack of consistency in reporting their responses to drought impedes the state's evaluation of how effectively water suppliers are managing reduced water supply conditions. Local entities would benefit from the development of best management practices regarding how to manage water resources most effectively during periods of short supply.

CONCERNS

- ◆ Water suppliers are not required to notify the Texas Commission on Environmental Quality when suppliers lift restrictions that were implemented in accordance with drought contingency plans. Suppliers also do not communicate changes in their drought responses regularly to the agency. This lack of notification inhibits the state's ability to verify whether local entities are complying with state law and to determine the water suppliers' effectiveness in managing reduced water supply conditions.
- ◆ The Texas Commission on Environmental Quality maintains a website listing of public water suppliers that limit water use to avoid shortages. The website does not include information to understand the relative degree of drought response in which water

suppliers may be engaged, such as whether an area has been listed in the Governor's Emergency Disaster Proclamation for Drought.

- ◆ Unlike state-required water conservation plans, water suppliers are not required to evaluate how effective their drought responses are. As a result, information about effective practices is not available to other suppliers or for inclusion in the State Water Plan.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require entities that are required to notify the Texas Commission on Environmental Quality about their drought contingency plan implementation to also notify the agency when they alter or lift drought restrictions.
- ◆ **Recommendation 2:** Amend statute to require the Texas Commission on Environmental Quality to post certain information on its website related to the condition of drought a public water supplier is undergoing and actions the supplier is taking to mitigate reduced water supplies.
- ◆ **Recommendation 3:** Amend statute to expand the powers and duties of the state's Water Conservation Advisory Council to include the monitoring and development of strategies that address drought conditions, and to assist the Texas Water Development Board and the Texas Commission on Environmental Quality with the development of best management practices for drought, as it does for water conservation.
- ◆ **Recommendation 4:** Amend statute to require entities that complete drought contingency plans to include detailed information regarding prior drought response and the effectiveness of those measures in additional iterations of their plans.

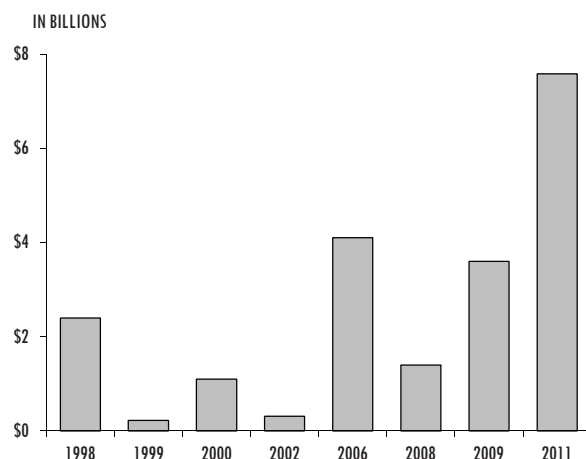
DISCUSSION

According to the Texas Water Development Board (TWDB), the term drought refers to periods of less than average precipitation during a certain period. Texas experienced the worst one-year drought in modern state history during 2011. According to TWDB, in September 2011 more than 96

percent of the state was in extreme or exceptional drought conditions. Since that time, intense drought has continued in parts of the state. The cumulative impact of prolonged drought has reduced the amount of water stored in reservoirs throughout Texas' river basins. In general, conditions have been worse in the western and inland areas. As of August 2014, approximately 38.2 percent of the state was classified by the U.S. Drought Monitor as being in severe to exceptional drought.

Estimated agricultural losses attributed to drought conditions, according to Texas A&M AgriLife Extension Service economists, are shown in **Figure 1**. Several state agencies also reported significant financial impact in fiscal year 2012 due to the drought. According to a Legislative Budget Board (LBB) staff survey of state agencies and public institutions of higher education, the total fiscal impact to state entities was \$131.9 million in fiscal year 2012, mostly resulting from damage attributed to wildfires. In addition to agricultural losses, drought increases the risk of wildfires. Wildfire damages increased during the 2011 drought, with more than 800 homes lost and more than 3.7 million acres burned. Water use statewide also increases during times of drought. According to the Texas Commission on Environmental Quality's (TCEQ) water rights database, surface water use from calendar years 2010 to 2011 increased from 3.6 million to 4.4 million acre feet, or 21.5 percent. Statewide surface water use also has increased 12.3 percent

FIGURE 1
TEXAS' ANNUAL AGRICULTURAL ECONOMIC LOSS
ATTRIBUTED TO DROUGHT CONDITIONS
CALENDAR YEARS 1998 TO 2011



SOURCE: Texas AgriLife Extension Service.

from 2009 to 2013, which may be attributable to population growth and to sustained drought conditions in the region.

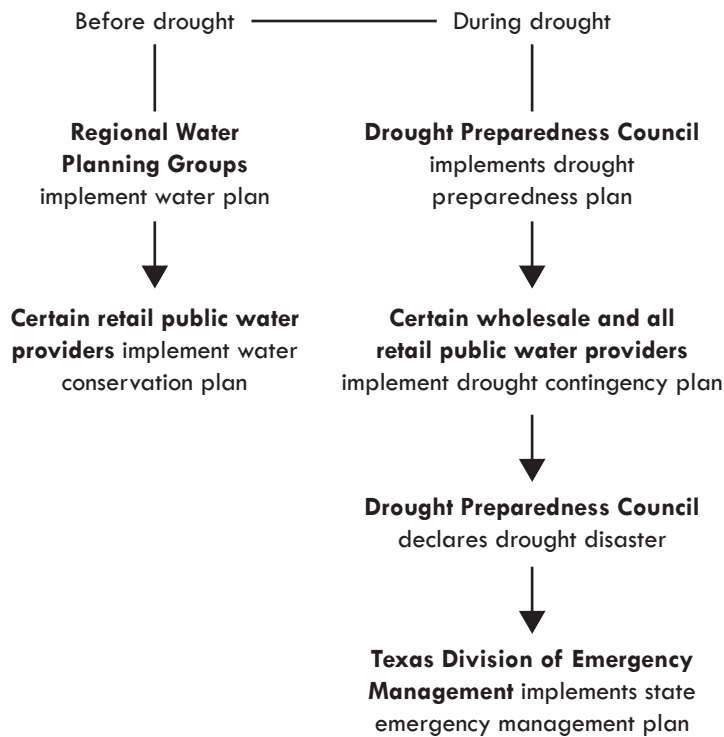
STATE AND LOCAL DROUGHT PLANNING AND RESPONSE

A variety of state and local mechanisms are in place to encourage drought management, which consists of temporary demand reduction techniques. **Figure 2** shows the sequence in which conservation and drought measures are implemented as water supplies decrease and the entity primarily responsible for implementing each plan.

TCEQ responds to drought conditions through public outreach and consulting activities, monitoring public drinking water systems and surface water use, and ensuring that senior water-right priority calls are honored. Almost 7,000 active public water systems operate in Texas. House Bill 252, Eighty-third Legislature, Regular Session, 2013, requires a retail public utility and each entity from which the utility obtains wholesale water service for the utility's retail system to determine the number of days of water supply available for use. The utility and its supplier then are required to report to TCEQ when the provider's available supply is less than 180 days. According to TCEQ, when a water system reports less than a 180-day supply of water remaining, TCEQ evaluates current and alternative supplies to assist the local entity in providing an adequate supply to its customers.

The Texas Water Code, Section 16.055, designates the state drought manager, who is the chief of the Texas Department of Public Safety's (DPS) Division of Emergency Management (TDEM), as the chair of the Drought Preparedness Council. The council is responsible for assessing and reporting on water supply conditions and advising the Governor on significant drought conditions. The council advises and coordinates between local, state, and federal entities for emergency management activities related to drought. Additionally, the council makes recommendations to DPS and TWDB regarding the state's response to drought-related disasters to be included in the State of Texas Emergency Management Plan and the State Water Plan. The council also advises regional water planning groups regarding drought-related issues to develop regional water plans. The Texas Governor, by executive order or proclamation, may declare a disaster or state of emergency for events such as drought. The Drought Preparedness Council advises the Governor regarding significant drought conditions. The council considers a variety of factors to determine whether a drought exists, including meteorological data, hydrological conditions, and water supply and demand information. The

FIGURE 2
TEXAS WATER CONSERVATION AND DROUGHT RESPONSE, FISCAL YEAR 2014



SOURCE: Texas Water Development Board.

Governor’s executive order or proclamation initiates components of the state’s Emergency Management Plan, administered by TDEM. The Texas Government Code, Section 418.014, provides that these proclamations stay in effect for up to 30 days. Since July 2011, the Governor regularly has renewed drought-related proclamations. Entities within the affected counties must implement their water conservation and drought contingency plans immediately upon the Governor’s declaration of disaster due to drought conditions. Water conservation plans are required for: entities that apply to or receive financial assistance from TWDB; each retail public utility that provides potable water service to 3,300 or more connections; water rights applicants; municipal, industrial or mining, and other nonagricultural water-right holders of 1,000 acre feet of water per year or more; and agricultural water-right holders of 10,000 acre feet of water per year or more. Conservation plans contain strategies to reduce the consumption of water, reduce the loss or waste of water, improve or maintain the efficiency in the use of water, or increase recycling and reuse of water. Conservation plan annual reports are required to be submitted to the state and to contain the water supplier’s self-reported progress in implementing its plan.

DROUGHT CONTINGENCY PLANS

Drought contingency plans (DCP) are local planning documents used to address temporary water supply scarcity during drought. DCPs are required for all wholesale public water suppliers, retail public suppliers serving 3,300 connections or more, and irrigation districts. Retail suppliers that serve fewer than 3,300 connections also are required to prepare and adopt DCPs and to make the plans available upon request. DCPs are required to be submitted every five years to coincide with the regional water planning group process. House Bill 3604, Eighty-third Legislature, Regular Session, 2013, amended statute to require entities that are subject to a governor’s emergency disaster proclamation for drought to enact their water conservation plans and DCPs. The bill also authorized TCEQ to enforce the disaster area requirement through administrative penalties or corrective measures.

TCEQ considers efforts made to develop and implement DCPs when examining the suspension or adjustment of water rights during drought. DCPs are required by political subdivisions when attempting to acquire rights to groundwater or surface water. Groundwater conservation

districts also may require submission of a DCP with an application for a new or amended well permit. Pursuant to statute, water suppliers' DCPs must include specific, quantifiable targets for reductions in water use during periods of water shortages and drought. TCEQ and TWDB identify target goals for DCPs that suppliers may use as guidelines, but neither agency has authority to enforce compliance with these goals. The Texas Water Code, Chapter 11, also requires TCEQ and TWDB to jointly develop model DCPs and best practices for different types of water suppliers. Minimum requirements for the contents of DCPs are found in the Texas Administrative Code, Title 30, Chapter 288, and include:

- provisions to inform the public and provide opportunity for public input;
- a program of continuing public education and information;
- coordination with regional water planning groups;
- information to be monitored by water suppliers;
- criteria to initiate and terminate drought response;
- emergency response stages to address unforeseen reductions in available water supply;
- specific, quantified targets for water use reductions;
- supply or demand management measures to be implemented during each stage of the DCP;
- procedures to initiate or terminate each drought response stage;
- procedures to grant variances to the DCP; and,
- procedures to enforce mandatory water use restrictions.

Water suppliers are required to notify TCEQ when implementing a DCP and as the stages of the plan increase. However, data currently available to the state may not be representative of actual drought responses from local water suppliers, as suppliers are not required to notify TCEQ upon lifting water use restrictions. Information provided to TCEQ during the course of drought is voluntary and submitted at the water supplier's discretion. Therefore, the state is impeded from determining compliance with state law by ensuring water restrictions remain in place for the duration of the emergency proclamation. The state also lacks the information necessary to determine the effectiveness of drought strategies that the supplier may have implemented. Additionally, water

suppliers have not submitted notification consistently to TCEQ upon changing their drought stage designation. For example, according to TCEQ's website, as of October 2014, the cities of Frisco, McKinney, Raymondville, Round Rock, and San Marcos have enacted Stage 1 water use restrictions. However, according to each city's website, all of these cities are implementing Stage 3 of their respective DCPs. Recommendation 1 would amend the Texas Water Code, Section 16.055, to require water suppliers that already must implement DCPs to immediately report to TCEQ when they enact specific provisions of the DCPs, when they change the level of those DCPs, and when they lift water use restrictions. Notification of changes to DCP strategies such as water use restrictions would enable the state to monitor compliance with state law and to determine how effectively water suppliers manage reduced water supply conditions. Recommendation 2 would amend the Texas Water Code, Section 16.055, to require TCEQ to augment its online list of public water systems that are limiting use to avoid water shortages with the following information for each water supplier:

- degree of drought severity in the supplier's county;
- whether the supplier is in a county subject to a governor's drought proclamation; and
- drought response stage the supplier has enacted.

Several regional planning groups included in the 2012 State Water Plan recommended that the state more actively monitor compliance with DCPs. Compiling and posting this information would provide transparency and incentivize local suppliers to conform to reporting requirements established in accordance with Recommendation 1.

DROUGHT PLANNING FOR REGIONAL WATER PLANNING GROUPS

The state is divided into 16 regional water planning groups (RWPG), each made up of approximately 20 members that represent a variety of interests. Among other tasks, RWPGs quantify current and projected population and water demand during a 50-year timeframe and evaluate water management strategies that may be necessary to meet projected demand. TWDB compiles information from these groups to develop the State Water Plan.

According to the Texas Administrative Code, Title 31, Chapter 357, RWPGs must:

- consider current drought preparations, including DCPs;

- prepare recommendations regarding drought indicators and responses for water sources in the region;
- collect information on emergency interconnections and consider future interconnections;
- consider drought management for any water user group that has an identified water need;
- evaluate potential emergency responses to local drought conditions or loss of existing supplies for entities that have populations of 7,500 or less and that rely on a single source of water; and
- make recommendations regarding implementation of local DCPs.

RWPGs also are required to develop drought response recommendations for groundwater and surface water management, including specific recommended drought response indicators and actions to be taken by the manager of each water source and the entities relying on each source. The RWPGs are required to develop region-specific model DCPs. According to TWDB, none of the 2001 and 2006 regional water plans contained any recommended drought management strategies. In 2011, only two of 16 planning groups included drought management strategies in their plans. In the 2012 State Water Plan, drought management as a water management strategy was recommended to supply approximately 2,000 acre feet per year by 2060. The State Water Plan identified total water needs at approximately 8.3 million acre feet. An impediment to including drought management as a relevant supply strategy in regional and state planning documents is the limited availability of informative data on the subject.

THE WATER CONSERVATION ADVISORY COUNCIL

The Water Conservation Advisory Council (WCAC) is a statutorily established council whose purpose is to provide state agencies, the Legislature, and the public with expertise in water conservation. Among its authorized powers and duties, WCAC oversees the development of a best management practices (BMP) guide and public recognition program for water conservation achievements. The BMP guide provides information on vetted policy and technical standards to increase water conservation in various sectors, including municipal, irrigation, industrial, and commercial and institutional sectors. TCEQ and TWDB are required to develop BMPs for water conservation plans and DCPs. The agencies have coordinated with WCAC to produce BMPs

related to water conservation, but efforts to do so for drought planning have been limited. Recommendation 3 would amend the Texas Water Code, Section 10.10, to expand the powers and duties of WCAC to include the monitoring and development of strategies to address drought conditions, and to assist TWDB and TCEQ with the development of best management practices for drought planning as it does for water conservation. BMPs developed with TCEQ and TWDB could be used by RWPGs and by local water suppliers to formulate DCPs. WCAC also should provide methodologies that may be used by suppliers to conduct post-drought assessments, as proposed in Recommendation 4. Leveraging WCAC's expertise would strengthen and provide uniformity in the assessment of whether investments in drought mitigation efforts are cost-effective.

GAUGING THE EFFECTIVENESS OF DROUGHT MANAGEMENT STRATEGIES

The State Water Plan compiles recommended strategies that are intended to ensure that Texas has sufficient water supplies during conditions similar to the drought of record. The plan does not, however, actively incorporate the effect of implementing local DCPs into this process to determine supply and demand needs during drought. According to a 2009 report by BBC Research and Consulting, total projected demand in the State Water Plan could be reduced by 5 to 20 percent, if the potential effects of DCPs are incorporated. Integrating the quantifiable effect of DCP measures could facilitate more focus on projects that have the greatest potential impact within the State Water Plan. However, impediments exist to confidently estimating savings achieved through drought response measures. Few studies have been performed on this issue, such as obtaining reliable estimates of water savings and costs of implementing various types of drought measures; the lack of research has limited the availability of informative data. According to BBC Research and Consulting, some DCPs do not have quantified water savings goals, and savings estimates vary among seemingly similar drought management measures.

More consistent and reliable estimates of drought management savings might be developed if suppliers collect, analyze, and share information from their drought management experiences. A survey of western state drought programs conducted by the American Society of Civil Engineers published in the *Natural Hazards Review* in 2012, found that state planning usually focuses on establishing networks of communication and monitoring in drought responses. Few states, however, assess the effectiveness of

those responses post-drought. States that have are able to use results to prioritize subsequent drought mitigation activities. For example, the state of Hawaii transitioned from using general drought indicators to also including a subjective assessment of those indicators to determine an appropriate response. Variables in this assessment include: rainfall, streamflow, and reservoir data; reports from farm service agencies; media reports; and consultations with county and agricultural representatives. Hawaii enacted this change as a result of receiving post-drought assessment comments. The state of Arizona, after engaging in a post-drought assessment process, assesses drought severity by using information collected on watersheds; the state's previous assessments relied on climate divisions that primarily considered precipitation compared to historical averages for that area.

Texas statute requires suppliers to report to the state on the entity's progress in implementing a water conservation plan. Conversely, there are no reporting requirements relating to achievement of water use reduction goals in DCPs. Recommendation 4 would amend the Texas Water Code, Section 11.1272, to require water suppliers to conduct post-drought assessments to gauge the effectiveness of strategies in their DCPs, if the suppliers have experienced significant drought in the previous five-year reporting period, and to include this information in the subsequent iteration of their DCPs. This requirement would apply to wholesale public water suppliers, retail public water suppliers serving 3,300 connections or more, and irrigation districts that submit DCPs. The law requires TWDB and TCEQ, in consultation with the WCAC, to develop a uniform, consistent methodology and guidance to calculate water use and conservation; this calculation is to be used by a municipality or water utility to develop water conservation plans and prepare reports. Additionally, Rider 24, page VI-61, 2014–15 General Appropriations Act requires TWDB to provide an online tool to quantify water conservation savings. These requirements, as well as the resources available from RWPGs will assist suppliers in implementing this requirement. Recording and evaluating specific drought response strategies would assist all water suppliers in identifying effective drought management strategies and aid in the future quantification of drought management strategies to be included in the State Water Plan.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would have no significant fiscal impact to the state. Recommendation 1 would require entities that complete DCPs to notify TCEQ when they lift

water restrictions. No fiscal impact is anticipated as a result of the recommendation.

Recommendation 2 would require TCEQ to maintain an ongoing list of drought- and drought-response-related criteria. This recommendation could be implemented using existing resources; TCEQ already maintains a website that includes related information.

Recommendation 3 would expand the activities of WCAC to include drought-related research, monitoring, and development of BMPs. No significant fiscal impact is anticipated as a result of the recommendation.

Recommendation 4 would require entities that already complete DCPs to also include information regarding the performance of their drought mitigation strategies. No fiscal impact is anticipated as a result of this recommendation.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

REVENUE ENHANCEMENT OPTIONS FOR THE WATER RESOURCE MANAGEMENT ACCOUNT

A significant portion of state funding for the Texas Commission on Environmental Quality's water programs are funded from the Water Resource Management Account No. 153 (General Revenue–Dedicated Funds). In addition, the Public Utility Commission and the Office of Public Utility Counsel began receiving funding out of the Water Resource Management Account during the 2014–15 biennium as a result of the enactment of House Bill 1600, Eighty-third Legislature, Regular Session, which transferred water and wastewater utility rate regulation responsibilities from the Texas Commission on Environmental Quality to the Public Utility Commission. However, revenue in the account is not expected to be sufficient to maintain 2014–15 biennial spending levels for the 2016–17 biennium and subsequent years. According to the agency's Legislative Appropriations Request for the 2016–17 biennium, the Texas Commission on Environmental Quality expenditures and budgeted amounts for 2014–15 total \$112.0 million from the Water Resource Management Account, including costs for the 2014–15 biennial state employee salary increase, and an additional \$16.0 million is estimated for employee-related benefits costs that are paid from the account. The Public Utility Commission reports expenditures of \$1.6 million for fiscal year 2015 only, while Office of Public Utility Counsel reports expenditures of \$1.0 million for the 2014–15 biennium from the account. This total results in \$130.7 million in appropriations from the Water Resource Management Account during the 2014–15 biennium. Meanwhile, revenues deposited to the account are expected to total \$129.8 million, according to Texas Commission on Environmental Quality's Legislative Appropriations Request for 2016–17, which means estimated appropriations and benefits costs out of the account are expected to exceed revenues by \$0.9 million.

It is possible that there might not be enough revenue and balances in the account to cover appropriations for the 2014–15 biennium, because the Texas Commission on Environmental Quality projected an unencumbered balance of only \$1.1 million in the Water Resource Management Account No. 153 (General Revenue–Dedicated Funds) on August 31, 2013, and the revenues and appropriations for benefits are estimated. Recommended appropriations from the Water Resource Management Account total \$112.0 million for the 2016–17 biennium, with estimated employee-

related benefits totaling \$17.6 million. The Public Utility Commission of Texas and the Texas Office of Public Utility Counsel have requested \$3.2 million and \$1.0 million, respectively, from the Water Resource Management Account. Thus, the total amount being requested by the three agencies combined is an estimated \$133.8 million for the 2016–17 biennium. The Texas Commission on Environmental Quality estimates that revenues for the 2016–17 biennium will total only \$128.9 million, leaving an estimated difference of \$4.9 million between revenues and expenditures. Combined with an estimated fund balance of only of \$0.2 million at the end of fiscal year 2015, the total shortfall in the Water Resource Management Account No. 153 is expected to reach \$4.8 million by the end of fiscal year 2017.

As part of the Texas Commission on Environmental Quality's 2016–17 biennial Legislative Appropriations Request, the agency has requested an exceptional item for \$8.0 million in General Revenue Funds to replace \$8.0 million in appropriations from Water Resource Management Account No. 153 (General Revenue–Dedicated Funds) as a way to avoid a shortfall in the account and provide a small cushion for subsequent years.

There are multiple options for increasing revenues to the Water Resources Management Account No. 153 (General Revenue–Dedicated Funds) to ensure that the account has sufficient funds to cover the current level of appropriation in future years, if the Legislature does not choose to provide General Revenue Funds to the Texas Commission on Environmental Quality for water program funding in place of funding the account. Options include examining the relation between fee payer groups and the use of fees deposited to the account, and considering options associated with the three largest fees deposited to the account: the Consolidated Water Quality Fee, the Public Health Service Fee and the Water Utility Regulatory Assessment Fee.

FACTS AND FINDINGS

- ◆ Balances in the Water Resources Management Account No. 153 (General Revenue–Dedicated Funds) are not expected to cover the anticipated revenue shortfall for the 2014–15 biennium.

- ◆ Expenditures from the Water Resources Management Account No. 153 (General Revenue–Dedicated Funds) and other amounts estimated to be necessary to cover employee benefits costs are expected to exceed revenues by \$0.9 million during the 2014–15 biennium.
- ◆ Cost increases relating to state employee salary increases for the 2014–15 biennium are expected to exacerbate the shortfall in the Water Resource Management Account No. 153 (General Revenue–Dedicated Funds) for the 2016–17 biennium, with an estimated gap of \$4.9 million between funding needs based on baseline spending levels and estimated biennial revenues.

CONCERNS

- ◆ Based on current revenue collections and anticipated expenditure needs during the 2014–15 biennium, it appears likely that the Water Resource Management Account No. 153 could come close to experiencing a shortfall during the current biennium and going forward, unless revenues are increased or General Revenue Funds are appropriated for the account’s funding. Although the Texas Commission on Environmental Quality has some discretion in setting water fee rates, statutory constraints limit the agency’s ability to generate targeted revenue amounts.
- ◆ Inequity exists among fee payers subject to the Consolidated Water Quality Fee assessed by the Texas Commission on Environmental Quality in that those entities discharging the greatest amounts of wastewater pay less by volume than many smaller entities.
- ◆ Inequity exists among fee payers of the Public Health Service Fee because the fee is based on a per-connection fee rather than a per-gallon fee; therefore, an industrial or commercial customer pays the same fee as a residential customer, regardless of the amount of water used.
- ◆ The Water Utility Regulatory Assessment Fee only applies to about 40 percent of water and wastewater customers in the state, but most of the Texas Commission on Environmental Quality’s water programs affect all water and wastewater customers in the state.

- ◆ There is a lack of legislative guidance regarding which groups of fee payers should bear the burden of any fee increase.
- ◆ As a result of the enactment of House Bill 1600, Eighty-third Legislature, Regular Session, the Texas Commission on Environmental Quality, the Public Utility Commission of Texas and the Texas Office of Public Utility Counsel all receive appropriations from the Water Resource Management Account No. 153 (General Revenue–Dedicated Funds). Because balances and revenues to the account might fail to cover all appropriations and expenditures from the account, it is unclear which agency(ies) would bear the consequences of a revenue shortfall.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Include a rider in the 2016–17 General Appropriations Bill specifying that appropriations to the Texas Commission on Environmental Quality, the Public Utility Commission of Texas, and the Texas Office of Public Utility Counsel are contingent upon existing balances and available revenues to the Water Resource Management Account No. 153 (General Revenue–Dedicated Funds) being sufficient to cover appropriations from the account for the 2016–17 biennium, including related employee benefits costs. The rider should also direct the Texas Commission on Environmental Quality to increase fee rates, if additional revenues are needed to cover such costs, and any such fee increases should be based on an evaluation that the Texas Commission on Environmental Quality would conduct pursuant to Recommendation 3, if that recommendation is implemented.
- ◆ **Recommendation 2:** Amend statute to redirect some of the fee revenues from the Water Utility Regulatory Assessment to the General Revenue Fund in an amount necessary to cover appropriations and related employee benefits costs at the Public Utility Commission of Texas and the Texas Office of Public Utility Counsel. A rider contingent on legislation making such changes should be included to provide appropriations from General Revenue Funds to the Public Utility Commission of Texas and the Texas Office of Public Utility Counsel relating to water utility rate regulation, and such appropriations

should be limited to revenue collected from applicable Water Utility Regulatory Assessment fees. The Texas Commission on Environmental Quality should be directed in the contingency rider to set the Water Utility Regulatory Assessment fees that would be deposited to the General Revenue Fund at a rate sufficient to meet appropriations to the Public Utility Commission of Texas and the Texas Office of Public Utility Counsel and related benefits for the 2016–17 biennium.

◆ **Recommendation 3:** Direct the Texas Commission on Environmental Quality to conduct a study to determine the level of agency workload related to each group of fee payers and the relative benefit each fee payer group receives from agency water quality permitting, water quality regulation, and safe drinking water programs. Using this analysis, the agency should develop a methodology to determine the appropriate fee rates for water-related fees, which would generate revenue in proportion to agency workload and fee payer benefits. Any future fee rate modifications to ensure sufficient revenues to the Water Resource Management Account No. 153 (General Revenue–Dedicated Funds) should be based on the new methodology. Options available to generate additional revenues to the account include the following:

- **Option 1:** Increase the Consolidated Water Quality Fee Multiplier—An increase in the Consolidated Water Quality fee rate multiplier from the current 1.20 to 1.25, for example, could generate an estimated \$1.1 million in additional annual revenue to the Water Resource Management Account. An increase to a rate of 1.55 could raise an estimated \$5.3 million in additional annual revenues. This option would not require a statutory change; instead, such a fee increase could simply be adopted by rule by the Texas Commission on Environmental Quality.
- **Option 2:** Eliminate the Statutory Maximum Single Fee for the Consolidated Water Quality Fee—Eliminating the current \$100,000 (adjustable for the U.S. Consumer Price Index to an estimated \$115,000 in 2015) fee per single permit could raise \$16.7 million in additional annual revenues to the Water Resource Management Account if the current fee were

applied across-the-board to all fee payers. Because this action would generate significantly more than the revenue shortfall in the Water Resource Management Account, the rate on all fee payers could be lowered to produce a targeted revenue amount. The result would be in a decrease in fees to all but the largest fee payers whose current permit fees are limited by the statutory cap. This option would not require a statutory change.

- **Option 3:** Increase the Public Health Service Fee Rate—An increase in the current rate of \$2.15 per connection to \$2.50, for example, would yield an estimated \$2.3 million in additional annual revenues to the Water Resource Management Account, while an increase to \$2.90 would yield an estimated \$5.8 million in additional revenues. This option would require a statutory change.
- **Option 4:** Increase Water Utility Regulatory Assessment (WURA) for Those Paying 0.5 Percent Rate to 1.0 Percent—If the 1.0 percent fee rate were assessed on all fee payers, not just those fee payers currently paying only a 0.5 percent rate, an estimated \$6.1 million in additional annual revenues would be generated to the Water Resource Management Account. Likewise, if a lower revenue target were established, an equal fee could be applied to all fee payers at some level below the current 1.0 percent level. For instance, applying a fee rate of 0.85 percent of receipts to all current fee payers would yield an estimated \$4.3 million in additional annual revenues. This option would require a statutory change.
- **Option 5:** Apply the Water Utility Regulatory Assessment to Entities that Currently Are Exempt—If the Water Utility Regulatory Assessment Fee were extended to include those entities currently exempt from the fee (mainly municipal systems) at a rate of 1.0 percent, it could generate an estimated \$19.5 million in additional annual revenues to the Water Resource Management Account. Because this option would raise significantly more revenue than is necessary to cover the anticipated shortfall in the account, the Water Utility Regulatory Assessment could be extended to all water and wastewater systems in the state, and a uniform fee rate could be established at a level to achieve a targeted fee

revenue amount. This action would likely result in a reduction in the fee rate assessed on at least some current fee payers, depending on whether those fee payers are currently paying the 0.5 percent or 1.0 percent rate. This option would require a statutory change.

- **Option 6:** Provide Authority to the Texas Commission on Environmental Quality to set the Water Utility Regulatory Assessment Fee by Rule. The Legislature could provide authority to the Texas Commission on Environmental Quality to set the Water Utility Regulatory Assessment rate at a level the Commission determines to be necessary to meet the level of appropriations that the Legislature would provide out of the Water Resource Management Account. This option would require a statutory change.

DISCUSSION

The Water Resource Management Account No. 153 (General Revenue–Dedicated Funds) provides the vast majority of state funding for the Texas Commission on Environmental Quality (TCEQ) Water Programs. For fiscal year 2014, of the state funding appropriated for the agency’s three primarily water-related strategies, Water Assessment and Planning, Water Resource Permitting, and Safe Drinking Water, approximately 93 percent are from the Water Resource Management Account, while the remaining state funds are appropriated from General Revenue Funds (1.7 percent) and the Watermaster Administration Account No. 158 (General Revenue–Dedicated Funds; 5.7 percent). Before the 2012–13 biennium, General Revenue Funds contributed a greater portion to the agency’s water programs. The Eighty-second Legislature, 2011, replaced \$13.9 million in General Revenue Funds with appropriations from the General Revenue–Dedicated Water Resource Management Account for the 2012–13 biennium. The Water Resource Management Account, at the time, had a significant unencumbered balance (approximately \$20.0 million). The account balance has been reduced due to expenditures exceeding revenues in recent years. This trend is expected to continue, absent a fee increase or an appropriations reduction for TCEQ water programs.

Programs funded primarily by the Water Resource Management Account include the following:

- Bay and Estuary;
- Clean Rivers;

- Dam Safety;
- Groundwater Protection and Management;
- Nonpoint Source;
- Total Maximum Daily Load;
- Water Assessment and Planning;
- Water Quality Standards;
- Edwards Aquifer; and
- Water Resource Permitting.

In addition, Water Utility Rate Regulation at the Public Utility Commission of Texas (PUC) and related consumer representation in water and wastewater rate cases at the Texas Office of Public Utility Counsel (OPUC) are also funded out of the Water Resource Management Account, as a result of the enactment of House Bill 1600, Eighty-third Legislature, Regular Session, 2011.

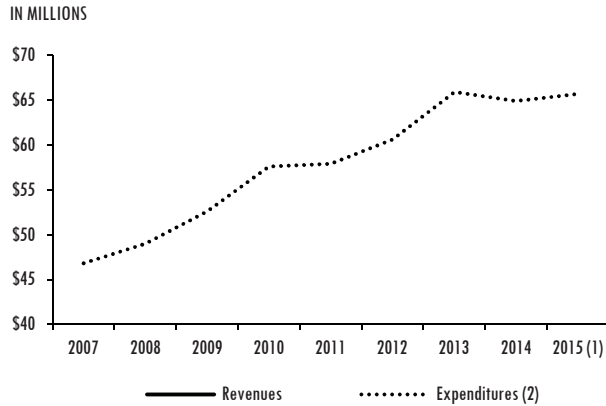
FEES DEPOSITED TO THE WATER RESOURCE MANAGEMENT ACCOUNT

The revenue stream for the Water Resources Management Account consists of 23 different fees generating from \$62.5 million in revenues for 2013 to a projected \$65.5 million for 2014. Three fees accounted for more than 82 percent of the fee revenue deposited to this account for fiscal year 2013. For fiscal year 2013, the Consolidated Water Quality (CWQ) Fee earned approximately \$22.6 million in revenues, while the Public Health Service (PHS) Fee earned approximately \$20.4 million, and the Water Utility Regulatory Assessment (WURA) Fee earned approximately \$8.5 million. Total revenues and expenditures for the Water Resource Management Account from fiscal year 2007 through 2015 are shown in **Figure 1**.

The spike in revenues for fiscal year 2010 (approximately \$20.0 million greater than fiscal year 2009) was a result of the last major increase in fee rates for the CWQ fee and the PHS Fee, which resulted from increases adopted by TCEQ in July 2009 to avoid a potential revenue shortfall anticipated.

The expended/budgeted amount from the Water Resource Management Account totals approximately \$64.9 million in fiscal year 2014, including transfers to the PUC and OPUC as a result of the enactment of House Bill 1699, Eighty-third Legislature, Regular Session, 2013, and estimated payroll-related benefit costs. Revenues for fiscal year 2014 totaled \$65.5 million. Thus, revenues exceeded expenditures by only

FIGURE 1
WATER RESOURCE MANAGEMENT ACCOUNT NO. 153
(GENERAL REVENUE–DEDICATED FUNDS) ANNUAL
REVENUES, FISCAL YEARS 2007 TO 2015



NOTES:

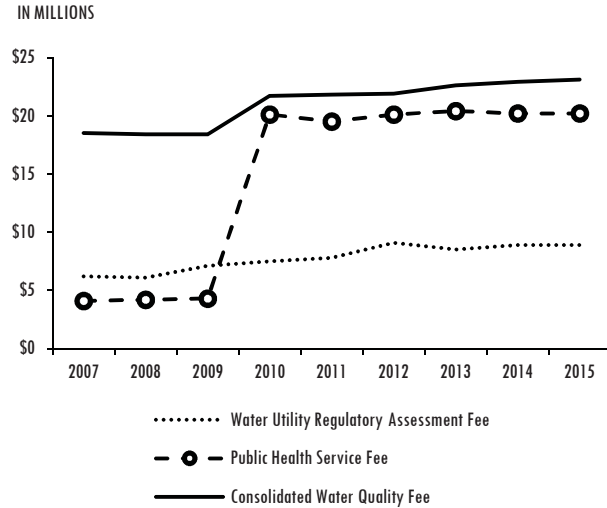
- (1) Revenue estimates based on the Texas Comptroller of Public Accounts' Biennial Revenue Estimate for the 2014–15 biennium.
- (2) Expenditure data provided by the Texas Commission on Environmental Quality and includes deductions from the account for non-appropriated funds, such as benefits. 2014 and 2015 amounts are estimated.

SOURCES: Texas Commission on Environmental Quality; Texas Comptroller of Public Accounts.

\$0.5 million. For fiscal year 2015, budgeted amounts total \$65.7 million, while revenues are projected to be \$64.3 million, resulting in an expected \$1.4 million revenue shortfall. Balances in the account will need to be used to continue this level of appropriations for the 2016–17 biennium. The agency projects a balance of \$1.1 million in the account on August 31, 2013; therefore, additional funding will be necessary to support programs at TCEQ, PUC, and OPUC. To address the potential revenue shortfall for the 2016–17 biennium, a rider should be included in TCEQ's bill pattern to specify that appropriations to TCEQ, PUC, and OPUC are contingent upon existing balances and available revenues to the Water Resource Management Account being sufficient to cover appropriations, including related employee benefits costs (Recommendation 1). The rider should also direct TCEQ to increase fee rates, if necessary, based on an evaluation of the equity among fee payers that the agency would conduct in accordance with Recommendation 3.

Revenues deposited to the Water Resource Management Account include fees assessed on water utilities, water rights holders, industrial water users, and 17 other fees. Of these fees, only the three shown in **Figure 2** were considered as potential sources of additional revenue, due to the significant

FIGURE 2
TOP THREE FEE REVENUE SOURCES OF WATER RESOURCE
MANAGEMENT ACCOUNT NO. 153 (GENERAL REVENUE–
DEDICATED FUNDS), FISCAL YEARS 2007 TO 2015



SOURCE: Texas Commission on Environmental Quality.

gains that could be realized from applying them to a broad base of eligible fee payers. Although any of the 20 other fees could be increased to raise revenue for the Water Resource Management Account, many of these fees focus on a small group of fee payers, and none generates more than \$2.0 million in annual revenue individually.

CONSOLIDATED WATER QUALITY FEE

The CWQ Fee is assessed annually for each permit authorizing the treatment and/or discharge of wastewater issued pursuant to the Texas Water Code, Chapter 26. Each permit is evaluated based on pollutant potential and permitted limits for flow volume, pollutants, toxicity, storm-water authorization, and major/minor facility status. Many utilities have several CWQ permits, one for each facility that discharges wastewater. Irrigators are not subject to the CWQ fee.

TCEQ sets the CWQ Fee rates; however, the agency is restricted by the Texas Water Code, Section 26.0291(e), in assessing the annual fee to a limit based on the Consumer Price Index (CPI). The fee maximum per permit is estimated to be \$115,000 for 2015, based on the CPI. TCEQ assesses the CWQ fee based on an agency rule that estimates a multiplier applied to the base fee to produce a targeted amount of revenue to meet spending requirements for each annual agency operating budget. TCEQ has set the maximum multiplier rate at 1.75 the amount of the fee rate, and, as of June 2014, the multiplier rate is 1.20, but there is no

statutory maximum multiplier rate. TCEQ estimates an increasing multiplier by the following amounts would yield additional annual revenues (Option 1):

- 1.25—\$1.1 million
- 1.35—\$2.5 million
- 1.45—\$3.9 million
- 1.55—\$5.3 million

An increase in the multiplier would mean that smaller water utilities and industrial users would pay a greater portion of the costs than they are now paying, because larger entities which are already paying the fee maximum would not see an increase in the fees they are paying. However, if the limit were removed and the current fee rate of 1.20 were applied to all fee payers without a per-permit ceiling, TCEQ estimates that an additional \$16.7 million could be gained in annual revenue to the Water Resource Management Account (Option 2).

The estimated effect resulting from removing the maximum fee limit (currently estimated to be \$115,000 in 2015) while keeping the rate the same is shown in **Figure 3** for the top five fee payers. Each of these fee payers has several permits for which their fees reach the limit.

**FIGURE 3
CONSOLIDATED WATER QUALITY FEE INCREASE FOR THE
TOP FIVE FEE PAYERS IF THE MAXIMUM FEE RATE WERE
ELIMINATED, FISCAL YEAR 2014**

PAYER	AMOUNT
City of Houston	\$2.9 million
International Paper Company	\$2.3 million
Luminant Generation Company	\$2.0 million
Shell Oil Company	\$1.6 million
City of Dallas	\$1.4 million

SOURCE: Texas Commission on Environmental Quality.

PUBLIC HEALTH SERVICE FEE

TCEQ sets the PHS Fee rates and assesses it on all public drinking water systems based on the number of retail connections served by the system. Proceeds of the fee are used by TCEQ to assess the quality of water provided by water systems through the Public Drinking Water Program. Operators with fewer than 25 connections pay \$100 per year; operators with 25 to 160 connections pay \$175 per year; and those systems with 161 or more pay \$2.15 per number of retail connections. The fee earns \$20.4 million in revenue per fiscal year.

If the current \$2.15 rate per connection on systems of more than 161 connections was increased, a substantial amount of revenue could be generated. TCEQ estimates, for example, that increasing the rate would yield the following annual revenues (Option 3):

- \$2.50 (an additional \$0.35 per connection per year)—\$2.3 million
- \$2.70 (an additional \$0.55 per connection per year)—\$4.0 million
- \$2.90 (an additional \$0.75 per connection per year)—\$5.8 million

Figure 4 shows the potential effect that increasing the PHS Fee by \$0.55 per connection per year would have on the five largest fee payers. The estimate is based on fiscal year 2014 assessments and a 25.6 percent increase in the fee rate.

**FIGURE 4
EFFECTS OF INCREASING THE PUBLIC HEALTH SERVICE FEE
TO \$2.70 PER CONNECTION PER YEAR (AN INCREASE OF
\$0.55), JULY 2014**

PAYER	REVENUE
City of Houston	\$485,736
San Antonio Water System	\$292,715
Dallas Water Utility	\$251,917
City of Fort Worth	\$176,837
City of Austin Water and Wastewater Utility	\$117,079

SOURCE: Legislative Budget Board.

The Texas Health and Safety Code, Section 341.041, provides that, among other factors, in setting the PHS Fee, TCEQ should consider equity among persons required to pay the fees as a factor in determining the amount of the fees. The statute further provides that the commission may use the fees to cover any other costs incurred to protect water resources in the state, including assessment of water quality, reasonably related to the activities of any persons required to pay a fee pursuant to the Texas Water Code, Section 5.701(q), which includes a variety of fee payers. Because the PHS Fee is assessed per connection and not by quantity, an increase in the fee would have a disproportionate impact on those using the least amount of water, such as residential customers, as opposed to commercial and industrial users that might use substantially more water per connection than a typical household.

Another option to increase revenue from the PHS Fee would be to assess a higher fee on commercial and industrial users, or to link water usage to the fee so that revenues would be proportionate to an entity's use. However, no data appears to be readily available to determine what percentage of an entity's users are industrial or commercial users. Thus, any option involving the assessment of the PHS fee would require additional research and, thus, is not one of the previously mentioned options.

WATER UTILITY REGULATORY ASSESSMENT

The WURA is collected by public utilities, water supply service corporations, and water districts. It is established in the Texas Water Code, Section 5.701(n), and it is assessed against each retail customer at a rate of 0.5 percent of the charge for retail water or sewer service by public utilities as defined in the Texas Water Code, Section 13.002, and against water supply and service corporations (nonprofit corporations) at a rate of 1 percent of the charge for retail water or sewer service by water districts, as defined in the Texas Water Code, Section 50.001. The fee currently earns \$8.0 million to \$9.0 million per year, and it is assessed on approximately 3.3 million connections. Municipal and county-owned water and wastewater systems, which represent 5.4 million, or about 62 percent of the 8.7 million connections in the state, typically are exempt from the fee.

The Legislature could modify the existing statute to apply the 1 percent rate to all current fee payers (Option 4). This would generate an estimated additional \$6.1 million per year. A smaller increase, to 0.85 percent, for example, is estimated by the TCEQ to generate an additional \$4.3 million in annual revenues. Another option would be to apply the fee to systems currently exempt from the fee (Option 5). If the 0.5 percent rate were extended to include municipal systems, an additional \$19.5 million in annual revenues could be collected, while extending the 1 percent fee to municipal systems could generate \$39.0 million. Because this option would generate significantly more revenue than needed to meet the anticipated shortfall in the Water Resource Management Account, the fee could be applied to all fee payers at a rate lower than either of the rates currently being assessed. For example, to generate \$5.0 million in revenue within the current revenue stream for the 2014–15 biennium (increasing from \$8.9 million per year to \$13.9 million per year), the fee rate could be set at an estimated 0.36 percent of annual receipts.

Because the WURA rates are set in statute, TCEQ does not have the ability to modify fee rates to respond to funding needs. If the WURA were assessed on all water and wastewater customers in the state, including those currently exempted from the fee, then it would be reasonable to authorize TCEQ to use discretion in setting the fee rates through rulemaking (Option 6). This authorization would allow the agency to assess the fee at a level that would generate adequate funds to meet the appropriations which the Legislature provides out of the Water Resource Management Account, thereby avoiding potential shortfalls or surpluses in the account when spending levels are maintained.

House Bill 1600, Eighty-third Legislature, Regular Session, 2013, transferred water utility rate regulation from TCEQ to PUC and OPUC and continued funding for the programs out of the Water Resource Management Account No. 153; therefore, three agencies now share revenues produced by that account. Given that the account's revenues and balances are in jeopardy of being able to support the full appropriations and benefits costs to the three agencies, the agencies will be vying for a dwindling and uncertain funding stream. Thus, it is recommended that the portion of funding appropriated to the PUC and OPUC should be separated from TCEQ's funding from the Water Resource Management Account No. 153 (Recommendation 2). This separation would require a statutory change. One way this could be accomplished is by redirecting the proceeds of fee revenues from fee payer groups that contribute WURA fees; fees from those entities related to TCEQ's jurisdiction would continue to be deposited to the Water Resource Management Account, while fees related to PUC and OPUC's jurisdiction would be deposited instead to the General Revenue Fund.

House Bill 1600 provides that regulation of water utility rates for counties, investor-owned utilities (IOU), water supply corporations, and exempt entities be moved from TCEQ to PUC and OPUC. Thus, it would be reasonable to direct the fee revenues from those fee payers from the Water Resource Management Account to General Revenue Funds. TCEQ estimates that approximately \$4.0 million of the \$8.6 million in annual revenue from WURA is attributable to the entities whose regulation was moved to PUC and OPUC, while the remaining \$4.6 million in annual revenue is attributable to water districts, whose regulation remains with TCEQ. Total costs of water utility regulation programs at PUC and OPUC are estimated at \$2.6 million per year, including transfers for employee benefits. As a result, implementation of Recommendation 2 would result in an

estimated \$1.4 million in revenue in excess of PUC and OPUC program costs being diverted to General Revenue Funds. Although this would serve to exacerbate the shortfall in the Water Resource Management Account, it would be logical to separate the funding streams for WURA-funded programs to correspond to the fee payers being regulated, and the excess revenue being collected from PUC- and OPUC-regulated entities could be used to cover increased program costs at both agencies. Furthermore, moving PUC- and OPUC-related funding from the Water Resource Management Account would eliminate competition between the TCEQ and PUC/OPUC for funding from a limited source.

EQUITABLE ASSESSMENT OF WATER FEES

The three major fees that contribute revenues to the Water Resource Management Account each target a different group of fee payers and are assessed based on different criteria. The CWQ fee is assessed based on water usage, which would appear to be an equitable method of assessing fees. However, because the CWQ fee has a statutory limit (\$115,000) on the maximum fee rate that can be assessed on any single permit (currently \$115,000), those entities that do not reach the fee maximum pay a higher incremental rate than entities that have exceeded the fee maximum. The PHS Fee is assessed based on the number of connections a system has, so the fee is applied without regard to the number of industrial, commercial, or heavy-usage customers a system may have. Finally, the WURA is based on the amount that a water or sewer provider bills its customers. Although this provides for a somewhat equitable fee assessment, the fee is only assessed on certain systems (around 40 percent of water and wastewater customers), and it is applied at different rates to different entities, depending on the statutory authority that established each system.

Each of the main sources of revenue for the Water Resource Management Account falls short in some way of achieving equity among fee payers. In addition, there is little, if any, relationship between the level of revenues being collected from each of the various water fees deposited to the account and TCEQ’s workload as it relates to the entities paying those fees or the benefits those groups of fee payers may experience as a result of TCEQ water programs. Thus, the Legislature should direct TCEQ to conduct a study to determine which entities benefit most from the agency’s work in regulating and monitoring water quality in the state, and which entities are responsible for direct agency workload in the water program areas (Recommendation 3). Using this

analysis, the agency should develop a methodology to assess each of the water fees to generate necessary revenue that would cover the agency’s costs in providing service, oversight, and the provision of safe drinking water to each of the respective fee payer groups. If Recommendation 3 is implemented in conjunction with Recommendation 2, and WURA fees relating to entities regulated by PUC and OPUC are redirected to General Revenue Funds, any study that TCEQ would conduct regarding water fees would consider both fees deposited to the Water Resource Management Account No. 153 and WURA fees deposited to General Revenue Funds, combined with appropriations and employee benefits-related costs for each of the respective agencies.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 requires the Texas Commission on Environmental Quality to increase fee rates to a level necessary to cover the expected shortfall in the Water Resource Management Account (General Revenue–Dedicated Funds) for the 2016–17 biennium, which is estimated to be \$4.8 million or \$2.4 million per fiscal year. The five-year fiscal impact is shown in **Figure 5** and assumes the increased fee rate and expenditure of additional revenue would continue in future biennia.

**FIGURE 5
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 1
FISCAL YEARS 2016 TO 2020**

YEAR	PROBABLE SAVINGS/ (COST) IN GENERAL REVENUE– DEDICATED ACCOUNT 153	PROBABLE REVENUE GAIN/(LOSS) IN GENERAL REVENUE– DEDICATED ACCOUNT 153
2016	(\$2,400,000)	\$2,400,000
2017	(\$2,400,000)	\$2,400,000
2018	(\$2,400,000)	\$2,400,000
2019	(\$2,400,000)	\$2,400,000
2020	(\$2,400,000)	\$2,400,000

SOURCE: Legislative Budget Board.

Recommendation 2 requires a statutory change that would move an estimated \$2.6 million in WURA fee revenues collected from entities regulated by PUC and OPUC from the Water Resource Management Account No. 153 to the General Revenue Fund, shown in **Figure 6**. It is assumed that those revenues would be appropriated back to the PUC and OPUC.

Completing the study required by Recommendation 3 would have no significant fiscal impact and could be done within existing TCEQ resources. If TCEQ and/or the Legislature were to implement any of the six options identified to generate additional revenue for the Water Resource Management Account No. 153, there would be a gain in General Revenue–Dedicated Funds. The amount of the gain would vary depending on which option(s) was(were) implemented and would range from \$2.3 million to \$19.5 million annually.

The introduced 2016–17 General Appropriations Bill includes a rider in the General Provisions section implementing portions of all three of these recommendations.

FIGURE 6
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 2, FISCAL YEARS 2016 TO 2020

YEAR	PROBABLE SAVINGS/ (COST) IN GENERAL REVENUE FUNDS	PROBABLE REVENUE GAIN/(LOSS) IN GENERAL REVENUE FUNDS	PROBABLE SAVINGS/ (COST) IN GENERAL REVENUE–DEDICATED ACCOUNT 153	PROBABLE REVENUE GAIN/(LOSS) IN GENERAL REVENUE–DEDICATED ACCOUNT 153
2016	(\$2,600,000)	\$2,600,000	\$2,600,000	(\$2,600,000)
2017	(\$2,600,000)	\$2,600,000	\$2,600,000	(\$2,600,000)
2018	(\$2,600,000)	\$2,600,000	\$2,600,000	(\$2,600,000)
2019	(\$2,600,000)	\$2,600,000	\$2,600,000	(\$2,600,000)
2020	(\$2,600,000)	\$2,600,000	\$2,600,000	(\$2,600,000)

SOURCE: Legislative Budget Board.

OVERVIEW OF RESPONSIBILITIES AND STATE OVERSIGHT OF RIVER AUTHORITIES

In 1917, Texas voters adopted a constitutional amendment to allow for the establishment of conservation and reclamation districts. At the time, flooding was of greater concern than drought, and local governments were limited in their ability to issue bonds for large, long-term projects such as reservoir construction. Certain districts established through this authorization are now known as river authorities, and their primary purposes are to conserve the state's water resources and provide water-related services, such as wholesale or retail water. A river authority's boundaries typically span multiple counties, and they are governed by a board of directors generally appointed by the Governor. River authorities are considered governmental agencies and bodies politic and corporate.

According to the Texas Commission on Environmental Quality, there are 17 river authorities in Texas, all formed to address challenges unique to their river basin. As is the case for other water providers, state oversight for river authorities includes water rights permitting, water usage reports, and overseeing development of water conservation plans and drought contingency plans. River authorities also submit financial and management audits to the Texas Commission on Environmental Quality and are subject to ongoing general supervision by this agency. Additional state oversight varies depending on the activities the particular authority engages in and would apply to any other type of entity engaging in that activity.

FACTS AND FINDINGS

- ◆ The Texas Commission on Environmental Quality has statutory authority to supervise most activities of river authorities. From the agency's perspective, there are no gaps in state oversight of river authorities.
- ◆ The board of directors for a river authority is typically appointed by the Governor, with the advice and consent of the Senate. The number and qualifications of board members for river authorities, like other water districts, varies. River authority boards range from 5 to 25 members, with 11 members on average.
- ◆ Four of 17 river authorities are permitted the majority of water in their designated basins. Some river authorities are not directly permitted any surface water.

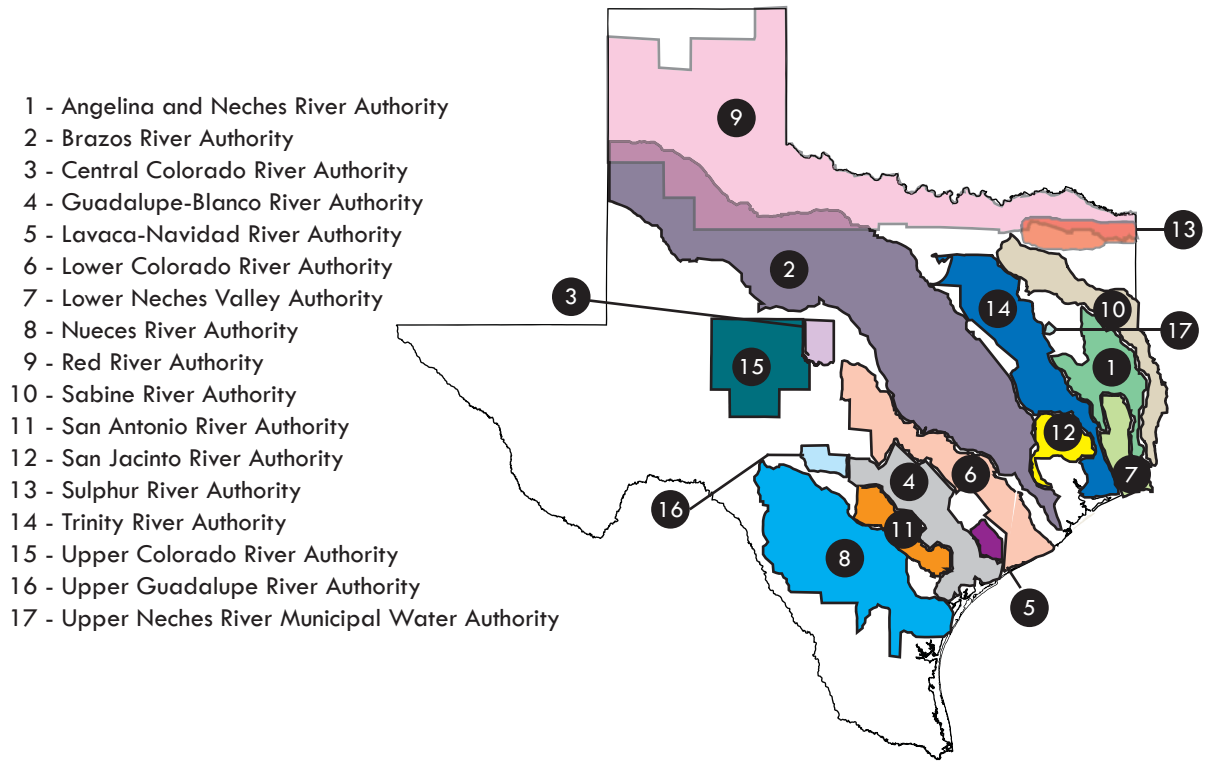
- ◆ The Texas Commission on Environmental Quality is the state's water oversight agency for surface water regulation, including the permitting and usage of water. The agency may also establish a watermaster program in areas of the state where concerns over proper water usage may arise.

DISCUSSION

In 1917, voters adopted a constitutional amendment which added language to the Texas Constitution stating that the conservation and development of all of the natural resources of this state are public rights and duties and that conservation and reclamation districts may be formed to accomplish this purpose. Flooding that occurred in 1913 and 1914 solidified the view that the state should have a role in preventing floods and conserving its natural resources. Leading up to the adoption of this amendment, state and local governments had limited authority to levy taxes to provide funding that would allow them to pursue large scale water improvement projects such as constructing and storing water in a reservoir. Limitations also existed on indebtedness that constitutionally authorized water districts could incur for these types of improvements. The passage of the 1917 constitutional amendment provided constitutional authority for these districts to levy taxes and incur debt for large scale water improvement projects. Certain districts, authorized to be established by the Texas Constitution, Article III, Section 59, as "governmental agencies and bodies politic and corporate," were subsequently renamed as river authorities in their enabling statutes. Additional specific authorizations for river authorities are codified in each authority's enabling statute.

The Texas Water Code, Chapter 30, defines a river authority as any district or authority created by the Legislature which contains an area within its boundaries of one or more counties and which is governed by a board of directors appointed or designated in whole or in part by the Governor, or by the Texas Water Development Board, including without limitation the San Antonio River Authority. According to the Texas Commission on Environmental Quality (TCEQ), 17 districts are classified as river authorities. **Figure 1** shows the location of river authorities in Texas. Most river authority boundaries, but not all, follow river basin boundaries.

FIGURE 1
LOCATION OF TEXAS RIVER AUTHORITIES, AS OF FISCAL YEAR 2014



SOURCE: Texas Water Development Board.

The first river authority formed was the Brazos River Authority in 1929, and the most recently established river authority is the Sulphur River Basin Authority in 1985. Additional general provisions related to river authorities are in the Texas Constitution, Article XVI, Section 59, and the Texas Water Code, Chapter 49. TCEQ rules provide that the agency interprets the term authority interchangeably with the term district to connote any entity created by the Texas Constitution, Article III, Section 52, or Article XVI, Section 59.

River authorities pay various state fees for activities in which they participate. In fiscal year 2013, TCEQ collected 18 separate fees from river authorities, which resulted in \$2.6 million in General Revenue Funds and General Revenue–Dedicated Funds combined. The greatest share of this revenue was from collections of the Air Emissions Fee, Watermaster Fees, Consolidated Water Quality Fee, and Water Use Assessment Fee. Fees that generated more than \$100,000 per fiscal year are shown in **Figure 2**. River authorities, as a special district or political subdivision of the state, are exempt from sales taxes, excise and use taxes, and

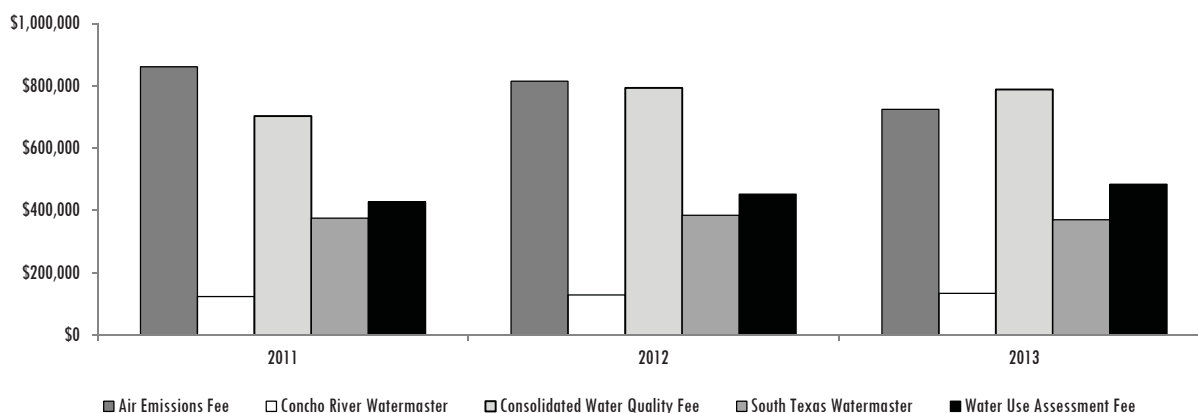
application of property taxes on the portion of the property in the Authority used for public purposes.

Each river authority is established individually through the passage of legislation that defines the authority’s boundaries, internal governing body, administration, powers, and duties in statute. In addition to these statutory provisions, river authorities are subject to state oversight and requirements applicable to specific programs for which they qualify or choose to participate. TCEQ has statutory authority to supervise most activities of river authorities. From the agency’s perspective, there are no gaps in state oversight of river authorities.

AUTHORIZED POWERS AND DUTIES

A river authority has specific powers and duties conferred on it by the Legislature to address challenges unique to its territory. These fall into two primary categories. River authorities have a duty to conserve the state’s water resources, which generally refers to storing waters in a reservoir. They also generally have a duty to provide water-related services, such as wholesale or retail water service, or provide raw water

FIGURE 2
FEE REVENUE IN EXCESS OF ONE HUNDRED THOUSAND DOLLARS ANNUALLY, COLLECTED FROM RIVER AUTHORITIES,
FISCAL YEARS 2011 TO 2013



SOURCE: Texas Commission on Environmental Quality.

or treated drinking water. Some river authorities also provide wastewater treatment, flood control, and/or electric power, and the Texas Constitution authorizes them to engage in firefighting activities. All of these services may be financed by internal funds or the issuance of bonds.

The Texas Constitution, Article III, Section 59, and the Texas Government Code, Chapter 49, allow river authorities and any other type of district authorized in those statutes to issue both tax-supported and revenue debt. For bond issuances not supported by authority revenue, statute requires certain documentation relating to proposed bond issuances be made available for public inspection and a public election approving the issuance of those bonds. The Texas Constitution, Article III, Section 59, and the Texas Government Code, Chapter 49, also authorize an ad valorem tax to be levied for ongoing operations and maintenance costs of a district or authority, subject to voter approval. However, only certain river authorities may levy taxes; the enabling statutes for the Central Colorado River Authority, Lower Colorado River Authority, and Lower Neches Valley Authority do not authorize this. The San Antonio River Authority is specifically provided taxation authority in its enabling legislation of up to two cents per \$100 of taxable property to be levied in its territory.

The Office of the Attorney General (OAG) reviews public security debt offerings for legality and provides the Comptroller of Public Accounts with an opinion and record of proceedings. This review applies to a variety of governmental entities, including river authorities, state agencies and political subdivisions of the state. Unlike state

agencies, Texas Bond Review Board (BRB) is not directly involved in reviewing river authority bond issuances unless a river authority were to apply through a Private Activity Bond (PAB) program that BRB administers as a conduit issuer. BRB does collect debt information from local entities, including river authorities that are included in its Local Government Annual Report. According to information from BRB, total debt outstanding for all river authorities combined at the end of fiscal year 2013 was \$7.7 billion (excluding conduit debt), 99 percent of which was issued as revenue debt and 1 percent as tax-supported general obligation debt. Over half of the outstanding issuances, or \$4.0 billion, are held by the Lower Colorado River Authority, with the Trinity River Authority and San Jacinto River Authority holding \$2.0 and \$1.0 billion in outstanding issuances, respectively.

Figure 3 shows the variety of activities river authorities are authorized to perform. River authorities do not have any significant regulatory authority provided by the state. Generally, river authorities must go through the same process as other entities wishing to engage in a given activity, such as applying for a water rights permit with TCEQ to gain access to and use of water supplies.

In addition to the powers and duties shown in **Figure 3**, river authorities may participate in the state water planning processes. The state’s 16 regional water planning groups prepare a water plan that provides for the development, management, and conservation of water to ensure sufficient supplies will be available during drought conditions. River authorities may participate in activities undertaken by the planning groups, and many act as fiscal agents to administer

**FIGURE 3
AUTHORIZED POWERS AND DUTIES OF RIVER AUTHORITIES, AS OF APRIL, 2014**

ENTITY (1)	DIRECTORS (2)	WATER SALES		WHOLE-SALE		RESERVOIRS & DAMS AUTHORIZATION		RIGHTS PERMITS		WASTE WATER AUTHORIZATION		DISCHARGE PERMITS		SOLID WASTE AUTHORIZATION		DRAINAGE/ FLOOD CONTROL AUTHORIZATION		WELL SPACING &/OR PUMPING REGULATION		PROVIDES IRRIGATION		NAVIGATION		GENERATE &/OR SELL ELECTRIC		INSTALL/ MAINTAIN PARKS		POLICE/ SECURITY							
		RETAIL	✓	✓	✓	✓	YES	NUMBER HELD	YES	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓						
Angelina & Neches	9	✓	✓	✓	✓	✓	1	✓	1	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓						
Brazos	21		✓	✓	✓	✓	15	✓	2	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓						
Guadalupe-Blanco	9	✓	✓	✓	✓	✓	15	✓	9	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓						
Lavaca-Navidad	9		✓	✓	✓	✓	1	✓	1	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓						
Lower Colorado	15	✓	✓	✓	✓	✓	19	✓	19	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓					
Lower Neches Valley	9	✓	✓	✓	✓	✓	2	✓	1	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓					
Nueces	21	✓	✓	✓	✓	✓	1	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓				
Red	9	✓	✓	✓	✓	✓	6	✓	2	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓				
Sabine	9	✓	✓	✓	✓	✓	4	✓	5	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓			
San Antonio	12	✓	✓	✓	✓	✓	8	✓	6	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		
San Jacinto	7	✓	✓	✓	✓	✓	9	✓	3	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		
Trinity	25	✓	✓	✓	✓	✓	4	✓	7	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		
Upper Neches River MWA	9	✓	✓	✓	✓	✓	1	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	
Central Colorado	5	✓	✓	✓	✓	✓	3	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Sulphur River Basin Authority	6	✓	✓	✓	✓	✓	0	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Upper Colorado	9	✓	✓	✓	✓	✓	2	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Upper Guadalupe	9	✓	✓	✓	✓	✓	1	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

NOTES:
 (1) The river authority designation for the purpose of this chart is based on the term river authority as defined in Texas Water Code, Chapter 30. TCEQ sources from individual river authority enabling legislation or from Texas Water Code, Chapter 49. The numbers of waste discharge permits shown are held in the authority's name.
 (2) All Directors are appointed by the Governor, except for the San Antonio River Authority whose directors are publicly elected.
 SOURCE: Texas Commission on Environmental Quality.

state planning grants for the group. Each regional water planning group designates a political subdivision of the state to apply for grant funds on behalf of the group. Seven river authorities serve in this capacity and are responsible for the procurement and contracting necessary for regional water planning: Red River Authority (Region A); Brazos River Authority (Region G); San Jacinto River Authority (Region H); Lower Colorado River Authority (Region K); San Antonio River Authority (Region L); Nueces River Authority (Region N); and Lavaca-Navidad River Authority (Region P).

Legislation passed by the Eightieth Legislature, Regular Session, 2007, requires TCEQ to adopt environmental flow standards for river basins and bay systems, develop information on environmental needs and ways those needs can be met by a voluntary consensus-building process. River authorities may voluntarily participate as members of ongoing environmental flow committees, which are local stakeholder advisory committees charged with determining and recommending flow regimes adequate to support a sound ecological environment for Texas rivers, bays, and estuaries. Instream flow recommendations will be considered when TCEQ issues future water rights, including amendments.

STATE REQUIREMENTS UNIQUE TO RIVER AUTHORITIES

Statute establishes some requirements unique to each river authority, such as the structure of its board. Other requirements, such as those to establish certain administrative policies or undergo audits, apply to all river authorities, but not necessarily to other districts or entities that may perform similar functions as river authorities.

BOARD STRUCTURE OF RIVER AUTHORITIES

The board of directors of a river authority is typically appointed by the Governor, with the advice and consent of the Senate. This is consistent with how boards are appointed for state agencies. River authority board sizes range from 5 to 25 members, with 11 members on average; 9 of the 17 authorities have 9 members. The only river authority with elected board members is the San Antonio River Authority, which has 12 members.

Statute requires various qualifications of board members for each river authority. Some river authorities, such as the Angelina and Neches River Authority, have requirements that each director must be a freehold property taxpayer and a voter of the state. The Lower Colorado River Authority is

required to have at least one director from certain counties within their statutorily-defined territory, except Travis County, which is required to have two directors. Three directors are required to be appointed at large from the counties served with electric power, other than the counties included in statute. The Red River Authority is required to have directors who are freehold property taxpayers and voters of the state and each director must be a resident of the region they are appointed to represent.

ADMINISTRATIVE AND AUDIT REQUIREMENTS

The Texas Water Code, Chapter 12, provides that TCEQ has a “continuing right of supervision” of districts and river authorities established under the Texas Constitution, Article III, Section 52 and Article XVI, Section 59. This supervision includes, but is not limited to, inquiring into the competence of officers and directors, requiring audits or other financial or programmatic information be obtained, instituting investigations, and issuing rules necessary to supervise these entities.

Statute requires TCEQ to establish certain administrative policies unique to river authorities. These requirements are set forth in the Texas Administrative Code, Section 292.13. River authorities are required to file administrative policies with TCEQ, which include a code of ethics, standards of conduct, personal financial disclosure, and conflict of interest policies.

River authorities are required to have an annual financial audit of their fiscal accounts and records and file a copy of the audit report with TCEQ not later than the 160th day after the date the authority’s fiscal year ends. The audit must be performed according to generally accepted auditing standards, and financial statements must be prepared in accordance with generally accepted accounting principles as adopted by the American Institute of Certified Public Accountants.

River authorities are also required to have an independent management audit every five years and submit these audits to TCEQ. In lieu of a management audit, river authorities may establish an internal audit office that reports to the board of directors. Based on current audit information provided to TCEQ, three river authorities have established an internal audit function—Brazos River Authority, Lower Colorado River Authority, and Sabine River Authority.

River authorities are public entities; therefore, meetings of the board of directors are open to the public as required by

the Texas Open Meetings Act. River authorities are also subject to the Texas Open Records Act, so records may be requested by a member of the public and made available in accordance with state law.

GENERAL STATE OVERSIGHT OF ENTITIES THAT SUPPLY WATER

In addition to the unique requirements for river authorities, authorities are required to comply with other requirements and subject to related oversight when they engage in certain activities. These requirements and oversight apply to river authorities and other entities that may also undertake these activities. TCEQ oversees a variety of natural resource functions that a river authority could become involved in, such as granting water rights, overseeing drinking water and wastewater treatment plants, and regulating solid waste disposal facilities operated by river authorities or other entities.

WATER RIGHTS PERMITTING

Most but not all river authorities hold water rights. Texas surface water is owned by the state and is held in trust for the public. A water right allows for the holder to impound, divert, or use state water. The seniority of one water right compared to another is determined by who received their water right first, also known as the prior appropriations doctrine. River authorities, like any other water rights holder, are subject to this doctrine. Water rights are granted by and supervised by TCEQ.

Entities, including river authorities, apply to TCEQ for water rights permits. TCEQ determines whether to grant the permit. In doing so, TCEQ examines whether there is water available in the watercourse and whether the water will be put to beneficial use or if it will negatively affect existing water rights or public welfare. Public protests may occur during this process, including in an administrative hearing held by the State Office of Administrative Hearings, which makes a recommendation to TCEQ as to whether the permit should be granted or not.

River authorities are responsible for complying with the terms and conditions of water rights permits granted to them by TCEQ and their enabling legislation. The specific use of permitted water must be reconciled against other uses of water that have a higher statutorily designated priority, which in descending order, is:

1. Domestic and municipal;
2. Agricultural and industrial;

3. Mining and recovery of minerals;
4. Hydroelectric power;
5. Navigation;
6. Recreation and pleasure; and
7. Other beneficial uses.

Figure 4 shows the volume of water permitted by the state to river authorities for diversion or consumptive use, and the percentage of that water relative to that particular river basin. Only 4 of 17 river authorities hold permits for the majority of water in their basin. Some river authorities do not hold permits for any surface water. The statewide percentage of surface water authorized to river authorities is approximately 29.6 percent.

STATE WATERMASTER PROGRAM

To ensure compliance with water rights provisions, TCEQ may directly monitor stream flows, reservoir levels, and water use by instituting a watermaster in that region of the state. Watermasters coordinate diversions and regulate reservoirs as needed to prevent the wasting of water or it being used in quantities beyond a user’s right. Water right holders in these areas of the state must notify the watermaster of the intent to divert at a specific time and the specific amount of water to be diverted prior to diversion. If the water is available and the water right holder will not exceed its annual authorized appropriation of water, the watermaster authorizes the diversion and records this against the right.

There are three active watermaster programs in Texas. The Rio Grande Watermaster coordinates releases from the Amistad and Falcon reservoir system for irrigation, municipal, and industrial uses. The South Texas Watermaster serves the Nueces, San Antonio, Guadalupe, and Lavaca river basins, as well as the adjacent coastal basins. The Concho Watermaster, currently a division of the South Texas Watermaster, serves the Concho River segment of the Colorado River Basin. In response to public petitions submitted to TCEQ in 2013, a watermaster will be established in the portion of the Brazos River Basin encompassing Possum Kingdom Lake and below in 2015. Six river authorities are partially located within the jurisdictions of the already established watermaster programs:

- Concho Watermaster—Upper Colorado River Authority
- South Texas Watermaster—Guadalupe-Blanco River Authority, Lavaca-Navidad River Authority, Nueces

FIGURE 4
SURFACEWATER AUTHORIZED TO RIVER AUTHORITIES FOR DIVERSION OR CONSUMPTIVE USE, APRIL 2014

RIVER AUTHORITY	AMOUNT AUTHORIZED IN ACRE-FEET (1)	RIVER AUTHORITY'S PERCENTAGE OF TOTAL AUTHORIZED WATER IN RIVER BASIN (2)
Angelina-Neches River Authority	85,507	4% Neches River Basin
Brazos River Authority	863,901	33% Brazos River Basin
Central Colorado River Authority	326	>1% Colorado River Basin
Guadalupe-Blanco River Authority (3)	289,923	37% Guadalupe River Basin
Lavaca-Navidad River Authority	134,622	79% Lavaca River Basin
Lower Colorado River Authority	3,094,144	74% Colorado River Basin
Lower Neches Valley Authority	1,173,876	54% the Neches River Basin
Nueces River Authority	N/A (4)	>1% the Nueces River Basin
Red River Authority	14,080	2% the Red River Basin
Sabine River Authority	1,323,860	74% the Sabine River Basin
San Antonio River Authority	1,820	1% the San Antonio River Basin
San Jacinto River Authority (5)	310,044	25% the San Jacinto River Basin
Sulphur River Authority	0	0% the Sulphur River Basin
Trinity River Authority	462,392	10% the Trinity River Basin
Upper Neches Municipal Water District	238,110	11% the Neches River Basin
Upper Colorado River Authority	80,650	2% the Colorado River Basin
Upper Guadalupe River Authority	2,000	>1% the Guadalupe River Basin

NOTES:

- (1) Does not include contracts or temporary authorizations.
- (2) TCEQ keeps records by river basins. Many river authorities have territories outside of the river basin.
- (3) The Guadalupe-Blanco River Authority has large amounts of hydroelectric power generation water rights that were not included in these totals as they are not considered diversion or consumptive water rights.
- (4) Nueces River Authority owns a 20 percent undivided interest in Certificate of Adjudication No. 21-3245. The City of Corpus Christi uses, diverts, and manages Nueces River Authority's portion of the Certificate.
- (5) The San Jacinto River Authority receives some of its water from other river basins through interbasin transfers.

SOURCE: Texas Commission on Environmental Quality.

River Authority, San Antonio River Authority, and Upper Guadalupe River Authority

WATER-RELATED REPORTING REQUIREMENTS

Entities with water rights, including river authorities, are required to report on water use and may be required to develop and implement drought contingency plans and water conservation plans if they meet certain thresholds. Statute requires all water right holders, including river authorities, to submit annual water use reports. Data submitted in water use reports is published on TCEQ's website. Based on water use reports submitted by river authorities in fiscal years 2010, 2011, and 2012, no river authorities have exceeded their permitted water rights allotments.

Under TCEQ rules, river authorities that are wholesale public water suppliers or retail water suppliers with over

3,300 connections must submit drought contingency plans (DCPs) to TCEQ every five years, the next of which is due May 1, 2019. DCPs are required by political subdivisions attempting to acquire rights to groundwater or surface water. TCEQ considers efforts made to develop and implement DCPs when examining the suspension or adjustment of water rights during drought.

Water conservation plans (WCPs) are also required to be submitted to TCEQ every five years. The next five year due date is May 1, 2019. River authorities or other entities that own the following types of water rights are required to develop and implement WCPs:

- Municipal, industrial/mining and other non-agricultural water rights for 1,000 acre-feet of water per year or more.
- Agricultural water rights for 10,000 acre-feet of water per year or more.

WCPs and annual water conservation progress reports are considered in the development of the regional water plans that are integrated into the State Water Plan. Applicants for state financing, such as for access to the Drinking Water State Revolving Fund, must submit copies of their most recent iteration of the WCP to the Texas Water Development Board (TWDB). WCPs must also be submitted as part of applications for new water rights and, in some cases, for amendments to currently existing water rights.

House Bill 3604, Eighty-third Legislature, Regular Session, 2013, amended statute to require entities residing in a county listed in the Governor's Emergency Disaster Proclamation for Drought to enact both their WCP and DCP. The bill also authorized TCEQ to enforce this requirement through administrative penalties or corrective measures. TCEQ oversight for both DCPs and WCPs consists of verifying that plans are administratively complete.

RESERVOIR PERMITTING AND OVERSIGHT

Reservoirs exist to capture and store flood waters so the water can be supplied for beneficial use in the future. Some river authorities are primarily vested in the management of water resources through operating a system of reservoirs throughout their basin. River authorities that wish to construct a reservoir must complete a review process that requires detailed studies for environmental impacts, stream flow impacts, legal issues, and other considerations.

The majority of permitting and oversight for major reservoirs is administered by the U.S. Environmental Protection Agency (EPA) and Army Corps of Engineers (USACE) under the Clean Water Act Section 404 permitting process. Responsibilities for EPA and USACE during this review process is to ensure that "no discharge of dredged or fill material shall be permitted if there is a practicable alternative to the proposed discharge which would have less adverse impact on the aquatic ecosystem".

USACE is also authorized to pursue the construction of their own federal, multi-purpose flood control and water supply projects. River authorities may enter into partnerships with USACE to acquire conservation storage space within those reservoirs. Additional roles of USACE may include providing flood control, maintaining a release schedule from USACE operated reservoirs, permitting intake structures and pipelines, and accounting for and gauging water in the streams of the basins in which they conduct operations.

Entities that plan for the construction of new large-scale reservoirs may also need to coordinate with additional stakeholders such as local and state authorities like TCEQ, TPWD, and TWDB during the planning, financing, and building of a reservoir. Water stored in reservoirs is permitted for use by TCEQ, which may also impose additional requirements on the usage of those waters during supply constraints, such as exceptional drought conditions or during priority calls.

WATER QUALITY MONITORING

River authorities are part of the state's structure for monitoring water quality. River authorities must form basin wide steering committees with representatives from appropriate state agencies to develop assessments and reports on the water quality in each watershed and river basin in the state. Each river authority must submit summary reports of the water quality assessment of the authority's watershed to TCEQ, TPWD, and the State Soil and Water Conservation Board. TCEQ must also set water quality standards based on all quality assured data obtained by the TCEQ, including information from the local watershed and river basin database. Water quality data is obtained from river authorities, wastewater discharge permit holders, state and federal agencies and other relevant sources.

STATE FINANCIAL ASSISTANCE FOR RIVER AUTHORITIES

As political subdivisions of the state, river authorities are eligible for all financial assistance programs administered by TWDB. These programs provide funds to help develop water supply, water and wastewater treatment, and flood control projects. **Figure 5** shows financial assistance awarded to river authorities for State Water Plan projects, as of the 2012 iteration of the plan. As shown, financial assistance is awarded to entities with projects listed in the State Water Plan to develop supplies to meet growing population demands over a 50 year timeframe. TWDB has a supervisory function over bond issuances for which a river authority seeks financing through the agency.

OVERSIGHT OF ELECTRIC GENERATION AND SALES

The majority of river authorities are authorized to generate or sell electricity. River authorities are one of four basic types of utilities, including investor-owned utilities (IOUs), publicly owned municipal utilities (MOUs), and cooperatives. River authorities that generate or transmit electrical power are supervised by the Public Utility Commission of Texas (PUC) and, when applicable, the Electric Reliability Council of

**FIGURE 5
STATE WATER PLAN PROJECT FUNDS AWARDED TO RIVER AUTHORITIES FROM TEXAS WATER DEVELOPMENT BOARD
FISCAL YEAR 2011**

ENTITY	WATER INFRASTRUCTURE FUND (IN MILLIONS)		STATE PARTICIPATION (IN MILLIONS)	POPULATION SERVED		SUPPLY GENERATED (ACRE-FEET)	
	DEFERRED	CONSTRUCTION		2010	2060	2010	2060
Brazos River Authority	-	\$22.0	-	151,729	524,852	26,505	70,246
San Jacinto River Authority	\$21.5	-	-	-	-	-	52,534
Angelina and Neches River Authority	-	-	\$48.5	98,078	142,311	-	75,700
Guadalupe-Blanco River Authority	\$4.4	-	-	96,521	287,647	-	25,000
Guadalupe-Blanco River Authority	\$2.5	-	-	-	-	-	49,777

SOURCE: Texas Water Development Board.

Texas (ERCOT). PUC maintains, oversees, and monitors the competitive energy market in Texas, enforcing rules and regulations as needed. PUC also handles customer complaints relating to utilities and retail electric providers, including on topics related to rates charged for transmission and distribution of electricity. River authorities generating or selling electricity in areas where PUC jurisdiction does not apply are regulated by any applicable local board or city council. ERCOT operates the electric grid and manages the deregulated electric market for Texas, which consists of approximately 75 percent of Texas' land area and 85 percent of the state's electric load.

The Lower Colorado River Authority (LCRA) has more installed electric capacity than any other river authority and is a wholesale provider of electricity to retail utilities, MOUs, and electric cooperatives. LCRA coordinates its generation and transmission operations with ERCOT. PUC approves transmission line routes, which has also included directing LCRA to construct additional transmission lines to help move electricity from one area of the state to another, as part of the legislatively directed Competitive Renewable Energy Zone (CREZ) project.

EXTERNAL AUDIT AND REVIEWS

The Legislature has, over time, deliberated the role and function of river authorities, periodically assigning interim charges or state agencies with the task of reviewing river authorities. House Bill 2362, Eighty-third Legislature, Regular Session, 2013, expanded the authority of the Legislative Budget Board (LBB) to conduct efficiency reviews of river authorities. The LBB released a performance review on the Brazos River Authority (BRA) in December 2014. The LBB's review of BRA examined governance, planning, stakeholder engagement, and various components of BRA's

overall approach to water resource management including water supply strategies and BRA's adherence to water conservation best management practices. The overall conclusion of the report was that although BRA could improve certain aspects of its governance, stakeholder engagement, and water conservation actions, BRA had successfully met all of its contractual water supply obligations during recent drought conditions, as well as provided over 200 stakeholder and customer education and outreach meetings throughout the basin since 2010.

The Texas State Auditor's Office (SAO), the independent auditor for Texas state government, regularly performs audits and investigations related to finance, compliance, and effectiveness of various state entities. As stated in the Texas Water Code, Chapter 49, SAO is authorized to audit the financial transactions of any district. Additionally, SAO may assist TCEQ in the establishment of standards and procedures for review of district audits by TCEQ, subject to approval by the Legislative Audit Committee. The most recent audit SAO conducted of a river authority was of BRA and published in August 2014. The objective of the audit was to determine whether selected BRA financial management processes and related controls help ensure compliance with state requirements and BRA policies and procedures and prevent or detect fraud, waste, and abuse. SAO found that BRA had processes and controls for financial management, determining employee compensation, and funding and managing capital projects to ensure it complies with state requirements and its own internal policies and procedures.

The Sunset Advisory Commission (SAC) previously had authorization to examine river authorities; but this authorization was repealed by the Seventy-first Legislature. However, since then the Legislature has directed SAC to review specific river authorities. The enactment of House Bill

1675, Eighty-third Legislature, Regular Session, 2013, added the Sulphur River Basin Authority to the list of entities subject to the Sunset Act. As a result, SAC must assess the Sulphur River Basin Authority's governance, management, and operating structure and the authority's compliance with legislative requirements. The review will be conducted during the 2016–17 biennium in preparation for the Eighty-fifth Legislature. The last review by SAC of a river authority was of the Guadalupe-Blanco River Authority (GBRA) in 1994, for the Seventy-fourth Legislature. SAC found that GBRA had taken steps to address certain management and planning concerns previously identified by the Texas Legislature, that no other river authorities were subject to the Sunset Act during the review, and recommended that the terms of the GBRA board of directors be continued and that the provision related to Sunset review of GBRA be repealed.

OVERVIEW OF FUNDING AND MAINTENANCE NEEDS FOR THE TEXAS STATE PARK SYSTEM

State law authorizes the Texas Parks and Wildlife Department to plan, acquire, improve, operate, and maintain a system of public lands. The state park system represents a large portion of the agency's land holdings, including 95 parks, natural areas, and historic sites covering about 630,400 acres. The State Parks Division, the agency's largest, allocated funding for 1,317 full-time-equivalent positions to manage the state park system in fiscal year 2014.

The Texas state park system does not generate enough revenue to fully support its operations. As a result, a mix of sources fund state park operations, maintenance, and support functions. The Sporting Goods Sales Tax (General Revenue Funds) and revenue from state park fees are the system's two major funding sources. Statute caps the allocation of Sporting Goods Sales Tax collections deposited to the State Parks Account at 74 percent of the agency's overall allocation. This allocation may be higher than actual funding levels, because statute also makes state parks funding subject to legislative appropriations. Both Sporting Goods Sales Tax appropriations and revenue from state park fees are deposited in the State Parks General Revenue–Dedicated account and have been used in varying degrees to fund the state park system.

FACTS AND FINDINGS

- ◆ Expenditures of All Funds for state park operations fluctuated from \$78.2 million to \$65.3 million to \$84.5 million in fiscal years 2010, 2012, and 2014, respectively. General Revenue Funds provided \$57.9 million, or 68.6 percent, of total funding for state park system operations in fiscal year 2014. Funding from the Sporting Goods Sales Tax accounted for 69.5 percent of that amount.
- ◆ The two largest sources of revenue for state parks, the Sporting Goods Sales Tax statutory allocation and revenue from state park fees have varied in different ways over time.
- ◆ The Sporting Goods Sales Tax statutory allocation for state parks increased 7.8 percent from \$84.3 million in fiscal year 2010 to \$90.8 million in fiscal year 2014. The allocation can be used for operations, debt service, state park administration, and employee benefits. Sporting Goods Sales Tax appropriations as

a percentage of statutory allocations fluctuated from 70.9 percent to 45.3 percent to 68.3 percent in fiscal years 2010, 2012, and 2014, respectively.

- ◆ State Park Fee revenue decreased by 3.5 percent in fiscal year 2011, but increased overall by 17.5 percent from fiscal years 2010 to 2014.
- ◆ To maximize park revenue while also promoting park visitation, the agency conducts an annual fee modification process. During the process, state park staff analyzes their competition, visitor satisfaction, peak visitation trends, and cost recovery for high cost amenities.
- ◆ The agency is requesting an additional \$51.0 million for state park related capital projects in the 2016–17 biennium. Of this amount, 56.4 percent is proposed to fund state park repairs that address health and safety and deferred maintenance concerns.

DISCUSSION

Texas' state park system offers outdoor recreation and educational opportunities, and conserves important natural and historic resources. The Texas Parks and Wildlife Department (TPWD) operates 95 state parks, historic sites, and natural areas across the state. To manage the park system, TPWD allocates funding for 1,160 full-time-equivalent (FTE) positions for park operations, and 158 FTE positions for regional and statewide support and administration. State park visitors pay entrance and usage fees for campsites and other facilities. The Texas state park system, however, does not generate enough revenue to fully support its operations. As a result, the Texas Legislature appropriates additional funds to operate and maintain state parks.

Funding for the state park system comes from four sources. The largest source, appropriations of General Revenue Funds, includes the Sporting Goods Sales Tax, Unclaimed Refunds of Motorboat Fuel Taxes, and regular General Revenue. State law allocates 75 percent of Unclaimed Refunds of Motorboat Fuel Tax revenue to TPWD. The General Revenue–Dedicated State Park Account No. 64 (State Park Account) represents the second largest category, which includes state park visitor fee and other park-related revenue. Federal Funds and Appropriated Receipts (Other

Funds), such as specialty license plate sales, are the other two categories. Total funding for state park operations from these sources fluctuated from \$78.2 million to \$65.3 million to \$84.5 million in fiscal years 2010, 2012, and 2014. This fluctuation reflects a significant decrease in funding for the 2012–13 biennium that was reversed for the 2014–15 biennium.

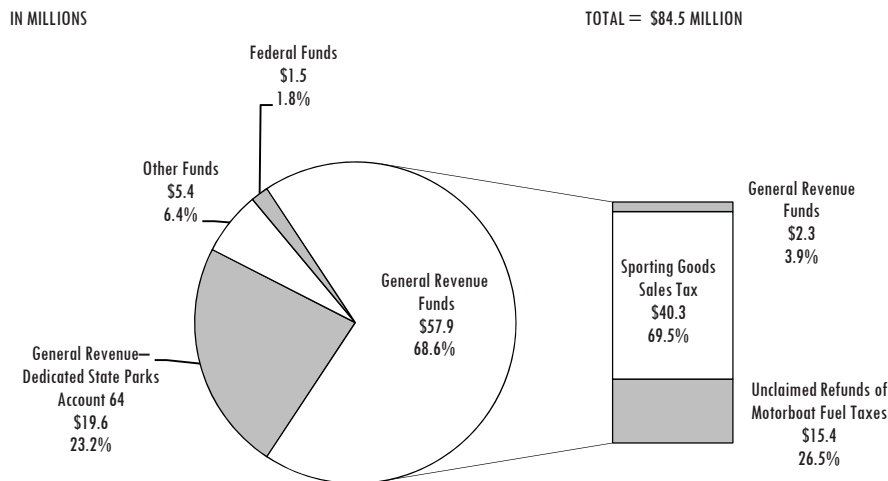
As shown in **Figure 1**, General Revenue Funds represented \$57.9 million, 68.6 percent, of the total \$84.5 million state parks funding in fiscal year 2014. Within the General Revenue Funds category, the Sporting Goods Sales Tax (SGST) accounted for 69.5 percent, followed by Unclaimed Refunds of Motorboat Fuel Taxes at 26.5 percent, and regular General Revenue Funds at 3.9 percent. The State Park Account represented \$19.6 million, or 23.2 percent of total expenditures. Other Funds and Federal Funds made up the remaining 8.2 percent.

SGST is revenue from the sales tax on sporting goods based on the definition of sporting goods in the Texas Tax Code, Section 151. The Comptroller of Public Accounts (CPA) estimates the amount of sales tax revenue collected from the sale of these items. Based on legislation passed by the Eightieth Legislature in 2007, statute designates a maximum allocation of SGST available for state parks funding. Pursuant to the Texas Tax Code, Section 151.801, TPWD and the Texas Historical Commission are allocated 94 percent, and 6 percent, respectively, of the CPA’s biennial revenue estimate

for SGST collections. From TPWD’s allocation, 74 percent is allocated to the State Parks Account, as directed by the Texas Parks and Wildlife Code, Section 11.035. The allocation was \$90.8 million for fiscal year 2014, and \$94.0 million for fiscal year 2015. Finally, 15 percent is allocated to an account for local park grants to jurisdictions with populations under 500,000, 10 percent to an account for local park grants to jurisdictions under that threshold, and 1 percent to an account for TPWD conservation and capital projects.

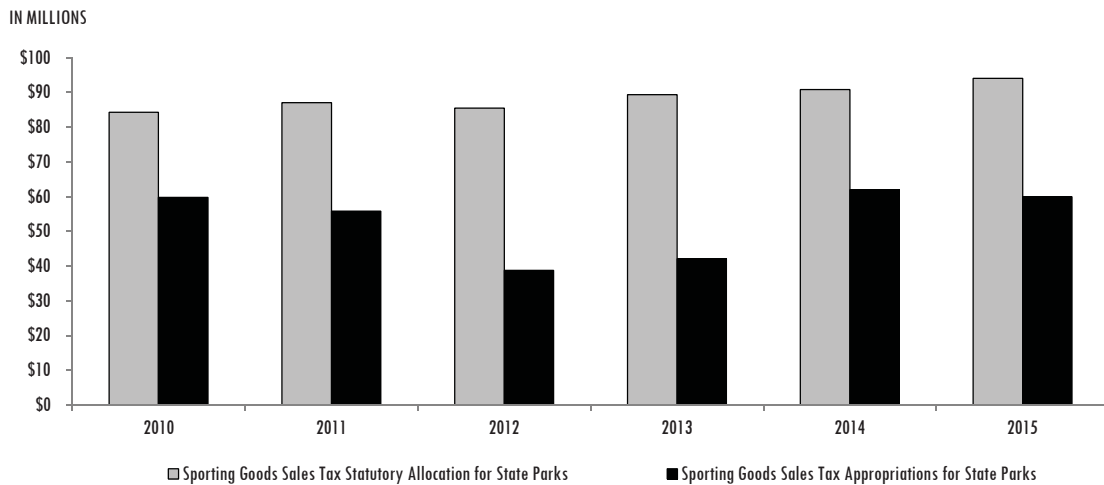
Statutory allocations are upper limits that may differ from SGST appropriations. This difference is possible because statute provides that SGST funding is subject to legislative appropriations. **Figure 2** shows statutory allocations compared to appropriations for fiscal years 2010 to 2015. In addition to state park operations, SGST is appropriated for park-related debt service on General Obligation (GO) bonds, state park administration, and employee benefit costs. Also, a portion of the state parks allocation is transferred to the General Land Office for coastal erosion projects. In fiscal year 2010, \$59.8 million was appropriated for state park-related functions, about \$24.5 million less than the statutory allocation of \$84.3 million. In fiscal year 2012, the state park’s allocation increased to \$85.5 million but the system’s appropriation decreased to \$38.7 million. For that year, the actual appropriation was \$46.8 million less than the statutory allocation. This decrease mirrored appropriation reductions throughout the state budget for the 2012–13 biennium.

FIGURE 1
METHOD OF FINANCING FOR STATE PARK OPERATIONS, FISCAL YEAR 2014



NOTE: Percentages for Sporting Goods Sales Tax, General Revenue Funds, and Unclaimed Refunds of Motorboat Fuels Tax are a subset of the larger General Revenue Funds percentage of 68.6 percent.
SOURCE: Legislative Budget Board.

**FIGURE 2
COMPARISON OF STATUTORY ALLOCATION AND APPROPRIATIONS OF SPORTING GOODS SALES TAX
FISCAL YEARS 2010 TO 2015**



SOURCE: Legislative Budget Board.

The Legislature increased appropriations from the SGST by 50.8 percent for the 2014–15 biennium to address concerns that 20 parks sites would be closed, and necessary park maintenance would not occur, without additional funding. As a result, \$62.0 million in SGST was appropriated for fiscal year 2014, or \$28.8 million less than the statutory allocation of \$90.8 million. The fiscal year 2014 appropriation includes \$3.6 million in employee benefit costs that were appropriated from SGST beginning that year. The appropriation as a percentage of the allocation fluctuated from 70.9 percent to 45.3 percent to 68.3 percent in fiscal years 2010, 2012, and 2014, respectively.

COMPARING REVENUE SOURCES

The two largest sources of revenue for state parks, the SGST state parks allocation and revenue from state park fees have fluctuated in different ways over time. As shown in **Figure 2**, from fiscal year 2010 to fiscal year 2014, the SGST allocation increased from \$84.3 million to \$90.8 million, with an average annual change of 1.9 percent. During that period, annual changes in the SGST allocation ranged from a 1.9 percent decrease in fiscal year 2012 to a 4.5 percent increase in fiscal year 2013.

Revenue from state park fees fluctuated significantly during the same period. Serious drought and heat conditions affected state park visitation in fiscal years 2010 and 2011. As shown in **Figure 3**, fee revenue, which totaled \$38.7 million in fiscal year 2010, declined by 3.5 percent in fiscal year

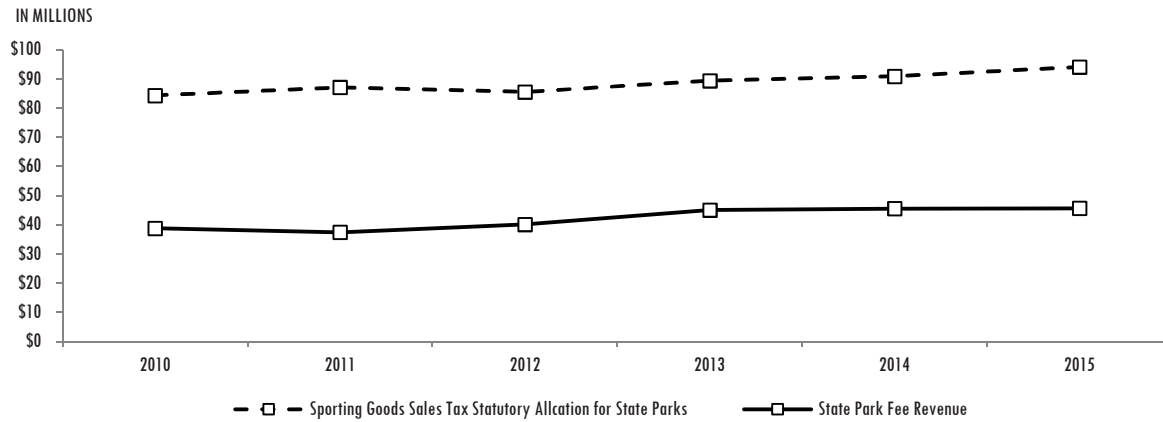
2011. That same year, park visitation decreased by more than 5,000 in 16 parks. To address this problem, the agency undertook a public relations campaign and raised park fees. As a result, fee revenue rose by 7.2 percent in fiscal year 2012, then by 12.3 percent to \$45.0 million in fiscal year 2013. The next fiscal year, fee revenue increased slightly, to \$45.5 million. No significant change in fee revenue is projected for fiscal year 2015. Overall, state park fees generated \$6.8 million, or 17.5 percent, more in fiscal year 2014 than fiscal year 2010.

Both sources of revenue have increased since fiscal year 2013. With a small annual fluctuation and general upward trend, the SGST allocation represents a stable funding source that the Legislature can use at its discretion. The statutory allocation for state parks increased from \$71.7 million to \$79.7 million, or 11.1 percent, from fiscal years 2010 to 2014. Fee revenue has climbed in recent years, but the continued drought may adversely impact future visitation and revenue, especially in those parks providing lake access such as Lake Colorado City State Park.

STATE PARK FEE MODIFICATION PROCESS

The TPWD conducts an annual park fee modification process from August through December. As the first step, staff at each park conduct a detailed analysis and submit proposed park fees to regional directors for review. Regional directors review and recommend fees for parks in their area, and forward their proposals to leadership staff in Austin. The

FIGURE 3
COMPARISON OF SPORTING GOODS SALES TAX AND STATE PARK FEE REVENUE, FISCAL YEARS 2010 TO 2015



SOURCE: Legislative Budget Board.

Director of the State Parks Division studies the statewide list and recommends fees to the agency’s Executive Director for final decision-making. Each park’s fee structure usually goes into effect in January. Park superintendents, however, are granted the flexibility to alter fees in response to visitor reactions and park conditions.

Park staff use a marketplace analysis to develop their fee proposals. This process has several components, including an internal assessment of park strengths and weaknesses, a comparability study, a review of park visitor satisfaction and usage, and cost recovery considerations. The comparability study focuses on the fees, facilities, and amenities of nearby competitors. These could be private facilities, such as Kampgrounds of America, and locally owned parks. Park staff compare the fees and features their competitors offer to those of their own park. Fee adjustments may result from this analysis if fees are considerably higher or lower than nearby competitors.

Visitor satisfaction information is collected through surveys, comment cards, and daily contact with visitors. Factors such as facility conditions, historic or natural attractions, fee affordability, and security can affect visitor perceptions. One park was able to raise its fees significantly following park renovations and facility additions that improved visitor satisfaction. The new features caused visitation to increase by one third in one year. Due to higher visitation and fee increases, park revenue rose by 82.5 percent. Visitor reactions to poor facility conditions, however, may lead park staff to recommend continuing current fee levels. For all parks, visitor reaction to possible fee increases is taken into

consideration by park staff. Park usage over the year is reviewed to identify seasonal peaks in visitation. Certain months have higher visitation than others depending on visitor preferences. Parks with high visitation seasons will recommend or maintain peak season rates, such as with Enchanted Rock State Park. Also, parks may recommend lower fees in some months to attract off-season visitors. The need to reduce overcrowding of a park can also lead to higher fees in certain seasons.

According to the agency, cost recovery is a primary goal for the state park system. This goal may influence fee decisions for specific sites. For example, campsites with high electric power usage, such as recreation vehicle sites with 50 ampere connections, have cost-recovery based fees. Also, fees for group special events and social functions are determined in a way that recovers costs. Financial agreements with private concessions are structured to generate full cost recovery for the agency, while allowing a reasonable return on investment for businesses.

Park fee increases have occurred in more than 68 parks from fiscal years 2012 to 2014. The need to generate additional park revenue led to substantial fee increases in fiscal year 2013. As previously mentioned, higher visitation and the fee adjustment increased park revenue by \$4.9 million in fiscal year 2013. State parks with high visitation typically generate more revenue than they spend, while the opposite is usually true for parks with low visitation.

VISITATION AND COST RECOVERY IN STATE PARKS

Figure 4 shows the percentage of operating expenses covered by revenue for the five parks with the highest visitation, and lowest visitation, in fiscal years 2011 and 2013. Garner and Enchanted Rock State Parks brought in more than twice the revenue expended for operations in fiscal year 2013, and both saw higher visitation in fiscal year 2013 than fiscal year 2011. Brazos Bend State Park, in the Houston area, also experienced an increase in visitation and recovered 144.2 percent of operating costs compared to 123.2 percent in fiscal year 2011. Similar to other lake access parks, Cedar Hill State Park experienced a decrease in visitation, but recovered 115.4 percent of its operating costs.

Among those parks with the lowest visitation, Lake Colorado City State Park experienced significantly lower visitation in fiscal year 2013, a 51.3 percent decrease. This decrease was due to declining lake levels, which affects boating and fishing. The park covered a higher percentage of its costs because it reduced operating expenses by half. Big Bend Ranch State Park is the agency’s largest park in the area, but is still relatively undeveloped, with a guest lodge and only primitive campsites. The park employs few people, 17 FTE positions, and its revenue covered about the same percentage of operating costs, 25 percent, in both fiscal years 2011 and 2013. Sea Rim and Resaca de la Palma State Parks, both on or near the coast, recovered less than 20 percent of their costs in fiscal year 2013 despite increased visitation that year.

PARK REPAIRS

State parks require deliberate and constant maintenance to ensure a positive and safe user experience. TPWD classifies repairs to state parks into one of three categories:

- **Cyclical maintenance** refers to the maintenance of facilities and grounds necessary to ensure park assets function properly. Maintenance prevents facilities from deteriorating and extends the useful life of park assets.
- **Minor repair** projects include repairs to facilities that protect their usefulness. These projects generally cost less than \$100,000 and address facility problems that need immediate repairs.
- **Capital projects** include repairs, restoration, and conversion projects that cost more than \$100,000. These projects include the construction of new buildings and facilities, repairs or rehabilitation of buildings and facilities, and construction of certain roads. The agency allocated \$10.5 million in General Obligation bond proceeds for state park capital projects in the 2014–15 biennium.

Repairs that are most costly and extensive are categorized as capital projects. These are projects that are identified under the capital budget section of the agency’s Legislative Appropriations Request (LAR) for each biennium.

**FIGURE 4
COST RECOVERY IN STATE PARKS WITH HIGHEST AND LOWEST VISITATION, FISCAL YEARS 2011 AND 2013**

PARK	2011 VISITS	2011 COST RECOVERY	2013 VISITS	2013 COST RECOVERY
Five Highest Visitation Parks				
Garner	256,436	175.2%	276,124	209.3%
Cedar Hill	225,137	104.2%	216,860	115.4%
Palo Duro Canyon	178,255	186.1%	204,505	178.2%
Enchanted Rock	155,345	250.8%	185,940	272.7%
Brazos Bend Ranch	156,875	123.2%	167,571	144.2%
Five Lowest Visitation Parks				
Sea Rim	5,889	16.8%	9,786	17.7%
Copper Breaks	6,943	17.3%	7,767	21.6%
Resaca de la Palma	4,997	10.3%	6,173	14.5%
Lake Colorado City	10,942	28.6%	5,331	35.6%
Big Bend Ranch	4,146	26.8%	4,106	25.3%

NOTES:

- (1) All visits are paid visits, and exclude those for which fee payments are waived.
- (2) Five lowest visitation parks are those with campsites and that generated revenue in fiscal year 2013.

SOURCE: Legislative Budget Board.

To determine when capital repair projects will be initiated, TPWD uses a prioritization process including both a quantitative analysis and qualitative assessment of projects. The agency uses an analytical model to evaluate proposed capital projects across financial and business variables, while accounting for measures of public need, health and safety, regulatory requirements for facilities, and mission-oriented priorities. Based on that analysis, the agency calculates a cost-benefit ratio for each project.

Selected staff of each TPWD division then rank projects by their relative priority. Division staff assign projects a value based on this assessment. The cost-benefit ratio and the assigned values, taken together, produce a priority score for each project. Next, TPWD executive leadership review the resulting scores and rank each project by its relative priority to the agency. A prioritized list of capital projects for the entire agency is developed for executive leadership based on this assessment and the cost-benefit ratios.

Once TPWD executive leadership determines the biennial capital project funding levels it will propose in the TWPD LAR, the total funding amount is used to determine which projects are included in the LAR. This allows executive leadership to identify the highest priority projects than can be funded within the total funding request. A similar process is used after each legislative session to identify the highest priority projects that can be funded with the amounts appropriated in the General Appropriations Act. It should be noted that costly emergency repairs may be funded with the capital projects budget. In these cases, projects that would have been allocated capital funding will be deferred until the next biennium. Emergency repair needs may be caused by adverse factors, such as the wildfire that significantly damaged Bastrop State Park.

Figure 5 shows the amounts requested by TPWD for state park capital projects in the 2016–17 biennium. These requests are in addition to the capital projects whose total funding is within the agency’s 2014–15 biennial funding level. Eight new construction projects costing \$22.1 million are proposed in the agency’s LAR. These projects include \$6.5 million for restoration of facilities at Galveston Island State Park, and \$11.5 million to replace restrooms in several parks. Seventeen health and safety related projects are proposed totaling \$17.5 million, of which \$9 million is for repairing or replacing water and wastewater systems. Finally, 10 deferred maintenance projects, totaling \$11.4 million, are recommended in the agency’s LAR. Deferred maintenance includes \$2.2 million for marina and fishing pier repairs at

FIGURE 5
TEXAS PARKS AND WILDLIFE DEPARTMENT LEGISLATIVE APPROPRIATIONS REQUEST, STATE PARK CAPITAL PROJECTS, 2016–17 BIENNIUM (IN MILLIONS)

CATEGORY	STATE PARKS CAPITAL PROJECTS FUNDING REQUEST	CATEGORY AS A PERCENTAGE OF TOTAL	TOTAL PROJECTS
New Construction	\$22.1	43.3%	8
Health and Safety	\$17.5	34.4%	17
Deferred Maintenance	\$11.4	22.3%	10
Total	\$51.0	100.0%	35

NOTE: Battleship Texas capital project is not included.
 SOURCE: Legislative Budget Board.

Lake Livingston State Park. The *Battleship Texas* restoration project, for which TPWD is requesting \$25 million, differs in scope and cost from other capital projects and is not included in the \$51 million total.

All of the proposed projects would be funded either by General Revenue Funds or the SGST. Another option that was used in the past is to finance capital repair projects with bond proceeds. To exercise this option, a constitutional amendment is required to grant TPWD new bonding authority. Minor repair projects are usually funded through the State Parks Account, which relies on revenue from state park fees as its main source of funding.

Some parks generate significantly more revenue than they spend, and contribute positively to the State Parks Account. This is not the case system-wide, however, which explains the historical practice of subsidizing the park system with General Revenue Funds. Legislative appropriations for fiscal year 2014 used less than 58.1 percent of the total SGST allocated under statute for state parks. SGST allocations represent a steady source of potential funding both for operations and capital repairs for state parks. Revenue from state park fees increased 17.5 percent from fiscal years 2010 to 2014, but this source of revenue is subject to fluctuations because park visitation is affected by variables such as drought. The agency has taken steps to boost revenue through fee increases and a marketing campaign. These efforts may allow the agency to generate more revenue and offset the effects of adverse weather on park visits.

ENSURE SOLVENCY AND ACCOUNTABILITY OF THE TEACHER RETIREMENT SYSTEM RETIREE INSURANCE FUND

The Teacher Retirement System has provided health insurance, known as TRS-Care, for retired public education employees since fiscal year 1987. The agency administers a self-insured preferred provider plan and two fully insured managed care plans. The plans offer a range of options from low premium, high deductible to higher premium, lower deductible coverage. Most of the contribution sources generating revenue for the TRS-Care fund are tied to public education payroll. Because public education payroll has grown at a slower rate than TRS-Care healthcare claims, annual revenue has been less than expenditures since fiscal year 2012, resulting in a projected negative balance for fiscal year 2016. For the 2016–17 biennium, the TRS-Care fund is projected to need an additional \$727.2 million to stay solvent.

A similar problem faced the Legislature during the 2003 legislative session. The funding shortfall was addressed by a combination of state and active member contribution rate increases, the establishment of a new school district contribution source, and additional revenue from retiree premiums. By implementing a similar cost sharing approach, Texas could ensure solvency of the TRS-Care fund for at least the next biennium. The cost to maintain TRS-Care fund solvency should be allocated as follows: 50 percent to an increase in the state contribution, 25 percent to an increase in retiree costs, and 12.5 percent to both active member and school district contributions. Also, the Legislature and the public would benefit from more transparency and accountability regarding TRS-Care cost containment features. This could be accomplished through an annual report that describes TRS-Care cost containment features and associated savings.

FACTS AND FINDINGS

- ◆ Beginning in fiscal year 2012, total expenditures exceeded total revenue for TRS-Care, resulting in a declining fund balance. The fund is projected to be insolvent in fiscal year 2016.
- ◆ Total expenditures have outpaced total revenue growth primarily because healthcare expenditures have increased at a faster rate than the combined contributions from the state, active participants, and school districts—which are tied to the historically

slower growing public education payroll. From fiscal years 2012 to 2017, total revenue is projected to increase by an average annual rate of 1.8 percent, primarily due to payroll growth. Total expenditures, which are affected by healthcare cost trends and retiree enrollment growth, are projected to increase by an average annual rate of 9.0 percent.

- ◆ In 2003, the Legislature addressed a similar insolvency problem by spreading the overall solvency cost to the state, active members, school districts, and retirees. Combined, these sources contributed an additional \$1.1 billion for the 2004–05 biennium. This contribution included \$546.6 million in additional state funding.
- ◆ A rider in the General Appropriations Act for the 2012–13 biennium and 2014–15 biennium has indicated legislative intent that TRS not increase retiree premiums during that four year period.

CONCERNS

- ◆ The Teacher Retirement System's Legislative Appropriations Request for the 2016–17 biennium includes an exceptional item request for \$874.8 million to maintain the solvency of the TRS-Care fund. The agency has subsequently reduced the insolvency estimate to \$727.2 million. Combined with the projected current state contribution of \$611.1 million, state funding for TRS-Care would more than double if this request were approved.
- ◆ Providing a one-time appropriation to address the projected negative fund balance, without permanent contribution rate and retiree premium increases, will not address funding deficiencies that will result in greater shortfalls in the future.
- ◆ The Teacher Retirement System does not inform the public in one central document about TRS-Care cost containment features and the savings associated with them. This information is necessary because the state entrusts the agency with substantial appropriations for retiree health insurance and has enabled the agency to take any actions required to efficiently manage the program. By not providing

an annual report about cost containment efforts, the Teacher Retirement System foregoes an opportunity to maintain accountability and transparency in administering TRS-Care.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute so the projected cost to maintain TRS-Care fund solvency is allocated as follows: 50 percent to an increase in the state contribution, and 12.5 percent each to increases in the active member and school district contributions for the 2016–17 biennium.
- ◆ **Recommendation 2:** Include a contingency rider in the 2016–17 General Appropriations Bill appropriating additional General Revenue, reflecting an increase in the state contribution rate that provides 50 percent of the TRS-Care projected solvency cost, and deleting a specific school district contribution rate in the General Appropriations Bill.
- ◆ **Recommendation 3:** Delete the rider expressing legislative intent that the Teacher Retirement System not increase retiree premiums from the 2016–17 General Appropriations Bill.
- ◆ **Recommendation 4:** Include a contingency rider in the 2016–17 General Appropriations Bill requiring the Teacher Retirement System to take appropriate actions, such as premium increases and plan design changes, to offset at least 25 percent of the projected cost to maintain the TRS-Care fund’s solvency for the 2016–17 biennium. Direct the Teacher Retirement System to submit a report to the Legislative Budget Board and Governor describing premium and/or plan design changes prior to implementation.
- ◆ **Recommendation 5:** Amend statute to require the Teacher Retirement System to produce an annual report identifying and describing each of its major cost containment features and indicating the savings they generate. The goal of the report will be to inform the public of TRS-Care cost containment and fraud prevention efforts that also support high quality health insurance for retirees and their dependents.

DISCUSSION

The Legislature authorized the Texas Public School Retired Employee Group Insurance Program in 1985 and designated the Teacher Retirement System (TRS) as the administering

agency. Referred to as TRS-Care, the program provides health insurance coverage for retired public education employees. TRS administers three self-funded Preferred Provider Organization (PPO) plans: a high deductible catastrophic option, and two lower deductible options that vary by benefit levels and premiums. TRS-Care also includes two Medicare managed care plans: Medicare Advantage and Medicare Part D prescription drug program. Premium levels are based on the retirees’ years of active service, Medicare enrollment status, and the plan option selected by the retiree.

Figure 1 shows the various TRS-Care plan options and their benefit levels. Statute requires that TRS offer a basic health plan option at no premium cost for retiree-only coverage (TRS-Care 1); however, it has the highest deductible. Insured members can also choose from two optional plans with lower out-of-pocket cost levels: TRS-Care 2 and 3. The no-cost TRS-Care plan for non-Medicare participants has the highest annual deductible at \$4,000, while the Medicare Advantage Care 3 plan has the lowest deductible at \$150. This low deductible is intended to incentivize insured members to enroll in this managed care plan.

**FIGURE 1
TRS-CARE BENEFIT LEVELS FOR INDIVIDUAL COVERAGE
AS OF SEPTEMBER 1, 2014**

PLAN	ANNUAL DEDUCTIBLE	MAXIMUM OUT-OF-POCKET
TRS-Care 1 - Retiree not eligible for Medicare Part A	\$4,000	\$6,350
TRS-Care 2	\$1,000	\$4,400
TRS-Care 3	\$300	\$3,700
Medicare Advantage Care 2	\$500	\$3,500
Medicare Advantage Care 3	\$150	\$3,150

SOURCE: Teacher Retirement System.

Figure 2 shows premium rates for retiree only coverage options in the TRS-Care plans. Retirees not eligible for Medicare who choose the high deductible plan (TRS-Care 1) receive coverage at no cost. Those choosing the lower deductible plans pay varying premiums based on the years of service they were employed. Retirees with less than 20 years of active service participating in Medicare Parts A and B pay \$80 per month for TRS-Care 2, and \$110 per month for TRS-Care 3. The lower cost of Medicare Advantage plans is reflected in premium rates—retirees pay, at most, \$95 per month for Medicare Advantage Care 3.

FIGURE 2
TRS-CARE MONTHLY PREMIUM RATES FOR INDIVIDUAL COVERAGE, AS OF SEPTEMBER 1, 2014

PLAN	TRS-CARE 1	TRS-CARE 2	TRS-CARE 3
Retiree not in Medicare			
Less than 20 Years of Service	\$0	\$210	\$310
Between 20 to 29 Years of Service	\$0	\$200	\$295
More than 30 Years of Service	\$0	\$190	\$280
Retiree in Medicare Parts A and B			
Less than 20 Years of Service	\$0	\$80	\$110
Between 20 to 29 Years of Service	\$0	\$70	\$100
More than 30 Years of Service	\$0	\$60	\$90
Retiree in Medicare Advantage Plan			
Less than 20 Years of Service	No TRS-Care 1 option	\$65	\$95
Between 20 to 29 Years of Service	No TRS-Care 1 option	\$55	\$85
More than 30 Years of Service	No TRS-Care 1 option	\$45	\$75

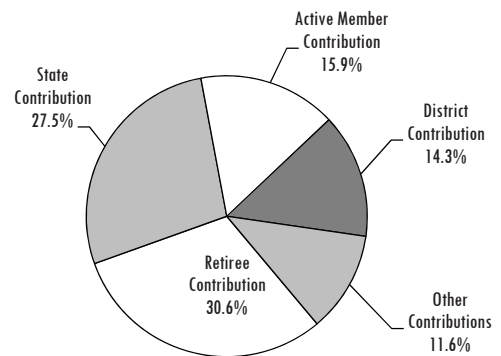
SOURCE: Teacher Retirement System.

TRS-Care is funded on a pay-as-you go basis for each biennium. Funding sources include three contributions that are based on a percentage of public education payroll: the state contributes 1.0 percent; active members contribute 0.65 percent; and school districts contribute 0.55 percent. Premiums paid by retirees also contribute to the fund. Revenue from investment income and federal reimbursements based on Medicare-covered prescription drugs provide the balance of program funding. **Figure 3** shows the proportional shares that each source contributes toward funding of the program. In fiscal year 2014, retiree contributions provided the largest share at 30.6 percent, followed by the state at 27.5, active members at 15.9 percent, school districts at 14.3 percent, and other sources at 11.6 percent. These proportions meet the statutory requirement that the state contributes no more than 55 percent and retirees contribute no less than 30 percent to the fund.

TRS-CARE FUND PROJECTED TO BE INSOLVENT

According to TRS, although total contributions will provide more than \$2.0 billion in the 2014–15 biennium, TRS-Care expenditures will exceed that amount by \$380.4 million. As **Figure 4** shows, total expenditures, which include medical and drug claims, first exceeded total contributions in fiscal year 2012. As this gap has widened, the fund’s ending balance has declined from \$741.0 million in fiscal year 2012 to an estimated \$170.6 million for fiscal year 2015. As of September, 2014, the TRS-Care fund is projected to be insolvent in fiscal year 2016, and have a shortfall of \$727.2 million by the end of fiscal year 2017. The TRS-Care fund is

FIGURE 3
TRS-CARE FUNDING SOURCES, FISCAL YEAR 2014

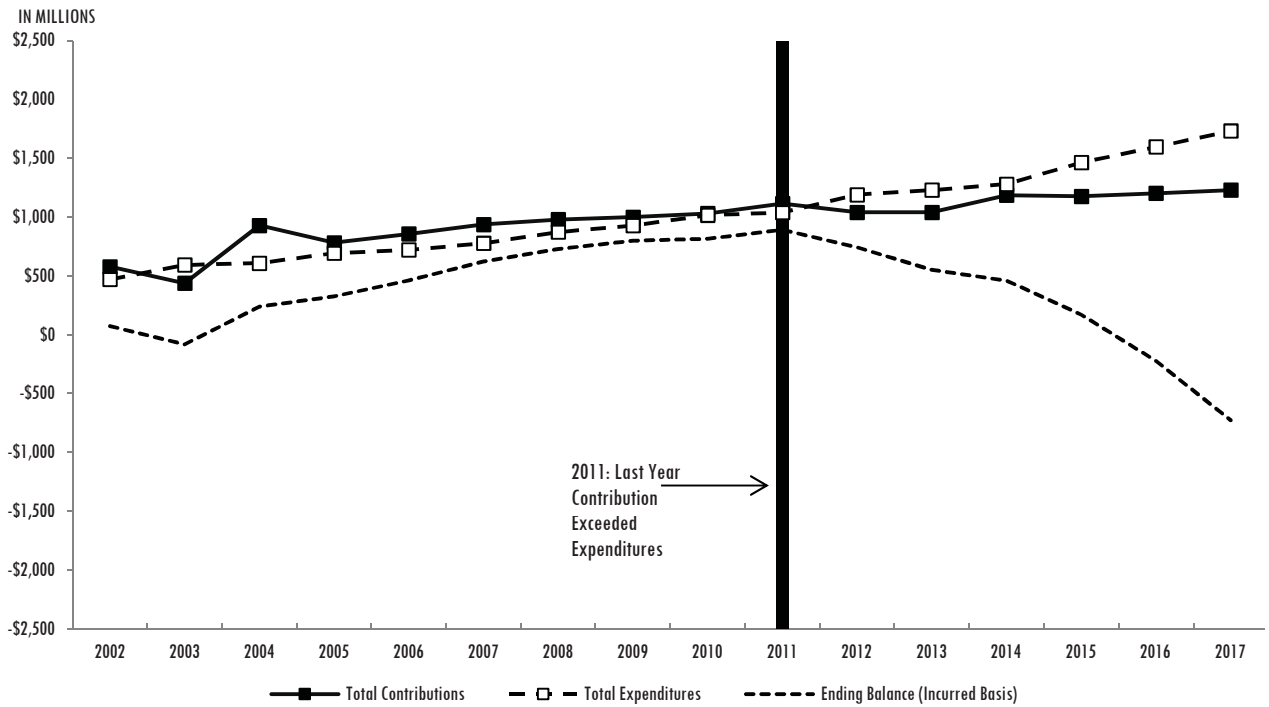


NOTE: Retiree contributions include retiree premiums only.
SOURCE: Legislative Budget Board.

a trusted account in the state Treasury. This potential insolvency has emerged because total contributions, which are tied to public education payroll, have grown at a slower rate than expenditures, which include faster growing healthcare claims. Also, a rider in the General Appropriations Act has discouraged TRS from increasing retiree premiums since fiscal year 2011, which is a significant source of revenue for the TRS-Care fund.

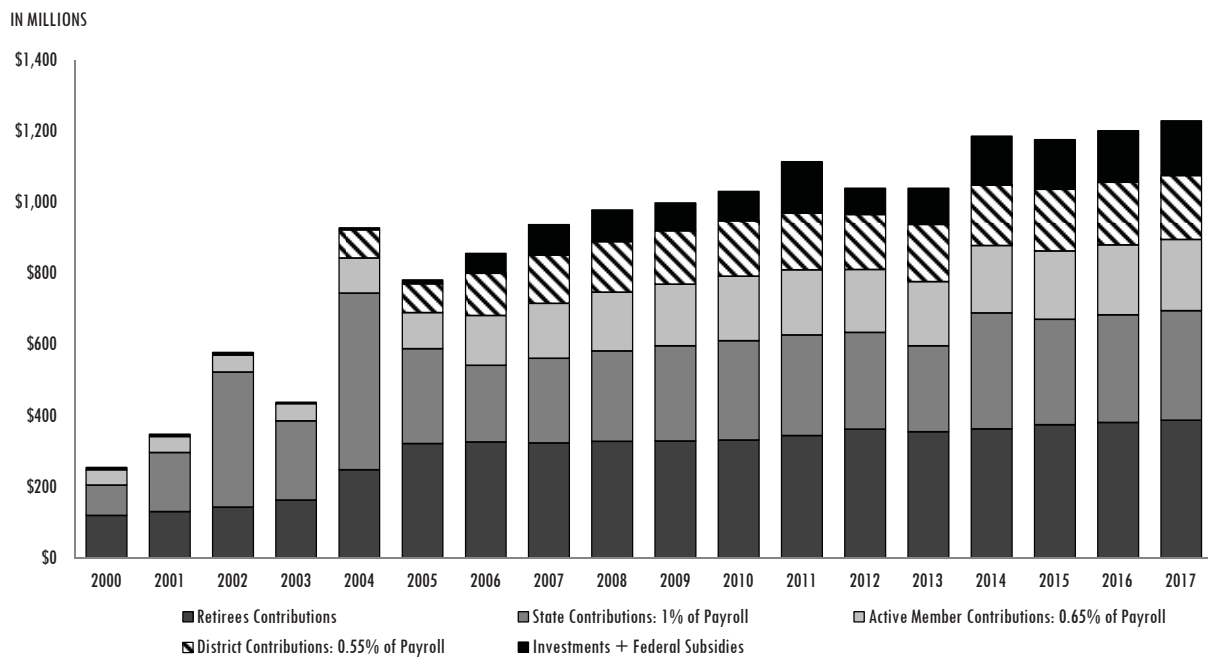
Figure 5 shows TRS-Care fund revenue for each contribution source from fiscal years 2000 to 2017. Total contribution growth stabilized by fiscal year 2006, following the contribution rate changes made by the Legislature in 2003. From fiscal years 2006 to 2011 total contributions grew by an average annual rate of 6.1 percent. The decline in public

FIGURE 4
TRS CARE FINANCIAL HISTORY AND PROJECTION, FISCAL YEARS 2002 TO 2017



NOTE: Fiscal years 2014 to 2017 are projected.
 SOURCE: Legislative Budget Board.

FIGURE 5
TRS CARE REVENUE SOURCES, FISCAL YEARS 2000 TO 2017



NOTE: Fiscal years 2001 to 2005 state contributions include solvency supplement appropriations.
 SOURCE: Legislative Budget Board.

education payroll and a temporary decrease in the state contribution rate in the 2012–13 biennium decreased contributions by 6.7 percent. TRS projects that total contributions will increase at an average annual rate of 2.2 percent in each fiscal year of the 2016–17 biennium.

Figure 6 shows TRS-Care fund expenditures from fiscal years 2000 to 2017. Driven by rapidly growing healthcare claims and retiree enrollment growth, total expenditures are projected to increase from fiscal years 2006 to 2015 by an average annual rate of 7.8 percent. Medical claims during that period will increase by an average rate of 5.3 percent, while drug claims will grow by an average of 10.9 percent. Claims expenditures, however, can fluctuate a great deal. In fiscal year 2012, medical and drug claims expenditures increased by 13.1 percent and 18.3 percent, respectively. TRS projects that medical claims will increase by an average annual rate of 5.8 percent and drug claims by 11.4 percent, with total expenditures increasing by 8.8 percent in each fiscal year of the 2016–17 biennium.

Among other factors, two significant cost drivers affect medical and drug claims. First, average claim expenditures for retirees under age 65 who are not eligible for Medicare are significantly higher than those enrolled in Medicare. **Figure 7** shows the difference in average claims cost for each plan option. TRS-Care 3 has the most significant difference, with annual medical claims per Medicare eligible retiree of \$1,495

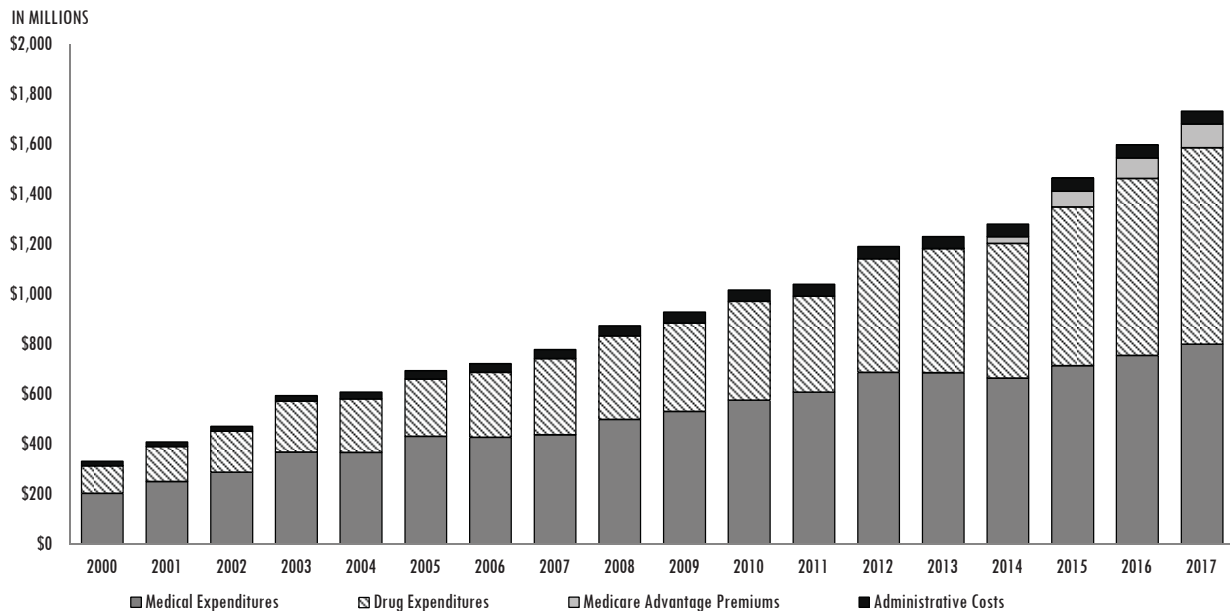
compared to non-Medicare retiree annual claims of \$9,051, or six times more.

The rapid growth of drug claims is another significant cost driver. **Figure 8** shows the percentage increase each year from fiscal years 2000 to 2015 for medical and drug claims. Drug claims for fiscal year 2015 are projected to increase 472 percent over fiscal year 2000 claims. Medical claims for fiscal year 2015 are projected to increase 252 percent over fiscal year 2000 claims. According to TRS, the growing use of specialty drugs is having an effect on drug claims. Specialty drugs are medications that require special handling, administration, and monitoring; and are used to treat complex chronic conditions such as hepatitis C and hemophilia. The high cost of specialty drugs has led TRS and its pharmacy benefit manager to establish specialty drug services that ensure patient compliance with prescribed treatment.

SHARING THE COST OF MAINTAINING SOLVENCY

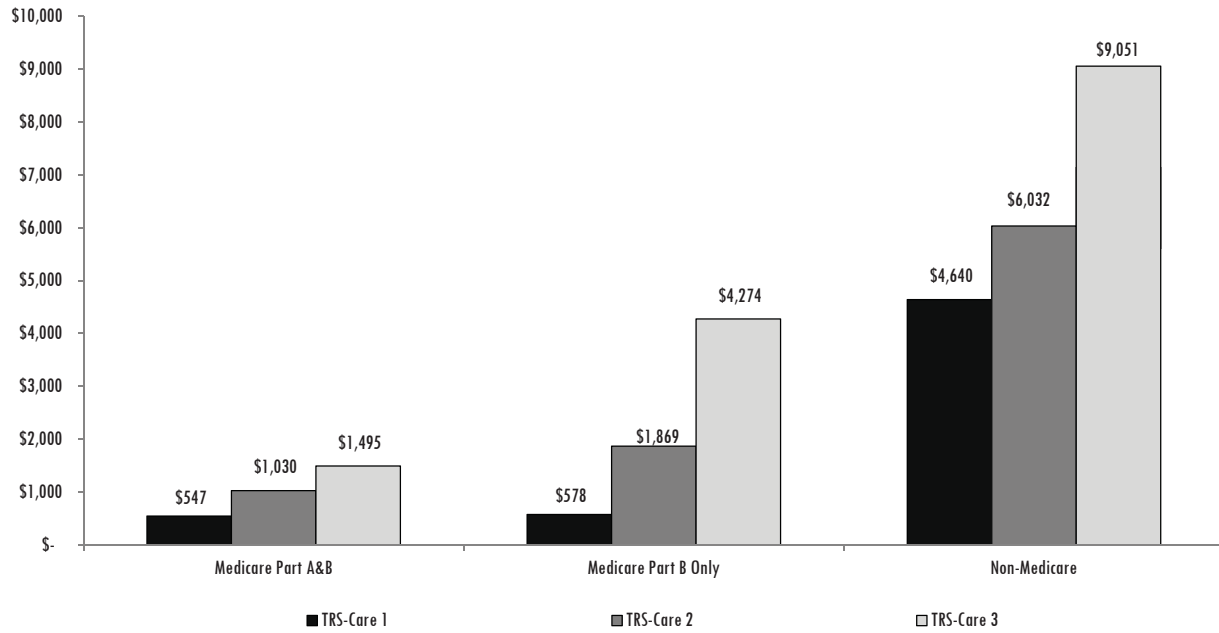
The Legislature faced a similar insolvency for both the 2002–03 and 2004–05 biennia. After appropriating a solvency supplement in the 2001 legislative session of \$410.2 million in General Revenue Funds for the 2002–03 biennium, the subsequent Legislature took a different approach for the 2004–05 biennium. Rather than relying solely on state General Revenue Funds to make the TRS-Care

FIGURE 6
TRS CARE EXPENDITURES, FISCAL YEARS 2000 TO 2017



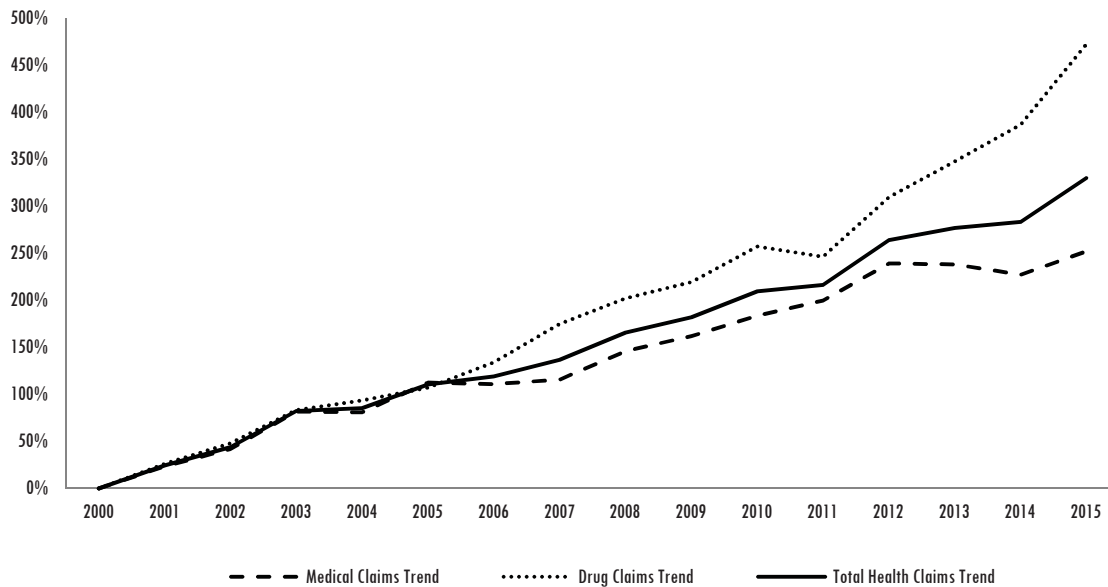
SOURCE: Legislative Budget Board.

**FIGURE 7
MEDICARE AND NON-MEDICARE CLAIMS EXPENDITURES PER MEMBER, FISCAL YEAR 2014**



SOURCE: Legislative Budget Board.

**FIGURE 8
TRS-CARE HEALTHCARE EXPENDITURE TRENDS FROM FISCAL YEARS 2000 TO 2015**



SOURCE: Legislative Budget Board.

fund solvent, the Legislature increased the state contribution rate from 0.5 percent to 1.0 percent of payroll and the active member rate from 0.25 percent to 0.50 percent. A new source of contribution was added—school districts were required to make a payroll based contribution of an amount to be specified in the General Appropriations Act (GAA), within a range of 0.25 percent to 0.75 percent, beginning in fiscal year 2004. The 2004–05 GAA specified a 0.40 percent school district contribution rate for that biennium. Also, the Legislature appropriated \$362.4 million in General Revenue Funds as a solvency supplement for TRS-Care. The increased state contribution rate combined with the supplemental appropriation provided an additional \$546.6 million for the 2004–05 biennium.

Retiree contributions increased as TRS-Care introduced a new premium structure based on the retiree's years of service and Medicare participation in fiscal year 2005. This premium structure, and various benefit plan design changes, resulted in retirees, overall, paying more for health insurance. As a result of contribution rate and insurance plan changes, and retiree enrollment growth, state and active employee funding increased by 100.0 percent, and retiree contributions increased by 86.3 percent from the 2002–03 biennium to the 2004–05 biennium. All sources combined contributed an additional \$1.1 billion for the 2004–05 biennium above total revenue projected for the biennium. These changes provided the TRS-Care fund with a long term revenue source that has helped maintain solvency for 12 fiscal years.

Current statutory cost sharing requirements were also established in the 2003 session—no more than 55 percent of the funds revenue can come from the state and no less than 30 percent can come from retiree contributions. A 2004–05 GAA rider required TRS to adjust the levels of state and retiree healthcare cost sharing to comply with these new limits by fiscal year 2005. TRS responded to the rider by adjusting premiums and plan design so that the retiree contribution share for the 2004–05 biennium overall was slightly higher than the minimum, at 31 percent. Legislation passed in the 2003 legislative session also tightened eligibility requirements so that fewer retirees under age 65 could enroll in TRS-Care.

USE THE COST SHARING APPROACH TO ENSURE SOLVENCY

TRS' Legislative Appropriations Request for the 2016–17 biennium contains an exceptional item funding request for a TRS-Care solvency supplement of \$874.8 million. TRS

subsequently reduced the insolvency estimate to \$727.2 million. The \$727.2 million supplement, combined with the projected state contribution for the 2016–17 biennium of \$611.1 million, would more than double the state's biennial funding to TRS-Care. According to TRS, this would maintain solvency for the 2016–17 biennium only. Another supplement would be needed for the 2018–19 biennium.

The precedent established during the 2003 legislative session offers an alternative funding approach. The cost sharing policy authorized by legislation passed that session not only spread responsibility for maintaining solvency in the short term, it allowed the fund to stay solvent for 12 fiscal years. By raising state and active employee contribution rates, adding in school district contributions, and requiring greater retiree premium revenue, in addition to cost containment programs, TRS-Care total revenue exceeded expenditures until fiscal year 2012.

Another cost sharing approach can be used to maintain TRS-Care fund solvency in the 2016–17 biennium. The \$727.2 million projected solvency cost could be allocated 50.0 percent and 25.0 percent to state contributions and retiree costs, respectively, and 12.5 percent each to active member and school district contributions. As a result, the state would cover twice the cost allocated to retirees, and four times the cost allocated to active members and school districts. This allocation would apportion significantly more of the funding increase to the state to moderate the impact on retirees. The state contribution amount would increase 60.0 percent, while costs associated with retiree premium and benefit changes would increase 23.6 percent, over the current 2016–17 projected levels. Active member and school district contribution costs would increase 23.1 percent and 25.3 percent, respectively. Also, TRS could mix premium increases and plan design changes to offset 25.0 percent of the solvency cost.

Recommendation 1 would amend the Texas Insurance Code, Section 1575, by increasing the state contribution rate to provide 50 percent of the projected cost to maintain the TRS-Care fund's solvency in the 2016–17 biennium. Based on current projections, an increase from 1.0 percent to 1.60 percent would provide this funding. The recommendation would amend statute to allocate 12.5 percent of the projected TRS-Care solvency cost to increases in the active member and school district contribution rates. The active member rate would increase from 0.65 percent to 0.80 percent, and the school district rate would increase from 0.55 percent to 0.73 percent.

Recommendation 2 would include a contingency rider in the 2016–17 General Appropriations Bill appropriating additional General Revenue, reflecting an increase in the state contribution rate that provides 50 percent of the projected TRS-Care solvency cost, and deleting a specific school district contribution rate in the General Appropriations Bill. Implementing Recommendations 1 and 2 would cost the state \$366.7 million in General Revenue Funds during the 2016–17 biennium.

Recommendation 3 would delete the rider from the introduced 2016–17 General Appropriations Bill expressing legislative intent that TRS not increase retiree premiums. This provision has discouraged TRS from making incremental premium changes that provide additional revenue for TRS-Care. Eliminating the rider would recognize TRS’s ability to adjust premiums or make plan design changes as needed.

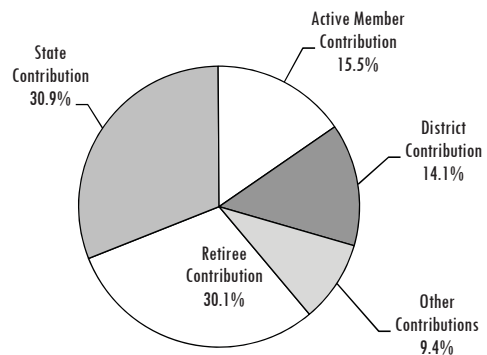
Recommendation 4 would include a contingency rider requiring TRS to take actions needed to offset at least 25 percent of the projected TRS-Care solvency cost. TRS could do this through a combination of retiree premium increases or plan design changes, such as raising the maximum-out-of-pocket cost. The agency would submit a report to the Legislative Budget Board and Governor describing premium and/or plan design changes prior to implementation.

Figure 9 shows the actual allocation of the \$727.2 million additional funding using the percentage shares, the new contribution rates for the payroll based sources and the additional funding each would provide. This approach would align overall cost sharing so that the state and retirees each provide about 30 percent of total funding, and the active employee contribution would be about half of that, at 15.5 percent. The school district share would decrease from 14.3

percent in fiscal year 2013 to 14.1 percent in the 2016–17 biennium. The other sources’ share would change slightly, but the amount that would be provided would not change because they include federal drug-related subsidies. If current cost trends continue, contribution rate and retiree cost increases may not prevent a shortfall from occurring in the 2018–19 biennium. The recommended adjustments would, however, reduce the potential 2018–19 biennium shortfall by more than half than would result from a one-time solvency supplement.

Figure 10 shows the new shares of total TRS-Care funding based on the recommended allocation of the solvency cost. The percentages reflect changes in the state and retiree shares so that each provide about 30 percent, while active members and school districts would provide about 15.5 percent and 14.1 percent, respectively. State and retiree funding would be closer aligned under the recommendations.

**FIGURE 10
NEW SHARES OF TRS-CARE TOTAL FUNDING
2016–17 BIENNIUM**



SOURCE: Legislative Budget Board.

**FIGURE 9
CONTRIBUTION SOURCE COST SHARING TO MAINTAIN SOLVENCY, 2016–17 BIENNIUM**

CONTRIBUTION SOURCE	SHARE OF SOLVENCY COST	SOLVENCY FUNDING	NEW CONTRIBUTION RATE	CURRENT SHARES OF TOTAL FUNDING	NEW SHARES OF TOTAL FUNDING	PERCENTAGE INCREASE FROM CURRENT PROJECTION
State	50.2%	\$366.7	1.60%	27.5%	30.9%	60.0%
Retirees	25.0%	\$181.8	N/A	30.6%	30.1%	23.6%
Active Members	12.6%	\$91.7	0.80%	15.9%	15.5%	23.1%
School Districts	12.3%	\$90.2	0.73%	14.3%	14.1%	25.3%
Other Sources	N/A	N/A	N/A	11.6%	9.4%	N/A

NOTES:

- (1) Retiree funding includes premiums only and omits out of pocket costs such as deductibles and coinsurance.
- (2) Current shares of total funding reflect fiscal year 2013 amounts for each source.
- (3) Other Sources, primarily federal drug reimbursements, would not change as a result of new supplemental funding.

SOURCE: Legislative Budget Board.

IMPACT ON RETIREES OF PREMIUM INCREASES

Recommendation 4 would require TRS to take actions necessary to offset 25.0 percent of the projected TRS-Care 2016–17 solvency cost. TRS could do this by raising premiums, making plan design changes that adjust benefit levels, or a combination of the two. The impact on retirees would vary depending on the changes TRS makes, as well as their current income, health condition, and Medicare status. **Figure 11** shows the impact of increasing premiums, assuming they would rise by the same percentage that total retiree contributions would increase in fiscal year 2016 of 23.6 percent. The average retiree in TRS-Care 3 without Medicare coverage would see their premiums as a percentage of the monthly annuity increase from 10.8 percent to 13.3 percent. The average retiree in TRS-Care 3 covered by Medicare would see their premiums as a percentage of the average monthly annuity increase from 4.8 percent to 6.0 percent.

TRS-CARE SUSTAINABILITY STUDY

At the November TRS board meeting, TRS actuaries presented a report on TRS-Care policy options. The Sustainability Study includes several options designed to address the healthcare program’s projected insolvency. Three options would maintain solvency on a biennial or longer term basis through contribution and premium increases, four others would make significant changes in retiree cost sharing and healthcare cost containment. The study indicated potential state contribution rate increases or retiree premium impacts associated with various options. TRS will solicit input from stakeholders and conduct more analysis prior to release of the final report.

ENHANCE COST CONTAINMENT ACCOUNTABILITY AND TRANSPARENCY

Cost containment features of insurance programs include a wide range of measures. TRS-Care, similar to the Employees Retirement System (ERS) group insurance program for state employees, relies on preferred provider networks, claims limitations, and healthcare-focused features to minimize

their plan costs. Benefit levels, such as deductibles and co-pays, associated with in-network and non-network providers incentivize member to use network healthcare providers. Network providers cost the plan less because their rates are lower than non-network providers. Claim limitations, such as insuring only eligible charges, reduce the net claims amount to which benefit levels are applied. Healthcare focused measures include utilization and case management that works with members to avoid or minimize high cost healthcare. Other plan features such as member cost sharing, prescription drug rebates, and disease management also reduce TRS-Care costs.

To inform the public of its efforts to reduce health insurance costs, ERS provides statutorily required information about the group insurance program’s cost containment features. The annual *ERS Cost Management and Fraud Control Report* describes each cost containment feature, how it functions, and the savings it generates.

The ERS report has several benefits. First, the report provides a detailed itemization of specific cost containment features and groups them according to the type of impact they have on the insurance program. Second, because the report identifies features that are consistent from year to year, several reports taken together allow for a comparison of savings over time. Finally, the Legislature can use the reports to hold ERS accountable for maintaining a robust set of cost containment features. Statute requires ERS to produce a report containing information about the effectiveness and efficiency of the program’s managed care cost containment practices and fraud detection and prevention procedures. This provision, which has been in effect since 2003, shows legislative intent to hold ERS accountable for managing the group insurance program in a fiscally prudent manner.

TRS does not produce a report that informs the public about TRS-Care cost containment features and the savings associated with them. The state entrusts the agency with substantial appropriations for retiree health insurance. Issuing a report similar to the one produced by ERS would

**FIGURE 11
IMPACT OF INCREASING PREMIUMS BY 23.6 PERCENT, FISCAL YEAR 2016**

CATEGORY	FISCAL YEAR 2015 PREMIUM	AVERAGE MONTHLY ANNUITY	PREMIUM AS A PERCENTAGE OF ANNUITY	FISCAL YEAR 2016 INCREASED PREMIUM	PREMIUM AS A PERCENTAGE OF ANNUITY
Average Retiree in TRS-Care 3 without Medicare	\$295	\$2,740	10.8	\$364.2	13.3
Average Retiree in TRS-Care 3 with Medicare	\$100	\$2,073	4.8	\$123.6	6.0

SOURCE: Legislative Budget Board.

enhance TRS’s ability to maintain accountability and transparency in administering TRS-Care.

Recommendation 5 would amend the Texas Insurance Code, Section 1575, to require TRS to produce an annual report identifying and describing each of its major cost containment features and indicating the savings generated by them. The goal of the report would be to inform readers of the effectiveness of TRS-Care cost containment and fraud prevention efforts that also support high quality healthcare insurance for retirees and their dependents. Because the ERS report has a well established structure, TRS could mirror that pattern and also include TRS-Care specific components so that readers can see the unique features used by its vendors, Aetna and Express Scripts. The groupings used by ERS keep the report length manageable, and still allow the agency to include information about healthcare trends and new cost containment features.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 would amend statute to increase the state contribution rate to offset 50 percent, and increase active member and school district contribution rates each to offset 12.5 percent, of the biennial 2016–17 projected insolvency cost. Based on current projections, the state contribution rate would increase from 1.0 percent to 1.60 percent of total public education payroll, and cost \$366.7 million in General Revenue Funds for the 2016–17 biennium. Current projections also indicate the school district contribution rate would increase from 0.55 percent to 0.73 percent of public education payroll, and cost school districts \$90.2 million in the 2016–17 biennium. Recommendation 2 would include a contingency rider in the 2016–17 General Appropriations Bill to implement the state contribution rate increase, and delete the rider stipulating a specific school district contribution rate. Recommendation 3 would delete an existing rider that seeks to limit TRS premium rate-setting flexibility. Recommendation 4 would include a contingency rider requiring TRS to take actions, such as premium increases or plan design changes, to offset 25 percent of the projected biennial 2016–17 solvency cost, and submit a report describing those action by August 1, 2016. This could result in a 23.6 percent increase in retiree costs. Recommendation 5 requiring TRS to produce a report about cost containment features can be implemented with existing resources and has no significant fiscal impact.

**FIGURE 12
FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2016 TO 2020**

YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS
2016	(\$181,514,000)
2017	(\$185,144,000)
2018	(\$188,847,000)
2019	(\$192,624,000)
2020	(\$196,476,000)

SOURCE: Legislative Budget Board.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

INCREASE FISCAL ACCOUNTABILITY AND TRANSPARENCY OF SCHOOL DISTRICTS' GENERAL FUND BALANCES

School districts use their general fund to pay for operating expenditures related to daily operations. A school district's general fund balance is the difference between its total assets and liabilities. Districts maintain a balance in their general fund sufficient to cover a portion of operating and unforeseen expenditures and ensure cash flow while waiting for revenue. Neither statute nor the Texas Education Agency require Texas school districts to have a general fund balance policy or to maintain a minimum general fund balance.

National accounting standards for state and local governments require school districts to report their general fund balances in five categories, including nonspendable, restricted, committed, assigned and unassigned. As of fiscal year 2013, Texas school districts reported a total of \$13.7 billion in general fund balances. Of that total, 70 percent (\$9.5 billion) was classified as unassigned and is available for any legal expenditure. School districts are not required to disclose the intended use of these public funds. By requiring school districts to maintain minimum general fund balances and publicly report the funds' intended usage, Texas would increase districts' financial accountability and transparency.

FACTS AND FINDINGS

- ◆ Beginning in fiscal year 2011, school districts were required to adopt standards that changed the categories districts must report in their general fund.
- ◆ School district and charter school entitlement in accordance with statutory formulas was reduced by \$4.0 billion in the 2012–13 biennium. In fiscal year 2012, school districts increased the amounts held in their general fund balances by approximately \$1.5 billion, and decreased total operating expenditures by approximately \$1.6 billion.
- ◆ Before fiscal year 2011, the Texas Education Agency required school districts to maintain at least two months of operating funds in their general fund balances, and the agency monitored compliance with the requirement. In fiscal year 2011, the agency eliminated this minimum balance requirement and the requirement to disclose information about the intended use of any general fund balance.

- ◆ At the end of fiscal year 2013, school districts consistently maintained larger general fund balances in relation to total operating expenditures (an approximately 6 percent increase) compared with levels before fiscal year 2011.

CONCERNS

- ◆ The Texas Education Agency does not require school districts to maintain a minimum general fund balance or disclose the intended use of balances. In fiscal year 2013, 49 school districts did not have fund balances sufficient to cover two months of operating expenditures; however, more than 100 school districts had fund balances sufficient to cover more than one year of operating expenditures. The lack of public reporting limits access to objective information needed to promote transparency and accountability.
- ◆ Not all Texas school districts have formal policies governing the use of their general fund balances. Local school boards are not required to adopt formal general fund balance policies. As a result, boards may not explicitly deliberate appropriate uses of balances, and stakeholders may lack information about plans for the balances.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require the Texas Education Agency to reinstate a requirement that school districts maintain minimum general fund balances and require school districts to publicly report the intended use of general fund balances in excess of a certain percentage of operating expenditures.
- ◆ **Recommendation 2:** Amend statute to require school district boards of trustees to formally adopt general fund balance policies.

DISCUSSION

School districts use their general fund to pay for operating expenditures related to daily operations. A school district's general fund balance is the difference between its total assets and liabilities. As of fiscal year 2013, Texas school districts reported a total of \$13.7 billion in general fund balances.

In fiscal year 2011, the Governmental Accounting Standards Board (GASB), the independent organization that establishes and improves standards of accounting and financial reporting for U.S. state and local government, changed how school districts, as local government entities, must classify and report funds in their general fund which is reported in their annual financial report. Before fiscal year 2011, there were three classifications in the general fund, including undesignated unreserved, designated unreserved, and reserved. GASB Statement 54 expanded the general fund categories from three to five categories to provide increased transparency regarding the use of public funds. The general fund is now classified into the following five categories:

- nonspendable fund balance includes amounts that cannot be spent because they are either (a) not in spendable form, or (b) legally or contractually required to be maintained intact; includes items not expected to be converted to cash, such as inventories and prepaid amounts, and may include long-term amounts of loans and receivables, as well as property acquired for resale and the corpus (principal) of a permanent fund;
- restricted fund balance should be reported when constraints placed on the use of resources are either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments, or (b) imposed by law through constitutional provisions or enabling legislation;
- committed fund balance reflects specific purposes pursuant to constraints imposed by formal action of the district's highest level of decision-making authority (typically, the governing board); such constraints can be removed or changed only by the same form of formal action;
- assigned fund balance reflects amounts that are constrained by the district's intent to be used for specific purposes, but meet neither the restricted nor committed forms of constraint; and
- unassigned fund balance is the residual classification for the general fund only, where negative residual amounts for all other governmental funds would be reported; these funds are available for any legal expenditure.

Figure 1 shows the fiscal year 2013 general fund balance for all Texas independent school districts, not including charter schools, according to the GASB 54 fund categories. Of the

**FIGURE 1
GENERAL FUND BALANCE FOR ALL TEXAS SCHOOL DISTRICTS, FISCAL YEAR 2013**

CATEGORY	BALANCE (IN BILLIONS)	PERCENTAGE OF TOTAL AMOUNT
Nonspendable	\$0.3	2.0%
Restricted	\$0.2	1.8%
Committed	\$2.4	17.3%
Assigned	\$1.3	9.2%
Unassigned	\$9.5	70.0%
TOTAL	\$13.7	

NOTES:

- (1) Categories are from the independent national organization Governmental Accounting Standards Board (GASB), Statement 54.
 - (2) Total excludes one district's annual financial report, not available.
 - (3) Percentages may not sum due to rounding.
- SOURCE: Texas Education Agency.

\$13.7 billion that school districts had in their general funds at the end of fiscal year 2013, approximately 70 percent (\$9.5 billion) was in the unassigned category.

The Texas Education Code, Chapter 41, provides mechanisms to equalize variations in the value of the property base per weighted student among school districts. School districts with wealth in the form of property value that exceeds statutorily determined levels are required to reduce wealth per weighted student to the statutory level. Local revenue paid to the state or to other school districts for this purpose is commonly called recapture. Recapture paid to the state is used as a method of financing the state appropriation for the Foundation School Program (FSP). The FSP is the primary source of distributing state aid to Texas public schools. School districts may retain portions of their general fund balances for recapture payments or to provide sufficient funds for district operations until tax collections are remitted. Of the total general fund balances shown in **Figure 1**, 41 percent (\$5.6 billion) was held by districts classified as Chapter 41.

FIVE-YEAR GENERAL FUND BALANCE

School district general fund balances have increased in recent years. **Figure 2** shows the general fund balance amounts for fiscal years 2009 to 2013, along with associated operating expenditures. From fiscal years 2009 to 2011, total statewide general fund balances as a percentage of total operating expenditures remained stable (from 29 percent to 31 percent). However, statewide, general fund balances have increased by approximately 5 percent, more than \$2.0

**FIGURE 2
GENERAL FUND BALANCES FOR ALL TEXAS SCHOOL DISTRICTS, FISCAL YEARS 2009 TO 2013**

YEAR	BALANCE (IN BILLIONS)	TOTAL OPERATING EXPENDITURES	BALANCE AS A PERCENTAGE OF TOTAL OPERATING EXPENDITURES
2009	\$10.2	\$35.1	29%
2010	\$10.6	\$36.5	29%
2011	\$11.6	\$36.8	31%
2012	\$13.0	\$35.2	36%
2013	\$13.7	\$37.0	37%

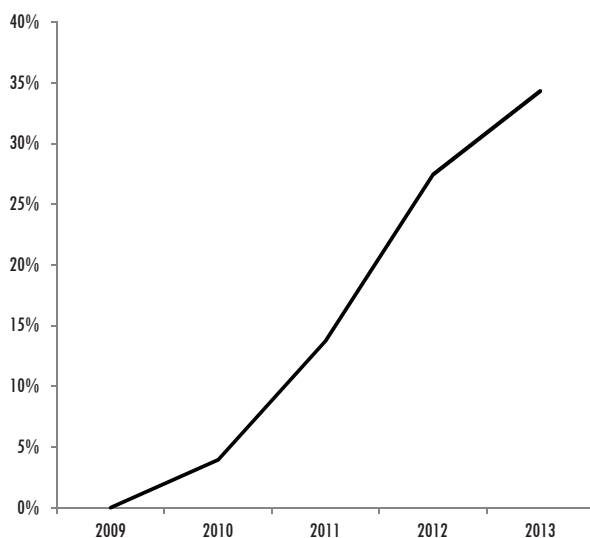
NOTE: Total for 2013 excludes one district's annual financial report, not available.

SOURCE: Texas Education Agency.

billion, from fiscal years 2011 to 2013. More detailed information is available on this subject at the Interactive Graphics link of the Legislative Budget Board's website <http://www.lbb.state.tx.us/Interactive.aspx>.

Figure 3 shows the five-year general fund balance percentage increase for all school districts. Overall, districts' general fund balances increased 34.3 percent from fiscal years 2009 to 2013. The average year-over-year percentage increase in general fund balances from fiscal years 2009 to 2013 was approximately 6.9 percent.

**FIGURE 3
PERCENTAGE CHANGE IN GENERAL FUND BALANCES FOR ALL TEXAS SCHOOL DISTRICTS FISCAL YEARS 2009 TO 2013**



NOTE: Figure excludes one district's annual financial report which was not available.

SOURCE: Texas Education Agency.

EFFECT OF FUNDING REDUCTIONS ON SCHOOL DISTRICTS' GENERAL FUND BALANCES

The Eighty-second Legislature, 2011, reduced FSP entitlement funding for the 2012–13 biennium. This legislative action was in response to a projected budget shortfall for the 2012–13 biennium, along with increasing state costs to the FSP. In total, school district and charter school entitlement for the 2012–13 biennium was \$4.0 billion less than the amount that would have been necessary to maintain 2011 entitlement funding levels.

Many Texas school districts adjusted to the economic uncertainty by increasing the amounts held in their general fund balances. From fiscal years 2011 to 2012, school districts increased the amounts held in their general fund balances by approximately \$1.5 billion, and decreased their total operating expenditures by approximately \$1.6 billion. From fiscal years 2011 to 2013, 218 school districts (21 percent) had decreases to their general fund balances. However, during that period, 803 districts (79 percent) had increases in their general fund balance amounts. Figure 4 shows the number of districts whose general fund balances changed, and the percentage changes in those balances from fiscal years 2011 to 2013.

School districts (excluding charter schools) increased their general fund balances in fiscal year 2011 by 9 percent from fiscal year 2010. In fiscal year 2012, school districts further

**FIGURE 4
TEXAS SCHOOL DISTRICTS' PERCENTAGE CHANGE IN GENERAL FUND BALANCES, FISCAL YEARS 2011 TO 2013**

CHANGE	DISTRICTS	PERCENTAGE OF TOTAL DISTRICTS
<-201%	1	0%
-151% to -200%	0	0%
-101% to -150%	4	0%
-100% to -50%	13	1%
-49% to 0%	200	20%
1% to 50%	428	42%
51% to 99%	146	14%
>=100% to 150%	68	7%
151% to 200%	39	4%
>200%	122	12%

NOTE: Number of districts does not include five districts with negative general fund balances for 2011 and one district that has not submitted its annual financial report for 2013.

SOURCE: Texas Education Agency.

increased their general fund balances through various strategies:

- reducing payroll expenditures paid from general funds from \$30.2 billion to \$28.6 billion, a \$1.6 billion reduction;
- eliminating nearly 25,000 full-time-equivalent (FTE) positions, representing 3.8 percent of total FTEs. Teaching positions had the largest reduction, with approximately 11,000 positions eliminated (a 3.2 percent decrease). FTE data reflects the number of positions, which may or may not have been filled; and
- reducing spending on total program expenditures from \$27.9 billion to \$26.6 billion, a decrease of \$1.3 billion.

School districts' tax collections increased slightly from fiscal years 2011 to 2012; however, districts increased their local tax collections in fiscal year 2013 from \$16.6 billion to \$17.5 billion, an increase of \$943.0 million. For the 2014–15 biennium, the Legislature increased the FSP entitlement by \$3.4 billion.

FUND BALANCE TRANSPARENCY

Before state funding was decreased for the 2012–13 biennium, TEA required school districts to maintain at least two months of operating funds in their general fund balances as part of TEA's School Financial Integrity Rating System of Texas (School FIRST), and the agency monitored compliance with the requirement. School FIRST rates the reliability of public schools' financial management practices and use of resources. In fiscal year 2011, TEA anticipated that many districts would need to use portions of their general fund balances to meet financial obligations and the agency eliminated this minimum balance requirement from School FIRST. For fiscal year 2013, 49 school districts (approximately 5 percent) held less than two months' operating expenditures in their general funds.

TEA has not reinstated the School FIRST requirement and does not require school districts to maintain minimum general fund balances to cover unforeseen expenditures and upcoming financial obligations. As a best practice, the Government Finance Officers Association (GFOA) recommends that districts adopt formal general fund balance policies that define appropriate fund balance levels, given their circumstances and fiscal responsibilities. The GFOA also recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund

balances in their general funds of no less than two months of regular operating revenues or expenditures. The GFOA stresses that this is a minimum recommendation only, and other local factors must be taken into consideration, including the timing and dependability of revenue sources.

TEA also does not require school districts to report the intended uses of general fund balances. While planning for contingencies and unforeseen expenditures is important, it is also necessary for a district to safeguard assets and be transparent about how public monies will be allocated. As of fiscal year 2013, 506 school districts (49 percent) had general fund balances sufficient to cover from two to six months of operating expenditures; 333 districts (31 percent) had from six months to one year's worth; and 136 districts (13 percent) had fund balances sufficient to cover more than one year of operating expenditures. As districts' general fund balances increase, it is important that districts manage these funds effectively and are transparent with local taxpayers and stakeholders about the intended uses of public funds.

Before fiscal year 2011, TEA required districts to include worksheets showing their optimum fund balances and cash flow calculations as part of the districts' annual financial reports. The worksheet required districts to state the intended uses of positive general fund balances. The goal was to have a large enough fund balance to meet the districts' needs but not have an excess amount of cash on hand without a plan for how the funds were to be used. In fiscal year 2011, TEA removed the requirement for districts to include the schedule of optimum fund balance that previously had been required in financial statements. The schedule is now optional.

Recommendation 1 would amend statute to require TEA to: (1) reinstate a requirement that school districts maintain minimum general fund balances; and (2) require school districts to publicly report the intended use of general fund balances in excess of a certain percentage of operating expenditures. Requiring school districts to report on the planned use of their general fund balances would promote financial transparency and communication with local taxpayers and stakeholders about district priorities and the use of public funds.

FUND BALANCE POLICY

School districts maintain general fund balances for many reasons. Timing differences in remittals from local property taxes, unforeseen expenditures, and budgeting for longer-term goals are all reasons that public schools might maintain general fund balances. Each district has its own priorities and

should budget and manage its general fund balance accordingly to meet its financial obligations.

School district board members need a solid understanding of district finances to provide responsible financial stewardship. As part of this responsibility, districts should consider the resources needed to meet long-term goals and provide financial stability as unforeseen needs arise. However, school districts are not required to adopt formal policies to govern the use of their general fund balances, and TEA has not developed guidelines to help districts establish general fund balance policies. As a result, not all school districts have formal policies to govern the use of their general fund balances. The Legislative Budget Board (LBB) staff has recommended in school performance reviews that school district boards adopt policies toward establishing and monitoring general fund balances to prepare for financial uncertainty.

Recommendation 2 would amend statute to require school district boards of trustees to formally adopt general fund balance policies. TEA could establish guidelines to help boards develop policies that meet their needs. Requiring school district boards to formally adopt a general fund balance policy would allow each district to assess available resources. The requirement also would help districts to define goals for how to respond to financial uncertainties, and how to reach longer-term objectives.

FISCAL IMPACT OF THE RECOMMENDATIONS

It is estimated that these recommendations would have no significant fiscal impact on the state. It is expected that TEA could perform the required tasks and activities by using existing resources.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.

TRENDS IN THE NUMBER AND SALARIES OF ADMINISTRATORS IN TEXAS PUBLIC SCHOOLS

Public school administrators play key roles in ensuring that schools function smoothly. Administrators are involved in nearly all aspects of school operation, from overseeing the school budget and planning curricula to student behavior management. For school year 2012–13, the most recent school year data available, more than 25,000 administrators served in Texas public schools. During the past 10 school years, the number of administrators increased at a greater annual rate than teachers, auxiliary staff, and educational aides, but at a lesser rate than professional support staff. The average salary of central and campus administrators each increased at greater rates than the average salaries of teachers and professional support staff. The average salary of campus administrators, however, increased at a lower rate than central administrators.

FACTS AND FINDINGS

- ◆ From school years 2004–05 to 2012–13, the total number of public school administrators in Texas increased by an average of 1.9 percent annually. This average annual increase was greater than the 1.2 percent average annual increase in total number of school employees during this period.
- ◆ From school years 2004–05 to 2008–09, the rate of growth for the number of school administrators exceeded the rate of enrollment growth. That trend reversed in 2009–10, when the annual rate of enrollment growth exceeded the rate of growth among administrators.
- ◆ The average annual increase in the total number of public school administrators statewide was 0.6 percentage points greater than the increase in numbers of teachers, 1.2 percentage points greater than auxiliary staff, and 1.7 percentage points greater than educational aides. However, the increase in number of professional support staff was 1.0 percentage points greater than that of administrators.
- ◆ Statewide, the average salary of public schools' central office administrators increased by an annual average of 2.3 percent from school years 2004–05 to 2012–13. This increase was greater than the increase in salaries of campus-level administrators (1.7

percent), teachers (2.1 percent), and professional support staff (1.9 percent).

DISCUSSION

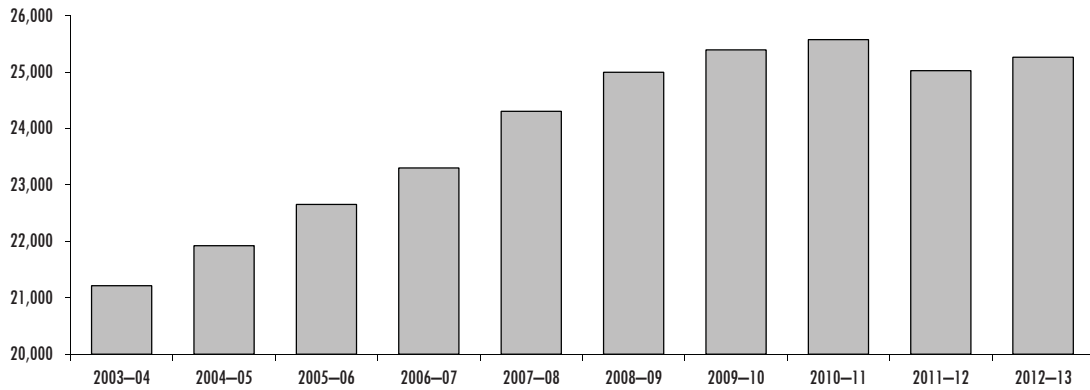
School administrators organize and manage the administration, support systems, and activities that enable the operation of educational institutions for kindergarten to grade 12. The Public Education Information Management System (PEIMS) is used by Texas public schools for reporting data to the Texas Education Agency. PEIMS includes two classifications of administrators. One classification is central administrators, which include superintendents, presidents, chief executive officers, chief administrative officers, business managers, athletic directors, and other administrators with a central office ID and not a specific campus ID. The other classification is campus administrators, which include principals, assistant principals, and other administrators reported with a campus-level ID. Central and campus administrators are combined under the term “administrators.” PEIMS also provides data on the salaries of campus and central administrators. This information is presented as a total of the amount paid to all administrators and as an average salary for campus and central administrators. PEIMS groups school staff into five categories. These categories include administrators, teachers, educational aides, auxiliary staff, and professional support staff.

TOTAL NUMBER OF ADMINISTRATORS

During the last 10 school years, school employment trends fluctuated, including trends in school administrator employment. From school years 2003–04 to 2012–13, the total number of administrators statewide increased by 4,049. **Figure 1** shows the number of administrators in public schools from 2003–04 to 2012–13.

As shown in **Figure 1**, the total number of administrators statewide increased from 21,215 for school year 2003–04 to 25,264 for 2012–13. During this period, the number of administrators increased annually by an average of 1.9 percent. The number of administrators increased every year for the first eight years, reaching a high of 25,577 in 2010–11. In 2011–12, the number of administrators decreased by 2.2 percent. Although the number of

FIGURE 1
ADMINISTRATORS IN TEXAS PUBLIC SCHOOLS, SCHOOL YEARS 2003–04 TO 2012–13



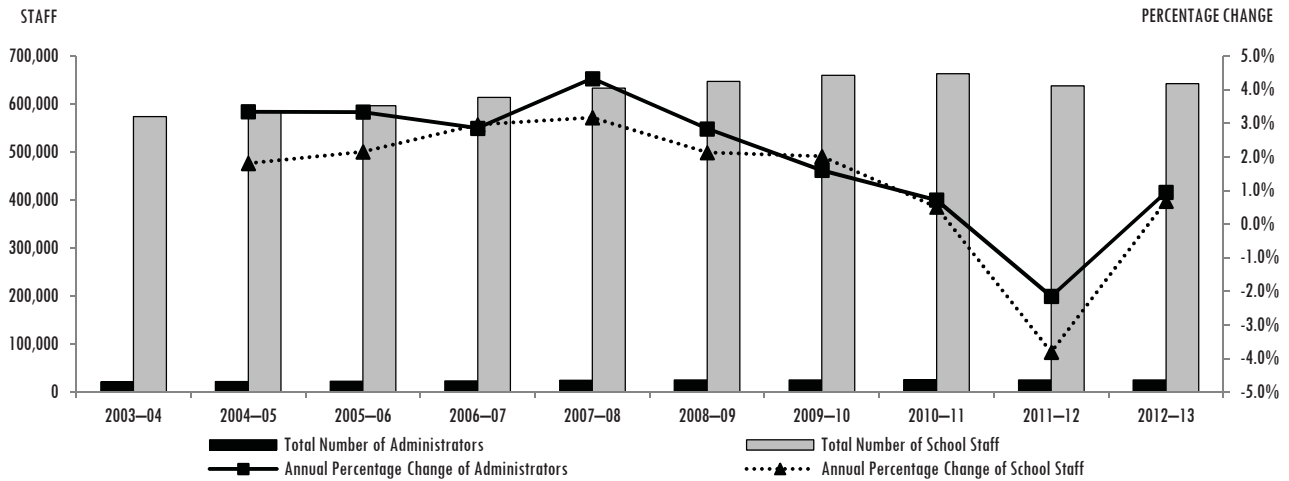
SOURCE: Texas Education Agency.

administrators increased by 1.0 percent the following year, the total number remained below its peak.

This trend in administrator employment mirrored trends in overall school employment. Statewide, the total number of school staff (including administrators) increased every year for the first eight years, before decreasing by 3.8 percent for school year 2011–12. **Figure 2** shows the numbers of administrators and school staff statewide from 2003–04 to 2012–13 and the percentage that each changed from the previous year.

As shown in **Figure 2**, from school years 2003–04 to 2012–13, the average annual increase in the number of school staff statewide was 1.2 percent. This was 0.7 percent less than the average annual increase in the number of administrators during this period. Within these nine school years, the trends in the increase in number of school staff often mirrored the increase in number of administrators. The largest increase in the number of school staff was 3.2 percent in 2007–08. Likewise, the largest increase in the number of administrators, 4.3 percent, was also in 2007–08. The largest annual decrease in the number of school staff was 3.8 percent for 2011–12. During this school year, the number of

FIGURE 2
ADMINISTRATORS AND SCHOOL STAFF IN TEXAS PUBLIC SCHOOLS, SCHOOL YEARS 2003–04 TO 2012–13



NOTES:

- (1) Percentages for school year 2003–04 are not shown as it is the first year of the 10-year period and there is no previous data to compare.
- (2) The total number of school staff also includes administrators.

SOURCE: Texas Education Agency.

administrators also decreased 2.2 percent. This was the only school year that the number of administrators decreased from the previous year. During this 10-year period, the number of administrators consistently increased at a higher annual rate than the number of school staff. However, the growth and reduction in one group's rate always coincided with the same change in the other group's rate.

ADMINISTRATORS TO STUDENT ENROLLMENT

From school years 2004–05 to 2008–09, the rate of growth for the number of school administrators exceeded the rate of growth for student enrollment. That trend reversed in 2009–10, when the annual rate of growth of student enrollment exceeded the rate of growth of administrators. **Figure 3** shows the annual percentage change in the numbers of administrators and students for each school year from 2004–05 to 2012–13.

The average annual increase in student enrollment statewide from school years 2003–04 to 2012–13 was 1.7 percent. This change compares to an average 1.9 percent growth rate in the number of administrators during this period. The number of students per administrator also decreased during this 10-year period. For 2003–04, there were 203.23 students for every administrator, and this number dropped to 200.24 students for every administrator in 2012–13.

Figure 3 shows that the annual increase in student enrollment remained steady from school years 2004–05 to 2012–13. In six of the nine years, student enrollment increased at rates

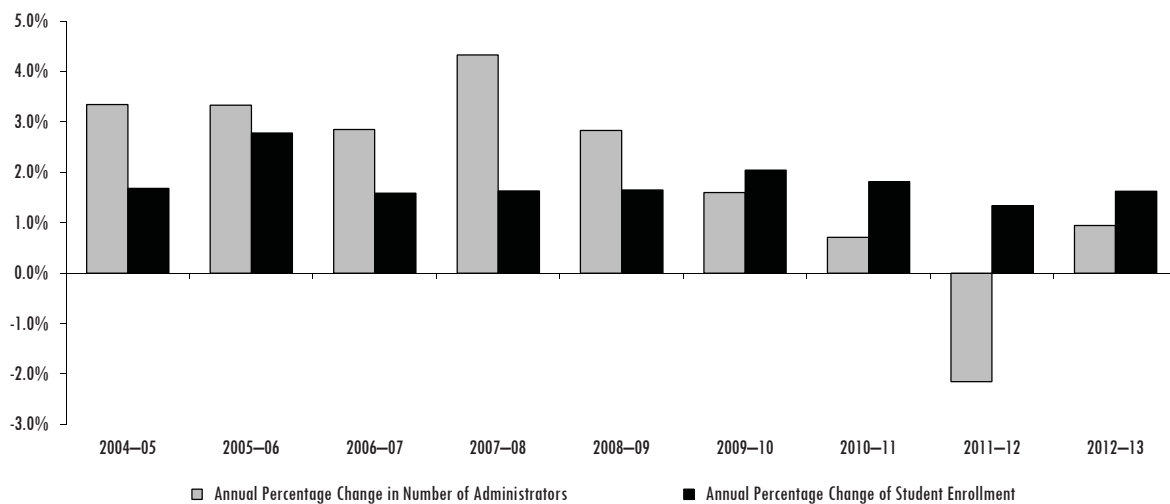
between 1.6 percent and 1.8 percent annually. From 2004–05 to 2008–09, the annual growth rate in the total number of administrators was greater than the increase in student enrollment. The largest change in growth was for 2007–08 when the number of administrators increased by 4.3 percent, while student enrollment increased by 1.6 percent. Beginning in 2008–09, this trend changed. From 2009–10 to 2012–13, student enrollment increased annually at a higher rate than that for administrators. Over these three years student enrollment increased by an average of 1 percent annually, while administrators decreased by an average of 0.4 percent.

ADMINISTRATORS TO TEACHERS

The school staff designation of teacher is given to an individual who leads classroom instruction; the designation includes teachers, special duty teachers, and substitute teachers. **Figure 4** shows the total number of administrators and teachers statewide from school years 2003–04 to 2012–13 and the percentage that each changed from the previous year.

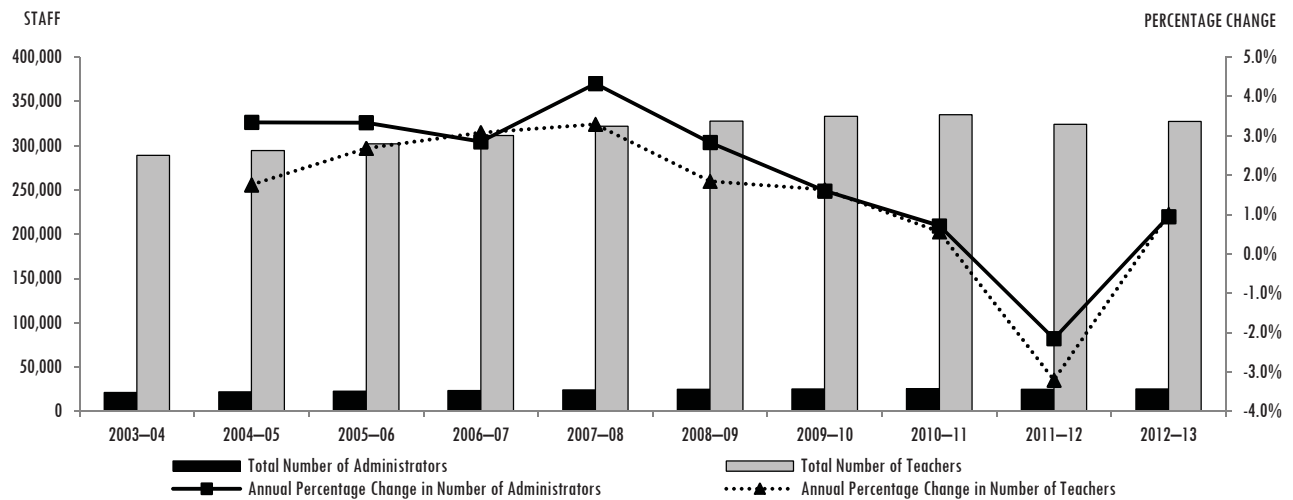
From school year 2003–04 to 2012–13, the total number of teachers in public schools increased by 38,232. The average annual increase in the number of teachers was 1.3 percent. The trends in teacher employment fluctuated during this 10-year period. From 2003–04 to 2009–10, Texas schools added 43,819 new teachers. During this seven-year period, the number of teachers increased by an average of 2.2 percent

FIGURE 3
CHANGES IN STUDENT ENROLLMENT AND TOTAL NUMBER OF ADMINISTRATORS IN TEXAS PUBLIC SCHOOLS
SCHOOL YEARS 2004–05 TO 2012–13



NOTE: Percentages for school year 2003–04 are not shown as it is the first year of the 10-year period and there is no previous data to compare.
 SOURCE: Texas Education Agency.

FIGURE 4
SCHOOL ADMINISTRATORS AND TEACHERS IN TEXAS PUBLIC SCHOOLS, SCHOOL YEARS 2003–04 TO 2012–13



NOTE: Percentages for school year 2003–04 are not shown as it is the first year of the 10-year period and there is no previous data to compare.
 SOURCE: Texas Education Agency.

annually. These trends shifted for 2010–11. From 2010–11 to 2011–12, the number of teachers decreased by 10,731, or 3.2 percent. The number of teachers increased the next year, resulting in an average annual decrease of 0.7 percent during this three-year period.

From school years 2003–04 to 2012–13, the number of school administrators increased by an average of 1.9 percent annually, which was 0.6 percent higher than the average annual increase in the number of teachers during this period. As shown in **Figure 4**, during this 10-year period, the number of administrators increased at a higher rate than teachers every year except 2006–07 and 2012–13. During the first six years of this period, 2003–04 to 2008–09, the number of administrators increased by an average of 3.0 percent annually, compared to a 2.2 percent increase in the number of teachers. Beginning in 2009–10, these rates became more aligned. From 2009–10 to 2012–13, the number of administrators decreased by an average 0.1 percent annually, compared to a 0.4 percent average annual decrease in the number of teachers. In 2012–13, the number of teachers increased by 1.0 percent while the number of administrators increased by 0.9 percent.

ADMINISTRATORS TO AUXILIARY STAFF AND EDUCATIONAL AIDES

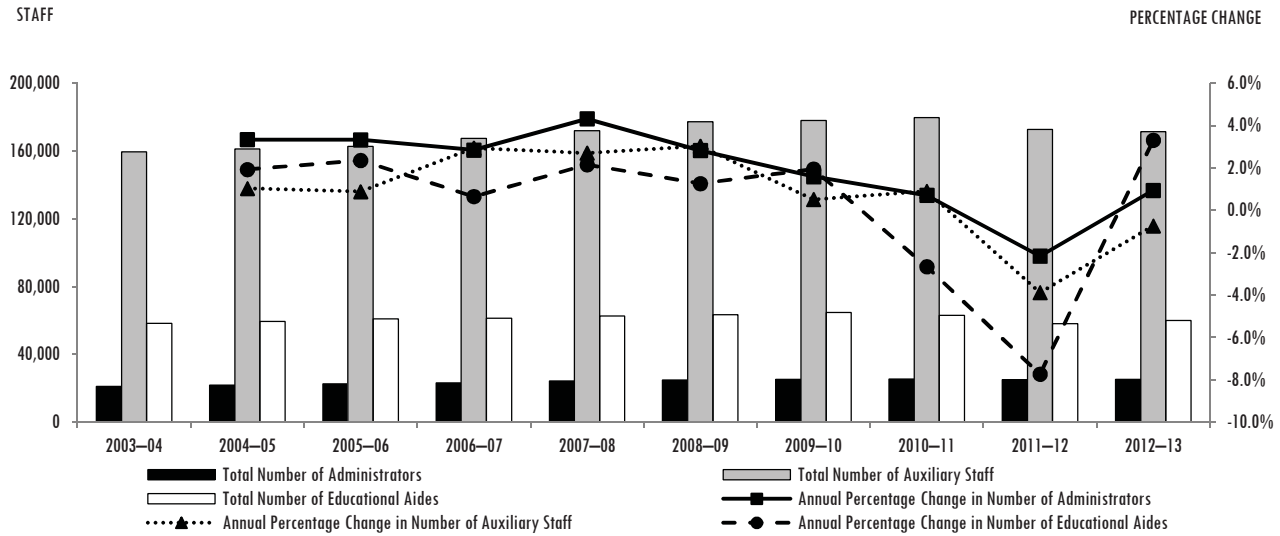
Two other categories of school employees designated in PEIMS are auxiliary staff and educational aides. Auxiliary staff is defined as school staff reported without a defined role

but with a PEIMS employment and payroll record. Examples include food service workers, bus drivers, security guards, clerks (such as attendance, purchasing, accounting, payroll, general office, file, and mail), maintenance workers, secretaries, and custodial staff. Educational aides are defined as individuals who perform routine classroom tasks with the supervision of a certified teacher or teaching team. These include educational aides and interpreters for deaf or hearing-impaired students. **Figure 5** shows the total number of administrators, educational aides, and auxiliary staff statewide from school year 2003–04 to 2012–13 and the percentage that each group changed from the previous year.

As shown in **Figure 5**, during the 10 years from school years 2003–04 to 2012–13, the total number of auxiliary staff increased by 11,918, while the total number of educational aides increased by 1,626. During this period, the number of auxiliary staff increased by an average of 0.7 percent annually, while the number of educational aides increased annually by an average of 0.3 percent. The average annual increases of both groups were less than the 1.9 percent increase in number of administrators during this period.

The total number of both auxiliary staff and educational aides consistently increased at rates lower than administrators during this period. However, as was seen in the numbers of both administrators and teachers, the employment trends of auxiliary staff and educational aides changed for school year 2010–11. From 2003–04 to 2009–10, the number of

FIGURE 5
ADMINISTRATORS, EDUCATIONAL AIDES, AND AUXILIARY STAFF IN TEXAS PUBLIC SCHOOLS
SCHOOL YEARS 2003–04 TO 2012–13



NOTE: Percentages for school year 2003–04 are not shown as it is the first year of the 10-year period and there is no previous data to compare.
 SOURCE: Texas Education Agency.

auxiliary staff increased by an average of 1.7 percent annually and educational aides increased by 1.5 percent annually. This compares to a 2.8 percent increase in the number of administrators during this same period. From 2010–11 to 2012–13, the number of auxiliary staff decreased by an average of 1.5 percent annually. Likewise, the number of educational aides also decreased annually by an average of 1.6 percent. During this period, the number of administrators decreased by an average 0.4 percent annually.

ADMINISTRATORS TO PROFESSIONAL SUPPORT STAFF

Professional support staff is defined as school staff that provides professional support at the campus level. Professional support staff includes therapists, psychologists, counselors, diagnosticians, physicians and nurses, librarians, department heads, and other support roles. This category does not include secretaries.

Figure 6 shows the total number of administrators and professional support staff statewide from school years 2003–04 to 2012–13 and the percentage that each changed from the previous year.

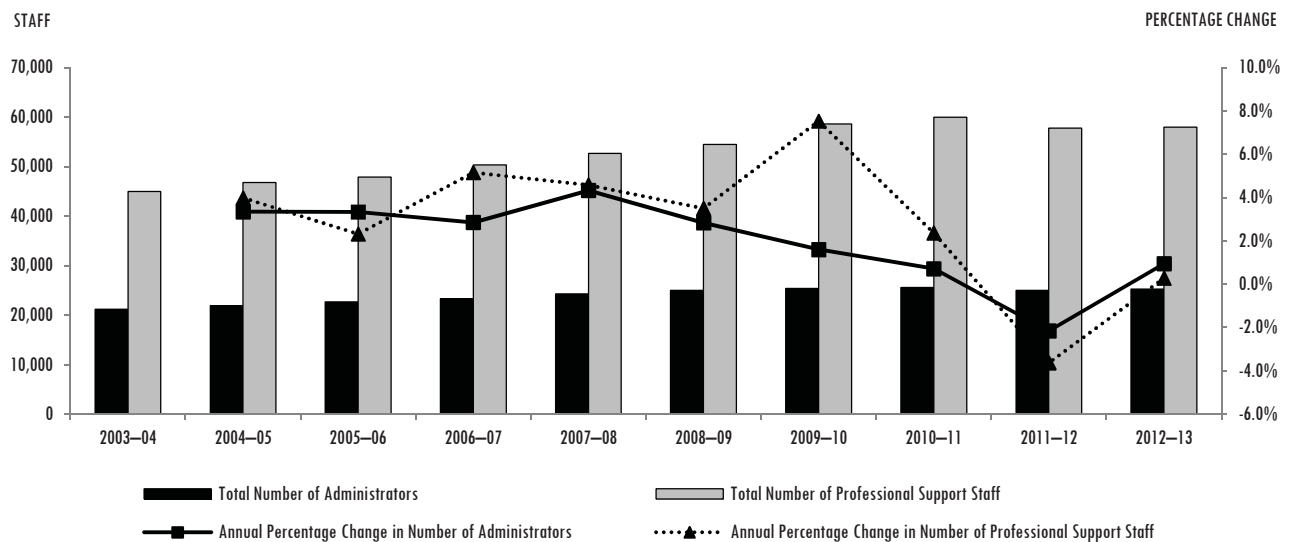
Statewide, between school years 2003–04 and 2012–13, the number of professional support staff increased at a greater average annual rate than that of administrators. Of the five employee categories in PEIMS, professional support staff experienced the greatest average annual percentage increase

during this 10-year period. From 2003–04 to 2012–13, the number of professional support staff increased by 12,949, or an average annual percentage of 2.9 percent. During this period, the total number of administrators increased by an average of 1.9 percent annually.

Similar to rates among the other PEIMS employee groups, the average annual increase in the total number of professional support staff was larger in the first six years of this period. The average annual increase in the number of professional support from school years 2003–04 to 2009–10 was 4.3 percent. During this period, the number of administrators increased by an average annual rate of 2.8 percent. However, the growth in number of professional support staff slowed from 2010–11 to 2012–13. During these three school years, the number of professional support staff decreased by an average of 1.1 percent annually, while the number of administrators decreased by an average of 0.4 percent annually.

During the 10 years from school years 2003–04 to 2012–13, Texas public schools experienced substantial growth in employment. During this period, the average annual increase in the total number of school staff was 1.2 percent. As part of this overall growth, the number of administrators statewide increased annually by an average of 1.9 percent. This increase was greater than almost all of the designated school staff groups. The average annual increase in the number of

FIGURE 6
ADMINISTRATORS AND PROFESSIONAL SUPPORT STAFF IN TEXAS PUBLIC SCHOOLS, SCHOOL YEARS 2003–04 TO 2012–13



NOTE: Percentages for school year 2003–04 are not shown as it is the first year of the 10-year period and there is no previous data to compare.
 SOURCE: Texas Education Agency.

administrators was 0.6 percentage points greater than the average annual increase in number of teachers, 1.2 percentage points greater than that of auxiliary staff, and 1.6 percentage points greater than that of educational aides. However, the average annual increase in number of professional support staff was 1.0 percentage points greater than that of administrators. During this period of school employment growth, non-instructional staff (auxiliary staff, professional support staff, and administrators) increased at a greater average annual rate than teachers and educational aides. This growth rate among non-instructional staff was more a result of an increased number of professional support staff than of administrators.

ADMINISTRATOR SALARIES

Administrator salaries can have a significant financial impact on school districts. PEIMS data provides information on the salaries of all administrators and the average salaries of central administrators and campus administrators. Salary data includes the pay that school staff receives for regular duties only and does not include supplemental payments for extra duties. The data also does not include benefits.

For school year 2012–13, the total salaries of administrators statewide accounted for 7.4 percent of all school staff salaries. This rate compares to 7.1 percent for school year 2003–04. From school years 2003–04 to 2012–13, the total salaries of administrators increased annually by an average of 4.1 percent.

The total salaries of all school staff increased by an average of 3.7 percent annually during this period. **Figure 7** shows the percentage at which the salaries of administrators and school staff changed annually from 2004–05 to 2012–13.

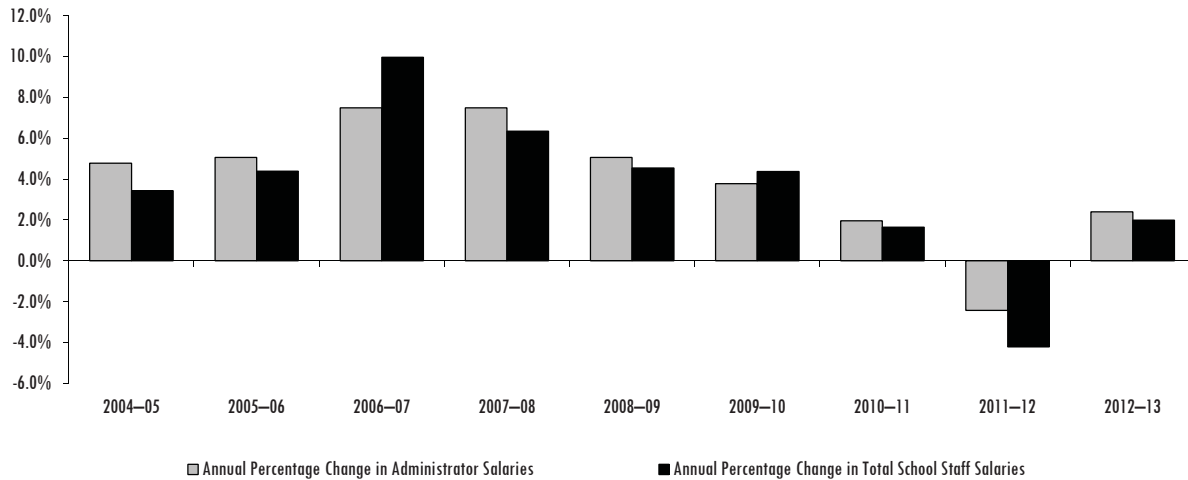
As shown in **Figure 7**, the total salaries of administrators generally increased at an annual rate greater than the salaries of all school staff. The only exceptions were in school years 2006–07 and 2009–10. Salary trends of administrators mirrored the trends for school staff. The greatest rate of increase for both groups occurred in 2006–07 and 2007–08. The only year that both groups' salary growth rates did not increase was 2011–12.

The average salary of central administrators increased from \$74,728 in school year 2003–04 to \$91,993 in 2012–13. The average salary of campus administrators increased from \$60,822 in 2003–04 to \$71,259 in 2012–13. **Figure 8** shows the statewide average salaries of central and campus administrators from 2003–04 to 2012–13.

Figure 8 shows that the average salaries of central and campus administrators increased every year during this period with the exception of school year 2011–12. The average salaries of both categories increased by the largest percentages in 2006–07 and by the lowest percentages in 2011–12.

The statewide average salary of central administrators increased annually by an average of 2.3 percent from school

FIGURE 7
SALARIES OF ADMINISTRATORS AND TOTAL SCHOOL STAFF IN TEXAS PUBLIC SCHOOLS
SCHOOL YEARS 2004–05 TO 2012–13

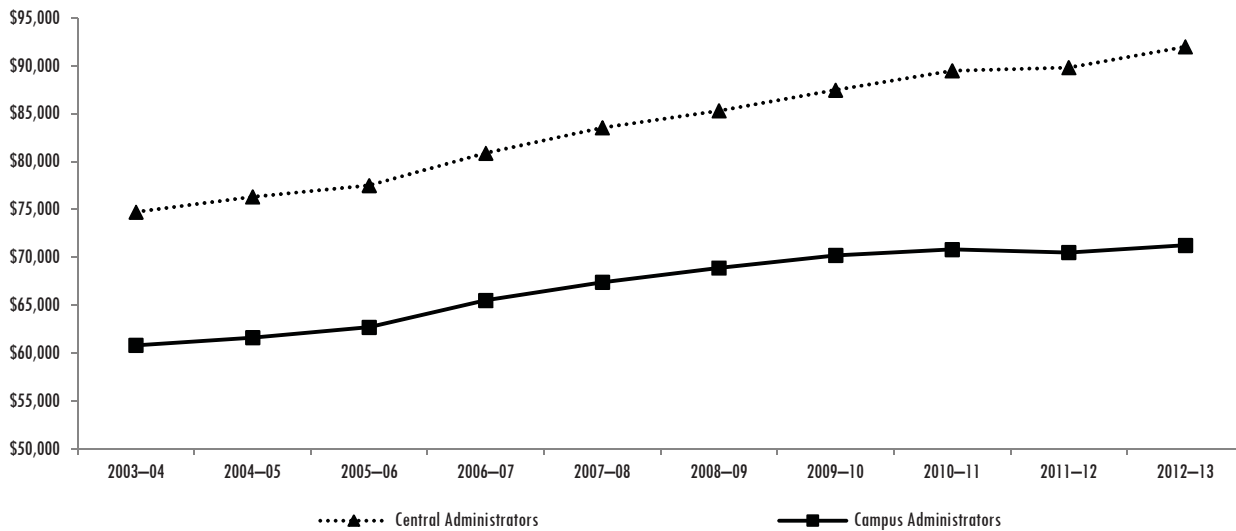


NOTES:

- (1) Percentages for school year 2003–04 are not shown as it is the first year of the 10-year period and there is no previous data to compare.
- (2) Total school staff includes administrators.

SOURCE: Texas Education Agency.

FIGURE 8
AVERAGE SALARIES OF CENTRAL AND CAMPUS-LEVEL ADMINISTRATORS IN TEXAS PUBLIC SCHOOLS
SCHOOL YEARS 2003–04 TO 2012–13



SOURCE: Texas Education Agency.

years 2003–04 to 2012–13. However, the rate at which the average salary of central administrators increased during this 10-year period was not consistent. From 2003–04 to 2008–09, the average salary of central administrators increased annually by an average of 2.4 percent. This rate differs from a 1.3 percent increase from 2009–10 to

2012–13. The most significant deviation was in 2011–12, when the average salary of central administrators increased by only 0.4 percent.

Figure 8 also shows statewide trends in the average salary of campus administrators. The average salary of campus administrators increased by an average of 1.7 percent

annually, which was 0.6 percent less than the average annual increase in the average salary among central administrators. The salary trends for campus administrators during this period were similar to central administrators' trends. From school years 2003–04 to 2008–09, the average salary of campus administrators increased annually by an average of 2.2 percent. From 2009–10 to 2012–13, the salary of campus administrators only increased by 0.4 percent.

TEACHER SALARIES

PEIMS includes salary data for administrators within the designation of professional staff. The other two groups in this designation include teachers and professional support staff.

The average salary of teachers statewide increased from \$40,478 in school year 2003–04 to \$48,821 in 2012–13. During this 10-year period, the annual increase in the average salary of teachers was consistent with the increase in the average annual salary of campus administrators and less than the increase in the average annual salary of central administrators. During this period, the average salary of teachers increased annually by an average of 2.1 percent.

The rate of increase for the average salary of teachers fluctuated from school years 2003–04 to 2012–13. For the first five years of this 10-year period, the annual rate of increase in the average salary of teachers kept pace with and often exceeded the increase in the average salaries of central and campus administrators. From 2003–04 to 2007–08, the average salary of teachers increased by 2.8 percent annually. This rate was a greater percentage increase than those among central or campus administrators. The average salary of central administrators increased annually during that period by 2.4 percent, and the average salary of campus administrators increased by 2.2 percent.

However, the average salary of teachers increased at a lower rate from school years 2008–09 to 2012–13. During this five-year period, the average salary of teachers increased by 0.7 percent annually. This percentage was identical to the increase in the average annual salary of campus administrators, but less than the 1.6 percent increase in the average salary of central administrators. As was the case with the salaries of central and campus administrators, the largest deviation in teachers' salaries came in 2011–12 when the average salary of teachers decreased by 0.5 percent.

PROFESSIONAL SUPPORT STAFF SALARIES

PEIMS provides salary data for the category of professional support staff. The average salary of professional support staff

increased from \$48,039 in school year 2003–04 to \$57,253 in 2012–13. During this period, the statewide average salary of professional support staff increased at a greater average annual rate than that of campus administrators, but less than that of central administrators.

The average salary of professional support staff increased annually by 1.9 percent each year from school years 2003–04 to 2012–13. During this period, the average salary of campus administrators increased by an average of 1.7 percent annually, while the average salary of central administrators increased by an average of 2.3 percent annually.

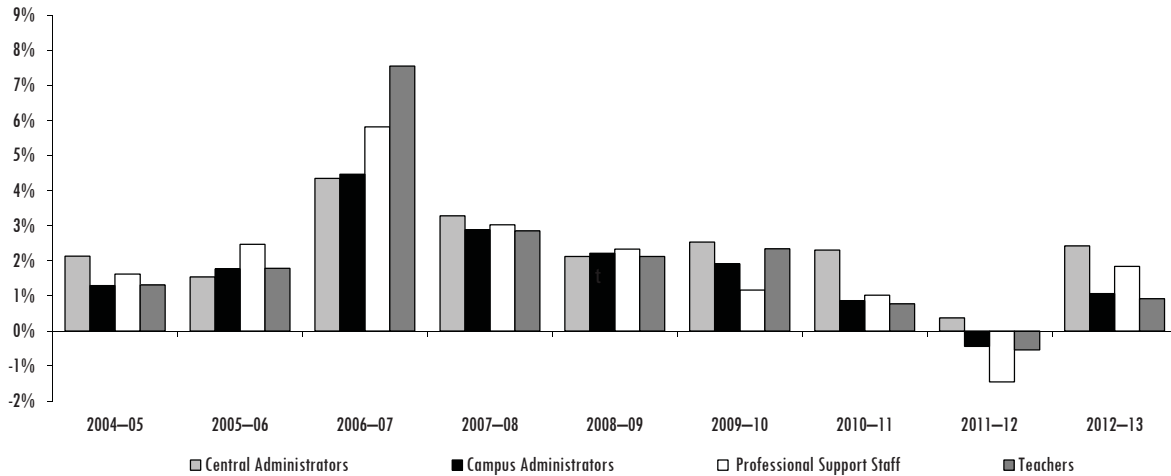
However, the salary trends of professional support staff shifted within this period. From school years 2003–04 to 2008–09, the average salary of professional support staff increased annually by an average of 2.7 percent. This rate was larger than that of central (2.4 percent) and campus (2.2 percent) during this period. However, in the most recent four-year period, the average salaries of professional support staff increased at a lower rate. From 2009–10 to 2012–13, the average salary of professional support staff increased at an average annual rate of 0.3 percent. This rate was less than that of both central (1.3 percent) and campus (0.4 percent) administrators during this period.

During the 10-year period from school years 2003–04 to 2012–13, the statewide average salaries of central and campus administrators both increased, but at different rates. **Figure 9** shows the annual percentage change in the average salaries of teachers, professional support staff, central administrators and campus administrators.

As shown in **Figure 9**, during this period, the average salary of central administrators increased at a rate greater than the average salaries of teachers, professional support staff, and campus administrators. The average salary of campus administrators, however, increased at a lower rate than those of teachers, professional support staff, and central administrators. From school years 2003–04 to 2012–13, the average salary of central administrators increased annually by an average of 2.3 percent, while the average salary of campus administrators increased by 1.7 percent. This rate compares to a 2.1 percent average annual increase in the average salary of teachers and a 1.9 percent average annual increase in the average salary of professional support staff.

From school years 2003–04 to 2008–09, the total number of school staff statewide increased significantly, as did the statewide average salaries of all the PEIMS-designated groups of professional school staff. During these six years, the salaries

FIGURE 9
ANNUAL PERCENTAGE CHANGE OF AVERAGE SALARIES OF TEXAS PUBLIC SCHOOL STAFF
SCHOOL YEARS 2004–05 TO 2012–13



NOTE: The percentages for school year 2003–04 are not shown as it is the first year of the 10-year period being examined and there is no previous year’s data to compare.
 SOURCE: Texas Education Agency.

of all groups of school staff increased by an average of 2.2 percent or more each year. During this period, the average salaries of teachers increased annually by an average of 2.8 percent and professional support staff 2.7 percent. These increases were both higher than those of central (2.4 percent) and campus (2.2 percent) administrators during this period. In the most recent four-year period, these trends changed; the average salaries of all three groups of professional school staff increased at lower rates. From 2009–10 to 2012–13, the average salary of central administrators increased at a greater average annual rate than any other school staff group’s rate. During these four years, the average salary of central administrators increased annually by an average of 1.4 percent. The average salary of campus administrators increased by an average of 0.4 percent annually. This compares to a 0.3 percent average annual increase in each of the average salaries of teachers and professional support staff. Overall, the average salary of campus administrators increased at a rate consistent with those of teachers and professional support staff.

More detailed information is available on this subject at the Interactive Graphics links of the Legislative Budget Board’s website <http://www.lbb.state.tx.us/Interactive.aspx>.

OVERVIEW OF FUNDING AND ACCOUNTABILITY FOR BILINGUAL AND ENGLISH AS A SECOND LANGUAGE PROGRAMS IN TEXAS PUBLIC SCHOOLS

Approximately 900,000 students in Texas public schools were identified as English language learners during school year 2013–14. The number of students classified as English language learners is steadily increasing. To meet both their academic and English language-acquisition needs, these students are offered services in a bilingual or English as a second language program. Both the federal and state governments provide enhanced funding to support special language programs and to help offset the cost of these services. The U.S. Department of Education provides formula-based grants to state education agencies based on the number of English language learner and immigrant students in the state. The Texas Foundation School Program provides additional funding for special language programs. The Foundation School Program entitlement is based on the average daily attendance of bilingual and English as a second language students in a school district or charter school.

Bilingual and English as a second language programs include unique monitoring and accountability requirements. The Texas Education Agency annually monitors and evaluates the performance and effectiveness of these programs in public schools using the Performance-Based Monitoring Analysis System. The Texas Education Agency may select school districts or charter schools that do not perform well on these performance indicators for interventions.

FACTS AND FINDINGS

- ◆ An English language learner is a student who is in the process of acquiring English and has another language as the native language. Texas Education Agency rules state that the term English language learner is used interchangeably with limited English proficient.
- ◆ For school year 2013–14, Texas public schools classified 899,780 students as English language learners. Of these, 521,491 students were enrolled in a bilingual program, and 357,078 were enrolled in an English as a second language program. A total of 21,211 English language learners did not participate in a special language program.
- ◆ The number of students classified as English language learners increased by an average of 2.1 percent annually from school years 2009–10 to 2013–14.

Total student enrollment increased by an average of 1.3 percent annually during this period.

- ◆ The federal Elementary and Secondary Education Act, Title III, Part A, as reauthorized pursuant to the federal No Child Left Behind Act of 2001, authorizes supplemental grant funding to states to ensure that English language learners attain proficiency in English and meet the same state academic content requirements and academic achievement standards expected of all students. For school year 2013–14, Texas received approximately \$98.4 million in Title III grants, or 14.0 percent of total Title III funding for that year.
- ◆ State funding is provided to school districts and charter schools to help meet the educational needs of English language learners. The total Texas Foundation School Program entitlement attributable to bilingual/English as a second language attendance for school year 2013–14 was approximately \$477.5 million.
- ◆ The Texas Education Agency monitors and evaluates the performance and effectiveness of bilingual and English as a second language programs each year. Based on the results, the agency identifies public schools for interventions. For school year 2013–14, 315 school districts and charter schools, or 25.7 percent, were selected for a stage of bilingual/English as a second language program interventions.

DISCUSSION

The Texas Education Code, Chapter 29, Subchapter B, formally recognizes that large numbers of students in the state come from environments in which the primary language is not English. Students from such environments often demonstrate limited English proficiency. The Texas Education Code defines a student of limited English proficiency (LEP) as a student whose primary language is other than English and whose language skills are such that the student has difficulty performing ordinary classwork in English. The term LEP is used in state and federal statute to refer to this population of students. In recent years, use of the phrase LEP is decreasing. Instead, the term English language learner (ELL) has gained prominence. The Texas

Administrative Code defines an English language learner as a student who is in the process of acquiring English and has another language as the first native language. The Texas Administrative Code uses the phrase ELL almost exclusively in rules regarding bilingual education and special language programs. Texas Education Agency (TEA) rules state that the term LEP is used interchangeably with ELL.

According to the Texas Education Code, Chapter 29, Subchapter B, public school classes in which instruction is provided only in English often are inadequate for the education of ELL students. Bilingual education and special language programs can meet these students' needs and facilitate their integration into the regular school curriculum. In recognition of these students' special needs, the Texas Education Code, Section 29.051, establishes bilingual education and special language programs in public schools to provide services to ELL students.

BILINGUAL AND ENGLISH AS A SECOND LANGUAGE PROGRAMS AND STUDENTS

The Texas Education Code, Section 29.053, establishes when school districts and charter schools must offer bilingual and English as a second language (ESL) programs. The primary distinction between bilingual and ESL programs is the language in which instruction is delivered. The goals of both bilingual education and ESL programs are to enable ELL students to become competent in listening, speaking, reading, and writing in English. In bilingual programs, these goals are achieved through the development of literacy and academic skills in both the primary language and English. However, ESL programs achieve English competency through the delivery of academic instruction in English, accompanied by strategies that promote language acquisition.

According to TEA rules, any district or charter school with an enrollment of 20 or more ELL students in any language

classification in the same grade level is required to offer bilingual education. In such districts and charters, a bilingual program must be offered to the ELL students who speak that language in the elementary grades, which must include pre-kindergarten through grade five. Bilingual education must also be offered in grade six in public schools in which this grade level is clustered with the elementary grades. School districts and charter schools are authorized to offer bilingual programs at grade levels in which bilingual education is not required. All ELL students for whom a school district or charter school is not required to offer bilingual education must be provided with an ESL program. **Figure 1** shows the requirements regarding bilingual and ESL programs.

To identify students who need bilingual or ESL services, the Texas Administrative Code, Section 89.1215, requires districts and charter schools complete a home language survey for each new student. Public schools use the survey to determine the language normally spoken by the student and used in the home. If the home language survey indicates that a language other than English is used, public schools test the student to determine the student's proficiency level in English. If a bilingual program in the student's home language is offered, public schools also administer an assessment in the home language to determine the student's oral proficiency level.

In accordance with the Texas Administrative Code, Section 89.1220, public schools must establish and operate a language proficiency assessment committee (LPAC). The LPAC serves as the ELL students' advocate to make certain they receive appropriate services. The Texas Education Code, Section 29.056, authorizes the LPAC to classify a student as an ELL, based on student assessment. The LPAC recommends the ELL student's initial instructional placement in the required program. Parents and guardians of ELL students are notified in writing of the students' classification and

**FIGURE 1
REQUIREMENTS TO PROVIDE BILINGUAL AND ENGLISH AS A SECOND LANGUAGE PROGRAMS, 2014**

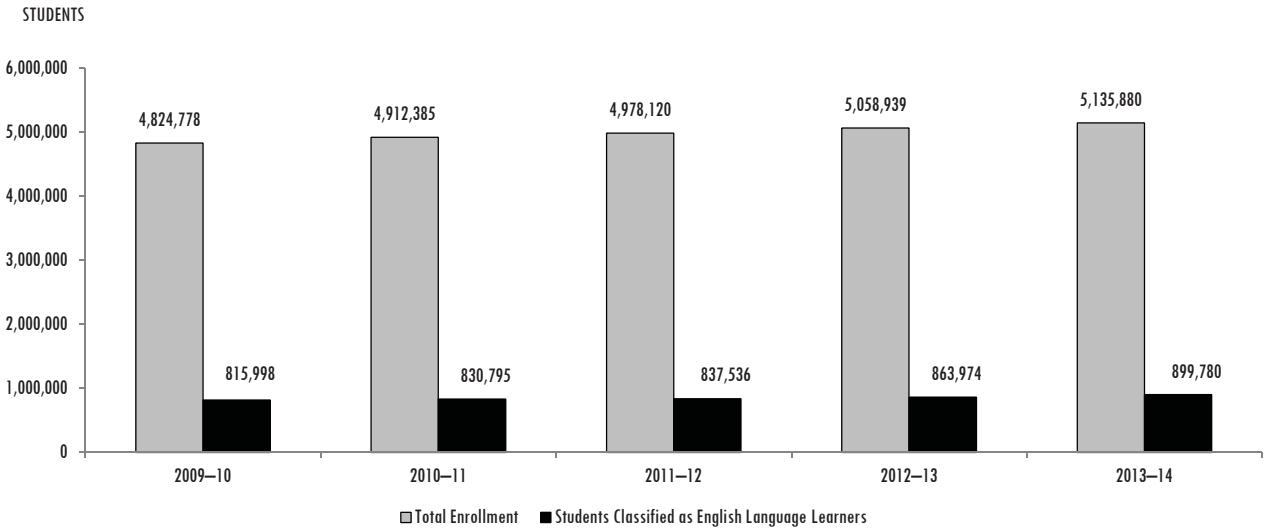
SCHOOL	BILINGUAL PROGRAM	ESL PROGRAM
Elementary (pre-kindergarten to grade 5 or 6)	Required in districts or charter schools with an enrollment of 20 or more English language learner (ELL) students in any language classification in the same grade level.	Must be offered to any ELL student for whom a district or charter is not required to offer a bilingual program.
Middle/Junior High (Grades 6 or 7 to 8)	Optional	Must be offered to any ELL student for whom a district or charter does not offer a bilingual program.
High (Grades 9 to 12)	Optional	Must be offered to any ELL student for whom a district or charter does not offer a bilingual program.

NOTE: ESL – English as a second language.
SOURCE: The Texas Administrative Code.

placement. This notification must be provided in English and the parents' primary language. A parent or guardian must give consent for the student to participate in a bilingual or ESL program.

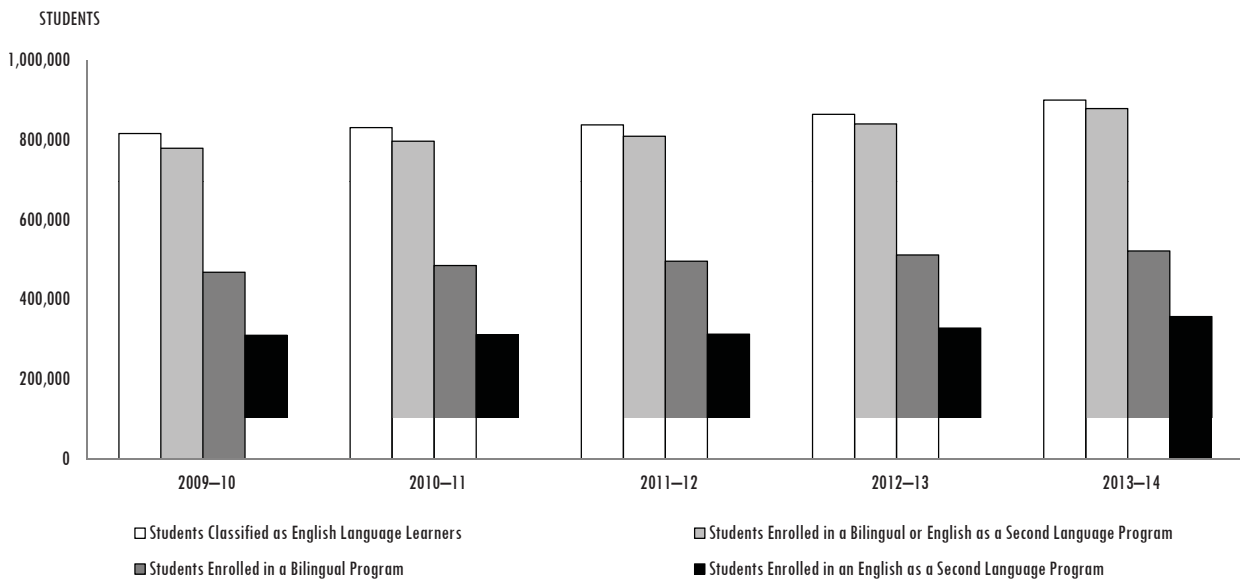
Participation in bilingual and ESL programs, along with the total ELL student population, is increasing. **Figures 2 and 3** show trends in ELL enrollment and participation in bilingual and ESL programs from school years 2009–10 to 2013–14.

FIGURE 2
TEXAS' TOTAL STUDENT ENROLLMENT COMPARED TO ENGLISH LANGUAGE LEARNER ENROLLMENT
SCHOOL YEARS 2009–10 TO 2013–14



SOURCE: Texas Education Agency.

FIGURE 3
ENGLISH LANGUAGE LEARNERS AND BILINGUAL/ESL PROGRAM ENROLLMENT
SCHOOL YEARS 2009–10 TO 2013–14



NOTE: ESL – English as a second language.
SOURCE: Texas Education Agency.

The number of students enrolled in Texas public schools increased by an average of 1.3 percent annually from school years 2009–10 to 2013–14. The number of students classified as ELLs increased by an average of 2.1 percent annually during this five-year period. The rate of growth in the number of ELL students was twice the growth rate of student enrollment in school years 2012–13 and 2013–14. Despite the increase in ELL enrollment, the percentage of students classified as ELLs has remained fairly stable, increasing from 16.9 percent to 17.5 percent of the total student population during the last five school years.

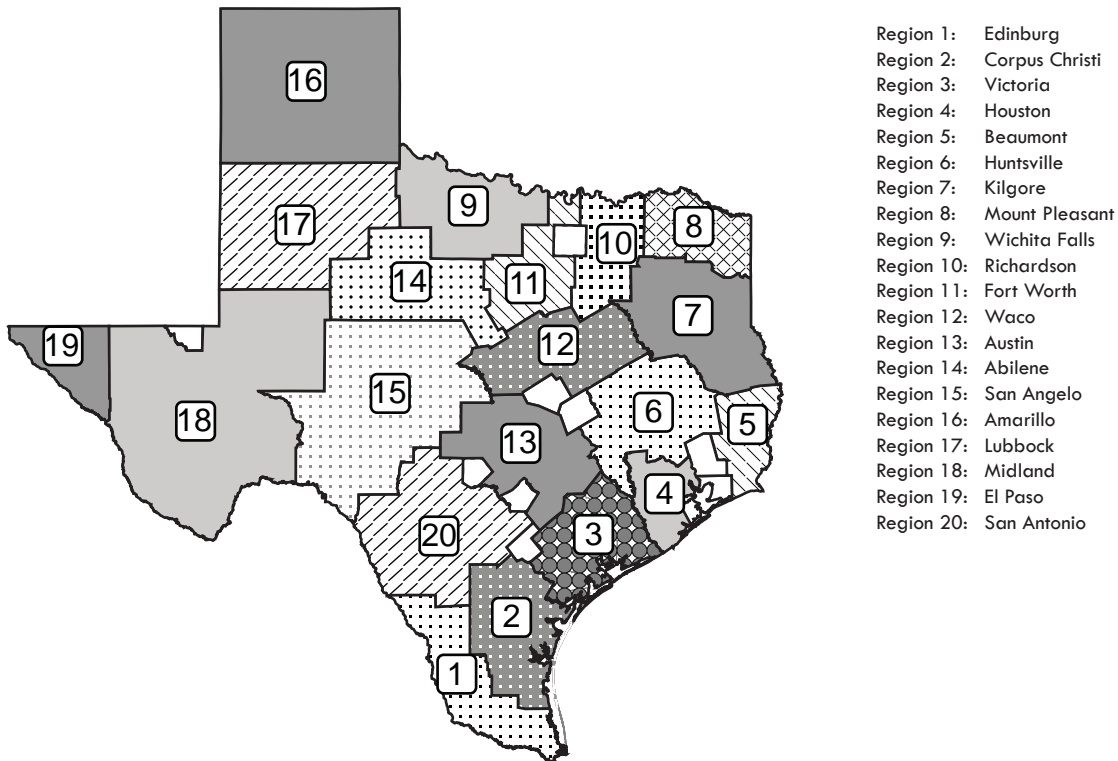
Of the 899,780 students in Texas public schools classified as ELLs in school year 2013–14, 521,491 students were enrolled in bilingual programs, and 357,078 were enrolled in ESL programs. A total of 21,211 ELLs were not enrolled in special language programs during this school year. Among the ELL student population, enrollment in a bilingual program increased by 11.3 percent from school years 2009–10 to 2013–14. Enrollment in ESL programs increased by 15.1 percent during this period.

The state of Texas is divided into 20 regions that are served by regional education service centers (ESC). **Figure 4** shows the locations of the ESCs within Texas.

Figure 5 shows the percentage of total students and the percentage of students who participated in a bilingual or ESL program in Texas public schools for school year 2013–14 by ESC region. Distribution of students participating in bilingual or ESL programs corresponded with overall student distribution throughout the state in most ESC regions. However, Region 1 contained 8.2 percent of total students while containing 17.0 percent of students enrolled in a bilingual or ESL program.

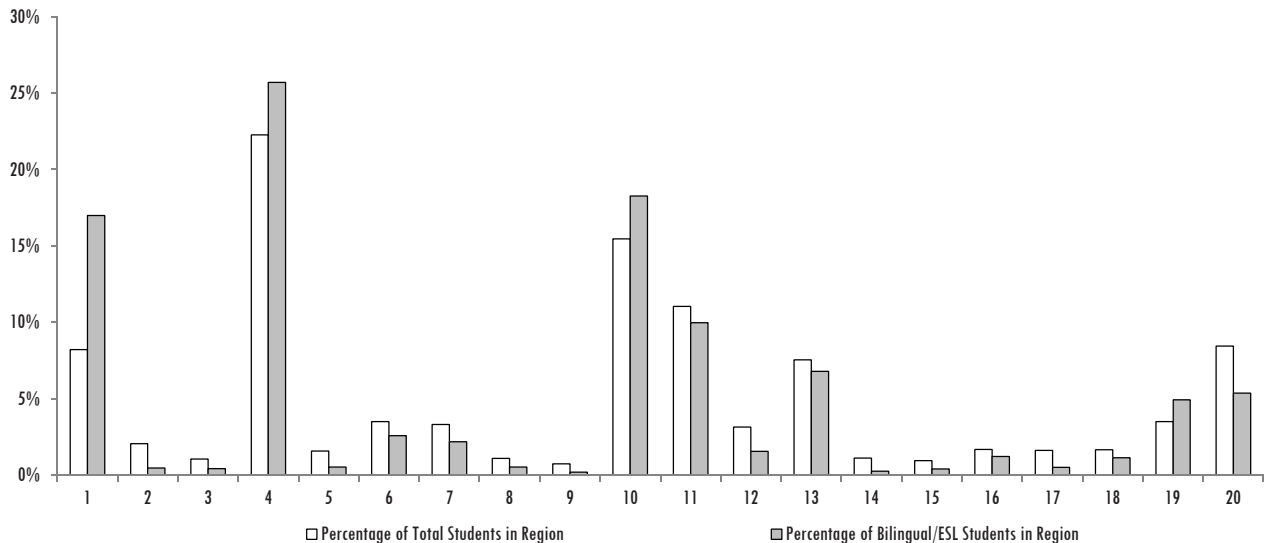
The largest percentage of bilingual and ESL students, 25.7 percent, is located in Region 4, which includes the Houston area. This is followed by Region 10, which includes Dallas and the surrounding suburbs, with 18.3 percent of the state’s bilingual/ESL student population. A large percentage of bilingual/ESL students, 17.0 percent, is also found in Region 1, which includes the city of Edinburg and is located along the Texas-Mexico border.

FIGURE 4
TEXAS EDUCATION SERVICE CENTER REGIONS, 2014



NOTE: Counties shown in white cover two ESC regions.
SOURCE: Texas Education Agency.

FIGURE 5
PERCENTAGE BILINGUAL/ESL VS. TOTAL ENROLLMENT BY REGION, SCHOOL YEAR 2013–14



NOTE: ESL = English as a second language.
SOURCE: Texas Education Agency.

ENHANCED FUNDING

Schools incur costs related to student assessment, instructional materials, teacher training, and hiring certified teachers to provide special language programs. To help school districts and charter schools cover the costs of special language programs, enhanced funding is provided by both the federal and state governments.

The U.S. Department of Education distributes formula grants to state education agencies. Formula-based grants are allocated to states according to the size of their ELL and immigrant student populations. The formula provides 80 percent of funding based on the number of ELL students and 20 percent based on the number of immigrant students in the state.

The state of Texas also provides enhanced funding to help meet the educational requirements of ELLs. The Foundation School Program (FSP) entitlement is generated in part by the average daily attendance (ADA) for students in bilingual and ESL programs.

FEDERAL FUNDING

The federal Elementary and Secondary Education Act, Title III, Part A, as reauthorized pursuant to the federal No Child Left Behind Act of 2001, supports innovation and effectiveness in the education of ELLs. This law, also known as the English Language Acquisition, Language Enhancement,

and Academic Achievement Act, authorizes supplemental grant funding to ensure that ELLs, including immigrant children and youth, attain proficiency in English, develop high levels of academic attainment in English, and meet the same state academic content requirements and student academic achievement standards expected of all students.

To meet these objectives, Title III, Section 3115, outlines required and authorized uses for these funds. **Figure 6** shows the uses for Title III English language acquisition grants.

Funds from federal Title III grants must be used to supplement, not supplant, the level of federal, state and local funds that, in the absence of such availability, would have been expended for programs for ELLs and immigrant children and youth. In addition, funds from Title III grants cannot be used to fund programs that are required by state law.

Figure 7 shows the Title III English language acquisition grants awarded to the state of Texas from school years 2009–10 to 2013–14.

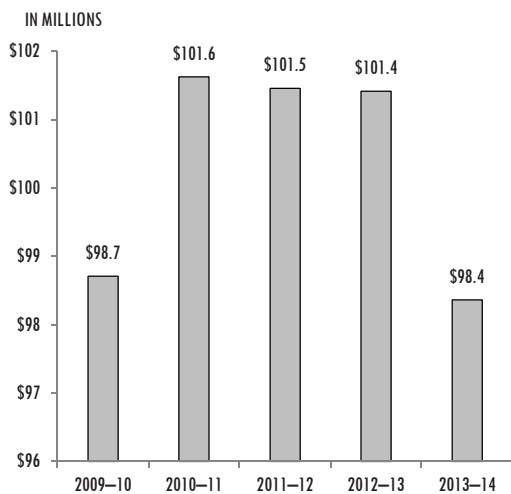
For school year 2013–14, Texas received approximately \$98.4 million in Title III grants, or 14.0 percent of total Title III funding for that year. The Title III grant awarded to the state of Texas decreased from approximately \$101.4 million in school year 2012–13 to \$98.4 million in school year 2013–14, a decrease of 3.0 percent. Nationwide, federal Title

**FIGURE 6
REQUIRED AND AUTHORIZED USES FOR TITLE III GRANTS, 2014**

REQUIRED	AUTHORIZED
<ol style="list-style-type: none"> Increase the English proficiency of English language learners (ELL) by providing high-quality, research-based language instruction educational programs that have been shown to be effective in increasing: <ul style="list-style-type: none"> English proficiency; and student academic achievement in core academic subjects. Provide high-quality professional development to classroom teachers (including teachers in classroom settings that are not the settings of language instruction educational programs), principals, administrators, and other school or community-based organizational personnel that is: <ul style="list-style-type: none"> designed to improve the instruction and assessment of ELLs; designed to enhance teachers' ability to understand and use curricula, assessment measures, and instruction strategies for ELLs; based on scientifically based research demonstrating the effectiveness of the professional development in increasing children's English proficiency or substantially increasing subject matter knowledge, teaching knowledge, and teaching skills; and of sufficient intensity and duration to have a lasting impact on the teacher's performance in the classroom; funds cannot be used for an activity that is one component of a long-term, comprehensive professional development plan established by a teacher and the teacher's supervisor based on an assessment of the needs of the teacher, the supervisor, the students of the teacher, or any local education agency employing the teacher. 	<ol style="list-style-type: none"> Upgrading program objectives and effective instruction strategies. Improving the instruction program for ELLs by identifying, acquiring, and upgrading curricula, instructional materials, educational software, and assessment procedures. Providing: <ul style="list-style-type: none"> tutorials and academic or vocational education for ELLs; and intensified instruction. Developing and implementing elementary school or secondary school language instructional educational programs that are coordinated with other relevant programs and services. Improving the English proficiency and academic achievement of ELLs. Providing community participation programs, family literacy services, parent outreach, and training activities to ELLs and their families to: <ul style="list-style-type: none"> improve the English language skills of ELL children; and assist parents in helping their children to improve their academic achievement and becoming active participants in the education of their children. Improving the instruction of ELLs by providing for: <ul style="list-style-type: none"> the acquisition or development of educational technology or instructional materials; access to, and participation in, electronic networks for materials, training, and communication; and incorporation of these resources and materials into curricula and programs. Carrying out other activities that are consistent with the purposes of this section.

NOTE: A local education agency may use no more than 2% of its Title III, Part A, English language acquisition grant for administrative costs.
SOURCE: The U.S. Elementary and Secondary Education Act.

**FIGURE 7
FEDERAL TITLE III ENGLISH LANGUAGE ACQUISITION
AWARDS TO TEXAS, SCHOOL YEARS 2009–10 TO 2013–14**



SOURCE: Texas Education Agency.

III funding decreased from \$732.1 million to \$693.8 million, a 5.2 percent decrease, during that period.

Federal Title III grant awards are distributed to state education agencies which, in turn, distribute funds to local education agencies (LEA), a term that includes both school districts and charter schools. TEA makes subgrants to LEAs by allocating funds based on the ELL and immigrant student populations served in those areas, according to the most recent Public Education Information Management System (PEIMS) data available. Pursuant to statute, the state may not award a subgrant to an LEA that totals less than \$10,000. LEAs that are scheduled to receive less than \$10,000 are required to join a shared services arrangement with one or more LEAs to receive funding. In addition, states are required to set aside a portion of their allotments, up to 15 percent, for subgrants to LEAs that have, when compared to the two preceding fiscal years, experienced a significant increase in the number of immigrant students.

The U.S. Department of Education holds state education agencies and LEAs accountable for improving ELLs’ academic performance and English language proficiency outcomes. To receive supplemental funds, Title III requires heightened levels of accountability to ensure that states and public schools are improving ELLs’ language proficiency and academic outcomes.

To meet accountability requirements, each state education agency that receives a Title III English language acquisition grant must develop annual measurable achievement objectives (AMAO) to evaluate ELLs’ progress in gaining English proficiency and meeting state academic content and student achievement standards. Title III, Section 3122, requires that states use the following AMAOs:

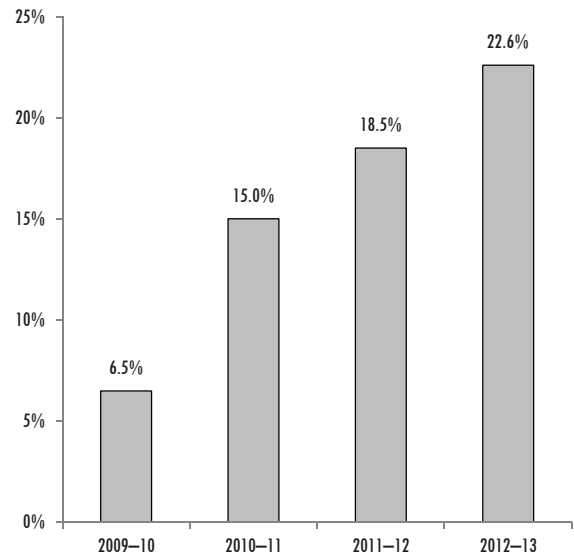
- AMAO 1 (Progress) measures how many ELLs in an LEA have made progress in learning English.
- AMAO 2 (Attainment) measures how many ELLs within an LEA have become proficient in English.
- AMAO 3 (ELL Accountability) measures how many ELLs in an LEA have met the performance and participation targets in reading/English language arts and mathematics as part of the state’s academic achievement standards.

Each LEA must meet all AMAOs to earn a status of “met.” According to Title III, Part A, LEAs that do not meet all AMAOs, as well as the state education agency that oversees them, must perform interventions that vary according to the number of consecutive years that an LEA has failed to meet all AMAOs. **Figure 8** shows the percentage of Texas LEAs that failed to earn a “met” status for school years 2009–10 to 2012–13, the last four years for which data is available.

Eighty LEAs did not earn a “met” status on the Title III language acquisition AMAOs in school year 2009–10. This number increased to 278 in school year 2012–13. There are annual targets for the AMAOs that districts must meet to earn a “met” status. According to TEA, both the annual AMAO targets and the shift to a new state assessment program contributed to the increase in the number of public schools failing to meet all AMAOs.

Of the 278 LEAs that failed to earn a “met” status in school year 2012–13, 11 have not met the AMAOs for four consecutive years, and six LEAs have not met the AMAOs for five consecutive years. After failing to meet all AMAOs for four consecutive years, the state education agency may determine whether an LEA should continue to receive

FIGURE 8
PERCENTAGE OF TEXAS LOCAL EDUCATION AGENCIES THAT FAILED TO MEET ANNUAL MEASURABLE ACHIEVEMENT OBJECTIVES FOR TITLE III LANGUAGE ACQUISITION GRANTS
SCHOOL YEARS 2009–10 TO 2012–13



SOURCE: Texas Education Agency.

funds from Title III grants. At the time of this analysis, TEA has not withheld Title III grant funding from any LEA for failure to earn a “met” status on the AMAOs for four or more consecutive years.

STATE BILINGUAL AND ESL FUNDING

The Texas Foundation School Program (FSP) also provides enhanced funding to help meet the educational requirements of ELLs. The FSP entitlement generated by the average daily attendance (ADA) for students in bilingual and ESL programs consists of two major components. The first of these components is the Tier 1 formula bilingual/ESL add-on allotment. Pursuant to the Texas Education Code, Section 42.153, school districts and charter schools receive a Tier 1 entitlement bilingual/ESL allotment from the FSP for each student that is enrolled in a bilingual or ESL program. To calculate the bilingual/ESL FSP allotment, the district or charter school’s adjusted per-student allotment is multiplied by 0.1 and then multiplied by the number of bilingual and ESL students in average daily attendance.

The Texas Education Code, Section 42.153, specifies how a public school’s bilingual/ESL add-on allotment may be used. **Figure 9** shows the authorized uses of this allotment.

FIGURE 9
AUTHORIZED USES OF STATE BILINGUAL/ENGLISH AS A SECOND LANGUAGE ADD-ON ALLOTMENT, 2014

USE	DESCRIPTION
Program and Student Evaluation	The bilingual/English as a second language (ESL) allotment can be used to purchase assessments for bilingual and special language programs and English language learners (ELL) as long as these are not assessments required to be administered to all students as part of other district/school evaluations. These include assessment instruments for identification, placement, and exiting of students.
Instructional Materials and Equipment	The bilingual/ESL allotment can be used to purchase materials that ensure linguistic and academic differentiation/support of ELLs. Such materials include visual aids and manipulative materials that are directly related to the enhancement of instruction to ELLs. These instructional materials and equipment that serve the needs of ELLs are above and beyond the materials and equipment provided to all teachers in the general education program.
Staff Development	The bilingual/ESL allotment can be used to build educators' capacity to differentiate instruction, curriculum, and assessment for linguistically, academically, and culturally diverse students. This staff development includes training in English language proficiency standards, sheltered English instruction, teaching gifted and talented ELLs, training regarding the Texas English Language Proficiency Assessment System, and language proficiency assessment committee training. The allotment can be used to pay for educators to attend conferences, district, and regional Education Service Centers bilingual and ESL trainings to serve the needs of ELLs, if these trainings are above and beyond the trainings received by all other teachers in the general education program.
Bilingual or ESL Certification Training and Certificate	At district discretion, the bilingual/ESL allotment can be used to provide training for teachers to obtain a bilingual or ESL certification and/or to provide a stipend for certification.
Supplemental Staff Expenses	The bilingual/ESL allotment can be used to provide extended-day tutorials for ELLs; academic enhancement; and linguistic acceleration of English proficiency acquisition. It can be used to hire bilingual teacher assistants to supplement instruction provided by bilingual and/or ESL certified teachers.
Salary Supplements for Teachers	The bilingual/ESL allotment can be used to provide a stipend to secure highly qualified bilingual and ESL teachers for ELLs.
Other Supplies Required for Quality Instruction and Smaller Class Size	The bilingual/ESL allotment can be used for printing costs of additional bilingual/ESL materials required for quality instruction and smaller class size.
NOTE: Excludes allowable use of a percentage of a district's Foundation School Program special allotments for indirect costs. SOURCE: Texas Education Agency.	

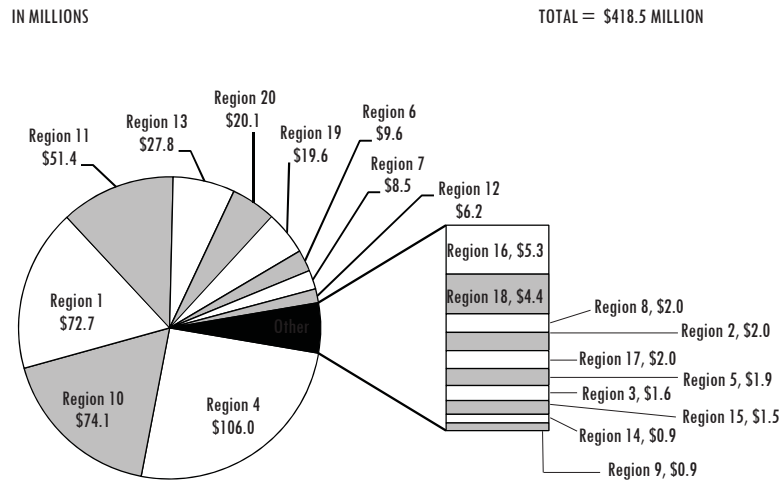
For school year 2013–14, the statewide Tier 1 entitlement bilingual/ESL allotment was approximately \$418.5 million. **Figure 10** shows the total bilingual/ESL allotment received by school districts and charter schools in each of the 20 education service center regions in the state for school year 2013–14.

The Tier 1 bilingual/ESL add-on funding allotment each ESC region received for school year 2013–14 corresponded within 2.3 percentage points to the percentage of the state's bilingual/ESL student population located within the region. For example, Region 4 received 25.3 percent of the state bilingual/ESL add-on allotment and contained 25.7 percent of the state's bilingual/ESL students. Region 10, with 18.3 percent of the state's bilingual/ESL student population, received 17.7 percent of the total bilingual/ESL add-on allotment; and Region 1, with 17.0 percent of the bilingual/ESL population, received 17.4 percent of the allotment.

Additional funding for bilingual/ESL programs is generated through other portions of the FSP. Bilingual/ESL ADA also affects a portion of the FSP entitlement determined by weighted average daily attendance (WADA) because the Tier 1 bilingual/ESL add-on allotment affects the calculation of WADA. For school year 2013–14, the WADA-based FSP entitlement attributable to bilingual/ESL attendance provided approximately \$59.0 million in additional funding, resulting in a total FSP entitlement attributable to bilingual/ESL attendance of \$477.5 million for that school year. **Figure 11** shows the total FSP entitlement attributable to bilingual/ESL attendance for school years 2009–10 to 2013–14.

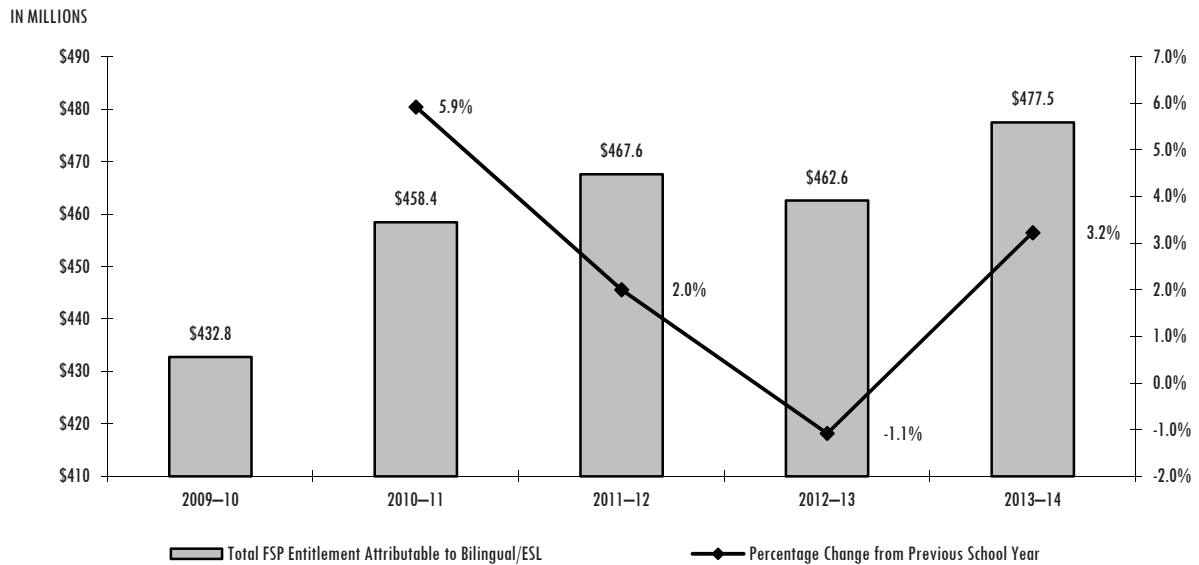
The total FSP entitlement attributable to bilingual/ESL increased from approximately \$432.8 million for school year 2009–10 to approximately \$477.5 million for school year 2013–14, a 10.3 percent increase. The number of students in Texas public schools enrolled in a bilingual or ESL program increased by 12.8 percent during this period. From school

FIGURE 10
TEXAS FOUNDATION SCHOOL PROGRAM TIER 1 BILINGUAL/ESL ADD-ON ALLOTMENT BY REGION, SCHOOL YEAR 2013–14



NOTE: ESL – English as a second language.
 SOURCE: Legislative Budget Board.

FIGURE 11
TEXAS FOUNDATION SCHOOL PROGRAM ENTITLEMENT ATTRIBUTABLE TO BILINGUAL/ESL ATTENDANCE AND PERCENTAGE CHANGE IN ENTITLEMENT FROM PREVIOUS SCHOOL YEAR, SCHOOL YEARS 2009–10 TO 2013–14



NOTE: FSP – Texas Foundation School Program; ESL – English as a second language.
 SOURCE: Legislative Budget Board.

years 2009–10 to 2013–14, the total FSP entitlement attributable to bilingual/ESL attendance that public schools received fluctuated from a decline of 1.1 percent to an increase of 5.9 percent, with an average annual increase of 2.1 percent over the five-year period.

LEAs must meet the accountability standards established in the AMAOs to ensure that they continue to receive federal

Title III English language acquisition grants. However, state funding to support bilingual and ESL programs requires no additional accountability. School districts and charter schools receive FSP funding for bilingual and ESL students based on the ADA of students enrolled in these programs. Although the FSP entitlement attributable to bilingual/ESL attendance that each school district or charter school receives is not

linked to state accountability measures, TEA monitors the performance of students enrolled in each public school's bilingual and ESL programs.

PERFORMANCE-BASED MONITORING AND INTERVENTIONS

The Texas Education Code, Section 7.028, authorizes TEA to monitor compliance with requirements applicable to a process or a program provided by a school district, campus, program, or charter. TEA annually monitors and evaluates the performance and effectiveness of the bilingual and ESL programs in school districts and charter schools each year using the Performance-Based Monitoring Analysis System (PBMAS).

Pursuant to the Texas Administrative Code, Section 97.1005, the PBMAS evaluates bilingual and ESL programs by using student performance and program effectiveness indicators. TEA annually provides the results of the PBMAS to public schools in a summary report. The report uses performance levels to rate a public school's effectiveness on the performance indicators. Performance levels range from zero to three. A level of zero indicates that a public school met the standard, while level three indicates that a public school performed significantly below the standard.

The assignment of levels is based on specific criteria and calculations. Indicators and performance levels are established by the Commissioner of Education. The criteria and calculations used in the PBMAS are determined each year by the commissioner and are communicated to public schools. The 2014 PBMAS used 10 performance indicators to measure the effectiveness of bilingual and ESL programs. These indicators include:

- the bilingual education (BE) State of Texas Assessments of Academic Readiness (STAAR) grades 3 to 8 passing rate;
- the ESL STAAR grades 3 to 8 passing rate;
- the ELL (not served in BE/ESL) STAAR grades 3 to 8 passing rate;
- the ELL year-after-exit STAAR grades 3 to 8 passing rate;
- the ELL STAAR end-of-course passing rate;
- the ELL annual dropout rate (grades 7 to 12);
- the ELL recommended high school program/distinguished achievement program diploma rate;

- the ELL graduation rate;
- the Texas English Language Proficiency Assessment System (TELPAS) reading beginning proficiency level rate; and
- the TELPAS composite rating levels for students in U.S. schools for multiple years.

TEA monitors bilingual and ESL programs to promote program effectiveness and improved student performance. The Texas Administrative Code, Section 97.1071, outlines the authority of the commissioner to use graduated stages of intervention to address student performance, program effectiveness, and/or data quality deficiencies. TEA uses the annual PBMAS review along with the results of longitudinal performance-based monitoring to determine which stage of intervention, if any, is appropriate for each public school.

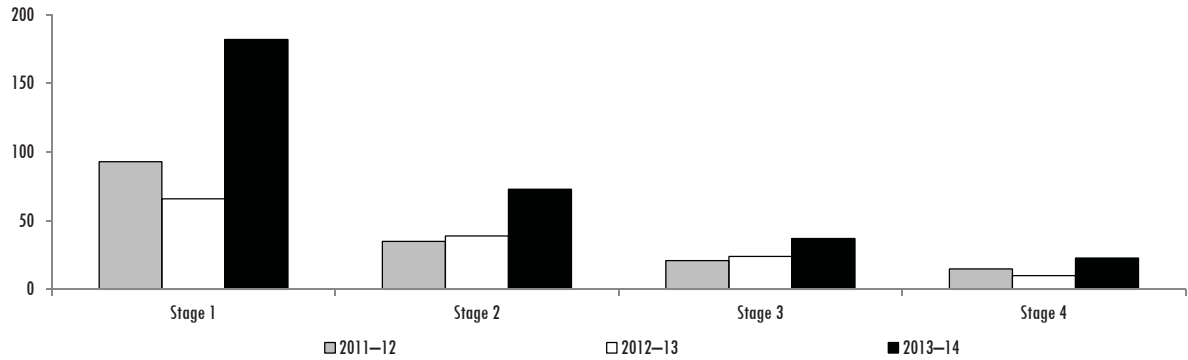
There are four stages of intervention for bilingual and ESL programs. Stage one is the least intensive level of intervention, while stage four is the most rigorous. For school year 2013–14, 315 school districts and charter schools, or 25.7 percent of all districts and charters, were assigned a stage of PBMAS bilingual/ESL program interventions. **Figure 12** shows the number of school districts and charter schools receiving each stage of intervention from school years 2011–12 to 2013–14. Before this period, PBMAS used different intervention staging levels.

School districts and charter schools required to conduct interventions must perform specific activities designed to identify and address factors that contribute to below-standard performance. The required intervention activities include: focused analysis of district data; district review of program effectiveness; public meetings; focused compliance reviews; on-site reviews; and continuous improvement planning.

Figure 13 shows the frequency at which school districts and charter schools were assigned PBMAS interventions for bilingual education/ESL programs from school years 2011–12 to 2013–14.

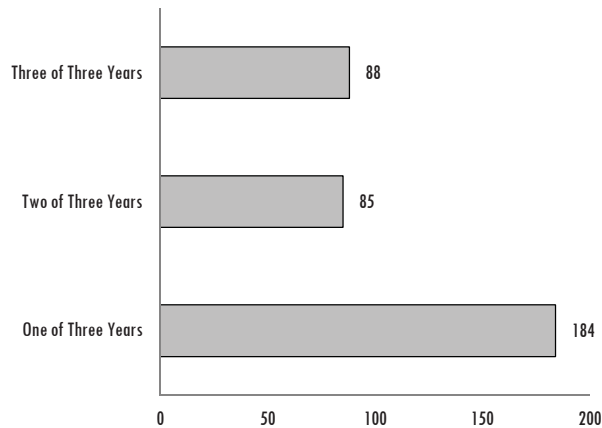
From school years 2011–12 to 2013–14, 357 school districts and charter schools were assigned a stage of PBMAS interventions for bilingual/ESL programs. Approximately half of these, 51.5 percent, were assigned a stage of intervention only one of these three years. Eighty-five districts and charter schools, or 23.8 percent, were assigned a PBMAS intervention stage two of the three years. However, 88 districts and charter schools, or 24.6 percent, were selected

FIGURE 12
TEXAS SCHOOL DISTRICTS AND CHARTER SCHOOLS BY STAGE OF PERFORMANCE-BASED MONITORING ANALYSIS SYSTEM INTERVENTION FOR BILINGUAL EDUCATION/ESL PROGRAMS, SCHOOL YEARS 2011–12 TO 2013–14



NOTE: ESL – English as a second language.
 SOURCE: Texas Education Agency.

FIGURE 13
FREQUENCY OF PERFORMANCE-BASED MONITORING ANALYSIS SYSTEM INTERVENTIONS FOR TEXAS SCHOOL DISTRICTS AND CHARTER SCHOOLS' BILINGUAL/ESL PROGRAMS, SCHOOL YEARS 2011–12 TO 2013–14



NOTES:
 (1) ESL – English as a second language.
 (2) Figure only includes school districts and charter schools assigned a stage of PBMA bilingual/ESL program interventions.
 SOURCE: Texas Education Agency.

for a stage of PBMA interventions for bilingual/ESL programs all three years. Districts and charter schools that remain at higher stages of interventions for multiple years may be subject to on-site review, special accreditation investigation, and/or other possible sanctions, as deemed necessary by TEA.

OVERVIEW OF TEXAS EDUCATION AGENCY'S PROJECT SHARE ONLINE RESOURCES

To maintain teaching certificates, Texas educators must complete a certain number of continuing professional education credit hours. Continuing professional education requirements vary depending on the type of certificate. Classroom teachers must complete 150 hours of continuing education every five years, while other professionals, such as principals and superintendents, must complete 200 hours. Educators can earn continuing education credit through various methods; including face-to-face courses provided by Education Service Centers or private companies, and online learning through video conferences and online courses.

The Texas Education Agency's Project Share is a web-based platform that offers online professional development courses and educational resources at no cost to the user. These resources include online supplemental lessons and math-related assessments for students, and access to learning sources such as the *New York Times* Knowledge Network and the PBS Digital Learning Library. Educators can also use Project Share to collaborate with their peers through professional learning communities. The agency uses a platform and learning management system called Epsilon to provide Project Share services. The program was appropriated \$18.0 million in General Revenue Funds for the 2014–15 biennium.

FACTS AND FINDINGS

- ◆ As of September 2014, approximately 2,010 professional development providers could offer courses to Texas educators. Providers include public and private entities that have been approved by the Texas Education Agency to offer professional development courses.
- ◆ During fiscal year 2014, 167,865 educators took online professional development courses through Project Share. Educators can access these courses from Project Share websites managed by the Texas Education Agency, Education Service Centers, and school districts.
- ◆ Educators use Project Share to assign their students online supplemental lessons. During fiscal year 2014, 123,699 students took supplemental lessons called OnTRACK, an increase from 24,626 students

during fiscal year 2012. This growth mirrors a growth in the number of students with active Project Share accounts, which increased from 616,776 in fiscal year 2012 to 2,697,416 in fiscal year 2014.

- ◆ Project Share's four math-related assessments identify students who need additional instruction to ensure high school algebra-readiness. The number of students that were assessed decreased from 643,358 in fiscal year 2012 to 373,085 in fiscal year 2014. Texas Education Agency staff attributes the decrease to implementation of a new assessment system within Project Share with which districts needed time to become familiar.
- ◆ From fiscal years 2010 to 2014, the Texas Education Agency paid three Education Service Centers and various institutions of higher education \$41.1 million to develop online courses and student-related content for Project Share. During the same period, content developers produced or updated 149 professional development courses, 3 student algebra-readiness assessments, and 50 OnTRACK student lessons.
- ◆ The Texas Education Agency expended \$14.8 million for a statewide license to use the Epsilon platform and learning management system from fiscal years 2010 to 2014. The original Epsilon provider, ConnectEDU, declared bankruptcy in spring 2014. The Texas Education Agency contracted with the new Epsilon provider, Graduation Alliance, for school year 2014–15 to prevent a potential service disruption. As of November 2014, the Texas Education Agency was developing a plan to improve Project Share's user experience and provide new methods to access Project Share's services.

DISCUSSION

Educators in Texas are required by statute to complete continuing professional education (CPE) requirements to renew a professional certificate. CPE requirements, pursuant to the Texas Administrative Code, Section 232.13, vary depending on the type of certificate. Classroom teachers must earn 150 clock hours of CPE credit every five years. Educators who hold other professional certificates must earn

200 clock hours every five years. Professional certificates are held by counselors, learning resource specialists and school librarians, reading specialists, educational diagnosticians, master teachers, superintendents, and principals. At least 80 percent of CPE activities must be directly related to the certificate being renewed.

Some school districts have their own professional development requirements. For example, Cypress–Fairbanks Independent School District requires teachers to earn 25 clock hours annually or 75 clock hours within three years. Plano Independent School District requires teachers to complete 30 CPE clock hours during a calendar year. School districts may pay educators a stipend as compensation for their time spent in professional development courses outside of normal school hours.

Organizations or individuals must be approved by the Texas Education Agency (TEA) to offer professional development services to educators. Providers include public school districts; accredited public and private schools outside of Texas; regional education service centers; accredited institutions of higher education; professional education associations; certain TEA staff; accredited private schools based in Texas; and private companies approved by TEA. Educators can earn CPE credit through various methods, including in-person learning at venues such as conferences or school district workshops, or online learning through video conferences or online courses. As of September 2014, TEA records identify approximately 2,010 approved professional development providers that could operate in Texas.

Project Share is a web-based platform that offers online professional development courses and other learning opportunities to educators and students at no cost to the user. Using Project Share, educators can take online courses at any time rather than arranging their schedules to attend face-to-face courses with fixed dates. Districts benefit from online courses because they can avoid travel costs to send educators to fixed-location courses. Project Share also gives educators and students access to a variety of online resources and allows educators to interact with their peers based on professional interests. These services are made available by a company that hosts a web-based environment, or platform, and entities that develop the system's content in accordance with TEA agreements. The agency is authorized to administer Project Share by a rider in the 2014–15 General Appropriations Act that allocates \$9.0 million per year for the program. From fiscal year 2010, when Project Share

services began, to fiscal year 2014, TEA expended \$51.0 million on Project Share.

Since its inception in fiscal year 2010, Project Share has expanded from being a professional development provider to a broad-based educational resource. This growth required funding to develop online content and purchase the Epsilon-developed platform license. From fiscal years 2010 to 2013, TEA funded Project Share using discretionary transfers from other programs with similar purposes. For the 2010–11 biennium, TEA allocated \$11.9 million to Project Share from the Student Success Initiative (SSI) program. Project Share was allocated another \$13.6 million for the 2012–13 biennium from the SSI program. Project Share received a direct rider appropriation of \$18.0 million for the 2014–15 biennium. Out of this appropriation, TEA designated \$8.0 million for the platform license and \$10.0 million for content development. From fiscal years 2011 to 2014, TEA allocated \$1.25 million a year from the State Instructional Materials Fund to develop OnTRACK lessons.

PROJECT SHARE STRUCTURE AND ACCESS

Project Share's technical infrastructure consists of the Epsilon platform, a web-based, integrated environment, which supports a learning management system (LMS) and access to a variety of learning resources. As of fiscal year 2015, TEA contracts with Graduation Alliance for the use of the Epsilon system. An LMS is software that educators use to supplement classroom instruction with online lessons, administer and score tests, and maintain gradebooks. The Epsilon LMS provides those services, online professional development courses, and other tools used by educators to improve student achievement.

For educators to begin using the Epsilon LMS, the school districts, any of the 28 regional Education Service Centers (ESC), or TEA must establish user accounts for them. According to TEA, almost all certified educators have been assigned user accounts as of September 2014. To begin using their accounts, educators log into the main screen, or portal, that provides a menu to access professional development courses, user groups, communication tools, and other education resources. Educators can take an online training course that shows them how to use the LMS. Project Share has a main website, projectsharetexas.org, through which educators can access a professional development course catalog and other resources organized by Texas Essential Knowledge and Skills (TEKS) standards.

SERVICES FOR EDUCATORS

Project Share provides online professional development courses for CPE credit and non-CPE credit. The courses, which are organized by subject area, usually include text and videos explaining concepts and instructional strategies, and downloadable classroom materials. As of fiscal year 2014, these courses were available in math, science, social studies, English language arts, career and technical education, technology applications, and English language proficiency standards. Other professional staff also can take online courses in relevant topics. For example, Project Share offers a course for high school counselors to improve student college and career readiness. School districts can import Project Share courses and adapt the courses to their needs.

As **Figure 1** shows, enrollment in certain online course increased from 15,895 in fiscal year 2011 to 167,865 in fiscal year 2014. These figures reflect enrollment in professional development courses that are provided through TEA, ESCs, and school districts. According to TEA, enrollment increased because ESCs provided Project Share training to school districts and promoted the program's services. Also, TEA made a wider variety of courses available each year, and more districts became familiar with the Epsilon LMS.

TEA bases decisions to add new or redesign existing online courses on changes in TEKS standards, data from statewide student assessments indicating weaknesses in meeting TEKS-based learning objectives, and input from educators. For example, the agency added online courses during fiscal year 2014 to address changes in the math TEKS for kindergarten through grade eight, which were implemented in fiscal year 2015. TEA also convenes two educator focus groups each school year to solicit input about Project Share. The focus

groups provide feedback regarding current courses and lessons, and result in requests for new Project Share services. For example, a focus group during fiscal year 2014 requested more resources for elementary teachers.

Project Share allows teachers to administer four math-related formative assessments. A formative assessment gauges student learning over time. Teachers administer the Elementary School Students in Texas: Algebra Ready (ESTAR) Universal Screener to students during grades two to four, and the Middle School Students in Texas: Algebra Ready (MSTAR) Universal Screener during grades five to eight. The Universal Screener can identify whether students understand math instruction and are progressing toward high school algebra-readiness. Educators then can administer an ESTAR or MSTAR Diagnostic Assessment to determine the reasons students may be struggling and the types of supplemental instruction they need. The assessments are scored electronically, and teachers receive reports providing detailed information about their students' algebra-readiness.

The number of students assessed by the MSTAR/ESTAR Universal Screener or the MSTAR Diagnostic Assessment grew from 243,113 in fiscal year 2011 to 643,358 in fiscal year 2012. This increase is partly due to the Project Share support and training provided to school districts by ESCs mentioned previously. The number of students receiving ESTAR/MSTAR assessments decreased from 643,358 in fiscal year 2012 to 373,085 in fiscal year 2014. TEA staff attribute the decrease to implementation of a new assessment system within Project Share. School districts needed time to become familiar with features of the new system. The agency expects that improvements to Project Share will result in

**FIGURE 1
TEXAS EDUCATION AGENCY'S PROJECT SHARE SERVICES AND USAGE
FISCAL YEARS 2011 TO 2014**

SERVICE	USAGE	2011	2012	2013	2014
Professional Development	Course Enrollment	15,895	95,860	147,857	167,865
	Available Courses	17	40	63	110
ESTAR/MSTAR Assessments	Student Assessments	243,113	643,358	465,977	373,085
OnTRACK Lessons	Student Lessons	20	24,626	81,492	123,699
Educator Services: Portfolios, Professional Learning Communities, Professional Development	Educator Accounts	341,882	418,476	473,110	531,992
Student Services: Portfolios, Online Assignments, OnTRACK Lessons	Student Accounts	99,284	616,776	2,039,263	2,697,416

NOTE: ESTAR = Elementary School Students in Texas: Algebra Ready; MSTAR = Middle School Students in Texas: Algebra Ready. Courses available do not include those imported for use by school districts.
SOURCE: Legislative Budget Board.

more students undergoing online assessments in fiscal year 2015.

In addition to online courses and assessments, Project Share provides personalized services for educators. By joining professional learning communities through the LMS, educators can share effective practices and explore new instructional methods and strategies. They also can build digital portfolios to manage and store professional accomplishments. Until fiscal year 2013, educators were assigned accounts by ESCs and school districts. Since then, teachers typically request accounts directly from TEA. According to TEA, the number of school districts and educators taking advantage of Project Share services has increased since fiscal year 2010. As a result, educator accounts in Project Share have grown from 341,882 in fiscal year 2011 to 531,992 in fiscal year 2014.

SERVICES FOR STUDENTS

Students can benefit directly from Project Share by using OnTRACK lessons. These are supplemental learning sessions, which students can access during and after school. Lessons contain videos, graphics, and online activities that teachers assign based on their students' needs. OnTRACK lessons can help students enhance their skills before taking the State of Texas Assessment of Academic Readiness (STAAR). The LMS tracks student results on lesson exams, which assists teachers to identify specific points where students may need further instruction. Districts can use OnTRACK lessons as a part of their summer school curriculum to prepare students for a retest of the STAAR if they failed the first time. Students began receiving OnTRACK lessons during fiscal year 2011, and enrollment has increased from 24,626 in fiscal year 2012 to 123,699 students in fiscal year 2014.

The number of Project Share student accounts increased from 99,284 in fiscal year 2011 to 2,697,416 in fiscal year 2014. This increase resulted from more teachers using the LMS to assign lessons and homework. The LMS assists teachers to reach students who cannot attend classes. Additionally, students can collaborate on projects and interact outside of class to complete assignments. Student accounts include a portfolio feature where they can record their accomplishments.

SHARED SERVICES FOR STUDENTS AND EDUCATORS

The Project Share Gateway provides access to a variety of educational resources. Gateway resources are typically smaller

portions of online courses or OnTRACK lessons that educators and the public can view at any time. Users can search the Gateway for specific learning objects by TEKS standards and keywords. Gateway learning objects are TEKS-related resources that are available for use as instructional materials.

Project Share also offers educational resources for students and educators, known as collections, in the web-based Texas Education on iTunes U. Collections include lessons and videos on topics such as history, science, and high school algebra. As of November 2014, Texas Education on iTunes U contained 82 collections. Additionally, Project Share provides access to learning sources such as the *New York Times* Knowledge Network and the PBS Digital Learning Library.

PROJECT SHARE CONTENT DEVELOPMENT

To generate content for Project Share, TEA awarded grants to several content developers: ESC Regions 13, 4, and 20; the Institute for Public School Initiatives at the University of Texas at Austin; and seven other institutions of higher education. The agency selected content developers based on their expertise in specific academic subject areas. Before developing Project Share resources, the entities had shown they could produce professional development content that met TEA quality standards.

Content developers collaborate with TEA to ensure that online courses, OnTRACK lessons, and math assessments undergo an extensive development and quality assurance process before release. At several points during the process, content developers submit draft material to TEA for review and approval. This process can last up to a year, depending on the complexity and length of the course. For example, a professional development course may be reviewed multiple times by TEA staff and external content experts before release on the LMS. After a course is released, the content developer also is responsible for improving content based on educators' feedback and for providing assistance to school districts as requested. **Figure 2** shows expenditures and performance associated with each content developer from fiscal years 2010 to 2014.

TEA awarded funding to ESC Region 13 beginning in fiscal year 2010 to develop and update online math courses for educators, ESTAR/MSTAR algebra-readiness assessments, and math-related resources for the Project Share Gateway. Region 13 expended \$11.7 million in grant funding from TEA for these services from fiscal years 2010 to 2014. During this period, Region 13 produced and updated 54 professional

FIGURE 2
TEXAS EDUCATION AGENCY'S PROJECT SHARE EXPENDITURES AND PERFORMANCE, FISCAL YEARS 2010 TO 2014

CONTENT DEVELOPER	EXPENDITURES	ONLINE COURSES PRODUCED OR UPDATED	GATEWAY RESOURCES PRODUCED	ONTRACK LESSONS PRODUCED OR UPDATED
Region 13: Math Courses and Assessments	\$11,740,490	54	91	0
Region 4: Science Courses and TxAIR Assessments (1)	\$9,462,115	24	42	0
Region 20: English Language Proficiency Standards Courses	\$1,654,884	6	0	0
Institute for Public School Initiatives at the University of Texas at Austin: Various Courses, OnTrack Lessons, Support Center	\$9,433,945	56	427	50 (2)
Various Institutions of Higher Education: Career and Technical Education Courses (3)	\$3,773,286	9	0	0
TOTAL	\$41,064,720	149	560	50

NOTES:

- (1) TxAIR = Texas Achievement Items Repository.
- (2) The Institute for Public School Initiatives at The University of Texas at Austin was the only entity that received funding to produce OnTRACK lessons.
- (3) Career and Technical Education courses were produced by Sam Houston State University, Texas Agrilife Research, Austin Community College, Southern Methodist University, Baylor University, Tarleton State University, and University of North Texas.

SOURCE: Legislative Budget Board.

development courses, 91 Gateway resources, and the MSTAR/ESTAR Universal Screeners and Diagnostic Assessments.

ESC Region 4 was awarded funding starting in fiscal year 2010 to develop and update science-related content for Project Share. Region 4 expended \$9.5 million in grant funding from TEA for these services from fiscal years 2010 to 2014. Using this funding, Region 4 has produced or updated 24 professional development courses and produced 42 learning objects for the Gateway. Region 4 also created the Texas Achievement Items Repository (TxAIR) assessment system, which can assist educators to develop and administer exams in math and science.

TEA awarded funding to ESC Region 20 beginning in fiscal year 2010 to develop online professional development courses related to English Language Proficiency Standards. Educators who take these courses identify ways to increase achievement among English language learners, assisting these students to understand instruction in core subjects such as math and science. Region 20 expended \$1.7 million in grant funding from TEA for these services from fiscal years 2010 to 2014. During this period, Region 20 produced or updated six online professional development courses.

The Institute for Public School Initiatives (IPSI) at the University of Texas at Austin has performed two roles for

Project Share. From fiscal years 2010 to 2014, IPSI operated the Project Share Support Center, which provided statewide help desk services, organized annual teacher focus group sessions, and developed training materials to help educators use Project Share for professional development credit. During this period, IPSI also produced 50 OnTRACK student lessons, which were viewed by 123,699 students during fiscal year 2014. Additionally, IPSI produced 56 online courses in a variety of subjects.

TEA awarded funding to seven other institutions of higher education to produce specific sets of online courses beginning in fiscal year 2011. The institutions include Sam Houston State University, Texas Agrilife Research, Austin Community College, Southern Methodist University, Baylor University, Tarleton State University, and University of North Texas. These institutions produced online courses that educators must complete to meet professional development requirements for teaching career and technical education courses that high school students can take to earn math or science credit. The agency awarded \$3.8 million to these institutions, which produced nine professional development courses from fiscal years 2011 to 2014.

PROJECT SHARE EXPENDITURES

Figure 3 shows Project Share expenditures by function from fiscal years 2010 to 2014. TEA administrative expenditures

FIGURE 3
TEXAS EDUCATION AGENCY'S PROJECT SHARE EXPENDITURES, FISCAL YEARS 2010 TO 2014

FUNCTION	2010	2011	2012	2013	2014
Texas Education Agency Project Share Administration	\$47,372	\$48,980	\$26,606	\$26,606	\$45,235
Content Development and Support Center Services	\$2,810,694	\$7,585,908	\$9,625,623	\$9,728,209	\$6,314,286
Epsilen Platform and Learning Management System	\$1,000,000	\$3,000,000	\$3,500,000	\$3,500,000	\$3,782,500
TOTAL	\$3,858,066	\$10,634,888	\$13,152,229	\$13,254,815	\$10,142,021

SOURCE: Legislative Budget Board.

decreased in fiscal years 2012 and 2013 because Project Share did not receive direct funding those years. A 2014–15 rider appropriation for Project Share increased administrative funding for fiscal year 2014. Expenditures for content development and support centers reflect grant funding awarded to the entities mentioned previously. Epsilen platform and LMS license expenditures increased from fiscal years 2010 to 2014 because service usage by educators and students increased, and TEA added new service requirements to the contract with ConnectEDU.

PROJECT SHARE IN TRANSITION

During fiscal year 2010, TEA purchased a \$1.0 million software license for the Epsilen LMS. Epsilen since has evolved into a platform that supports the LMS, MSTAR/ESTAR assessments, and the TxAIR assessment system. For fiscal years 2012 and 2013, TEA paid \$3.5 million per year to ConnectEDU for the Epsilen platform. For fiscal year 2014, TEA had agreed to pay ConnectEDU \$4.0 million for the platform. However, in spring 2014, ConnectEDU declared bankruptcy and could no longer manage the platform. TEA was able to continue Project Share services until another firm, Graduation Alliance, purchased ConnectEDU's assets in early summer 2014. In October 2014, TEA signed an emergency contract with Graduation Alliance for school year 2014–15. Under the contract, TEA will pay Graduation Alliance \$1.5 million for the Epsilen platform.

As of November 2014, TEA was developing a plan to improve Project Share services, including modifications to enhance user experience, and enable school districts to use their own LMS to access Project Share. The agency has asked its content developers to solicit feedback from stakeholders about their future Project Share-related needs. The content developers also have been asked to identify new methods for delivering online courses and other educator resources. These new methods would address TEA's interest in taking advantage of changing technologies, such as mobile devices, and an overall system that is platform-neutral. The agency

has indicated that Project Share funding for the 2016–17 biennium funding, regardless of service delivery changes, can continue with the 2014–15 General Revenue Funds appropriation of \$18.0 million.

OVERVIEW OF SERVER CONSOLIDATION WITHIN DATA CENTER SERVICES

In 2005, the Seventy-ninth Legislature initiated a program to merge the data centers of 27 state agencies into two consolidated data centers located in Austin and San Angelo. Consolidated data center services include mainframe, server, and bulk print and mail operations; standardization of security and disaster recovery plans and annual testing; and replacement of older technology, including a hardware and software refresh schedule. With the goal of upgrading technology, increasing security, and reaping economies of scale, the Legislature directed the Department of Information Resources to contract for data center services on behalf of the state. The agency first contracted with a vendor to provide complete data center services, including server consolidation, beginning in 2007. The state entered the contract expecting to complete consolidation by April 2009; however, by August 2009 the vendor had consolidated only 11 percent of participating agencies' data center servers. The agency re-procured the contract as three separate contracts, which took effect in 2012. Server consolidation is still incomplete, though user satisfaction has improved since the re-procurement of the contract. According to DIR, approximately 57 percent of servers have been consolidated as of September 2014. Some servers will not be consolidated for business or logistical reasons.

Some server consolidation depends on the remediation of outdated applications. Remediation involves any programming code modification needed to allow that application software to run on current levels of operating software and hardware. This application remediation is not part of the data center services contract, so it must be paid for by the agencies themselves. Application remediation and consolidation efforts also require the participation of and coordination with many individuals within an agency to ensure that programs continue functioning correctly during the transition. For these reasons and others, current consolidation capacity by the vendor exceeds demand from the agencies. This report provides a history of the data center services program administered by the Department of Information Resources and a summary of challenges that have impacted timely consolidation and the achievement of cost savings and increased efficiency.

FACTS AND FINDINGS

- ◆ The Department of Information Resources first contracted with IBM, effective in 2007, to provide data center services, including server consolidation, for 27 state agencies. The agency then re-procured the contract as three separate contracts with new vendors, effective in 2012. Server consolidation is not yet complete.
- ◆ Appropriations for data center services are made to participating agencies, and then funds are paid to the Department of Information Resources through the Statewide Technology Account. For the 2014–15 biennium, appropriations to this account totaled \$388.1 million in Interagency Contracts. The Legislature has appropriated \$1.3 billion for this program since implementation of the program in the 2006–07 biennium.
- ◆ For the data center services program, the per unit prices the vendor charges agencies are determined by total state consumption. As agencies consolidate and consume services above the estimated baseline within the state data center, the per unit price the state pays for a given service decreases, and the per unit cost of serving the legacy data centers increases.
- ◆ The contractual obligation for the service providers to maintain consolidation capacity ends in August 2016. After August 2016, servers may still be consolidated as part of other services included in the contract, but agencies may have to pay additional costs for labor or project management.
- ◆ Consolidating a server requires preparation work by agencies and cooperation between the agency and service providers. In some cases applications on agency servers must be remediated before they can be consolidated, which can require additional resources from the agency.

DISCUSSION

Consistent with national trends in state and federal government information technology (IT) practices, Texas has been consolidating IT infrastructure and services for several years. Data center consolidation is one aspect of this

statewide consolidation effort. A data center is generally defined as a centralized facility dedicated to the management of information resources including people, processes, and technologies. Data center consolidation initiatives have been pursued not only for cost efficiency, but also to improve performance and mitigate risks. In a 2007 survey of state Chief Information Officers, disaster recovery and system redundancy were the most commonly listed reasons for consolidating data centers. Cost savings and security concerns were the next most frequently cited reasons in the survey.

Prior to this initiative, the agencies selected to participate in the data center consolidation had independently managed data centers at 31 statewide locations. These locations are now referred to as the legacy data centers and were often housed at the agency's headquarters. Some agencies also had servers or data centers at remote locations to govern local functions, such as systems to govern prison doors. These agency-managed facilities required support staff, specialized build out and environmental controls, emergency power, and disaster recovery capabilities. However, as of 2004, fewer than half of agency-managed facilities had defined standards and procedures in place to provide consistent availability of services. In 2005, the Seventy-ninth Legislature passed legislation authorizing DIR to consolidate data center and disaster recovery services for multiple state agencies at two state data centers located in San Angelo and Austin, referred to as the data center services (DCS) program. Proponents of this initiative intended for consolidation to allow the state to benefit from economies of scale and reduce costs for hardware, software, facilities, and staff. In addition to reducing costs, consolidation was intended to standardize practices and processes, including procurement, and improve security and server facility environments. DIR was to prioritize migrating services from agencies to the data centers based on the size of the agency's technology centers, with the largest 25 having priority. DIR initially selected 27 state agencies for data center consolidation, based on fiscal year 2004 information technology expenditures related to data center operations. Since that time, DIR has executed four contracts for consolidation-related services, which are summarized below.

PRICING AND FUNDING HISTORY

Throughout the history of the DCS program, the per unit prices DIR charges agencies for services have been determined based on total program use of consolidated services. In general, as agencies consolidate and consume services above DIR's baseline estimate of services to be consolidated within

the state data center, the per unit price the state pays for a given service decreases, and the per unit cost of serving the legacy data centers increases. If overall consumption of consolidated services falls below baseline estimates, the price per unit increases. This dynamic pricing model applies to aggregate consumption, meaning that one agency's actions to delay or speed up consolidation affect all other agencies' prices. If additional entities began participating, the increase in volume would decrease per unit costs for all existing participating agencies.

The contract allows for periodic benchmarking reviews in which DIR may engage an independent third party to determine whether DIR is receiving competitive pricing and levels of service compared to current market rates. If the review finds that the aggregate charges subject to the benchmarking are greater than the lowest 50 percent of the prices charged by the comparison group for similar quality and quantity of work, then the service providers will have to reimburse DIR for the cost of the benchmarking and renegotiate rates. If rates are not lowered within 180 days, DIR may terminate the contract.

The Texas Legislature provides each agency with the authority to spend appropriated funds for DCS through a capital budget rider in their bill pattern in the General Appropriations Act. Participating agencies then pay DIR for services used and billed. DIR also charges 2.95 percent of the agency's monthly invoice to fund direct and indirect operating expenses. Agencies' payments are deposited into the Statewide Technology Account (Other Funds) as Interagency Contracts (IACs). DIR then pays the DCS contracted vendor from this account for total billed services. For fiscal years 2014 and 2015, appropriations across all state agencies are comprised of 43 percent General Revenue Funds, 8 percent General Revenue–Dedicated Funds, 34 percent Federal Funds, and 15 percent Other Funds. **Figure 1** shows the All Funds amounts appropriated from fiscal years 2008 to 2015.

Approximately \$4.6 million was expended in fiscal year 2006 and \$4.2 million in fiscal year 2007 for start up costs. DIR began billing agencies in 2007, and spent approximately \$32.6 million in IACs in fiscal year 2007.

**FIGURE 1
ALL FUNDS APPROPRIATIONS FOR INTERAGENCY
CONTRACTS FOR DATA CENTER SERVICES
FISCAL YEARS 2008 TO 2015**

YEAR	APPROPRIATIONS IN MILLIONS
2008	\$142.3
2009	\$129.3
2010	\$183.1
2011	\$168.4
2012	\$168.9
2013	\$150.4
2014	\$190.8
2015	\$197.3
TOTAL	\$1,330.5

SOURCE: Legislative Budget Board.

The DCS program currently provides fully managed services to 28 state agencies. The agencies participating in DCS have changed since the program’s inception. For agencies with fully managed services, the vendor provides all the hardware, software tools, and technical staff to support information technology infrastructure. These services include:

- disaster recovery,
- backup,
- monitoring,
- security,
- storage,
- production control,
- data center network,
- architecture design,
- capacity management,
- operating system support,
- hardware refresh, and
- facilities.

An additional four agencies receive partial data center services voluntarily. **Figure 2** shows the 32 agencies participating in the DCS program as of September 2014.

DATA CENTER CONSOLIDATION UNDER IBM

As previously noted, since the implementation of the DCS program, DIR has contracted for data center related services.

In November 2006, DIR signed a contract with IBM for the DCS program, which included mainframe and server operations, disaster recovery, and print and mail services. IBM and its affiliates began providing data center services to participating agencies on April 1, 2007. According to the seven-year contract, consolidation would be completed within two years, by April 1, 2009. However, in October 2008, the Governor suspended consolidation because IBM had not properly backed up data for some state agencies. Consolidation could not resume until each agency certified that IBM had documented the agency’s critical data and prepared a backup schedule. As of August 2009, 23 of the participating 27 agencies had signed certification letters. A number of other problems also arose that slowed server consolidation. These problems included difficulty identifying applications that might need remediation to be consolidated, issues with service levels provided by IBM, and issues with timely procurement of equipment and software. According to a 2009 survey of IT directors, these problems and others resulted in 90 percent of participating agencies being dissatisfied with the services IBM provided.

Beginning in fiscal year 2009, agencies were charged a cost-of-living adjustment (COLA) for certain components of the IBM contract. The Eighty-second Legislature eliminated funding for the COLA, which represented a \$38.3 million decrease in appropriations to DCS agencies for the 2012–13 biennium. Agencies funded the difference out of other appropriations.

By August 2009, most of the print and mail servers and all of the mainframes had been consolidated, but only three agencies (11 percent) had completed their server consolidation into the data centers. On July 16, 2010, DIR sent a letter giving IBM Notice to Cure Breaches of the Master Service Agreement (MSA). DIR’s Notice to Cure indicated IBM had failed to perform in accordance with the terms of the MSA and was in breach of contract. DIR released a Request for Offer to re-procure the contract in November 2010, and signed contracts with new vendors in December, 2011. DIR reached a settlement with IBM on March 9, 2012, and IBM ceased operations April 30, 2012. Services were anticipated to commence July 1, 2012, but the new vendors also provided short-term walk-in, take-over services beginning May 1, 2012, due to IBM ceasing operations.

CURRENT CONTRACTS

Given the challenges experienced with the IBM contract, DIR redesigned the DCS contract model to separate the

FIGURE 2
AGENCIES PARTICIPATING IN THE DATA CENTER SERVICES PROGRAM, SEPTEMBER 2014

AGENCIES RECEIVING FULLY MANAGED SERVICES

Angelo State University	Texas Facilities Commission
Department of Aging and Disability Services	Texas Commission on Environmental Quality
Department of Assistive and Rehabilitative Services	Texas Department of Criminal Justice
Department of Family and Protective Services	Texas Department of Insurance
Department of Information Resources, including Texas.gov	Texas Department of Licensing and Regulation
Department of Motor Vehicles	Texas Department of Transportation
Department of State Health Services	Texas Education Agency
Health and Human Services Commission	Texas Higher Education Coordinating Board
Health Professions Council	Texas Juvenile Justice Department
Office of the Attorney General	Texas Parks and Wildlife Department
Public Utility Commission	Texas State Library and Archives Commission
Railroad Commission	Texas Veterans Commission
Secretary of State	Texas Water Development Board
Texas Alcoholic Beverage Commission	Texas Workforce Commission

AGENCIES RECEIVING EMAIL SERVICES ONLY

- Texas Military Department
- Texas Board of Architectural Examiners
- Texas Racing Commission

AGENCIES RECEIVING PRINT AND MAIL SERVICES ONLY

- Texas Department of Agriculture

SOURCE: Legislative Budget Board.

technical consolidation work from program oversight by contracting for them individually. DIR re-procured DCS services through three contracts, estimated to cost \$1.3 billion in total over the contracted periods. Services were delegated to two service component providers (SCPs) and one multi-sourcing integrator, which integrates and manages the services of the SCPs for the program. These contracts are:

- A six-year, \$127.0 million contract with Capgemini to provide a service desk and satisfaction monitoring, invoicing, and certain program management activities.
- A six-year, \$54.0 million contract with Xerox Corporation to provide bulk printing and mailing services.
- An eight-year, \$1.1 billion contract with Xerox State and Local Solutions, Inc., formerly ACS State and Local Solutions, to deliver infrastructure services for mainframes, servers, networks, and data center operations. This vendor will be referred to as Xerox for the remainder of the report.

DIR provides contract oversight, serves as a liaison between participating agencies and the service providers if escalation

is necessary, and interprets the contracts for the state. DIR also makes payments to the service providers on behalf of the state.

CHANGES TO CONSOLIDATION MODEL AND PROCESSES

In addition to separating the contracts by function, the 2011 contracts also contained new provisions. To accelerate consolidation, the contract with Xerox included:

- **Pricing incentives**—in the prior contract, server support prices were the same regardless of whether the server resided in the state data centers or in an agency’s legacy data center, and the agencies paid the same price for consolidated and non-consolidated servers. Given that some agencies had upfront costs and labor associated with consolidation, there was actually a financial disincentive to consolidate. In the Xerox contract, prices are lower for server instances in the consolidated data center. The term server instance refers to both physical and virtual servers. The average costs to operate in a consolidated versus non-consolidated environment are lower by the following approximate amounts: Intel All Server Instance Tiers,

27 percent; Unix All Server Instance Tiers, 37 percent; Storage, 5 percent; and Tape Backups, 33 percent.

- **Seed equipment**—the current contract required Xerox to establish an initial capacity of virtualized server equipment. This eliminated the need for Xerox to purchase, deliver, install, connect and configure the hardware required for consolidation each time a server instance was built.
- **Discovery tools**—the contract requires Xerox to provide a software tool that can run throughout the DCS network and “discover” all servers, storage, and software types that need to be consolidated.
- **Move group process**—Xerox worked with agencies to identify groups of servers to be moved to the data centers, rather than the prior approach to move all of a selected agency’s servers at one time. The server groups were also selected based on connectivity and software requirements discovered through automated tools, rather than based solely on application.

According to DIR, the contract with the multi-sourcing integrator, Capgemini, includes the following elements designed to improve consolidation effectiveness, quality, and schedule reporting:

- **Server consolidation process oversight**—Capgemini created and implemented processes for Xerox and the agencies to develop consolidation plans and to execute server consolidation.
- **Project management tools**—Capgemini developed and installed project management tools for Xerox, DIR, and participating agencies to better manage server consolidation projects.

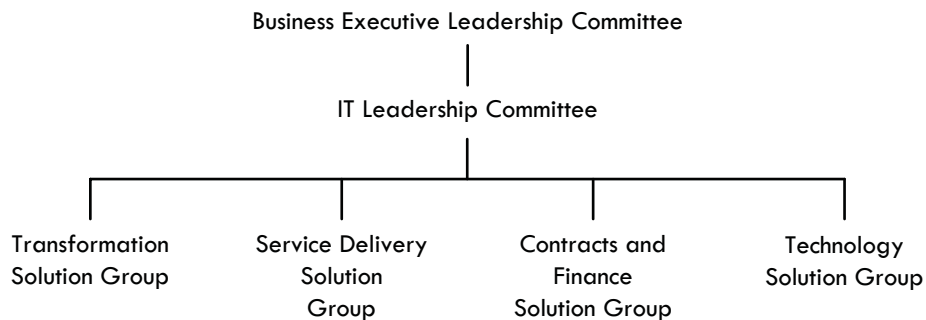
CONSOLIDATION GOVERNANCE MODEL

Relationship management and agency participation in the consolidation process also changed over the course of the contract with IBM and again with the transition to Xerox and Capgemini. During the contract with IBM, and in reaction to performance issues mentioned previously, a new governance model was implemented to increase participating DCS agency involvement and improve performance of the initiative. This governance model included advisory committees with agency representation that would have input on issues encountered through the process of consolidation.

With the new Xerox and Capgemini contracts, participating DCS agencies became “owner-operators,” and the advisory committees were empowered to have more decision making authority on enterprise-wide issues that arise. A new committee on contracts and finance was also added with the transition.

Under the owner-operator governance model, DCS participating agencies “own” the business being supported but also have responsibilities to operate selected processes necessary to receive service. According to DIR, the model actively involves DIR, DCS participating agencies, and DCS service providers as full members of committees and solution groups for strategic decision-making and program issue resolution. DCS participating agencies are organized into five “partner groups.” The IT leadership from each partner group appoints representatives to participate on chartered solution groups and leadership committees. The groups also include designated representatives from the service providers and DIR. Solution groups and committees have written charters and defined responsibilities. **Figure 3** shows the structure of the governance committees.

**FIGURE 3
DATA CENTER SERVICES GOVERNANCE COMMITTEES, 2014**



SOURCE: Department of Information Resources.

DCS agency business executives serve on the business executive leadership committee. This committee has overall responsibility for DCS program governance and strategy, and must approve global business decisions regarding the DCS outsourcing relationship. The committee meets monthly.

The IT leadership committee includes agency IT directors, CIOs, and IT managers who approve IT-related decisions, including the addition or deletion of services. The committee meets monthly.

The technology solution group is made up of agency technical staff, DCS agency representatives, and IT management. It serves as the technology steering committee that approves technology standards and the enterprise technology plan, and evaluates emerging technologies. This group also approves exception requests for agencies, and provides technical advice and recommendations to other groups and committees. The solution group meets monthly.

The transformation solution group is comprised of agency representatives that are involved in consolidation efforts, which is typically multiple representatives per agency. The group monitors and addresses issues related to server consolidation and transformation plans, milestones, and accomplishments and helps prioritize interests where there is competition. This group meets on an as needed basis.

The service delivery solution group includes agency IT management, such as IT directors, IT managers, and DCS agency representatives. It monitors trends in service level agreement performance, root cause analysis, and problem resolution. The group also oversees requests for service project prioritization methodology and process; recommends changes to enterprise service levels, services, and performance reporting to align with business needs; and consults on agency satisfaction survey results and action plans. The group meets monthly.

The contracts and finance solution group is made up of agency financial management representatives. It reviews contractual and financial trends related to the DCS program. This may include reviewing proposed contract amendments or approving changes to enterprise financial report templates. This group also coordinates development of DCS agency legislative appropriation requests (LAR) related to the DCS program and aligns messaging on DCS enterprise financial matters. This group meets monthly.

The level of authority of each governance group is further defined in group charters and a detailed decision matrix

identifying which governance group or stakeholder is responsible, accountable, consulted, or informed for subject areas.

For daily service issues, the DCS agencies interact directly with DCS service provider personnel to communicate needs, exchange information and status, and resolve operational issues.

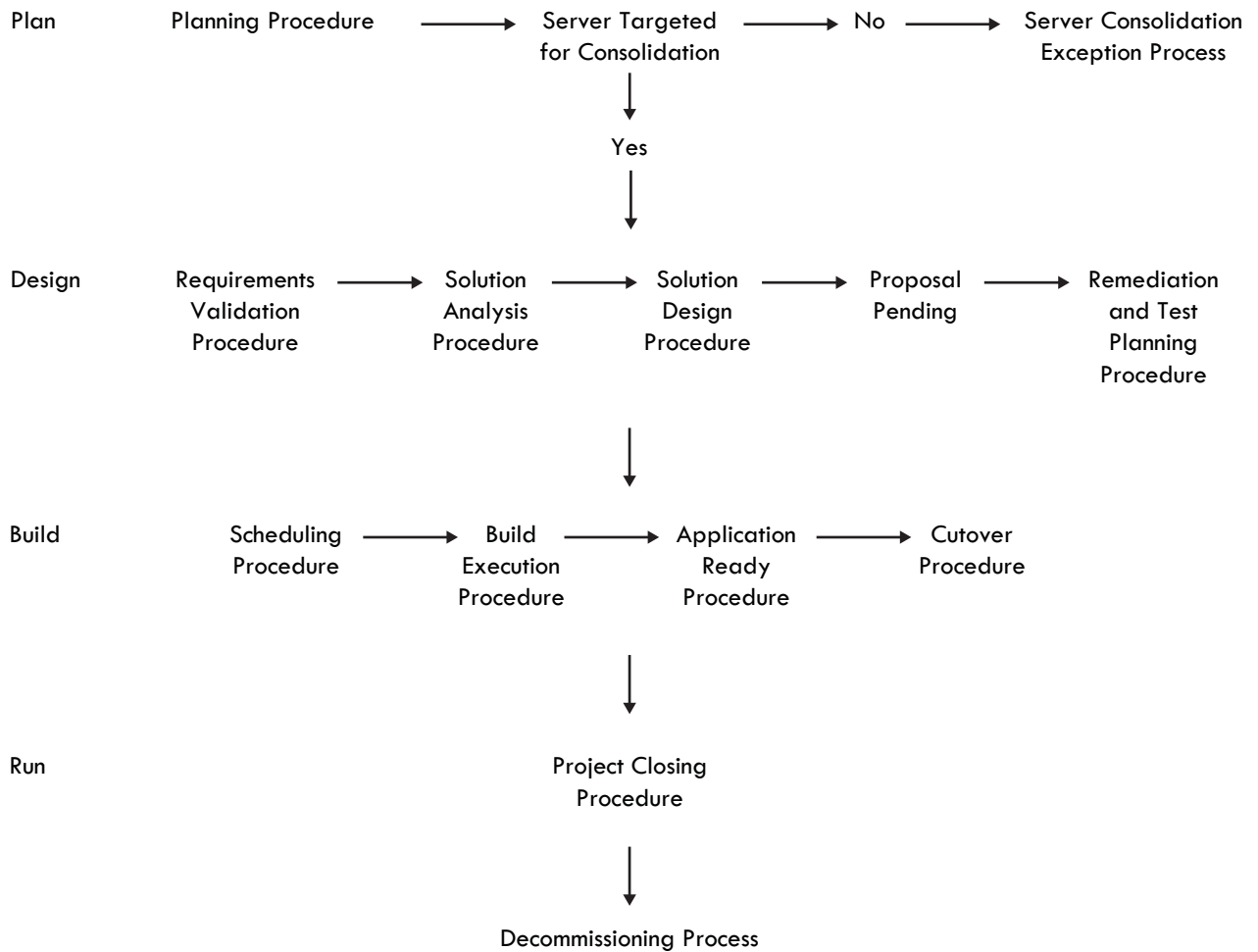
PROCESS FOR SERVER CONSOLIDATION

Consolidating a server requires preparation work by the participating agency and cooperation between the agency and the service providers. Some agency applications are so outdated they require extensive application remediation before consolidation to ensure they will function on more modern hardware and operating systems. Agencies are responsible for completing needed application remediation, which could include any programming code modification needed to allow that application software to run on current levels of operating software and hardware. The amount and type of modifications needed depend on the capabilities and age of the application code, the currency of the operating software and the age of the hardware. This effort could take weeks or months to finish, depending on the age and complexity of the application. Previously, remediation was required to be completed before a server could be consolidated. In April 2013, DIR began allowing agencies to transfer their servers “as is” and remediate the applications later. This allows the agency to pay the lower rate applied for a consolidated server. However, some applications are too outdated to take advantage of this option.

According to DIR, agencies must establish a team to adequately determine the requirements for the consolidation of a server for all applications that reside on legacy servers to be moved to the data center. Such a team may include business owners, business subject matter experts, application architects, application developers, database administrators, network engineers, and operating system and storage specialists. In many cases, several business applications may run on a given legacy server; thus necessitating multiple teams for which a high level of coordination is required from the agency.

To begin the consolidation process for a given server, an agency must submit a formal work ticket with the service providers; neither DIR nor the service providers can initiate the process without the agency. **Figure 4** shows the process for server consolidation. **Figure 5** shows a high level division of consolidation responsibilities between the agency and the

**FIGURE 4
PROCESS FOR SERVER CONSOLIDATION, 2014**



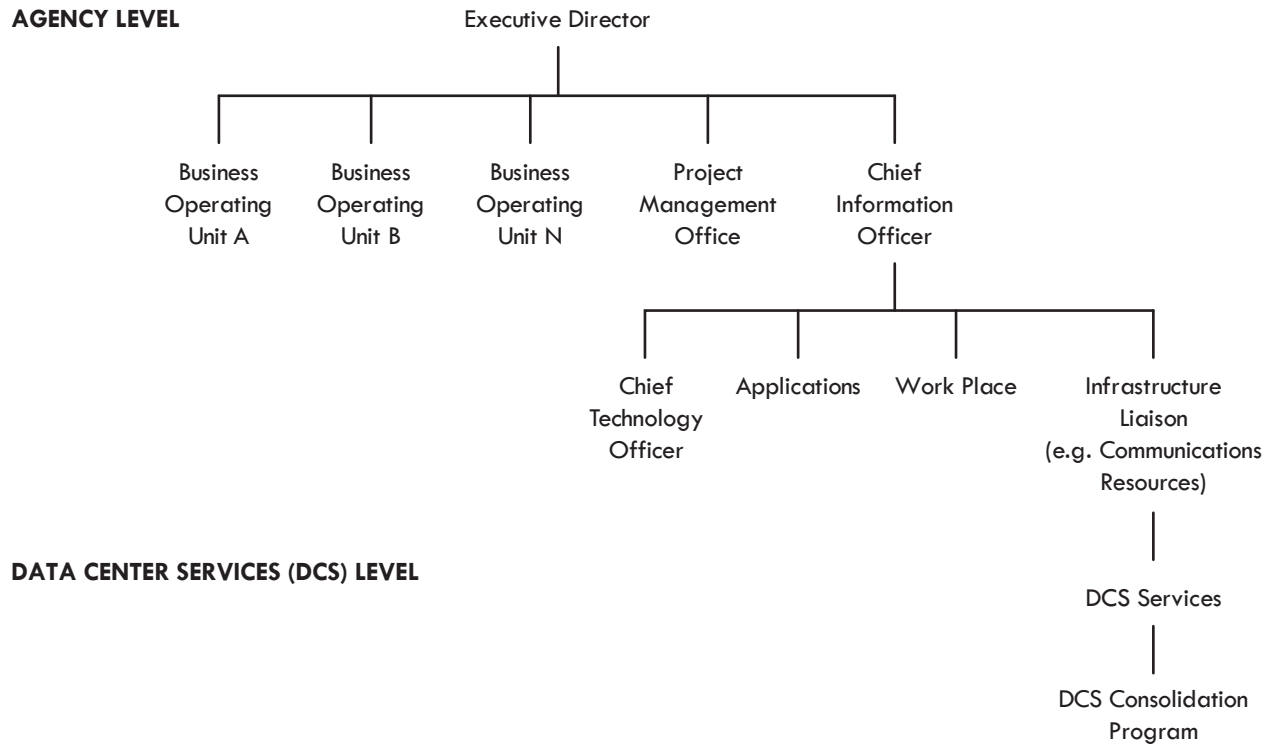
SOURCE: Legislative Budget Board.

DCS service provider. On average, it takes approximately four to five months to make the necessary decisions and plan, design, build, and consolidate to a new server.

When work under the new contracts commenced in July 2012, the vendors had 120 days to conduct an inventory of agencies’ servers and adjust baseline service volumes for billing purposes. Actual server counts from this process were significantly lower than the estimates IBM had provided, which had been used for the projections for agencies’ LARs for the Regular Session of the Eighty-third Legislature. While server counts decreased, tape storage costs increased, resulting in a net increase to costs. Participating agencies’ LARs for the Regular Session of the Eighty-fourth Legislature are the first to use the projections based on the current service providers’ estimates of unconsolidated servers.

Given this change in inventory counts, comparisons before and after the transition about the number or percentage of servers consolidated may be misleading. Some servers are exempt from consolidation and are managed by the agency itself or another third party, though those exemptions have expiration dates. To obtain exemptions, agencies must submit a letter of request to DIR and receive approval. Other servers are managed by Xerox and are either consolidated within the data centers or not physically consolidated and still at the agency. Some of those remaining at the agency have been granted exceptions (called “leave behinds”) by DIR for technical or business reasons. Servers with exceptions will not be consolidated during the current contract. Agencies must apply for an exception for DIR to grant it, so there may be servers for which agencies plan to apply for the exception, but have not yet done so. As illustrated in **Figure 6**, these

**FIGURE 5
DIVISION OF RESPONSIBILITIES FOR DATA CENTER SERVICES CONSOLIDATION, 2014**



AGENCY LEVEL RESPONSIBILITIES

- | | |
|--|--|
| <ul style="list-style-type: none"> • Provide agency sponsorship • Gain commitment across agency business operating units, and applications groups • Define agency application roadmap, rationalization plan, and transformation timing requirements • As applicable, provide resources for intra-agency project management, application architecture, network, business filing (DBA), etc. | <ul style="list-style-type: none"> • Perform agency application remediation and testing • Engage in consolidation planning with Data Center Services (DCS) program • Review and sign off DCS consolidation solution • Final acceptance of DCS consolidation solution |
|--|--|

DCS LEVEL RESPONSIBILITIES

Plan

- Work with agency to define consolidation plan (specific servers, timing, etc.)
- Incorporate plan into legislative appropriation request

Design

- Develop solution and gain agency approval for target compute and consolidation infrastructure solution
- Develop and gain agency approval for DCS-level project schedule and plan

Build

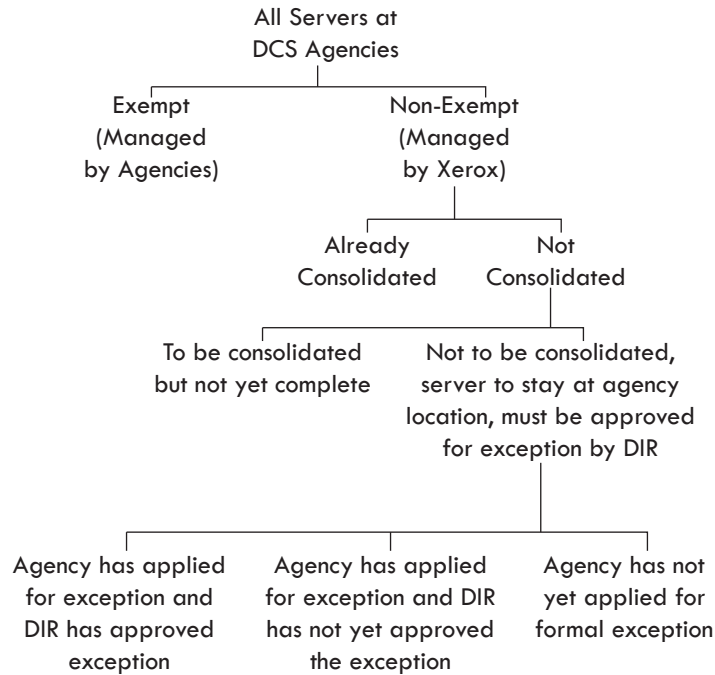
- Manage project through to completion
- Build target compute and relocate application executables, data files, etc.

Cutover to Run

- Support agency application remediation and testing efforts
- Ensure all systems monitored and compute is accepted by agency
- Close out project and record new systems information in configuration management database
- Report overall program status

SOURCE: Department of Information Resources.

FIGURE 6
SERVER STATUS CATEGORIES, 2014



SOURCE: Legislative Budget Board.

would not be consolidated, but they would also not be counted as approved exceptions. There may also be pending applications for exceptions that DIR has not yet approved. Some agencies may consider their consolidation complete, because they have consolidated all the servers they plan to, but figures from DIR may not reflect that completion because those exceptions have neither been applied for nor approved. **Figure 6** shows the relationship between the various groups and subgroups of servers.

Consolidation will be complete once all servers that are managed by Xerox and that do not have exceptions have been consolidated. This will be somewhat less than 100 percent of all non-exempt servers. The percentage that represents completion depends on the number of servers ultimately granted exceptions or otherwise eliminated. Because some exceptions have not yet been applied for or approved, this percentage is currently unclear.

PROGRESS AND WORK REMAINING

According to DIR, approximately 57 percent of all non-exempt servers have been consolidated as of September 2014. **Figure 7** shows server consolidation by participating agency, according to DIR.

To achieve the intended benefits of data center consolidation, non-exempt servers must continue to be consolidated into the state’s data centers.

According to DIR, the service providers have the capacity to consolidate 180 servers per quarter, but this capacity exceeds agency demand. DIR’s contract with the service providers was written to reimburse them for providing capacity. Both Capgemini and Xerox are paid a milestone payment for the completion of the quarter’s planned server consolidation. If the service providers have completed their work, the servers are counted as completed, and they receive the quarterly consolidation payment, even though the server is not considered consolidated by DIR until the agency completes testing of the new server and approves the decommissioning of the legacy server.

The contractual obligation for the service providers to maintain consolidation capacity ends in August 2016. After August 2016, servers may still be consolidated under the contract using the request for new services (RFS) program or the refresh program. The RFS program includes a pool of service provider hours with which to build new servers in the consolidated data centers at no additional cost to the agency. There are a fixed number of pooled hours available per month

FIGURE 7
SERVER CONSOLIDATION BY PARTICIPATING AGENCY, SEPTEMBER 2014

AGENCY	REMOTE SERVERS	LEGACY DATA CENTER SERVERS	CONSOLIDATED DATA CENTER SERVERS	TOTAL SERVERS BY AGENCY (REMOTE + LEGACY + CONSOLIDATED)	APPROVED LEAVE BEHINDS (EXCEPTIONS) INCLUDED IN REMOTE AND LEGACY DATA CENTER SERVERS TOTALS
Angelo State University	0	0	62	62	0
Department of Aging and Disability Services	24	49	99	172	24
Department of Assistive and Rehabilitative Services	0	16	44	60	2
Data Center Services Shared*	3	17	658	678	1
Department of Family and Protective Services	5	0	88	93	0
Department of Information Resources, including Texas.gov	0	0	96	96	0
Department of State Health Services	62	440	192	694	0
Health and Human Services Commission	10	310	351	671	0
Health Professions Council	0	0	4	4	0
Office of the Attorney General - Administrative and Legal	19	7	81	107	2
Office of the Attorney General - Child Support	67	12	359	438	2
Public Utility Commission	0	9	19	28	2
Railroad Commission	8	30	72	110	1
Secretary of State	0	27	9	36	4
Texas Alcoholic Beverage Commission	0	10	29	39	0
Texas Commission on Environmental Quality	40	116	155	311	36
Texas Department of Criminal Justice	32	23	115	170	2
Texas Department of Insurance	0	13	90	103	9
Texas Department of Licensing and Regulation	4	0	22	26	0
Texas Education Agency	0	167	273	440	0
Texas Facilities Commission	4	0	11	15	0
Texas Higher Education Coordinating Board	0	7	69	76	0
Texas Juvenile Justice Department	24	15	47	86	0
Texas Parks and Wildlife Department	6	74	44	124	2
Texas State Library and Archives Commission	1	0	19	20	0
Texas Veterans Commission	0	0	5	5	0
Texas Workforce Commission	17	95	127	239	19
Texas Water Development Board	0	27	7	34	0
Department of Motor Vehicles	16	46	93	155	0
Texas Department of Transportation	189	548	147	884	0
TOTAL	531	2,058	3,387	5,976	106

NOTE: "DCS Shared" represents infrastructure servers in the enterprise which are not dedicated to an agency such as backup servers. These are non-billable infrastructure devices which support multiple DCS agencies.

SOURCE: Department of Information Resources.

for all DCS agencies to share. Agencies that have a project that exceeds available pooled hours can pay for additional hours from Xerox. The refresh program is also included in ongoing contract costs, and it provides upgrades to system hardware and software on a five-year cycle. However, costs to migrate or copy applications from old hardware at a legacy data center are not included and additional labor costs would be required. Unless a server has been approved for an exception or is already consolidated, it will be moved as part of the refresh process. Apart from consolidating through these services, servers could also be consolidated on a project-by-project basis, at the agency’s request and with additional agency funding.

CHALLENGES TO SERVER CONSOLIDATION

To increase understanding of the factors that resulted in slower than anticipated consolidation under both the former and current contracts, Legislative Budget Board (LBB) staff gathered feedback from DIR and participating agencies about the challenges experienced with server consolidation. DIR identified the following barriers to server consolidation:

PAST

- Agencies had financial disincentives to consolidate.
- Prior vendor offered substandard service delivery.
- Prior vendor was not able to accurately build and consolidate servers.
- Data center had network limitations.
- Server build and consolidation process were inordinately lengthy.

PRESENT

- Agency technical and business staff that are needed to complete consolidation plans and testing have competing priorities, so may not be available.
- Agencies may not have the resources needed to organize, optimize, or remediate, applications prior to consolidation.
- Agencies and service providers need more detailed and coordinated consolidation plans and schedules and need to comply better with those schedules.

LBB staff sent questionnaires to the other 27 agencies participating in server consolidation, not including DIR. In open ended responses, agencies were asked to identify the main barriers to server consolidation in the past and present. **Figure 8** shows the agencies’ responses grouped into key issues and how frequently those key issues were indicated by agencies.

Examples of implementation plan problems mentioned by agencies included scheduling DCS resources and incorrect assumptions about agency computing environments. Other agencies cited a lack of clear procedures, confusion over the roles and responsibilities of agency versus DCS staff, and a need for more agency oversight of DCS staff than expected. However, agencies generally agreed the situation has improved since DIR changed service providers. Agencies were also asked what they, DIR, and the DCS vendor needed to speed up consolidation going forward. Fourteen of the agencies indicated that they considered consolidation complete or that nothing else was needed. Of the other 13 agencies, 9 indicated that additional dedicated resources and

**FIGURE 8
KEY ISSUES IDENTIFIED BY DATA CENTER SERVICES AGENCIES AS BARRIERS TO SERVER CONSOLIDATION, PAST AND PRESENT, FISCAL YEAR 2014**

ISSUE	AGENCIES IDENTIFYING KEY ISSUE AS BARRIER (OUT OF 27)	PERCENTAGE OF RESPONDENTS IDENTIFYING KEY ISSUE AS A BARRIER
Implementation plan problems	17	63%
Responsiveness of vendor	16	59%
Limited staffing either by vendor or agency	15	56%
Transition of vendors and turnover of staff	9	33%
Service and performance issues	8	30%
Higher costs in data center services	7	26%
Application remediation needed	6	22%
Less control over servers once consolidated	1	4%
No significant barriers	1	4%

SOURCE: Legislative Budget Board.

staff were needed at both the agency and the DCS vendor to focus on consolidation work instead of having projects compete for priority. Three agencies said the DCS vendor needed to better meet timelines for server delivery. One agency explicitly mentioned additional funding for application remediation.

AGENCY SATISFACTION

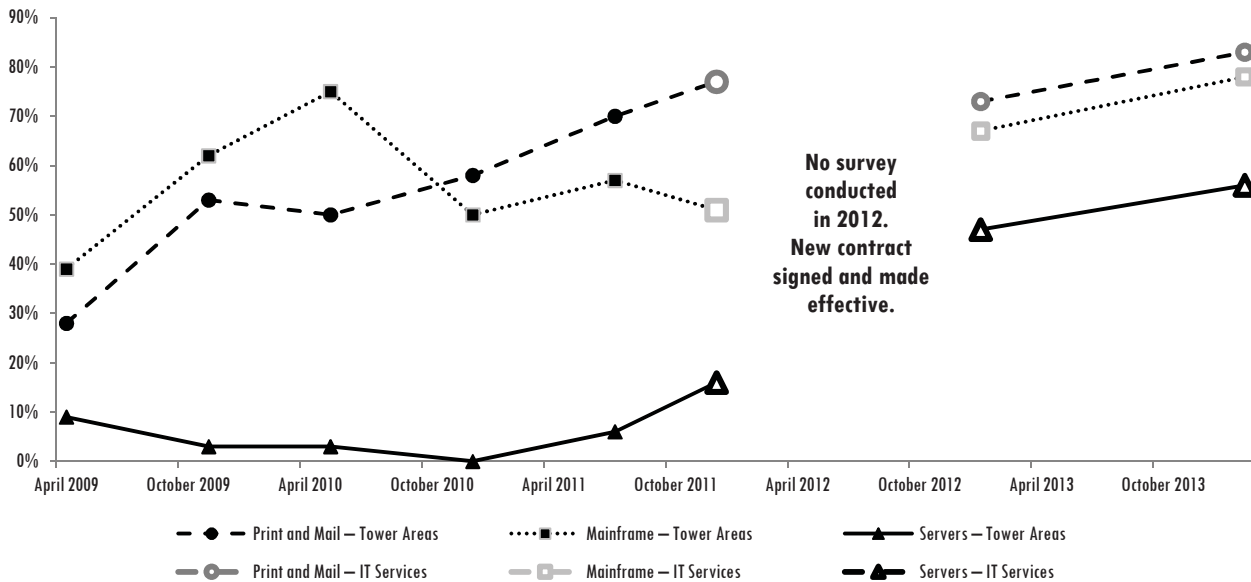
Over time, surveys of agency staff provide an indication of changes in agency satisfaction. Satisfaction of both agency executives and IT directors has improved since the transition to the new vendors. In May 2010, 97 percent of IT directors at participating agencies were dissatisfied with the services provided by IBM, and only 3 percent were somewhat satisfied. In February 2014, 24 percent of IT directors and agency representatives were dissatisfied, and 58 percent were somewhat or very satisfied overall with the services provided through the DCS program. Agency satisfaction ratings specifically for server services also increased from a low in December 2010 of 0 percent to a high of 56 percent in February 2014. **Figure 9** shows the IT directors and other staff satisfaction ratings for print and mail, mainframe, and server services respectively.

Though satisfaction with server services has improved, the February 2014 survey of IT staff found that both dissatisfied and satisfied respondents said that issues with backups and a lack of skilled staff with technical expertise were areas for improvement. High costs and server issues were also mentioned as problematic by the satisfied respondents. Respondents also suggested that improved timeliness on projects, responsiveness to problems, and communication with agencies were necessary changes for future success of the DCS program overall.

OPPORTUNITIES FOR EXPANSION

Increasing the number of servers consolidated in the data center could reduce costs for current participating agencies. While any new entity would have to pay for the costs to transition its servers, mainframes, and print/mail services, adding new entities would increase volume in the program, which could decrease per unit costs for all existing participating agencies. Statute provides DIR with the authority to select and require other state agencies to consolidate into DCS, if a cost and requirements analysis is conducted and notice is given about the services to be provided and the associated costs. Agencies and local governments can also participate voluntarily and may choose

FIGURE 9
SATISFACTION WITH SPECIFIC IT SERVICES IN THE DATA CENTER SERVICES PROGRAM, FISCAL YEARS 2009 TO 2014



NOTE: Only points with labels represent reported survey results. No survey was conducted in 2012. Survey respondents changed from IT Directors only from April 2009 to December 2011 to IT Directors and Agency Representatives and other staff in January 2013 and beyond. Responses were only counted from those agencies that used the service. In the December 2011 survey question, respondents were asked about their satisfaction with the "Tower Areas services provided by IBM" as opposed to with the "IT services."
SOURCE: Legislative Budget Board.

to use a more limited scope of services, such as email or disaster recovery services only. **Figure 2** shows which agencies currently use only email or print and mail services. DIR is also considering additional services to offer within DCS. Through the use of shared services and “software as a service,” agencies could pay a small monthly amount to use programs available through the Internet, or that DCS has purchased, rather than have to procure or develop the applications themselves.

Server consolidation into DCS has been slower than originally expected for a variety of reasons. Further progress depends on a prioritization of consolidation work by agencies and the Legislature and a high degree of collaboration between the DCS vendor, DIR, and participating agencies.

ENHANCE THE PROCESS USED TO REMOVE NONINTEGRAL ROADS FROM THE STATE HIGHWAY SYSTEM

In fiscal year 2013, the Texas Department of Transportation determined that 6,900 lane miles of urban roadways in 59 communities were no longer integral to the connectivity of the state highway system. The total cost to maintain these lane miles is estimated at \$165 million per year. A portion of these roads includes farm to market and ranch to market roads, which are state-built and -maintained roads that originally were established to connect rural or agricultural areas to market towns. As a result of population growth in Texas, many of these roads now serve urban regions. In March 2014, the Texas Department of Transportation executed a memorandum of understanding with key stakeholders for a voluntary turnback program to transfer control of nonintegral roads to local governments. Transferring these nonintegral roads, which function more like city streets, to local control makes state road maintenance funds available for other transportation needs for the connectivity of the state highway system.

Although the memorandum of understanding for the program contains a review of roads for potential turnback, this review process does not include criteria to determine roads that are the best candidates to be turned over, which limits its effectiveness. Also, there is no statute or agency rule requiring this road review; as a result, cities' participation is not guaranteed. Additionally, no state oversight is planned for the voluntary program. Establishing a consistent process to ensure the joint review of eligible roads for the program and a mechanism to track program performance would allow a determination of the program's effectiveness. Without such a mechanism, it will be difficult for the state to determine whether the program has been successful and how much revenue has been made available for other transportation priorities. Establishing oversight of the program and an annual review process would help ensure that all eligible urban roads are reviewed consistently and that maintenance funds made available as a result of the program are maximized to address more urgent transportation needs.

FACTS AND FINDINGS

- ◆ A highway turnback program is the transfer of state-owned roads that function more like city streets than state highways to the municipalities in which the roads are located. Transferring these nonintegral roads

makes state maintenance funds available to be spent on other transportation needs.

- ◆ Thirty communities have expressed interest in participating in the turnback program in fiscal year 2015, and Texas Department of Transportation staff are working with seven cities to transfer roads to local control.
- ◆ The Texas Department of Transportation anticipates transferring a total of 500 lane miles by the end of fiscal year 2017 to local governments; however, any savings associated with these turned-back roads will be minimal in fiscal years 2016 and 2017. In accordance with the turnback program memorandum of understanding, a portion of maintenance savings from the program—up to \$100 million—will be used to fund the first year of maintenance costs for each transferred road.

CONCERNS

- ◆ The turnback program for Texas roads is voluntary and does not require a regular review of or have criteria to identify roads that are the best candidates for turnback. As a result, opportunities to remove roads from the state highway system and make funds available for other transportation projects could be missed.
- ◆ No mechanism is planned to ensure the transparency and accountability of the voluntary turnback program. This will limit the state's ability to determine program effectiveness and the amount of maintenance revenue made available and redirected to other transportation projects.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require the Texas Department of Transportation to establish criteria, by rule, to identify the best candidate roads for the turnback program and to develop detailed and consistent procedures to guide the process of transferring these roads to local governments in collaboration with stakeholders.

- ◆ **Recommendation 2:** Amend statute to require an annual review of roads in eligible communities by a city, its municipal planning organization, and Texas Department of Transportation district staff to determine whether any roads should be transferred voluntarily based on criteria developed in accordance with Recommendation 1. The best candidate roads with potential for transfer and any roads planned for transfer would be included in each district’s Department Work Program.
- ◆ **Recommendation 3:** Include a rider in the introduced 2016–17 General Appropriations Bill to require the Texas Department of Transportation to report key performance information regarding the turnback program to the Legislative Budget Board and the Office of the Governor to ensure accountability and assess program effectiveness.

DISCUSSION

At a June 2013 Texas Transportation Commission (TTC) workshop, Texas Department of Transportation (TxDOT) staff reported that approximately 10,000 non-freeway lane miles are part of the state highway system in 59 communities with populations of more than 50,000. Lane miles represent the unidirectional single-vehicle, travel-way mileage on state maintained roads. Approximately 6,900 of these non-freeway lane miles were found to not be integral to the connectivity of the state highway system and, therefore, candidates for transferring to local control. Selection of these roadways was based primarily on functionality and location. All of these roads were in highly urban and developed areas and function as city streets that provide access to local businesses, which was not their original purpose. Of the 6,900 lane miles identified, 42.6 percent are classified as state highways or related spurs and loops, and 39.6 percent are classified as farm to market (FM) and ranch to market (RM) roads.

The Texas Transportation Code defines a highway as a tolled or nontolled public road or part of a tolled or nontolled public road and a bridge, culvert, building, or other necessary structure related to a public road. State highways are highways that the TTC has determined are necessary for the operation of the state highway system maintained by TxDOT. A state loop is a state road that serves as a bypass, and a state spur is a roadway that connects a state highway to a non-state system road. These roadways are part of a comprehensive network of public highways across the state that connects cities. However, some roadways designated as part of the state highway system have begun to function as local roads. An example of such a highway is Lamar Boulevard (State Highway Loop 343), which runs through the urban center of Austin.

According to TxDOT, FM and RM roads are state roads established to connect rural or agricultural areas to market towns so that products could be transported to distribution centers. FM and RM roads were built by the state and are maintained by TxDOT. These roads typically are in rural areas; however, as a result of population growth in Texas, many FM and RM roads that originally served rural areas now serve urban areas. According to TxDOT, approximately 8.7 percent of the state’s total FM and RM roads are within urban areas; these roads are funded entirely by the state. Examples of FM roads in metropolitan areas are Martin Luther King Jr. Boulevard (FM 969 East) in Austin, Lake Shore Drive (FM 3051) in Waco, and Westheimer Road (FM 1093) in Houston. **Figure 1** shows the number of lane miles for road types considered to be nonintegral to the state highway system.

TxDOT estimates the total cost to maintain these approximately 6,900 lane miles is \$165 million per year. The Texas Transportation Code, Section 201.103, provides TTC the authority to remove a segment of the state highway

**FIGURE 1
NONINTEGRAL AND TOTAL LANE MILES OF TEXAS HIGHWAYS, FISCAL YEAR 2013**

HIGHWAY CLASSIFICATION	NONINTEGRAL LANE MILES	TOTAL LANE MILES	PERCENTAGE OF NONINTEGRAL MILES
Business Interstate/Business State/Business U.S. Highway	642.4	3,017.4	21.3%
Farm to Market/Ranch to Market	2,735.0	84,806.9	3.2%
Park Road/Principal Arterial Street System	93.7	607.1	15.4%
State Highway/State Highway Spur/State Highway Loop	2,937.8	39,673.4	7.4%
U.S. Highway	494.1	34,603.0	1.4%
TOTAL	6,903.1	162,707.8	4.2%

SOURCE: Texas Department of Transportation.

system it determines is not needed for system connectivity. In fiscal year 2013, TxDOT staff proposed transferring ownership of these state-owned roads to the municipalities in which they are located through TTC.

Removal of these lane miles from the state highway system would allow TxDOT to reprioritize maintenance funds toward roads that are integral to the connectivity of highway systems and for other transportation needs. Local governments would be able to control issues such as driveway access, speed limits, on-street parking, and maintenance schedules for these transferred roads. Additionally, transferred roads could allow for more flexibility in city planning that could lead to economic development and urban renewal.

Local governments, which were not contacted by TxDOT prior to the proposal being announced, expressed concern about the financial burden the program could pose. As a result, TTC directed TxDOT staff to reexamine the turnback program and to work with local governments to develop a mutually acceptable process.

VOLUNTEER TRANSFER OF ROADS

In January and February 2014, TxDOT convened meetings with members of the Texas Municipal League (TML) and the Association of Texas Metropolitan Planning Organizations (TEMPO). These meetings resulted in a memorandum of understanding (MOU) between TxDOT, TML, and TEMPO for a voluntary program that allows transfer of nonintegral roads to local governments. According to TxDOT staff, the agency is able to implement the necessary processes within its existing statutory authority and no rules for the program have been or are planned to be promulgated. The parties executed the MOU in March 2014.

Individual metropolitan planning organizations (MPOs) must ratify the MOU, and as of September 2014, TEMPO was working with MPOs to do so. The ratification process involves each MPO policy board concurring with the MOU via a resolution. TEMPO estimates ratification will be completed by all MPOs no later than December 2014. According to TEMPO, each municipality that chooses to participate in the program has the ability to negotiate specific terms in a local implementation plan that best meet the unique needs of its communities. The collaborative MOU between TxDOT, TML, and TEMPO will be reviewed every two years to allow any necessary adjustments to be made.

The MOU provides that:

- the program is available to any city within the boundaries of an MPO. An MPO is required by federal statute for each urban area with a population of more than 50,000;
- TxDOT will ensure a proposed road is in satisfactory condition before a transfer occurs;
- no road will be transferred unless the local government agrees that it is in satisfactory condition; and
- TxDOT will not use a city’s refusal to accept a turned-back road as a reason to reduce spending in the city or an associated TxDOT district.

The MOU does not clarify whether statewide planning documents would be updated to reflect these transferred roads. According to TxDOT staff, the agency considers the turnback program to be a tool for managing the highway system. Transferred roads in an area may be considered when developing projects related to highway capacity and mobility.

LOCAL IMPLEMENTATION PLAN

One key provision of the collaborative MOU is the development of local implementation plans to facilitate the turnback program. According to the MOU, each city, its MPO, and the TxDOT district will meet and develop an implementation plan for FM and RM roads and all other highways in the area. As part of this plan, these entities will determine which roads: (1) do not correspond to the functional classification, and therefore should remain state highways; and (2) should be considered for the voluntary turnback program based on their functional classification. The MOU allows implementation plans to provide for delayed turnover of a road so that:

- a local government may phase in the transition of the transferred roads to fit within the government’s budgetary constraints; and/or
- TxDOT may complete projects that are planned for the next four years.

TxDOT is in the process of developing a base template that can be modified for each agreement between the agency and the local entity. Each local implementation plan will be negotiated individually and customized to local needs and conditions. The plans will include implementation timelines and commitments for all parties. These plans will be reviewed and approved by TxDOT administration before being submitted to a city’s governing body for consideration and approval to ensure an acceptable level of consistency and

uniformity. Additionally, a city's municipal maintenance agreement, which divides maintenance responsibilities between cities and TxDOT, will be updated to reflect the transferred highways. According to TxDOT staff, the local implementation plans are flexible and can be modified at any time. However, there is no requirement that these plans be reviewed in the future to determine whether they accurately reflect all roads eligible for turnback.

FINANCIAL INCENTIVE PROGRAM

Another significant provision of the MOU is a financial incentive program. According to the MOU, as an incentive for participation, TxDOT will use a portion of its future maintenance savings, capped at a statewide total of \$100 million, to fund the first year of maintenance costs for the transferred roads on a first-come, first-served basis. The MOU also provides that any additional maintenance savings will be used on eligible transportation projects within a city that accepts responsibility for a transferred road. Based on information from TxDOT, it is not clear how savings will be accounted for, and how local maintenance projects eligible for funds will be selected. According to TxDOT, 30 of the 59 communities that can participate in the turnback program have expressed interest in participating in fiscal year 2015, and staff are working actively with seven cities, or approximately 12 percent of the eligible communities, to transfer control of roads. Additionally, the agency estimates approximately 150 lane miles will be transferred to local governments in 2015, and anticipates transferring a total of 500 lane miles by the end of fiscal year 2017. The total represents approximately 7 percent of the 6,900 nonintegral lane miles originally identified by TxDOT for transfer to local communities. Because the program is voluntary, TxDOT staff do not expect that all of the lane miles originally identified as eligible for turnback will be transferred to local entities.

TxDOT anticipates that any savings associated with transferring roads will be minimal in the next two fiscal years. The agency estimated the maintenance cost for the transferred roads to be \$22,000 or less per lane mile. Using this figure, the \$100 million set aside for transferred roads equates to approximately 4,500 lane miles. Because TxDOT is paying cities for the cost of the first year's maintenance up to the \$100 million cap, TxDOT will not achieve any savings during the first year a road is turned back unless more than 4,500 lane miles are transferred to local control. Additionally, because potential savings are anticipated to be reinvested in local maintenance projects within a city that accepts a

transferred road, the turnback program will not result in savings but rather lead to cost-avoidance of maintenance needs for which the state is responsible. TxDOT should realize some of this cost-avoidance during the second year after a road is transferred. However, in some cases, TxDOT also is making pavement improvements pursuant to the MOU before transferring roads. This could result in an upfront cost that would offset some of the future cost avoidance in maintenance funds.

IMPROVE THE TURNBACK PROGRAM TO ENSURE EFFECTIVENESS

Other states have implemented voluntary road transfer programs. To improve Texas' turnback program, the state could consider other states' best practices and effective strategies. Pennsylvania established a voluntary highway transfer program in statute in 1983 and has turned back 4,700 lane miles of roadway since the program's inception. The state currently has a goal to transfer an additional 25 lane miles each year. The original objective of Pennsylvania's program is the rehabilitation, maintenance, and transfer of state-owned roads that function more like city streets than highways to local municipalities. Before a road can be transferred to a municipality in Pennsylvania, local government officials must adopt a resolution to authorize the acceptance of a transferred road. After the turnback process is complete, municipalities receive annual payments of \$4,000 per mile for the maintenance of the roadway. Depending on the road, the \$4,000 payment may cover all maintenance costs for some transferred roads and may not cover all costs in other instances. The payments are released March 1 beginning two years after the road was transferred.

Some significant elements of the Pennsylvania program include: (1) a statutorily required annual review of the proposed local highways to be transferred to ensure each eligible road is reviewed annually; (2) suggested criteria for selecting roads for turnback; and (3) a biennial joint review by the House and Senate transportation committees of the effectiveness and performance of the highway transfer program. Additionally, Pennsylvania has detailed policies and procedures to facilitate the transfer process.

Texas' program lacks some of these components, which could limit its effectiveness. These limitations include: (1) a statutorily required annual review of highways eligible to be transferred to local control; and (2) criteria for selecting roads that are candidates for the program. In the Texas program, each eligible road may not be reviewed effectively

by TxDOT and the affected municipality on an annual basis. As a result, the state could be missing an opportunity to transfer some roads to local control, which would allow funds to be redirected to other highway needs.

According to TxDOT, district offices regularly review roads in their districts to identify roads that could be turned over to local governments. From fiscal years 2008 to 2014, TxDOT turned over 12 FM and RM roads to municipalities totaling 63 lane miles. These transfers included seven urban roads, which is a TxDOT designation of certain FM and RM roads located in whole or in part within urban areas of populations of 50,000 or more. No roads from other functional classifications were turned over during this period.

To enhance the Texas program and help TxDOT achieve its objective of removing more nonintegral roads from the state highway system, Recommendation 1 would amend the Texas Transportation Code, Section 201.103, to require TxDOT to establish criteria, by rule, to identify the best candidate roads for transfer to local entities, in collaboration with TML and TEMPO. The criteria would be used to develop a prioritized list of eligible roads for transfer. Examples of criteria that Pennsylvania uses include: roads with low average daily traffic; roadways that are part of the local road network that do not serve in a statewide or regional capacity; and roads that do not isolate structures such as bridges, culverts, and railroad crossings within the state's jurisdiction. TxDOT would also be required to establish more detailed and consistent procedures to facilitate the process of transferring these roads to local governments. Pennsylvania's *State Highway Transfer Policies and Procedures Manual* provides a framework to develop detailed and consistent procedures that could guide the Texas program.

Recommendation 2 would amend the Texas Transportation Code, Section 201.103, to require an annual review of roads in eligible communities by a city, its MPO, and TxDOT district staff using the established criteria to determine which roads could be transferred voluntarily. This recommendation also would amend the Texas Transportation Code, Section 201.103, to include in each district's Department Work Program a: (1) prioritized list of the 20 best candidate roads for transfer in the district, or fewer in the event there are less than 20 qualifying roads; and (2) list of any roads planned for transfer. The work programs, which are required by statute and cover a four-year period, include all TxDOT district projects proposed to be implemented during this timeframe, including updates on major transportation projects. These work programs resulted from a

recommendation made by the Texas Sunset Advisory Commission in a 2011 report which identified a lack of transparency and accountability of TxDOT's transportation projects. This report also recommended the development of criteria for major transportation projects and benchmarks to evaluate project progress. Texas' turnback program does not include similar criteria to evaluate the effectiveness and performance of the voluntary program. Without such an oversight mechanism, it would be difficult to determine the impact of the new turnback program and the \$100 million incentive, including the amount of maintenance revenue that is made available and redirected.

Recommendation 3 would include a rider in the introduced 2016–17 General Appropriations Bill to require TxDOT to report biennially regarding the status of the voluntary turnback program to the Legislative Budget Board and the Office of the Governor. Information reported should include, at a minimum: (1) the number of communities participating in the voluntary turnback program; (2) a list of roads transferred to local governments; (3) the number of lane miles transferred to local governments; (4) information on the amount of maintenance funds made available as a result of the transferred roads; (5) a list of the priority maintenance projects on which the newly available funds are being spent; and (6) a list of state roads that are the best candidates for potential transfer. TxDOT should use this data to evaluate the program and make recommendations to enhance the program in this biennial report.

FISCAL IMPACT OF THE RECOMMENDATIONS

It is anticipated TxDOT could implement Recommendations 1, 2, and 3 within existing agency resources. Additionally, the state could realize some increased level of cost-avoidance associated with Recommendations 1 and 2; these recommendations would facilitate the transfer of more roads to local control, which would make additional maintenance revenue available to be redirected to other transportation needs. The amount of cost-avoidance, however, cannot be determined at this time but would be available in the future via the report required by Recommendation 3.

The introduced 2016–17 General Appropriations Bill includes a rider to implement Recommendation 3.

INCREASE THE FEE FOR A DUPLICATE MOTOR VEHICLE TITLE TO RECOVER STATE COSTS

The owner of a motor vehicle registered in Texas is required to apply to the Texas Department of Motor Vehicles for a title to the vehicle. The title establishes the applicant as the legal owner of the vehicle, and the vehicle may not be operated legally on a public highway until the owner obtains a title. When the original vehicle title is lost or destroyed, owners must submit an application to the Texas Department of Motor Vehicles for a certified copy of title.

A certified copy of motor vehicle title can be requested via mail, or in person at 16 regional offices. The Texas Department of Motor Vehicles issues more than 300,000 duplicate titles a year. The mail-in application fee for these documents was set in statute in 1983 at \$2. The in-person application fee has been \$5.45 since 1993 based on the statutory fee as well as add-on fees set via administrative rule. According to the department, regardless of application method, on average it costs the agency about \$16 to issue a certified copy of motor vehicle title. In fiscal year 2013, the agency expended \$4.1 million more than it collected to provide duplicate titles. Authorizing the Texas Department of Motor Vehicles to set this fee at a rate that fully recovers the cost of issuing a certified copy of title would allow the program to be self-supporting.

CONCERN

- ◆ Fees charged by the Texas Department of Motor Vehicles to provide a certified copy of motor vehicle title do not fully offset the cost to the agency to produce and distribute this document. As a result, the agency receives appropriations for the program that are in excess of the amount generated by the fee assessed to obtain a duplicate title.

RECOMMENDATION

- ◆ **Recommendation 1:** Amend statute to authorize the board of the Texas Department of Motor Vehicles to set the fee for a certified copy of motor vehicle title in rule. This would allow the state to fully recover the cost of providing duplicate titles.

DISCUSSION

As specified in the Texas Transportation Code, Section 501.022, the owner of a motor vehicle registered in the state

must apply to the Texas Department of Motor Vehicles (DMV) for a title to the vehicle. The title establishes the applicant as the legal owner of the vehicle. A motor vehicle owner may not operate or permit the vehicle's operation on a public highway until the owner obtains a vehicle title and registration.

Motor vehicle titles must include: the name and address of each purchaser and seller at the first sale or a subsequent sale; the make of the motor vehicle; the body type of the vehicle; the manufacturer's permanent vehicle identification number, or the motor number if the vehicle was manufactured before the date that stamping a permanent identification number was adopted universally; the serial number for the vehicle; the name and address of each lienholder and the date of each lien on the vehicle, listed in the chronological order in which the lien was recorded; a statement indicating rights of survivorship; the odometer reading at the time of title application, if the vehicle has an odometer; and any other information required by DMV.

The fee for a new motor vehicle title is \$33, if the applicant's residence is in one of the 17 counties located within a nonattainment area, as defined by the federal Clean Air Act, Section 107(d), (42 U.S. Code, Section 7407). A nonattainment area exceeds national standards for air quality. In the remaining 237 counties, the new motor vehicle title fee is \$28.

FEES TO OBTAIN A DUPLICATE MOTOR VEHICLE TITLE

When the original motor vehicle title is lost or destroyed, vehicle owners must apply to DMV for an official duplicate certificate of title, also known as a certified copy of original motor vehicle title. The duplicate title fee was set by the Forty-first Legislature, Second Called Session, 1929, at \$1. The fee was increased to \$2 by the Sixty-eighth Legislature, Regular Session, 1983. Vehicle owners can submit a duplicate title application via mail, or they can apply in person at DMV's 16 regional service centers.

The mail-in duplicate title fee amount is set by the Texas Transportation Code, Section 501.134. In September 1993, the agency added administrative fees to the cost of a duplicate title application that is submitted in person, which totals \$5.45. The amount of these fees is set in the Texas Administrative Code, Title 43, Part 10, Chapter 217. The fee

is remitted to DMV and is deposited to the General Revenue Fund.

According to DMV, including both application methods, the agency typically issues more than 300,000 duplicate titles each fiscal year. As **Figure 1** shows, approximately 85.0 percent of the duplicate titles requested in fiscal year 2013 were submitted in person.

**FIGURE 1
DUPLICATE MOTOR VEHICLE TITLES PROVIDED BY THE TEXAS DEPARTMENT OF MOTOR VEHICLES
FISCAL YEARS 2009 TO 2013**

YEAR	WALK-IN APPLICATIONS	MAIL-IN APPLICATIONS	TOTAL
2009	271,752	86,789	358,541
2010	277,318	87,854	365,172
2011	279,301	90,034	369,335
2012	302,794	62,877	365,671
2013	312,307	54,627	366,934

SOURCE: Texas Department of Motor Vehicles.

In fiscal year 2013, according to DMV, it cost the agency on average approximately \$16 to issue a duplicate title, regardless of application method. According to the agency, these costs are attributable to the use of secure paper, printing, and administrative and personnel costs. Therefore, fees collected to produce and distribute duplicate titles do not fully cover the agency’s administrative cost to issue these documents. Based on information provided by DMV, in fiscal year 2013 the agency expended \$4.1 million more than it collected to provide duplicate titles.

TITLE FEES IN SELECTED OTHER STATES

Fees that other states charge for new and duplicate motor vehicle titles vary. Fees charged in some of the other most populous states, shown in **Figure 2**, range from a low of \$19 in California to a high of \$95 in Illinois. Of these states, Texas has the second-lowest fee for a new motor vehicle title and the lowest fee for a duplicate motor vehicle title.

Most states in this selected sample typically charge the same amount for duplicate and new titles.

INCREASE FEES TO RECOVER STATE COSTS

The Eighty-third Legislature, Regular Session, 2013, amended statute to authorize DMV to collect a fee set by the DMV board in rule, in addition to other registration fees, for the issuance of license plates or registration insignia. The purpose of this fee is to cover the expenses of collecting

**FIGURE 2
MOTOR VEHICLE TITLE FEES IN SELECTED STATES
FISCAL YEAR 2013**

STATE	NEW TITLE	DUPLICATE TITLE
California	\$19.00	\$19.00
Florida	\$77.25	\$77.25
Illinois	\$95.00	\$95.00
Ohio	\$15.00	\$15.00
New York	\$50.00	\$20.00
Texas	\$28 / \$33	\$2 / \$5.45

NOTE: In Texas, the amount of a new title fee depends on the county issuing the title. The duplicate title fee is \$2 for a mail-in submission and \$5.45 for an in-person submission.
SOURCE: Legislative Budget Board.

registration fees. To recover all costs associated with issuing a duplicate title, Recommendation 1 would amend the Texas Transportation Code to authorize the DMV board to set the fee for a duplicate title in rule. The DMV board would be authorized to set the fee in an amount that covers the expenses of issuing a duplicate title and to round the fee to the nearest dollar to simplify cash transactions. As a result of this recommendation, the agency would realize a revenue increase that could be used to offset the cost of issuing duplicate titles.

FISCAL IMPACT OF THE RECOMMENDATION

Recommendation 1 would authorize DMV to set duplicate title fees by rule. It is assumed the agency would set duplicate title fees at the approximate average replacement cost of \$16, which would result in an estimated \$8.2 million gain in General Revenue Funds for the 2016–17 biennium. This estimate is based on expenditures and revenue collected by the agency for duplicate titles in fiscal year 2013.

**FIGURE 3
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 1
FISCAL YEARS 2016 TO 2020**

YEAR	PROBABLE REVENUE GAIN/(LOSS) IN GENERAL REVENUE FUNDS
2016	\$4,145,248
2017	\$4,145,248
2018	\$4,145,248
2019	\$4,145,248
2020	\$4,145,248

SOURCE: Legislative Budget Board.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of this recommendation.

IMPROVE THE OPERATIONS AND STATE OVERSIGHT OF OVERWEIGHT CORRIDORS

Overweight corridors are a general designation used to identify roadways or segments of roadways as a route where commercial vehicles can transport loads that exceed state weight and size limits. Without an overweight corridor, trucks transporting loads exceeding these limits would need to either reduce or divide cargo, which can increase the time and cost required for shipping goods, or obtain an alternative permit that allows certain oversize or overweight vehicles to travel on Texas' roads. As of December 2014, Texas had six statutorily authorized overweight corridors on state highways, three of which were operational. Local entities that operate these corridors can charge commercial vehicles a maximum of between \$80 and \$100 per trip for corridor travel with loads weighing up to between 110,000 and 140,000 pounds. Local entities are authorized to retain up to 15 percent of permit revenue for administration, and the remaining revenue is deposited in the State Highway Fund to pay for the corridor's maintenance needs. If fee revenue is insufficient to cover the cost of maintenance, the entities may provide alternative funding sources to cover the difference.

Overweight corridors have been approved on an ad hoc basis and outside of the state's transportation planning process. As a result, these corridors are not considered in the context of requirements for road maintenance and expansion of the state's wider transportation system. State oversight of the operation of the corridors is limited to monitoring financial reports and pavement performance. As a result, it has not been possible to determine the effects of Texas' overweight corridors on economic development. Improving state oversight of overweight corridors and requiring that best practices be applied to future corridors would allow state and local entities to ensure the efficiency of these corridors.

CONCERNS

- ◆ Overweight corridors are established as an incentive for economic development. Authorizing local entities to issue overweight corridor permits, in lieu of the state's oversize/overweight permits, results in the state foregoing revenue. However, not all authorized corridors are currently operational because of concerns that the demand for permits is insufficient to offset operational costs, suggesting the economic

development potential of these corridors was limited at the time the corridor was authorized.

- ◆ The Port of Brownsville reports financial information to the Texas Department of Transportation on a monthly basis. However, no performance indicators, such as travel time or amount of cargo transported, are reported. Without this information, it is difficult to monitor the effectiveness of the Port of Brownsville's corridor and evaluate the potential benefit of future corridors.
- ◆ The Texas Department of Motor Vehicles does not have statutory authority to issue overweight corridor permits on behalf of local entities. As a result, local entities that issue permits individually contract for services with the same provider the state uses to issue oversize/overweight permits. These entities are missing an opportunity to lower their administrative costs by using the Texas Department of Motor Vehicles' existing automated Texas Permitting and Routing Optimization System.
- ◆ Minor variations in traffic can significantly affect pavement performance and accelerate the need for substantial maintenance improvements. Based on the Texas Department of Transportation's pavement projections, current revenue generated through permits is insufficient to cover the cost of maintaining ideal conditions on all roadways within the Port of Brownsville's corridor. Local entities are responsible for costs related to maintenance of the corridors, and it is unclear whether they have the information required to adequately plan for higher-cost maintenance needs.

RECOMMENDATIONS

- ◆ **Recommendation 1:** Amend statute to require the Texas Department of Transportation to set baseline requirements to determine the feasibility, viability, and potential impact of any new overweight corridors and use these requirements to periodically develop recommendations for any additional overweight corridors that would be beneficial for the state.
- ◆ **Recommendation 2:** Amend statute to require the Texas Department of Transportation to work with

stakeholders to establish performance measures for each operational corridor and require that results be reported to the Texas Department of Transportation and the Legislature to allow for evaluation of the corridor's impact on freight movement.

- ◆ **Recommendation 3:** Amend statute to authorize the Texas Department of Motor Vehicles to issue overweight corridor permits on behalf of local entities and to authorize the department to establish a fee in an amount sufficient to recover the actual cost of issuance.
- ◆ **Recommendation 4:** Amend statute to require the Texas Department of Transportation to complete a pavement management plan for each operational corridor to ensure all parties have information regarding the long-term cost of maintaining corridors.
- ◆ **Recommendation 5:** Amend statute to require local entities to consider the pavement management plan provided by the Texas Department of Transportation when setting permit rates.

DISCUSSION

Overweight corridors, also known as heavy haul corridors, are designated roadways or segments of roadways that facilitate the direct movement of loads that exceed state weight and size limits between ports, border crossings, and industrial parks. Overweight corridors allow heavy loads to move into Texas through water ports or across the border and then travel to a storage or staging area without the cost or time delays associated with transloading or dividing cargo. By expediting the movement of goods in this manner, overweight corridors result in transportation-related cost savings along the supply chain and help to reduce congestion. These results benefit businesses and local entities such as ports, counties, or regional mobility authorities. For example, the superintendent of the McAllen-Hidalgo-Reynosa International Bridge and the Anzalduas International Bridge estimated transporters would save between \$1,200 and \$2,000 per trip as a result of Hidalgo County's overweight corridor.

Texas is the leading state for exports with 17.7 percent of the nation's market, and is ranked second among states for imports with 13.7 percent of the nation's market. In addition, Texas' location means regional and national corridors traverse the state's borders. Trucks are the primary mode for moving freight in Texas, and account for 60 percent of the value of freight transported and 58 percent of total weight of freight transported in the state. In calendar year 2013, 68.7 percent of

loaded truck containers crossing the U.S.–Mexico border traveled through Texas. Texas' weight tolerance limits are lower than Mexico's. As a result, trucks traveling into the state from Mexico are required to divide their loads to legally meet Texas' weight restrictions, or must reroute to other ports such as Veracruz.

The state's ports also handle more than 500 million tons of cargo annually and are ranked first in the country in exports and waterborne commerce. Containers transporting cargo via marine carriers can greatly exceed limits for traveling on Texas highways. Freight transportation in Texas is challenged by congestion, and rail capacity for handling additional freight is constrained. The Texas Department of Transportation (TxDOT) has identified overweight corridors as one solution to help address freight mobility in Texas. Ports gain a competitive advantage from these corridors because eliminating the need to divide loads and reducing congestion allows goods to leave the port quicker. Changes in demand and cost can cause shippers to move business between competing ports. The potential cost and time savings associated with overweight corridors are considered to be a tool for attracting shippers to Texas ports and cities.

OVERWEIGHT CORRIDORS IN TEXAS

The enactment of Senate Bill 1276 by the Seventy-fifth Legislature, Regular Session, 1997, established the first overweight corridor in the state. This legislation authorized the Texas Transportation Commission (commission) to approve an overweight corridor route for the Port of Brownsville. Upon the commission's approval of an agreement between TxDOT and the Port of Brownsville, the port was authorized to issue optional permits to vehicles carrying cargo on certain state highway segments. Statute and the Texas Administrative Code outline local responsibilities and prescribe administrative requirements for the issuance of optional permits for travel on overweight corridors that have been approved by the Legislature and the commission. These requirements include:

- issuing permits for travel on overweight corridors to vehicles or vehicle combinations that exceed state size and weight limits designated in the Texas Transportation Code, Chapter 621, Subchapters B and C, but do not exceed loaded dimensions of 12 feet wide, 16 feet high, or 110 feet long, or gross weight limits ranging from 125,000 to 140,000 pounds, depending upon the issuing authority;

- charging a maximum permit fee per trip that varies by issuing authority, but ranges between \$80 and \$100;
- retaining up to 15 percent of permit revenue to cover administrative costs and remitting the remainder to TxDOT for deposit in the State Highway Fund to pay for maintenance of designated highways;
- posting a surety bond of \$500,000 to reimburse TxDOT in the event revenue collected from permits is insufficient to cover required maintenance—local entities have the option to make direct restitution to TxDOT for actual maintenance costs in lieu of the agency filing against the surety bond in cases of insufficient revenue; and
- entering into a maintenance contract with TxDOT for routine maintenance, preventive maintenance, and total reconstruction of the roadway and bridge structures as determined by TxDOT to maintain the current level of service.

The Texas Legislature has authorized the designation of six overweight corridors on state highways. **Figure 1** shows the statutorily set maximum permit fee, gross weight limit, and maximum speed limit for each of these authorized overweight corridors.

Of the four corridors authorized prior to calendar year 2011, only the Port of Brownsville’s corridor is operational, meaning the port issues permits for overweight vehicles to travel on its

designated routes. The Port of Freeport received legislative authorization to designate an overweight corridor in calendar year 2011 and began issuing permits in October 2013. The Hidalgo County Regional Mobility Authority was legislatively authorized to operate an overweight corridor in calendar year 2013 and issued its first permit in July 2014. **Figure 2** shows the total mileage of overweight corridor routes authorized in statute as well as routes currently authorized under agreements between local entities and TxDOT.

According to TxDOT, one reason not all corridors are currently operational is that the demand for permits is too low to generate enough revenue to offset the cost of operating the corridor. The impact of corridors on economic development is difficult to ascertain. However, the low interest in permits suggests the contribution of these corridors to economic development is limited. The corridors have been approved on an ad hoc basis and separately from the state’s transportation planning process that considers factors such as projected traffic volumes and the impact of road maintenance and expansion projects on the state’s wider transportation system.

Recommendation 1 would amend the Texas Transportation Code to require TxDOT to set baseline requirements to determine the feasibility, viability, and potential impact of any new overweight corridors. These baseline requirements would consider traffic volumes, ability to recoup fees, economic impact, and the role of overweight corridors within the state’s larger freight mobility plan. TxDOT would be required to use

**FIGURE 1
STATUTORILY AUTHORIZED OVERWEIGHT CORRIDORS ON STATE HIGHWAYS, FISCAL YEAR 2015**

ENTITY	STATUTORY REFERENCE	YEAR STATUTE ENACTED	MAXIMUM PERMIT FEE	GROSS WEIGHT LIMIT	MAXIMUM SPEED LIMIT
Port of Brownsville	Texas Transportation Code, Chapter 623, Subchapter K	1997	\$80	125,000	55
Port of Freeport	Texas Transportation Code, Chapter 623, Subchapter K	2011	\$80	125,000	55
Victoria County Navigation District	Texas Transportation Code, Chapter 623, Subchapter L	2003	\$100	140,000	55
Chambers County	Texas Transportation Code, Chapter 623, Subchapter M	2005	\$80	100,000	55
Port of Corpus Christi Authority (Special Freight Corridor Permits)	Texas Transportation Code, Chapter 623, Subchapter P	2009	\$80	125,000	55
Hidalgo County Regional Mobility Authority	Texas Transportation Code, Chapter 623, Subchapter Q	2013	\$80	125,000	55

NOTE: The Legislature added Texas Transportation Code, Chapter 623, Subchapter O, in 2009, which authorizes the Port of Corpus Christi Authority to issue Roadway Permits for travel only on roads owned and operated by the port. Because these permits do not authorize overweight vehicles to travel on any segments of state highways, information regarding this corridor is not included in the table. There is no weight limit for travel with these permits, which cannot exceed \$80.

SOURCE: Legislative Budget Board.

**FIGURE 2
AUTHORIZED AND OPERATIONAL OVERWEIGHT CORRIDOR MILEAGE, AS OF JULY 2014**

OVERWEIGHT CORRIDOR	STATUTORILY AUTHORIZED		AUTHORIZED UNDER AGREEMENT WITH TxDOT	
	MILEAGE	BRIDGES	MILEAGE	BRIDGES
Brownsville Navigation District	31.7	51	22.5	14
Hidalgo County Regional Mobility Authority	2	0	20.6	11
Freeport Navigation District	33.9	30	33.9	30
Victoria County Navigation District	14.8	9	No current agreement exists	
Chambers County	9.4	4	No current agreement exists	
Port of Corpus Christi	N/A	N/A	No current agreement exists	

NOTES:

- (1) Segments listed as statutorily authorized are not currently included in an agreement with the Texas Department of Transportation.
- (2) Statute for the Port of Corpus Christi overweight corridor references a road that has not been built.
- (3) Only the Brownsville Navigation District, Freeport Navigation District, and Hidalgo County Regional Mobility Authority were issuing permits as of December 2014.

SOURCE: Texas Department of Transportation.

these requirements to periodically review overweight traffic and make recommendations on any potential overweight corridors that could help reduce freight bottlenecks or would be beneficial to the state. These recommendations should be included in TxDOT’s International Trade Corridor Plan or a similar report provided to the Legislature on a biennial basis that relates to freight transportation in Texas. The International Trade Corridor Plan is statutorily required to be updated and provided to the Legislature biennially. The plan currently includes a description of Texas’ international transportation infrastructure, trade-related statistics affecting commercial traffic in Texas, and a discussion of freight flows and forecasted volumes on Texas corridors that serve international trade.

To ensure freight is adequately considered in the state’s transportation planning process, TxDOT established the Freight Advisory Committee in 2013. This committee includes members from all modes of freight, representatives from local and state government entities, and representatives from industry associations. The committee was tasked with providing input into the Statewide Freight Plan, helping to identify and prioritize freight investments, and recommending freight performance measures. The committee’s final report is expected in calendar year 2015.

PERMITS FOR OVERWEIGHT VEHICLES TRAVELING IN TEXAS

The statutorily defined maximum legal weight limit authorized for travel on most Texas roads is 80,000 pounds, and the maximum legal axle weight cannot exceed 20,000 pounds for a single axle, 34,000 pounds for a tandem axle, and 42,000 pounds for a triple axle. A vehicle exceeding these weight limits

that travels on a state highway not designated as an overweight corridor is required to obtain from the Texas Department of Motor Vehicles (DMV) an oversize/overweight permit pursuant to the Texas Transportation Code, Chapter 623, Subchapter B or Subchapter D. Revenue from these permits is deposited in the General Revenue Fund, which can be used for a variety of purposes, and the State Highway Fund, which may be appropriated for any function TxDOT performs. The type of permit issued and associated fee varies depending upon the type of load being transported, as shown in **Figure 3**. The most commonly issued permit for an oversize or overweight vehicle is the general oversize/overweight permit, which is valid for one trip from a specific point of origin to a specific destination.

Without an overweight corridor allowing overweight trucks to legally transport non-divisible loads, these trucks would have to either lighten their loads or obtain one of the permits listed below. Additionally, the Texas Transportation Code, Chapter 623, Subchapter B, does not allow divisible loads to exceed 84,000 pounds. Therefore, the only option for divisible loads with a weight of more than 84,000 pounds would be to lighten their load.

The maximum weight authorized for travel on the Port of Victoria’s corridor, which is not currently operational, is 140,000 pounds. As shown in **Figure 4**, this weight is the highest limit of any corridor identified throughout the United States. The State of Washington has a corridor on which weights up to 137,788 pounds are allowed. Overweight corridors in other states allow vehicles with weights between 90,800 and 98,000 pounds to travel on designated roadways.

**FIGURE 3
OVERSIZE/OVERWEIGHT PERMIT DETAILS, FISCAL YEAR 2015**

LOAD TYPE	PERMIT	FEE	PERIOD VALID	ALLOWABLE SIZE AND WEIGHT
Non-divisible	General Single-Trip Permit	\$60; loads exceeding 80,000 pounds must also pay the highway maintenance fee of \$150 to \$375 depending on gross weight exceeding 80,000 pounds	One movement within times specified on the permit	Allows weight limits up to 254,300 pounds; maximum width, height, and length limits are not specified, however, exceeding width of 20 feet, height of 18 feet 11 inches, and length of 125 feet requires additional certification
	Annual Envelope Permit	\$4,000 per vehicle	Annual	Allows travel for vehicles up to 12 feet wide, 14 feet high, 100 feet long and 120,000 pounds gross weight
Divisible	Over Axle/Over Gross Weight Tolerance Permit	\$90 base fee, \$5 administrative fee, county fee between \$175 and \$1,000 depending upon the number of counties designated for travel	Annual	Allows for a 10 percent tolerance on axle weights and 5 percent tolerance on gross weight (gross weight cannot exceed 84,000 pounds)

NOTE: The highway maintenance fee for vehicles with a gross weight between 80,001 and 120,000 pounds is \$150. This fee is \$225 for vehicles with a gross weight between 120,001 and 160,000 pounds. No overweight corridors are authorized to permit travel for vehicles heavier than 140,000 pounds.

SOURCE: Legislative Budget Board.

Fees for permits authorizing travel on an overweight corridor in Texas are statutorily prohibited from exceeding either \$80 or \$100, depending on the corridor. Each local entity that operates a corridor has discretion to set the fee at a lower amount. The local entity operating the corridor is authorized to retain up to 15 percent of fees collected to cover administrative costs, and the remainder of the revenue is remitted to TxDOT and deposited into the State Highway Fund. Per statute, this revenue can only be used to maintain the overweight corridor for which the permit fee was paid. These permits are issued in lieu of the state’s oversize/overweight permits, and do not include the highway maintenance fee. As a result, the state foregoes revenue that would be generated from the issuance of oversize/overweight permits when an overweight corridor permit is issued instead.

Local entities are statutorily required to report to TxDOT certain information for permits issued for travel on an overweight corridor. Administrative rules also require monthly and annual reports be provided to TxDOT regarding permits issued and all associated fees collected and authorize TxDOT to annually audit permit issuance activities for overweight corridors. Audits may include a review of permits issued, financial transaction records, vehicle scale weight tickets, and monitoring of personnel. However, information related to corridor performance is not reported or audited, and no other reporting is statutorily required. As a result, there is a lack of available information regarding the effects of the corridor on freight transportation. Examples of measures that could track performance include truck travel times (how long a trip on a corridor takes), truck hours of delay (the amount of time spent

traveling because of congested conditions), and the amount of goods transported. Without such information, it is not possible to determine the effectiveness of overweight corridors that operate in Texas or to evaluate the potential for future corridors to achieve time and/or cost savings for shippers or congestion avoided as a result of the corridor.

Recommendation 2 would amend the Texas Transportation Code, Chapter 201, to require performance measures to be established for overweight corridors operating in Texas. These measures could be used to evaluate a corridor’s effects on freight movement and congestion. TxDOT would be required to develop these measures and should work with all parties involved to determine appropriate measures. Each entity operating an overweight corridor would be required to report data related to these performance measures to TxDOT, and TxDOT would be required to include disaggregated results for operational corridors in its International Trade Corridor Plan. Including performance data for overweight corridors in the plan would help state policymakers assess the effects overweight corridors are having on freight shipping, Texas’ infrastructure, and economic development. Additionally, these measures will allow TxDOT and local entities to conduct performance-based planning, monitor system performance, and could be taken into account when considering the establishment of any future corridors.

**FIGURE 4
OVERWEIGHT CORRIDORS IN OTHER STATES, AS OF APRIL 2014**

STATE	CORRIDOR ROUTE	PERMIT NAME	MAXIMUM AUTHORIZED WEIGHT	PERMIT COST	OTHER
Arizona	Between the Mariposa Commercial Port of Entry and the commercial zone of Nogales	Single Trip Overweight Border Permit	90,800 pounds	\$75 per trip	Established because of concerns about the length of time it took to move produce across the border and efforts to address congestion and security issues at the port. Reports indicate emissions and congestion at the port have been reduced and carriers have saved an average of \$285 per load as a result of the permit.
California	Between the Port of Los Angeles and certain sections of the City of Los Angeles and the City of Long Beach	Overweight Vehicle Special Permit	95,000 pounds	\$16–\$90 depending upon period of issuance (single-trip, annual, and prorated annual permits are issued)	Overweight vehicles that travel on California state highways are required to obtain an Overweight Vehicle Special Permit. Additionally, if an overweight vehicle travels through both the City of Los Angeles and the City of Long Beach, permits must be obtained from both entities.
California	Between the Port of San Francisco and certain freeways and the port's waterfront	N/A	93,000 pounds	\$90 per truck tractor per year	Established to enable travel between all major cargo handling facilities that use the port.
Texas	Authorized for certain roads in Brownsville, Freeport, Victoria County, Chambers County, Corpus Christi, and Hidalgo County	N/A	100,000–140,000 pounds, depending on the corridor	Not to exceed \$80–\$100, depending on the corridor	N/A
Washington	Designated roadways between transload facilities and marine terminals within Tacoma	Tacoma Heavy Haul Industrial Corridor Permit	98,000 pounds	\$3,000 per year	Authorized for vehicles with overweight loads that are transporting sealed ocean-going containers used in international trade.
Washington	US 97 between the Canadian border and the City of Orville	US 97 Heavy Haul Industrial Corridor Permit	137,788 pounds	\$100 per month or \$1,000 per year	N/A

SOURCE: Legislative Budget Board.

PORT OF BROWNSVILLE'S OVERWEIGHT CORRIDOR

The Port of Brownsville operates as the only deepwater port on the Texas side of the Texas–Mexico border. To compete with Mexican seaports, the port wanted to synchronize weight

restrictions for trucks transporting goods between the port and the border. Before the establishment of the overweight corridor, overloaded trucks traveled across the border, which caused enforcement issues due to Mexico's higher legal load limits, or

carriers had to divide loads into multiple trucks when they reached the border. The Seventy-fifth Legislature, Regular Session, 1997, amended the Texas Transportation Code to designate an authorized overweight corridor route on which trucks weighing up to 125,000 pounds can travel between the port and the border. Between fiscal years 2008 and 2013, the port issued 184,052 permits, which represents an average of 30,675 permits per year.

The port indicates the current fee (\$30) is based on what industry is willing to pay, and it has signed an agreement with TxDOT stating the fee will not be lowered. The port reports the amount it retains for administrative costs is split between itself and the online vendor that issues the permits. According to the port, this amount does not cover administrative costs; but the permits drive tonnage to the port, so costs are assumed to be recovered in other ways.

In 2006, the Port of Brownsville began using Texas Pro Miles to administer its online permitting system for the overweight corridor. DMV uses the same vendor for its online permitting system, the Texas Permit Routing Optimization System (TxPROS). TxPROS is a Web-based application that automates and integrates permitting and routing tasks by calculating the exact mileage for a route taken by an overweight vehicle, providing an interface for permit applications, automating route and permit issuance and restrictions, and managing map data. It currently costs DMV an average of \$7.50 to issue an oversize/overweight permit through TxPROS. Additionally, TxPROS is set up to allow self-issuance of permits via the Internet. Since the system was established, approximately 50 percent of permits have been obtained through the self-issue process. For permit applications that are submitted to DMV, rather than self-issued, it took DMV an average of 34.4 minutes to process and issue the permit in fiscal year 2013.

DMV does not have the express or implied statutory authority to issue permits on behalf of local entities. As a result, local entities that administer an overweight corridor may be missing an opportunity to reduce costs. Recommendation 3 would amend the Texas Transportation Code, Chapter 623, to authorize DMV to issue overweight corridor permits on behalf of local entities and to establish a fee in an amount sufficient to recover DMV's actual cost of issuance. This would mirror the statutorily established process for DMV to issue permits on behalf of other states and to establish a fee to recover the cost of issuing those permits. Authorizing DMV to issue overweight corridor permits would reduce local entities' administrative costs if they determine it is cheaper to issue permits via the

state's online permitting system rather than through their own systems.

MAINTENANCE NEEDS ASSOCIATED WITH OVERWEIGHT CORRIDORS

Variations in traffic and loading can significantly affect pavement performance and accelerate the need for substantial maintenance improvements. Few studies quantify the relationship between vehicle weight and the cost of road damage or maintenance. Results from existing studies vary due to factors such as different environmental conditions and pavement structures. A Senate Committee on Transportation and Homeland Security report to the Eightieth Legislature, 2007, stated that a single 80,000-pound truck is equivalent to 9,200 passenger cars relative to pavement stress and road damage. Pavement damage is dependent on a number of factors, including but not limited to:

- vehicle weight;
- axle weight, the number of axle loadings, and the spacing with axle groups;
- traffic volume or distance traveled;
- pavement condition, performance, and structural capacity; and
- climate and environmental conditions.

Unlike other statutes governing overweight vehicles, current statutes establishing overweight corridors only address the gross weight of cargo transported by overweight vehicles permitted to travel and do not provide for maximum legal axle weights. Because variations in overweight vehicle traffic can significantly affect pavement performance and accelerate the need for substantial maintenance improvements, it is important to plan for the anticipated higher cost of addressing future maintenance needs along these corridors. To measure pavement condition and identify maintenance and rehabilitation requirements, TxDOT uses the Pavement Management Information System (PMIS), which analyzes distress ratings and ride quality measurements. PMIS scores range from 1 to 100, with 90 to 100 being very good and 1 to 34 being poor, as shown in **Figure 5**.

Figure 6 shows the average PMIS condition score for roadway segments included in the Port of Brownsville's overweight corridor since fiscal year 2008. In fiscal year 2013, one roadway segment was classified as fair while the other five segments were classified as good or very good.

**FIGURE 5
PAVEMENT MANAGEMENT INFORMATION SYSTEM
CONDITION SCORE CLASSES
FISCAL YEAR 2015**

CONDITION SCORE	DESCRIPTION
90 to 100	Very Good
70 to 89	Good
50 to 69	Fair
35 to 49	Poor
1 to 34	Very Poor

SOURCE: Texas Department of Transportation.

Statute requires a local entity with an overweight corridor to make payments to TxDOT for maintenance of state highways in the corridor. Statute authorizes a fee of up to \$80 to be charged for the Port of Brownsville’s overweight corridor permit and authorizes the port to retain up to 15 percent of the revenue collected for administrative costs. The remainder of the revenue is statutorily required to be deposited to the State Highway Fund for maintenance and improvement of the state highways within the overweight corridor. The current permit fee is set by the port at \$30, and has not changed since the corridor became operational. Based on the current fee, TxDOT receives \$25.50 of each permit issued, and the port retains \$4.50 for administration. In the event of a shortfall in revenue from permits, the local entity has the option to use other revenue sources to provide this payment. Additionally, the Texas Administrative Code authorizes TxDOT to require a local entity with an overweight corridor to post a surety bond for the purpose of reimbursing actual maintenance costs if sufficient revenue is not collected from permit fees.

Based on pavement projections developed by TxDOT, it would cost \$1.7 million per year to maintain optimal road conditions (i.e., a PMIS score categorized as very good) in the Port of Brownsville’s overweight corridor. Annual revenue

currently generated by permits is insufficient to cover this amount, with an anticipated shortfall of close to \$1 million per year. The agreement between the Port of Brownsville and TxDOT states the corridors will be maintained to a level of service similar to other system roadways or pavement conditions in accordance with TxDOT regulations and engineering standards and practices. TxDOT reports that while the goal is to maintain roads so that they have a PMIS score of 90 or above, roads with a PMIS score below 70 (i.e., below good) would not fall within TxDOT standards and practices.

Figure 7 shows TxDOT’s estimates of future pavement scores if no maintenance is done on the roads in the Port of Brownsville overweight corridor. Pavement scores on average would decrease 18.8 percent between fiscal years 2014 and 2017; by fiscal year 2017, one segment would be classified as poor, three segments would be classified as fair, and two would be classified as very good.

To date, permit revenue for the Port of Brownsville’s overweight corridor has exceeded maintenance costs. At the end of fiscal year 2013, the balance based on accumulated receipts minus expenditures was \$4.5 million. During fiscal year 2013 permit revenue remitted to the State Highway Fund was \$725,367 and maintenance costs on the corridor were \$18,492. The maintenance costs have been limited to routine maintenance and have not included more expensive activities, such as more involved preventive maintenance and road rehabilitation or reconstruction. Additionally, overweight vehicles cause more bridge deterioration than normal truck loadings. According to TxDOT, future maintenance will be more involved and costly and current permit revenue is not believed to generate enough funds to offset the cost of replacing bridges along the corridor. When a bridge is determined to be structurally deficient, reduced weight limits are required. As a result, a balance is

**FIGURE 6
AVERAGE ROAD CONDITION SCORES FOR THE PORT OF BROWNSVILLE OVERWEIGHT CORRIDOR
FISCAL YEARS 2008 TO 2013**

ROADWAY	2008	2009	2010	2011	2012	2013
State Highway 48	96.9	85.9	97.1	88.6	89.1	83.6
State Highway 4	84.0	90.5	70.8	48.5	60.5	58.4
US Highway 77 North Bound	99.5	99.2	99.5	93.3	95.9	84.8
US Highway 77 South Bound	97.2	97.8	98.6	95.7	90.2	85.4
State Highway 550 East Bound	N/A	N/A	N/A	100.0	98.2	98.6
State Highway 550 West Bound	N/A	N/A	N/A	100.0	95.1	100.0

NOTE: State Highway 550 East Bound and West Bound was not a designated route within the overweight corridor until fiscal year 2012.

SOURCE: Texas Department of Transportation.

FIGURE 7
FUTURE ROAD CONDITION SCORES FOR THE PORT OF BROWNSVILLE OVERWEIGHT CORRIDOR WITHOUT MAINTENANCE
FISCAL YEARS 2014 TO 2017

ROADWAY	2014	2015	2016	2017	EXPECTED % CHANGE FROM 2014
State Highway 48	81.3	75.8	67.0	61.1	(24.8)
State Highway 4	56.1	50.0	44.2	37.8	(32.6)
US Highway 77 North Bound	84.6	79.4	72.5	62.9	(25.7)
US Highway 77 South Bound	83.0	78.6	70.5	64.5	(22.3)
State Highway 550 East Bound	98.7	98.5	97.2	95.8	(2.9)
State Highway 550 West Bound	100.0	99.6	97.7	95.4	(4.6)

SOURCE: Texas Department of Transportation.

needed to offset future expenditures that are anticipated to be more than typical maintenance operations.

In fiscal year 2014, TxDOT developed a pavement management plan for the Port of Brownsville's overweight corridor. This plan is expected to be completed in calendar year 2015. This plan provides information that can be used to anticipate the long-term cost of maintaining an overweight corridor. Recommendation 4 would amend the Texas Transportation Code, Chapter 623, to require that TxDOT complete a pavement management plan for each operational corridor to ensure all parties have access to information regarding the long-term cost of maintaining corridors. Additionally, because local entities are solely responsible for setting permit rates within the statutory cap, TxDOT has no formal authority in the rate setting process. To date, the Port of Brownsville has agreed not to lower its permit rate despite the revenue reserve that has been generated. This decision was made on TxDOT's recommendation with consideration for the cost of expected major rehabilitation needs. Recommendation 5 would amend the Texas Transportation Code, Chapter 623, to require local entities to consider the pavement management plan provided by TxDOT in setting their permit rates.

FISCAL IMPACT OF THE RECOMMENDATIONS

It is expected that any cost associated with these recommendations would not be significant and could be absorbed within existing resources. Local entities operating an overweight corridor could realize savings as a result of Recommendation 3, which would authorize DMV to issue overweight corridor permits on behalf of local entities. During the past six fiscal years, the Port of Brownsville has issued an average of 30,675 permits. DMV has indicated there would be no additional cost to process these additional permits assuming

the current levels of permit types and customer self-issuance remains the same. If permits for additional overweight corridors or an increase in traffic at the Port of Brownsville lead to additional costs for DMV to issue overweight corridor permits, these recommendations would authorize DMV to charge a fee to cover its costs. Any resulting revenue and expenditures cannot be estimated at this time; but it is not anticipated a fee would be assessed in the 2016–17 biennium.

The introduced 2016–17 General Appropriations Bill does not include any adjustments as a result of these recommendations.