



TEXAS MUNICIPAL LEAGUE
Empowering Texas cities to serve their citizens

President **David Rutledge**, Mayor, Bridge City
Executive Director **Bennett Sandlin**

April 27, 2023

The Honorable Paul Bettencourt
Chairman, Senate Local Government Committee
Texas Senate
P.O. Box 12068
Austin, TX 78768-2068

Dear Chairman Bettencourt:

I am writing on behalf of the Texas Municipal League to express our opposition to **S.B. 976**. As spelled out below, the bill would make two primary changes to the property tax rate adoption process that would negatively impact the financing of needed infrastructure and economic development across the state.

Changes to Definition of “Debt”

S.B. 976 would redefine “debt” for purposes of calculating a property tax rate to exclude any debt not approved at an election. This would include debt instruments like certificates of obligations (COs) along with other obligations like tax notes, lease-purchase agreements, and other equipment financing debt. By requiring these debt instruments to be funded from maintenance and operations revenue despite fitting any conventional definition of “debt,” S.B. 976 would largely eliminate the use of these instruments altogether since maintenance and operations revenue is capped and necessary for operating costs subject to significant cost drivers. This would not only hinder the development of necessary water, sewer, electric, transportation, and broadband infrastructure across the state, but force taxpayers to pay more in the process.

According to the Bond Review Board, the majority of outstanding city debt in Texas is not tax-supported debt but instead is considered “self-supporting” debt.¹ This means most city debt is ultimately issued for water, sewer, and other revenue producing projects that are paid by utility revenues, and not property taxes. Cities have a couple of different debt options to pay for utility system work – revenue bonds and COs. Both debt obligations require attorney general approval, neither requires an upfront election, but COs are issued with more notice and the potential for voter approval, unlike revenue bonds. And, most importantly, COs can be issued in a significantly more cost-efficient way for city residents.

Cities commonly issue COs in lieu of revenue bonds to finance needed utility construction and upgrades. The reason for this is pretty straightforward – COs typically cost much less to issue than

¹ See BRB’s 2022 *Local Government Annual Report*:
<http://www.brb.state.tx.us/pub/lgs/fy2022/2022LocalARFinal.pdf>.

a revenue bond. COs issued by cities are generally repaid with revenues from city utility systems instead of property taxes. However, the city's property tax base can serve as "credit support" in a CO, thus reducing borrowing costs and interest rates. Overall, the use of self-supporting COs by Texas cities has saved taxpayers hundreds of millions of dollars as compared to other debt instruments.² By effectively eliminating the use of COs, S.B. 976 would have the unintended effect of costing city taxpayers and ratepayers significantly more money, with no discernable public benefit.

It should also be noted that COs are regularly used by Texas cities to evidence loans under state and federal financial assistance programs. For instance, cities commonly issue COs to the state to draw down funding from the Texas Water Development Board for various critical water infrastructure project needs. In doing so, cities obtain reduced interest rates and financial assistance from the state. The state agency receives stronger credit ratings in return due to the underlying property tax pledge supporting the CO. S.B. 976 would significantly discourage the use of COs by a city to draw down needed state and federal infrastructure funding. This means that at the same time the Texas Legislature potentially invests billions of dollars into water infrastructure projects this session, S.B. 976 would drastically limit cities' ability to access the new funding.

The Texas Legislature has enacted several substantive and process reforms relating to the issuance of COs and other non-voter-approved debt instruments in recent years. In 2015, the legislature passed H.B. 1378 to prohibit the issuance of a CO within three years of a failed bond election on the same project. Four years later in 2019, the legislature passed H.B. 477, which significantly enhanced the notice required when a CO is issued, from requiring additional published and internet notice to increasing the amount of time voters may circulate a petition to call an election on a CO issuance. Last session, H.B. 1869 passed to eliminate some of the rare but controversial uses of COs and other non-voter-approved debt instruments. And this session, this committee has passed out legislation that would put additional safeguards on the use of COs and tax notes. We ask this committee to let recent reforms continue to work, while rejecting attempts to effectively eliminate the use of COs and other obligations as S.B. 976 proposes to do.

Elimination of De Minimis Rate

S.B. 976 would also repeal the de minimis rate and the associated tax rate adoption procedure for smaller taxing units calculating the de minimis rate. From a city perspective, the de minimis rate is designed to provide a small degree of flexibility to cities under 30,000 population. This bill would eliminate that flexibility, making it more difficult for small communities to finance necessary services and infrastructure.

When the concept of the de minimis rate was adopted as part of S.B. 2 in 2019, many referred to it as the "fire truck" provision. The de minimis rate is the amount necessary to generate an additional \$500,000. In smaller taxing jurisdictions, the 3.5 multiplier in the voter-approval rate calculation may only increase the property tax revenue for the city by a few hundred or a few thousand dollars. This means that if a city needed to buy a new fire truck, for instance, and wished to do so with maintenance and operation property tax revenue, it wouldn't be able to do so without holding an election. (It should be pointed out, however, that the cost for a ladder truck in 2023

² Masterson, Drew. "What if Certificates of Obligation Go Away." *Texas Town and City*, March 20, 2021, https://www.tml.org/DocumentCenter/View/2540/032021_TTC.

exceeds the de minimis amount of \$500,000 by a healthy margin.) In some cases, the cost of holding the election may exceed the amount of money generated by the proposed tax rate in a small town.

Important safeguards were added to S.B. 2 to ensure accountability for small taxing units to which the de minimis rate applies. Instead of simply allowing smaller taxing units to go up to the de minimis rate without any accountability to the voters, the legislature established a process allowing voters to petition for an election on a tax rate adopted by a smaller taxing entity even if the proposed rate doesn't exceed the de minimis rate. In other words, a balance was struck in S.B. 2 to provide necessary flexibility to small communities while still preserving accountability to the voters. S.B. 976 would eliminate that safeguard by deleting the petition process altogether.

There also is no evidence that small cities are routinely adopting tax rates in excess of the voter approval tax rate, much less the de minimis tax rate. The comptroller's 2021 tax rate data for cities shows that over 82 percent of cities under 30,000 population adopted a tax rate less than or equal to the voter approval rate.³ Though the comptroller doesn't track the de minimis rate in each city under 30,000 population, the League is unaware of any automatic November election for a city under 30,000 population because the adopted rate exceeded the de minimis rate. Further, we are only aware of one petitioned-for election in a small city for a rate exceeding the voter approval rate but less than the de minimis rate. All of this supports the conclusion that the framework established by S.B. 2 involving the de minimis rate is not being abused by Texas cities.

By repealing S.B. 2's de minimis rate framework, S.B. 976 would handcuff small towns in Texas at a time many are focusing on economic development efforts to revitalize their communities. The bill would undermine existing fiscal flexibility in these communities, despite a lack of evidence of abuse of the current structure. S.B. 976 would also force small towns towards debt, as financing capital costs or equipment on a pay-as-you-go basis becomes less feasible with the bill's changes. In short, repealing the de minimis rate altogether is unneeded, and ultimately harmful to small towns and other rural taxing units.

For all of the reasons stated above, the League opposes S.B. 976.

Sincerely,



Monty Wynn
Director, Grassroots and Legislative Services
Texas Municipal League

³ See City Rates and Levies, 2021. <https://comptroller.texas.gov/taxes/property-tax/docs/2021-city-rates-levies.xlsx>.